सत्यमेव जयते

AUDIT QUALITY REVIEW REPORT (AQRR)

Statutory Audit of:

IL&FS Transportation Networks Limited (ITNL) for the Financial Year 2018

Conducted by:

SRBC & Co LLP,
Chartered Accountants
Firm Registration Number (FRN):
324982E/E300003

SEPTEMBER 23, 2021

National Financial Reporting Authority
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1. INTRODUCTION

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

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

1.2.1. review working papers (including audit plan and other documents) and communications related to the audit;

1.2.2. evaluate the sufficiency of the quality control system of the auditor and the manner of documentation of the system by the auditor; and

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

1.3. The statutory audit of IL&FS Transportation Networks Limited (ITNL) for the financial year 2017-18 (the **"Engagement"**) was carried out by **SRBC & Co LLP (Firm Registration No. 324982E/E300003) ("Audit Firm/"Auditor"")**. Pursuant to the Companies Act and the NFRA Rules, NFRA has taken up the **AQR** of the statutory audit for the financial year 2017-18. This **AQR** has the objective of verifying compliance with the Requirements of Standards on Auditing (SAs) by the **Audit Firm** relevant to the performance of the **Engagement.** The **AQR** also has the objective of assessing the Quality Control System of the **Audit Firm** and the extent to which the same has been complied with in the performance of the Engagement.

1.4. The observations made in this **AQRR** 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.

1.5. NFRA commenced an Audit Quality Review **(AQR)** of the statutory audit of ITNL for the year 2017-18 and arrived at Prima Facie Conclusions **(PFC)**, which were detailed in the PFC Report dated 24th March, 2020. A Supplementary **PFC** Report was issued on 17th April 2020. The response of the Audit Firm to the **PFC** Reports was received on 3rd July 2020. A Draft Audit Quality Review Report **(DAQRR)** was issued on 8th March, 2021. The Audit Firm submitted its written response to the **DAQRR** on 10th July, 2021. An oral presentation in response to DAORR was made by the Audit Firm on 8th September, 2021. A brief response to the questions posed by the NFRA during the oral presentation was also received on 11th September 2021. All this has been examined and taken into account while preparing the final AQRR.

1.6. Refer to *Chronology of the events regarding **AQR** of the statutory audit of IL&FS Transportation Networks Limited for the financial year 2017-18 carried out by SRBC & Co LLP* (**Annexure 1**), for details of communication between NFRA and the Audit Firm. All this material would need to be consulted to present the background to the present **AQRR**, and, when found necessary, to support the reasoning in the present **AQRR** in respect of any observation. Wherever the **Audit Firm** has provided satisfactory responses to the conclusions of the **DAQRR**, or has pointed out inaccuracies in the **DAQRR**, those issues have been dropped from the summary findings of the **DAQRR** that have been included in this **AQRR**. The detailed discussions on the evidence in the Audit File and in the responses of the **Audit Firm** to the prima facie conclusion/**DAQRR** on any matter, and NFRA's analysis and conclusions thereon, is not repeated in the AQRR in the interest of conciseness.

1.7. The AQRR 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 AQRR 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.

Summary of AQRR

1.8. The following is a summary of the most important observations of the AQRR. Details of the evidence in support of these observations, and the reasoning leading thereto, are provided in the subsequent Sections of this DAQRR.

1.8.1. The initial appointment of SRBC & Co LLP, and the continuation of SRBC & Co LLP, as statutory auditor of ITNL, was prima facie illegal and void. Nevertheless, NFRA has proceeded to examine compliance by the Audit Firm with the SAs, in their performance of this Engagement, without prejudice to this finding.

1.8.2. The Audit Firm has failed to appropriately and sufficiently evaluate the use of the going concern basis of accounting by the Management and has thus failed to note the implications thereof in the Auditor's Report.

1.8.3. In assessing the Risks of Material Misstatements (ROMM), the Audit Firm did not discuss the susceptibility of the financial statements to material misstatement due to fraud, did not identify and assess revenue recognition and management override of controls as serious potential risks, which ultimately resulted in several violations of applicable Ind AS and SAs, as highlighted in the AQRR, thus making the Financial Statements subject to serious material misstatements and therefore unreliable.

1.8.4. ITNL's financial exposure to its subsidiaries, associates and joint ventures amounting to Rs. 3,346 crore was not properly valued as per the applicable Accounting Standards because the Audit Firm had failed to obtain sufficient appropriate evidence to justify the valuation of ITNL's investment and loans to these entities.

1.8.5. The Company's losses during 2017-18 were understated by at least Rs. 2021 crore on account of unjustified reversal of Expected Credit Loss (ECL) on loans given to the SPV and on trade receivables, and due to incorrect impairment valuation. This is excluding the impact due to incorrect treatment of the letter of comforts amounting to Rs 2654 crore, which should have been correctly treated as financial guarantees as per the accounting standards, the effect of which on profit/loss is not quantified. NFRA further concludes that there is a clear attempt to obscure material information in the Financial Statements by vague and misleading disclosures by the management regarding ECL reversal.

1.8.6. The Audit Firm has not evaluated the work done by Management's Expert while adopting the Expert's opinion, and thus the Auditor's opinion expressed under the Companies' (Auditor's Report) Order, 2019 (CARO) clause (iii) stating that the terms and conditions of the Company's loans of Rs. 111.20 crore to joint ventures and to the not-fully owned subsidiaries at zero interest rate are not prejudicial to the company's interest, is not supported by sufficient appropriate evidence and is in violation of requirements of SA 500.

1.8.7. The Audit Firm's EQC partner has failed to report material misstatements known to him to appear in a financial statement with which he is concerned in his professional capacity and has not exercised due diligence to obtain sufficient information to objectively evaluate the significant judgements of the Engagement Team and conclusions reached by them.

1.8.8. The Audit Firm has not determined the persons comprising TCWG. Further, NFRA has not found any communication to TCWG relating to Auditor's independence, and the relationships and other matters between the firm, network firms.

1.8.9. The Audit Firm has failed to maintain documents as per SA 230. The integrity of the Audit File is questionable due to tampering and inconsistency pointed out at several places in the AQRR.

1.9. While reference has been made in most cases to SAs which have a direct bearing on the issues under consideration, it needs to be borne in mind that certain generally applicable requirements of the SAs, such as the need to exercise professional scepticism, the need to obtain sufficient appropriate evidence, performance of procedures to address the assessed risks, etc., are integral in all individual cases discussed in the AQRR even if they are not specifically included in individual paragraphs of the Report.

1.10. Based on the conclusions in the AQRR, it appears that the Audit Firm has failed to meet the requirements of SA 700, para 11 while forming their opinion on the Company's Financial Statements for FY 2017-18. The instances discussed in this Report are of such significance that, in NFRA's view, the Audit Firm did not have any justification for issuing the Audit Report asserting that the audit was conducted in accordance with the SAs. NFRA draws attention to Response 12 in the ICAI's Implementation Guide on Reporting Standards (November 2010 edition) that says that " **a key assertion that is made in this paragraph is that the audit was conducted in accordance with the SAs"; and that "If during a subsequent review of the audit process, it is found that some of the audit procedures detailed in the SAs were not in fact complied with, it may tantamount to the auditor making a deliberately false declaration in his report and the consequences for the auditor could be very serious indeed**" (emphasis added). Failure to comply with any of the requirements of applicable SAs indicates that the Audit Firm has failed to achieve the central purpose of audit, and that there was not an adequate justification for issuing the Audit Report.

2. COMPLIANCE WITH INDEPENDENCE REQUIREMENTS

2.1. NFRA had conveyed the following prima facie conclusions:

2.1.1. The several stipulations and conditions to be fulfilled pertaining to the independence of Statutory Auditors are laid down in the following:

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

ii. Companies Act, 2013: Section144, which lists the non-audit services that an Auditor is prohibited from providing.

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

iv. 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.

v. Regulation 190A of the Chartered Accountants Regulation, 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 resolution of the Council.

vi. SQC 1 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 Standards on Auditing (SA) and hence has the force of law in terms of Section 143(10) of the Companies Act,2013. SA200 (Overall Objectives of the Independent Auditor) also requires that the Auditor comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. This requirement also encompasses the need to comply with the Code of Ethics of the ICAI and the SQC1.

2.1.2. The Guidance Note on Independence of the Auditors issued by the Institute of Chartered Accountants of India (ICAI) states as follows:

2.1.3. *"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.*

2.1.4. *There are two interlinked perspectives of independence of auditors, one, independence of mind: and two, independence in appearance.*

2.1.5. *The Code of Ethics for Professional Accountants, issued by International Federation of Accountants (IFAC) defines the term 'Independence' as follows:*

2.1.6. *"Independence is:*

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

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."

2.1.7. 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:

i. The eligibility of any Chartered Accountant/Firm to be appointed as a statutory auditor of a Company and to continue as such has to be ascertained and verified at the threshold. Section 141(3)(e) disqualifies a firm that has a business relationship with the company, or its subsidiary, or its holding company or associate company or with a subsidiary of such holding company or associate company. A business relationship, for this purpose, is defined by

Rule 10(4) of the Companies (Audit and Auditors) Rules, 2014, to include any commercial transaction except only those professional services that can be rendered by an auditor in terms of Section 144. Section 141(3)(h) disqualifies an auditor who renders any service prohibited by Section 144. Section 141(4) further says that where an existing auditor incurs any of the disqualifications listed in Section 141(3) after his appointment, he shall immediately vacate his office as such auditor, the vacation being treated as a casual vacancy.

ii. 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.

iii. 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.

iv. While interpreting the scope of the prohibited services listed in Section 144 of the Companies Act, 2013, the interpretation must be based on 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.

2.1.8. 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) seem to be 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.

2.1.9. 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.

2.1.10. 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.

2.1.11. 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. The Audit Committee is not a mere delegatee of the Board of Directors. It is, on the other hand, a statutory body, whose powers and functions are governed by Sec 177 of the Act. In addition to whatever the board may choose to include in its terms of reference, the Audit Committee has independent statute-granted powers and functions relating, inter alia, to independence of auditors, the audit process etc. These functions and powers of the Audit Committee cannot be usurped by the Board of Directors 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 Board of Directors.

2.1.12. 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**.

2.1.13. NFRA had taken up for examination the cases listed in Appendix 1 to DAQRR, where services have been provided by the **Audit Firm** and its related entities (as defined by the Explanation to Section 144) to either ITNL, or its holding company, ILFS Ltd.

2.1.14. The prima facie observations/comments/conclusions made by NFRA were as follows:

i. In the case of the EL now listed at (a) of Appendix 1 to DAQRR, the services provided directly by SRBC to ITNL, are in the nature of accounting and bookkeeping services, design and implementation of a financial information system, and management services, which are violative of the Code of Ethics and are prohibited services under Section 144 of Companies Act.

ii. In the case of the EL now listed at (a) to (f) of Appendix 1 to DAQRR, the services provided directly or indirectly by SRBC to ITNL or its holding company, are in the nature of management services which are violative of the Code of Ethics, and are prohibited services under Section 144 of Companies Act.

iii. The case of the EL now listed at (c) of Appendix 1 to DAQRR includes the clause of "Success Fee" of Rs. 1.5 crore which is a violation of ICAI Code of Ethics.

iv. In the cases examined (as now listed in Appendix 1 to DAQRR), prohibited services under section 144 were rendered during the course of the statutory audit engagement. Thus, the appointment of the Audit Firm as the Statutory Auditor of ITNL was ab-initio illegal and, thus, void as per the provisions of Section 141 (3)(i) of the Act. The Audit Firm was guilty of gross professional misconduct in accepting and continuing with the Audit Engagement.

v. In all the cases where services were provided by the Auditor or its Related Entities to ITNL or its holding or subsidiary company, continuing from before, or commenced after, their appointment as Statutory Auditors of ITNL, (as now listed at (g) to (h) in Appendix 1 to DAQRR) Audit Committee approvals as mandated by Section 144 of the Companies Act, 2013 are also not found.

vi. Both the EP as well as the EQCR Partner were required to evaluate whether the Audit Firm fulfilled the requirements of Para 11 and Para 21 of SA 220 (relating to evaluation of firm's independence in relation to the audit engagement). No evidence in the Audit File of such assessment having been carried out by the EP and the EQCR Partner is found. Thus, the Audit Firm is guilty of professional misconduct.

vii. EYLLP and EY Merchant Banking Services (EYMBS) are covered under the definition of directly or indirectly as mentioned under explanation (ii) of Section 144 of the Act.

2.2. NFRA has examined in detail the replies to the PFC submitted by the Audit Firm on the above matters and further observed in the DAQRR as follows:

Direct/Indirect Relation among SRBC, EYLLP and EYMBS

2.3. The Audit Firm submits in page no. 18 of their reply that "EYLLP and EYMBS are not covered directly and indirectly within the meaning of explanation (ii) to section 144 of the Act". It further states that "SRBC is an independent member firm of an International Network called Ernst & Young Global Limited ("EYG") of which EY LLP and EYMBS are also independent members…….SRBC, EY LLP and EYMBS are member firms of EYG, by itself is neither relevant nor appropriate and certainly not adequate or sufficient to qualify that EY LLP or EYMBS are covered directly or indirectly within the meaning of Explanation (ii) to Section 144 of the Act." The Audit Firm also submits that EY LLP and EYMBS are not chartered accountant firms. In page 20 of the reply the Audit Firm states that "EY LLP and EYMBS are both independent member firms of EYG and they use and share EYG's Global Brand "EY". SRBC cannot and does not use the said brand "EY". SRBC under ICAI COE is not allowed to use any brand or trademark to provide the services."

2.4. The Audit Firm's assertion that SRBC is not related to EYLLP and EYMBS in the manner provided under Section 144 is factually incorrect. Also, the claim SRBC does not use the EY brand is completely wrong and misleading in light of the following:

2.5. Explanation (ii) to Section 144 of Companies Act, 2013, states that "*For the purposes of this sub-section, the term 'directly or indirectly" shall include the rendering of services by the auditor, -*

(i) *in case of auditor being an individual, either himself or through his relative or any other person connected or associated with such individual or through any*

other entity, whatsoever, in which such individual has significant influence or control, or whose name or trade mark or brand is used by such individual;

(ii) *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*".

2.6. For the provision of any services "indirectly" five different modalities have been included vide the above explanation:

i. Through a parent;

ii. Through a subsidiary entity;

iii. Through an associate entity;

iv. Through any other entity whatsoever in which the firm, or any partner of the firm has significant influence or control; or

v. Through any other entity whatsoever whose name or trade mark or brand is used by the firm or any of its partners.

2.7. Provision of any non-audit service through any one or more of the five different modalities listed above would be the provision of such service "indirectly" by the statutory auditor.

2.8. The categories used here are not specially defined, and so have to be understood according to their common meanings. While doing so, the mischief that is sought to be remedied by the section and its explanation has to be kept in mind.

2.9. Sec 144 is a section that has the preservation of the independence of the statutory auditor as its principal objective. The Statement of Objects and Reasons of the Companies Bill says that "Provisions relating to prohibiting auditor from performing non-audit services revised to ensure independence and accountability of auditor".

2.10. The legislative history of the specific provision, which eventually became Sec 144 of the Companies Act, 2013, shows that the Standing Committee Report, 2012 [Para 84 of Chapter IV of Part I of the Report (Suggestions on the Companies Bill, 2011)], categorically rejected suggestions relating to Section 144 that sought to curb/restrict/relax the proposed prohibitions. In fact, one suggestion (at Sl. No.(vii) of the list) was that if at all the Bill needs to cover any non-audit services, the Bill itself should contain only minimum restrictions and further restrictions may be prescribed through the Code of Ethics.

2.11. Earlier, the Ministry, in its comments, had referred to the provisions of Clause 127 of the Companies Bill, 2009, which was examined by the Committee and recommendations on which are at Para 34 and Para 10.50 in its 2010 Report thereon. The Ministry had suggested that the provisions in the new Bill (namely Companies Bill, 2012, which has now become Companies Act, 2013) were in accordance with the recommendations of the Standing Committee Report, 2010, and should therefore be retained.

2.12. It is seen that Para 34 of the Standing Committee's Report, 2010 (page 31 of the pdf file) listed out suggestions received by the Committee about the need to make provisions relating to audit and auditors more stringent. The suggestions included:

i. prohibition of rendering of non-audit services both "directly as well as indirectly", and suitably defining the term "directly or indirectly" in the Bill itself;

ii. the prohibition should apply not only to the audit client company but also for its holding company, subsidiary company, and associate company; and

iii. through a residual clause, prohibit the provision of "any kind of consultancy services" to take care of any non-audit services not covered in already provided clauses. Para 10.50 of the Report recommended that the Ministry should consider extending the scope of Clause 127 to cover specified services rendered to subsidiary companies as well.

2.13. In its comments to the Standing Committee 2012, the Ministry had referred to all this background, and the fact that the recommendations of the Standing Committee 2010, had been accepted virtually in toto.

2.14. All entities that are related to a common parent entity would have to be considered as associate entities of each other. With a view to giving effect to the intention of the provision, as has been explained in detail above, the widest possible amplitude should be given to the scope of the categories of entities listed in the explanation. While deciding in any case, therefore, whether a non-audit service is being provided through an "indirect" modality or not, it is necessary to avoid resort to hyper technical distinctions, which do not have any difference in substance, to claim that such non-audit service is not being provided "indirectly", when such "indirect" provision is, in fact, blindingly apparent.

2.15. From the description given by the Audit Firm, and for the various reasons explained below, it is clear that:

2.15.1. EYG is a parent entity as far as the member firms of EYG are concerned. Consequently, all EYG member entities in India are associate entities of each other, within the meaning of explanation (ii) to Sec 144 of the Act.

2.15.2. Also, SRBC Affiliates Network firms use the EY brand and Trade Mark for obtaining and providing audit services.

2.15.3. The Audit Firm admits that SRBC is an independent member firm of an International Network called Ernst & Young Global Limited (EYG).

2.15.4. The EY newsletter, which is circulated globally, contains the following standard sentences in all editions under the heading 'About EY' - "**EY is a global leader in assurance**, tax, strategy, transaction and **consulting** services. ……. EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. **Ernst & Young Global Limited**, a UK company limited by guarantee, **does not provide services to clients**." (Emphasis added). The website of EYG www.ey.com also repeats the second part of the above information. The Wikipedia page on EY states "EY operates as a network of member firms which are structured as separate legal entities in a partnership, which has close to 300,000 employees in over 700 offices in more than 150 countries around the world". From the above content in the public domain, it is clear enough that the EY network, through its legally separated, but operationally harmonised, network entities, provides various services including assurance and consulting. While on the one hand EYG claims to not provide any services to its clients, in the same breath it claims itself to be a global leader in various services. So, it is clear that the 'clients' referred here are the clients of the network members and the services are the services provided by such network entities. Such widely circulated information by the global network is also intended to induce the public perception that brand 'EY' is the single global entity providing all such services to the clients.

2.15.5. The Email Id of all the Engagement Team (ET) members has the domain names *in.ey.com* as evident from the WP ITNL PACE Assessment M18 in ITNL – Canvas files folder – Jun-2018, Scope and Strategy. The domain ey.com belongs to the brand EY as evident from the website of EY (www.ey.com). Use of logo and domain name of EY is further evident from the instances available on public domain and social media platforms. (Refer Appendix 2 to DAQRR for details).

2.15.6. There are multiple references to EY in the audit work papers of SRBC. The answer to the question "Is EY required to be independent of the entity being evaluated" is in affirmative. Moreover, the criteria for selecting "Yes" as an answer to this question has been mentioned just above it, which h states that:

"Please select "Yes" to question 1 if:

this entity is an audit client (including all affiliates of the audit client under the EYG Independence Policy), or

you are aware that EY is targeting this entity as an audit client and the "audit and professional engagement period" has started."

2.15.7. The answer to another question "Will there be another (non-EY) auditing firm involved in the engagement?" is also in affirmative. (Refer Appendix 2 to DAQRR for details).

2.15.8. The domain name srb.in used by the partners of SRBC in their email ids used for communication with NFRA has the host names as 'ussecrazdns01.ey.com', 'derusrazdns01.ey.com', 'defrnrazdns01.ey.com', 'sgsinrazdns01.ey.com'. The domain 'ey.com' has also the same host names. (Source: https://whois.whoisxmlapi.com/lookup-report/Xa2Lnbqjkq). The Domain's registrant is S.R Batliboi and Co, another network member of EY. Also, SRBC uses the email Id having ey.com as domain name (naveen.kapur@in.ey.com) as registered email id in LLP registration details available in MCA website (Refer Appendix 2 to DAQRR for details).

2.15.9. SRBC uses various platforms of EY, like Ernst & Young online eRoom for managing audits as evident from an addendum to agreement dated 19th July 2016, available in one of the engagement letters for non-audit services. (Refer Appendix 2 to DAQRR).

2.15.10. SRBC uses the same brand logo as EY as displayed on the website of EY (www.ey.com). The response dated 3rd July 2020 provided by the Audit Firm to NFRA, contains various documents which are either the internal documents/policies of EY or are on the letter head of EY. A few are as follows (appendices referred below relate to the submissions made by the Audit Firm).

i. Appendix 5- The Global Information Security Standard

ii. Appendix 6- Application Security Review (Redacted)

iii. Appendix 7- CAB Approval Checklist

iv. Appendix 8- EY Global Information Security Policy

v. Appendix 9- EY Global Code of Conduct

2.15.11. The EY logo and Trademark are used for Auditing Services in India. Since EYG does not directly provide any professional services, the auditing services are provided by the SRBC Affiliates Network using the EY brand name. By using the logo and an email id with the domain name of EY, it is clear that the communications by the Audit Firm to their Audit Clients and other entities invariably gives the perception that SRBC and EY are the same entities for all practical purposes.

2.15.12. In page 20 of the reply the Audit Firm states that "EY LLP and EYMBS are both independent member firms of EYG and they use and share EYG's Global Brand "EY". In page 19 of the reply the Audit Firm states that "SRBC conducts and signs its audits under its own name and style and does not use or share the use of any name, trade mark or brand which is owned or used either by EY LLP or EYMBS in any of its papers, stationary or otherwise for any purpose. In this regard, the LLP filing details of EYMBS shows its email id 'rashmi.grover@in.ey.com' and that of EY LLP shows 'kapil.bagadia@in.ey.com' (source :www.zaubacorp.com). The website of EY LLP points to 'www.ey.com' in searches. There is no separate logo or brand name available for these entities in the public domain, not even an official social media presence or website. These entities are also using the global brand name 'EY' to provide their services. Hence there is no sanctity in the claims of the Audit Firm that they do not use brand name or logo of EY LLP or EYMBS, when these entities themselves do not use any, if at all they have any such symbols of identity.

2.15.13. The office address of Mumbai SRBC & Co LLP and Kolkata SRBC & Co LLP is same as of Mumbai EY LLP and Kolkata EY LLP, respectively.

2.15.14. SQC Policy of SRBC & Co LLP as submitted by the Audit Firm to NFRA itself states that "Each of S.R. Batliboi network of Audit Firms is member firm of EYG and in this report we refer to ourselves collectively as "Firm"". EY Global Code of Conduct, EYG Ethics and Independence Policy, EYG client and engagement acceptance global policy etc. forms part of SQC Policy submitted by SRBC. At several places in SQC Policy it is mentioned that SRBC & Co LLP is bound by EYG Policies. For instance, the policy mentions that "As employees of a member firm of EY Global, you are bound by EY Global's Guidelines on the use of social media."

2.15.15. In its communication dated 4th November, 2019, regarding policies and procedures for audit documentation and archival, the Audit Firm submitted the extract of Audit Guidance in this respect which, inter alia, states that "We prepare our documentation to comply with applicable professional standards, legal and regulatory requirements and EY policies."

2.15.16. NFRA has also examined the Annual Report in Form 2 for Reporting Year 2017-2018 filed by SRBC & Co LLP to PCAOB (available on the PCAOB website). In the said filing, SRBC & Co LLP states that it has: a) an affiliation with EYG 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;; and c) arrangement with EYG through which the Firm employs or leases personnel to perform audit services.

2.15.17. The filing shows that S R B C & CO LLP employs or leases personnel from other EYG member firms in India to perform audit services, including from Ernst & Young LLP and S.R. Batliboi LLP in order that the Firm's client teams comprise the right mix of highly qualified people who have the right knowledge and experience to deliver consistently high-quality service. Also, EYG member firms in India who are involved in providing audit and related services are required to follow identical procedures, quality standards and other internal controls as are required by EYG.

2.15.18. If any further proof of this use of the EY brand name by the SRBC Network is required, this is provided by the fact that even the Audit Committee of IL&FS Limited perceived SRBC as an EY firm. At the 73rd Audit Committee Meeting of IL&FS Limited held on 27th February, 2017, it was recorded that - "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 added). It is a clear proof that SRBC & Co LLP obtained audit assignments under the EY brand name.

2.15.19. Electronic WP file named '438GL(R)-Paper documentation form-1" states the "Purpose" of the form as "We sign this form to assert that we are in compliance with DOC+ARC, i.e. that EY-prepared documentation is in electronic form and the use of paper profiles is appropriate".

2.15.20. The "Audit engagement team members (excluding Audit Partner) Independence confirmation" available in the Audit File mentions that one of the members 'Dinesh Agarwal' as "Tax Partner". As per the information in the public domain (refer Appendix 2) he is a partner of Ernst & Young Pvt. Ltd., Kolkata, describing himself as "partner at EY". Similarly, the EQCR partner CA Vinayak Pujare uses EY logo in his profile page in LinkedIn and his contact info points to www.ey.com as company website.

2.16. The above instances clearly prove that even SRBC identifies itself as an EY entity. All the above facts show that the audit network of SRBC is clearly EY itself, when substance over form is considered. 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 arguments presented by the Audit Firm to try and make out that they have no "indirect" connection (as contemplated by explanation (ii) to Sec 144) with EYG entities are clearly intended only to mislead and deceive. All entities in the EY network clearly hold themselves out as EY constituents. In summary, it is crystal clear that any entity providing any non-audit services under the EY brand name is to be regarded as providing the said non-audit services indirectly, as contemplated by the explanation to Section 144 of the Act. The separate legal structure of the entities providing the non-audit services does not exclude them from being considered as services provided "indirectly" for the purposes of explanation (ii) to Sec 144.

2.17. Explanation to section 144 of the Companies Act, 2013 is an inclusive one, not exhaustive, since it reads "For the purposes of this sub-section, the term "directly or indirectly" **shall include** rendering of services by the auditor……" (Emphasis added). Thus, relations other than what is provided in the explanation can also fall under the ambit of indirectly provided services, if such relations are in the nature of the relations mentioned in the explanation to section 144. The fact, that SRBC, EY LLP and EYMBS are the network firms of EYG, alone makes them fall under the ambit of explanation to section 144.

2.18. As explained above, all the entities (SRBC, EY LLP and EYMBS) are part of a single network (EY), sharing the same brand name, logo, policies, resources and infrastructure. The network members identify themselves as EY and benefit from an intentionally induced public perception of a single entity called EY. In such a situation, the subtle legal structuring, attempting, but not succeeding, to create a distinction, cannot wish away the strong relationships between the network entities. Thus, all the non-audit services provided by the network entities are in the nature of those provided either through the parent, partners or through any other entity whose name or trade mark or brand is used by the firm or any of its partners.

2.19. Therefore, NFRA concludes that SRBC, EYLLP and EYMBS are covered under directly or indirectly related entities as per explanation (ii) to Sec 144 of the Act. Read with conclusions in section above, the non-audit services provided by these entities fall within the purview of the prohibited services, including management services, covered under section 144 of the Companies Act, 2013.

Non-Audit services provided in violation of Sec 144 of the Companies Act

2.20. In page 11 of the reply, the Audit Firm submits that "Section 144 of the Act prescribes certain services which a statutory auditor is barred from performing. From a conjoint reading of Sections 141 and 144 of the Act and Rule 10 of the Companies (Audit and Auditors) Rules, it stands to reason that if the statutory auditor, directly or indirectly, provides prohibited services to the audited company or its parent company/ subsidiary company, it is deemed to result in a prohibited business relationship under section 141 of the Act." In this regard while agreeing with the statement, NFRA notes that the statement does not give the complete meaning of section 141.

2.21. Rule 10 of the Companies (Audit and Auditors) Rules, 2014 defines that "For the purpose of clause (e) of sub-section (3) of section 141, the term "business relationship" shall be construed as any transaction entered into for a commercial purpose, except - (i) commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or Audit Firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;"

2.22. *Section 144 stipulates inter alia that "*An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be" and the section then goes ahead to list prohibited services in clauses (a) to (i). In the case of ITNL which, as a listed company, is mandatorily required to have an Audit Committee, the body competent to accord approval under Sec 144 is only the Audit committee. Because of the quoted stipulation in section 144, any services provided by the Auditor, other than the specifically prohibited services listed in clauses (a) to (i), which are not approved by the Audit Committee are also not permitted services under section 144. Hence the prohibited business relationships include all such other services which are not approved by the Audit Committee as well.

2.23. In page no. 22 of the reply, the Audit Firm argues that the non-audit services provided by SRBC, EY LLP and EYMBS do not fall under the category of *"management services"* as used under the section 144 of the Act, and hence are not prohibited. In page 23 the Audit Firm states that "if a service being provided by a statutory auditor is not commonly understood as part of any of the services specified in (a) to (h) of Section 144 of the Act, it is not open to the NFRA to deem it as part of one of these services by artificially enlarging the commonly understood scope of such prohibited service." and "SRBC has understood "management service" to be any service/activity which puts auditor in the shoes of company's management or places auditor in a decision-making role akin to company's management. **In other words, "management services" are understood to mean "services that essentially constitute management responsibilities"**. This is also the most widely understood meaning of management services across the globe by various regulators including IESBA Code of Ethics and US Securities and Exchange Council ("SEC")" (emphasis added). The Audit Firm has also quoted Para 600.7 A4 of ICAI Code 2019 and states in page 27 of the reply that ICAI itself believes that the prohibition on a statutory auditor is only on assuming management responsibilities.

2.24. 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. Instead of following this accepted principle of interpretation of law, the Audit Firm has gone ahead with **defining the term** 'management services' on its own by referring to various extraneous materials.

2.25. Using the above principles of interpretation, 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.

2.26. Thus, by a plain reading of section 144 of the Companies Act, 2013 as rightly done by NFRA, the literal meaning of the words management services includes any services provided by the Audit Firm to/for the management. The dictionary meaning of the word service is "providing something" and the term management means "the act of running and controlling a business or similar organization" and/or "the people who run and control a business or similar organization" [Reference: Oxford Learners Dictionary].

2.27. It is completely impermissible in all accepted norms of statutory construction to import concepts, meanings, and definitions from extraneous sources in a situation where a plain reading of the words of the statute does not indicate that this is either permissible or is necessarily to be done. The Audit Firm's reference to IESBA Code of Ethics and US Securities and Exchange Council ("SEC") is not acceptable, both for the reason of being completely extraneous and, therefore, irrelevant in interpretation of the Companies Act provisions, and also because the term purportedly being dealt with there, viz., "management responsibilities" is very different from the term "management services" used in the Companies Act.. So NFRA is justified in ignoring the extraneous matter such as statutes in others countries, Code of Ethics prescribed by International Bodies etc., quoted by the Audit Firm in a situation where the plain meaning of the words used in the statute is clear and does not require any such additional aids to interpretation.

2.28. 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".

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

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

2.31. Referring to section 2(2)(iv) of the Chartered Accountants Act, the Audit Firm states in page 28 of their reply that "the section lays down the services which, if provided by a chartered accountant would deem him to be a "chartered accountant in practice". As against this, Section 144 of the Companies Act, in terms, lists the services which a statutory auditor is prohibited from providing. There is no nexus between the two sections and the interpretation of the NFRA in this regard is completely misplaced and has no rationale. In fact, the reliance on Section 2(2)(iv) of the Chartered Accountants Act is completely extraneous to the issue at hand." The statement shows poor understanding of the Audit Firm regarding scope of section 144. As already mentioned above, the term "management services" contemplated in section 144, should be interpreted only as services that can be, or potentially can be, provided by the auditor to the management of the company. By virtue of the section 2(2)(iv) the Council resolved that the services that may be rendered by a Chartered Accountant in practice include the entire range of Management Consultancy Services, thus making the management consultancy a **service that can be provided** by a Chartered Accountant in practice. However, since "management services" is a broader category of services and encompasses management consultancy services, an Auditor of a Company cannot provide to the Company any service falling even under the category of "management consultancy" services.

2.32. The Audit Firm has not produced any evidence of Approval of Audit committee, as mandated by section 144, for services that are claimed by them as permitted under section 144.

2.33. Therefore, NFRA concludes that non-audit services provided by SRBC and by all other EY entities fall squarely within the purview of the prohibited services, including management services, covered under section 144 of the Companies Act, 2013.

Violations of ICAI Code of Ethics 2019

2.34. As explained above, all the non-audit services directly or indirectly provided by the Audit Firm are prohibited services in terms of section 144 of the Companies Act, 2013. Without prejudice to this fact, NFRA has examined the other submissions made by the Audit Firm regarding individual assignments mentioned in the preliminary findings and concludes as follows.

2.35. Regarding the services of Ind AS implementation directly provided to ITNL by SRBC vide engagement letter dated July 19, 2016, the **Audit Firm** submits in page no. 14 of their reply that "the services provided by SRBC does not fall under either "accounting and bookkeeping services" or "design and implementation of a financial information system". Citing para 290.162, 290.163, 290.164 and 290.165 of ICAI Code of Ethics, 2009, the Audit Firm submits in page 16 of their reply that "From a perusal of the aforesaid clauses of the ICAI Code, it is clear and unambiguous that the ICAI allows the statutory auditor to advise the company in compliance of accounting standards as well as ensuring that financial statements are free from defects. The same is not considered to be a prohibited service as long as there are no management decisions being made by the statutory auditor. The engagement letter of SRBC with ITNL dated July 19, 2016 clearly spells out that SRBC will simply provide review comments and provide advice on conversion of consolidated financial statements. ITNL's financial statements were prepared by ITNL itself. SRBC's scope of work was only to review and provide advice and it was management's prerogative to accept such advice, as it deemed fit. Accordingly, SRBC was not playing any management role or taking any decisions on behalf of the Company". In page 17 of the reply, the Audit Firm details the scope of the said works as "In connection with your conversion from accounting principles generally accepted in India ("Local GAAP") to Ind AS's, we will provide Advice on conversion of consolidated financial statements for the years ended March 31, 2015 (for opening balances sheet as at April 1, 2015) and March 31, 2016 and Quarterly interim periods ended June 30, 2015 to June 30, 2016 from Local GAAP to Ind AS. Further, the advice was limited to following services:

i. Discussion with ITNL Management on accounting policy options available under Ind AS and their implications, including providing insight on Ind AS.

ii. Provide Ind AS technical materials and guidance of a general nature.

iii. Advise to ITNL Management in understanding available accounting options under Ind AS.

iv. Advise, review and provide observations on technical accounting memoranda prepared by ITNL Management and proposed accounting policies under Ind AS prepared by the management

v. Advise, review and provide observations on the results of calculations of the specific adjustments needed to convert Local GAAP to Ind AS prepared by ITNL Management

vi. Advise and comment on the skeleton lnd AS financial statements and disclosures prepared by ITNL Management".

2.36. NFRA observes in this regard that the Audit Firm's interpretation of Code of Ethics and Section 144 of the Companies Act 2013 is incorrect because: -

2.36.1. ICAI Code of Ethics 2009 does not allow the statutory auditor to assist an audit client in matters such as preparing financial statements. Para 290.162 of the Code states "Assisting a financial statement audit client in matters such as preparing accounting records or financial statements may **create a self review threat when the financial statements are subsequently audited by the firm**". (Emphasis added).

2.36.2. Para 290.163 states inter alia that "If firm, or network firm, personnel providing such assistance **make management decisions, the self-review threat created could not be reduced** to an acceptable level by any safeguards. Consequently, personnel should not make such decisions". (Emphasis added)

2.36.3. Para 290.164 states "The **audit process involves extensive dialogue** between the firm and management of the financial statement audit client. **During this process**, management requests and receives significant input regarding such matters as accounting principles and financial statement disclosure, the appropriateness of controls and the methods used in determining the stated amounts of assets and liabilities. *Technical assistance of this nature and advice on accounting principles for financial statement audit clients are an appropriate means to promote the fair presentation of the financial statements. The provision of such advice does not generally threaten the firm's independence.* **Similarly, the financial statement audit process may involve** *technically assisting an audit client in resolving account reconciliation problems, analyzing and accumulating information for regulatory reporting, assisting in the preparation of consolidated financial statements (including the translation of local statutory accounts to comply with group accounting policies and the transition to a different reporting framework such as Financial Reporting Standards), drafting disclosure items, proposing adjusting journal entries and providing technical assistance and advice in the preparation of local statutory accounts of subsidiary entities.* **These services are considered to be a normal part of the audit process** and do not, under normal circumstances, threaten independence". (Emphasis added).

2.36.4. Para 290.165 states "Self-review threats may be created if the **firm is involved in the preparation** of accounting records or **financial statements** and those financial statements are subsequently the **subject matter information of an audit engagement** of the firm". (Emphasis added).

2.36.5. Based on the above provisions it is clear that the involvement of the statutory auditor in the preparation of accounting records or financial statements which is subsequently audited leads to self-review threat and hence cannot be taken up by the Auditor. In addition, if the statutory auditor makes management decisions, then also self-review threat will be created. The "significant inputs" and assistance in "the preparation of consolidated financial statements" contemplated by para 290.164 are essentially services considered to be a **normal part of the statutory audit process** and hence happen during the statutory audit process – not any separate specialised engagement, distinct from the statutory audit, which does not form part of the scope of statutory audit process.

2.37. Thus, the Audit Firm's reliance on the above said paras to contend that the said services - awarded by a separate engagement letter and involving separate scope of services distinct form the statutory audit, having a separate financial consideration, and having a separate/defined timeline for completion - are permitted under ICAI Code of ethics is totally against the express provisions of the Code of Ethics.

2.38. As the word accounting services are not defined in the Companies Act, 2013, by taking its literal meaning (i.e., any activity related to keeping records of business transactions), the non-audit engagement of "advice on conversion of consolidated financial statements" with the scope of work as detailed above, falls under the prohibited category as per section 144 of the Act. The said service is also prohibited under the Code of Ethics, since there is unavoidable self-review threat.

2.39. By rendering the said services pertaining to the Company's Ind-AS Reporting System and assisting or reviewing in developing accounting policies, the Audit Firm put itself in a position where it would audit and evaluate professional judgements that it had previously rendered leading to self- review threat.

2.40. The EL states that the Audit Firm is responsible for discussing with the management **all the options available for accounting policies** and making them understand each such accounting policy option. Though the ultimate decision of the choice of the accounting policy is of the management, such choice will surely be one of the options recommended by the Audit Firm. So, while carrying out the Statutory Audit of the auditee, the Audit Firm will review and comment invariably on its own recommendations, irrespective of the choice exercised by the management leading again to self-review threat. This also tantamount to making management decisions.

2.41. Without prejudice to all the above, NFRA notes that the contention of the Audit Firm that the services are merely "advice" in the matters stated in the scope of services, has no face value. The scope of works detailed by the Audit Firm and reproduced above clearly indicates that the company requires expert advice in all areas of Ind AS financial statements, including accounting policies, technical aspects, accounting options, preparation of technical accounting memoranda, adjustment entries and format of the financial statements. A separate assignment awarded by the management for this purpose shows that there was absence of expertise within the organisation. In such a scenario, the management would not normally have been in a position to prepare all the required inputs to be supplied to the Audit Firm for the so called "review" and "advise". In practice, the Audit Firm, expected to have sufficient expertise, themselves would have prepared all the basic documents, discussed those with the management, and provided final inputs that would invariably have gone into the final Ind AS financial statements which would have been audited by the Audit Firm in their capacity as statutory auditor. Such a dual role, of acting as an expert for the management and also as the statutory auditor of the Company, is not in line with the principles of Code of Ethics as detailed above. In sum, and as explained earlier, these services also fall under the category of management services as prohibited under section 144 of the Act.

2.42. Regarding the observations of NFRA on valuation services provided vide EL Date: September 1, 2016 with addendum dated October 10, 2016, by EYMBS the Audit Firm submits in page 35 of their reply that "as the Company did not wish to avail the services, the engagement was discontinued by EYMBS before the SRBC's appointment date of February 10, 2017 and no report was issued by EYMBS to the Company". However as there is neither any proofs submitted nor a completion/ termination date mentioned, the contentions are not accepted. Also, as the engagement was ongoing at the date of consideration by the Board of ILFS for appointment as Auditor, the prohibition under section 144 would kick in from that date.

2.43. Regarding finance advisory services provided vide EL Date: October 15, 2015, the Audit Firm submits that the engagement has been "completed in March 2016 which was well before start of financial year 2016-17. The final invoice was raised on July 20, 2016". Regarding bidding support services provided vide EL Date: March 7, 2016 the Audit Firm submits that "the work under this engagement was completed and last invoice raised on November 23, 2016 i.e. before the date of appointment of SRBC as auditor of the Company (February 10, 2017)". In view of the submission, the comments of NFRA regarding these engagements stand withdrawn.

2.44. All the other engagements listed in the Appendix 1 are provided indirectly by the Audit Firm and are in the nature of prohibited services as detailed above, and also do not have the approval of the Audit Committee of ITNL as required by section 144 of the Companies Act, 2013. Out of these cases, all cases except (e) and (f) have been subsisting as on the date of appointment of the Audit Firm (i.e. 2nd December 2016) as statutory auditors of ITNL. Consequently the Audit Firm had violated section 144, and hence the Audit Firm suffered from the disqualification under section 141(3)(e) and 141(3)(i).

2.45. Without prejudice to the above, engagements undertaken vide EL Dated April 7, 2017 (FY 2017-18) and vide EL Dated April 20, 2018 (FY 2018-19) (cases at (e) and (f) Appendix 1 to DAQRR) also attract the stipulations in section 141(4), requiring vacation of office as auditor. By not doing so, the Audit Firm was guilty of gross professional misconduct.

2.46. In view of the above observations, NFRA concludes that the EP and the EQCR Partner have been grossly negligent in complying with the requirements of Para 11 and Para 21 of SA 220. Para 11 of SA 220 stipulates that the EP shall obtain relevant information from the firm and, where applicable, network firms to identify and evaluate circumstances and relationships that create threats to independence. Para 21 of SA 220 requires that for audits of financial statements of the listed entities, the EQCR Partner shall consider the ET's evaluation of firm's independence in relation to the audit engagement.

2.47. Thus, subject to the above observations, NFRA reiterated its findings in the preliminary stage and concluded in the DAQRR that:

i. The appointment of the Audit Firm as Statutory Auditor of IFIN was ab initio illegal and void for violation of Section 141(3)(e) and Section 141(3)(i) of the

Act, because of the provision of non-audit services, in violation of section 144 of the Act, as listed in Appendix 1, except the two services mentioned above. Because of the two non-audit services detailed above, the Audit Firm has violated section 141(4) as well.

ii. 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.

iii. The Audit Firm had grossly violated the provisions of Section 144 of the Companies Act, 2013.

iv. The Audit Firm had been in serious breach of the Code of Ethics.

v. The violations had undoubtedly fatally compromised the independence in mind and independence in appearance required of the Audit Firm. Independence in appearance stood 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.

vi. EP and the EQCR Partner were guilty of professional misconduct arising out of gross violations of the applicable Auditing Standards.

2.48. NFRA has examined in detail the replies dated 10th July 2021 and the oral submissions made by the Audit Firm (replies to the DAQRR) regarding the above observations in the DAQRR.

2.49. The Audit Firm reiterates its submissions at the PFC stage. As these submissions have already been examined as explained in the DAQRR, such repetitions are not analysed again in this AQR. The Audit Firm also raises questions on NFRA's jurisdiction regarding the engagement. As this is a matter before the Delhi High Court for consideration, no comments in this regard are made in this AQR. The High Court has so far not imposed any restrictions on NFRA in exercising its jurisdiction. Also, the sweeping statements made by the Audit Firm such as *"Many of the conclusions arrived at in the DAQRR are based on assumptions, presumptions, surmises and conjectures, without any factual or legal foundations"*, *"NFRA has failed to appreciate that the Auditing Standards are not in the nature of strict rules"*, *"to understand the complexities of such an audit in their correct perspective, NFRA would have required expert assistance"*, *"NFRA has chosen to refer only to selective paragraphs of Auditing Standards, selected workpapers and has interpreted isolated provisions in vacuum"* etc. are not addressed specifically since there is no basis provided by the Audit Firm for such remarks. The DAQRR is a self-explanatory document. It covers in detail the reasons and justifications for all the conclusions reached, based on factual position of law and material available on record. Hence the interpretation issues raised by the Audit Firm do not require any more explanations. Wherever additional evidence, explanations or documents from the Audit File are submitted, such cases are revisited in this AQR and the conclusions in the

DAQRR are amended wherever required as specifically stated hereinafter. In all other cases, the conclusions in the DAQRR will be final.

2.50. After eliminating the repetitions, and statements not supported by any evidence or basis, the remaining relevant matters submitted by the Audit Firm have been examined in the succeeding paragraphs. (The above position applies to all the sections of this AQRR).

Direct/Indirect Relation among SRBC, EYLLP and EYMBS

2.51. The Audit Firm states that "*NFRA's non-application of mind is clearly evidenced from the fact that in Paragraph 2.47, NFRA states that the appointment of statutory auditor of IFIN was ab initio illegal whereas the DAQRR pertains to ITNL*". This clerical error stands rectified in this AQR.

2.52. The Audit Firm states that "*It is stated that SRBC or its network firms or audit engagement team members have no financial interests in or business relationships of any kind with ITNL or its related entities or its director or officers or other individuals in senior management in the audit period and audit engagement period………. The NFRA has to establish that SRBC's independence had indeed been compromised and it has failed to do so.".* In this regard, para 2.1.13 and 2.1.14 of the DAQRR lists down the engagements that fall under the category of prohibited services under Section 144 of the Companies Act. It was also shown there that these services were rendered/ongoing during the statutory audit engagement. Other than some sweeping statements that these services do not attract Section 141 (3)(i) of the Act, the Audit Firm has not provided any evidence to show that these are permitted services and are not rendered during the period of engagement. Also, there is no need to revisit the interpretation of 'management services' explained in detail in the DAQRR as the Audit Firm failed to provide any additional evidence to the contrary. NFRA has interpreted the said term based on its literal meaning as used in the Companies Act, 2013 and hence require no revision. In any case, in the given facts and context, it is necessary for the Audit Firm to prove that its independence was not compromised. NFRA has adduced adequate evidence to show that independence in appearance certainly, and independence, in fact, stood undeniably compromised.

2.53. The Audit Firm states that *"SRBC reiterates that it does not use the EY brand and has demonstrated hereinafter that the said assertion is wrong."* In this regard, the DAQRR clearly describes several instances of the use of the EY brand name and logo by SRBC and its partners/staff, including in documents submitted to NFRA. The Audit Firm offers no explanations regarding these specific matters but resorts to the usual practice of sweeping denials without any support of evidence.

2.54. The Audit Firm states that *"It is not denied that Section 144 of the Companies Act is an inclusive definition. However, it is reiterated that Section 144 clearly states that the services must be provided 'through' any other entity necessitating a relationship of agency. Such a relationship has not been established by NFRA, and bald statements or averments that SRBC, EY LLP and EYMBS are network firms of EYG alone make them fall under the ambit of the explanation (ii) of Section 144, does not factually or legally establish a 'direct or indirect' connection as contemplated under Section 144. Without prejudice to the aforesaid and without admitting to the same, it is reiterated that any public perception would not be sufficient to establish a lack of independence or 'direct or* *indirect' relationship. In view of the same the NFRA's conclusion that SRBC, EY LLP and EYMBS are covered under 'direct or indirect' entities as per explanation (ii) to Section 144, is wrong on facts and in law.*" The Audit Firm further submits that *"in terms of Explanation (ii) to the Section, the test of significant influence and control is sine qua non to be exercised by the firm either itself or through its partners, in the other entity which is providing prohibited services to the auditee entity*". The Audit Firm also explains in detail the separate legal status of EYG and its network entities and the areas of cooperation between them as per agreements between the network entities.

2.55. The above interpretation made by the Audit Firm is not acceptable since section 144 uses the words "through any other entity, whatsoever" which does not imply any relationship of agency. NFRA reiterates that the explanation to section 144 of the Companies Act, 2013 is an inclusive one, not exhaustive. Thus, relations other than what is enumerated in the explanation can also fall under the ambit of indirectly provided services, if such relations are in the nature of the relations mentioned in the explanation to section 144. The fact, that SRBC, EY LLP and EYMBS are the network firms of EYG, alone makes them fall under the ambit of explanation to section 144. Also, there is no evidence submitted by the Audit Firm to disprove extensive use (as detailed in the DAQRR) of the name, trade mark and brand of EYG by the Audit Firm and its partners.

2.56. There is no evidence in the submission of the Audit Firm to disprove the conclusion in the DAQRR that the instances detailed therein clearly prove that even SRBC identifies itself as an EY entity. All those facts show that the audit network of SRBC is EY itself when substance over form is considered. In such a situation, the subtle legal structuring, attempting, but not succeeding, to create a distinction, cannot wish away the strong relationships between the network entities. Thus, all the non-audit services provided by the network entities are in the nature of those provided either through the parent, partners or through any other entity, whatsoever, whose name or trademark or brand is used by the firm or any of its partners.

2.57. Therefore, NFRA reiterates that SRBC, EYLLP and EYMBS are covered under directly or indirectly related entities as per explanation (ii) to Sec 144 of the Act. Read with conclusions in the DAQRR above, the non-audit services provided by these entities fall within the purview of the prohibited services, including management services, covered under section 144 of the Companies Act, 2013

Non-Audit services provided in violation of Sec 144 of the Companies Act

2.58. The Audit Firm states that *"In response to para 2.21, it is submitted that the Companies (Audit and Auditor) Rules, 2018, makes it very clear that commercial transactions which are in the nature of professional relationship are exempted from the purview of Section 141(3)(e) of the Companies Act. It is further clarified that upon reading of the ICAI Code of Ethics, 2009 it is abundantly clear that a business relationship cannot even be the business relationship' in the ordinary course of business, but would have to involve a commercial or a common financial interest*".

2.59. The Audit Firm has made a distorted reading of the Act and Rules here. The said rules clearly state (as also quoted by the Audit Firm) that "commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts" shall be exempted for being considered as a business relationship. All other professional services by the Audit Firm falls under the category of the business relationship. The list of services provided in the DAQRR are all prohibited services as per section 144 of the Act as detailed at length in the DAQRR. Hence provision of such services amounts to business relationship. As these services were ongoing during the period of engagement, the audit firm has clearly violated section 141(3)(e). The support drawn from ICAI Code of ethics is extraneous and unwarranted.

2.60. The Audit Firm also submits that Section 141(3)(i) "does not apply to a firm of chartered accountants. The unamended, as well as the amended section, uses the word 'person'. This has to be contrasted with the use of the word 'firm' wherever applicable, in the said section itself."

2.60.1. The first point to be noted here is that the present Audit Firm is an LLP. It is a body corporate that is an artificial juridical person as far as the law is concerned. That an LLP is considered a "person" for the purposes of Sec 141(3) is clear from clause (a) thereof which makes an express exception to LLPs from the list of persons who cannot be appointed as auditors.

2.60.2. Secondly, the interpretation put forth by the Audit Firm, viz., that there is a distinction intended by the Act between the words "person" and "firm" in this context is completely negated by the opening phrase of Sec 141(3). If such a distinction were, in fact, intended, it should have been made in that opening phrase itself.

2.60.3. Thirdly, Section 139 (1) stipulates that every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor. This section further requires the auditor to satisfy the criteria provided in section 141. According to explanation II to section 140, for the purposes of Chapter X of the Act the word "auditor" includes a firm of auditors also. Therefore, the term auditor applies to both individual and firm.

2.61. Therefore, NFRA reiterates that non-audit services provided by SRBC and by all other EY entities fall squarely within the purview of the prohibited services, including management services, covered under section 144 of the Companies Act, 2013.

Violations of ICAI Code of Ethics 2019

2.62. The Audit Firm submits that *"the Engagement letter in Serial no. (a) in Appendix – I is for services provided by SRBC to ITNL. However, the EL was signed on July 19, 2016 and services were completed on 21st December 2016, which was before the date of appointment of SRBC as statutory auditors of ITNL, i.e, February 10, 2017. The addendum letters dated September 15, 2016, and March 31, 2017, were only related to changes increase in fees and there was no agreement to provide any additional service change/addition in the scope of service agreed with ITNL Management vide engagement letter dated July 19, 2016.".* There is no proof submitted for the claims regarding the completion of the engagement. The addenda referred there do not indicate anything that confirms the completion of the engagement beforehand. On the contrary, an addendum to an agreement can be made only when the agreement is live and has not expired. In addition, the date of start of engagement is not 10th February 2017 as claimed by the Audit

Firm. It is 2nd December 2016, the date on which the ITNL Board has recommended the appointment of SRBC as the auditors.

2.63. The Audit Firm reiterates its earlier submissions during the PFC stage and submits that *"As the services did not include preparation of accounting records or financial statements or converting financial statements into IND AS; or assuming any management responsibilities, or performing any activities related to Company's information systems, the only conclusion is that this engagement is permitted under Section 144 of the Act."* However, these issues are covered extensively with reasons and justifications in the DAQRR. There is no new legal position or factual matters brought in by the Audit Firm.

2.64. The Audit firm submits that *"As regards engagements under serial nos. (d), (e), (f) and (h) in Appendix – I, SRBC submits that NFRA has not provided any explanation on why they believe that the said services are prohibited services. Rather, NFRA has provided a general statement that the said services are prohibited in NFRA's opinion."*. However, this statement is not true since para 2.1.14 (which the Audit Firm had already replied to during the PFC stage) and para 2.44 of the DAQRR clearly state the reasons therefore.

2.65. The Audit Firm states that *"The need for audit committee preapproval is required only for services rendered by the auditor after its appointment in accordance with provisions of the Section 144 of the Act, to the auditee company."* It is already explained in the DAQRR that all the prohibited non-audit services were subsisting at the date of the start of the engagement, i.e., on 2nd December 2016. Therefore, the claims of the Audit Firm that these services were not required to be approved by the audit committee are untenable.

2.66. The Audit Firm also states that *"…SRBC was appointed as statutory auditor of ITNL on February 10, 2017 and not on December 2, 2016."* In this regard, NFRA observes that February 10, 2017, is the date on which a resolution had been passed by the extraordinary general meeting of ITNL approving the appointment of SRBC as auditors. However, the Board of ITNL had considered this matter on December 2, 2016, itself. The Board recommends the appointment of the auditor only on satisfying itself that the auditor is not disqualified under the Companies Act. This is confirmed by the auditor, that the appointment if made, will be in accordance with the provisions of Section 141 (1) of the Act. Therefore, the relevant date for the purpose of qualification and disqualifications of the auditor is the date of the Board meeting in which the matter was approved.

2.67. In view of the above, NFRA reiterates its observations in the DAQRR and concludes that:

i. The appointment of the Audit Firm as Statutory Auditor of ITNL was ab initio illegal and void for violation of Section 141(3)(e) and Section 141(3)(i) of the Act, because of the provision of prohibited non-audit services, in violation of section 144 of the Act. Because of the two non-audit services detailed in para 2.45 above, the Audit Firm has violated section 141(4) as well.

ii. 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 Audit Firm had grossly violated the provisions of Section 144 of the Companies Act, 2013.

iii. The Audit Firm had been in serious breach of the Code of Ethics.

iv. The violations had undoubtedly fatally compromised the independence in mind and independence in appearance required of the Audit Firm. Independence in appearance stood 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.

3. GOING CONCERN

3.1. NFRA has conveyed the following prima facie comments/ observations/ conclusions:

3.1.1. Where the going concern basis of accounting is a fundamental principle in the preparation of financial statements, the preparation of the financial statements requires management to assess the entity's ability to continue as a going concern even if the financial reporting framework does not include an explicit requirement to do so. (Para 4, SA 570 Revised)

3.1.2. The **auditor's responsibilities** are to **obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis** of accounting in the preparation of the financial statements, and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern. (emphasis added) (Para 6, SA 570 Revised).

3.1.3. When performing risk assessment procedures as required by SA 315, the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern. In so doing, the auditor shall determine whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern. (Para 10, SA 570 Revised)

3.1.4. The risk assessment procedures required by paragraph 10 help the auditor to determine whether management's use of the going concern basis of accounting is likely to be an important issue and its impact on planning the audit. These procedures also allow for more timely discussions with management, including a discussion of management's plans and resolution of any identified going concern issues. (Para A4, SA 570 Revised).

3.1.5. The auditor shall evaluate management's assessment of the entity's ability to continue as a going concern. (Para 12, SA 570 Revised).

3.1.6. **If events or conditions have been identified** that may cast significant doubt on the entity's ability to continue as a going concern, **the auditor shall obtain sufficient appropriate audit evidence** to determine whether or not a material uncertainty exists. (Para 16, SA 570 Revised). (Emphasis added).

No record of Projected Cash Flow:

3.1.7. NFRA has noted from the Audit Files pertaining to Going Concern Assessment that there is no record in the file of projected cash flows prepared by the management. Needless to mention, a projected cash flow statement is an absolutely essential element and starting point of any evaluation of any going concern assumption. Thus, it is evident that the Audit Firm has failed to examine the projected cash flows of the Company over a minimum period of twelve months from the date of financial statements, rendering the entire assessment of going concern as meaningless as there is no credible basis against which the management's assumptions could be evaluated.

3.1.8. In response to NFRA's preliminary questionnaire, the Audit Firm has referred to projected cash flow attached to the Going Concern Memo. However, NFRA has observed that the "Projected cash flow" stated to be attached to Going Concern Assessment Memo (Document: Going Concern Assessment Memo March 2018)' does not form part of the Audit File submitted by the Audit Firm. NFRA, in its email to the Audit Firm dated 28.01.2020, sought clarification regarding work paper reference to Projected Cash Flow attached to the document Going Concern Assessment Memo March 2018. In response, the Audit Firm submitted a 12-page explanation vide Annexure 1 along with its letter dated 03.02.2020 but failed to provide a direct reference of any WP from the audit file which was submitted to NFRA. NFRA therefore concludes that the Audit Firm's submission is an attempt to wilfully mislead NFRA.

Lack of adequate evidence and documentation

3.1.9. Notwithstanding NFRA's conclusion stated above, NFRA has examined the Audit File pertaining to the Audit Firm's work done on Going Concern, and has noted the following serious lapses in the Audit Firm's analysis of whether a material uncertainty exists in respect of events or conditions that may cast significant doubt about the entity's ability to continue as a going concern.

3.1.10. One of the requirements, when performing risk assessment procedures under SA 315, is to assess whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. In doing so, the Audit Firm shall determine whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern. NFRA has noted from the working papers referred by the Audit Firm that the evaluation of the management's assessment of going concern assumption, as part of Audit Firm's assessment of ROMM, was not done.

3.1.11. NFRA notes from the work paper, 'Going Concern Assessment memo (Document: Going Concern Assessment Memo March 2018),' that the Audit Firm has recorded following indicators that may cast doubt on the going concern assumption:

i. The Company has fixed term borrowings of Rs. 3095 crore maturing in next 12 months and short-term borrowings of Rs. 1612 crore as on March 31, 2018.

ii. Negative cash flows in standalone financial statements for March 2018.

iii. High debt-equity ratio.

iv. One notch reduction in credit rating of certain loans.

3.1.12. These indicators, apparent from the financial statements of the Company, should have been enough to prompt the Audit Firm to call for the cash flow projections over the next twelve months, profit and other relevant forecasts of the management, in order to form an opinion on the going concern assumption.

3.1.13. Instead, NFRA notes that the Audit Firm has evaluated the assessment of these indicators, based on the management representation, as follows:

i. "Negative Operating Cash Flows: Negative Cash Flows are on account of fact that some of the major projects have been completed in last few years. These being new assets would start paying in future years once they mature thereby releasing working capital;

ii. Adverse key financial ratios: The new assets will provide positive cash flow going forward. Also, projects under construction have resulted in high debt which is expected to reduce in future. The company also plans to raise equity capital which further reduces the debt equity ratio.

iii. Reduction of credit ratings by a notch: This did not have a material impact on the borrowings of the company and its classification on the borrowing cost."

3.1.14. NFRA observes from the said WP that the Audit Firm's assessment is simply a reproduction of management's views (seen from the Minutes of the Meeting with CFO dated 28-May-2018 and Minutes of Meeting with Non-Executive Director, Joint Managing Director and Vice-president of the Company, dated 28-May-2018). In fact, regarding work done by them to evaluate management's assessment (as per Para 12 and Para 14 of SA 570), the Auditors have stated that they performed an inquiry with the management with respect to their plan to generate sufficient cash to service debt including interest and principal payments. Management represented and also presented their plan of a four-year cash flow projection to the audit committee and board of directors in their meeting held on 29-May- 2018. As per the management plan the Company was to become cash positive by FY 2019-20.

3.1.15. There is no evidence of any analysis carried out by the Audit Firm, and no accompanying evidence, to support the management assumptions. In NFRA's opinion, there were strong grounds to doubt these assumptions due to the following reasons:

i. **Fixed-term borrowings and excessive reliance on short-term borrowings:** Management plan to replace Rs.5,667 crores of SPVs borrowings with low interest borrowing next year is devoid of any appropriate and conclusive evidence obtained by the Audit Firm for this assessment. The assessment that "The Group/Company also has plans to dispose certain assets/investments to be able to service its debts any time in past" is not supported by any conclusive evidence obtained by the Audit Firm. Additionally, by using the term "certain assets/ investments" it implies that these SPVs and investments have not been identified. In assessing the Company's receivables/ claims that were expected to be realised in March 2019, the audit evidence supporting the verification of underlying assumptions is not available in the Audit file.

ii. **Negative Operating Cash Flows:** The fact that some of the major projects have been completed should rather restrict the cash outflows, and in the normal course of operations with continuous and constant cash inflows, the overall operating cash flows should only increase. The very fact of negative operating cash flows should have led the Audit Firm to question the Company's ability to maintain cash flows from operations, and its heavy reliance on cash flows from financing activities. No further work has been performed by the Audit Firm in this area. The Audit Firm's opinion that "new assets would start paying in future years once they mature thereby releasing working capital" is without any support of credible evidence which can vouch for the assumptions underlying the forecast, and hence cannot be accepted.

iii. **Adverse key financial ratios:** The reason for increase in debt of the Company as cited by the auditor indicated unplanned, poor and risky business management practices of the Company's Management. Further, the plans to raise equity capital to reduce the debt-equity ratio also not only prove uncertainty in the Management's plan of action but also heavy reliance on cash flows from financing activities. The Audit Firm's assessment is bereft of any evaluation of the reliability of the Company's or its Management's plan, and therefore cannot be accepted.

iv. **Reduction of credit ratings by a notch:** A reduction in credit rating is a direct indication of the company's general creditworthiness, and as such lower credit ratings result in higher borrowing costs because the borrower is deemed to carry a higher risk of default. Further, a rating downgrade has a direct impact on the market value of the shares, and investors' outlook and behaviour towards a company. Without doubt, a credit rating downgrade would also impact the Company's plan to raise equity capital.

3.1.16. Further, despite noting the credit rating downgrade, the report of credit rating agency based on which the rating was downgraded, has not been obtained and examined by the Audit Firm. No such report is available in the Audit File. Further, there is no audit evidence in support of the ET's assessment that reduction in credit rating did not have a material impact on the borrowings and classification of borrowing cost. Therefore, the Audit Firm's assessment is not accepted.

3.1.17. NFRA further notes that:

i. Letter of Representation from management (Document: ITNL Signed LOR- Standalone March 2018 and ITNL Signed LOR- Consolidation- March 2018), the only written representation from management in the matter of going concern, which has been received only on the date of signing of the Audit Report, does not talk about any mitigation plan to address the risks on account of negative indicators about the Company's ability to continue as a going concern.

ii. Further, the Auditors' meeting with the Company's CFO and the Company's Management were held on 28-May-2018 that is only day before the date of signing of the Audit Report.

iii. The WP 'Going Concern Assessment Memo' has been signed-off on 28-May-2018, which is only a day before the Audit Report was signed.

Therefore, it is evident that the Auditors' documentation of work done regarding going concern assessment was merely a paper work to meet the procedural requirements, rather than a substantive assessment, based on the analysis of the validity of the underlying justification of the management for the going concern assumption. This was not withstanding serious doubts about the Company's ability to function as a Going Concern.

iv. Hence, the only inference that can be drawn is that the events or conditions had been identified that should have led to the conclusion that Material Uncertainty existed. The Audit Firm should have appropriately and sufficiently evaluated the use of going concern basis of accounting by the Management and should have noted the implications thereon in the Auditor's Report as required by Paras 21, 22 and 23 of SA 570 (Revised), i.e.,

a. If in the auditor's judgement, management's use of going concern basis is inappropriate, the auditor shall express an adverse opinion (Para 21);

b. If adequate disclosure about the material uncertainty is made by the management, the auditor shall include a separate section under the heading "Material Uncertainty Related to Going Concern" (Para 22);

c. If adequate disclosure about the material uncertainty is not made by the management, the auditor shall express a qualified opinion or adverse opinion (Para 23).

3.1.18. Based on the observations noted above, NFRA had Prima Facie concluded that the Audit Firm is found to have:

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

ii. Failed to report a material misstatement known to them to appear in a financial statement with which they are concerned in professional capacity;

iii. Not exercised due diligence, or have 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 exceptions are sufficiently material to negate the expression of an opinion;

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

3.2. The Audit Firm has responded to the Prima Facie Conclusions (PFC) of NFRA in its written response dated July 3rd, 2020. This has been examined by NFRA in detail and NFRA's observations in the DAQRR were as follows:

In respect to PFC para 3.1.1 to 3.1.6 above

3.3. Audit Firm in page 48 of its response submits that "the scope of Audit Quality Review ("AQR") must be circumscribed by principles enumerated in the Technical Guide on Conducting Quality Review issued by the Quality Review Board for reference of Technical Reviewer" and quoted the para 2.13, 2.14 & 2.15 of the Technical Guide. In page 49 of their reply the Audit Firm states that "The Audit Quality Reviewer cannot substitute his / her own professional judgement for that of the auditor and identify conflicts of opinion and conflicts of judgements as issues of breach of auditing standards. The essence of auditing standards simply stated is the formulation and implementation of robust policies and practices – these are ever evolving standards and are never static. Further, the consistency of approach in exercising auditing professional judgements in similar situations would be another litmus test for the quality review of an audit exercise. The Audit Quality Reviewer cannot sit in appeal or judgement of the auditor's professional judgement exercised during the conduct of the audit".

3.4. The above comments of the Audit Firm stem from a poor understanding of the changed scenario of Audit Regulation in India. NFRA is a statutory authority constituted by the Central Government under section 132 of Companies Act, 2013. The duties and responsibilities of NFRA are defined by the said section and the corresponding rules notified in this regard. The Technical Guide on conducting quality review issued by Quality Review Board of ICAI has no relevance to the functioning and monitoring activities carried out by NFRA.

3.5. The new format of SAs, which has been made applicable from 1st April, 2008, incorporates the fundamental principles of the SAs in the requirements section of each SA, and these are represented by the use of "shall", whereas prior to the new standards, the word used for this purpose was "should". (Page 5 of the Handbook of Auditing Pronouncements ICAI 1st Feb, 2019). The ICAI issued the Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services to be effective from April 1, 2008. Para 8 of this Preface states that "**Statements on Auditing are issued with a view to securing compliance by professional accountants on matters which, in the opinion of the Council, are critical for the proper discharge of their functions. Statements are, therefore, mandatory**" (emphasis supplied). Moreover, by virtue of section 143 (9) every auditor of a Company shall comply with the auditing standards.

3.6. Also, SAs make it mandatory to document professional judgments. **Para 8 of SA 230** stipulates that "The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions." **Para A27 SA 200** states that "Professional judgment needs to be exercised throughout the audit. It also needs to be appropriately documented". **Para A9 of SA 230** states "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. **Para A10 of SA 230** states that "Some examples of circumstances in which, in accordance with paragraph 8, it is appropriate to prepare audit documentation relating to the use of professional judgment include, where the matters and judgments are significant: The rationale for the auditor's conclusion when a requirement provides that the auditor 'shall consider' certain information or factors, and that consideration is significant in the context of the particular engagement". In the absence of any such documentation, all reasoning provided will be taken as afterthoughts, hence inadmissible as evidence of work done (refer Para A5 of SA 230).

3.7. Accordingly, NFRA as mandated under section 132 (2) (b) shall monitor and enforce the compliance with auditing standards. Hence none of the arguments of the Audit Firm has the support of the law and are hence are totally out of place.

3.8. On examination of the reply NFRA also observes that the Audit Firm has simply echoed the management's views and expectations without any evidence of objective analysis carried out by the Audit Firm. No accompanying evidence from Audit File is referred to support the management assumptions (as stated by the Audit Firm) while there were strong grounds to doubt these contentions. Though the Audit Firm has provided lengthy explanations, none of the conclusions reached, professional judgments made and the basis for such conclusions are documented. The lengthy replies are just verbal smokescreens intended to confuse and draw attention to irrelevant matters. Notwithstanding this fact NFRA has examined in detail the submissions made and observe as detailed in the subsequent paragraphs.

No record of Projected Cash Flow

3.9. Audit Firm submits in page 51 of their reply that "audit team has considered the continuous assessment of going concern since the planning stage including the client planning meetings as required by para 10 and A4 of SA 570 (Revised)". "Final cash flow projections were shared by the management with Audit Firm vide an email dated May 25, 2018 (Refer Cash flow Projections attached to - Going Concern Assessment Memo March 2018, Hard copy binder Part 6 of 6 - P.6.4)………were discussed in the meeting with management on May 28, 2018 to confirm the that the management plan was feasible." It further states that "We have also documented examination of cash flow projections from the management in third bullet point of paragraph 6 of Going Concern Assessment Memo March 2018 (Refer hard copy Binder Part 6 of 6 – P.6.4)". Audit Firm further submits in page 72 that the Going Concern Assessment Memo March 2018 including the "Projected cash flow" attached thereto forms part of audit work papers submitted to NFRA.

3.10. Vide NFRA letter dated 28-1-2020, the Audit Firm has been asked to provide the projected cash flow, supported by direct reference to Workpaper from the Audit File submitted by the Audit Firm. Instead of giving a clear reference to any Workpaper, the Audit Firm in their reply (letter dated 03-02-2020), referred WP "P.6.4 Going concern assessment memo" and reproduced the summary of the memo. The WP "P.6.4 Going concern assessment memo" (hard copy binder) initially submitted (letter dated 22-03-2019 and 21-08-2019) by Audit Firm to NFRA does not contain the Cash Flow projections. The going concern assessment memo provided subsequently on 17 July, 2020 contained a cash flow projection, which is an excel file converted into PDF and attached with the scanned copy of the memo. This fact makes it clear that the cash flow projections are not part of the manual binder as claimed by the Audit Firm**.** As the IT system used by the Audit Firm has several structural issues that make the audit documentation vulnerable to changes at any time (detailed elsewhere in this DAQRR), the Audit Firm is at liberty to add or delete any documents in the electronic Audit File, without leaving any user-verifiable logs of changes in the system. Hence the contentions of the Audit Firm and subsequent submissions claiming that the cash flow statement was available in the Audit File are rejected.

3.11. Further in response to PFC, the Audit Firm has provided a summary of the cash flow projections, management's evaluation and workpaper reference to documents supporting their assessment in tabular form (Refer page no. 52-71 their reply). In the remarks column of this table the Audit Firm states its conclusions, which are not recorded in the Audit File and hence not acceptable. Even assuming, but not admitting, that the projected cash flow statement attached to the WP "P.6.4 Going concern assessment memo" is provided by the management and evaluated by Audit Firm, NFRA has found that there is no management estimate/judgement/assumptions written, based on which the projected cash flow statement should have been prepared. This confirms the observation made by NFRA regarding no evidence of any analysis carried out by the Audit Firm with respect to the evaluation of the reliability of underlying data generated and assumptions used in the forecast provided by management to the Audit Firm.

Lack of adequate evidence and documentation

3.12. Para 9 of SA 500 requires that when using information produced by the entity, the auditor shall evaluate whether the information is **sufficiently reliable** for the auditor's purposes, including as necessary in the circumstances: (a) **Obtaining audit evidence about the accuracy and completeness** of the information; and (b) **Evaluating whether the information is sufficiently precise and detailed** for the auditor's purposes. The Projected Cash Flow Statement attached to the WP "P.6.4 going concern assessment memo" provided to NFRA on **17 July, 2020** is a PDF file in which only numbers are given without any supporting evidence of how these estimated numbers are arrived at. The assumptions used and basis of estimations and the conclusions regarding validity of going concern assumption are not available in the projections. Even the purpose of making the projections was not mentioned in this document.

3.13. Though the Audit Firm mentions about a forwarding mail from the company of the cash flows, no such mail is seen attached with the reply of the Audit Firm or in the Audit File. Further there is no WP reference given by the Audit Firm regarding audit evidence to support the management projections. This clearly shows that the Audit Firm has not done anything in practice and only obtained/made a projected cash flow and attached it in audit file subsequent to the communication from NFRA.

3.14. Without prejudice to the fact that the projected cash flow was not available in original Audit File submitted to NFRA, NFRA has examined the cashflow statement subsequently submitted on 17 July 2020 and found that there is no audit evidence available to support the cash inflows shown there in, viz, EPC Contract Rs. 644 crore, Stake sale of MBEL & CTNL Rs. 792 crore, Repayment by SPV's through Claims Rs. 1,213 crore and Equity Issue Rs. 1,500 crore etc. There was no certainty about the realization of the same before March 31, 2019. No audit evidence has been seen in the Audit File in instances like refinancing of loans of CNTL and MBEL (reduction in interest amount was not disclosed), and evaluation of RBI circular dated Feb 12, 2018 (in Going concern assessment memo point 7).

3.15. Going concern assessment memo states in point 8(k) that Company has identified assets worth Rs 2,641 crore as held for sale with liabilities of Rs 1,780 crore but no workpaper has been referred by the Audit Firm whereas note no. 13 of ITNL Annual Report 2018 (page no 136) shows that the Company has disclosed only Rs. 701.93 crore of assets held for sale as on March 31, 2018. Hence the amount of Rs. 2,641 crore is bereft of any conclusive evidence.

3.16. NFRA has examined the WP "P.1.1 Audit Strategy Memorandum" & WP "Client Planning Meeting ITNL March 2018" and found that there is no assessment made regarding Going concern. There is only a plan that Audit Firm will do going concern assessment at year end. Para 14 of Ind AS 7 states that cash flows arising from operating activities is a key indicator of the extent to which the operations of the entity have generated sufficient cash flows to repay loans, maintain the operating capability of the entity, pay dividends and make new investments **without recourse to external sources of financing**. Despite knowing that fact that there is a negative operating cash flow, the Audit Firm has relied blindly relied on the management estimates and plans and management representation rather than performing substantive audit procedures. Further excessive dependence of ITNL on IL&FS for routine operations, with no internal free reserves of the company is again a sign of poor financial health of ITNL.

3.17. As per para 10 read with para A3-A6 of SA 570 (Revised), adverse key financial ratios is one of the indicators of events or conditions exist that may cast **significant doubt on the entity's ability to continue as a going concern**. Para 14 of SA 570 (Revised) requires that in evaluating management's assessment, the auditor shall consider whether management's assessment includes **all relevant information** of which the auditor is aware as a result of the audit. The Audit Firm has not obtained conclusive audit evidence which supports that the increasing debt equity ratio (increased to 4.36 times from 4.13 previous year), Debt Service Coverage Ratio (reduced to 0.26 times from 0.36 in previous year) and increased interest cost as a percentage to Revenue from operations (increase to 46% from 41% in previous year) will be improved in future. Further, in WP "P.6.4 Going concern assessment memo" auditor's assessment mentions that "some of the major assets are new and would provide positive operating cash flow going forward. Also, Company has projects under construction resulting in higher debt. This is expected to reduce in future." This observation itself shows that Audit Firm has not even identified and documented the assets/projects under construction and simply noted the management views.

3.18. SA 230 requires that auditor shall prepare 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, results of the audit procedures performed, and the audit evidence obtained, significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. NFRA found that Audit Firm has failed to document the audit evidence which includes but is not limited to Projected Cash Flow Statement, key features of the EPC agreement, rationale of the Credit Rating Report etc. which were required to understand the nature of the audit procedures performed, results of the audit procedures performed, and the audit evidence obtained, significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. Further para 26 of SA 330 stipulates that "The auditor shall conclude whether sufficient appropriate audit evidence has been obtained. In forming an opinion, **the auditor shall consider all relevant audit evidence, regardless of whether it appears to corroborate or to contradict** the assertions in the financial statements". (Emphasis added). However, the Audit Firm has not considered all the audit evidence which may lead to contradict the assertions in the financial statements and had just accepted the management projections and management estimates/judgements without objectively evaluating the same. Thus, NFRA reiterates its earlier observation that while there were strong grounds to doubt the assumptions made by the management, there is no evidence of any analysis carried out by the Audit Firm, and no accompanying evidence, to support the management assumptions.

Audit Firm's assessment of going concern is simply a reproduction of management's views

3.19. Audit Firm submits in page 76-77 of their reply that the management on the basis of its preliminary assessment was confident with respect to the going concern status of the Company. It further submits that, considering the indicators identified by Audit Firm viz, (i) Negative operating cash flows at standalone financial statements level and positive cash flow at consolidated financial statements level (ii) Heavy dependency on borrowings and adverse key financial ratios like debt-equity, interest coverage; and (iii) Reduction of credit ratings by one notch, "the engagement team insisted for the management's reassessment of going concern with detailed management plan / future cash flow projections. The management provided its assessment in the form of future cash flow projections. These projections were discussed with the management and those charged with governance including the audit committee. The plan was presented by the management at the audit committee and the board meeting held on May 29, 2018 and the management, the audit committee and the Board of Directors exhibited confidence in executing the said management plan and the going concern status of the Company. Further, SRBC had performed procedures around the going concern assessment of the management. Considering the above and more specifically that the audit committee and the board of directors were all convinced with respect to the management plan and going concern assessment performed by the management, SRBC had no reason to doubt the management going concern assessment and management mitigation plan".

3.20. None of the above conclusions of the Audit Firm are documented or are otherwise supported by evidence in the Audit File. In this regard para 12 of SA 570 (Revised) requires that the auditor **shall evaluate** management's assessment of the entity's ability to continue as a going concern. Further para A10 of SA 570(Revised) required that "evaluating management's assessment of the entity's ability to continue as a going concern, as required by paragraph 12, may include an evaluation of the process management followed to make its assessment, the assumptions on which the assessment is based and management's plans for future action and whether **management's plans are feasible in the circumstances**." However, there is no supporting document in the Audit File to prove that an evaluation has been made by the Audit Firm to confirm that the management's plans are feasible in the current circumstances. The word **shall** used in the Para 12 of SA 570(Revised) shows requirement of para is **unconditional and mandatory**. However, the Audit Firm has simply accepted the management contention, that negative cash flows are on account of some of the major projects having been completed in last few years and these new assets would be paying in future years, without any reference to any supporting information/documents in the Audit File.

3.21. The Audit Firm has documented in "WP Going Concern Assessment Memo" that management expects cash flow of Rs 644 crore from an EPC project which has been awarded to the Company. But the Audit Firm did not verify the contractual conditions of this project, the operational status or feasibility of revenues while evaluating management assertions. NFRA found that the Audit Firm when providing WP "P.6.4 Going concern assessment memo" vide letter dated 17.7.2020 (in soft copy which included the projected cash flow) had attached 3 pages of EPC agreement to support the cash inflow of 644 crore (this was not provided in original submission of audit file to NFRA) but failed to note that the projected cash flow of 10% shown in the cash flow projections has certain key conditions that makes the said cash flow of no use to the company. The said projection is only a mobilization advance in 2 instalments of 5% (Rs. 297.45 crore) each for incurring mobilization expenses of the EPC project. The second instalment of 5% shall be released only after satisfactory utilization of earlier advance. Further advance of up to 2.5% of the EPC Contract Price will be received for purchase of new machinery. This shows that additional amount expected to receive shall be used for incurring additional expenses and cannot be used for current running expense of the Company.

3.22. Thus, it is clear that the Audit Firm has simply echoed the management views in "WP Going concern Assessment Memo" without performing any objective, detailed analysis required by Para 12 and A10 of SA 570 (Revised).

3.23. Without prejudice to the fact that NFRA is duty bound to look only into the evidence documented in the Audit File for its review, the lengthy submissions made by the Audit Firm have been examined in detail and NFRA observes as follows.

3.23.1. Regarding Fixed-term borrowings and excessive reliance on short-term borrowings, the Audit Firm in its response, has referred Annual Report of ITNL and concluded that, based on past trends it was considered to be feasible to refinance loans for SPVs where projects had been completed in previous years. Further Audit Firm states that they have read the minutes of the BOD meeting dated February 09, 2018 where decision to refinance the RIDCOR & CNTL was taken.

3.23.2. NFRA observes that the Audit Firm has relied, without objective evaluation, on the management decision to refinance the loan of (i) Road Infrastructure Development Company of Rajasthan Limited (RIDCOR) & (ii) Chenani Nashri Tunnelway Limited (CNTL) which the management expected to reduce the interest cost. The Audit Firm has not done any analysis to verify the amount of interest which is expected to be reduced due to refinancing. The Audit Firm also failed to examine how the management has projected reduction of 300-350 basis points despite the lowering of credit rating and previous refinancing (which was done for Jorabat-Shillong Expressway Limited and Jharkhand Road projects

Implementation Company Limited) at a reduced the rate of interest only by 200-250 basis points (Refer Annual Report ITNL March 31, 2018 Page No. 47). Hence the contention of the Audit Firm that refinancing was supported by past trend is not acceptable and it is clear that no analysis was actually done as per the requirement of para 12 of SA 570(Revised).

3.23.3. Indicators showing increasing debt equity ratio, decreasing debt service coverage ratio and reduction of credit rating cast significant doubt on how the Audit Firm has evaluated that the management will be successful in refinancing (Refer Table 1 and 2 below for the ratios and trends). Further there is no evidence obtained which shows that refinancing process has in fact been initiated.

3.23.4. NFRA examined the minutes of board meeting held on February 9, 2018 under the heading "Update on Initiatives" (refer page 1272 of "ITNL M18 - Minutes") in which CFO informed to BOD that refinancing of (i) Road Infrastructure Development Company of Rajasthan Limited (RIDCOR) & (ii) Chenani Nashri Tunnelway Limited (CNTL) **was targeted in Q4** which was expected to result in saving in interest cost by 300-350 basis points. The Audit Firm did not cross question the TCWG in the subsequent meeting held on 28.5.2018 & 29.5.2018 about the status of the same.

3.23.5. Audit Firm has referred to the approval for issue of masala bonds of Rs. 2,000 crore but no information has been given relating to when the masala bond will be issued. Further no information was given for savings in cash outflow due to refinancing of Jorabat-Shillong Expressway Limited (JSEL) and Jharkhand Road Projects Implementation Company Limited (JRPICL) done in previous year. Hence the Audit Firm's contention that refinancing will be expected to reduce the future interest is not supported by evidence.

3.23.6. NFRA notes that minimum cash outflow towards repayment of borrowings for next FY (FY 2018-19) was Rs. 4,938 crore (current maturity of long term borrowing Rs. 3,095 crore, accrued interest Rs. 231 crore & short term borrowings Rs. 1,612 crore) and the projected cash flow shows surplus of only 3,000 crore for repayment. Audit Firm has not made any evaluation, basis which the extra payment of Rs. 1,938 crore will be made. Further, cash inflows shown projected was doubtful to be achieved within 1 year as there is no conclusive action plans to achieve the same.

3.23.7. Regarding Group/Company plans to dispose certain assets/investments to be able to service its debts, the Audit Firm has stated at length various plans of the Company by referring certain minutes of the Company's Board meeting, and the cash flow projections and copy of certain agreements provided subsequently to NFRA as attached to the Going Concern evaluation memo. None of the conclusions detailed by the Audit Firm is found documented in the Audit File. Other than echoing the management's stand, there is hardly any objective evaluation done by the Audit Firm in any of these cases.

3.23.8. On an examination of WP "IRL Share Sale Agreement", "PSRDCL Valuation Report" it is observed that it is only a draft and not signed by any party of the contract. Audit Firm has referred management plan to monetise investment of CNTL, MBEL and Yuhe as discussed and noted in the Board meeting held on May 29, 2018. The Audit Firm did not have any other objective evidence to support the management assumptions.

3.23.9. Regarding Negative Operating Cash Flows, the Audit Firm again reproduce in detail the plans and expectations of the Company, without any reference or documentation in the Audit File. The only Audit Procedure the Audit Firm has stated in their reply in this regard is verification of the EPC agreement for certain projects, again not properly documented in the Audit File. Such audit procedures do not comply with the requirements of para 16 of SA 570 (Revised). The Audit Firm has **failed to test the source of the cash genera**ted and company's ability to meet the immediately arising future liabilities.

3.23.10. Audit Firm mentioned that out of total 25 operational projects under ITNL, 16 projects have got PCoD/CoD in last 5 years and these new assets would pay in future years once these matures thereby releasing working capital. NFRA observes that no details of these projects and no analysis of how much increase in revenue and gross margin will be realised from these projects are documented in the Audit File. Thus, growth in cash balances due to increase in revenue from such projects is not at all tested with sufficient audit evidence as required by para 8-11 of SA 230.

3.23.11. Audit Firm contention that it has verified the EPC agreement for new project which generate future cash flow is not properly supported by evidence since Audit Firm has documented only 3 pages of 1 EPC Agreement and not evaluated the operational status or feasibility of revenues from all these projects.

3.23.12. There is no audit evidence available and no analysis done which supports the cash inflow shown in projected cash flow statement from repayment by SPV's through Claims Rs. 1,213 crore and Equity Issue Rs. 1,500 crore etc.

3.23.13. Regarding the Adverse key financial ratios**,** NFRA in the PFC, has observed about the Audit Firm's evaluation & reliability of management plan for which there is no response given by Audit Firm. Further, the Audit Firm in its response has explained reason for increase in borrowings that infrastructure sector being a capital-intensive sector, and reproduced management's explanations, nothing of which are documented in the Audit File. Despite knowing the fact that adverse key financial ratio is a key indicator, as per para A3 of SA 570 (Revised), that may cast significant doubt about the Entity's ability to continue as a going concern, the Audit Firm has not evaluated the management plan and also has not performed any additional audit procedure as mentioned in Para 16 of SA 570 (Revised). The financial results of ITNL shows that Debt/ Equity Ratio has been increasing continuously and Debt Service Coverage Ratio was not improving from previous 3 years (Refer Table 1 below). These ratios indicates that ITNL was not able to generate proper revenue and was focused on borrowings to meet even short-term cash flow requirements. Annual trend of total income and finance cost (Refer Table 2 below) clearly shows that the Company was paying higher cost of capital for earning the same amount of Revenue from operations. Despite knowing that finance cost is almost half of the revenue from operations, Audit Firm has not carried out any analysis nor questioned the management or made proper disclosures in the Audit Report.

Table 1

Particulars	**March 31, 2016**	**September 30, 2016**	**March 31, 2017**	**September 30, 2017**	**March 31, 2018**
Debt/ Equity Ratio	3.62	3.88	4.13	4.27	4.46
Debt Service Coverage Ratio (DSCR)	0.26	0.25	0.36	0.26	0.26
Interest Service Coverage Ratio (ISCR)	0.90	1.18	1.14	1.16	1.22

Table 2 (Rs. in crore)

Particulars	**March 31, 2015**	**March 31, 2016**	**March 31, 2017**	**March 31, 2018**
Revenue from Operations	3,522.93	4,762.03	3,400.65	3,536.83
Other Income	358.89	500.21	999.86	1,172.65
Total Income	**3,881.82**	**5,262.24**	**4,400.51**	**4,709.48**
Finance Cost	738.12	1,102.35	1,377.95	1,642.10
Finance Cost as a % on Total Income	0.19	0.21	0.31	0.35
Finance Cost as a % on Revenue from operations	0.21	0.23	0.41	0.46

3.23.14. The source of cash was primarily debt as can be seen from financial statement where total borrowing was Rs. 13,730 crore (Long term + Short term + Other financial liabilities) in FY 2017-18 and Rs. 11,670 Crore in FY 2016-17 which increased by 18% from previous year. Debt Equity ratio was 4.46 times and was the highest of last 3 financial years. Accepting without questioning an increase in assets, without assessing the sources from where these assets will be financed, is not an appropriate way of evaluating the going concern assumption in terms of SA 570.

3.23.15. The investments held for sale was Rs. 702 crore in March 31, 2018 and the closing balance of cash and cash equivalents was merely Rs. 175 crore which is 18% of the current borrowings of Rs. 4,938 crore outstanding on 31st March 2018. Other assets like unbilled revenue, loans to SPVs and retention money to contractors may not be sources of adequate liquidity. There is also no surety that the projects which have provisional commercial operation date in last 5 years will generate higher revenues and cash flows in future years since Audit Firm has not documented any such data in the Audit File. It has also not compared past projections with actual outcome to verify the feasibility of these projects and reliability of the management estimates.

3.23.16. The Company was continuously paying dividend in previous years (Refer Annual Report of FY 2015-16 & FY 2014-15) and has paid dividend of Rs. 4 per equity share and Rs. 2 per equity share on 14 August 2015 and 29 July 2016 further the Company has not paid dividend for FY 2017 and FY 2018. This was one of the indicators that Company does not have adequate cash flow to meet its obligations, but the Audit Firm failed to enquire from management about this in assessment of going concern.

3.23.17. Reduction of credit ratings by a notch, as NFRA observes in the PFC, is an early indicator that can lead to further reduction in credit rating in future period. Audit Firm admits that credit rating report was not documented in Audit File. Substantive audit evidence in view of poor debt equity ratio, deteriorating debt service coverage and interest service coverage ratios and weaknesses in other solvency ratios were not obtained and documented in the Audit File. This is despite the fact that such declining ratios will lead to further reduction of credit ratings, increase borrowing cost and ultimately impact the going concern of the Company. The Audit Firm states in page 78 of their reply that “We have performed a detailed assessment with respect to reduction in credit rating by a notch in para 8 of the Going Concern Assessment Memo”. However, in all cases of the loan covenants stated to be dependent on the credit rating and so stated as examined in the said para 8, the Audit Firm has simply copied the management’s views without any objective verification of the tenability or veracity of those claims.

Absence of Timely communication under SA 260 (Revised)

3.24. NFRA in its PFC has observed that, regarding the significant matters para 16(c) and (e) of SA 260 (Revised) requires that, the auditor **shall** communicate with those charged with governance, the significant matters arising during the audit. Para 21 of SA 260 (Revised) requires the auditor to communicate with TCWG on a **timely basis**. Further, on plain reading of para A50 of SA 260 (Revised), the timely communication shall be made at the time the auditor identifies significant matters.

3.25. The objective of the auditor as mentioned in Para 9(c) of SA 260 (Revised) is to communicate with TCWG **on a 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. Audit Firm had stated that they had multiple rounds of discussion with management and a final discussion with Chief Financial Officer on May 28, 2018 wherein the management mitigation plan including cash flow projections were discussed. Audit Firm also states having a detailed discussion with the audit committee members in the meeting held on May 29, 2018 with respect to the management's assessment of going concern and the management mitigation plan including the cash flow projections. However, as per Para 9(c) of SA 260 (Revised), there is no evidence that Audit Firm has communicated any matters relating to going concern **during the audit process** so as to give sufficient time to both the Auditor and Auditee to evaluate matters relating to going concern adequately. Thus, the communications stated as made by the Auditor on the concluding day and the immediately previous day does not meet the requirements of SA 260 (Revised). Further para 22 of SA 260 (Revised) requires that auditor **shall** evaluate whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit. In the present case there is no such two-way communication that happened between the Audit Firm and TCWG. Hence, the Audit Firm has violated Paras 16(c) and (e), 21, 22 and A50 of SA 260 (Revised) and has also failed to meet the objectives of SA 260 (Revised) as stipulated in Para 9(c).

3.26. Without prejudice to the above, none of the Audit Committee Presentation Slides, have Audit Firm's observations or significant findings on their evaluation of judgements and estimates provided by the management of the company. These presentation slides only have details/ information about Management's estimates and Management's views thereon. Therefore, the contention of the Audit Firm that it has communicated the significant observations in Audit Committee Meeting held on May 29, 2019 is not acceptable.

3.27. NFRA, after carefully examining the response of the Audit Firm, reiterates its conclusion on PFC that the events or conditions that had been identified should have led to the conclusion that material uncertainty on going concern may exist. The Audit Firm has failed to appropriately and sufficiently evaluate the use of going concern basis of accounting by the Management and has not disclosed the implications thereon in the Auditor's Report as required by Paras 21, 22 and 23 of SA 570 (Revised).

Events or conditions had been identified that should have led to the conclusion that Material Uncertainty existed

3.28. Para 20 of SA 570 (Revised) requires that "if events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide **adequate disclosures about these events or conditions**. The same was also concluded by Audit Firm in its conclusion section of WP "P.6.4 Going concern assessment memo". Further Para A24 requires that some financial reporting frameworks may address disclosures about:

i. Principal events or conditions;

ii. Management's evaluation of the significance of those events or conditions in relation to the entity's ability to meet its obligations;

iii. Management's plans that mitigate the effect of these events or conditions; or

iv. Significant judgments made by management as part of its assessment of the entity's ability to continue as a going concern

3.29. NFRA observes that, the Audit Firm, despite concluding that adequate disclosure about these events or conditions should be made in financial statement, has failed to check and conclude that such disclosures were in fact made. Further para 23 of SA 570 (Revised) requires that if adequate disclosure about the material uncertainty is not made in the financial statements, the auditor **shall:**

i. Express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705 (Revised); and

ii. In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

3.30. The word "shall" makes the requirement of the SA unconditional **and mandatory.** Hence NFRA reiterates its conclusion of PFC that Audit Firm has failed to report the matter which was required to be reported as per SA 570 (revised).

3.31. NFRA therefore, reiterated its conclusions made in the PFC, that the Audit Firm is found to have:

3.31.1. Failed to comply with SA 570 (Revised), SA 260 (Revised) SA 230, SA 330 and SA 500.

3.31.2. Failed to disclose material facts known to them which are not disclosed in financial statements, but disclosure of which is necessary in making such financial statements where they are concerned with that financial statements in professional capacity;

3.31.3. Failed to report a material misstatement known to them to appear in a financial statement with which they are concerned in professional capacity;

3.31.4. Not exercised due diligence, or have been grossly negligent in the conduct of their professional duties;

3.31.5. 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;

3.31.6. Failed to invite attention to a material departure from the generally accepted procedure of audit such as SA 570, SA 500, SA 230 and SA 330 applicable to the circumstances.

3.32. NFRA has examined in detail the replies of the Audit Firm to the DAQRR and the oral submissions made. The Audit Firm reiterates its replies at the PFC stage and makes sweeping statements at many places without specifically mentioning any observations in the DAQRR.

3.33. The Audit Firm states that:

3.33.1. "the Quality Review Team should not, under any circumstance, use "hindsight" (i.e. perception or retrospection) in their evaluation of exercise of professional judgment by the auditor".

3.33.2. "The Audit Quality Reviewer cannot substitute his / her own professional judgement for that of the auditor and identify conflicts of opinion and conflicts of judgements as issues of breach of auditing standards…….. The essence of auditing standards simply stated is the formulation and implementation of robust policies and practices – these are ever evolving standards and are never static. The Audit Quality Reviewer cannot sit in appeal or judgement of the auditor's professional judgement exercised during the conduct of the audit."

3.33.3. "The documents available on the audit file should prove that the auditor had the material on which to apply his mind. The final conclusions should then be documented in accordance with para 8 of SA 230."

3.34. In this regard as explained extensively in the DAQRR, all the observations of NFRA are made based on the documents available in the Audit File submitted by the Audit Firm and based on the information available in the public domain as published by the company or its subsidiary companies before the date of the audit report.

3.35. In this regard, SA 230 clearly lays down that the Audit File should be capable of speaking for itself without the need for any other aids to interpretation. Apart from SA 230, there are other SAs that also require the documentation of events, data, evidence, opinions and conclusions. SA 230 makes it very clear that reliance can be placed only on the audit file as evidence of what was done. Para A5 of SA 230 makes this explicit in the following words: "Oral explanations by the auditor, on their own, do not represent adequate support for the work auditor performed or conclusions the auditor reached, but may be used to explain or clarify information contained in the audit documentation". Accordingly, the audit file is a contemporaneous record of the work of the audit. By using this as the sole evidence, the regulator avoids judging matters with the benefit of hindsight.

3.36. NFRA also reiterates observations in para 3.6 above and draws attention to the legal status of SAs as per the Companies Act. In the absence of any documentation of professional judgment as required by the SAs, all reasoning provided will be taken as afterthoughts, hence inadmissible as evidence of work done. NFRA never substitutes its professional judgment for that of the auditor but evaluates the evidence available on record to judge whether a reasoned and documented professional judgment has been in fact made by the auditor. In all cases where NFRA has questioned the professional judgment of the auditor, this has been done based on evidence clearly explained in the respective paras. A claim of having made a professional judgment in a significant area of audit is valid only if it is recorded and supported by documented evidence.

3.37. While NFRA agrees with the contention that the conclusion, and the evidence of material on which the auditor has relied to arrive at those conclusions, need to be documented, it should also be emphasised that the documents available in the audit file should not contradict such conclusions. If so, how the auditor has addressed such contradictions shall also be documented to comply with para 8 of SA 230. As explained in detail in the paras above, there is abundant evidence to contradict the claims of the Audit Firm that they had exercised a reasoned professional judgment in significant matters.

No record of Projected Cash Flow

3.38. The Audit Firm states that:

3.38.1. "detailed audit procedures were performed to assess the going concern during the course of audit and documented in the Going Concern Assessment Memo March 2018 (Hard copy binder Part 6 of 6 – P.6.4) which was prepared taking cognizance of various workpapers documented in different sections of the audit file. A summary of the cash flow projections, management's evaluation and workpaper reference to documents supporting our assessment is provided in table below along with our explanation in remark column to explain / clarify the same as requested / asked for by NFRA.".

3.38.2. "SRBC, in good faith, submitted a detailed response by providing reference to all relevant workpapers to corroborate the explanations provided. As an auditor SRBC has evaluated management's plans for future actions in relation to its going concern assessment and challenged the management's plans around feasibility in the circumstances, however, it appears that NFRA has not considered the entire going concern assessment performed by SRBC.".

3.38.3. "SRBC submits that the Going Concern Assessment Memo March 2018 including the "Projected cash flow" attached thereto forms part of hard copy audit work paper file submitted to NFRA on March 22, 2019. SRBC had provided reference to "Index to box file Exhibit A which contains 6 binders each has a detailed index of workpapers. The Going Concern Assessment Memo March 2018 in hard copy file binder Part 6 of 6 – P.6.4."

3.38.4. "SRBC reiterates that the Cash flow projections are in hard copy audit file attached to the Going Concern Assessment Memo March 2018 in hard copy file binder Part 6 of 6 – P.6.4 submitted to NFRA on March 22, 2019 and there is no role whatsoever of the IT system associated with SRBC in documenting the aforesaid hard copy audit workpapers.".

3.38.5. "The audit team has taken cognizance of such audit procedures performed and has not reproduced the same in the going concern section. The entire audit has to be viewed holistically, and not segmented into silos based on individual Standards of Audit. In fact, even the various Standards cannot be read and applied in isolation; they are inter-related. Going concern assessment memo clearly spells out the procedures performed and the outcome of the said procedures.".

3.39. NFRA observes the following in this regard.

3.39.1. The Audit Firm's submission that the cash flow projections formed part of the hard copy working paper file is not true to the facts. In order to bring clarity, an extract of the table ("sequence of discussions with management on going concern") from the reply to the PFC provided by the Audit Firm on the same observation is reproduced below.

Date	Particulars	Hard Copy file/Binder Number	Reference/Flap Number in hard copy file/Binder
20-04-2018	Post Interim Event (PIE) – March 2018	File 1	A2-185 to A2-188
01-05-2018	SRBC discussed with ITNL management on its going concern assessment and communicated to the component auditors to assess Going concern at SPV level	File 1	A1-284 to A1-286
25-05-2018	Final Cash flow projections received from the management (attached to Going Concern Assessment Memo March 2018)	Part 6 of Binder	P.6.4.1
28-05-2018	Minutes of meeting with CFO	Part 6 of Binder	P.6.4.3
28-05-2018	Minutes of meeting with Directors	Part 6 of Binder	P.6.4.2

It can be observed from the above table that the hard file repeatedly mentioned by the audit firm in their replies about the cash flow projections is the hard copy binder part 6 (out of total of 6 parts). The said binder contains machine numbered pages from page no. 489 to 575. The going concern assessment memo starts at page number 557 and ends at page number 567 (11 pages). The next page in sequence, i.e., page no. 568 is the minutes of the meeting held on 28th May, 2018 between the Company and the Auditors, which is the only attachment to the going concern assessment memo. It runs up to page number 575, which is the last page of binder 6.

3.39.2. Subsequent to submission of the audit files in hard copy, NFRA had asked the audit firm to submit a scanned copy of all the submitted hard copy files and the Canvas files (which was earlier submitted by the audit firm in a non-printable form in a proprietary tool loaded in its own laptop) in a searchable and printable format in accordance with the procedure for submission of audit files to NFRA. In the soft copies so submitted, NFRA observed that the file folder named 'Binder' contained a PDF file named 'P.6.4 going concern assessment memo.pdf'. This scanned document having page numbers from 39755 to 39765 (11 pages) is the going concern assessment memo which is earlier submitted in hard copy. Page numbers 39766 to 39774 are the cash flow projections and page no. 39775 to 39777 are the extracts from an EPC contract. Both these annexures were not available in the original hard copy submissions. The minutes of the meeting which was available in the hard copy is then seen scanned and attached but without page numbering. It was in this context that NFRA observed in the DAQRR (in para 3.10 above) that "The going concern assessment memo provided subsequently contained a cash flow projection, which is an excel file converted into PDF and attached with the scanned copy of the memo.". While all other documents in the second submission are directly scanned from the printouts, the cash flow projections mentioned above are not scanned from print, but directly converted from excel to PDF. Therefore, it is clear enough that the cash flow projections were not submitted in hard copy to NFRA. But while providing the scanned copies of all the hard copy submissions, the audit firm added the PDF version (not scanned, but directly converted to PDF) of an excel file (the source of which is not supported by evidence) along with the scanned hard copy documents and then numbered it serially. These documents were submitted to NFRA on 17th July 2020, i.e., after the communication of PFC by NFRA. The above sequence of events clearly shows that the Audit Firm has attempted to tamper with the Audit File and create fresh evidence after receiving the PFC.

3.40. Thus, NFRA reiterates that the cash flow projections were not available in the hardcopy audit file submitted to NFRA. However, as these projections were mentioned in the going concern assessment memo (on pages 567 to 577 of the WP), NFRA examined the projections in detail when the audit firm submitted it subsequently and the observations have been provided in <u>para 3.46</u> of this AQRR.

Lack of adequate evidence and documentation

3.41. The Audit Firm submits that *"the going concern assessment memo (in hard copy file binder Part 6 of 6 – P.6.4) which was prepared taking cognizance of various workpapers documented in different sections of the audit file summarized in the table in point 5 to SRBC's response to NFRA's DAQRR on Going Concern para 3.5 to 3.8 above clearly spells out our detailed assessment of management's evaluation of going concern assumption of ITNL for the year ended March 31, 2018 including the estimates/judgment/ assumptions used by the management to prepare the same. From the above mentioned workpapers it is evident that SRBC has obtained evidence about the accuracy and completeness of the information provided by the management and also evaluated that the information is sufficiently precise and detailed for the purpose of going concern assessment."*.

3.42. In this regard the Audit Firm has provided a table showing "*Summary of the cash flow projections, management's evaluation and workpaper reference*", which is the same table given earlier in their reply to PFC. NFRA had already examined in detail this table in the DAQRR itself. To clarify the matter again, it is reiterated that the matters explained in the table do not evidence **objective evaluation** of the forecasts made by the management. The evidence referred therein with respect to the account balances/balance sheet items alone are not sufficient to confirm the reasonability of the cash flow projections. The remarks regarding each of the projections simply echo the management views. The going concern assessment memo also had simply copied the management views with respect to projections without any **independent objective evaluation by the audit firm**. E.g., regarding the proposed rights issue, the only supporting is the discussions the ET had with the management and the claims made by the management in this regard. There is no objective evaluation of the submissions made by the management, say, whether any study or analysis was done by the management regarding the feasibility of a rights issue or any steps were initiated to start the process of rights issue etc. In the absence of an objective evaluation, the audit firm has failed to obtain sufficient appropriate audit evidence to confirm the management projections.

3.43. Para 3.13 above stands deleted since the issues raised in that para are clarified elsewhere in this AQRR. Also, the sentences in para 3.16 that *"NFRA has examined the WP "P.1.1*

Audit Strategy Memorandum" & WP "Client Planning Meeting ITNL March 2018" and found that there is no assessment made regarding Going concern. There is only a plan that Audit Firm will do going concern assessment at year end." stands deleted in view of the explanations.

3.44. Regarding the observation in para 3.16 above, the Audit Firm states inter alia in their reply that *"Another reason for increase in borrowings was that the SPV's had borrowed sub-debt from ITNL to fund the cost over-runs against which many of them had filed claims with the respective authorities. On realisation of claims from the authorities the SPVs would repay the borrowings from ITNL.*" The audit firm makes such a statement without any basis. Sub-debt, by its very nature, will be repaid after all other senior term debts are repaid. So how it is practical for the SPV to repay sub-debt when senior debts are outstanding? Moreover, many of the sub-debt agreements of ITNL has a condition/right to convert it into equity, instead of repaying in cash. There is no such examination seen documented in the Audit File.

Audit Firm's assessment of going concern is simply a reproduction of management's views

3.45. In this regard, the Audit Firm repeats its earlier replies and states that *"During the course of audit, the management had provided SRBC with cash flow projections of its subsidiaries / SPVs and SRBC had corroborated managements statement from the said cash flow projections"*. However, NFRA reiterates, as already detailed in the above paras, that there is no evidence in the Audit File regarding the **objective evaluation of the claims made by the management**.

3.46. Regarding the observation in para 3.21 regarding EPC Cash flows projected, the audit Firm submits that *"management had considered Rs.644 crore which mainly comprises of both the instalments of mobilization advance of Rs.297.45 crore each considering the management's expectation of progress of work during the year ended March 31, 2019. Further, the balance amount of advance represented, the expected advance for purchase of machinery for which the management had also considered "Capex" spends under Application of Funds in the future Cash flow projections. Accordingly, we are unable to understand NFRA's contention with regards to the above."* This submission clearly corroborates NFRA's findings regarding the absence of objective evaluation. While an amount of Rs 644 crore is projected as EPC receipts, the Capex projected for the year is only Rs 139 crore. Since the EPC receipts projected represents mobilisation advance, this must be fully utilised in incurring mobilisation expenses for the project. However, as per the management projections, the surplus cash flow from EPC contracts (mobilisation advance) will be utilised in servicing other obligations of the company, which is a false assumption. The Audit Firm failed to verify even such obvious aspects while blindly accepting the management contentions.

3.47. With respect to para 3.23.6 above, the Audit Firm submits that *"the net cash surplus as per the cash flow projections was Rs.3,001 crore which would be used to repay the current maturities of long term borrowings and the short term borrowings of Rs.1,612 crore were to be rolled over to the next year."*. This is not documented in the Audit File. Also, there is no basis is seen documented to support the assumption that the short term borrowings will be rolled over unconditionally by the lenders.

3.48. Regarding observation in para 3.23.11, the Audit Firm submits that *"SRBC submits that it had verified the entire EPC contract which comprised of 691 pages. Further, the ground-breaking ceremony for the project had taken place on May 19, 2018 i.e. after the year-end, hence only relevant pages pertaining to the mobilization advance were retained on the audit file to corroborate management's assumption for receipt of mobilization advance*." Based on the replies provided, para 3.23.11 stands modified as follows.
The Audit Firm's contention that it has verified the EPC agreement for new projects which generate future cash flow is not properly supported by evidence since there is no evidence of evaluation of the operational status or feasibility of revenues from these projects.

3.49. The Audit Firm submits that they *"were informed that the Company had decided to pursue EPC contracts which would help the Company to manage its working capital and cash flows"*. To corroborate this decision of the company, the Audit Firm quotes a remark from the Chairman's message in the annual report which states that "*We will look to build on our EPC project portfolio by bidding both as a single entity for large complex projects and in JVs while aiming to secure feasible HAM projects that meet the Company's criteria*". Such a vague statement can in no way support the assumption that the company will generate cash flows from EPC contracts to manage working capital requirements. Firstly, the statement made by the Chairman describes only a remote possibility, subject to satisfaction of several factors like availability of new projects that satisfy the business model of the company, the company getting qualified in the bids based on the eligibility criteria for respective projects, availability of resources to bid for the projects, getting a qualified JV partner wherever required, ability to place a competitive bid, finding the resources required for the preliminary project expenses, completing the legal formalities like transfer of land, if any, execution of agreements etc. Secondly, road infrastructure projects take much time from conceptualisation to commencement, owing to the peculiarities of such projects, like land acquisition issues, rehabilitation issues, geographical and environmental issues etc. Without having in sight any projects matured enough to take it to the bidding stage, such statements only indicate ambitions, not workable plans, to generate revenue. Surprisingly, the Audit Firm, which claims to be having abundant expertise in the road infrastructure sector, blindly rely on such vague statements to support the cash flow generation plans underlying the going concern assumption.

3.50. Based on the replies furnished, para 3.23.12 above stands modified as follows.
There is no audit evidence available, and no analysis done which supports the assumption of cash inflow generation from Equity Issue Rs. 1,500 crore.

3.51. Regarding para 3.23.15, the audit Firm has provided working paper references (WP on impairment analysis) evidencing comparison of projected operating cash flows of SPVs. In view of this, the last two sentences in para 3.23.15 stand deleted.

Absence of Timely communication under SA 260 (Revised)

3.52. In this regard, the Audit Firm submits that *"As can be seen from the above table, the first communication with the management with respect to Going concern assessment took place at the planning stage on November 1, 2017 and throughout the audit process there were various discussion with the management on the said matter. Accordingly, the* *auditors had provided adequate time to the auditee to evaluate matters relating to going concern adequately.”.*

“*SRBC has communicated the going concern matter to TCWG during the audit committee meeting held on May 29, 2018 wherein the management had also discussed the mitigation plan with TCWG.”*

3.53. NFRA observes in this regard that the submissions of the Audit Firm in the first para in the above quote are not true to the facts and even contradictory to its own submissions. The table mentioned in the reply quoted above gives a list of events. The first one being the client planning meeting held at the start of the engagement. In reply to para 3.16 the Audit Firm themselves stated that *““It is obvious that at planning stage, the auditor is required to form an audit strategy / audit plan which is executed during the course of audit. Accordingly, SRBC had planned to evaluate the management’s Going Concern Assessment….*” Such planning meeting in no way constitutes communication of significant matters to the TCWG in accordance with Para 9(c) of SA 260 (Revised). Other than the concluding communications mentioned in para 3.25 above, there is absolutely no communication **during the audit process**. Also, the presentation made in the Post Interim Event (PIE) (which is stated to have happened during the course of the audit) is an internal meeting of the ET, as evidenced from the WPs cited. Also, there is no specific reply to the observations in para 3.26 above. Therefore, none of the contentions of the Audit Firm in this regard are accepted.

Events or conditions had been identified that should have led to the conclusion that Material Uncertainty existed

3.54. With respect to the observations in para 2.27 to 3.30, the Audit Firm submits matters like the limitations of an audit, the nature of audit procedures etc. The Audit Firm also submits that *“We have sought and obtained all the information and explanation which to the best of our knowledge and belief were necessary for the purpose of our audit…..SRBC was not aware of any other material facts which were not disclosed in the audited financial statements for the year ended March 31, 2018”*. However, there is no specific reply to the observations made by NFRA in the said paras. The observations were based on the provisions of SAs and the matters recorded by the Audit Firm in their WPs. The Audit Firm has documented in the audit File and submits at several places in its reply that *“SRBC submits that the management, based on its preliminary assessment was confident with respect to the going concern status of the Company. However, considering the following indicators identified by SRBC:*

- *Negative operating cash flows at standalone financial statements level and positive cash flow at consolidated financial statements level*
- *Heavy dependency on borrowings and few adverse key financial ratios like debt-equity, interest coverage; and*
- *Reduction of credit ratings by one notch*

The engagement team insisted for the management’s reassessment of going concern with detailed management plan / future cash flow projections.” This and the other factors observed by the Audit Firm are matters squarely falling under para 20 of SA 570 (Revised), as detailed in para 3.28 above. However, the Audit Firm offers no explanations in this regard.

3.54.2. The Audit Firm further states that "*SRBC is of the view that NFRA reviewer is getting influenced by subsequent developments and is applying hindsight in forming his opinion and hence letting a bias slip in his review of the audit file.*" There is no basis given by the Audit Firm for such statements. It must be noted that NFRA has pointed out various instances based on documents available in the Audit File from which it is very clear that events and conditions existed that should have led to the conclusion that material uncertainty existed. Thus, the Audit Firm should have dealt with the case in accordance with applicable SAs, which it has not done.

3.54.3. In the Absence of any explanations, supported by evidence from the Audit File, NFRA reiterates its conclusion in the said paras.

Conclusion

3.55. In view of the above, NFRA observes that the Audit Firm has failed to provide adequate evidence supporting their assessment of going concern. Therefore, as detailed in the above paras NFRA reiterates its conclusions in the DAQRR that the Audit Firm is found to have:

3.55.1. Failed to comply with SA 570 (Revised), SA 260 (Revised) SA 230, SA 330 and SA 500.

3.55.2. Failed to disclose material facts known to them which are not disclosed in financial statements, but disclosure of which is necessary in making such financial statements where they are concerned with those financial statements in a professional capacity;

3.55.3. Failed to report a material misstatement known to them to appear in a financial statement with which they are concerned in a professional capacity;

3.55.4. Not exercised due diligence, or have been grossly negligent in the conduct of their professional duties;

3.55.5. 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;

3.55.6. Failed to invite attention to a material departure from the generally accepted procedure of audit such as SA 570, SA 500, SA 230 and SA 330 applicable to the circumstances.

4. EVALUATION OF RISK OF MATERIAL MISSTATEMENTS (ROMM)

4.1. NFRA had conveyed the following prima facie comments/ observations/ conclusions:

4.1.1. SA 315 on Risks of Material Misstatement requires that:

i. The auditor shall document the discussion among the engagement team where required by paragraph 10, and the significant decisions reached. (Para 32(a), SA 315)

ii. The engagement partner and other key engagement team members shall discuss the susceptibility of the entity's financial statements to material misstatement, and the application of the applicable financial reporting framework to the entity's facts and circumstances. (Para 10, SA 315)

4.1.2. NFRA notes that it is incumbent upon the auditor to hold discussion among the engagement team as required by Para 32(a) of SA 315, whereby the auditor shall perform audit assessment procedures to identify the risks at both financial statement level and assertion level, due to both fraud and error. NFRA has reviewed in detail the WP 'Hard Copy File 1' referred by the Audit Firm based on their submission dated 19- Sep-2019, and has, inter alia, found following documents, listed chronologically, pertaining to the requirement of Para 32(a) of SA 315:

i. ITNL TPE Minutes (20-Nov-2017) (Hard copy file 1 – pages A1-86 to A1-89)

ii. ITNL Fraud Considerations form (30-Nov-2017) (Binder part 1 – pages 000046 to 000061)

iii. ITNL Audit Strategies Memorandum (ASM) (30-Nov-2017) (Binder part 1 – pages 000001 to 000013)

iv. 260GL-TPE (19-Dec-2017) (Hard copy file 1– pages A1-72 to A1-85)

v. ITNL TPE Presentation (19-Dec-2017) (Hard copy file 1 – pages A1-90 to A1-141)

4.1.3. NFRA has noted from the audit file that first risk assessment discussion happened on 20-Nov- 2017 and is minuted in the WP 'ITNL TPE Minutes (20-Nov-2017) (Hard copy file 1 – pages A1- 86 to A1-89)' which says as follows:

"Further to meeting held with management of ITNL dated November 1, 2017, we have conducted first team planning event with ITNL audit team and other relevant teams to discuss the audit strategy for the current year."

4.1.4. NFRA has observed that as per the documents listed above, the audit procedures have not been performed in a consistent manner as guided by the SAs. The observations listed in one document do not form basis for conclusions derived in another. For example, the WP 'TPE Minutes' does not discuss any fraud risks, while 'Fraud Considerations Form' dismisses any fraud risk, without even assessing presumed fraud risks. The Audit Strategy Memorandum contains the staggering conclusion, not supported by any evidence of substantive work being done, that the ET has discussed the potential for risks of material misstatement due to fraud or error, including significant risks, and where specifically they may occur, and that based on procedures performed, no fraud risks were identified. NFRA has observed that there is no documentation in the audit file regarding such procedures being performed, nor of any discussions about identification or rebuttal of fraud risks. The work done and intermediate conclusions derived do not support the firm's overall conclusions on ROMM conclusively. Thus, the entire audit execution and strategy appears to be flawed. For example, individual risk assertions noted in 'Document: Audit Strategy Memorandum' neither flow from overall ROMM identified, nor lead to the conclusion that the identified ROMM have been adequately dealt with sufficient appropriate evidence for the auditor to obtain reasonable assurance in writing the audit report.

Observation Part-1

4.1.5. SA 315 regarding risk assessment procedure requires that:

4.1.6. The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion. (Para 5, SA 315)

4.1.7. The auditor's documentation of the understanding of the entity and its environment and the assessment of the risks of material misstatement required by SA 315 (Para 32) shall include: (a) The significant decisions reached during the discussion among the engagement team regarding the susceptibility of the entity's financial statements to material misstatement due to fraud; and

4.1.8. The identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level. (Para 44, SA 240)

4.1.9. Obtaining an understanding of the entity and its environment, including the entity's internal control (referred to hereafter as an "understanding of the entity"), is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. The understanding establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit, for example, when:

i. Assessing risks of material misstatement of the financial statements;

ii. Determining materiality in accordance with SA 320;

iii. Considering the appropriateness of the selection and application of accounting policies, and the adequacy of financial statement disclosures;

iv. Identifying areas where special audit consideration may be necessary, for example, related party transactions, the appropriateness of management's use of the going concern assumption, or considering the business purpose of transactions;

v. Developing expectations for use when performing analytical procedures;

vi. Responding to the assessed risks of material misstatement, including designing and performing further audit procedures to obtain sufficient appropriate audit evidence. (Para A1, SA 315)

4.1.10. The risks to be assessed include both those due to error and those due to fraud, and both are covered by this SA. However, the significance of fraud is such that further requirements and guidance are included in SA 240. (Para A4, SA 315)

4.1.11. SA 240 (Paras 25-27) provides further requirements and guidance in relation to the identification and assessment of the risks of material misstatement due to fraud. (Para A135, SA 315)

4.1.12. 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. (Para 26, SA 240)

4.1.13. Management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Although the level of risk of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities. Due to the unpredictable way in which such override could occur, it is a risk of material misstatement due to fraud and thus a significant risk. (Para 31, SA 240)

4.1.14. The auditor shall treat those assessed risks of material misstatement due to fraud as significant risks and accordingly, to the extent not already done so, the auditor shall obtain an understanding of the entity's related controls, including control activities, relevant to such risks. (Para 27, SA 240)

4.1.15. Based on the requirements from the SA, it was required that the Audit Firm:

i. discuss the components of the entity's financial statement and arrive at significant decisions regarding susceptibility of the financial statements to material misstatement due to fraud;

ii. perform risk assessment procedures to identify and assess fraud risks, significant risks and other risks at financial statement level and assertion level;

iii. obtain an understanding of the entity and its environment, including the entity's internal control, through which it establishes a frame of reference within which it plans the audit and exercises professional judgment throughout the audit;

iv. identify fraud risk 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; and

v. understand that management override of controls is nevertheless present in all entities and therefore a fraud risk;

vi. obtain an understanding of the entity's related controls, including control activities, relevant to such risks.

4.1.16. However, from analysis of the Audit File, NFRA has observed as follows:

i. Extract from WP 'ITNL TPE Minutes (20-Nov-2017) (Hard copy file 1 – pages A1-86 to A1-89)'

ii. Team Planning Event', reads:

a. "Nikhil Padte then discussed the agenda for the TPE. He discussed about the scope of the audit for the year March 31, 2018. He also discussed the budgeted hours and put an emphasis over achieving the deadlines mentioned by Ravi."

b. "Nishant updated the team about the business risk, significant risk. He also discussed with the team that we should be sceptical about revenue and construction cost since it involves element of judgement."

c. "Nishant Mankodi explained the background and functioning of this sector in detail based on expertise in this sector. He also discussed the major risk areas and our audit procedures for the significant areas revenue and cost. For e.g. checking of the physical progress of the project for assuring the reasonableness of the total cost estimates used in POCM calculations, ensuring vendor reconciliations including retention balances."

d. "Ravi thanked all the team members for their participation and inputs and requested to next meeting scheduled in the month of December so that we have monitor the progress. Meeting was concluded after this."

4.1.17. Based on the minuted discussions as quoted above, NFRA has analysed the workpapers and notes that:

i. The Audit Firm did not discuss susceptibility of the financial statements to material misstatement due to fraud, and did not identify and assess revenue recognition and management override of controls as presumed fraud risks.

ii. There is no discussion around revenue recognition and management override of controls as a presumed fraud risk, based on which the consequent WP "ITNL Fraud Considerations form' (30-Nov-2017) (Binder part 1 – pages 000046 to 000061)" has been developed.

iii. There is no discussion on understanding the entity to perform risk assessment procedures to identify and assess fraud risks, significant risks and other risks at financial statement level and assertion level.

iv. The WP only mentions that Nishant updated the team about the business risk, significant risk. However, there are no further details to it. Similarly, it is plainly documented that Nishant Mankodi explained the background and functioning of the entity's sector in detail based on expertise in this sector, and that he also discussed the major risk areas and audit procedures for the significant areas of revenue and cost. However, there is neither documentation on the so called explanation of the background and functioning of the entity's sector, nor any discussion about the major risks and the auditor's audit procedures. There is no reference to any other workpaper as well, which support these vague statements.

v. The sole reference that "we should be sceptical about revenue and construction cost since it involves element of judgement", in essence shows the casual approach of audit.

vi. The WP Entity Level Controls, is a voluminous document with detailed statements based on the theory underlying the SAs. However, the WP fails to document any conclusive actioned procedures of evidentiary value. Some of the examples are as follows:

vii. On Page 000066 of this document, it is stated that, "We obtain audit evidence that the elements and characteristics of the control environment component of internal control are in operation by performing procedures beyond inquiry of the entity's personnel." However, no documentation of any such audit procedure is found in the audit file.

viii. Page 000072 of this document states the various human resource policies and controls related to hiring, training and performance appraisals of the employees. The Audit Firm has failed to document testing of controls in the HR and Payroll department and its subsequent impact on the financial statements, especially in light of the fact, that the Company's payroll function has been outsourced to HGS International Pvt Ltd during the FY 17-18. This is also an important requirement as per SA 402.

ix. No audit evidence as to verification done by the Audit Firm of controls put in place to identify non-routine matters or those including judgement and how management responds to associated risks is seen in this workpaper or in the audit file (Refer Para A136, SA 315).

4.1.18. The Audit Firm has, hence, failed to identify or note any exceptions or observations in the internal control environment of the Company.

Observation Part-2

4.1.19. SA 240 regarding Risks of Fraud in Revenue Recognition, states that:

4.1.20. The presumption that there are risks of fraud in revenue recognition may be rebutted. (Para A30, SA 240)

4.1.21. 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. (Para 47, SA 240)

4.1.22. The auditor's documentation of the responses to the assessed risks of material misstatement required by SA 330 (Para 28) shall include: (a) The overall responses to the assessed risks of material misstatement due to fraud at the financial statement level and the nature, timing and extent of audit procedures, and the linkage of those procedures with the assessed risks of material misstatement due to fraud at the assertion level; and (b) The results of the audit procedures, including those designed to address the risk of management override of controls. (Para 45, SA 240)

4.1.23. Based on the above laid requirements from the SA, it was required that the Audit Firm:

i. identify and assess the risks of material misstatement due to fraud, including revenue recognition and management override of controls as presumed risk;

ii. document the responses to the assessed risks of material misstatement as per Para 28 of SA 330;

iii. rebut such identified and assessed fraud risks, and document the reasons for such conclusion, if upon performing assessment procedures for the said risks, the auditor concludes that fraud risk is not applicable in the circumstances.

4.1.24. However, from analysis of the audit file, NFRA has observed as follows:

i. WP 'ITNL Fraud Considerations form (30-Nov-2017) (Binder part 1 – pages 000046 to 000061)' Fraud consideration assessment - The WP, inter alia, states, "We remain alert to new information and re-evaluate our conclusions with respect to fraud risks throughout the execution of the audit." (2nd page of the WP)

ii. The WP also states, "We determine fraud risk factors in the context of the three conditions generally present when fraud occurs (i.e., incentive/pressure, opportunity and attitude/rationalisation)" and "Our response includes obtaining and understanding, and evaluation the controls that address the fraud risk." (3rd page of the WP)

iii. As per the WP, the auditor identifies risks of material misstatements due to fraud by obtaining information during the planning phase of the audit by performing enquiries, analytical review and data analysis, and observation. (Diagram, 3rd page of the WP)

iv. In the Part-B (Identify Fraud Risk) of the WP, the ET has not identified any fraud risk.

v. In Part-C (Determine responses to Identified Fraud Risks) of the said WP, the ET has merely mentioned, "Based on the enquiries conducted above and based on our understanding of the entity we did not come across any fraud risk within the entity."

4.1.25. NFRA has analysed the workpapers and concludes that:

i. there is no discussion about fraud risk factors in the context of the three conditions generally present when fraud occurs, as per the stated requirement within the WP;

ii. the ET has not referred to or mentioned any analytical procedures or data analysis done by the ET in the said WP. Also, there are no evidentiary audit observations noted by the ET;

iii. the audit execution has failed to perform sufficient enquiries, analytical review and data analysis, and observations during the execution of the audit;

iv. the enquiries of the ET have been limited to key management personnel (KMP also reiterated as TCWG by ET) and the internal audit function; the enquiries are found incomplete in view of Para A7 of SA 315;

v. the WP has failed to meet the requirements of the WP as noted by the Audit Firm itself within the WP template;

vi. the auditor has not only failed to identify revenue and management override of control as a fraud risk as required by SA 315 and SA 240, but also to document responses to the assessed risks as required by SA 330, and reasons for rebuttal of fraud risk as required by SA 240. A blanket assertion that "based on the enquiries conducted above and based on our understanding of the entity we did not come across any fraud risk within the entity," is a general statement that would be blindly applicable in the case of any entity and, being bereft of any supporting evidence specific to the present entity, is a meaningless assertion. Besides, the assertion, without any supporting analysis/evidence, does not in any way help in devising the necessary and appropriate audit strategy and procedures to mitigate risk of such ROMM due to fraud. The aforementioned is clear evidence of a complete failure on the part of the auditor to assess the ROMM due to fraud and devise appropriate audit strategy, plan and procedures to reduce such ROMM to a reasonable level, as required by the SAs. NFRA finds that the document appears to have been prepared as a paperwork formality, clearly evidencing a highly casual approach in the audit;

vii. while the WP document has been signed on 30-Nov-2017, it is stated within the document that enquiries with those charged with governance, internal audit function and others have been conducted on 02-May-2018 as well. This is a clear evidence of back dating a workpaper and/or fudging an existing workpaper, and making a false claim of happening of an event which has in fact not taken place as on the signing date. The casual approach towards audit and questionable integrity of the audit file is further enhanced by this evidence.

Observation Part-3

4.1.26. SA 240 and SA 315 regarding Identification and Assessment of the Risks of Material Misstatement, require that:

i. In accordance with SA 315 (Para 25), the auditor shall identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures to provide a basis for designing and performing further audit procedures.

ii. The auditor shall document the identified and assessed risks of material misstatement at the financial statement level and at the assertion level as required by paragraph 25. (Para 32(c), SA 315)

4.1.27. Risks of material misstatement at the financial statement level refer to risks that relate pervasively to the financial statements as a whole and potentially affect many assertions. Risks of this nature are not necessarily risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level. Rather, they represent circumstances that may increase the risks of material misstatement at the assertion level, for example, through management override of internal control. Financial statement level risks may be especially relevant to the auditor's consideration of the risks of material misstatement arising from fraud. (Para A117, SA 315)

4.1.28. Examples of conditions and events that may indicate the existence of risks of material misstatement: (Para A127, SA 315)

i. Going concern and liquidity issues including loss of significant customers.

ii. Constraints on the availability of capital and credit.

iii. Changes in the entity such as large acquisitions or reorganisations or other unusual events.

iv. Entities or business segments likely to be sold.

v. The existence of complex alliances and joint ventures.

vi. Use of off-balance-sheet finance, special-purpose entities, and other complex financing arrangements.

vii. Significant transactions with related parties.

viii. Transactions that are recorded based on management's intent, for example, debt refinancing, assets to be sold and classification of marketable securities.

ix. Accounting measurements that involve complex processes.

x. Events or transactions that involve significant measurement uncertainty, including accounting estimates.

xi. Pending litigation and contingent liabilities, for example, sales warranties, financial guarantees and environmental remediation.

4.1.29. Assessing Risks of Material Misstatement

i. The auditor shall assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions; (Para 26(b), SA 315)

4.1.30. Relating Controls to Assertions

i. The auditor shall relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; (Para 26(c), SA 315)

ii. In making risk assessments, the auditor may identify the controls that are likely to prevent, or detect and correct, material misstatement in specific assertions. Generally, it is useful to obtain an understanding of controls and relate them to assertions in the context of processes and systems in which they exist because individual control activities often do not in themselves address a risk. Often, only multiple control activities, together with other components of internal control, will be sufficient to address a risk. (Para A128, SA 315)

iii. Controls can be either directly or indirectly related to an assertion. The more indirect the relationship, the less effective that control may be in preventing, or detecting and correcting, misstatements in that assertion. (Para A130, SA 315)

4.1.31. Likelihood of Misstatement

i. The auditor shall consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement. (Para 26(d), SA 315)

4.1.32. Based on the above laid requirements from the SA, it was required that the Audit Firm:

i. identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures, and document them categorically, because risks at the financial statement level are not necessarily risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level;

ii. provide a basis for designing and performing further audit procedures by identifying and assessing the risks of material misstatement;

iii. relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that are likely to prevent, or detect and correct, material misstatement in specific assertions; and

iv. consider the likelihood of misstatement, including the possibility of multiple misstatements.

4.1.33. From analysis of the Audit File, NFRA has observed as follows:

i. WP 'ITNL TPE Presentation (19-Dec-2017) (Hard copy file 1 – pages A1-90 to A1-141)'

Assessment of entity level controls (Slide 27):

a. "Conclusion on effectiveness of Internal Control – Effective"

b. "Engagement Team discussions for fraud risk considerations – ?"

Significant risks (Slide 30):

c. "Management override on cost estimation resulting in incorrect percentage of completion and improper revenue recognition in case of project business."

d. "Impairment of investments/ Goodwill: The Company has made large investments in its subsidiaries, associates and JVs."

e. "Risk associated with RPT transactions – We did not identify the same as fraud risk as most of the transactions are with the entities forming part of the consolidation process. Also these are agreement based."

ii. WP '260GL-TPE (19-Dec-2017) (Hard copy file 1– pages A1-72 to A1-85)'

a. "This form provides a list of required and other discussion topics for the team planning event (TPE), including our discussion of estimates, fraud and error."

b. Purpose: This form facilitates completion of the EY Canvas task(s):

c. Hold team planning event, including discussion of estimates and risks of material misstatement due to fraud and error

d. Prepare audit strategy documentation

e. When this form is used as an agenda, the results of the discussion at the TPE are documented in the audit strategies documentation (i.e. ASM, APT or equivalent documentation such as minutes of the team events) to demonstrate that the audit team developed, discussed and approved an overall audit strategy, setting the scope, timing and direction of audit.

f. When this form is used as the audit strategies documentation, we include enough detail to demonstrate our overall audit strategy. We are not then required to create a separate ASM or minutes of the meeting.

g. Applicable methodology: Our team events include:

- Discussion of audit strategy at the TPE (Team Events 2)
- Discussion of estimates (Team Events 3)
- Discussion of fraud and error (Team Events 4)

h. The estimates and fraud discussions may be held either as part of the TPE or as separate team events.

4.1.34. The Audit Firm had identified the following risks as significant risks:

i. "Risk of management override on cost estimation leading to incorrect percentage completion and revenue recognition in case of project business:

- Initially we has identify this as a fraud risk however based on the discussion carried out during the team meeting we understand that costs estimates involved in this are approved by the MCA. We will obtain and verify the physical completion report for projects from independent site engineer. We will also verify the relevant documents for change in the costs estimates along with the MCA approval.
- Based on this, we concluded to consider this risk as significant risk and not the fraud risk.

ii. Risk of material misstatement associated with Related party Transactions:

- Most of the transactions with related parties are with those entities which are forming part of the consolidation process.
- These transactions are based on the agreements entered between parties
- Also most of the transactions are approved by the shareholders and audit committee."

iii. Impairment of investment and goodwill: "We have identify as significant risk."

4.1.35. For all other observations and assertions, fragmented references have been made to TPE presentation, TPE minutes, ASM, etc.

4.1.36. NFRA has analysed the workpapers and concludes that:

i. As already observed in (viii)(b) above, the WP 'Entity Level Controls', is a voluminous document with detailed statements based on theory of the SAs. However, the audit team fails to document any conclusive actioned procedures of evidentiary value. Consequently, in the WP 'ITNL TPE Presentation,' the observations and conclusions appear vague, with no relation to any procedures performed.

ii. There is no conclusion to the ET's discussions on fraud risk considerations. The Audit Firm is completely silent even about possibilities of existence of fraud risk. Blanket statements such as "We did not identify the same as fraud risk as most of the transactions are with the entities forming part of the consolidation process," are noted from the presentation, which are absolutely meaningless and prove that the exercise of identification and assessment of fraud risks is a complete sham.

iii. The auditee Company being one involved in infrastructure financing and development, and being of strategic importance to the country's economy, required serious audit procedures being performed sincerely. The entity is structured in layers of subsidiaries and JVs, which makes it susceptible to a number of potential risks of fraud in revenue recognition, investments, related party transactions, etc. Cases such as management override of controls in lending zero interest loans to subsidiaries, evergreening loans, investments prejudicial to the interests of company, cost overruns due to SPVs, risk of money laundering, etc., should have been identified and tested for fraud risk, alongside revenue recognition. However, the auditor had not even identified and assessed presumed risk of fraud in revenue recognition as was required by the SAs, and even as required by its workpaper templates.

iv. Having failed to identify fraud risks, the Audit Firm has neither been able to rebut them nor identify and assess 'significant risks' sufficiently, appropriately and objectively. The listed significant risks by the Audit Firm in Slide 30 of 'TPE Presentation' are not assessed for multifarious possibilities of their risk. The poor identification of risk and corresponding explanation to it, such as "Risk associated with RPT transactions – We did not identify the same as fraud risk as most of the transactions are with the entities forming part of the consolidation process. Also these are agreement based," reflect poorly on the Audit Firm's judgement and professional scepticism. NFRA has failed to understand how entities forming part of the consolidation process mitigate the risk associated with RPT transactions. Furthermore, how agreement based transactions mitigate the risk of management's override of controls to transact business prejudicial to the interests of the company, or risk of fraud due to money laundering, etc is not clear. The cavalier attitude of the audit reinforces NFRA's view that the entire exercise of identification and assessment of risks of material misstatement due to fraud and error is a complete sham.

v. In the WP 'Related Party transaction,' the following documents could not be traced:

   a. ACM 09.11.2017 Omnibus approval

   b. ITNL M18 Related Party Transaction

   c. Register of Contracts with related parties- ITNL_31-3-18

vi. This document contains references to several other working papers, many of which were not traceable. Further, no significant observations or exceptions arising from testing of controls have been documented in this work paper. Thus, the Audit Firm has merely relied on the information supplied by the Management, and no audit procedures, as claimed to have been performed, have in fact been performed.

vii. As self-evident from the WP '260GL-TPE' template, a number of requirements and topics for discussion to be taken up by the ET for the Team Planning Event that were listed, had in fact NOT been acted upon by the auditor. Topics such as understanding the entity, business risk and more have been merely found named and not discussed, whereas topics such as discussion of estimates, and discussion of fraud and error have NOT even found mention in the workpaper.

viii. Auditor's statement such as "Initially we has identify this as a fraud risk however based on the discussion carried out during the team meeting we understand that costs estimates involved in this are approved by the MCA," with reference to 'Risk of management override on cost' estimation' finds no basis, introduction or discussion leading to the conclusion that this statement is without basis. Further, the assessment of risk in related party transactions is completely misleading and lacks professional scepticism.

ix. The auditor has not only failed to identify, assess and discuss the fraud risks and significant risks as required by SA and its own template guidance, but also to sequentially arrange the documented WPs and make sense out of their interconnections. NFRA views the documentation of risk assessment and team planning event as an afterthought and a complete sham.

Observation Part-4

4.1.37. SA 240 and SA 315 regarding Identification and Assessment of the Risks of Material Misstatement, require that:

i. Identifying Significant Risks

a. In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following: (Para 28, SA 315)

b. Whether the risk is a risk of fraud;

c. Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment, etc., and, therefore, requires specific attention;

d. The complexity of transactions;

e. Whether the risk involves significant transactions with related parties;

f. The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and

4.1.38. Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

i. Significant risks often relate to significant non-routine transactions or judgmental matters. Non- routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty. Routine, non-complex transactions that are subject to systematic processing are less likely to give rise to significant risks. (Para A131, SA 315)

ii. Risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates, arising from matters such as the following: (Para A133, SA 315)

- Accounting principles for accounting estimates or revenue recognition may be subject to differing interpretation.
- Required judgment may be subjective or complex, or require assumptions about the effects of future events, for example, judgment about fair value.

iii. SA 330 (Para 15 and 21) describes the consequences for further audit procedures of identifying a risk as significant.

iv. Controls over significant risks

v. When the auditor plans to rely on controls over a risk the auditor has determined to be a significant risk, the auditor shall test those controls in the current period. (Para 15, SA 330)

vi. Substantive Procedures Responsive to Significant Risks

vii. When the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall perform substantive procedures that are specifically responsive to that risk. When the approach to a significant risk consists only of substantive procedures, those procedures shall include tests of details. (Para 21, SA 330)

viii. Paragraph 21 of this SA requires the auditor to perform substantive procedures that are specifically responsive to risks the auditor has determined to be significant risks. Audit evidence in the form of external confirmations received directly by the auditor from appropriate confirming parties may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error. For example, if the auditor identifies that management is under pressure to meet earnings expectations, there may be a risk that management is inflating sales by improperly recognising revenue related to sales agreements with terms that preclude revenue recognition or by invoicing sales before shipment. In these circumstances, the auditor may, for example, design external confirmation procedures not only to confirm outstanding amounts, but also to confirm the details of the sales agreements, including date, any rights of return and delivery terms. In addition, the auditor may find it effective to supplement such external confirmation procedures with inquiries of non-financial personnel in the entity regarding any changes in sales agreements and delivery terms. (Para A53, SA 330)

ix. The auditor shall document the risks identified, and related controls about which the auditor has obtained an understanding, as a result of the requirements in paragraphs 27-30. (Para 32(d), SA 315)

4.1.39. Based on the above laid requirements from the SA, it was required that the auditor:

i. identify risks and related controls about which the auditor has obtained an understanding, as a result of the requirements of paragraphs 27-30 of SA 315; and

ii. perform substantive procedures that are specifically responsive to risks the auditor has determined to be significant risks.

4.1.40. However, from analysis of the audit file, NFRA has observed as follows:

WP "ITNL Audit Strategies Memorandum (ASM) (30-Nov-2017) (Binder part 1 – pages 000001 to 000013)"

About guidance to ASM, it is stated, "It can serve as the audit strategy documentation as required by Team-Events documentation. The ASM references detailed audit documentation, rather than reproducing it."

"Significant changes in the nature of the entity or its environment and effect on our audit

i. On June 30, 2017, the Company has entered into a Share Purchase Agreement, Shareholders Agreement and Escrow Agreement with Paranjape Group for transfer of its entire equity stake in RLHL (carrying value Rs.2.5 crore) to Pario Developers Private Limited (PDPL). The Company acquired 33% equity stake in PDPL by way of 3,300 equity shares of Rs.10 each at par. As a consideration for transfer of RLHL shares to PDPL, the Company is entitled to 15 crore Non-Convertible Redeemable Preference shares of Rs.10 each of PDPL i.e. worth Rs.150 crore. There is no further update on the same.

ii. During the quarter, the Company has completed registration for its investment property- Kohinoor Projects. Management expects fair valuation of this property to be higher than cost recorded in the books.

iii. As represented by the management, the company continues to hold significant influence over GRICL post sale of investments in equity shares. Hence GRICL is still classified as an associate and no fair valuation is done for the balance stake (16.33%) in this entity held by GRICL.

iv. The Company has granted a loan amounting to Rs.36 crores to Kohinoor Projects Private Limited (KPPL) which has further invested the amount in Equity Share Capital of Kohinoor CTNL Infrastructures Limited (KCTNL). The Company has accrued interest amounting to Rs.41 crores till March 31, 2017 on such loan.

v. With effect from June, 2017, the Company has outsourced its payroll function to HGS International Pvt. Ltd. HGS is responsible for maintaining the salary register and perform salary computation every month.

vi. With effect from July, 2017, the Company has started invoicing on manual basis due to GST transition which was earlier processed through system."

4.1.41. "Response to AQR and other regulatory review findings – Few of the AQR findings discussed at Executive meeting held dated 7 December 2017:

i. No timely and sufficient involvement of EP & EQR

ii. No Timely sign off

iii. No discussion of estimates in TPE

iv. No evidence of the discussions held during PIE (Post Interim Event)

v. Management review controls not identified

vi. ITRA/FAIT-Inappropriate classification of IT/ITDM controls

vii. JE-No discussion on risk of management override of controls"

4.1.42. "Observations from our analytical procedures on financial and non-financial information"

i. "We have performed detailed understanding of the entity's business and also performed overall analytical review for quarter ended June and September 2018. Refer UTB and respective OAR's attached in Canvas."

ii. "Internal control matters – Company has effective entity level controls in place. We will perform the testing of the entity level control to assess their effectiveness. Refer Entity Level Control form and workpaper in canvas for assessment done."

iii. "Previous experiences with the entity," and "Significant and Fraud risks" –

4.1.43. "Based on procedures performed, no fraud risks were identified"

i. "Significant risks:

Management override on cost estimation resulting in incorrect percentage of completion and improper revenue recognition in case of project business

Impairment of investments in subsidiaries"

4.1.44. NFRA has analysed the workpapers and concludes that:

i. It is clear from the introduction in the WP 'Audit Strategies Memorandum (ASM),' that this WP is a consequence of team planning event, and that it reflects details on the basis of discussion in team planning event. NFRA notes following deficiencies in relation to WP "ASM" :

ii. For the significant changes in the nature of the entity or its environment noted in the WP, there are no effects on audit discussed or documented.

iii. It appears from the ASM that the Audit Firm had discussed "the AQR findings discussed at Executive meeting held dated 7 December 2017". However, it is noted that the ASM has been prepared and signed on 30-Nov-2017, whereas the observations of AQR are as on 07-Dec-2017. As previously noted, this is again a clear evidence of back dating a workpaper and/or fudging an existing workpaper, and making a false claim of happening of an event which has in fact not taken place as on the signing date. The questionable integrity of the audit file is reinforced by this evidence.

iv. Irrespective of the signing date of ASM, it is noted that the TPE Presentation dated 19- Dec-2017, continues to carry the flaws such as: no discussion of estimates in TPE, no evidence of the discussions held during PIE (Post Interim Event), non-identification of management review controls, insufficient discussion on risk of management override of controls. The ET has maintained a completely casual and cavalierly approach towards audit.

v. Since there has been gross negligence in identification and evaluation of risks of material misstatements by the auditor, the audit responses planned to reduce or mitigate the identified risks are insufficient, improper and inadequate ab initio.

vi. NFRA has not found any performance of detailed understanding of the entity's business or analytical procedures within the audit file. Further, comments regarding internal control matters referred to in WP 'Entity Level Control form' have already been noted above.

vii. The auditor has made a sweeping conclusion that "based on procedures performed, no fraud risks were identified". However what procedures were performed and what fraud risks were identified, have nowhere been discussed. NFRA could not find any connection or continuity between the two WPs, namely, 'Fraud Considerations form' and 'ASM'.

viii. Hard copy WP '102GL UTB', is a general document describing the Company, industry, regulatory framework etc. In the "Business Risks Section" of this document, debt financing risk is also identified as a risk of material misstatement, which is not found or addressed in any other work paper. This indicates that the entire risk assessment procedure was unsatisfactory.

ix. The WP 'CRA_ Summary (File 1 Page A1-245 to 247)', is not a dated document and therefore it cannot be established whether risk assessment was done at the beginning, throughout or towards the end of audit. Further, there is no evidence of any incremental evaluation or analysis of risk made by the ET as required by the SA. Therefore, it is seen that the WP has failed to provide sufficient appropriate evidence as per Para 32 of SA 315.

x. The WP 'ITNL BS OAR March 2018', does not contain any information regarding ROMM and are mere notes to the balance sheet. WPs 'ITNL BS OAR March 201' and 'INTL PL OAR March 2018' are merely working papers finalised at the end of audit after substantive testing and not relevant to assessment of ROMM in the planning stage.

xi. NFRA, thus, concludes that the entire process of identification and assessment of ROMM due to fraud and error is insufficient, inadequate and a complete sham. The integrity of the audit file is questionable and thus cannot be relied upon. The entire documentation, designed to be inter-connected, actually is unrelated, fragmented and clearly includes afterthoughts. The auditor has failed to identify and assess fraud risks and significant risks of material misstatement both at the financial statement level and at assertion level. The consequent audit strategy and procedures thus performed are insufficient to deliver the targeted audit impact.

4.1.45. Based on the observations noted in the above paragraphs, NFRA prima facie concludes that the Audit Firm has:

i. failed to appropriately identify and assess risk of material misstatements and consequently failed to reduce the risks of material misstatements to an acceptably low level as required under SA 315

ii. not exercised due diligence, or are grossly negligent in the conduct of their professional duties;

4.2. NFRA has examined in detail the replies submitted by the Audit Firm to the above observations in the PFC and observed in the DAQRR as follows.

Discussion of Susceptibility of Financial Statements to Material Misstatements due to Fraud.

4.3. In reply to para 4.1.1 to 4.1.4 above, the Audit Firm in page number 108 to 117 of their reply explains their "audit scope and strategy" that they had determined for the audit of ITNL for the year ended March 31, 2018. It concludes that "detailed planning of scope and strategy had been discussed including the discussion on Risk of Material Misstatement of financial statements for the year ended March 31, 2018. Accordingly, the audit procedures had been carried out by an audit team having appropriate audit experience and under guidance of engagement audit partner and with inputs from engagement quality reviewer at appropriate stages of the audit".

4.4. The reply does not mention anything about compliance with Para 10 and para 32(a) of SA 315. Also, there is no specific replies to the comments made by NFRA, particularly in para 4.1.4 above. In this regard the Audit Firm mentions about the Team Planning Event sessions (TPE) and states that "During the ITNL TPE, we discussed the susceptibility of the entity's financial statements to material misstatement, and the application of the applicable financial reporting framework to the ITNL's facts and circumstances". However, this statement is not supported by any evidence and none of the work papers referred by the Audit Firm with respect to TPE in page 115 and page 122 of their reply meets the documentation requirements of para 32(a) of SA 315. Thus, NFRA reiterates its comments in para 1 to 4 above and concludes that the Audit Firm has failed to discuss the components of the entity's financial statements and arrive at significant decisions **regarding susceptibility of the financial statements to material misstatement due to fraud**, in accordance with para 10 of SA 315.

Failure to identify and rebut fraud risks and failure to identify and assess significant risks.

4.5. In reply to the observation of NFRA in PFC para 14.1 that "there is no discussion about fraud risk factors in the context of the three conditions generally present when fraud occurs, as per the stated requirement within the WP", the Audit Firm submits in page 142 of their reply that:

4.5.1. "Based on the understanding of the business and assessment of entity level controls and process level controls engagement team made a professional judgement that the three factors viz. incentive/pressure, opportunity and rationalisation did not indicate any risk of material misstatement due to fraud (Refer Entity Level Control Form in hard binder Part 1 of 6 page no. P.1.7, Testing of Entity Level Controls in hard copy file 1 page no A1- 199 to A1- 207, Fraud Consideration Form in hard copy binder Part 1 of 6 page no P.1.6, Refer Audit Strategy Memorandum in hard copy binder Part 1 of 6 page no P.1.1, TPE minutes in form 260 GL dated December 19, 2017 hard copy File 1, 260GL-TPE, page no. A1-72 to A1-85, Team planning event presentation in hard copy file 1 page reference no. A1- 90 to A1-141, Minutes of team planning event on November 20, 2017 in hard copy file 1 page reference no. A1- 86 to A1-89)"

4.6. NFRA examined all these WPs and observes that none of these WPs even mention these three conditions except for the theory in page 3 of the Fraud Consideration Form which states that "We determine fraud risk factors in the context of three conditions generally present when fraud occurs (i.e., incentive/pressure, opportunity and attitude/rationalisation. FRAUD-RISK Appendix 1 provides further guidance on the three conditions that potentially lead to fraud……..”. This theory in no way provides any evidence that the ET had in fact tested these three conditions based on objective evidence and reached a considered opinion.

4.7. The reply of the Audit Firm to the above observation of NFRA runs to three pages wherein the Audit Firm refers to 17 instances of WPs, none of these in fact address the issue in question. Nowhere in the reply does the Audit Firm point out to a WP reference that gives an unambiguous evidence showing that the Audit Firm has at least discussed these three factors and documented its conclusions based on objective evidence. Instead, the Audit Firm is trying to collect all possible WPs where the word fraud or risk is written and then try to build new theories, in their futile attempt to establish that something is done, which is far from reality. This is the general approach followed by the Audit Firm in almost all the observations of NFRA regarding ROMM.

4.8. Regarding observation of NFRA that the Audit Firm had failed to perform sufficient enquiries, analytical review and data analysis in assessing ROMM, the Audit Firm submits in page 143 of their reply that “The engagement team had carried out the planning activity in November – December 2017 and accordingly performed analytical procedures for the quarters / half year ended September 30, 2017 which are documented in files “ITNL – OAR June 17”, “ITNL – BS OAR Sep17” and “ITNL – PL OAR Sep17” in Canvas”. However, the only analysis present on these WPs is the variance analysis (year on year comparison) between different quarters done in connection with the limited review. There is not even a single ratio analysis or data analysis seen documented in these WPs. The WP Audit Strategy Memorandum (ASM) states in page 5 that “We have performed detailed understanding of the entity’s business and also performed overall analytical review for quarter ended **June and September 2018.** Refer UTB and respective OAR’s attached in Canvas” (Emphasis added). This false statement again proves that the Audit Firm had not done any analytical review at all other than the routine check of variance analysis done in connection with the limited review.

4.9. Regarding the observation in the PFC that “the enquiries of the ET have been limited to key management personnel (KMP also reiterated as TCWG by ET) and the internal audit function; the enquiries are found incomplete in view of Para A7 of SA 315” the reply of the Audit Firm in page 144 to 147 does not provide any evidence of having “inquiries of others within the entity and other employees with different levels of authority” as required by Para A7 of SA 315. None of the assertions of the Audit Firm in this regard are documented in the Audit File. Referring to para A7 and A13 of SA 230 the Audit Firm also states that “it is neither necessary nor practicable for auditor to document every matter considered, or professional judgment made, in an audit”. In many places of their reply for various observations in PFC the Audit Firm has resorted to the same argument that audit documentation is not required in every matter. However, this argument of the Audit Firm is not in line with the specific requirement of SAs, as already detailed in section regarding ‘Going Concern’ of this DAQRR. In the instant case the requirement of para A7 arises from the substantive requirement in para 6 (a), which uses the word “shall” and hence the requirement is mandatory. Audit documentation is also mandatory for such requirements as explained in the said section of this DAQRR. Moreover, a professional judgment not documented at the time of Audit is not a professional judgment at all. It is just an opinion given post facto, and as an afterthought, with zero evidentiary value. Hence the contentions of the Audit Firm are not acceptable and NFRA reiterates its observation in the PFC that the Audit Firm failed to comply with the requirements of para A7 of SA 315.

4.10. In the document Audit Strategy Memorandum – Internal control over financial Reporting, (Refer Hard copy files folders, Binder) construction revenue and cost related to management override on cost estimation are identified as fraud risks. Further, it states "We will do certain procedures (as agreed in the Fraud risk considerations form) for management override on cost estimation for revenue and cost related process." The team planning meeting held on Dec. 19, 2017 (Refer document 260 GL TPE in hardcopy files and folder, File 1) on the other hand dismissed the fact saying that these are significant risks and not fraud risks. Thus, NFRA reiterates its observation on PFC that the Auditor's statement (page 305 of their reply) such as "Initially we has identify this as a fraud risk however based on the discussion carried out during the team meeting we understand that costs estimates involved in this are approved by the MCA," with reference to 'Risk of management override on cost estimation' is without any basis. The Audit Firm's argument that, since cost estimates are approved by the Management Committee, so there is no risk of management override of controls is absolutely meaningless and not acceptable.

4.11. Further, the document P.1.1 Audit Strategy Memorandum mentions, "Based on the procedures performed, no fraud risks were identified." The Fraud Consideration Form also mentions that, "Based on the inquiries conducted above and based on our understanding of the entity we did not come across any fraud risks within the entity." There appears to be no connection between the workpapers. Besides, the assertion, that no fraud risk was identified, without any supporting analysis/evidence, is absolutely meaningless and does not in any way help in devising the necessary and appropriate audit strategy and procedures to mitigate such ROMM due to fraud.

4.12. There are two versions of the WP 'ITNL TPE Minutes March 2018' - hard copy (final) and soft copy (draft). It is imperative to note that there are various important points discussed during the TPE meeting that are omitted to be documented in the final hard copy version but are present in the soft copy draft which include:

4.12.1. Discussion about fraud risk and the fact that revenue and construction to be considered as a fraud risk.

4.12.2. The discussion regarding involvement of the valuation team for impairment testing of material investments in books of ITNL and further insights provided by the valuation team to the ET.

4.12.3. Discussion regarding the margin ITNL gets from the SPVs on construction contracts and reasons for the fluctuations in the margin.

4.12.4. The practice of revenue recognition of construction contracts only after completion of 10% the project was discussed.

4.13. The intentional omission of these important discussions from the final copy of the TPE meeting, without any justification, clearly shows that the Audit Firm did not take the audit seriously and it went along with the management without question.

4.14. The Audit Firm is completely silent even about the possibilities of existence of fraud risk. The exercise of identification and assessment of fraud risk is a complete sham. Hence, the entire process of audit strategy and execution appears to be flawed. NFRA finds that the document appears to have been prepared as a paperwork formality, clearly evidencing a highly casual approach in the audit.

4.15. The contention of the Audit Firm in page 141 of their reply that "The work carried out was being closely monitored by the regulators (NHAI / state government authorities through the independent engineers) on a monthly basis, thus, there is no scope for the Company to misrepresent the financial position of the Company" is completely baseless. The auditor shall perform risk assessment procedures as required by para 6 and A5 of SA 315 and paras 25-27 of SA 240, and based on those procedures the auditor shall document its conclusions regarding risk as per para 32 of SA 315. Factors such as the ones stated by the Audit Firm do not absolve the Audit Firm from its statutory duties as laid down in the SAs.

4.16. Regarding observation of NFRA on evaluation of unusual transactions outside the normal course of business, the Audit Firm does not refer to any WP evidencing such testing.

4.17. Regarding Risk of material misstatement associated with Related party Transactions, the Audit Firm submits in page 169 of their reply that, "significant transactions with related party which largely cover revenue and investments and loans and receivables. Out of the above, revenue was already considered as significant risk and investment and loans and receivables are covered as part of the impairment testing which was also considered to be a significant risk." However, NFRA observes that the Audit Firm has identified cost and revenue estimation as a significant risk. But this will not cover the sale and purchase transactions with the related parties. Further, only impairment of investment in subsidiaries is considered as a significant risk. This does not cover other types of transactions with related parties like loans and advances and receivables which cover a significant part of the related party transactions. It can be seen from the above that significant risk related to revenue and cost stated to be identified by the Audit Firm has not been addressed by it adequately. Thus, it is clear that the Audit Firm has not performed adequate audit procedures as required by para 6 and 7 of SA 330, and thus failed to obtain and document sufficient appropriate audit evidence as required by para 28 of SA 330 to address the identified risk.

4.18. Therefore, the Audit Firm has failed to assess for multifarious possibilities of their risk. Having failed to identify fraud risks, the Audit Firm has neither been able to rebut them nor identify and assess 'significant risks' sufficiently, appropriately and objectively. The cavalier attitude of the Audit Firm reinforces NFRA's view that the entire exercise of identification and assessment of risks of material misstatement due to fraud and error is a complete sham.

Identification and assessment of revenue recognition and management override of controls as presumed fraud risks.

4.19. The Audit Firm in page 120 to124 of their reply submits that revenue recognition has been identified as a significant risk and states that documentation has been done in accordance with para 47 of SA 240. The Audit Firm states that "The engagement team had determined, then considered and rebutted the presumption that there was a risk of fraud in revenue recognition. The detailed discussions that the engagement team had during the team planning event was summarised in the minutes of TPE held on December 19, 2017 ……in accordance with the requirements of para 47 of SA 240. ………The variation in total estimated cost by the management will directly impact the recognition of revenue (measurement assertion). Hence, management override of control with respect to cost estimation resulting in incorrect percentage of completion and improper revenue recognition was identified as a Significant risk and linked to Construction revenue." Further, the Audit Firm submits that "Though revenue recognition and construction costs estimation in conjunction with management override of controls were identified as significant risks, the nature, timing and extent of audit procedures designed and performed were not less than the procedures that would have been performed, had it been identified as a fraud risk."

4.20. In this regard NFRA observes that the factors attributed (in page 123 of the reply of the Audit Firm) for not considering revenue recognition as a fraud risk has not been documented in the Audit File except certain controls relating to revenue and cost of construction. Even the reply of the Audit Firm is silent on how these factors rebut the presumption of risk of fraud in revenue recognition. For example, factors such as "The revenue is recognised based on Percentage of Completion", "The total estimated revenue was based on the construction contract (development agreements)with the SPVs and / or approval of the Management Committee comprising of executive director sand senior management", "The estimated costs was also evaluated and approved by the Management Committee" are all instances where the management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records related to revenue. To quote these factors as reasons for rebutting the fraud risk presumption in revenue recognition is gross negligence and grave dereliction of duty.

4.21. Moreover, the Audit Strategy Memorandum notes in para 1 that "With effect from July, 2017 the Company started invoicing on manual basis due to GST transition which was earlier processed through system". This shows a total shift of controls and the WPs are silent on how the Audit Firm has addressed this issue in risk evaluation. A manual system of invoicing increases the chances for perpetrating fraud by the management or employees.

4.22. There is no evidence that the Audit Firm had in fact considered the likelihood of misstatement, including the possibility of multiple misstatements due to fraud. Thus, the claim of the Audit Firm that they have done documentation in accordance with para 47 of SA 240 is not substantiated by evidence. There is no valid reason provided by the Audit Firm as to why revenue recognition and management override of controls are not recognised as fraud risk. In fact, it appears from the explanations and the lengthy replies (major chunks of it are afterthoughts since they are not documented in the Audit File) that the Audit Firm did not even consider revenue recognition and management override of controls as fraud risks at all.

4.23. The Audit Firm has referred to the following additional WPs for procedures performed regarding risk with respect to revenue recognition:

i. 'Journal Entries Analysis'- NFRA analysed the WP and noted that there is only one journal entry regarding cost and no entry regarding revenue testing in the said WP.

ii. TPE Presentation (for review of accounting estimates) – In the section 'key estimates', the Audit Firm has only documented items of estimates and the responses it plans to perform like - "We will involve valuation team to evaluate models prepared by SPV's", "We will test goodwill and investment for impairment at reporting date", "Obtain age wise report and project wise inventory status", "provision for slow moving status" etc. The actual procedures performed and documentation of the same are not mentioned in the WP. Moreover, no WPs are referred for the procedures performed.

4.24. Thus, NFRA reiterates its observation in PFC that the Audit Firm failed to identify fraud risk based on a presumption that there are risks of fraud in revenue recognition and consequently failed to evaluate which types of revenue, revenue transactions or assertions give rise to such risks. The Audit Firm has also failed to understand that management override of controls is invariably present in all entities and therefore a fraud risk.

4.25. Regarding the observation in the PFC that the Audit Firm had also failed to document reasons for rebuttal of fraud risk in revenue recognition as required by SA 240, the Audit Firm submits in page 150 of their reply that "The Engagement team had assessed the risk of material misstatement due to fraud and discussed and assessed revenue recognition as a fraud risk consideration. The engagement team had detailed discussions around process of revenue and controls instituted by ITNL" The Audit Firm then lists five 'considerations' the ET has made and states in page 151 that "The engagement team had determined, then considered and rebutted the presumption that there was a risk of fraud in revenue recognition". However, there is no linkage between the so-called 'considerations' the ET has made and the rebuttal of the presumption that there was a risk of fraud in revenue recognition. No work papers referred by the Audit Firm tell the reasons for the rebuttal or explain how these five considerations (all except one such consideration are purely internal to the company and has a clear element of fraud risk) eliminate the fraud risk in revenue recognition. The work papers referred do not even show whether the revenue recognitions processes are automated or manual.

4.26. It is detailed in chapter related to Revenue Recognition of this DAQRR that the procedures performed to address the risk related to revenue and cost estimation is insufficient and inadequate. Thus, even though the Audit Firm has claimed that it assessed revenue as a significant risk, the Audit Firm has failed to perform proper procedures, even in that direction and has concluded without adequate basis that, "Based on the audit procedures performed, we conclude that there is no material misstatement with respect to revenue recognition."

4.27. In the absence of any evidence provided by the Audit Firm, NFRA reiterates its conclusion that the Audit Firm has failed to document responses to the assessed risks as required by SA 330, and reasons for rebuttal of fraud risk as required by SA 240.

***Identification of exceptions or observations in the internal control environment of the Company*.**

4.28. In reply to the observation in the PFC regarding failure to identify exceptions or observations in the internal control environment of the Company, the Audit Firm submits in page 132 of their reply that "We have obtained evidence of these controls which is documented in file Testing of Entity Level Controls March 2018 in hard copy file 1 page no A1- 199 to A1- 207 and the supporting documents are in canvas zip folder name "ITNL Entity Level Controls – Policies March 2018"". NFRA examined these workpapers and observes that audit evidence regarding verification of controls put in place to **identify non-routine matters** or **judgemental matters** and how management responds to associated risks is absent in these workpapers. (Reference to para A 124 of SA 315 in PFC stands corrected as para A136 of SA 315 as rightly pointed out by the Audit Firm). Though the Audit Firm has listed a set of work papers in this regard, no non-routine or judgmental matters are seen identified in these work papers. The Audit Firm has not ruled out absence of such matters in these work papers, either.

4.29. Para 18 of SA 315 stipulates that "The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting". NFRA observes that the Audit Firm has not documented any understanding of the information system including the related business processes in the WP Entity Level Controls. There is no assessment of the controls put in place to identify information technology system procedures through which transactions are initiated, processed, and transferred to GL and reported; how information system captures other events and conditions which are not significant; financial reporting process used for financial statements including accounting estimates and disclosures; journal entries including non-standard entries used for recording non-recurring, unusual transactions or adjustments. Further, there is no evidence in the audit file regarding how management responds to these risks.

4.30. Hence, NFRA reiterates its conclusion in the PFC that the Audit Firm has failed to identify or note any exceptions or observations in the internal control environment of the Company, in accordance with para A136 of SA 315. The whole process performed by the Audit Firm in understanding of the entity and its related controls as required by SA 315 appears to be insufficient and inadequate. Consequently, the audit strategy and procedures performed are insufficient to deliver the targeted audit impact.

Back dating of workpaper and/or fudging an existing workpaper.

4.31. Regarding the observation in the PFC that back dating a workpaper and/or fudging an existing workpaper the Audit Firm submits in page 162 of their reply that "risk assessment being a continuous, dynamic process of gathering, updating and analysing information throughout the audit. Accordingly, we have performed inquiries before framing our audit strategy and have updated those inquiries after completion of interim audit …… We document our conclusion on the risk of material misstatement in Summary Review Memorandum (SRM) which has been signed on May 29, 2018……… Upon performing update inquiry procedures on May 2, 2018 as there was no change in response from relevant personnel, we had updated the dates on the relevant pages without again obtaining signoffs which were done along with the Audit Strategy Memorandum. We obtained signoff at the conclusion stage directly on the SRM". Regarding a similar observation in the PFC, the Audit Firm has given a similar submission in page 217 of their reply to PFC.

4.32. The replies of the Audit Firm confirm the conclusions of NFRA in the PFC. The replies shows that the integrity of audit documentation has been totally disregarded by the Audit Firm. The WP in question is a hard copy document and if the reply of the Audit Firm is correct, it means that anybody can alter any hardcopy WP without the knowledge of the ET members who have prepared and signed off the document. If this is not the case, then the document is clearly a fudged document. While signing off the SRM, the EP has not even checked whether the underlying data forming the summary conclusions has been, at least, properly signed off by an ET member, let alone the basis of such conclusions. This instance of unauthorised changes in a WP noted by NFRA shows the absence of proper review by EP and EQCR. In the absence of a proper explanation, NFRA reiterates its conclusion that this is a clear evidence of back dating a workpaper and/or fudging an existing workpaper, and making a false claim of happening of an event which has in fact not taken place as on the signing date. The casual approach towards audit and questionable integrity of the audit file is further enhanced by this evidence.

Other facts corroborating the above conclusions of NFRA

4.33. The Audit Firm submits in page 189 of their reply that since ITNL is in infrastructure development sector and carry out BOT projects through SPVs, establishment of separate SPVs is an industry norm / regulatory requirement and not a matter of choice and this does not mean that ITNL is into infrastructure financing business. The Audit Firm further states that "Even if the project were to be executed directly by ITNL instead of being executed through a subsidiary, ITNL would still have to invest funds in the project due to the very nature of BOT contracts. Accordingly, SRBC was not aware of evergreening of loans, during the period of our audit nor did SRBC come across any such instances. Further, SRBC is also not aware of what risk of material misstatements could evergreening of loans possibly have on the financial statements of ITNL, considering that all loans given and receivables as at period end were subjected to expected credit losses as per Ind AS 109 based on the future cash flow projections". In this regard NFRA observes that:

4.33.1. The contention that ITNL being an infrastructure company operating through SPVs and hence there is no evergreening of loans is not a sensible argument. On a prima facie examination of the Annual Report 2018 of ITNL, there are indications of evergreening and roundtripping in the accounts, that pose a high risk of material misstatement. For e.g.: in note 39(b) under Related Party Disclosure, Loans given to related parties are shown as Rs 5648.25 crore. However, in note 5 of the SFS, out of total loans of Rs 5681.91 crore, loans to related parties are shown as Rs 5428.26 crore. On examination of related parties, it is seen that one of the project SPVs, viz, Rajasthan Land Holdings Limited (RLHL), ceased to be a subsidiary on June 30, 2017. RLHL has an opening loan balance of Rs 121.77 crore and a closing balance of Rs124.48 crore as on 31st March 2018. Note 4(b) in SFS states that "During the year ended March 31, 2018, the Company has sold its investment of 2,000,000 equity share held in Rajasthan Land Holding Limited to Pario Developers Private Limited against consideration received by way of preference shares which is included as investment in above schedule. The profit on sale of Rs 147.50 Crores is included under revenue from operations". In annexure I to Directors Report, it is stated that "Pario Developers Private Limited is an Associate Company engaged in the business of land development. The gross revenue and loss for FY 2017-18 was Rs 0.54 Crore and Rs (14.02) Crore respectively". In addition, Pario has an outstanding loan of Rs 1.60 crore. Investments in Preference Shares (at amortised cost) in Pario Development Private Limited is Rs 158.37 crore. Apart from this ITNL holds a 33% equity stake in Pario Development Private Limited at a cost of Rs 0.33 crore.

4.33.2. There are loans to non-project entities like IL&FS Engineering & Construction Company limited (Rs 33 crore) and IL&FS Maritime Infrastructure Company Limited (Rs 22.50 crore). It is mentioned in the report under Companies (Auditor's Report) order, 2016 that "The Company has granted loans to five companies covered in the register maintained under section189 of the Companies Act, 2013".

4.33.3. Moreover, the response of the Audit Firm that it is "not aware of what risk of material misstatements could evergreening of loans possibly have on the financial statements of ITNL, considering that all loans given and receivables as at period end were subjected to expected credit losses as per Ind AS 109" shows absence of professionalism of the Audit Firm. The Audit Firm ignores the fact that as per Ind AS 109, ECL provisioning is required to be made on the basis of assessment of the credit risk. If there is a significant increase in the credit risk, then loss allowance equal to the lifetime expected credit losses has to be recognized. On the other hand, if there is no significant increase in the credit risk, then expected credit loss of 12 months only is recognized. Further, under Ind AS interest on credit impaired assets is recognized as income in statement of profit and loss on the amortized cost of the asset, which is the gross carrying amount reduced by the expected credit loss allowance recognized on that asset.

4.33.4. If an entity indulges in evergreening of loans, it has the effect of concealing the loan default and helps the borrower to repay the interest on old loans out of the proceedings of the new loan. This way the lender is able to show regular payment of interest on the loan which would otherwise become an NPA/default asset. As a result, while calculating expected credit loss on such loans the credit risk is assessed inadequately, resulting in a lower ECL allowance. Consequently, the profits are in turn inflated. Similarly, in recognizing the interest income on such loans at an inflated amount (i.e. amortized cost less ECL provisioning) has the effect of recognizing increased interest income which again has the effect of inflating the profits.

4.33.5. The contentions of the Audit Firm further shows that the Audit Firm overlooked the basics of accounting and adopted a cavalier approach to the Audit without even caring to give due consideration to the nature of the entity and the purpose of the financial statements. ITNL is a listed company and also falls under the category of so-called public interest entities. Financial statements of such entities are expected to be directed towards the common information needs of a wide range of users. The aim of financial statements is to provide information about the financial position, performance and cash flows of an enterprise. Financial statements also show the results of the stewardship of management, or the accountability of management for the resources entrusted to it. The framework for preparation of financial statements states that "The economic decisions that are taken by users of financial statements require an evaluation of the ability of an enterprise to generate cash and cash equivalents and of the timing and certainty of their generation. This ability ultimately determines, for example, the capacity of an enterprise to pay its employees and suppliers, meet interest payments, repay loans, and make distributions to its owners". The framework further states that "If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form". The submissions of the Audit Firm that evergreening poses no risk of material misstatement undermines the very basic character of faithfulness and substance over form of the financial statements. It is well known that such fraudulent practices are intended to project a misleading state of affairs of the entity apart from deceiving the users of financial statements by showing a rosy picture about the ability of an enterprise to generate cash and cash equivalents and of the performance of its management, while the truth is entirely different.

4.34. With reference to NFRA's observation in the PFC regarding effects on audit of the significant changes in the nature of the entity or its environment not discussed or not documented, the Audit Firm submits in page 217 of their reply that "the section on "Significant changes in the nature of the entity or its environment and effect on our audit" of ASM requires us to document the significant changes in process of the Company, significant change in the assets and other such business updates, which could impact the financial statements. Accordingly, ASM includes the matter on such items which were required to be considered in the audit for the year ended March 31, 2018. The matters were discussed in the TPE dated November 20, 2017 / December 19, 2017 which is evident from the ASM and the TPE presentation slide deck. Further, these were specific matters and not pervasive and hence appropriate audit procedures were performed and documented in workpapers for respective areas". However, the Audit Firm has not referred to any WPs showing evidence of performing appropriate audit procedures for addressing each of such changes. The noting of changes in the nature of the entity or its environment has been done as a mere formality to complete the requirements of the form ASM. Apart from completing this formality, the Audit Firm did not care to look into the effects of each such changes and consequent documentation of the conclusions.

4.35. Regarding the observation in PFC that "NFRA has not found any performance of detailed understanding of the entity's business or analytical procedures within the audit file", the

Audit Firmin page 219 of their reply refers to certain WPs evidencing such performance. It refers to UTB 102GL UTB in hard copy file 1 as evidence of understanding of the entity's business. NFRA examined this WP and observes that nowhere in the WP the Audit Firm has shown any evidence of any risk identified with respect to the nature of entity's business. NFRA's observations about analytical procedures and understanding of controls are already provided above.

4.36. Regarding observation in the PFC, the Audit Firm submits in page 223 of their reply that "With respect to 102GL UTB, we documented our understanding of ITNL and the environment in which it operated that we had obtained by performing a number of audit procedures, including reviews of relevant information, inquiries, analytical procedures, observations and inspections in accordance with para 11 of SA 315." The statement cannot be taken at face value in the absence of evidence and in view of evidence to the contrary. For e.g., the analytical procedures referred by the Audit Firm is confined to variance analysis of year-on-year balances alone. Not much meaningful insights into understating an organisation flows from such an analysis. Even for the variance analysis made and differences observed, apart from explaining the reason for the difference in brief, no follow up procedures are seen documented to understand the implications of such differences in related areas of audit.

4.37. Regarding observation in the PFC that whether risk assessment was done at the beginning, throughout or towards the end of audit and there is no evidence of any incremental evaluation or analysis of risk made by the ET as required by the SA , the Audit Firm submits in page 225 of their reply that "risk assessment is a continuous process and is required to be updated upto the date of issuance of audit report based on our audit procedures performed and the developments updates obtained. Accordingly, incremental evaluation /analysis of CRA was also made and discussed in our team planning event held on December 19, 2017 …… in the post interim event held on April 19, 2018 ….. and while concluding our audit on in SRM on May 29, 2018". It is clear enough from this reply that the Audit Firm has not done any incremental evaluation or analysis of risk as required by the SA. After the initial planning event in December 2017, the next discussion happens only at the far end of the Audit in April 2018 and on concluding day of the Audit in May 2018. No new information is seen captured and analysed with respect to ROMM in these events. A few updates made in some of the WPs in between (as already commented by NFRA above) have not even been seen or reviewed by the EP. Thus, in the absence of evidence the contentions of the Audit Firm are not acceptable. Regarding dating of WP 'CRA_ Summary, the Audit Firm in its reply states that the document has been signed on 30th Nov, 2017. However, as verified from Canvas, the date of the WP 'CRA_ Summary (File 1 Page A1-245 to 247)' is 29th May, 2018. Further, there is no evidence of any incremental evaluation or analysis of risk made by the ET as required by the SA. Therefore, it is seen that the WP has failed to provide sufficient appropriate evidence as per Para 32 of SA 315.

4.38. Further to the observation in the PFC regarding '*WP 102GL UTB'*, NFRA observes that in the "Business Risks Section" of the said WP (in Hard copy files folders, File 1) debt financing risk is identified as a risk of material misstatement. The Audit Firm notes in the WP that "The Company has substantial debt and debt service obligations, and is, therefore, subject to various risks associated with debt financing. The level of debt and the limitations imposed on the Company, by present and future loan arrangements could have significant adverse consequences. This is primarily due to the cost of borrowings." Thus, it is clear that debt financing is a risk of material misstatements which should have been addressed properly by the Audit Firm by carrying out proper audit procedures. There is no further mention of this risk in any other work papers or there is no evidence of any procedures performed to address this risk. The reasons given by the Audit Firm in page number 223 and 224 of their reply to PFC, for not considering debt financing as a risk of material misstatements, have not been documented anywhere in the workpapers. Moreover, the procedures claimed as performed by the ET to satisfy itself about the said risk have also not been documented anywhere. Thus, the reply of Audit Firm in this regard is clearly an afterthought and a complete sham.

4.39. Further, delay in completion of projects resulting in increased project cost has also been identified as a risk of material misstatements in the business risk section of the above-mentioned document, which as stated in the document would impact the company's margin, and result in levy of penalty under concession agreement and loss of reputation in the market, which would in turn affect the going concern assumption of the company. This risk has also not addressed further, even though it is a significant risk. Moreover, what the management has done to mitigate this risk has not been documented by the auditor anywhere in the workpapers.

4.40. The WP M18 ITNL CRA also identifies trade receivables as a significant risk. But there is no further discussion or mention of the risk in any other work paper. Moreover, the fact that most of the debtors are related parties makes it more susceptible to fraud. Thus, adequate procedures should have been designed and performed by the auditor to attain reasonable assurance about the risk as required by the SA.

4.41. In the workpaper 'Z Caro WP ITNL' referred by the Audit Firm in 'Related Party transaction form' an analysis of arm's length price of the transactions with the related parties has been made. The arm's length criteria for the purchase of investments mentioned (in page number 545 of 557 of the document Z Caro) is that, "Investments should be made in line with means of financing approved for the project. Valuation of securities of SPV/Related parties done by registered valuer/merchant banker/practicing CA." The Audit Firm has commented (in page number 546 of 557 of Z Caro) that, "The Company holds 100% of the share capital of these entities and the investments were purchased directly from the entities at face value. Accordingly no valuation report was obtained." The fact that investments were purchased directly from the entities, or that 100% shares were purchased, or that shares were purchased at FV does not in any way relieve the auditor to comply with the requirements of the related party policy of the Company to ensure arm's length price. Thus, it is clear that the Auditor has knowingly ignored the Company's own policies and failed to point out at the deficiencies of the management.

4.42. In view of the evidences submitted, NFRA withdraws its comments in PFC that "Irrespective of the signing date of ASM, it is noted that the TPE Presentation dated 19-Dec-2017, continues to carry the flaws such as: no discussion of estimates in TPE, no evidence of the discussions held during PIE (Post Interim Event), non-identification of management review controls, insufficient discussion on risk of management override of controls. The ET has maintained a completely casual and cavalierly approach towards audit" except for insufficient discussion on risk of management override of controls, which is addressed separately in this DAQRR.

4.43. NFRA therefore reiterated its findings in the PFC and concluded in the DAQRR that the Audit Firm has:

i. failed to appropriately identify and assess risk of material misstatements and consequently failed to reduce the risks of material misstatements to an acceptably low level as required under SA 315.

ii. failed to discuss the components of the entity's financial statements and arrive at significant decisions regarding susceptibility of the financial statements to material misstatement due to fraud, in accordance with para 10 of SA 315.

iii. not performed adequate audit procedures as required by para 6 and 7 of SA 330, and thus failed to obtain and document sufficient appropriate audit evidence as required by para 28 of SA 330 to address the identified risk.

iv. failed to assess for multifarious possibilities of ROMM. Having failed to identify fraud risks, the Audit Firm has failed to document responses to the assessed risks as required by SA 330, and reasons for rebuttal of fraud risk as required by SA 240. The entire exercise of identification and assessment of risks of material misstatement due to fraud and error is a sham.

v. failed to identify fraud risk based on a presumption that there are risks of fraud in revenue recognition and consequently failed to evaluate which types of revenue, revenue transactions or assertions give rise to such risks. The Audit Firm has also failed to understand that management override of controls is invariably present in all entities and is therefore a fraud risk.

vi. failed to identify or note any exceptions or observations in the internal control environment of the Company, in accordance with para A136 of SA 315. The whole process performed by the Audit Firm in understanding of the entity and its related controls as required by SA 315 appears to be insufficient and inadequate. Consequently, the audit strategy and procedures performed are insufficient to deliver the targeted audit impact.

4.44. Therefore, the Audit Firm did not exercise due diligence and are grossly negligent in the conduct of their professional duties.

4.45. NFRA has examined in detail the replies dated 10th July, 2021 and the oral submissions made by the Audit Firm (replies to the DAQRR) regarding the observations in the DAQRR. The Audit Firm has denied all the observations of NFRA by repeating their earlier replies to the PFC and the DAQRR. However, the submissions made are examined again in detail and the observations are as follows.

Discussion of Susceptibility of Financial Statements to Material Misstatements due to Fraud.

4.46. The Audit Firm submits that *"the engagement partner and other key engagement team members discussed the susceptibility of the entity's financial statement to material* *misstatement and the application of the accounting framework to the entity's facts and circumstances and documented the same in the form of TPE presentation, TPE minutes, CRA summary and Audit Strategy Memorandum amongst others. (refer hard copy file 1 page no. A1-72 to A1-85, Refer hard copy file 1 page no. A1- 90 to A1- 141, refer hard copy file 1, page no.A-190 to A-198, refer hard copy file 1, page no. A1-238 to A1-247 and refer hard copy binder Hard copy Binder Part 1 of 6). SRBC and the engagement team have conducted enquiries and implemented procedures to ensure that significant risks are identified, assessed for risk of material misstatement and given special audit consideration. Further, SRBC has obtained an understanding and perused the process for identifying business risks relevant to financial reporting objectives, estimation and assessment of significant risks, likelihood of their occurrence and action plan to address and resolve such risks*."

4.47. The reply does not address the observation of NFRA in the DAQRR that *"the audit procedures have not been performed in a consistent manner as guided by the SAs. The observations listed in one document do not form basis for conclusions derived in another. For example, the WP 'TPE Minutes' does not discuss any fraud risks, while 'Fraud Considerations Form' dismisses any fraud risk, without even assessing presumed fraud risks. The Audit Strategy Memorandum contains the staggering conclusion, not supported by any evidence of substantive work being done, that the ET has discussed the potential for risks of material misstatement due to fraud or error, including significant risks, and where specifically they may occur, and that based on procedures performed, no fraud risks were identified. NFRA has observed that there is no documentation in the audit file regarding such procedures being performed, nor of any discussions about identification or rebuttal of fraud risks. The work done and intermediate conclusions derived do not support the firm's overall conclusions on ROMM conclusively. Thus, the entire audit execution and strategy appears to be flawed. For example, individual risk assertions noted in 'Document: Audit Strategy Memorandum' neither flow from overall ROMM identified, nor lead to the conclusion that the identified ROMM have been adequately dealt with sufficient appropriate evidence for the auditor to obtain reasonable assurance in writing the audit report.*"

Failure to identify and rebut fraud risks and failure to identify and assess significant risks.

4.48. Regarding compliance with SA 240, para A1, the audit firm submits *that "the documentation with respect to the different factors was available in other parts of the audit file which was also discussed in the Team planning event. It is pertinent to note that SRBC has conducted engagement team discussion regarding fraud risks, made inquiries of management and others in the Company to obtain their views about the risks of fraud and how those risks are addressed.*". In support of this claim, the audit firm cites different WPs and provides an analysis to establish the three factors (incentive/pressure, opportunity and attitude/rationalization) to assist the commission of fraud as mentioned in para A1 of SA 240 were not present in ITNL. But the said analysis is not forming part of the Audit File. The WP has some of the information which could be potentially used to conclude that such factors do not exist. However, this analysis is neither complete nor it considers other compelling reasons showing that the management may be under pressure, from sources outside or inside the entity, to achieve an expected (and perhaps unrealistic) earnings target or financial outcome (Para A1 of SA 240). The Audit Firm cites reasons such as *"During the year ended March 31, 2018 there were no new projects awarded to ITNL group except for construction of Zoji-la tunnel on EPC basis for which the work had not commenced. Accordingly, there were only existing contracts with agreed price and scope of work being executed during the year"* to state that there is no incentive/pressure on the management to achieve financial results. However, this could equally be a reason for artificially inflating growth to deviate attention from degrowth due to the absence of new projects. Similarly, as explained in other parts of this AQRR, many of the SPVs were having going concern issues and needed financial support in the form of debt from external/internal sources. The company itself is having going concern issues as explained in the section related to Going Concern in this AQRR. There was the unjustified reversal of ECL to boost profits. All these factors are obvious signs of pressure on the management to artificially inflate profits/reduce losses. However, the Audit Firm has not addressed any such issues in the referred WPs.

4.49. In this regard, SA 240 – Para 44 stipulates that the auditor's documentation of the understanding of the entity and its environment and the assessment of the risks of material misstatement required by SA 315 shall include the significant decisions reached during the discussion among the engagement team regarding the susceptibility of the entity's financial statements to material misstatement due to fraud. SA 230 also mandates documenting professional judgments of significant matters. Hence in the absence of such documentation in the Audit File, NFRA reiterates its conclusions in the DAQRR that nowhere in the reply does the Audit Firm point out to a WP reference that gives unambiguous evidence showing that the Audit Firm has discussed these three factors and documented its conclusions based on objective evidence.

4.50. Regarding inadequate analytical procedures, the Audit Firm states that *"SA 315, para A13, acknowledges that analytical procedures performed at the risk assessment stage could be at high level. This is mainly on account of the fact that these are performed at the planning stage before the audit execution commences." … "comparable information for prior periods i.e., variance analysis is also one of the acceptable analytical procedures"*. It then cites the same set of WPs as examined by NFRA earlier. These WPs do not show any analysis or conclusions reached out of analytical procedures, other than the period-on-period movement of significant account balances, as already concluded by NFRA. The Audit Firm's submissions to the contrary are not supported by evidence.

4.51. Regarding the observation that the reply to PFC does not provide any evidence of having "inquiries of others within the entity and other employees with different levels of authority", the Audit Firm submits that *"SRBC had performed inquiries with those charged with governance with reference to para A7 of SA 315. The workpaper template for fraud considerations form includes guidance for the engagement team to evaluate and to document the procedures performed in the form itself. The engagement team had performed inquiries with the management, internal audit function and others within the entity that SRBC considered relevant for inquiries relating to ROMM including those charged with governance and documented the response received from them in the form during the course of the audit."* In this regard, the Audit Firm also provides WP reference where discussions with Senior manager Accounts and Manager Accounts have been documented under the category *"Inquiries of employees involved in initiating, processing* *or recording complex or unusual transactions to evaluate the appropriateness of the selection and application of certain accounting policies."* The referred WP mentions the names of these two officers and observes that "*During course of our audit we have interacted with some of the Mid senioe level management employees both in the financial and operating areas and as per the information obtained from employees within the entity, they are not aware of any actual, suspected or alleged fraud."* [sic]. However, it can be seen from the above submissions that the discussions outside TCWG and management were limited to two persons in the accounts, while the audit firm itself falsely notes that they have interacted with mid and senior-level employees in the financial and operating areas. Also, these two are not the employees involved in initiating complex transactions. In the absence of evidence, NFRA concludes that the Audit Firm has failed in complying with para A7 of SA 315 by not having inquiries of persons and other employees within the entity (other than TCWG and management) with different levels of authority.

4.52. NFRA observed in para 4.10 above that *"In the document Audit Strategy Memorandum – Internal control over financial Reporting, (Refer Hard copy files folders, Binder) construction revenue and cost related to management override on cost estimation are identified as fraud risks. Further, it states "We will do certain procedures (as agreed in the Fraud risk considerations form) for management override on cost estimation for revenue and cost related process."* The reply of the Audit Firm in this regard is reproduced below as a snapshot.

The relevant extract of the above referred WP (as submitted to NFRA in a scanned PDF version by the Audit Firm) is also given as a snapshot below.

IV. SRBC response to DAQRR of NFRA on Evaluation of ROMM para 4.10, 4.11 and 4.14:

1. At the onset SRBC submits that the Audit Strategy Memorandum – internal control over financial reporting (Refer hard copy binder 1 of 6, P.1.2) **does not** identify construction revenue and cost related to management override on cost estimation as fraud risk. In fact, the Audit Strategy memorandum (Refer hard copy binder 1 of 6, P.1.1) clearly states that no fraud risks were identified (Refer screenshot below):

> Based on procedures performed, no fraud risks were identified
>
> We have identified the following significant risk:

NFRA has clearly tried to distort the facts which reflects NFRA reviewers premediated mindset.

P.1.2 Audit Startegy Memorandum - Internal control over financial reporting.pdf - Adobe Reader

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Controls related to fraud*

- Provide an overview of the Entity's controls related to fraud prevention and management override and our audit approach to address fraud risks in our control testing strategy.

> We have identified construction of revenue and cost related to management override on cost estimation resulting in incorrect percentage of completion and improper revenue recognition in case of project business as fraud risk. We will do certain procedure (as agreed in the Fraud risk considerations form) for management override on cost estimation for revenue and cost related process.

The Audit Firm also states in page 240 of their reply that *"SRBC submits that SRBC had considered risk of management override of controls on cost estimation leading to incorrect percentage completion and revenue recognition in case of project business as significant risk factors and had performed sufficient appropriate audit procedures which* *would have been adequate, had these been identified as fraud risk factors for the purpose of audit.*".

4.53. The above instances are self-explanatory and bring out the fallacy of the arguments made by the Audit Firm. This is yet another example of how the Audit Firm makes untrue statements to NFRA in its futile attempt to find non-existent reasons for the omissions. Given the above blatant lie submitted by the Audit Firm, NFRA reiterates its conclusions in para 4.10 and 4.11 above, as all other submissions are a repetition of what was stated at the PFC stage.

4.54. Similarly, in reply to para 4.12.4, the Audit Firm states that *"**NFRA has erred in quoting that the Company had a practice of recognizing revenue on construction contracts only after completion of 10% of the project.** The Company had a practice of recognition of margin on construction contracts only after completion of 10% of the project and it was being followed by the Company since past years. This was a known fact and also documented in our workpapers*" (emphasis added). However, para 15 in WP 'ITNL TPE Minutes March 2018' - soft copy cited by NFRA in para 4.12.4 states as follows:

*"15. **The practice of revenue recognition of construction contracts only after completion of 10% the project was discussed**. Prashant explained that since there is high level of uncertainty involved in these projects, the company is following the above mentioned accounting policy based on conservative approach."* (emphasis added).

This is also self-explanatory and shows that the Audit Firm is not certain about what is written in their own WPs. NFRA can accept only what is contained in the Audit File as evidence for the works done. Any explanations to the contrary are considered as afterthoughts only. The audit firm now explains the reasons why it omitted to finally document some of the important matters noted in the soft copy. However, in the absence of credibility of their explanations as demonstrated above, NFRA does not accept those explanations. More importantly, the best and honest practice expected from the Audit Firm in such circumstances is to document those explanations, whatever it is, in the WP itself rather than removing those observations altogether.

4.55. In reply to observation in para 4.15, the Audit Firm submits that *"Close monitoring by NHAI through their Independent engineers was just one of the factors amongst many other considered by SRBC while assessing the risk of material misstatement due to fraud or error and not the sole factor as being projected by NFRA."* This is yet another example of distorted replies by the Audit Firm. NFRA has not stated that this is the sole factor considered by the Audit Firm in their purported assessment of ROMM. NFRA has explained at length the flaws in other key procedures performed by the Audit Firm. The observation in para 4.15 brings out the fallacy of the claim of the Audit Firm that "*there is no scope for the Company to misrepresent the financial position of the Company"* because "*The work carried out was being closely monitored by the regulators"*.

4.56. In view of the WP references given by the Audit Firm the observation in para 4.17 stands deleted. Based on the above observations NFRA reiterates that the Audit Firm has failed to assess for multifarious possibilities of their risk. Having failed to identify fraud risks, the Audit Firm has neither been able to rebut them nor identify and assess 'significant risks' sufficiently, appropriately and objectively. The cavalier attitude of the Audit Firm reinforces NFRA's view that the entire exercise of identification and assessment of risks of material misstatement due to fraud is a complete sham.

Identification and assessment of revenue recognition and management override of controls as presumed fraud risks.

4.57. Regarding the observations of failure to identify revenue recognition and management override of controls and rebut presumed fraud risk and the failure to appropriately rebut these risks, the Audit Firm submits that "*The engagement team had determined using its professional judgement and skepticism, then considered and rebutted the presumption that there was a risk of fraud in revenue recognition. The detailed discussions that the engagement team had during the team planning event was summarised in the minutes of TPE held on December 19, 2017 (Refer hard copy File 1, page no. A77) in accordance with the requirements of para 47 of SA 240.".* The Audit Firm cites certain WPs also to support the claim. However, none of these WPs document, with reasons, either identification or rebuttal of the presumed fraud risk in revenue and management override of controls. It may be recalled that the Audit Firm itself had disowned its observation in one of the WPs where it was stated that revenue is a fraud risk (refer <u>para 4.53 above</u>). The above observations are further reinforced by the statement of the Audit Firm that "*Though revenue recognition and construction costs estimation in conjunction with management override of controls were identified as significant risks, the nature, timing and extent of audit procedures designed and performed were not less than the procedures that would have been performed, had it been identified as a fraud risk."* In the absence of evidence, NFRA reiterates that the Audit Firm failed to identify fraud risk based on a presumption that there are risks of fraud in revenue recognition and consequently failed to evaluate which types of revenue, revenue transactions or assertions give rise to such risks. The Audit Firm has also failed to understand that management override of controls is invariably present in all entities and therefore a fraud risk. The Audit Firm also failed to document responses to the assessed risks as required by SA 330, and reasons for rebuttal of fraud risk as required by SA 240.

Identification of exceptions or observations in the internal control environment of the Company.

4.58. In reply to the observation regarding failure to identify non-routine and judgmental matters, the Audit Firm states that *"SRBC had discussed and documented the significant non-routine and judgmental accounting and auditing matters in the TPE and PIE (Refer TPE presentation – business updates section in hard copy file 1, page no. A1-121 to A1-123, Refer ASM in hard copy binder Part 1 of 6 page no P.1.1, refer PIE presentation – business updates section in hard copy file 1, page no. A2-189 to A2-199 and SRM in hard copy binder Part 4 of 6 page no P.4.1)".* NFRA has examined these WPs and the other WPs referred to by the Audit Firm. None of these WPs addresses non-routine matters adequately. Accordingly, the observation in <u>para 4.28</u> above stands modified as below.

4.58.1. NFRA examined these workpapers and observes that audit evidence regarding verification of controls put in place to **identify non-routine matters** and how management responds to associated risks is absent in these workpapers. (Reference to para A 124 of SA 315 in PFC stands corrected as para A136 of SA 315 as rightly pointed out by the Audit Firm). Though the Audit Firm has listed a set of work papers in this regard, no non-routine matters are seen identified in these work papers. The Audit Firm has not ruled out the absence of such matters in these work papers, either.

4.59. In reply to the observation regarding the failure of understanding of the information system, the Audit Firm does not give a specific reply to the observations but refers to a host of WPs where it is claimed that such an understanding is documented. However, these WPs are mainly the test of controls and related matters for the significant classes of transactions. From these WP it is implied that the Company uses separate IT applications for different purposes such as financial accounting consolidation and forecasting. There is also a significant manual intervention in transferring data from one system to the other. Manual or semi-manual controls are employed in almost all significant areas even though the IT systems like SAP and Oracle Hyperion are in use for the above purposes. Despite all these factors, there is no assessment of the controls put in place to identify information technology system procedures through which transactions are initiated, processed, and transferred to GL and reported; how the information system captures other events and conditions which are not significant; journal entries including non-standard entries used for recording non-recurring, unusual transactions or adjustments. Further, there is no evidence in the audit file regarding how management responds to these risks. The observation in para 4.29 stands modified accordingly.

Backdating of workpaper and/or fudging an existing workpaper.

4.60. Regarding the above, the Audit Firm reiterates its earlier replies and submits that *"SRBC further submits that the hard copy audit workpaper file remains in the custody of the engagement team up to the archival of documents. Further, all SRBC Employees are required to read & affirm firms Global Code of Conduct annually and strictly abide by the same. Noncompliances if any are dealt with seriously. Apart from the above, it is the trust and person`s ethics and integrity which is relied upon to ensure that nobody alters/modify/edit/remove/discard any work paper from audit file. Accordingly, nobody will alter any hardcopy workpaper without the knowledge of the engagement team members who have prepared and signed off the said document. ………SRBC submits that the inquiries with the client on May 2, 2018 had taken place and since NFRA has alleged that such an event had not taken place, SRBC submits the calendar invite for the meeting for NFRA's reference".*

4.61. The above reply again confirms the observations in the DAQRR that the integrity of audit documentation has been disregarded by the Audit Firm. The WP in question is a hard copy document and it means that anybody can alter any hardcopy WP without the knowledge of the ET members who have prepared and signed off the document. While signing off the SRM, the EP has not even checked whether the underlying data forming the summary conclusions have been, at least, properly signed off by an ET member, let alone the basis of such conclusions. This instance of unauthorised changes in a WP noted by NFRA shows the absence of proper review by EP and EQCR. The casual approach towards audit and questionable integrity of the audit file is further enhanced by this evidence.

Other facts corroborating the above conclusions of NFRA

4.62. Regarding evergreening of loans, the Audit Firm submits that *"SRBC reiterates that ITNL was predominantly in infrastructure development sector and not in infrastructure financing sector as wrongly understood and mentioned by NFRA reviewer"*. However, NFRA has not stated anywhere in the DAQRR that ITNL is in the infrastructure financing sector. The reply of the Audit Firm running into 1056 pages contains hundreds of instances of unfounded statements like this, which shows the most unprofessional attitude of the Audit Firm in addressing factual matters observed in the DAQRR.

4.63. The Audit Firm further submits that *"As per the understanding of the business gained by SRBC, there was no such "evergreening" of loans given by the Company. Further, based on the audit procedures performed, SRBC had not come across any such instances of so called "evergreening" of loans. Also as mentioned above, considering that ECL was being provided by the Company on the basis of lifetime credit loss considering expected recoveries based on future cash flow projections of the SPV there would have been no impact on financial statements on account of the same and hence no risk of material misstatement*" and " *NFRA has failed to note that as per the accounting policy of the Company (Refer para B.18.5 on page 115 of the Annual report for the year ended March 31, 2018, the Company was recognizing ECL provision based on lifetime expected credit loss at each reporting date right from initial recognition and not 12 months expected credit loss and hence the credit risk was already factored in the discounted future cash flow projections based on which life time expected credit loss was calculated*." The Audit Firm also states that "NFRA has raised this allegation on a false premise without having any appropriate understanding of the facts in this regard. Thus, we are unable to understand NFRA's reasoning in para 4.33.4 of DAQRR and strongly refute and deny the same. We believe that NFRA reviewer is using hindsight and information emerging subsequently through the investigations carried out on the ILFS group."

4.64. There is no evidence in the Audit File that the Audit Firm has, in fact, checked the possibility of evergreening and round-tripping, even though the Company has a complex group structure. Also, the above replies are intended to mislead NFRA and are factually incorrect. The said note B.18.5 on page 115 of ITNL reads as "*The Company has followed simplified approach for recognition of ECL. The application of the simplified approach does not require the Company to track changes in credit risk. Rather, it recognises impairment loss allowance based on lifetime ECLs at each reporting date, right from its initial recognition."* As per para 5.5.15 of Ind As 109, the simplified approach is applicable only to trade receivables, contract assets and lease receivables. If the Audit Firm has applied this policy to loans also, it shows the extreme disregard of basic accounting principles by the Audit Firm. This again shows the Audit Firm's lack of professionalism and poor understanding of the basics. It can be seen that NFRA's conclusions are based only on information available to the Audit Firm at the time of audit. Also, the Audit Firm's statement that there is no risk of material misstatement due to Evergreening of loan clearly shows that the Audit Firm has not even considered this as a risk and thus the question of performing procedures to ensure that there is no Evergreening of loans does not arise at all. Thus, the Audit Firm's response that NFRA is using hindsight to allege regarding Evergreening of loans is also a baseless argument.

4.65. Even if a lifetime ECL model is applied to a loan by measuring the loss allowance based on the estimated realization date and considering all contractual terms over the expected life of the loans, it is evident that such models do not take into account the sources of repayments and hence the effect of evergreening or roundtripping will not be captured in such models. In evergreening, there is also the risk of overlooking a financial instrument that is originally credit-impaired. In the absence of factual evidence and proper explanations, NFRA reiterates its observations in the DAQRR in this regard.

4.66. Regarding the observation in <u>para 4.34</u> above, the Audit Firm has provided WP references stating that *"Since NFRA had not asked for those workpaper reference in PFC those were not provided by SRBC in its response to PFC."* Because of the evidence submitted, para 4.34 stands deleted.

4.67. Regarding failure to identify risks concerning the nature of the entity's business, the Audit Firm states that "*the business risks have been considered and documented in section 5 - The entity's objectives, strategies and business risks of UTB"*. However, as observed by NFRA earlier, this WP contains no major risks identified about the nature of the entity. Under business risks, there are only three entries in this document, which covers delay in completion of projects in one entry and debt financing in the next two entries. This is despite the fact that the Company itself has stated in the annual report (page 36) that *"India's infrastructure sector remains the backbone of socio-economic development. However, new risks and concerns have emerged in recent years. From ITNL's standpoint, the situation remains critical in view of the following challenges:"* It then proceeds to list 10 areas of challenges that are critical to the company. The Audit Firm failed to consider any of these risks areas (except debt financing) in its business risk analysis. SA 315 defines Business risk as "*A risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity's ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies*." As the management has identified these business risks, the auditor has to examine these risks to identify which of these business risks may result in risks of material misstatement under para 11 of SA 315. In this regard, para 11 of SA 315 makes it mandatory that the auditor shall obtain an understanding of the entity's objectives and strategies, and those related business risks that may result in risks of material misstatement. As this is a mandatory requirement, documentation of the same is also mandatory as per SA 230.

4.68. Regarding the observation of whether risk assessment was done at the beginning, throughout or towards the end of the audit, the Audit Firm failed to submit any evidence to support their claims. It submits that "*With respect to NFRA's DAQRR para 4.37, SRBC reiterates that risk assessment procedures were performed throughout the audit, however, each and every thought cannot be captured and documented.*"

4.69. In reply to the observation that there is no evidence of any procedures performed to address debt financing risk, the Audit Firm submits that *"it is clear from the above definition and references of SA 315 that a risk of material misstatement or a significant risk is a sub-set of Business risk and each and every business risk does not necessarily give rise to a risk of material misstatement or a significant risk. Business risks are further assessed to identify significant risk which could result into a risk of material misstatement to financial statements.*

Our understanding of ITNL and its environment helped us identify risk factors from which we determined whether any of these risk factors we identified were significant (i.e., that may give rise to risks of material misstatement in the financial statements). We determined *the effect these risk factors had on our significant risk assessment for the financial statements as a whole, individual accounts and disclosures and the relevant assertions.*"

"*The engagement team based on its professional judgement did not identify debt financing as a risk of material misstatement or a significant risk. It is evident from form 102GL UTB (refer hard copy file 1 page no A1-46 to A1-64) itself that debt financing had only been identified as business risk and not a risk of material misstatement. Accordingly, as per para 32 of SA 315, SRBC was not required to document the reasons for not considering it as a Risk of Material Misstatement.*"

4.70. The above contentions are contrary to the evidence available in the audit file. As established in <u>para above</u>, the audit firm failed to assess business risk properly and therefore the contention that the significant risks, which are the subsets of business risks, have been identified properly is not acceptable. Also, there is no evidence in the audit file that supports why some business risks are not significant risks or ROMM. Similar is the case of business risk related to delay in completion of projects resulting in increased project cost.

4.71. In the case of trade receivables, the Audit Firm submits WP references and states that *"adequate audit procedures were designed and performed to obtain sufficient appropriate audit evidence with respect to reasonable assurance for Trade receivables account assertion." As this evidence addresses the NFRA observations only partially, the observation in para 4.40 above stands modified as follows. "The WP M18 ITNL CRA also identifies trade receivables as a significant risk. But the fact that most of the debtors are related parties makes it more susceptible to fraud. Thus, adequate procedures should have been designed and performed by the auditor to attain reasonable assurance about the risk as required by the SA."*

4.72. Regarding failure to test the arm's length basis of RPT transactions, the Audit Firm states that *"As per the RPT policy (Refer in hard copy file 2, A3-646), screenshot reproduced below, of the Company approved by the Audit committee and the Board of Directors, related party transactions with wholly owned subsidiaries were exempt from prior approval of the Audit Committee, Omnibus approval and also approval of the shareholder and hence the RPT framework was not applicable to related party transactions with wholly owned subsidiaries…….Above demonstrates the NFRA reviewers biased approach and premediated mindset*". However, providing an omnibus approval does not mean that the transactions need not be on an arm's length basis. It is clear from other clauses of the RPT Policy of the company extracted below.

III **<u>Scope & Applicability:</u>**

This Policy applies to all the transactions of the Company with the Related Parties including changes if any in related parties from time to time. The Related Party Transactions of the Company as envisaged under the Act and the Regulations are summarised in **<u>Annexure II</u>**

IV **Policy Statement**:

(1) In terms of RPT Policy neither the Company nor its Officers or employees shall enter into any RPT unless such transaction is:
a. in the Ordinary Course of Business and on an Arm's Length Basis;
b. is a non-Material Transaction under the Regulations; and
c. is a RPT covered within the "RPT Framework"

X **RPT Framework**:

(1) The Audit Committee and the Board of Directors of the Company will approve the RPT Framework and delegate the implementation of the same to the Audit Committee which will regulate the RPTs falling within this Policy and such RPTs, being non-material RPTs, will be approved by the Management Committee in accordance with the RPT Policy and RPT Framework.

(2) The transactions with Related Parties falling within the said Framework would be considered / deemed to be in the Ordinary Course of Business and on an Arm's Length basis and would be considered as Exempt Transactions under Section 188 of the Act.

(3) The Board of Directors of the Company in its discretion may seek approval of the Shareholders of the Company for the RPT Policy and / or RPT Framework

(4) All the RPTs of the Company will be subject to an extensive evaluation and assessment procedure prescribed herein

4.73. The clause cited by the Audit Firm only provides for an exemption from the RPT framework in so far as the approval process is concerned. Moreover, compliance with section 188 of the Companies Act requires verification of arm's length basis of related party transactions in all cases. There cannot be any delegation for approval of "non-material" RPTs to anybody, including the Management Committee. There is no exception under Sec 177 for audit committee approval of ALL RPTs. The replies of the Audit Firm are intended to mislead NFRA and also reflects a poor understanding of the applicable laws and standards of auditing.

4.74. NFRA therefore, concludes that the Audit Firm has:

4.74.1. failed to appropriately identify and assess the risk of material misstatements and consequently failed to reduce the risks of material misstatements to an acceptably low level as required under SA 315.

4.74.2. failed to discuss the components of the entity's financial statements and arrive at significant decisions regarding the susceptibility of the financial statements to material misstatement due to fraud, in accordance with para 10 of SA 315.

4.74.3. not performed adequate audit procedures as required by para 6 and 7 of SA 330, and thus failed to obtain and document sufficient appropriate audit evidence as required by para 28 of SA 330 to address the identified risk.

4.74.4. failed to assess for multifarious possibilities of ROMM. The Audit Firm has failed to assess for multifarious possibilities of their risk. Having failed to identify fraud risks, the Audit Firm has neither been able to rebut them nor identify and assess 'significant risks' sufficiently, appropriately and objectively. The Audit Firm has failed to document responses to the assessed risks as required by SA 330, and reasons for rebuttal of fraud risk as required by SA 240. The entire exercise of identification and assessment of risks of material misstatement due to fraud and error is a sham.

4.74.5. failed to identify fraud risk based on a presumption that there are risks of fraud in revenue recognition and consequently failed to evaluate which types of revenue, revenue transactions or assertions give rise to such risks. The Audit Firm has also failed to understand that management override of controls is invariably present in all entities and is, therefore, a fraud risk.

4.74.6. failed to obtain audit evidence regarding verification of controls put in place to identify non-routine matters and how management responds to associated risks is absent in these workpapers in accordance with para A136 of SA 315. The Audit Firm has not ruled out the absence of such matters either.

4.74.7. the whole process performed by the Audit Firm in the understanding of the entity and its related controls as required by SA 315 appears to be insufficient and inadequate. Consequently, the audit strategy and procedures performed are insufficient to deliver the targeted audit impact.

4.74.8. failed to examine the business risks and consequently failed to comply with para 11 of SA 315.

5. INVESTMENTS

Noida Toll Bridge Company Limited (NTBCL)

5.1. NFRA in Prima Facie Conclusions conveyed the following:

5.1.1. NFRA notices from the WP 'ITNL H Investments March 2018 - "Investment Movement", that the investment in NTBCL, an associate company has been valued, , as on 31st March 2018, at Rs 162.33 crore at cost (4,90,95,007 shares of Rs.33 per share) as against fair value (quoted value) of Rs 59 crore approximately (i.e. 4,90,95,007 shares at Rs.11.94 per share) on the balance sheet date, which had further declined to Rs.49.09 crore on the date of signing of Auditor's Report on 29-MAY-2018.

5.1.2. The Audit Firm in the Summary Review Memorandum (SRM) has stated that: "The Auditors of NTBCL have given an EOM in their audit report, dated 21-MAY-2018:

5.1.3. We draw attention to note 30 to the Audited Financial Results in which, pending the outcome of the Company's appeal before the Hon'ble Supreme Court against the order of the Hon'ble High Court of Allahabad stalling the levy and collection of toll fee, based on a legal opinion, the Board has placed reliance on the provisions of the Concession Agreement relating to compensation and other recourses and taken a stand that the underlying value of the intangible and other assets is not impaired. Our opinion is not modified in respect of this matter."

5.1.4. The SRM further goes on to say that based on the assessment made by the management and considering the legal opinion provided by the management, engagement team has concluded that the matter involves significant judgement, the outcome being dependent on the decision of the Courts and considering the significance of the amount involved, emphasis of matter as given below to be continued in the audit report drawing attention to the explanatory note provided by management in the financial statements.

5.1.5. ***"We draw attention to Note 4 (footnote (j)) of the Ind AS financial statements, in respect of suspension of toll collection of an associate company pursuant to the order of Hon'ble High Court of Allahabad and the matter is pending with Hon'ble Supreme Court of India. An Emphasis of Matter paragraph is also given by the auditors of the associate Company. Our opinion is not modified in respect of this matter".***

5.1.6. NFRA's conclusions on this matter were as follows:

i. The Company was required to assess indicators of impairment of an asset at the end of the financial year 2017-18. In assessing such impairment, the Management was required to consider the provisions of Paras 9, 12(d) and 18 of Ind AS 36. Para 12 of Ind AS 36 lists, inter alia, external sources of information, that an entity shall consider **as a minimum**, when assessing whether there is any indication that an asset may be impaired (emphasis added).

ii. Para 12(d) of Ind AS 36, lists the carrying amount of the net assets of the entity being more than its market capitalisation, as one such indication. In the case of NTBCL, NFRA observes that the market capitalisation of the Company was Rs 223.44 crore (18.62 crore shares at market price of Rs 11.94 each per share as on 31-Mar-2018) while the carrying value of net assets of NTBCL as on the reporting date was Rs 463 crore. The Company incurred a loss of Rs 56.99 crore in the year 2017-18. These facts provide a clear indication of impairment as mentioned in Para 12(d) of Ind AS 36.

iii. Para 9 of Ind AS 36 lays down that if there is any indication that an asset is impaired, the entity shall estimate the recoverable amount of the asset.

iv. Para 18 of Ind AS 36 defines recoverable amount as the higher of an asset's or cash generating unit's fair value less costs to sell and its value in use. The above point clearly indicates the presence of impairment indicator. The Audit Firm should have evaluated the recoverable amount of the investment. However, as seen from the audit file, the recoverable amount was not assessed as required by Para 18 of Ind AS 36.

v. Given that the asset in question is equity shares, value in use is not relevant. Fair value is defined by Para 9 of Ind AS 113 as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Clearly the quotation in the stock exchange is the fair value that is consistent with this definition, and should therefore have been taken as the recoverable amount of the asset.

vi. In the WP, ITNL H Investments March 2018 under "Impairment" tab, the carrying amount of investment in NTBCL was assessed as Rs 162.33 crore and the fair value (assessed by Management) was assessed as Rs 59 crore approximately. Para 59 of Ind AS 36 states that if, and only if, the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable amount. This clearly shows that impairment loss should have been recognized according to Para 59 of Ind AS 36. Since impairment loss is not recognized, profit is inflated by at least Rs 103.33 crore for the FY 17-18.

vii. The WP, Management Representation note on NTBCL, referred by the Audit Firm is neither addressed to the Auditor nor is dated. Hence, the contention of the Audit Firm that they have sought management representation is not acceptable. In the said WP, the management has neither valued the recoverable amount of investment in NTBCL as Rs 162.33 crore nor explained the rationale for such valuation. In WP, ITNL ACM Presentation M18, the auditor has observed "Based on legal opinion and reliance on the provisions of the Concession Agreement, ITNL is confident that the underlying value of investment are not impaired".

viii. Legal opinion sought by the management, and referred to by the Audit Firm in response to NFRA's questionnaire, is neither dated nor provides any conclusive evidence of the recoverability of investment in NTBCL. More importantly, the legal opinion does not form part of the Audit File submitted to NFRA, which makes it unacceptable as audit evidence. Even if, for argument's sake, the legal opinion is considered, NFRA notes that the opinion merely discussed the alternative sources of compensation claimed from the Noida authority, treating the impact of the High Court judgement as a change in law situation, and the assumed recoverability of the same. This does not deal with the company's main source of revenue (as the main source of revenue was under litigation) available for NTBCL.

5.1.7. NFRA is therefore justified in concluding that the Audit Firm failed to exercise professional scepticism and question the Management's assumptions behind valuation of their investment in NTBCL, which was clearly impaired as shown by the indicators discussed above. The Audit Firm completely failed to discharge its duty of due diligence and to display professional judgment in obtaining sufficient appropriate audit evidence regarding the valuation of the investments in NTBCL and simply went by the Management's representation, which in this case was not even signed or addressed to the Auditor. Thus, the Audit Firm failed to bring to Management's notice that appropriate impairment was required to be charged in the case of the investments in NTBCL and that by not doing so, profit of the Company was inflated by at least Rs 103.33 crore for FY 17-18.

5.2. NFRA has examined the responses of the Audit Firm to the above observations and concluded in the DAQRR as follows:

NTBCL Investment value of Rs 162.33 crore as on 31-MAR-2018

5.2.1. At the time of first time Ind AS adoption in FY 2016-17, if the Company had fair valued NTBCL at year end, as stated in accounting policy of Company (Section D.5 Page 136 of Annual Report FY 16-17) then the fair value should have been Rs 55.23 crore calculated at the market price of Rs 11.25 per share as on 31-MAR-17 (WP ITNL H Investment March 2018, "Quoted Investment" tab) instead of Rs 162.33 crore. Evidently, the investment of NTBCL had not been fair valued and the Audit Firm failed to exercise sufficient professional scepticism in this regard.

5.2.2. In the Balance sheet of ITNL for financial year ended 31-MAR-2016 and 31-MAR-2015, the investment in NTBCL was Rs 187.16 crore for 4.719 crore shares i.e at a cost of Rs 39.66 per share. The Audit Firm also did not document anywhere in audit file the logic behind valuation of 4,90,95,007 shares at Rs 33.064 per share totalling to Rs 162.33 crore and the reason for decline in cost from Rs 187.16 crore in FY 2015-16 to Rs 162.33 crore in 2017-18.

Impairment testing of Investment in NTBCL

5.2.3. The company was required to assess indicators of impairment of an asset at the end of the FY 2017-18. In assessing such impairment, the Management was required to consider the provisions of Paras 9, 12(g) and 18 of Ind AS 36. Para 12 of Ind AS 36 lists, inter alia, external and internal sources of information, that an entity shall consider **as a minimum**, when assessing whether there is any indication that an asset may be impaired (emphasis added).

5.2.4. Para 9 of Ind AS 36 lays down that if there is any indication that an asset is impaired, the entity **shall estimate the recoverable amount of the asset** (emphasis added).

5.2.5. Para 18 of Ind AS 36 defines recoverable amount as the higher of an asset's or cash generating unit's fair value less cost of disposal and its value in use. Paragraphs 19-57 of Ind AS 36 sets out the requirements for measuring recoverable amount.

5.2.6. The working papers provided to NFRA include:

i. **Summary Review Memorandum (SRM)**: This document has been verified and referred in PFC as well. It does not calculate any recoverable value of the said investment.

ii. **Audit Committee Presentation**: It states that "The *management is confident of a positive outcome of arbitration process; Concession agreement has robust clauses for compensation in case of events of default and expecting favorable award; Based on legal opinion and reliance on provisions of Concession agreement, ITNL is confident that underlying value of Investment are not impaired;……..; Considering uncertainty and significance of amount involved, EOM has been given in audit reports."* This again does not quantify the recoverable value of investment.

iii. **Communications with TCWG/ CFO** are also mere management representations and provide no conclusive evidence of calculation of recoverable value. The extracts of reply of Dilip Bhatia (CFO) to enquiries made by Ravi Bansal (Engagement Partner- SRBC & CO LLP) and Nishant Mankodi (Associate Partner - SRBC & CO LLP) are as follows:

*iv. "Management is confident of a positive outcome of the arbitration process, in addition **that Concession agreemen**t has robust clauses for compensation in case of events of default and expecting favourable award. Also he insisted that the Company has sought **a legal opinion** and relied on the provisions of Concession Agreement, based on which management is confident that the underlying value of the investment are not impaired. Dilip has also added that Company continue to its obligations as per the service concession agreement."*

v. *Based on the above discussion and considering the progress of the arbitration process it was agreed to continue with the Emphasis of Matter paragraph in the audit report."*

5.2.7. The contention of Management that investment should be carried at cost as per Ind AS 27, Ind AS 28 and Accounting Policy of Company is correct, but the point here is related to impairment testing to be done every subsequent year and the methodology of impairment testing to be complied with as per the provisions of Ind AS 36 read with Ind AS 113.

5.2.8. The Audit Firm in Para II (7) of its response on Investment in NTBCL submitted to NFRA, has given a **calculation of recoverable amount** of Investment in

NTBCL. But such a calculation is not at all as per the workings in audit file. This clearly is an afterthought of the Audit Firm to justify the false and misleading assertions of Management.

5.2.9. The Audit Firm's contention that "*considering that the Company held 26.37% in NTBCL and NTBCL being an associate of the Company wherein the Company exercised significant influence, the stock market value may not be an appropriate basis of determining fair value of the investment considering the significant holding by ITNL in NTBCL as such large stake is not sold over the counter at stock exchange quoted prices*" , is not acceptable as the shares of NTBCL are listed and traded on the stock exchange. For any seller, "quoted price" is the price that would be received to sell an asset (i.e stock) or paid to transfer a liability in an orderly transaction between market participants at the measurement date. On careful reading and understanding of Para 20 of Ind AS 36, it is stated that, "*It may be possible to measure fair value less costs of disposal, **even if there is not a quoted price** in an active market for an identical asset*". This statement indicates **"quoted price"** is the first and foremost option in calculating recoverable amount. There is no need of estimating any value in use if market price of listed shares is readily available in the market. Hence the contention of Audit Firm to rely on value in use, the working of which is also not present in audit file, is not justified.

5.2.10. In the WP, *ITNL H Investments March 2018 under "Impairment"* tab, the carrying amount of investment in NTBCL was assessed as Rs 162.33 crore and the fair value (assessed by Management) was assessed as Rs 58.62 crore approximately. Even after being fully aware of market price of NTBCL, the Audit Firm did not insist on making the necessary provision for the impairment of the asset. This clearly shows lack of professional skepticism by auditor and mere reliance on management representations that stated that investments should not be impaired. This is also evidence of the Audit Firm having, through its Audit Report, certified a statement that was clearly false in material particulars, knowing it to be false.

5.2.11. To strengthen the point (iv) and (v) above, even definition of Fair value under Para 6 of Ind AS 36 **refers to Ind AS 113,** i.e., Fair value measurement which explains that fair value has to be derived as per Ind AS 113 for the purpose of impairment of investment.

5.2.12. Para 72 of IND AS 113 clearly states, "To increase consistency and comparability in fair value measurements and related disclosures, this Ind AS establishes a fair value hierarchy that categorises into three levels (see paragraphs 76-90), the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs).

5.2.13. From reading the above Para 72 of Ind AS 113, it is clearly evident that "**quoted price in active markets**" of the asset is the best and most logical method to measure fair value. Given that the shares were quoted in an active market, there was no option to disregard the quotation in calculating recoverable amount of investment in the case of NTBCL.

Legal Opinion

5.2.14. The Order of High Court of Allahabad directed NTBCL to stop collection of user fee and this was challenged in appeal to Supreme Court by NTBCL and the matter is still pending. A legal opinion was obtained by the Company which estimated some benefits accruing to NTBCL according to the Concession Agreement (CA) executed between NOIDA and NTBCL. The legal opinion has nowhere discussed the impact of outcome of legal dispute over the investment value in NTBCL for ITNL. There are other flaws as well due to which the Legal opinion cannot be considered as a reliable audit evidence for purpose of investment impairment. These are discussed in the succeeding paras.

i. The Legal opinion of Clarus Associates taken by ITNL mentioned the Judgement of Allahabad High Court as opining that "*the clauses relating to charging of user fee(Article 13 of Concession Agreement) to be without basis in law and the clause providing 20% Return on Total Cost of Project to the Concessionaire (Article 14 of Concession Agreement),* ***as being severed from the Concession Agreement****."*, The Legal Expert of NTBCL, "Clarus Law Associates" in Point 10(b) of its Legal opinion states that "*The potential value of the 20% IRR on the equity till the termination date would be in the region of Rs 800-880 crores."* There is no supporting documentation for the calculation of this amount, and no verification of any of the underlying assumptions by the Audit Firm. Secondly, the Audit Firm did not go through the Concession Agreement to document circumstances that could lead to Direct Political Force Majeure Events or NOIDA Events of Default to verify the authenticity of representations and claims made by the Company. The **potential value of claim on termination is also doubtful after the severance of Clause 14 of the Concession Agreement and severance of 20% Return on Equity** declared by Allahabad High Court. Till the dispute is resolved, there is no certainty in the compensation receivable by NTBCL.

ii. "*The potential value of the 20% IRR on the equity till the termination date would be in the region of Rs 800-880 crores"* that is stated in Legal opinion, must be **based on some calculations or probability workings of the likely outcomes,** given by the Management to the Legal expert, on which he relied upon.

iii. But on perusal of audit file, it is very clear that Audit Firm did not obtain from the Company any probability based workings and calculations or other audit evidence to assure itself of the termination benefits accruing to NTBCL on the basis of the Concession Agreement. Even the legal opinion does not disclose any such workings. The legal opinion states the potential termination payable by NOIDA to NTBCL as Rs 800-900 crores (Section 18.3 of CA) and Rs 5000 crores (Section 18.1 of CA) whereas the Management note claims compensation in the range of Rs 13,510 mn to 40,600 mn (Page G381 to G385). Thus, the verification process of NTBCL matter by Audit Firm lacked critical evaluation of ALL the clauses of the Concession Agreement, and independent verification of workings, and shows uncritical and full reliance on the Management Representation letter.

iv. Since the evaluation of NTBCL legal case required expertise in a field other than accounting or auditing, the standard audit procedure that should have been adopted by the Audit Firm was "***Using the work of an Auditor's Expert***" **(i.e SA 620).** This would have helped the Auditor to evaluate the work of the Lawyer whose services were used by the Management and thereafter draw correct and well reasoned conclusions. This is all the more important because the probability of recovery by NTBCL cannot be fairly ascertained without evaluating the **counter party's i.e. NOIDA's arguments and claims**. Apart from this, the Auditor's Expert would have been in a better position to assess the various legal provisions in agreements, the exact financial impact of the legal dispute on the Company and whether assumptions used by the Legal expert of the Company were correct or not. However, the Audit Firm did not consider it necessary to consult an Expert during the audit and accepted the management's representations as it is, which demonstrates lack of due diligence and gross negligence on the part of the Audit Firm.

v. In addition to above, merely keeping the previous year's working paper in the current year audit file **without verifying the new updates/counter claims** will **prevent the Audit Firm from knowing the true picture.** The Audit Firm has not performed any additional audit procedure other than enquiry with the Management to assure and apprise itself of all the current updates/ progress and status of NTBCL before forming an opinion. The Audit Firm completely failed to discharge its duty of due diligence, and was grossly negligent in obtaining sufficient appropriate audit evidence regarding valuation of investments in NTBCL.

vi. It is stated in point 7 and 8 of Management representation Note (Page G380 to G384) that "*On July 20, 2017, NTBCL filed an Interlocutory Application for appropriate directions/ orders before the Supreme Court in this matter which is listed for Aug 11, 2017. The Application came up before the Hon'ble Supreme Court on 11.08.2017, the Supreme Court permitted copy of full CAG report to be provided to NTBCL. The CAG report clearly specifies that Total Cost of Project has not been recovered by NTBCL. The CAG report also contains some other observations by CAG, which are outside the scope of its remit.*"

vii. As clearly stated above, the CAG report was made available to NTBCL. In such a situation, the Audit Firm should also insisted and obtained a copy of the said CAG Report and should have considered the **CAG Report** as the Report would have provided useful inputs to the Audit Firm during the audit of FY 17-18. It would have given a fair idea of the recovery of costs along with other material facts and thereby helped the Audit Firm to verify the reasonableness of Management's assumptions. However, the Audit Firm failed to ask for the CAG report from the Component Audit Firm and evaluate it. Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfilment of management's responsibilities, or about specific assertions. (Para 3 – SA 580)

viii. 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)

ix. It is the Audit Firm's duty to evaluate the Management Expert's findings, relevance, completeness and **accuracy of source data** and other matters stated in Para A48 of SA 500. Due to absence of adequate reliable audit procedures for assessment of the work of Management Expert in the audit file, it is concluded that the Audit Firm failed to properly comply with each provision of Para 8 of SA 500.

5.2.15. In the light of uncertainty of outcome of NTBCL case and the time of settlement being unknown at the time of audit, it was not prudent to rely on any legal opinion, without having the value thereof independently tested, for ascertaining the recoverable amount of investment. The **legal opinion is simply an eye wash and coverup** used by Management of ITNL as it has nothing to do with investment valuation.

Lack of Professional Scepticism and complete reliance over Management Representations and NTBCL Audit Report

5.2.16. There is complete reliance on management representations that can be seen from multiple working papers. Some of them are as follows:

i. **Summary Review Memorandum (SRM)**: "This document has been verified by us and quoted in our PFC as well. It only states the management views and the Component's (NTBCL) audit report".

ii. **Audit Committee Presentation**: It states that "*The management is confident of a positive outcome of arbitration process; based on legal opinion and reliance on provisions of Concession agreement, ITNL is confident that underlying value of investments are not impaired; Considering uncertainty and significance of amount involved, EOM has been given in audit reports.*"

This document again states the management opinion and decision and contains no assessment by the Audit Firm.

iii. **Communications with TCWG/ CFO** are mere written conclusions and provide no conclusive evidence of calculation of recoverable value or impairment.

iv. **Management Representation Letter (Page G380 to G384)** describes the legal status of Noida Toll Bridge Company by the Management and a favourable award of Rs 1,351 to 4,060 crore. This is in contrast to what is stated in the Legal opinion. Moreover, this management representation letter/ note is neither dated nor addressed to anyone.

5.2.17. The SRM further goes on to say that "*Based on the assessment made by the management and considering the legal opinion provided by the management, engagement team has concluded that the matter involves significant judgement, the outcome being dependent on the decision of the Courts and considering the significance of the amount involved, emphasis of matter as given below to be continued in the audit report drawing attention to the explanatory note provided by management in the financial statements.*"

5.2.18. The EOM in Standalone Financials of ITNL states, "*In respect of the matter explained in Note 4 (footnote (j)) of the standalone Ind AS financial statements, in respect of suspension of toll collection of an associate company pursuant to the order of Hon'ble High Court of Allahabad and the **matter is pending with Hon'ble Supreme Court of India**. Our opinion is not modified in respect of this matter*". However, Note 4(j) reads as follows**, "***Pursuant to the order of the Hon'ble High Court of Allahabad, the collection of toll at an associate company was suspended since October 26, 2016 **and the matter is pending with the Arbitrator**. Based on the provisions of the Concession agreement (relating to the Compensation and other recourses) supported by legal opinion, the Company is confident that the underlying value of the Intangible and other assets of associate are fully recoverable. Consequently, the Company is of the view that it would be appropriate to carry its investment of the associate at Rs 162.33 crores*." In this regard NFRA observes that:-

5.2.19. The EOM is referring the matter pending before the Supreme Court of India which is the appeal against the Allahabad High Court judgement striking down the toll collection right, while note 4(j) mentions the matter pending before the Arbitrator, which is about the claim for compensation from the NOIDA Authority for the alleged change of law. These are two entirely different matters, with outcomes not related to each other in any way. The apparent inconsistency between the disclosures proves clearly the utter lack of the required due diligence on the part of the Audit Firm and their gross negligence.

5.2.20. The Audit Firm, after relying on management representation, legal opinion and NTBCL's Audit Report, has given an Emphasis of Matter Paragraph (EOM) under SA 706 which should not be confused with impairment testing of Investments and is altogether on a different topic. The statement that an EOM is made in the audit report of ITNL owing to the uncertain outcome of NTBCL, should not be considered as the correct accounting treatment as far as Investments are concerned.

5.2.21. Based on the above observations, NFRA concluded in the DAQRR that Audit Firm is guilty of the following:

i. Not disclosing complete information to users of Financial Statements as required under relevant Financial Reporting Framework;

ii. Not carrying out the audit according to Standards of Auditing;

iii. Not maintaining professional scepticism, professional competence and due care and other ethical requirements during the audit;

iv. Failure to obtain sufficient information and appropriate audit evidence which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion;

v. Certifying financial statements that are false in material particulars, knowing it to be material.

5.3. NFRA has examined in detail the replies dated 10th July, 2021, and the oral submissions made by the Audit Firm (replies to the DAQRR) regarding the above observations in the DAQRR. These are essentially a repetition of the earlier responses that had already been very carefully examined before concluding as in the DAQRR. NFRA has, nevertheless, again examined the above observations in light of the repeated replies by the Audit Firm and, observes as follows. Also, the submissions of the Audit Firm are not supported by audit evidence in the audit file. The references to WPs in the reply are the same as already provided in their response to the PFC of NFRA.

5.3.1 Regarding the observations on the value of the investments of Rs 162.33 crore as of 31-03-2018, the Audit Firm submits in its reply that the investment of Rs.157.87 crores was fair valued as of April 1, 2015, as a onetime option. After the transition to Ind AS, this investment was carried at its deemed cost as per the accounting policy adopted by the Company. In the year ended March 31, 2017, the Company had purchased additional investment which was accounted at cost and consequently, the total investment increased to Rs.162.33 crore as at March 31, 2017. Hence *"SRBC was not required to document the logic behind the valuation or the reason for decline in cost from Rs.187.16 crore in FY 2015-16 to Rs.162.33 crore in 2017-18*". However, this reply does not address the observation that "the investment of NTBCL had not been fair valued and the Audit Firm failed to exercise sufficient professional scepticism in this regard". The Audit Firm's contention that "*it was not considered necessary to call for the CAG report from the component auditor....."* underlines the absence of the required professional skepticism as rightly observed by NFRA. The replies of the Audit Firm and the facts observed by NFRA clearly shows that the Audit Firm has failed to gather sufficient evidence to confirm that the investment is properly recorded and carried at cost or fair value.

5.3.2 After ignoring the subject matter as above, the Audit Firm cites accounting policy of the company which states that "*Investment in subsidiaries, associates and joint* *ventures are measured at cost as per Ind AS 27."* and then states that "*The above allegation of NFRA clearly demonstrates that the NFRA reviewer is intentionally only referring to select sentences from the accounting policy and accounting standard to justify the baseless allegation, while intentionally ignoring the relevant para/ lines*". This contention of the Audit Firm is baseless because NFRA has already taken note of the complete accounting policy as evident in para 5.2.7 above.

5.3.3 The assertion of the Audit Firm is that the company chose the option of deemed cost under Ind AS 101 for determining the cost of the investments in NTBCL. However, at the end of each reporting period, the company is required to assess the impairment loss in terms of Ind AS 36, which was not done in the present case as already explained in detail.

5.3.4 Regarding impairment testing, the Audit Firm submits that "*SRBC submits that since in the given case, value in use was considered to be the recoverable amount (as it was higher than the quoted price), the application of Ind AS 113 for computation of fair value is not applicable and hence para 5.2.11, 5.2.12 and 5.2.13 of NFRA's DAQRR are not relevant for this matter".* Further, the Audit Firm states that *"SRBC further submits that the quoted market price was considered as an indicator by SRBC basis which SRBC had discussions with the management; and after evaluating the submissions of the management, including the legal opinion, SRBC concurred with management's view that there was no impairment in case of NTBCL. However, considering the uncertainty attached to the litigation, SRBC continued with the Emphasis of Matter para in the audit report for the year ended March 31, 2018. Accordingly, SRBC demonstrated high level of professional skepticism with respect to the above matter and did not merely rely on management representations as alleged by NFRA. Had that been the case, SRBC would not have given the Emphasis of Matter paragraph in its audit report…."* The Audit Firm also admits that *"investment made by the Company in NTBCL is not classified as "stock", rather it is classified as an investment in "Associate" wherein the Company exercised significant influence over NTBCL".*

5.3.5 In this regard, as already explained in the DAQRR, the value in use calculations submitted by the Audit Firm is not supported by evidence in the Audit File.

5.3.6 Also, the said calculations are made based on the net worth; including a large, expected claim to be received from the Authority (which is sub judice), which is then discounted at weighted average borrowing costs of ITNL. In this regard para 42 of Ind AS 28 inter alia states that "In determining the value in use of the net investment, an entity estimates:

a. its share of the present value of the estimated future cash flows expected to be generated by the associate or joint venture, including the cash flows from the operations of the associate or joint venture and the proceeds from the ultimate disposal of the investment; or
b. the present value of the estimated future cash flows expected to arise from dividends to be received from the investment and from its ultimate disposal.

Using appropriate assumptions, both methods give the same result"

5.3.7. Considering the above facts, the calculation of value in use, as claimed to have been done by the Audit Firm, has serious flaws since:

i. The audit firm has not examined whether ITNL can control the declaration of dividends by the associate because of its significant influence. If this is not established, the selection of cash flow as a proxy for value in use has no basis.

ii. There is no evidence of examining the "appropriate assumptions" to align the investment's cash flows to those of the investee, as stated in para 42 of AS 28.

iii. The discount rate does not reflect whether or not ITNL has control over the cash flows or dividends.

iv. Whether the court case has any impact on the dividend.

5.3.8. NFRA does its AQR based on the evidence available in the Audit File. The Audit File should be capable of speaking for itself as already explained in detail in this AQRR. In the AQR process, NFRA is not required to make its own Audit of the entity as this is not the objective of an AQR. Therefore, based on documents available in the AQR, NFRA observes that there is no supporting/basis/information in the Audit File for the value in use calculation. As fair value is the only available credible value for recoverable amount, NFRA is at liberty to assume that fair value is the recoverable value. The onus to prove otherwise vests with the Audit Firm. However, in this case, the Audit Firm miserably failed to prove that the value in use is higher than the Fair value less cost of disposal.

5.3.9. Incidentally, the Audit Firm has stated at several places in its reply to the DAQRR that NFRA may get evidence from external sources other than Audit File to confirm the contentions made by the Audit Firm. Some of such statements are *"This fact can be verified with ITNL management and its Board of Directors by NFRA using its powers and rights" "NFRA can use its powers and rights to confirm this accounting position with any IND AS experts or from the ICAI Ind AS expert group" "If NFRA reviewer has doubt about the same then they may exercise their powers and right to confirm the same with the Company"*. Such comments of the Audit Firm arise from a poor understanding of the purpose and importance of Audit documentation, the objectives of the AQR, and its failure to perform the required audit procedures. The Audit Firm cannot expect NFRA to fill the gaps in their statutory duties.

5.3.10. Hence NFRA concludes that the Audit Firm:

i. did not carry out the audit according to the Standards on Auditing,

ii. did not maintain professional skepticism, professional competence and due diligence during the audit,

iii. 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, and

iv. certified the financial statements that are false in material particulars, knowing it to be material.

Pario Developers Pvt Ltd (PDPL)

5.4. NFRA had conveyed the following prima facie conclusions:

5.4.1 Rajasthan Land Holding Limited (RLHL) was a wholly owned subsidiary of the Company with 20 lakh shares of Rs.10 each. As such the entire share capital of Rs.2 crore was held by the Company and shown in the books as Investment in Subsidiaries as on 31-Mar-2017. During the year, the Company sold its entire stake in RLHL to PDPL, a wholly owned subsidiary of Paranjape Group. On 30- JUN-2017, ITNL intimated the NSE and BSE regarding the sale transaction. ITNL held preference shares amounting Rs.158.37 crore and equity shares amounting Rs.33 lakh in PDPL as on 31-Mar-2018, which had been acquired during the year after disinvestment in RLHL.

Non availability of Sale Agreement in Audit File

5.4.2 An agreement of sale constitutes the terms and conditions of sale of a property by the seller to the buyer. These terms and conditions include the amount at which the property is to be sold and the future date of full payment. Though the Audit Firm has indicated in the working papers that the 'Agreement for Sale' of RLHL shares should be referred, no 'agreement for sale' was found in the audit file. Thus, no conclusive evidence of the sale transaction exists in the Audit File on the basis of which the Audit Firm could have verified the claims of the Management about the sale value of ITNL's stake in RLHL of Rs 150 crore and consequent profit of Rs 147.5 crore recognised in Statement of Profit & Loss of the Company. The Audit Firm has merely referred to Minutes of Meeting of Committee of Directors dated 15-Jun-2017 (Item no. 21) as the supporting evidence for the sale transaction which is not at all sufficient audit evidence under provisions of SA 500.

Doubtful valuation of Sale Consideration of Rs 150 Crore

5.4.3 The Company has taken the Valuation Report from N.M Raiji & Co. for assessing the value of RLHL. The valuer has arrived at a valuation of Rs 1494.8 million. RLHL is involved in construction, real estate and civil engineering and it has three wholly owned subsidiaries. From Company's intimation to NSE and BSE dated 30-JUN-2017 (Hard file 6 Page H370), the Company has stated that "Please note that the Company has today signed an agreement with Paranjape Group, a renowned group engaged in real estate development in Mumbai, Pune and other metros (including development of SEZs) for transfer of its entire equity stake comprising of 20,00,000 equity shares of Rs 10 each in RLHL, a subsidiary of the Company having ownership of certain land parcels". Valuation Report is signed by N.M Raiji & Co on 28-Jun-2017. This clearly indicates that valuation report has been obtained after the date of sale agreement and cannot be considered as reliable audit evidence. Further, no assessment of the work of Management's expert has been done by the Auditor as required under Para 8 of SA 500 as no such working paper is found in the Audit File. NFRA further notes that N.M Raiji & Co are the Statutory auditors of one of the associates of ITNL i.e NTBCL, over which ITNL exercised significant influence. Hence, their engagement for providing valuation services to the Company is clearly in violation of Code of Ethics, raising questions about the independence of the valuation service provider. The Audit Firm, however, remained completely oblivious to such risks and accepted the valuation report as such, without subjecting the report to independent verification. Thus, the valuation of the sale consideration of ITNL's investment in RLHL to PDPL is highly doubtful.

Acquisition of Preference Shares in PDPL

5.4.4 NFRA has noted from W/P Summary Review Memorandum (SRM) (Binder no 4 page 308) that Company's policy to impair investments in other than project SPVs is by comparing the net worth of the Subsidiary, Associates and Joint venture with the investment amount in the books. PDPL (Acquiree Company) has Rs 13.43 crore negative net worth as on 31-Mar-2018 which clearly requires that Company should recognise impairment loss as per the Company's own policy stated above. Since ITNL had recognised the investment, by way of preference shares, of Rs 158.37 crore in PDPL on 30-Jun-2017, the Audit Firm was required to verify impairment as per Para 5.5 (5.5.1. to 5.5.20) of Ind AS 109 to take into account credit risk, if any, in the valuation of Investments in Pario Developers Pvt Ltd as on 31-Mar-2018. This was particularly critical in light of the poor financial position and losses of PDPL during the FY 2017-18. In the absence of any evidence to the contrary, it has to be assumed that the fair value of the preference shares was zero, and the impairment loss of Rs. 158.37 crores was ignored.

5.4.5 It is clear that the Audit Firm failed to evaluate the impairment losses for the investment in PDPL as per the provisions of Ind AS 109 and the Company's own policy on impairment of investment. This resulted in overstatement of profit by Rs. 158.37 crore.

5.4.6 Para 12(a) of SA 260 requires the Auditor to communicate with Those Charged with Governance about significant qualitative aspects of entity's accounting practices, including accounting policies, accounting estimates and financial statements disclosures. However, on perusal of WP ITNL ACM Presentation M18, ITNL Signed LOR- Standalone-March 2018, no such communications by the Audit Firm to TCWG could be traced. Hence, the requirements of Ind AS 109 and SA 260 have been violated.

5.4.7 NFRA has examined WP "Minutes of Committee of Directors dated 15-JUN-2017" (Item no 21) – "In consideration of transfer of shares of RLHL to PDPL, the Company will be issued preference shares worth Rs 150 crore by Pario. In addition, the Company will be acquiring 33% equity stake of Pario comprising of 3,300 equity shares at a price of Rs 10 per share from Paranjape Group which presently holds 100% equity stake of Pario and thereafter subscribe to an additional 3,30,000 equity shares of Rs 10 each for cash at par and balance 7,70,000 equity shares to be subscribed by Paranjape Group." From the Annual Report for the FY 2017-18 and in the audit file submitted to NFRA, it is clearly evident that as on 31st March 2018, the Company had acquired and accounted for 3,300 equity shares of Rs 10 each in PDPL. Note no 4 of Standalone Financial Statements discloses the number of shares as 3,300 at Rs 10 per share which amounts to Rs 33,000, whereas the actual amount of investment disclosed in the Balance Sheet was Rs 33,00,000 which is a clear misstatement. Thus, investments have been materially misstated by an amount of Rs 32,67,000 in the financial statements.

5.4.8 Para A123 of SA 315, provides the assertions the auditor uses to consider different types of potential misstatements that may occur. In this particular case, the assertions related to account balances at the period end and presentation and disclosure were not adhered to by the Audit Firm, as required by Para A123 of SA 315.

5.4.9 In view of the observations stated in preceding paragraphs, NFRA is of the view that the Company has resorted to a complex chain of transactions involving sale of its equity in RLHL to PDPL and acquisition of preference shares and equity shares in PDPL, none of which are adequately supported by evidence. It will therefore not be unjustified to conclude that profits have been overbooked by Rs 158.37 crores, due to not making the required provision for the impairment of ITNL's investment in PDPL. In addition, the Financial Statements carry a clear misstatement of Rs 32,67,000 on account of wrong booking of ITNL's equity in PDPL, which the Audit Firm has failed to point out.

5.5. NFRA had conveyed the following in its Draft Audit Quality Review Report (DAQRR):

Fraudulent basis for Sale Valuation of RLHL shares and Overstatement of Profit by Rs. 147.5 crore

Valuation Report of RLHL

5.5.1 The Audit Firm has referred to N.M Raiji Valuation report in the audit file that has used "Discounted Cash Flow of RLHL" as the basis for deriving the value of RLHL shares sold to PDPL. NFRA observes the following key deficiencies in the Report:

i. Profit after Tax (PAT) is projected as INR 2,844.6 million from FY 19 to FY 24 arising from Revenue from New Projects - The nature of projects and details of parties involved in the new projects are not mentioned either in Report or in audit file.

ii. New Project Reports not available – details of nature of sources of revenue from different Projects like restaurants, petrol pumps or amusement parks; detailed feasibility analysis obtained from an Expert of each such venture; number of projects (one or multiple); estimated traffic projections; revenue projected for each project and the underlying assumptions used were not clearly documented anywhere by Audit Firm.

iii. Verification of the Projects from Object Clause of Company and whether to be carried out itself or through a joint development model has not been verified by Audit Firm.

iv. Status of regulatory approvals and sanctions to be obtained from Government and other Agencies has not been verified by the Audit Firm. This would have given the status of the actual progress of the planned future Projects.

v. Location of New Project- Valuation report completely ignores the location of the New Project which plays a very important role in estimating the revenue and growth of Project. Whether the project will be established near a developed metro city/ tourist spot/ religious place or in a remote and backward place will impact the traffic flow. No consideration was given to such factors by the Audit Firm during verification of N.M Raiji's Valuation Report.

vi. The extracts of Valuation Report are given below:

Discounted Cash Flows (Rs in million)	***FY 18***	***FY 19***	***FY 20***	***FY 21***	***FY 22***	***FY 23***	***FY 24***
No of months	*9*	*12*	*12*	*12*	*12*	*12*	*12*
PAT	*-*	*222.0*	*497.6*	*519.2*	*618.4*	*713.9*	*273.5*
Add: Depreciation	*-*	*-*	*-*	*-*	*-*	*-*	*-*
Inflows	*-*	*222.0*	*497.6*	*519.2*	*618.4*	*713.9*	*273.5*
Less: *Working Capital Changes*	*-*	*(11.6)*	*(172.7)*	*(139.2)*	*(100.4)*	*(115.9)*	*(45.5)*
Fixed Asset	*-*	*-*	*-*	*-*	*-*	*-*	*-*
Borrowings	*-*	*-*	*609.5*	*43.7*	*-*	*-*	*-*
Outflows	*-*	*(11.6)*	*436.8*	*(95.4)*	*(100.4)*	*(115.9)*	*(45.5)*
Net inflows	*-*	*233.6*	*60.8*	*614.6*	*718.7*	*829.8*	*318.9*
Discount Rate (%)	*14.5%*	*14.5%*	*14.5%*	*14.5%*	*14.5%*	*14.5%*	*14.5%*
Discount factor	*0.5*	*0.79*	*0.69*	*0.60*	*0.53*	*0.46*	*0.40*
Discounted Cash Flows	***-***	***184.5***	***41.9***	***370.4***	***378.5***	***381.7***	***128.2***

Valuation (Rs in million)	
Explicit Period	1485.2
Terminal Value	9.6
Equity Value	1494.8

5.5.2 The Audit Firm did not perform any test or working to check the fairness of the Valuation Report while evaluating the share value as no separate working was referred by the Audit Firm in their response. The Firm was required to rigorously verify each of the above questions related to the New Project before accepting the value of ₹ 150 crore (or ₹ 1,494.8 million). But the Audit Firm did not raise a single doubt or query from the Company. The Audit Firm has, thus, colluded with the Management, and has overstated the profit by ₹ 147.5 Crores.

Caveats, Limitations and Disclaimers in Valuation Report

5.5.3 N.M Raiji Report in Hard copy File 6 (Page 268) states the following:
*"**Our scope of work does not enable us to accept responsibility for the accuracy and completeness of the information provided to us.** We have, therefore, not performed any audit, review or examinations of any of the historical or projected information provided to us and, therefore, do not express any opinion with regard to the same.*
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………
***Neither N.M Raiji & Co, nor its partners, managers, employees make any representation or warranty, express or implied, as to the accuracy, reasonableness or completeness of the information**, based on which the valuation is carried out. All such parties expressly disclaim and all liability for, or based on or relating to any such information contained in the valuation".*

5.5.4 This shows that Valuation Expert refused to accept responsibility for accuracy, reasonableness or completeness of information provided to them. The Expert has stated "*We have, however, evaluated the information provided to us by the Company through broad inquiry, analysis and review, but have not carried out a due diligence or audit of the information provided for the purpose of this engagement.*" Due to the given limitation and disclaimer by N.M Raiji in his report, it becomes all the more important for Audit Firm to evaluate all the assumptions, projections, content of Valuation report diligently. However, by not evaluating the underlying assumptions critically, Audit Firm has colluded with Management in overstatement of profits by ₹ 147.5 Crores and resulted in a material misstatement in financial statement for the year ended FY 17-18.

5.5.5 The Committee of Directors (COD) Meeting held on 15-Jun- 2017, Resolution no 21 states that "*The Committee was then informed that the Company was in* *discussions with Pario Developers Private Limited(Pario), for development of the land parcels held by RLHL…………….. The Committee was further informed that as per the ongoing discussions with Pario, the Company will transfer 100% equity holding in RLHL comprising 20,00,000 equity shares of ₹ 10 each to Pario and one of the Paranjape Group Company which also holds certain land parcels valued at approximately ₹ 150 crores in Maharashtra including in SEZ will be transferring its 100% equity holding to Pario.*"

5.5.6 This shows that the price of RLHL shares has already been fixed by the COD before the date of Valuation Report. The unsigned Valuation Report obtained on 28-Jun-2017 was obtained just to support the management decision.

5.5.7 Professional **Scepticism** is defined 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 audit evidence."* However, SRBC failed to exercise professional scepticism and highlight to the TCWG that Committee of Directors Meeting had already fixed the price of ₹ 150 crores before the Valuation Report was sought.

5.5.8 Appendix 1 to SA 240 - "The Auditor's Responsibility relating to fraud in an audit of Financial Statements" describes incentives/ pressures as fraud risk factors. Some examples are *"High degree of competition or market saturation, accompanied by declining marg*ins" and "*There is excessive pressure on management or operating personnel to meet financial targets established by those charged with governance, including sales or profitability incentive goals"*. In the current situation, an abnormal gain of ₹ 147.5 crores should have alerted the Audit Firm to a possibility of fraud due to pressure on Management to meet financial targets. Hence, Audit Firm should have more carefully verified the whole transaction of RLHL shares, starting from the rationale behind PDPL agreeing to such a high valuation price of ₹ 150 crores to the possibility of any hidden gains or business connections of Directors and KMPs of PDPL and Paranjape Group with ITNL (or any Group Company). However, the Audit Firm failed to assess possibility of fraud as per provisions of SA 240.

5.5.9 Out of total profit of ₹ 251.76 crore of ITNL in the year 2017-18, ₹ 147.5 crore was from sale of RLHL shares ie almost 60% of PAT. Had the profit of ₹ 147.5 crores been removed, the profit of the Company would have reduced to ₹104.26 crore only. Thus, Audit Firm, colluded with management in overstating the profits by ₹ 147.5 crore.

5.5.10 Using **the Work of a Management Specialist -** (WP 130GL(R) form) has been mentioned in the audit file submitted to NFRA. Following extracts are mentioned from the WP:

PART A: Evaluate the competence, capabilities and objectivity of management's specialist *i. N.M Raiji & Co Chartered Accountants is a well known firm of Chartered Accountants in India offering services like statutory, tax, operational and internal audits. Management consultancy services like business valuation, financial due diligence, financial reconstruction and other business advisory etc. Vinay D Balse is a senior most partner in his firm having experience of 35 years with the firm. He is fellow chartered accountant.*

PART B: Obtain an understanding of the work of management's specialist:

ii. Apart from above assessment of management specialist, we have reviewed the other services rendered by above specialist to the Company, if any. In addition to this, we have also inquired with management of the Company and understood that, that these specialists and their firms are not related in any manner to ITNL except supply of expert service and not financially dependent on ITNL to influence their work.

iii. ITNL's management has independently sent a query in respect of the matter under consideration to these experts for their opinion on the matter. Management has reviewed and independently assessed opinion given by these experts and concluded that correct accounting treatment or disclosure has been given in the financial statements for the period ended March 31, 2018. We have performed independent assessment of the opinion given by these experts and conclusion drawn by the management by considering the facts of the issue and relevant underlying provisions and accordingly considered the same in our audit report.

iv. Valuation experts have followed valuation rules/ regulations and relevant underlying regulations/judicial precedents.

PART C EXECUTION: Evaluate and conclude whether the results of the specialist's work support the relevant assertions in the financial statements

v. Read the opinion obtained by the management of the Company from the independent expert and assessed the underlying assumptions and projections used for the purpose of valuation if appropriate.

vi. Assessed their competency and impact of their opinion on the financial statements of the Company.

vii. Refer individual workpapers of SPV's for which valuation was considered from independent valuer.

viii. There are no such conclusions in the findings and conclusions (Report) which have implications on financial statements of the Company and our reporting. Para 8 of SA 500: 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)*

- *Evaluate the competence, capabilities and objectivity of that expert; (Ref: Para A37- A43)*
- *Obtain an understanding of the work of that expert; and (Ref: Para. A44-A47)*
- *Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion. (Ref: Para A48)*

5.5.11 The Audit Firm has 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).

5.5.12 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. No such analysis of threats to objectivity of Management Expert or mitigating safeguards has been carried out by the Audit Firm. This was especially important in the context of the valuer, N. M. Raiji and Co being the statutory auditor of NTBCL.

5.5.13 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. 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.

5.5.14 WP 130GL(R) – Using the Work of a Management Specialist form, provides a mere STATEMENT "*Read the opinion obtained by the management of the Company from the independent expert and assessed the underlying assumptions and projections used for the purpose of valuation if appropriate"*. However, we have checked the Valuation Reports and the audit file but did not find Audit Firm's assessment of underlying assumptions and projections used in the valuation of RLHL. This shows that Audit Firm did not evaluate the appropriateness of Expert's work as audit evidence required by Para 8(c) of SA 500 and has made a false and misleading statement.

5.5.15 In its response, Audit Firm states that *"Technically speaking in an arm's length transaction, one does not even need an external valuation report and the value is usually decided by mutual consent between the two unrelated parties involved in the transaction (Point 1 of Section III of Response to NFRA)"* This assertion is not correct. This is because no financial transaction happens without a scientific and logical basis behind it. A sale transaction also is a transaction in which buyer pays seller the true value of goods/services/assets purchased and that price is ascertained using some rational, scientific and well-accepted method showing the value equal to or closest to the true value. Only after this, the price is mutually agreed between the parties. If the transaction is not done in such a way it means that it is not at arm's length.

5.5.16 Apart from the above, there did not exist any reliable audit evidence on the date of transaction (i.e 30-JUN-2017) as the Valuation report dated 28-Jun- 2017 issued by N.M Raiji was an unsigned copy. If there were no major changes or second thoughts over the valuation, then the signed valuation report should have been made available before the date of transaction. But the signed copy came only on 28-Jul-2018. The Sale Agreement is only a proof of the transaction having taken place but does not provide explanation or rationale as to how and why such value was fixed for RLHL shares sold to PDPL by ITNL. Moreover, NFRA does not have the Sale Agreement with it for review.

Issuance of Preference Shares of Rs 150 crore to ITNL in exchange of sale of RLHL shares without involving cash

Statutory Provisions for Issue of Preference Shares (Companies Act 2013)

5.5.17 The fact that raises a very strong suspicion that this is a FRAUDULENT TRANSACTION is that the complete transaction occurred **without any involvement of cash**. RLHL shares valued at a cost of ₹ 2.5 crore were sold at a huge value of ₹ 150 crore without any concrete basis for the valuation resulting in a whopping profit of ₹147.5 crore. In return, ITNL was issued 15 crore preference shares at a face value of ₹ 10 each.

5.5.18 The Audit Firm failed to question the issue of preference shares in light of provisions of Companies Act 2013. Section 55 of Companies Act 2013 states that:

i. *Where a company is not in a position to redeem any preference shares or to pay dividend, if any, on such shares in accordance with the terms of issue (such shares hereinafter referred to as unredeemed preference shares), it may, with the consent of the holders of three-fourths in value of such preference shares and with the approval of the Tribunal on a petition made by it in this behalf,* ***issue further redeemable preference shares equal to the amount due****, including the dividend thereon, in respect of the unredeemed preference shares, and on the issue of such further redeemable preference shares, the unredeemed preference shares shall be deemed to have been redeemed:*

   Provided that the Tribunal shall, while giving approval under this sub-section, order the redemption forthwith of preference shares held by such persons who have not consented to the issue of further redeemable preference shares.

5.5.19 PDPL also took the safest mode of not getting trapped in any sort of legal complications in event of default by issuing preference shares to ITNL. This is because even if PDPL fails in the redemption of preference share at the time of redemption, it can issue further redeemable preference shares equal to the amount due including dividend. Such a further issue of preference shares will not tantamount to additional issue of shares but redemption of unredeemed preference shares. Hence no outflow of cash will be involved. In such a manner, PDPL and ITNL both will be in a win-win situation.

Valuation of Preference Shares issued by PDPL

5.5.20 The Audit Firm has stated in Para 4 of Section IV, that "*As per the terms of preference shares issued by PDPL against the transfer of RLHL shares to PDPL by the Company, these shares were to be redeemed in three annual tranches beginning on March 31, 2021 with an aggregate redemption value of Rs.243.75 crore. The redemption proceeds had been discounted and the implicit rate of return and accordingly, the preference shares were recorded at Rs.150 crore as on June 30, 2017(discounting working in work paper in hard copy file 6, page no. H156)(Refer Para 4 of Section IV).*" However, this explanation does not match with explanation given earlier where the sole basis for value of PDPL Preference shares effectively was the Valuation Report of the RLHL Equity Shares by N.M Raiji.

5.5.21 The Discounting WP in Hard copy file 6, does not provide clear understanding of interest calculation (as preference shares was recognised as debt in books of PDPL) according to any agreed terms or conditions nor any clue about the way value of ₹ 150 crore has been derived as the present value of preference shares. The calculation has directly started from ₹ 152.05 crore with complex interest workings and no explanations of assumptions used in the working. It is more like a manipulated piece of paper with no self-verification or re-computation done by Audit Firm.

Issue of 3,30,000 Equity Shares to ITNL by Pario Developers Private limited (PDPL)

5.5.22 It has been understood from the Committee of Directors Meeting dated 15-Jun-2017 stated that 3,30,000 shares will be issued to ITNL by PDPL. However, it has been noticed in Hard copy File 6 Page H147 that the total outstanding equity shares of Pario Developers Private Limited as per DEMAT Statement on 31.3.2018 (Print Date on 5-Apr- 2018, HC File 6, Page H147) was only 3,300 shares instead of 3,33,300. The same quantity of 3,300 has been quoted in the Balance Sheet also for year end. The Audit Firm has not verified the bank statement of ITNL to vouch the outflow of cash on account of investment in PDPL for 3,30,000 equity shares.

5.5.23 The unavailability of audit evidence of actual number of shares in PDPL puts a question mark on the existence of investment of 3,30,000 equity shares in PDPL by ITNL as on 31-Mar-2018.

Impairment of Investment in PDPL

5.5.24 The Audit Firm has stated the reasons for non-impairment of investments in PDPL as follows (Section IV of PDPL Response to NFRA PFC):

i. PDPL is a holding Company of RLHL and RLHL's three other step down subsidiaries. RLHL and RLHL's three other step down subsidiaries are holding land parcels which were jointly to be developed along with Paranjape group for which valuation report of N.M Raiji & Co had been provided by the management according to which a value of Rs.150 crore had been determined as the net present value of investment.

ii. As per the terms of preference shares issued by PDPL against the transfer of RLHL shares to PDPL by the Company, these shares were to be redeemed in three annual tranches beginning on March 31, 2021 with an aggregate redemption value of Rs 243.75 crore………………... Further, as per the business plan as can be seen from the valuation report, the redemption value of Rs.243.75 crore was to be paid out of the profits of PDPL group over the period.

iii. Since, PDPL group was at the initial phase of commencement of the project and hence it reported a loss, which over the period of project development was expected to generate cash surplus.(Refer N.M Raiji Valuation Report; Para 4 Section IV)………………. PDPL being an associate Company in initial phase of developing the project, it was expected to repay the amount on the redemption due dates and hence there was no impairment as per para 5.5 of Ind AS 109. (Para 5, Section IV)

5.5.25 *PDPL had a negative net worth on March 31, 2018 as majority of its share capital was in the form of redeemable preference shares which had been classified as debt in its consolidated financial statement for the year ended March 31, 2018.(Para 4 Section IV)*

5.5.26 Further*, as per SA 600, we had also relied on PDPL's audited financial statements, wherein the goodwill on acquisition of RLHL was not impaired. (Para 4 Section IV)*

Applicable accounting provisions on Impairment of Investment in PDPL

5.5.27 The preference shares issued to ITNL of Rs 150 crore in exchange of sale of RLHL shares by PDPL were in the nature of financial asset (i.e debt to be recognised at amortised cost Ind AS 109). The following provision will be applicable:

5.5.28 As per Para 5.5.17 of Ind AS 109, "an entity shall measure expected credit losses of a financial instrument in a way that reflects:

i. an unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes;

ii. the time value of money; and

iii. reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions."

5.5.29 However, on perusal of audit file, there is no evidence of probability weighted calculation made of the amounts recoverable on preference shares (considered as financial asset and recognised at amortised cost) by ITNL. There is also no documentary evidence to support evaluation of current conditions and forecasts of future economic conditions by Audit Firm to determine expected credit loss according to Para 5.5.17 described above. Audit Firm has concluded in the response to NFRA that, "*PDPL being an associate Company in initial phase of developing the project, it was expected to repay the amount on the redemption due dates and hence there was no impairment as per para 5.5 of Ind AS 109"* without any concrete and reliable audit evidence.

5.5.30 Audit Firm states in the response that "*PDPL group was at the initial phase of commencement of the project and hence it reported a loss, which over the period of project development was expected to generate cash surplus (Refer N.M Raiji valuation report in HC 6)".* NFRA verified the Valuation Report as indicated in the response and found it was RLHL valuation, the business taken over by PDPL. There was no valid evidence to support profit projections for RLHL (now taken over by PDPL) for the FY 2019 to FY 2024. The assumption of future profits has not been questioned by Audit Firm despite RLHL having negative net worth of ₹ 11.64 crore in 2016-17, ₹ 11.46 crore in 2015-16 and ₹ 10.11 crore in 2014-15 and negative balances of reserves and surplus(ie of ₹ 12.10 crore) existed since 01-Apr-2015 till 31- Mar-2018. The Audit Firm failed to apply professional scepticism by ignoring the past trends of consistent losses and accepting management's false and misleading future projections. Audit Firm should have rejected management's false projections of profits in future years without any supporting and reliable audit evidence and instead reported this as qualification in the Audit Report according to provisions of SA 705.

5.5.31 NFRA has gone through the Consolidated financial statements of PDPL for year ended 31- Mar- 2018. PDPL had recognised a Goodwill amount of ₹ 131.79 crore on acquisition of net assets of RLHL fair valued only at ₹ 18.21 crore from ITNL at a purchase consideration of ₹ 150 crore (Assets : ₹ 161.25 crore and Liabilities: ₹ 143.04 crore). PDPL in return, issued 15 crore preference shares of Rs 10 each with total value of Rs 150 crore to ITNL. The net assets of RLHL as seen clearly from consolidated financial statements of PDPL were only ₹ 18.21 crore against the valuation of RLHL business made by N.M Raiji of ₹ 150cr. There is a huge gap in valuation of same business using two different methods. The Audit Firm did not question the same from the management which shows that they have blindly accepted management's assertions where in fact, the true value of the business was very less and this led to an overstatement of profits in the books of ITNL.

5.5.32 The Audit Firm states the reason for non-impairment of investment in PDPL that "Goodwill amounting to ₹ 131.79 crore in the consolidated financial statements of PDPL was not impaired." This reason does not suffice since it shows the mere reliance on Other Auditor's work without performing appropriate audit procedures. Para 12 of SA 600 states that "The principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment." Here in the specific case of PDPL, the Audit Firm (Principal Auditor) should have performed procedures to obtain sufficient appropriate audit evidence that the work of Other Auditor is adequate for its own reporting assignment rather than merely relying on the work of Other Auditor. This is particularly in the situation where there existed indicators of impairment for auditor to exercise professional scepticism and provide for impairment loss.

5.5.33 Further, PDPL had negative net worth during 2017-18 not on account of classification of redeemable preference shares to debt in the consolidated financial statement as stated by SRBC in its response. Rather it was because of huge losses PDPL incurred amounting to Rs 14.02 crores due to finance costs that ultimately resulted in negative net worth during 2017-18. These factors have also been ignored by the Audit Firm in evaluation of impairment of investment in PDPL by ITNL.

5.5.34 Based on the above, NFRA concluded in the DAQRR that the Audit Firm has:

i. Failed to exercise professional scepticism by not keeping an attitude of questioning mind and being alert to conditions which may indicate misstatement due to error or fraud, and a critical assessment of audit evidence.

ii. It has failed to highlight a material misstatement due to fraud by not evaluating audit evidence in compliance to provisions of SA 240.

iii. It has also failed to evaluate the work of Management expert as required by Para 8 of SA 500.

iv. NFRA is of the view that the Company has resorted to a complex chain of transactions involving sale of its equity in RLHL to PDPL and in turn acquisition of preference shares valued at Rs 158.37 crore in books and equity shares in PDPL. It has failed to properly assess the sale value of RLHL shares and further impairment of investment in PDPL through sufficient and appropriate audit evidence required by SA 500. This has led to overstatement of profits in the financials of 2017-18 by ₹147.5 crore.

5.6. NFRA has examined in detail the replies dated 10th July, 2021, and the oral submissions made by the Audit Firm (replies to the DAQRR) regarding the observations in the DAQRR.

These are essentially a repetition of the earlier responses that had already been very carefully examined before concluding as in the DAQRR. NFRA has, nevertheless, again examined the above observations in light of the repeated replies by the Audit Firm and, observes as follows:

5.6.1 The Audit Firm has not provided any new evidence to substantiate its claims. There is no evidence in the Audit File for procedures that are claimed to have been done in critical aspects. Regarding the valuation report, the Audit Firm states that "*For the purpose of valuation exercise, we understand that the valuer had:*

- *i. Discussions and interviews with senior management of ITNL to understand the future plans, key value drivers, projected operations, etc.*
- *ii. Reviewed the audited financial statements of RLHL and its subsidiaries for the year ended March 31, 2017, 2016 and 2015.*
- *iii. Reviewed the forecasted consolidated financial information for RLHL for the year ending March 31, 2018 to March 31, 2024.*
- *iv. Performed research and analysis on RLHL and the real estate related industry more specifically related to the demographics of the region in which RLHL had land.*
- *v. Performed research and analysis on publicly available financial data related to similar companies as RLHL's business / operations.*
- *vi. Performed a review and analysis of industry statistics, forecast and studies*".

5.6.2 None of the above submissions is supported by evidence and is clearly in the nature of hearsay. On the contrary, there is evidence as detailed in the above paras of DAQRR observations that the reliance placed on the valuation report is without adequate verification and hence is unjustified. The reliance placed on the valuation report throughout the reply of the Audit Firm is hence unacceptable.

5.6.3 The Audit Firm states that *"As can be seen from the minutes of COD meeting, the approval clearly states that the "The cost of land as per the books is Rs.71 crore which is valued at approximately Rs.150 crore". It is expected that management would generally have a sense and an expectation with respect to the value of asset held by the Company. Thus, the amount is management's assessment of the expected valuation based on the underlying plan to develop the assets and the future cash flow projections developed by the management. Further, the price in a commercial transaction is entered into based on the negotiations between two independent market participants, based on their varying expectation on returns and underlying strategic aspects for purchaser could influence the price. A purchase and sale transaction is possible only when two parties having difference views with respect to the value of assets, are eventually able to reach an agreement on the same. Further, entering into above transaction was the decision of the management and was approved by the Committee of Directors in their meeting held on June 15, 2017. The decision of the committee of directors was ratified by the Board of Directors in their meeting held on August 8, 2017. As statutory auditors we had performed adequate audit procedures to obtain sufficient appropriate audit evidence with respect to validity of the transaction"*. However, this submission does not address the observation that the price of RLHL shares has already been fixed by the COD before the date of the Valuation Report. The unsigned Valuation Report obtained on 28-Jun-2017 was obtained just to support the management decision. There are no specific replies to this specific observation that are based on facts of the case as extracted by NFRA from the Audit File. Similarly, the

Audit Firm's reply is silent or provides vague replies on many other specific facts observed by NFRA.

5.6.4 The Audit Firm states that *"SRBC had exercised professional judgement and professional skepticism and questioned the management with respect to consideration being received in the form of redeemable preference shares in our meeting with the management / TCWG on August 4, 2017, August 7, 2017 and August 8, 2017 wherein it was explained to SRBC that the land would be jointly developed by ITNL and Paranjape group and the cash generated out of the same would be used to redeem the preference shares of Rs.150 crore with a premium of Rs.93.75 crore. Further, as per the cash flow projections which was validated by N.M.Raiji & Co, sufficient cash flow was expected for PDPL to be able to redeem the preference shares. Accordingly, the question to applicability of section 55 of the Companies Act 2013 did not arise. SRBC notes that NFRA's comments in para 5.5.18 wherein NFRA has reproduced section 55 of the Companies Act 2013 and para 5.5.19 where NFRA has given an illusionary and hypothetical view with respect to PDPL's failure to redeem preference shares and reissue preference shares under section 55 of the Companies Act 2013 basis which NFRA has alleged SRBC for its failure to question ITNL for issuance of preference shares in light of section 55 of the Companies Act 2013. It is clear as per the discounted cash flow projections in the valuation report that such preference shares will be redeemed at their respective due dates"*. Many of the audit procedures stated as performed by the Audit Firm have not been documented in the Audit File and hence are not acceptable. As already explained, the reliance placed on the valuation report is also unacceptable in view of contradicting pieces of evidence and in the absence of due audit procedures and audit evidence. The discounted cash flow projection does not in any way confirm the intention of the management to redeem the preference shares, as it is only an estimation, not a management decision. By ruling out the probability of possible future outcomes (which are derived based on the prevailing law) as "*an illusionary and hypothetical view*" indicated by NFRA, the Audit Firm proves that it lacks required professional skepticism and competency.

5.6.5 The Audit Firm, inter alia, states that *"In the given case, the underlying source of cash flow to be used for redemption of preference shares issued by PDPL was the development of land in RLHL and its subsidiaries. As PDPL and RLHL did not have any other business in past, the past losses trend etc. were of no significance in the given case and what was relevant was the future forecast. Based on the future cash flow projections of RLHL which was validated by the valuation firm N.M.Raiji & Co, sufficient cash flow was expected to be available to PDPL to be able to redeem the preference shares on due dates. Hence, as per the management no lifetime credit loss was required to be provided against the said investment in the books of ITNL. (Refer draft valuation report dated June 28, 2017 in hard copy file 4 on page no. B-1096 to B-1123 and Refer final signed valuation report dated July 28, 2017 in hard copy file 6 page no H244 to H271)"*. This reply does not address why past trends of consistent losses have not been reflected in future projections and why management's false and misleading future projections were accepted without question. The basis on which the Audit Firm termed the past losses as having "no significance" is not explained in the reply. The negative net worth and negative reserves for both the entities put together are substantial as explained in the DAQRR.

5.6.6 The other parts of the reply of the Audit Firm are also in similar lines as explained above, without having any valid basis supported by evidence to substantiate its claims. As already detailed, in the absence of evidence in the Audit File, NFRA can only take that the required procedure as per the SAs/AS has not been done.

5.6.7 Regarding the unavailability of audit evidence of the actual number of shares in PDPL, the Audit Firm submits that "*ITNL had initially acquired 3,300 equity shares of Rs.10 each for Rs.33,000/- of PDPL and subsequently subscribed to another 330,000 equity shares of Rs.10 each for Rs.0.33 crores. …… SRBC had verified 3,300 equity shares from the Demat Statement (Refer hard copy file 6, H147) and 330,000 equity shares in hard copy certificate (Refer hard copy file 6, H141)…… while the value of equity shares of Rs.0.33 crores stated in Note 4 to the financial statements is appropriate, there is an apparent typographical error in case of the number of equity shares wherein instead of 333,300 it has been stated as 3,300*". Observations in para 5.5.22. and 5.5.23 stand deleted based on the above replies.

5.6.8 Therefore, NFRA concludes that the Audit Firm:

a) Failed to exercise professional scepticism by not keeping an attitude of questioning mind and being alert to conditions which may indicate misstatement due to error or fraud, and a critical assessment of audit evidence.

b) Failed to highlight a material misstatement due to fraud by not evaluating audit evidence in compliance with provisions of SA 240.

c) Failed to evaluate the work of Management expert as required by Para 8 of SA 500.

d) 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.

5.7. NFRA had conveyed the following prima facie conclusions:

Khed Sinnar Expressway Limited (KSEL)

5.7.1 ITNL's total financial exposure to this SPV is Rs 744.20 crore, which consists of loans advanced to the SPV of Rs 450 crores (including interest of Rs. 84 crore) and investments of ITNL of Rs 294.20 crore.

5.7.2 The discounted cash flow model for the SPV assumes projected cash inflow of Rs. 3000 million and Rs 1000 million in 2019 and 2020 respectively, on account of various claims lodged by the SPV with the Highway Authority, as shown in the Table below, taken from the Audit File.

Extract showing the Management's Projections of cash flow for next two years

Table 1 (Rs in Millions)

Particulars	**WP reference**	**Year ending 31-MAR-2019**	**Year ending 31-MAR-2020**

Opening Balance	Refer KSEL MI8 financials	20	2654
Sources/inflow			
Other income	Note 1	1	0
Short term Loan- ITNL	Note 2	6663	1852
Addition Term Loan	Note 3	1810	340
Refinance Loan	Note 4	-	12935
Toll Revenue	KSEL_1	703	1798
Grant	KSEL_2	50	728
CA adjustment	Note 8	208	-
GST Claim	KSEL_3	244	44
Claim	KSEL_4	3000	1000
Total		**12679**	**18697**

5.7.3 NFRA has further noted that the legal opinion obtained by the Management shows the probable amount of claim to be recovered as Rs 400 crore, as shown in Table 2 below which has been taken from the Audit File. NFRA has noted that the legal opinion is dated 28-SEP-2018 i.e. almost 4 months after the signing of the Auditors' Report by the Engagement Partner.

Amount of various elements of the claim lodged, their probability of acceptance as per the legal advice dated 28-SEP-2018

Table 2 (Rs in crores)

Sl. No	Description	Claim amount	Probability as per legal advice	Probable amount of claim to be received
1.	Damages for delay in Appointed Date	6.74	0%	0

2.	Damages for delay in Handing Over of the ROW	16.44	0%	0
3.	Increase in interest payment on debt as on 31.05.18	313.57	40%	125.42
4.	Additional cost incurred due to maintenance of existing carriageway for extended duration	2.30	80%	1.84
5.	Cost of idling of Resources due to delay in handing over of land and scattered handing over of land	268.56	80%	214.84
6.	Extra cost incurred due to increase in No. of traffic diversions	1.52	80%	1.21
7.	Insurance premium for extended period	0.91	80%	0.72
8	Project Management fee for extended	54.19	80%	43.35

9.	Loss in toll revenue because of reduced tollable length due to non-handing over ROW by the Authority	124.51	80%	99.6
	Total	**788.76**		**486.98 Rounded off to Rs 400 crores**

5.7.4 Since the Legal opinion was not obtained as on the date of preparation of Discounted Cash Flow of KSEL, it is inferred that the Audit Firm has merely relied on management's contention of claims amounting to Rs 4000 million that would be realised without verifying the relevance and reliability of the audit evidence (Para 7 of SA 500).

5.7.5 The Legal opinion is dated 28-SEP-2018 and exactly matches with the management's assumption of realizable claims of Rs 400 crore projected in discounted cash flows, clearly indicating that the legal opinion has been procured to match the management's assumptions.

5.7.6 In any event, the Audit Firm has not done any evaluation of the Management's claims about recovery of Rs. 400 crores. There is a complete failure to exercise professional scepticism, to exercise due diligence in obtaining sufficient appropriate audit evidence and subjecting the same to rigorous scrutiny.

Tampering of Audit File

5.7.7 NFRA has noted that as per SRBC & Co LLP's SQC 1 policy, Annexure XX to Appendix A (Documentation and Archive – India, page 535 of 1152), the documentation completion date is no later than:

i. "For audit deliverables to client: 21 days after the date of our auditor's report/other deliverables".

ii. "For group reporting engagements: In case of group reporting engagements, where the component audit team reports to another EY member from (primary or regional team), the due date for archiving of working papers relating to that engagement would be earlier of 21 days from signing of last deliverable or archive date as advised by the primary team."

5.7.8 Further, Para A21 of SA 230 states that "SQC 1 requires firms to establish policies and procedures for the timely completion of the assembly of audit files. An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report."

5.7.9 The Audit Firm's documentation of evidence which did not even exist on the date of signing of the Audit Report tantamount to tampering of Audit file, which was required to be closed within 21 days after the signing of the Audit Report as per SRBC's SQC 1 policy, as well as a gross violation of Para A21 of SA 230.

5.7.10 Based on the observations noted above, NFRA Prima Facie concluded that the valuation of ITNLs investment and loans to KSEL project was highly doubtful as there was no substantive basis to prove validity of management's assumptions regarding the entity's future cash flows. The Audit Firm is also guilty of tampering with the Audit File, in gross violation of its own SQC 1 policy and SA 230.

5.8. NFRA had conveyed the following in its Draft Audit Quality Review Report (DAQRR):

Audit Firm's reliance on Management's representation relating to claims on customers

5.8.1 Audit Firm in its response to PFC stated that "*since the management was in the process of filing its claim in the range of Rs. 800 to Rs. 900 crores (for reasons explained above), an amount of Rs. 400 crores was included in the cash flow statement in accordance with the principle of conservatism, and based on the experience in similar circumstances. The engagement team had found no reason to challenge this estimate of the management.*"

5.8.2 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:

5.8.3 Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions."

5.8.4 Para A9 of SA 230, "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."

5.8.5 However, the explanation in the Response as given above, does not form part of audit file. This makes it clearly evident that the Audit Firm has not documented its professional judgement for accepting Rs 400 crore as claim amount receivable by BAEL as required by Para 8 read with Para A9 to A11 of SA 230. This poses a serious doubt on the quality and reliability of the judgement and is a gross violation of SA 230.

5.8.6 Para 14 of Ind AS 11 states that "A claim is an amount that the contractor seeks to collect from the customer or another party as reimbursement for costs not included in the contract price. A claim may arise from, for example, customer caused delays, errors in specifications or design, and disputed variations in contract work. The measurement of the amounts of revenue arising from claims is subject to a high level of uncertainty and often depends on the outcome of negotiations. Therefore, claims are included in contract revenue only when:

i. negotiations have reached an advanced stage such that it is probable that the customer will accept the claim; and
ii. the amount that it is probable will be accepted by the customer can be measured reliably."

5.8.7 As stated above by Audit Firm in its response, the Management was in the process of filing its claim and had not filed the claim till the audit ended, hence there was no question of negotiations reaching an advanced stage nor the amount being certain since the claim was not yet filed nor accepted by NHAI. Since there existed no conditions at the balance sheet date that meet the criteria specified in Para 14 of Ind AS 11 or even slightly confirmed that the claims would be recognised in the near future, the projection of recognition of claim amount of Rs 400 crore by year end 2019 and 2020 is absolutely baseless and hypothetical, without any convincing evidence.

5.8.8 The Audit Firm's own admission of claim not being filed till the end of audit, indicates that the claim amount was not likely to accrue so early. There is no supporting evidence of any communication with NHAI on this claim matter or any other form of negotiation or intimation made to NHAI. Also, recognising claims in future without carefully verifying the underlying facts and seeking response from counter party would lead to material misstatement in the financial statements. The verification of the realisability of the claim was limited only to the management's assertions.

5.8.9 The amount of the claim that has been built into the financial statements was clearly material. Taking credit for this at a time when the claim had not even been made amounts to making a statement that is false in material particulars while knowing it to be false within the meaning of Section 448 of Companies Act 2013.

Insufficient and Inappropriate Audit Evidence under SA 500

5.8.10 The Audit Firm has stated in its Response that *"The legal opinion (claim amount of Rs.487 crore) was dated September 28, 2018 and claim calculation based on the said opinion were obtained during our subsequent period limited review for the quarter ended September 2018"*. This statement itself shows that the Audit Firm failed to obtain sufficient and appropriate audit evidence for verifying the claim amount of KSEL during audit of ITNL for FY 2017-18.

5.8.11 As per Para A2 of SA 500, audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, re- performance and analytical procedures in addition to inquiry. Para A18 states that "*external confirmation represents audit evidence obtained as a direct response to the auditor from a third party in paper, electronic form or other medium. External confirmations need not be restricted to account balances only. For example, the auditor may request* *confirmation of the terms of agreements or transactions an entity has with third parties."* In the absence of reliable audit evidence, one of the possible audit procedures should have been to obtain external confirmation from NHAI. This would have given a more direct, reliable and clear idea to the Audit Firm of the probability of realisability of these claims, which it failed to do.

Auditor's Duty related to Company's Claim Recognition Policy

5.8.12 It was explained in Audit Firm's response that Management had considered a policy for claim recognition as 50% of the claim expected to be filed. This policy of claim recognition was approved by the Audit Committee in its meeting held on March 28, 2017. The said approval was documented in the audit file of previous year ending 31st March 2017 and is stated to have been referred to by the Audit Firm. Such a policy of an arbitrary percentage recognition of claims, that is applied on an across-the-board basis, without consideration of the specific facts and circumstances of each case, should have been clearly unacceptable as audit evidence. NFRA is of the view that the duty of Audit Firm is to first evaluate the correctness and appropriateness of any Policy before checking if the same has been followed.

5.8.13 The Policy of the Company does not meet any accounting standards. It is not logical to recognise a standard 50% claim for all the projects since the probability percentage of success can vary from project to project. Some projects may have recoveries that are particularly specific to that Project and not applicable to all cases, so a common benchmark is not practical and correct. For instance, in case of Barwa Adda Project, claims were filed against losses incurred by the Concessionaire in implementing "Rip Rap" technique that did not exist in other Projects and probability of recovery was 25% as per legal opinion. Thus, the contention of 50% claim according to policy of the Company should have been rigorously challenged in light of the applicable accounting standards, which has not been done by the Audit Firm.

Complete reliance on Management representations SA 580

5.8.14 The Audit Firm stated in its Response to NFRA that "*In case of another SPV there was a claim filed during the year for similar amount and under similar heads for which the management had obtained a legal opinion and as per the legal opinion the overall claim receivable was over 50% of the amount claimed" (Point d page 286 of 751).* However, this is not documented in the audit file and hence not acceptable. Nevertheless, NFRA is of the view that comparison with legal opinions of other Projects should not be the basis for recognising claims for KSEL. The reason is that the facts of each case are different, and the counter claims/arguments of the other Party (NHAI) will be different for each case. For example, in the case of Barwa Adda Expressway Limited the loss towards interest during construction paid to lenders was given probability weightage of 90% in the Legal opinion whereas in the case of Khed Sinnar Expressway Limited, it was just 40% probable. Similarly, in legal opinion of Khed Sinnar Expressway Limited, claims against extra cost incurred due to increase in traffic diversions was 80% probable of recovery but it was only 25% probable in Barwa Adda Project.

5.8.15 The Audit Firm further stated "*Accordingly, in the absence of the legal opinion at the time of audit process, the management had considered it appropriate to include an amount of Rs. 400 crores in the projected cash flow statement. The engagement team had found no reason to challenge this estimate of the management (Point (b) on Page 285 of 751).*" This reasoning given now in the Response is not there in the audit file, and hence is an afterthought. The audit file in fact uses the extracts of legal opinion in the working papers to support the Management contention of Rs 400 crore claim in cash flow projections. This is despite the fact that the said legal opinion was obtained only in September 2018.

5.8.16 From reading the above extracts of response submitted by Audit Firm, it is understood that the Audit Firm did not obtain any legal opinion on 31st March 2018 to verify the claim and relied on the representations of Management without performing adequate procedures to verify the facts of the claim. As per the definition of "Written representations" in Para 6 of SA 580, written representation by management provided to auditor is to confirm certain matters or to support other audit evidence. Such representations are not the sole audit evidences on which the Audit Firm can rely upon as they only support other audit evidences. Hence, it is important to verify audit matters through other audit evidences and not rely only on management representations, as has been done by the Audit Firm in the present case.

5.8.17 According to SRBC & Co LLP's SQC 1 policy, Annexure XX to Appendix A (Documentation and Archive – India, page 535 of 1152), the documentation completion date is no later than 21 days after the date of auditor's report/other deliverables. Going by this policy, the documentation should have been closed within 21 days from the issue of the Audit Report dated 29 May 2018 i.e. by 19 June 2018. But from the Response of the Audit Firm and other facts of the given case, the audit file was not closed up to December 5, 2018 when the legal opinion dated 29-SEP-2018 for Khed Sinnar Expressway Limited was obtained.

5.8.18 Para 14 of SA 230, Audit Documentation states that "*The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.*" Para A21 of SA 230 states that assembly of the audit file is to be completed ordinarily not more than 60 days after the date of the auditor's report. However, the legal opinion is dated 29-SEP-2018 which is much after the timelines mentioned in Para A21 of SA 230.

5.8.19 The Audit Firm has clearly tampered with the audit file for the year ended 31st March 2018 by placing a document which was not obtained during the given financial year. This shows that documentation is seriously neglected, and audit evidence documented in audit file neither follow the principles of Standards of Auditing or the Audit Firm's own SQC policy.

5.8.20 Ind AS 36 Para 50 states that:

i. Estimates of future cash flows shall not include:
ii. cash inflows or outflows from financing activities; or
iii. income tax receipts or payments.

5.8.21 Para 50 read with Para 51 clearly provides to exclude financing cash inflows and outflows in impairment testing to avoid duplicity of assumptions, in the way discount rate is determined. Hence the short-term loans from ITNL to KSEL totalling Rs 895.6 crore should be excluded from the future cash flow projections of KSEL since it is derived from financing activities. (WP "ITNL M18 Financial models_KSEL"

5.8.22 Based on the above observations NFRA Concluded in the DAQRR that:

i. The Audit Firm has failed to exercise due diligence and has been found to be grossly negligent in the discharge of their duties as auditors.

ii. The Audit Firm has not conducted the audit in compliance with the Standards on Auditing;

iii. The Audit Firm failed to maintain requisite professional scepticism, professional competence and due care during the conduct of audit;

iv. The Audit Firm failed to obtain sufficient information and audit evidence which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion;

v. The Audit Firm has made a statement that is false in material particulars, knowing that the same was false.

5.9. NFRA has examined in detail the replies dated 10th July, 2021, and the oral submissions made by the Audit Firm (replies to the DAQRR) regarding the observations in the DAQRR. These are essentially a repetition of the earlier responses that had already been very carefully examined before concluding as in the DAQRR. NFRA has, nevertheless, again examined the above observations in light of the repeated replies by the Audit Firm and, observes as follows.:

5.9.1 The Audit Firm submits that *"The aforesaid claim was only considered for the purpose of future cash flow projections of the SPV for impairment testing and was not accrued in the books of accounts of ITNL for the year ended March 31, 2018. …….For the purpose of future cash flow projections management had considered claim amount of Rs.400 crore based on their best estimates. These estimates were based on the extension of time recommended by the independent engineer in his letter to NHAI dated March 17, 2018 wherein he had acknowledged that there were delays in providing land / right of way by*

NHAI due to which IE had recommended further extension of time to be granted to ITNL up to June 30, 2019…… SRBC noted the approval of extension of time by Independent Engineer and eligibility of the SPV to get a claim in accordance with the terms of concession agreement and basis the past experience of claim settlement by NHAI, the management had considered to include an amount of Rs. 400 crores in the future cash flow projections of KSEL……..Further, management had compiled all details/documents/information/calculation to file the claim and expected to recover part amount by end of March 31, 2019 and balance amount by March 31, 2020 (Refer future cash flow projections in hard copy file 13 page no 858-945). …….As can be seen from above, the claim accounting policy for ITNL's SPVs restricted the accounting for claim to 50% of the claims filed and were also subject to overall probability of acceptance of claims certified by technical experts……… Accordingly, SRBC had found no reason to challenge this estimate of the management".

5.9.2 The contention of the Audit Firm is contrary to its own WPs. Note on 'Impairment testing' in the impairment assessment workpaper in audit file hard copy file 6 page no H53 states that "*For preparation of cash flow projection the used following important data"[*sic] …. *"Claims from authority: claims have been considered in cash flow projections* ***on the basis of the claims filed with the authority****"* (emphasis added). In the present case, the Audit Firm knows very well that the present claims are not filed with the authority, still, it went along with the management in including these unmatured claims in the cash flow projections contrary to its understanding and information. Also, the claim accounting policy for ITNL's SPVs restricted the accounting for the claim to 50% of the **claims filed,** not the claims expected to be filed**.** These instances make the statements and actions of the Audit Firm untrustworthy.

5.9.3 Without prejudice to the above, NFRA also observes in this regard that the Audit Firm has not verified whether the calculation of the claim is as per the agreement conditions. In the absence of such an examination, there is no sanctity for the claim amounts. Also, though the IE has recommended an extension of time, the IE has not concurred any claim amounts. The claim accounting policy of restricting the claims to 50% of the total claims is baseless as it did not have any empirical basis. (Even otherwise it talks only about claims filed). Moreover, there is not even a single claim that has a 100% probability of realisation, while two claims are having 0% probability. This indicates that the valuation of the claim has a high degree of subjectiveness and is not fully in line with the contract conditions. Had the Audit Firm taken a conservative approach, none of these claims could have been considered for cash flow projections as there is no reasonability associated with these claims. The timing of the realisation of these claims also appears to be arbitrary as there is no evidence to substantiate the same. The Audit Firm did not perform any objective evaluation of these claims but accepted the contentions of the management without question.

5.9.4 The Audit Firm, inter alia, states that *"The legal opinion (claim amount of Rs.487 crore) dated September 28, 2018 and claim calculation based on the said opinion were obtained during our subsequent period limited review for the quarter ended September 2018 and were inadvertently kept on the hard copy audit file for year ended Mar'18 which was being used for reference purposes for previous cash flow projections. …….. SRBC has not tampered with the audit files in any manner whatsoever, and the document had unintentionally been placed on the audit file. It is a genuine human error by an audit team* *member, as one can observe and conclude the date of legal opinion and claim papers itself indicates that that same were inadvertently filed"*. The reply of the Audit Firm again underlines the fact that the audit documentation is accessible by anyone even after the date of archiving, which poses a serious threat to the integrity of the documentation. This may be read with NFRA's observations on the integrity of audit files in Chapter 14 of this AQRR. Also, the above reply does not address the reasons why the legal opinion obtained during limited review for the second quarter of 2018-19 exactly matches with the management's assumption of realizable claims of Rs 400 crore projected in discounted cash flows as of 31st March 2018.

5.9.5 Therefore, NFRA concludes that the Audit Firm:

a) Did not exercise due diligence and was grossly negligent in the conduct of its professional duties.

b) Did not conduct the audit according to the Standards on Auditing.

c) Did not maintain professional skepticism, professional competence and due care required during the audit.

d) Tampered with the Audit File and inserted documents created much beyond the last date for closure and archival of the Audit File.

5.10. NFRA had conveyed the following prima facie conclusions:

ITNL International Pte. Ltd, Singapore

5.10.1 NFRA observed that ITNL carries an investment of Rs. 779.92 crores in the company as on 31- Mar-2018. Para 12 and 13 of Ind AS 36 state that as regards investment in a subsidiary, joint venture or associate, if evidence is available that the carrying amount of investment in separate financial statements exceeds the carrying amount in consolidated financial statement of the investee's net assets, then the entity shall impair the investments.

5.10.2 NFRA has noted that carrying amount of net assets of ITNL International Pte Ltd in the consolidated financial statements of ITNL is Rs. 559.33 crore and the carrying amount of ITNL International Pte Ltd in the separate financial statements is Rs. 779.92 crore. This transaction clearly falls within the purview of Paras 12 and 13 of Ind AS 36, indicating impairment in value. However, on perusal of the Audit File submitted to NFRA, we have observed that though there exists an impairment indicator as stated in Para 12 and 13 of Ind AS 36, impairment of investments in ITNL International Pte Ltd. is not done and appropriate ECL was not recognised. This resulted in the inflation of profit by at least Rs. 220.59 crore. ET should have brought this fact to the notice of management and TCWG and sought justification for not impairing the investments in ITNL International Pte Ltd. However, there exists no documentation in the Audit File to support the fact that any discussions took place between the ET and the management or TCWG for the same, as required by Para 12(a) of SA 260. Hence, the Audit Firm has failed to meet the requirements of Para 12(a) of SA 260 and Ind AS 36.

5.11. NFRA had conveyed the following in its Draft Audit Quality Review Report:

5.11.1 ITNL International Pte Ltd (IIPL) is a wholly owned foreign subsidiary of ITNL incorporated in Singapore which holds investments in all the overseas subsidiaries of the Company. The Accounting Policy of ITNL under Section B.3 Investments in subsidiaries, associates and joint ventures of Financial Statements states that "*When necessary, the entire carrying amount of the investment (including goodwill) is tested for impairment in accordance with Ind AS 36 Impairment of Assets as a single asset by comparing its recoverable amount (higher of value in use and fair value less costs of disposal) with its carrying amount. Any impairment loss recognized is reduced from the carrying amount of the investment and recognized in the profit or loss*". The Audit Firm in point no 2 of its response to PFC has stated that ITNL International Pte Ltd. (IIPL) is principally an investment holding Company of ITNL group and IIPL had two major investments, Elsamex S.A. (Elsamex) and Chongqing Yuhe Expressway Co. Ltd. (CYECL). It is also stated that the Company had valued these two entities, Elsamex and CYECL through external Management Experts (N.M Raiji and Grant Thornton India LLP respectively). The valuation by the Experts used future cash flow projections of these entities, namely Elsamex and CYECL and the fair value of these two exceeded the carrying value in the books of IIPL. Hence, investment in IIPL was not impaired by ITNL. In this regard, NFRA has the following observations:

i. The subject matter here is regarding the applicability of the Requirements of IndAS 36 and impairment testing of investment in IIPL by ITNL. The WP "Summary Review Memorandum (SRM)", itself stated that "Management has carried out their impairment test as on March 31, 2018. The Management has prepared:

a) *cash flow models for all project SPVs and compared the discounted value of cashflows with the investment amount in the books.*
b) *For investments in other than project SPV's management has compared the net worth of the Subsidiary, Associates and Joint venture with the investment amount in the books.*

ii. The Audit Firm itself stated in their reply of para 3.4 of RLHL regarding SRM that "*The aforesaid para is not an accounting policy of the Company but a methodology adopted by the management for impairment testing".* Where IIPL was a non-project foreign SPV, a comparison should have been made only between the net worth and carrying value of investment of IIPL. But, in the WP *" Impairment assessment workpaper in audit file 6 Page H51",* it has been stated that *"the Company added an increase in fair value of Rs 401 crore of Elsamex and Yuhe as per valuation report to the net worth of IIPL of Rs 559.30 crore totalling to Rs 960.51 crore and compared it to carrying amount of Rs 779.92 crore and concluded that no impairment has been considered."*

5.11.2 Thus, it is evident that the Audit Firm had relied on the valuations done by external valuers (reports dated in the previous year) of two major investments made by IIPL and added the incremental fair value to the net worth of IIPL and compared such net worth with the carrying value of investments in the books of ITNL to check the applicability of Ind AS36. This procedure is not in line with Ind AS 36 because:

i. Ind AS 36 deals with assets in the books of account of the reporting entity, in this case assets in the books of ITNL. The Audit Firm has instead taken and relied on valuations of assets in the books of the subsidiary.

ii. Para 12 of Ind AS 36 stipulates that in assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, certain internal and external sources of information. The sources of information listed in subclause (a) to (g) in para 12 relates only to either the asset in question or the entity in whose books the assets are carried. Sub clause (h) states that "for an investment in a subsidiary, joint venture or associate, the investor recognises a dividend from the investment and evidence is available that:"

a) "the carrying amount of the investment in the separate financial statements exceeds the carrying amounts in the consolidated financial statements of the investee's net assets, including associated goodwill; or"

b) "the dividend exceeds the total comprehensive income of the subsidiary, joint venture or associate in the period the dividend is declared".

5.11.3 The Audit Firm has tested none of the requirements in subclause (a) to (g). Instead of testing the requirement in sub clause (h) the Audit Firm had simply relied on the valuation of two investments made by the subsidiary, while the separate and consolidated financial statements of ITNL provided information exactly as per sub clause (h) (i) of para 12 of Ind AS 36. The fair value of these two investments cannot be equated to the fair value of the investments in the subsidiary particularly in view of the fact that IIPL was incurring losses in its financials.

5.11.4 Considering all the above facts, as the impairment indicator clearly exists, the management should have calculated the recoverable value of the investment. As per para 18 of Ind AS 36 Recoverable value is higher of asset's cash generating unit's fair value less costs of disposal and value in use. But in this case the company has neither calculated the fair value of the investment nor calculated any value in use as per the requirement of Ind AS 36. Thus, the Company has not complied with Ind AS 36. The Company also violated its own accounting policy in this regard. The Audit Firm has not done any objective evaluation of the impairment testing by the Company.

5.11.5 Para 17 of SA 540 states that "For accounting estimates that give rise to significant risks, the auditor shall obtain sufficient appropriate audit evidence whether the following are in accordance with the requirements of the applicable financial reporting framework: (a) management's decision to recognise, or to not recognise, the accounting estimates in the financial statements; and …… (b) the selected measurement basis for the accounting estimates". Para 23 of SA 540 stipulates the documentation requirements as "The audit documentation shall include: (a) The basis for the auditor's conclusions about the reasonableness of accounting estimates and their disclosure that give rise to significant risks; and (b) Indicators of possible management bias, if any." The Audit Firm has failed to comply with both para 17 and 23 of SA 540.

5.11.6 The non-compliance with Ind AS 36 has resulted in the inflation of profit by at least Rs. 220.59 crore. ET should have brought this fact to the notice of management and TCWG and sought justification for not impairing the investments in ITNL International Pte Ltd. However, there exists no documentation in the Audit File to support the fact that any discussions took place between the ET and the management or TCWG for the same, as required by para 16 of SA 260 (Revised). Hence, the Audit Firm has failed to meet the requirements of Para 16 of SA 260 (Revised).

5.11.7 Therefore, NFRA concluded in the DAQRR that the Company did not comply with Ind AS 36. The Audit Firm has failed to report this non-compliance. The Audit Firm did not comply with the requirements of paras 17 and 23 of SA 560 and para 16 of SA 260 (Revised).

5.12. NFRA has examined in detail the replies dated 10th July, 2021, and the oral submissions made by the Audit Firm (replies to the DAQRR) regarding the observations in the DAQRR and concludes as follows:

5.12.1 Referring to Ind AS 36, the Audit Firm submits that *"Further, para 12(h)(i) states that "the carrying amount of the investment in the separate financial statements exceeds the carrying amounts* ***in the consolidated financial statements of the investee's*** *net assets, including associated goodwill"* ***The above para itself refers to the investee's consolidated financial statements for any indication of impairment****. Thus, the standard envisages that for impairment testing of the investment in investee, it is required to consider the underlying investments of the investee Company in stepdown operational entities" (Emphasis added).* The interpretation given by the Audit Firm is astonishing. It is baseless to interpret that the standard refers to investor's separate financial statements and investee's consolidated financial statements. The plain and sensible meaning of this provision is that 'the carrying amount of the investment in the separate financial statements exceeds the carrying amount of the investee's net assets, including associated goodwill in the consolidated financial statements.' Here both the SFS and CFS refers to the Company to which the standard applies. The word "investee's" qualifies "net assets".

5.12.2 The Audit Firm's utter lack of understanding of the provisions of Ind AS 36 is further highlighted by the following.

i. The Audit Firm states that *"IIPL had two major investments, Elsamex S.A. (Elsamex) and Chongqing Yuhe Expressway Co. Ltd. (CYECL). The Company had factored in the upside on valuation of these two major* *investments for impairment testing of IIPL after considering which there was no impairment for IIPL. ………..The aggregate upside of Rs.401 crore in the value of IIPL was higher than the difference of Rs.220 crore between the carrying value of IIPL of Rs.779 crore in books of ITNL and the networth of IIPL of Rs.559 crore. Based on the same it was concluded that there was no impairment. ………For the purpose of testing impairment of a Special Purpose Vehicle that is an investments holding entity (investment SPV) that hold investment in step-down operational entities, it is imperative that the value in use of the investment in the investment SPV will include the valuation of its step-down operational entities. ……… However, existence of indication does not by itself mean that the asset is impaired. As required by the standard, the asset has to be tested for impairment…. In the given case since there were indicators that existed, ITNL had tested the carrying value of its investment in IIPL for impairment. These para's do not require asset / investment do be impaired just because an indicator exists, rather, if such indicators exists, the entity shall estimate the recoverable amount of the asset as per para 9 and 13 of Ind AS 36. Accordingly, the recoverable amount of the asset had been determined by the Company and audited by us. (Refer Note 1 to Impairment assessment workpaper in audit file 6, page reference no. H51)*".

ii. The replies show that the Audit Firm fails to recognise the difference between testing for impairment and calculating the recoverable value of an asset that may be impaired based on the impairment indicators. Paragraphs 8–17 of Ind AS 36 specify **when the recoverable amount shall be determined. Paragraphs 18–57 set out the requirements for measuring the recoverable amount.** Para 13 makes it clear that the list in paragraph 12 is not exhaustive and an entity may identify other indications that an asset may be impaired and these would also require the entity to **determine the asset's recoverable amount** or, **in the case of goodwill, perform an impairment test** under paragraphs 80–99.

iii. Therefore, the Company is required to calculate the recoverable amount of the investments in the subsidiary, for the SFS of ITNL, as there is an indication of impairment as per para 12 of Ind AS 36. For this purpose, the carrying amount of the investment in separate financial statements should be compared with its recoverable amount, i.e. the higher of the fair value less costs of disposal and value in use. In the present case, the Audit Firm claims that the Company has "determined" the recoverable value, which is value in use, and the Audit Firm has audited it. In this regard, para 30 to 32 of Ind AS 36 stipulates the methodology for calculation of value in use as follows.

iv. Para 30 - "The following elements shall be reflected in the calculation of an asset's value in use: (a) an estimate of the future cash flows the entity expects to derive from the asset; (b) expectations about possible variations in the amount or timing of those future cash flows; (c) the time value of money, represented by the current market risk-free rate of interest; (d) the price for bearing the uncertainty inherent in the asset; and (e) other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset."

v. Para 31 – "Estimating the value in use of an asset involves the following steps: (a) estimating the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal; and (b) applying the appropriate discount rate to those future cash flows."

vi. Para 32 – "The elements identified in paragraph 30(b), (d) and (e) can be reflected either as adjustments to the future cash flows or as adjustments to the discount rate. Whichever approach an entity adopts to reflect expectations about possible variations in the amount or timing of future cash flows, the result shall be to reflect the expected present value of the future cash flows, ie the weighted average of all possible outcomes. Appendix A provides additional guidance on the use of present value techniques in measuring an asset's value in use.".

vii. As can be seen from the replies of the Audit Firm, the Company has not followed any of the conditions as above. The basic requirement in the case of the 'value in use' for an investment in a subsidiary is the calculation of the investor's share of the present value of the subsidiary's estimated cash flows. The present value of such expected cash flows shall factor in the fair value of outstanding debt of the subsidiary, non-interest-bearing inter-company balances if any, and other inflows and outflows etc. to determine the proportionate net amount available to the holding company. There is no evidence in the Audit File to show that the Company had calculated the value in use of IIPL as required by Ind AS 36. All the WPs referred by the Audit Firm refer to the supposed fair valuation of two of the subsidiaries of IIPL by external agencies.

5.12.3 The Company's policy of impairment in subsidiary states that "For investment in other than Project SPVs: compare net worth of subsidiary, associate and joint ventures with investment amount in books." In the present case instead of the net worth of the subsidiary, the company has taken another amount substituted for the net worth by selectively using the supposed fair value of two of the subsidiaries of IIPL, thus violating its own policy. If the Company's policy had been properly applied, the investment would have been impaired as on the reporting date.

5.12.4 Thus, it is evident that the Company has blatantly violated the principles of Ind AS 36 and the Audit Firm has failed to disclose the violations in its Audit Report and to the Company/TCWG. The Audit Firm did not comply with the requirements of paras 17 and 23 of SA 560 and para 16 of SA 260 (Revised). NFRA, therefore, concludes that the Audit Firm has not carried out the audit according to the Standards on Auditing and did not maintain professional skepticism, professional competence and due care during the audit.

5.13. NFRA had conveyed the following prima facie conclusions:

Barwa Adda Expressway Limited (BAEL)

5.13.1 ITNL has an investment of Rs 451.5 crore and loan amount of Rs 854.53 crore (including interest accrued Rs 178.88 crore) which constitutes total exposure of Rs. 1,305.53 crore in BAEL. From WP "ITNL H Investment March 2018-Investment Movement" tab, it is observed that Company has acquired 12,55,00,000 equity shares at Rs 10 each. Under work done section of the WP, it is noted that movement in investments have been verified from the financials and documents related to the movement have been obtained by the Audit Firm. However, on perusal of the above mentioned WP, NFRA has not found any evidence of share certificates relating to investments in BAEL, having been verified by the Audit Firm.

Assessment of Discounted Cash Flow Model (DCF)

5.13.2 The Company's policy of impairment in subsidiary, associates and joint ventures is as follows: (Page 000308 of WP Summary Review Memorandum)

i. Cash flow models for all project SPVs: compare DCF with investment amount in books.

ii. For investment in other than Project SPVs: compare net worth of subsidiary, associate and joint ventures with investment amount in books.

5.13.3 Hence, the verification of projected cash flows (or discounted cash flows) is significant in order to assess the valuation of investments and the impairment losses thereon. In the WP, "Projected Cash Flow of BAEL", Company has included estimated proceeds from the issue of bonds during the year ended 31-MAR-2020 amounting to Rs 2,413 crore. NFRA further notes from WP "ITNL- M18 ECL on loans & Advances- BAEL Sub debt, that loan amount of Rs854.53 crore (including interest) given by ITNL to the SPV is shown to be repaid by 31-MAR-2020. From the work paper it is inferred that proceeds from the Bond amounting to Rs 2,413crore are to be utilised for the closure of loan amount from the parent Company. The fact that such a substantial sum of future cash inflows was recognised in input model for the Financial Statements of 2017-18, should have led the auditor to exercise high degree of professional scepticism and to scrutinise the validity of Management's assumptions for recognising such cash inflows, as were required under the SA. According to Para A80 of SA 540 the reasonableness of the assumptions used may depend on Management's intent and ability to carry out the course of action and accordingly the audit procedures may include (a) review of written plans and other documentation, including, where applicable, formally approved budgets, authorisations or minutes. (b)Inquiry of management about its reasons for a particular course of action. (c) Evaluation of entity's ability to carry out a particular course of action given the entity's economic circumstances, including the implications of existing commitments. On perusal of audit files submitted to NFRA, it is noted that the worksheet Projected Cash Flow of BAEL does not contain any analysis and evaluation whatsoever of the assumptions used by the management to project the cash inflows from the proposed Bond issue. The

Audit Firm failed to obtain any supporting evidence such as management's documented plan regarding the Bond issue, nor did the Firm make any inquiries of the Management regarding their plans and preparations for the Bond issue. Thus, the Audit Firm completely failed in documenting their assessment of the Company's ability to raise money from issuance of bonds, in the light of economic circumstances and the existing commitments, in serious violation of Para A80 of SA 540.

5.13.4 NFRA has further noted from the audit file that the Commercial Operation Date (COD) of the six lane project of Barwa Adda Expressway has been assumed by the Management as 30-JUN-2019, based on legal opinion dated 31-Mar-2018 obtained by the Company. NFRA further note from Para 6 of the legal opinion that acquisition of land in bits and pieces has been one of the reasons for project delay and cost over-run.

5.13.5 As the Company was facing land acquisition issues, the commencement date and viability of the project to generate revenues and to recover the costs as scheduled, was clearly doubtful. However, the Audit Firm, completely failing to exercise professional scepticism and questioning the management's position on realizability of such an amount, accepted the management's estimates in violation of requirements of SA 540.

5.13.6 In the WP "Projected Cash Flow of BAEL" (Hard file 13), toll revenue projections are based on Management estimates. In the WP BAEL_1.4 comprising of toll revenue projections, a table is given which compares the management's estimates (toll revenue collections) with traffic study report of Translink. However, the traffic study report of Translink as verified by the ET is not part of audit file. In the absence of traffic report of Translink in the audit file, the auditor has clearly failed to consider the source, relevance and reliability of external data received from External Expert of the Management to assist in making the accounting estimate. Para A69 read with A78 of SA 540, explains testing of management's estimates to be made by the Auditor and the matters that the auditor may consider in evaluating the reasonableness of the assumptions used by the Management which include

i. Testing the extent to which data on which the accounting estimate is based is accurate, complete and relevant, and whether the accounting estimate has been properly determined using such data and management assumptions,

ii. Considering the source, relevance and reliability of external data or information, including that received from external experts engaged by management to assist in making an accounting estimate.

iii. Re-calculating the accounting estimate and reviewing information about an accounting estimate for internal consistency.

iv. Whether individual assumptions appear reasonable.

v. Whether the assumptions are interdependent and internally consistent.

vi. In the case of fair value accounting estimates, whether the assumptions appropriately reflect observable marketplace assumptions.

5.13.7 From examination of the working papers submitted, NFRA has observed that no verification has been done by the auditor to test the accuracy, completeness, relevance of data forming the basis of toll revenue projections. The Audit Firm has merely relied on the estimates given by the management and failed to test the management's estimates as required by Para A69 and A78 of SA 540.

5.13.8 In the WP "Projected Cash Flow Statement- BAEL", the Company has recognised claims of Rs 375 crore and Rs. 125 crore for the year ended 2020-21 and 2021-22 based on legal opinion, dated 31- Mar-2018. Para A47 of SA 540 *provides examples of accounting estimates that may have high estimation uncertainty and significant risks which includes judgments about the outcome of pending litigation or the amount and timing of future cash flows dependent on uncertain events many years in the future. Para A102 of SA 540 explains auditor's further substantive procedures for auditing the accounting estimates that give rise to significant risks which includes:*

i. How management has assessed the effect of estimation uncertainty on the accounting estimate, and the effect such uncertainty may have on the appropriateness of the recognition of the accounting estimate in the financial statements; and

ii. The adequacy of related disclosures.

5.13.9 Further, Para A48 of SA 500 on evaluating the appropriateness of the management's expert work provides that considerations when evaluating the appropriateness of the management's expert's work as audit evidence for the relevant assertion may include:

i. The relevance and reasonableness of that expert's findings or conclusions, their consistency with other audit evidence, and whether they have been appropriately reflected in the financial statements;

ii. If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods; and

iii. If that expert's work involves significant use of source data, the relevance, completeness, and accuracy of that source data.

5.13.10 On a perusal of the audit file, it is observed that the Audit Firm has failed to document its independent verification procedures relating to management's contention that claims amounting to Rs 375 crore and Rs 125 crore would be realised in 2020-21 and 2021-22. Although the SA clearly requires that pending litigation having high estimation uncertainty should be considered as a significant risk, there is no evidence in the audit file that explains auditor has considered pending litigations or claims as significant risks while planning the audit. There is no evidence of further substantive procedures for auditing the accounting estimates which have high estimation uncertainty that gives rise to significant risks as required by Para 102 of SA 540. There is no evidence in the working paper, as required by Para A48 of SA 500, to establish that the Audit Firm enquired from the management about the counter claims of the Highway Authority, if any, and status of the claim as on the date of signing of Auditor's report, making the entire assessment of the Auditor a meaningless exercise.

5.13.11 Para A68 of SA 540, states that the Auditor's review of accounting estimates made in the prior period financial statements suggest the effectiveness of management's process of making accounting estimates in the current period. However, on perusal of audit file submitted to NFRA, it is seen that the auditor's evaluation of prior period accounting estimates is not part of audit file. Hence, the requirements of Para A68 of SA 540 are not adhered to by the Audit Firm. This clearly indicates that auditor has merely relied on accounting estimates provided by the management without further evaluating the appropriateness of such estimates (such as toll revenue, percentage of completion of project and commercial operation date etc).

5.13.12 Based on the observations above, it is clear that the valuation of the entire financial exposure of Rs1350 crore of ITNL in Barwa Adda project was not tested and evaluated as per SAs. The Audit Firm failed to flag the unsubstantiated assumptions used by the management to establish the valuation of investments and loans in the Balance Sheet.

5.14. NFRA had conveyed the following in its Draft Audit Quality Review Report:

Investment of 12,55,00,000 equity shares at Rs 10 each in BAEL

5.14.1 As per Section 177 sub section (4) of Companies Act 2013, every Audit Committee shall approve or subsequently modify transactions of the Company with related parties. Provided that Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the Company subject to conditions as may be prescribed (Rule 6A of Companies (Meetings of Board and its Powers) Rules 2014.

5.14.2 Rule 6A of Co (Meetings of Board and its Powers) Rules 2014, lays down following requirements:

(3) the audit Committee shall satisfy itself on the need for omnibus approval for transaction of repetitive nature and that approval should be in the interest of the company.

(4) the omnibus approval shall contain the name of related parties, nature of transaction and maximum amount of transaction that can be entered into. Provided where the need for related party transaction cannot be foreseen, audit committee may make an omnibus approval for such transactions subject to their value not exceeding rupees one crore per transaction.

(5) Omnibus approval shall be valid for a period not exceeding one financial year and shall require fresh approval after expiry of such financial year.

5.14.3 Now in the present case of BAEL, the number of shares invested by ITNL in FY 2016-17 were 10.5 crore at a face value of Rs 10 each whereas in FY 2017-18 the total number of shares were 23.05 crore at a face value of Rs 10 each. There has been an increase of 12.55 crore shares from FY 16- 17 to FY 17-18 amounting to an increase of Rs 125.5 crore. In this regard the following points were noted:

Share certificate/ DMAT statements as on 31st March 2018

i. *The* WP Hard copy no 6 Page 141 mentions the "Work done" at the bottom. There it is mentioned "Physically verified all the Share certificates", "verified the Demat Statement for the Shares held in Demat Form" and "obtained documents for the pledged shares." However, there is not a single evidence of any physical share certificate verified by the Audit Firm. Merely writing the statement cannot be accepted as conclusive proof of Audit Firm having verified the share certificate. It should be supported either by extracts/copy of share certificate or verifiable data noted in the form of a work paper as required by Para A3 of SA 230 as it involves a significant amount (materiality of component entities is Rs 11.5 crore).

ii. There exists no evidence of verification whether the shares of BAEL were pledged with any third party. The Audit Firm also did not document the details of pledged shares in the mentioned WP "Hard copy File 6 (Page 141)". In the absence of audit evidence, it can be concluded that the Audit Firm did not perform a proper verification of the documents showing the existence and ownership of shares in BAEL. Thus, audit documentation has failed in providing evidence of engagement team being accountable for its work since it lacks the basic and essential documentary evidence for any Experienced Auditor having no previous connection with audit to be able to understand the work of Statutory Auditor.

iii. The Audit Firm mentioned three Audit committee minutes dated November 09 2017, February 8, 2018 and May 29, 2018 in its Response to the PFC.

iv. The Audit Committee minutes of 9.11.2017 show omnibus approval for investment in any related party up to Rs 1,000 crore and aggregate of all transactions with a particular related party not exceeding Rs 10,000 crore. It also provides the list of related parties for which the said omnibus approval was sought and that list included Barwa Adda Expressway Limited. This omnibus approval was effective for a period of one year effective from November 9, 2017.

v. *However*, perusal of Canvas file “ITNL H Investments March 2018” tab named “Investment Movement” shows that 3.5 crore shares of Rs 10 each were acquired in Barwa Adda Expressway Limited by ITNL in Q2 of FY 17-18 and 4.475 crore shares of Rs 10 each were acquired in Q3 for Rs 44.75 crore. The omnibus approval of Audit committee was taken on 9.11.2017 (vide Audit committee dated 9.11.2017 of Rs 1,000 crore for investment in subsidiaries). However, 3.5 crore shares in BAEL were acquired between July to Sep 2017 (Q2) without any approval of Audit Committee. For the 4.475 crore shares acquired in BAEL in Q3 i.e between Oct to Dec 2017, there exists no evidence of date of acquisition of these shares and whether Audit Committee approval was obtained if shares were acquired before 9.11.2017.

vi. Audit Firm has mentioned in point d) on Page 269 of 751 of its Response that investment in shares of BAEL was verified from the balance confirmation received from BAEL. But the document they have mentioned is “BAEL M18 Balance Sheet”. There is no sort of balance confirmation found in the audit file.

Bond Issue

5.14.4 Audit Firm submitted that after considering the understanding and explanation obtained from management, based on its professional judgement concluded that the management had the intent and ability to replace the borrowings. As a result, the Company had forecasted bond issue of Rs 2,413 crore in the year ended 31st March 2020 in cash flow projections. In this regard NFRA observes as follows:

i. The Audit Firm stated in the response that “*The procedures performed by SRBC have been documented in the future cash flow projections and the memo on “Procedures performed for testing impairment of Investment in SPVs of IL&FS Transportation Networks Limited” (Refer hard copy file 7 page no L6 to L11 and for future Cash flow projections refer hard copy file 13 page reference no.680 to 728).*”

5.14.5 The “Procedures performed for testing impairment of Investment in SPVs of IL&FS Transportation Networks Limited” in Hard Copy File 7 Page no L6 to L11 were more general procedures given as follows:

i. *Understanding the assessment done by management for testing impairment by the management.*

ii. *Involving EY valuation Team for CNTL, JSEL, KSEL, KNCEL, GRBDCL, Elsamex SA*

iii. *Procedures for verifying assumptions like Discount rate, Toll/Annuity Revenue, Claim from Authority, Construction Cost, Other operating expenses, Premium payable to Authority, Grant, Borrowings etc in case of all SPVs.*

5.14.6 But the WP did not discuss about audit procedures performed by Audit Firm to verify management assumption of Bond issue of BAEL.

5.14.7 The workpaper in Hard copy File 13 (Page 680 to 728) just contains a table of future repayments of bond amount and interest payments at a rate of 8.50% on Page 728. Apart from the tabular representation, there exists no corroborative audit evidence in the audit file to verify the management assertion of future cash flows from new bond issue.

5.14.8 Para 10 of SA 230 states that "The auditor shall document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place." (Ref: Para A14). Since bond issue of Rs 2,413 crore is a significant future transaction, the Audit Firm should have obtained sufficient and reliable audit evidence for this bond issue before accepting projections of cash inflows from it in future years. The audit file did not contain any minutes of meeting between the Management/TCWG/ other personnel within the entity or external parties and Audit Firm on this matter. Hence it can be concluded that the Audit Firm failed to document sufficient audit procedures to verify bond issue in BAEL. All other explanations given are discarded since there is no documentation in the audit file, hence they are all afterthoughts. The Audit Firm has also grossly violated the provisions of Para 10 of SA 230.

5.14.9 As per Para 13 of SA 540*: "*In responding to the assessed risks of material misstatement, as required by SA 330, the auditor shall undertake one or more of the following, taking account of the nature of the accounting estimate ………… Test how management made the accounting estimate and the data on which it is based. In doing so, the auditor shall evaluate whether: (Ref: Para. A68-A70).

5.14.10 The method of measurement used is appropriate in the circumstances; and (Ref: Para. A71- A76)

5.14.11 The assumptions used by management are reasonable in light of the measurement objectives of the applicable financial reporting framework. (Ref: Para. A77-A83)"

5.14.12 According to Para A80 of SA 540, the reasonableness of the assumptions used may depend on Management's intent and ability to carry out the course of action and accordingly the audit procedures may include: *review of written plans and other documentation, including, where applicable, formally approved budgets, authorisations or minutes.*

5.14.13 The above is supported by Para 10 of SA 540, which states that, "In identifying and assessing the risks of material misstatement, as required by SA 315, the auditor shall evaluate the degree of estimation uncertainty associated with an accounting estimate." (Ref: Para. A45-A46).

5.14.14 The Audit Firm failed to comply with the mandatory provisions of SA 540 (Para 10 and 13) and failed to assess the estimation uncertainty of proposed bond issue due to following reasons:

i. There exists no written agreement /MOU/Letter of Intent/Letter of Offer or any documentary evidence from which Audit Firm verified the authenticity of terms and conditions of proposed Bond issue to support the repayment schedule and interest rate given in audit file (interest rate mentioned as 8.5% in Hard copy file 13, Page H728).

ii. No information regarding the method used in estimating the bond issue of Rs 2,413 crore in March 2020 has been verified during audit.

iii. Details of prospective bondholders (whether institutional, private or public) from which money will be raised and their relationship with ITNL and its group entities have not been enquired into.

iv. In the absence of any written and documented audit evidence confirming terms and conditions and the source of this bond issue, it can be concluded that above Management's accounting estimate was not evaluated for the degree of estimation uncertainty associated with the accounting estimate. The written payment schedule given in audit file related to bond issue was not authenticated from any corroborative evidence and all other explanations given in the response to NFRA were mere afterthoughts. This has led to a violation of Para 13 and Para 10 of SA 540 by the Audit Firm.

5.14.15 Audit Firm stated in its response that it relied on management's history of carrying out its stated intention as seen in case of Jorabat-Shillong Expressway Limited (JSEL) and Jharkhand Road Projects Implementation Company Limited (JRIPCL) and issue of bonds in a foreign subsidiary during the year.

5.14.16 BAEL, unlike JSEL and JRPICL, suffered continuous negative cash flows during three years ending 2016, 2017 and 2018 which casts significant doubt on the repaying ability of the SPV. Also, WP ITNL Financial Models_ JRPICL (Hard copy file 13), Note 4, relating to payment of interest and repayment of NCD states that *"the payment is after the repayment of the existing NCDs and the availability of funds."* which indicates limited cash generation ability of JRPICL and a possibility of inability to repay NCDs in future. It can be seen that many SPV entities such as BAEL in this particular case are having negative cash flows from past years but Management of ITNL is still granting financial assistance (i.e loans) to them without any thorough credit assessment. Most of the refinancing of the SPVs from external lenders was done on the basis of "Letter of Support/Awareness or Financial Guarantees" from ITNL/IL&FS (i.e Holding and Ultimate Holding Company) to the Lenders since the SPVs themselves carried weak and negative cash flows. These letters of awareness are in the nature of financial guarantees to be accounted for as "Liabilities" under Ind AS 109 and the same is dealt in more detail under Section related to "Evaluation of Financial Guarantees" in this DAQRR. The Audit Firm should have been more vigilant to such policies because if all the SPVs will depend only on ITNL/ IL&FS for their repayments, it can lead to huge financial burden on Holding Company/Ultimate Holding Company and impact their credit ratings adversely. The Audit Firm despite being aware of negative cash flows in BAEL, accepted the future bond issue of Rs 2,413 crore without evaluating the credit risk with sufficient audit evidence.

5.14.17 The Audit Firm should have also questioned the Management about such optimistic estimates of bond issue in the light of the fact that the full land was not made available to BAEL by NHAI and a claim for the same, filed with NHAI, remained unsettled. Moreover, there was no calculation on which the bond value was based. The complete bond amount has been accepted as it is by Audit Firm without any sensitivity analysis of the different scenarios that may exist in market. Here, the Audit Firm should have challenged the management assumption and asked them for strong convincing evidence before accepting the projections.

5.14.18 The case of successful bond issue of ITNL Offshore Pte Ltd (mentioned on Page 46 and 47 of Annual Report of ITNL) was of a foreign subsidiary and not an Indian subsidiary. The terms and conditions and financial condition of foreign subsidiary would be very much different from an Indian subsidiary ie, BAEL in the present case.

5.14.19 Audit Firm explained in its response to PFC Point 4 (Page 272 of 751) that "*As BAEL was a 100% subsidiary with members of the management of ITNL comprising of Board of Directors of the SPV, the above plan corroborated by past trend and industry practice, was considered to be a clear intent of the management to refinance the debt".* This particular statement was not documented in the audit file and hence unacceptable as evidence.

5.14.20 Audit Firm stated in the Response to PFC that BAEL project was on track and to be completed by March 2019 having already started the toll collection. No adverse remarks were present in the audit report of the Component Auditor and no adverse remarks came to their attention about the SPV. NFRA is of the opinion that the performance materiality level of the BAEL was Rs 11.75 crores (WP 'Final Materiality (CPM) for component auditors group reporting for March 2018' in Canvas File).

5.14.21 Since the bond issue is a very material amount in the component's financial information, Principal Auditor was required to obtain sufficient appropriate audit evidence regarding the Bond issue from the Component Auditor as per Para 12 of

SA 600 which it failed to do so. Para 12 of SA 600 requires the Principal Auditor to perform procedures to obtain sufficient appropriate audit evidence, that the work of the Othe Auditor is adequate for the Principal Auditor's purposes, in the context of the specific assignment but there is no document related to bond issue obtained from Component Auditor that forms part of audit file. Even after knowing the materiality of amounts involved, the Audit Firm did not perform any supplemental tests as required by SA 600 (Para 16).

5.14.22 The Audit Firm should have definitely exercised sufficient due diligence in verifying the bond issue in BAEL cash flows. There is no evidence in the audit file which makes a critical assessment of ability of the SPV to raise Rs 2,413 crores (proceeds of bonds). The Audit Firm simply relied upon the management representation and did not exercise professional scepticism to obtain sufficient audit evidence to corroborate the management representation. It also violated Para 13 and 10 of SA 540 and Para 12 and 16 of SA 600 as explained above.

"Translink" Traffic Report

5.14.23 Audit Firm submitted in the response, *"Considering that this was a technical matter, the external experts report was used by SRBC to test reasonableness and reliability of management's assumptions and estimates. Accordingly, SRBC has not merely relied on the management estimates and has tested the same based on the traffic study report from an external expert*."

5.14.24 However, on scrutinising the audit file, NFRA has come across "Final Traffic Assessment Report" by "Feedback Infra Private Limited" (WP BAEL 2017-18 Traffic Report in EY Canvas) issued to ITNL in the month of February 2018. However, in the audit WP 'Projected Cash Flow of BAEL' Translink report has been mentioned. There seems to be a conflict between the two.

5.14.25 Further NFRA notices that there is no evaluation done by the Audit Firm of management's assumptions with the work of Management Expert related to traffic study and toll projections as required by provisions of SA 500. Following discrepancies were observed in the assessment of traffic study report of "Feedback Infra Private Limited" by Audit Firm:

i. Assessment of methodology used in traffic growth rate estimation in the specific case of Barwa Adda Expressway Limited (BAEL) and comparison with other similar projects for its reasonableness.

ii. Sensitivity analysis of projected traffic under three categories- most likely, optimistic growth rate and pessimistic growth rate for BAEL project and how it is incorporated to arrive at the final traffic projections was nowhere documented in audit file.

iii. No verification of average daily traffic and how it is used to calculate toll revenue in future years.

iv. No verification of correctness of toll rates/user fee rates used in estimating toll revenues of BAEL.

v. Variations if any in these traffic projections and how they have been dealt with.

vi. Verification of important variables in traffic study report of BAEL project with similar projects of different companies in same industry.

5.14.26 Since Audit Firm has not done an independent evaluation of above assumptions for BAEL project, it can be concluded that Audit Firm failed to comply with mandatory provisions of Para 8 of SA 500 with respect to:

i. Evaluating the competence, capabilities and objectivity of the Expert; (Para. A37-A43)

ii. Obtaining an understanding of the work of that Expert; and (Para. A44-A47)

iii. Evaluating the appropriateness of that expert's work as audit evidence for the relevant assertion. (Para A48)

5.14.27 Para 13 *of SA 540: "*In responding to the assessed risks of material misstatement, as required by SA 330, the auditor shall undertake one or more of the following, taking account of the nature of the accounting estimate …………………………………….. Test how management made the accounting estimate and the data on which it is based. In doing so, the auditor shall evaluate whether: (Ref: Para. A68-A70).

(a) The method of measurement used is appropriate in the circumstances; and (Ref: Para. A71-A76)
(b) The assumptions used by management arereasonable in light of the measurement objectives of the applicable financial reporting framework. (Ref: Para. A77-A83)"

5.14.28 Since Para 13 requires Audit Firm to mandatorily test how management has made the accounting estimate and whether it is reasonable, the Audit Firm's submission that para A69 and A78 of SA 540 are indicative procedures and not mandatory procedures is not correct.

5.14.29 Audit Firm also stated that, "*The auditor based on his professional judgement can decide the procedures required to obtain reasonable assurance with respect to the management estimates and assumptions."* But NFRA is of the opinion that this is not a satisfactory answer to the query. By merely putting Management traffic projections on one side and Translink projections on the other side without explaining or providing any calculations, workings, assessments of such projections clearly shows that no procedures were performed to check the accuracy and reliability of these figures. The Audit Firm was required to properly document adequate audit procedures for evaluation of management assumption and future estimates of toll revenue from the Project and document the conclusions reached after such evaluation.

5.14.30 Hence, it can be concluded that the Audit Firm has failed to comply with Para A69 of SA 540 to:

i. Consider management's review and approval processes

ii. Re-calculate the accounting estimate, and reviewing information about an accounting estimate for internal consistency

iii. Test the extent to which data on which the accounting estimate is based is accurate, complete and relevant, and

iv. Whether the accounting estimate has been properly determined using such data and management assumptions.

5.14.31 Para A9 of SA 230, Audit Documentation states that, "*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"*. In the case of toll revenue projections of BAEL, there exists no documentation of the professional judgements exercised in performing the evaluation of Management estimates in BAEL's future cash flows. Hence, this is a clear violation of Para A9 of SA 230.

Claim Recognition of Rs 500 Crore in future cash flows of BAEL

5.14.32 Para A47 of SA 540 provides examples of accounting estimates that may have high estimation uncertainty and significant risks which includes judgments about the outcome of pending litigation or the amount and timing of future cash flows dependent on uncertain events many years in the future. Para A102 of SA 540 explains auditor's further substantive procedures for auditing the accounting estimates that give rise to significant risks which includes:

i. How management has assessed the effect of estimation uncertainty on the accounting estimate, and the effect such uncertainty may have on the appropriateness of the recognition of the accounting estimate in the financial statements; and

ii. The adequacy of related disclosures.

5.14.33 The WP 'Projected Cash Flow Statement- BAEL', disclosed claims receivable of Rs 375 crore and Rs. 125 crore for the year ended 2020-21 and 2021-22. On perusal of audit file in relation to audit procedures taken by Audit Firm on verification of claims the following discrepancies have been noticed by NFRA:

***Letter of* Claim**

i. The Audit Firm stated in point 4(b) of Response (Page 278 of 751) that Audit Firm verified the letters of claims filed by the Management with the Authority. The WP, 'Procedures performed for testing impairment of Investment in SPVs of IL&FS Transportation Networks Limited' (Hard copy file7 page L6 to L11) has been submitted in support of the same. This WP states that "*Claims from authority are considered in cash flow projections on the basis of the claim opinion obtained by the management from the external consultants. Further, we have verified the letters of claims filed by the management with the Authority.*" This is more of a high level statement of procedures ET has performed for SPVs in general. There is no documentation of names of particular SPVs for which letters of claim have been obtained, the claim amount involved and the status of claim on reporting date.

***Legal* Opinion**

ii. In the WP "Projected Cash Flow Statement- BAEL", the Company has recognised claims of Rs 375 crore and Rs. 125 crore for the year ended 2020-21 and 2021-22 based on legal opinion, dated 31- Mar-2018. Audit Firm stated in the Response that the total amount of claim raised by BAEL on NHAI in March 2018 was Rs 741 crore. Audit Firm also stated in the response that "*the SPV had also obtained a legal opinion from an external legal expert which was provided to us by ITNL management. According to the said legal opinion the probable amount of claim recoverable by the SPV was Rs 550 crore. This was supported by the extension of time recommended by Independent engineer and approved by the NHAI wherein the IE and NHAI had admitted to delays by NHAI in providing encumbrance free land / right of way.*" However, the Audit Firm has not verified any letter from NHAI regarding admission of the delays in providing encumbrance free land to BAEL. It has simply relied on legal opinion and management explanation for claims due to delay in land availability without verifying whether such claims have actually been accepted by NHAI.

iii. The only supporting document found in audit file is the Legal opinion of "Advocate Krishnan Venkatraman" dated 31- Mar- 2018 which contains the probability of different components of claim to be received by BAEL from NHAI due to delay in land availability.

iv. As per Para 8 of SA 500 the Audit Firm was required to evaluate the reasonableness of Expert's conclusions, the relevance and reasonableness of significant assumptions and methods used and the completeness and accuracy of that source data used in the Expert's work which has not been complied or documented by Audit Firm. The Audit Firm has said in point no 5 (Page 279 of 751) of Response that in case of another SPV wherein the legal expert had provided an opinion in earlier years the claim awarded was within a reasonable range as assessed by the legal expert and hence his legal opinion was considered to a reasonable, relevant and reliable. But this conclusion is not recorded anywhere in audit file nor any kind of comparative analysis of the two separate cases has been done by Audit Firm. Hence, these statements are mere afterthoughts and unacceptable. There is no evidence in audit file to support that Audit Firm obtained an understanding of the work of Management Expert (i.e Legal expert) or evaluated appropriateness of Management expert's work according to provisions of Para 8 of SA 500.

External Confirmation

v. As per Para A2 of SA 500, audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, reperformance and analytical procedures in addition to inquiry. Para A18 states that "*external confirmation represents audit evidence obtained as a direct response to the auditor from a third party in paper, electronic form or other medium. External confirmations need not be restricted to account balances only. For example, the auditor may request confirmation of the terms of agreements or transactions an entity has with third parties*." In the present case of BAEL, one of the best possible audit procedures to confirm amount receivable under claims filed with NHAI was to obtain external confirmation from NHAI since the IE and the NHAI had reportedly admitted to delays by NHAI in providing encumbrance free land, and this was a factor that went to support the Audit firm's acceptance of the management position. This would have given the Audit Firm a more direct, reliable and accurate probability of claims to be recognised and status of the claim filed with NHAI (point (g) on page 280 of 751 of Response). However, the Audit Firm failed to do so.

Verification of* Claims *by communicating with the Component Auditor (SA 600)

vi. On reading Note 44, "Claim from Authority" of Special Purpose Financial Statements of BAEL, "BAEL_March_2018" in EY canvas, *"During the year, the management based on its assessment of the realisability of claims filed with NHAI, has recognised claims aggregating to Rs 370.57cr which have been accounted for as a reduction in the carrying value of its intangibles assets under development or credited to Statement of Profit and Loss depending upon whether the claims were of capital or revenue nature. The scheduled completion of the project was due on September 26, 2016 but due to conditions not attributable to the Company the completion has been delayed for which company has already* *preferred claims with NHAI/ IE for appropriate relief by way of Extension of Time which is under their consideration."*

vii. This statement itself shows that Extension of Time is only under consideration and has not yet been consented to by NHAI. However, the Audit Firm claims that the extension of time has been consented by NHAI without any reference of supporting evidence in audit file.

viii. The statement in Note 44 of BAEL financials, "*During the year, the management based on its* assessment *of the realizability of claims filed with NHAI",* shows that management of BAEL estimated the probable realisable claim value as Rs 370.57 crore and recognised it in the books. As per the Policy of BAEL, claim is to be recognised as a separate financial asset and either reduced from the intangible or credited to Profit & Loss account based on nature of amount.

5.14.34 Para 12 of SA 600 requires that "The principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment. When using the work of another auditor, the principal auditor should ordinarily (b) advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them." The Auditor of BAEL was MKPS & Associates for the year ended 31st March 2018. Hence, the Audit Firm of ITNL i.e SRBC was required to communicate, advise and obtain compliance of correctness of claim recognized from MKPS & Associates on the basis of management assessment of its realisability. But there exists no communication between Principal Auditor and Component Auditor under SA 600 in this regard. The document mentioned in response is just the copy of financials "BAEL_MARCH_2018" which solely does not serve the purpose.

5.14.35 Para 14 of Ind AS 11 states that claims should be included in contract revenue only when negotiations have reached an advanced stage such that it is probable that the customer will accept the claim.

5.14.36 No procedures have been performed to understand the background of claim of Rs 370.57 crore realised in BAEL financial statement of 2017-18, the period of filing of claim nor the series of responses of counter party that led to determination of claim of Rs 370.57 crore. This also leads to the doubt over the reliability of claim of Rs 500 crore to be received in future years 2020-21 and 2021-22 by BAEL. The Audit Firm has failed to exercise professional scepticism in this matter and accepted Management contention without obtaining and evaluating sufficient appropriate audit evidence.

Other matters (SA 500)

5.14.37 Audit Firm submits that the Company had considered the claim to be awarded within three years from the date of filing which was concluded to be reasonable considering that the claim of another SPV which was awarded within two years from the date of arbitration and conciliation proceedings. (Point 6 on Page 279 of 751 of Response)

5.14.38 But this statement given by Audit Firm is not in the audit file nor any comparative analysis of similarities and dissimilarities between BAEL and other SPV is part of audit file. Hence, this explanation is not acceptable.

5.14.39 Audit Firm has also stated in its response that "*The claim was filed by the Company in the month of March 2018 and we had performed inquiries with the management and those charged with governance with respect to subsequent event occurring after the balance sheet date and up to the date of signing our audit report and were not informed of any such counter claims.*" (Point 7(g) on Page 280 of 751 of Response).

5.14.40 However, no such confirmation of counter claims after the balance sheet date has been documented in the audit file by Audit Firm. No external confirmation was sought from any third party like NHAI for confirming the status of claim filed by BAEL.

5.14.41 Based on the above facts, it can be concluded that even though Para A47 mentions outcome of pending litigation to have high estimation uncertainty and Para A102 of SA 540 lists some audit procedures for auditing such accounting estimates involving high estimation uncertainty, the Audit Firm did not comply with them. It has failed to obtain apply the requisite procedures under SA 600 and to evaluate the work of external expert according to provisions of Para A48 of SA 500.

Prior Period estimates

5.14.42 In the PFC, Para A68 of SA 540 was quoted by NFRA stating that auditor's evaluation of prior period accounting estimates was not part of audit file. To this, the Audit Firm replied (Point 2 on Page 281 of 751) that SA 540 addresses only accounting estimates involving measurement at fair value and provision against the carrying amount of an investment where there is uncertainty regarding its recoverability is not a fair value estimate (Para A6 of SA 540).

5.14.43 Regarding the above, NFRA observes that the Para 1 "Scope of SA 540" mentions that SA 540 deals with the auditor's responsibilities regarding accounting estimates, including fair value accounting estimates, and related disclosures. Accounting estimate is defined as approximation of a monetary amount in the absence of a precise means of measurement. It is used for an amount measured at fair value where there is estimation uncertainty, as well as for other amounts that require estimation. Where this SA addresses only accounting estimates involving measurement at fair value, the term "fair value accounting estimates" is used.

Hence, on reading the definition of accounting estimate and Para 1 of SA 540 it is clear that the SA 540 covers all type of accounting estimates and not only fair value accounting estimates.

5.14.44 Further, Para 2 of Appendix to SA 540 states that “Additionally, different financial reporting frameworks may use such terms as “entity-specific value,” “value in use,” or similar terms, but may still fall within the concept of fair value in this SA.”

5.14.45 Thus, the contention of Audit Firm that provisions Para A68 of SA 540 is not applicable and is not correct.

5.14.46 Para 9 of SA 540 requires the Audit Firm to review the outcome of accounting estimates included in the prior period financial statements, or, where applicable, their subsequent re-estimation for the purpose of the current period. Further by reviewing prior period accounting estimates under Para A39 of SA 540, Audit Firm is able to obtain information regarding the effectiveness of management’s prior period estimation process, from which the Audit Firm can judge the likely effectiveness of management’s current process. It also enables the Audit Firm to obtain audit evidence that is pertinent to the re-estimation, in the current period, of prior period accounting estimates.

5.14.47 The importance of reviewing prior period accounting estimates is established in Para 34 of Ind AS 36. It requires the Management to assess reasonableness of assumptions of current cash flow projections by examining the causes of differences between past cash flow projections and actual cash flows. The current cash flow projections should be consistent with past actual outcomes.

5.14.48 Thus, the Audit Firm cannot negate the need of evaluating prior period accounting estimates for formulating current year cash flow projections on the stand that SA 540 is only applicable on fair value accounting estimates. The Audit Firm has grossly failed in complying with the provisions of SA 540 and Ind AS 36 in verifying assumptions of current year cash flow projections of BAEL (subsidiary of ITNL) by analysing prior period accounting estimates with actual outcome. This has led to faulty impairment testing and material misstatement in valuation of ITNL’s investment.

5.14.49 Based on the above, NFRA concluded in the DAQRR that Audit Firm has:

i. Not carried out the audit according to standards of auditing;
ii. Not maintained professional scepticism, and not exercised the professional competence and due care and other ethical requirements mandated during the audit;
iii. Failed to report material misstatement known to them as appearing in the financial statements.
iv. Failed to evaluate the work of Management expert as required by Para 8 of SA 500.

v. Failed to sufficiently discuss with the Component auditor significant matters in the component's financials and properly document them according to provisions of SA 600.

5.15. NFRA has examined in detail the replies dated 10th July, 2021, and the oral submissions made by the Audit Firm (replies to the DAQRR) regarding the observations in the DAQRR and concludes as follows:

5.15.1 The Audit Firm's contention that, "*related party transactions with wholly owned subsidiaries were exempt from prior approval of the Audit Committee, Omnibus approval and also from the approval of the shareholder and hence the RPT framework was not applicable to related party transactions with wholly owned subsidiaries ...... As can be seen from the Annual report for the year ended March 31, 2018, Barwa Adda Expressway Limited (BAEL) was a wholly owned subsidiary of the Company and hence, the investment in equity shares of BAEL did not require any approval and hence was considered appropriate. Additionally, in the Audit committee meeting held on November 9, 2017, the audit committee had as a best practice suo-moto passed a resolution providing Omnibus approvals for all related party transactions. Accordingly, the requirement to obtain Audit committee approval was not mandatory.*" is not acceptable. Compliance with section 188 of the Companies Act requires verification of arm's length basis of related party transactions in all cases. The replies of the Audit Firm are deliberately intended to mislead NFRA by quoting an inapplicable provision and reflects a poor understanding of the applicable laws and standards of auditing.

5.15.2 The Audit Firm seeks to rely on the present fourth proviso to Sec 177(4) to contend that transactions with a wholly owned subsidiary are exempt from the prior approval of the Audit Committee. This fourth proviso was introduced by the Companies (Amendment) Act, 2017, and was brought into force only with effect from 07th May, 2018, after the completion of the audit period currently under review. Fully aware of this, the Audit Firm has deliberately chosen to mislead NFRA by quoting this inapplicable provision. Under Sec 177, as applicable during the year under audit, the prior approval of the Audit Committee was mandatory in all cases. Further the fourth proviso to Sub-section (1) of Section 188 states that "Provided also that nothing in this sub-section shall apply to any transactions entered into by the company in its ordinary course of business other than transactions which are not on an arm's length basis". Hence, on a plain reading of the above proviso, only RPTs that satisfy the conditions therein are exempt from the requirement of approval of the Board at a meeting. However, as observed by NFRA in the DAQRR the Audit Firm has not verified the existence of prior approval or even whether the transaction is on an arm's length basis and in the ordinary course of business or not.

5.15.3 The Audit Firm states that "*SRBC reiterates that it had verified the share certificates / letter of allotment of shares by BAEL as at March 31, 2018 and has clearly documented in work done that SRBC had "Physically verified all the Share Certificates*" *(Refer hard copy file 6 page no H141 and H142)…… Inspite of clear documentation with respect to verification of share certificates on audit file, NFRA has alleged that the documentation is not sufficient since SRBC has not kept photocopies of share certificate on the audit file; such preposterous statements of NFRA reviewer frustrate us: going by NFRA's logic, does NFRA expect auditor to maintain photocopies of currency notes in case of verification of* *cash on hand by auditor?”*. NFRA cannot take such contentions on face value as there is no verifiable data noted in the work paper as required by Para A3 of SA 230 since it involves a significant amount. Also, the instances of doubtful integrity of the audit documentation of the Audit Firm as established elsewhere in this AQRR, e.g., in respect of ‘claims’ in paras above, forces NFRA to rely only on convincing evidence supported by verifiable data in all cases. For such an Audit Firm having such doubtful integrity of its documentation, there would be no surprise if a regulator insists on “*photocopies of currency notes in case of verification of cash on hand by auditor”*.

5.15.4 Regarding the bonds issue, which “*was **expected to take place** after two year from the end of the year under audit*”, the Audit Firm failed to substantiate its claims with verifiable evidence. It states that “*Post **completion of construction** and **stabilisation of traffic**, it was a **normal business model** of the Company to replace the existing debt with low interest debt on account of reduction in construction risk once the **project is fully operational**. In case of BAEL the Company had rights to collect toll from the date of start of construction, accordingly, **post completion of work the traffic was expected to increase** and as explained by the management, **there was a plan to replace the existing high interest loans** with new low interest loans **within a year from achieving CoD**. Accordingly, the amount funded by the Company by way of sub-debt and term loan to fund the project initially during construction phase would be **repaid by the SPV along with interest***.” (Emphasis added). As it can be seen from the above, the portions **in bold** are all future expectations/assumptions that require substantiating evidence to ensure reasonability. However, the Audit Firm has simply echoed the management expectations without any objective analysis. Professional scepticism involves, as its essence, a proactive search for evidence that is contrary to the claims of the management. It is only when such contrary evidence cannot be found that the Audit Firm can proceed to consider the management’s claims. The Audit Firm ignored to follow the provisions of para A80 of SA 540 in this regard on the pretext that these are not mandatory procedures. But after having done no procedure at all, the Audit Firm cannot take shelter under the contention that these are not mandatory procedures.

5.15.1 Regarding the claims, NFRA’s observations in the chapter relating to ‘Revenue from Operations’ of this AQRR may be seen for the doubtful integrity of the reports of the IE. Also, there is no evidence that the IE has recommended the claim to NHAI. There is no evidence that the claim filed by BAEL with NHAI were verified by the Audit Firm regarding the agreement conditions.

5.15.2 Regarding the traffic study, the Audit Firm submits that “….*SRBC had verified the Translink report basis which the aforesaid comparison has been made and analysed. Translink’s report was obtained during the audit of March 31, 2017 and the evaluation of work of management’s specialist was performed during the audit of year ended March 31, 2017 (Refer Annexure 3 for traffic study report and Annexure 4 for evaluation of work of Management specialist). As we understand, management had also obtained traffic study report from Feedback Infra Private Limited, however, it was under evaluation by the management and not considered for preparation of future cash flow projections of BAEL……. Considering that the it is a highly technical matter, the management has inhouse specialist to perform the traffic count. However, this being one of the most important variables, management also obtained a traffic study report from external experts every few years to compare with its estimates.”* However, there is no evidence in the Audit File to prove that the Audit Firm has done an independent evaluation of the external expert's work in compliance with Para 8 of SA 500. Apart from the above, the above reply makes it clear that the Audit Form has relied on an outdated report while there was a recent report available for verification. Hence, whatever procedures the Audit Firm claims to have been done makes no relevance in the present case.

5.15.3 Also as seen by NFRA earlier, the claim accounting policy of the company has no empirical basis, without which it does not provide an adequate audit evidence.

5.15.4 The Audit Firm submits that "*Obtaining external confirmation from authorities was not a practice in the industry and the highway authorities do not confirm the amount of claim and the expected period to settle the same*." Based on this, the para titled "<u>External Confirmation</u>" in the DAQRR has been edited. However, NFRA observes that the tone of the replies of the Audit Firm makes it clear that in all cases of the claims, the Audit Firm has relied only on the contentions and viewpoints of the management or its agencies. Approval of an EOT does not automatically imply that the claim for delay/damages is also approved by default. The EOT could also be without damages or with amended conditions. It is only a thorough examination of all facts, by stepping into the shoes of the NHAI, that can provide confirmation about the recoverability of the claims. No such efforts have been made by the Audit Firm.

5.15.5 Regarding the applicability of para A68 of SA 540, the Audit Firm states that *"NFRA's comment was specifically with respect to para A68 of SA 540. SRBC had responded to this specific comment of NFRA and explained that para A68 of SA 540 was not relevant. This is on account of the definition of accounting estimate in para 7 which clearly states that "Where this SA addresses only accounting estimates involving measurement at fair value, the term "fair value accounting estimates" is used" and **para A68 only refers to "fair value accounting estimate**" in case of impairment testing performed based on value in use. This clearly demonstrates the intent of SA540 and NFRA is trying to make an unfounded and stretched interpretation of its own*." The contention of the Audit Firm is meritless, as para A68 is application guidance for para 13(b) of SA 540. Para 13 (b) refers to all accounting estimates, not just fair value accounting estimates. Also, the portion of the para A68 referred to by NFRA uses the term 'accounting estimate' not 'fair value accounting estimate'. Only the first sentence in para A68 is restricted to 'fair value accounting estimate'. The remaining part of the para refers only to 'accounting estimate'. Both parts are not interdependent.

5.15.6 The other contentions of the Audit Firm are not supported by evidence in the Audit File. Based on the above, NFRA concludes that the Audit Firm has:

i. Not carried out the audit according to SA 540, SA 500 and SA 600;
ii. Not maintained professional scepticism, and not exercised the professional competence and due care during the audit;
iii. Failed to report material misstatement known to them as appearing in the financial statements.
iv. Failed to evaluate the work of Management expert as required by Para 8 of SA 500.
v. Failed to sufficiently discuss with the Component auditor significant matters in the component's financials and properly document them according to provisions of SA 600.

5.16. NFRA had conveyed the following prima facie conclusions:

Investment in Srinagar Sonmarg Tunnelway Limited (SSTL)

5.16.1 The Company in Note 4 "Investments" to the Standalone Financial Statements for the FY 2017-18 has presented investment in one of its subsidiaries (at deemed cost) i.e., Srinagar Sonmarg Tunnelway Limited (SSTL) at Rs.195.90 Crores as at 31-Mar-2018 (Previous Year: Rs. 195.90 Crores).

5.16.2 Para B.3 of Note 1 to the Standalone Financial Statements for the FY 2017- 18 on "Investments in subsidiaries, associates and joint ventures" provides that:

5.16.3 "Investment in subsidiaries, associates and joint ventures are measured at cost as per Ind AS 27."

5.16.4 NFRA has noted that the Company, on the first-time adoption of Ind AS during the FY 2016- 17, had disclosed, in Para D.5 of Note 1 to the Standalone Financial Statements for the FY 2016-17 that: D.5 Investments in Subsidiaries, Joint Ventures and associates.

5.16.5 In its separate financial statements, the Company has measured these investments at deemed cost i.e. the previous GAAP carrying amount at the date of transition. However, for the following investments in Subsidiaries, Joint Ventures and Associates, the Company has taken one-time fair value option at the transition date:

- Jharkhand Road Projects Implementation Company Limited
- Hazaribagh Ranchi Expressway Limited
- MP Border Check Posts Development Company Limited
- Pune Sholapur Road Development Company Limited
- Barwa Adda Expressway Limited
- Charminar Robopark Limited
- Futureage Infrastructure India Limited
- Thiruvananthapuram Road Development Company Limited
- ITNL Road Investment Trust
- Noida Toll Bridge Company Limited.

Assessment of ITNL's Investment in SSTL

5.16.6 On the basis of the Company's disclosure in the Financial Statements of 2016-17, it is evident that the Company had opted for the first time Ind AS adoption exemption to initially recognize the investment in SSTL at deemed cost i.e., the carrying value as per the existing GAAP as on the date of transition (01-APR-2015). The Company had stated in its notes to the financial statements for the FY 2016-17 that the investment in SSTL which was earlier presented as "Associate" has now been presented as "Subsidiary" due to change in the provisions of Ind AS.

5.16.7 The carrying amount of investment in SSTL on different dates, as stated in the Financial Statements of 2016-17, and 2017-18, is reproduced below:

(Rs. in Crores)

Particulars	**31- Mar-2018**	**31-Mar-2017**	**31-Mar-2016**	**31-Mar-2015**
Under IGAAP	-	-	5.68	5.68
Under Ind AS	195.90	195.90	190.25	136.19

5.16.8 The above referred table indicates that the investment in SSTL as per Ind AS was recognized at Rs.136.19 crore against the carrying amount of Rs 5.68 crore under the existing GAAP. The amount of investment subsequently increased to Rs 190.25 crore and Rs 195.90 crore (as on 31- MAR-2016 and 31-MAR-2017 respectively) in the Ind AS Financial Statements. There existed no explanation in the audit file of correctness of opening balances from 01-Apr-2015 to 01-Apr-2017 having been verified by the Auditor according to SA 510.

5.16.9 Footnote 2 to Note No.38 of the Standalone Financial Statements for the FY 2016-17 on "Ind AS 101 reconciliations" states as below:

"2. Under the previous GAAP, premium paid of Rs.100 crore to acquire the right to purchase investments in Srinagar Sonmarg Tunnelway Limited (SSTL) a tunnel project, was presented as Right under Intangible assets and was amortised over 20 years. Under Ind AS, the premium paid is considered and disclosed as Investments."

5.16.10 NFRA noted from Note 1 of the working paper on the "Yearly Cash Flow Statement of SSTL" referred in the Audit File No 13 Page No 1134, that *"ITNL currently holds 49% in SSTL. The current cost is Rs 195 crore including deemed equity of Rs 90.2 crore. ITNL has entered in MOU with Soma for remaining 51% stake to be transferred to ITNL. ITNL has also advanced purchase consideration of Rs 5.86 crore. Considering this MOU, ITNL has full control over SSTL and therefore the total value for 100% is (Rs 195+5.86 crore) 200.86 crore, adding to it the future equity investment of Rs188 crore, the total value comes to Rs 388 crore. To compare the total equity value, the value of fair value of loan will be added to the present value of equity and hence the present value of equity is Rs 432 crore (342.9+90.2 crore) which is compared to the total value of investment of Rs 388 crore. The net present value of equity being greater than the value of investment, there is no impairment in books."*

5.16.11 On examination of above-mentioned facts, NFRA observed that:

i. There is no explanation in the Audit File about how ITNL's investment of Rs. 5.68 crore (carrying cost of investments in SSTL under IGAAP) and Rs. 100

crore (premium paid to acquire the right to purchase investments in SSTL), the total of which comes to Rs 105.68 crore, have been accounted as Rs. 136.19 crore as of 31 MAR-2015 and have subsequently been assessed as Rs.190.25 crores, as shown in Para 7.5 above. There is no evidence in the Audit File that these opening balances have been verified by the Auditor, as required under Para 6 of SA 510 "Initial Audit Engagements-Opening Balances". Since the Audit Firm was joint auditor of the Company for the FY 2016-17 they were bound by the provision of SA 510 to the extent the audit areas in previous year were covered by the predecessor auditor. The Audit Firm has therefore been grossly negligent in the discharge of its professional duties in failing to obtain sufficient appropriate evidence about whether opening balances contain misstatements that materially affect the current period's financial statements.

ii. Further, there is no basis for arriving at the value of deemed equity of Rs. 90.2 crores as stated in Note 1 to the WP, 'Yearly Cash Flow Statement of SSTL'. Moreover, the Audit Firm has failed to question the management on the assumption of "deemed equity", a concept unknown to the Accounting Standards.

iii. The Audit Firm has failed to highlight Management's failure to apply the requirements of Ind AS 36 for testing impairment. Para 8 of Ind AS 36 states that an asset is impaired when its carrying amount exceeds its recoverable amount. Para 6 of Ind AS 36 defines recoverable amount of an asset or cash generating unit as higher of its fair value less cost of disposal and its value in use.

iv. In the case of SSTL, fair value had to be estimated on the basis of projected cash flows since the shares are not listed instruments and hence no quotation is available. NFRA observes that the entire working of SSTL cash flow statement is unintelligible and the figures used therein are not supported by any evidence. Specifically, it is seen that the cash flow projections include Rs. 188 crores as accrual to SSTL, where the amount is clearly to be paid to Soma for transfer of the remaining 51% stake to ITNL. Removing this amount of Rs. 188 crores from the cash inflows, the NPV of ITNL's equity investment in SSTL would only be approximately Rs. 87.61 crores. This results in impairing the investments by Rs. 108.29 crores.

v. The Audit Firm has failed to highlight these violations and has merely relied on the management estimates committing gross violation of professional behaviour required of a statutory audit.

vi. There is no evidence available in audit files on the audit procedures performed to verify the potential impact of MOU Dated 06-APR-2018 with Soma Enterprises Limited as enclosed in the Audit File i.e., WP "Soma MOU 06-04-18" on the valuation of investment in SSTL on account of shares to be acquired from Soma.

5.17. NFRA had conveyed the following in its Draft Audit Quality Review Report:

Advance amount of Rs 100 crore paid by ITNL in 2012-13

5.17.1 Without prejudice to NFRA's right to disregard and not accept explanations which are not part of audit file, NFRA had proceeded to examine the explanations and had made the following observations:

i. Note no 16 (i) Standalone Financial Statements of ITNL for the year ended 31st March 2013 states that "*During the year ended March 31, 2013, the Company has paid `1,000 million to acquire right to invest in equity of a special purpose vehicle ("SPV") to be formed for construction, operation and maintenance of Z-morh Tunnel including approaches on National Highway no. 1 (Srinagar Sonamarg Gumri Road) in the state of Jammu and Kashmir. Since the SPV has not been formed as at March 31, 2013 the amount paid has been shown as capital advance. On the formation of the SPV and the allotment of shares to the Company, the amount will be transferred to intangible assets and amortised over the concession period of the SPV.*"

ii. The above Note mentions that Rs 100 crore was paid to acquire right to invest in equity of SPV and treated as a capital advance since the SPV had not been formed. It does not specify any percentage of holding against this amount.

iii. On the contrary, the Audit Firm's response (Page 296 of 751) states that "*SRBC submits that, based on our understanding obtained from management and the joint auditor during the year 2012-13, ITNL had subscribed to 14.5% shares in SSTL for a consideration of Rs.5.68 crore and had paid premium of Rs 100 crore to SOMA to acquire 34.5% stake in SSTL, to acquire control over SSTL and a right to purchase the balance 51% stake from SOMA. By virtue of acquiring control of SSTL, ITNL had classified SSTL as a subsidiary as per IND AS 110.*"

iv. The statements in the Response and Note of Financials above are contradictory to each other. In the Financials of 2012-13, Rs 100 crore is shown as a right to acquire equity and in the Response of Audit Firm it has been stated as the cost of 34.5% stake in SSTL which are two different things. In the Note to Financials of 2012-13, there is no mention of percentage of shareholding against which the amount of Rs 100 crore has been advanced and the party to whom it is given.

v. The Audit Firm did not verify any supporting Agreement (or extracts thereof) to satisfy itself of the true details (nature, party to whom payment made, terms and conditions etc) of such material amount of advance since no supporting document was available in audit file submitted to NFRA. This has led to a material misstatement in opening balances brought forward from the previous year to the relevant year of audit (i.e FY 2017-18).

vi. Since the above advance of Rs 100 crore was paid in the year 2012-13, it should have been settled by 2017-18, since 5 years have already elapsed. That the transaction had not been completed even in the span of 5 years is something which should have caused suspicion in the mind of Audit Firm to enquire more about the transaction and verify the whole thing again scrupulously. But the Audit Firm did not perform any audit procedure such as inquiry from SOMA whether it will transfer balance 51% stake to ITNL and enquiry from Management regarding the authenticity of whole transaction and recoverability of amount advanced. The failure of Audit Firm to perform appropriate audit procedure on the reason for delay in completion of this transaction shows lack of professional competence and due diligence during audit.

vii. Note no 13 (2) of Standalone Financial Statements of FY 2014-15 states that, *"During the year ended March 31, 2013, the Company had paid `1,000 Million to acquire right to invest in equity of a special purpose vehicle ("SPV") to be formed for construction, operation and maintenance of z-morh Tunnel including approaches on National Highway no.1 (Srinagar Sonamarg Gumri Road) in the State of Jammu & Kashmir, Subsequently, the SPV has been formed during the year namely Srinagar Sonamarg Tunnelway Limited ("SSTL"). During the current year ended March 31, 2015 the Company has capitalised the aforesaid capital advances of ` 1,000 Million, to the intangible assets viz. Commercial Rights are being amortised w.e.f. July 1, 2014 over the concession period of 20 years. Accordingly, during the year, the company has amortised ` 37.77 Million to the statement of Profit and Loss."*

viii. The above Note states that the amount of Rs 100 crore paid to SSTL was booked as "Commercial Rights" (i.e Intangible) in the books of ITNL in the year 2014- 15. This means that the contention of Management that Rs 100 crore was paid to acquire control over shareholding of SSTL is false since it was booked as Intangible Asset and Rs 3.77 crore had already been amortised in the year 2014-15 itself. Had this amount of Rs 100 crore been treated as investment, there would have been no periodic amortisation.

ix. In addition to this, in the year 2014-15 the cost of investment in SSTL was Rs 5.68 crore for 49% (14.5% plus 34.5%) shareholding. Clearly, Rs 100 crore was not paid for acquiring the stake of 34.5% in SSTL as mentioned in Audit Firm's Response. The explanation of the Audit Firm is false and misleading. As already explained in the previous para, if the amount of Rs 100 crore was Intangibles viz Commercial Rights it cannot be accounted as Investment. Therefore, on transition to Ind AS, the amount of Rs 100 crore should not be included under heading of Investment (Note no 4 of Standalone Ind AS financials of ITNL for the year 2016-17 and 2017-18). Further, as per Appendix A of Ind AS 11, a service concession arrangement should be included in the books of SPV depending on nature of arrangement since SPV is the real Operator of the infrastructure facility and not ITNL. (Grantor is the National Highway Authority). The Audit Firm has colluded with the Management in inflating the investments by Rs 100 crore.

x. On verification of MOU dated 6th April 2018 executed between SOMA Enterprises Limited and ITNL, it has been stated that "*SOMA is currently the legal and beneficial owner of inter alia the Target Shares (59,07,750 shares)"*. The shareholding in Annexure A of the MOU shows that 51% of shares in SSTL was held by SOMA Enterprises Ltd on 6th April 2018.

xi. Further, there is no reference in the MOU to Rs 100 crore which has been claimed to be paid by ITNL to SSTL as per Management and supported by Audit Firm to acquire right to invest in equity of SSTL in the year 2012-13. Hence, Rs 10 crore has nothing to do with Investments as stated in the financials of 2017-18 and 2016-17. Further, the explanation given by Audit Firm that Rs 100 crore was paid to acquire 34.5% stake and right to purchase balance 51% stake in SSTL is not evident in the MOU at all.

5.17.2 From above points, it is evident that the opening balances contained misstatements that materially affected the current period's financial statements (FY 2017-18), hence the Audit Firm should have performed additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements. But the Audit Firm failed to verify the opening balances through adequate additional procedures and this led to a material misstatement in the opening balances of financial statements.

5.17.3 The Audit Firm colluded with the Management and failed to disclose a material fact known to it which is not disclosed in a financial statement, but disclosure of which is necessary in making such financial statement where he is concerned with that financial statement in a professional capacity. This amounts to professional misconduct as under Second Schedule Part I Clause 5 of the Chartered Accountants Act 1949.

Deemed Equity

5.17.4 The Audit Firm submits that:
i. "*the amount of Rs 136.19 crore as at March 31, 2015 comprised of Rs 5.68 crore of equity investment, Rs.100 crore paid to acquire the right to acquire investments in SSTL and Rs.30.52 crore of deemed equity component of loan provided to SSTL at preferential terms in earlier years this break-up was documented in audit file for the year ended March 31, 2017*" ((point b) on Page 296 of 751 of Response).

5.17.5 "ITNL *had given a loan including interest of Rs.55.78 crore to SSTL as at March 31, 2015 at preferential terms. In case of SSTL since the loan given by ITNL was at preferential terms, upon conversion to Ind AS, the loan was recorded at fair value* *of Rs.25.27 crore i.e. the present value of future cash flows at the then prevailing market rates and the difference of Rs.30.52 crore was added to investment in the said SPV as deemed equity contribute on. While this is a very well accepted accounting concept in IFRS and Ind AS, SRBC is surprised at NFRA's comment that it is a "concept unknown to accounting standards*" (point (d)(ii) on Page 296 of 751 of Response). It also explained that as there was no change in the value during 31st March 2018, audit team referred the said amount from previous year audit file.

NFRA had the following observations in this regard:

5.17.6 Para 5.1.1, 5.1.1A and B5.1.2A of Ind AS 109 states as follows:

i. 5.1.1 - Except for trade receivables within the scope of paragraph 5.1.3, at initial recognition, an entity shall measure a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

ii. 5.1.1A - However, if the fair value of the financial asset or financial liability at initial recognition differs from the transaction price, an entity shall apply paragraph B5.1.2A.

iii. B5.1.2A - The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price (ie the fair value of the consideration given or received, see also Ind AS 113). If an entity determines that the fair value at initial recognition differs from the transaction price as mentioned in paragraph 5.1.1A, the entity shall account for that instrument at that date as follows:

a) at the measurement required by paragraph 5.1.1 if that fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e a Level 1 input) or based on a valuation technique that uses only data from observable markets. An entity shall recognise the difference between the fair value at initial recognition and the transaction price as a gain or loss.

5.17.7 The Audit Firm in the instant case has used Discounted Cash flow model as the valuation technique for fair valuation of financial instrument at initial recognition using observable market data ie then prevailing market interest rate. Hence according to Para B5.1.2A (a) the difference of fair valuation and transaction price should be recorded as a gain or loss. The Company has included the difference between the fair value calculated at prevailing market rates and the carrying value of loan as "Deemed equity" which is in contravention of Para B5.1.2A of Ind AS 109. This has led to misstatement in investment by Rs 90.2 crore as stated in WP "ITNL M18 Financial Models_SSTL" in Hard Copy File 13.

5.17.8 The following extract has been provided as explanation of deemed equity in Response to NFRA PFC:

i. *Extract from Audit Firm's response to NFRA PFC: The accounting treatment of deemed equity is also supported by the analogy in ICAI's ITFG Bulletin 18 reproduced below:*

"Issue 3: S Ltd. has received an interest free loan from its holding company H Ltd which it is under obligation to repay at the end of five years. S Ltd. is required by Ind AS 109, Financial Instruments, to initially recognise the loan at its fair value determined in accordance with Ind AS 113, Fair Value Measurement. How should the difference between the loan amount and the fair value of the loan at initial recognition be accounted for at the time of initial recognition in the books of S Ltd?

Response: In the given case, since the subsidiary is under an obligation to repay the loan provided to it by the holding company, the loan represents a financial liability of the subsidiary and should be so recognised. On a consideration of the substance of the transaction and in the absence of any factors that lead to a different conclusion as to its nature, the excess of the loan amount over the fair value of the loan at initial recognition should appropriately be regarded as an equity infusion by the parent and should therefore be credited directly to equity."

5.17.9 However, NFRA observes that:

i. The ITFG Bulletin 18 provided by SRBC was issued on 7 Feb 2019 which is after 31 March 2018. This could not have been the basis for the decision of Audit Firm, because it was much later than the Audit Report;

ii. ITFG has given a clarification from the point of view of the lender. They have not used the term "deemed equity".

iii. This is not in the Audit File, and there is no support from the audit file to show that this indeed was the basis;

iv. ITFG has not quoted any provision of the Ind AS. It is not open to ITFG to offer any opinion that is not directly based on the applicable Ind AS;

v. The views of the ITFG do not have any authority whatsoever if they directly contradict the provisions of the Ind AS, as has been clearly shown to be the case here;

vi. Ind AS are statutory rules issued under the Companies Act;

5.17.10 The Audit Firm in Point d(i) on Page 296 of 751 of the Response states in context of deemed equity that "*This accounting concept / treatment not specifically dealt with by any accounting standard and hence reference has to be drawn from the*

Conceptual Framework." Then in point d (ii) Audit Firm states that "*While this is a very well accepted accounting concept in IFRS and Ind AS, SRBC is surprised at NFRA's comment that it is a "concept unknown to accounting standards.*" Both the sentences are contradictory to each other.

5.17.11 Audit Firm explains that for the purpose of impairment of Investment as per Ind AS 36, in Note 1 to the WP "ITNL M18 Financial Models_SSTL" (Hard copy 13), that "*To compare the total equity value, the fair value of loan will be added to the present value of equity and hence the present value of equity is Rs 432crore (342.90+90.2) which is compared to the total value of investment of Rs 388 crore."* Now, this meant that deemed equity of Rs 90.2 crore was added to the present value of future cash flows of Rs 342.90 crore to arrive at total amount of Rs 432 crore. But NFRA observes that Deemed equity is not prescribed by any IndAS and hence it should be charged to Statement of Profit and Loss due to reasons stated in preceding point (b) Deemed Equity. To the extent it is not charged to P/L Account, this results in inflation of profit. However, Audit Firm did not raise the above discrepancy before the Management or Those Charged with Governance. Hence, this has led to material misstatement in the financials of 2017-18.

Management's False Contention of Rs 188 crore in Cash Flow Projections

5.17.12 Audit Firm stated in its response that "*Further, the figures used in the cash flow statement are supported by evidence in the form of workpaper on audit file (Refer cash flow projection of SSTL in hard copy file 13 page no 1133 to 1137) and certain figures which continued from previous year were verified from previous year audit file……… The amount of Rs.188 crore as per the cash flow projections was the expected equity infusion by ITNL in SSTL in future years. This amount was not to be to be paid to SOMA for transfer of remaining 51% stake to ITNL. We are not aware of the basis of NFRA's conclusion that Rs 188 crore was to be paid to SOMA for acquiring 51% stake. Accordingly, the adjustment made in future cash flow projection of SSTL was appropriate and no impairment was required."*

5.17.13 The WP, "SSTL cash flow" in audit file states that, "*ITNL has entered in MOU with Soma for the remaining 51% stake to be transferred to ITNL. ITNL has also advanced the purchase consideration of Rs 5.86 crore. Considering this MOU ITNL has full control and therefore the total value for full 100% is Rs 200.86 crore (Rs 195+ 5.86 crore), adding to it the future equity investments Rs 188 crore, the total value comes to Rs 388 crore"* Now NFRA has simple and logical questions with regard to this:

i. Intercompany transfers such as transfer of funds from Parent to Subsidiary and vice versa does not amount to increase in recoverable value of investment since it is one's own funds which is being circulated from one hand to another. Hence, such a transfer of funds from ITNL to SSTL is an inadmissible entry in the estimated future cash flows and does not hold valid.

ii. Further Ind AS 36 Para 50 states that:
"Estimates of future cash flows shall not include: cash inflows or outflows from financing activities; or income tax receipts or payments"

5.17.14 Para 50 read with Para 51 clearly provides to exclude cash inflows and outflows from financing transactions. Hence equity infusion by Holding Company (ITNL) to Subsidiary Company (SSTL) is not as per Ind AS 36 (Para 50).

5.17.15 Therefore, the assumption of further infusion of equity in future cash flows of SSTL for an amount of Rs 188 crores does not seem logical. NFRA believes that the Cash Flow Statement of SSTL in audit file containing Rs 188 crore as part of future cash inflows was not according to provisions of Ind AS 36. If additional equity of Rs 188 crore is removed from the future cash flows and the present value of such future cash flows is calculated at 11% discount rate it comes to Rs 192 crore. Since the shareholding of ITNL in SSTL is only 49% as per the Investments schedule (Note 4 of Standalone Financial statements), the recoverable value of SSTL investment is Rs 94.22 crore (i.e., 49% of Rs 192 crore). The recoverable value of Rs 94.22 crore is less than cost of Rs 195.9 crore of investment. Thus, there arises impairment loss of Rs 101.68 crore (Rs 195.9 crore less Rs 94.22 crore) as per Ind AS 36. The Audit Firm did not exercise sufficient due care and this led to inflation of profit by Rs 101.68 crore.

5.17.16 The above stated deficiencies provide sufficient basis for attracting the attention of the Audit Firm. However, the Audit Firm remained oblivious to the matters above and did not exercise sufficient due care and professional competence in assessing them. This led to an incorrect estimation of recoverable value of investment in the books of account of the Company.

Cash Flow Projections

5.17.17 The cash flow projections of SSTL in audit file were based on unrealistic and baseless assumptions. Most of the assumptions were without any supporting and concrete evidence and contained only management explanations and workings. The Audit Firm did not verify any probability weighted cash flows using sensitivity analysis of the most likely, moderate and the worst possible outcomes.

5.17.18 The working papers did not have any comparison of prior period forecasts with actuals to estimate the reliability and certainty of Management assumptions.

5.17.19 The discount rate used in Hard copy is 11% and in soft copy is 9.42% (WP "ITNL M18 Financial Models"). No explanation for the said difference is mentioned in the audit file.

MOU executed between SOMA and ITNL dated 6th-Apr-2018

5.17.20 Audit Firm submits that it had *"verified the MoU between ITNL and Soma Enterprises Limited dated 6th April 2018 to acquire balance 51% stake for a consideration of Rs 5.86 crores as per clause E on page 2 of the MoU. The advance of Rs 5.86 crore was given by ITNL to Soma as on March 31, 2018 and SRBC had verified the MoU as an evidence to support the advance payment made to Soma as at 31st March 2018. As can be seen, it was merely an MoU with an understanding that a Sale Purchase agreement would be subsequently executed and hence it did not have any impact on the financial statements."* (Page 298 of 751 of Response to NFRA by Audit Firm)

5.17.21 NFRA has following observations in MOU signed between SOMA Enterprises Limited and ITNL:

i. The MOU was signed on 6th April 2018 between SOMA Enterprise Limited and ITNL i.e after the Balance Sheet date of 31st March 2018.

ii. There is no clue of the total consideration to be paid to SOMA in audit file for the remaining 51% stake. Further, the MOU does not indicate the amount of Rs 100 crore paid by ITNL in previous year 2012-13 as mentioned by Audit Firm in its response.

iii. Clause (B) of MOU states that "*SOMA is currently the legal and beneficial owner of inter alia the Target Shares (as defined hereinafter). The shareholding pattern after the Company as on Execution Date is provided in Annexure A hereof.*" Annexure A is tiled as "*Holding of SOMA in the Company as on the date of this MOU*". The Annexure A depicts 59,07,750 shares pledged by SOMA Enterprise Limited at a total amount of Rs 59,07,7500 (i.e 51% shareholding). This means that the legal owner of shares at the date of MOU was SOMA Enterprises Limited.

iv. Under the Agreement under Clause (C) that "*The Interested Party is desirous of acquiring from SOMA up to 59,07,750 equity shares held by SOMA in the Company, which currently represents 51% of the total issued, subscribed and paid up share capital of the Company ("Target Shares")."* This Interested Party is ITNL in the MOU. ITNL is only desirous and not yet acquired the balance 51% stake in SSTL.

v. Further, Clauses 2.3, 3 and 4 of MOU is extracted below:

2.3 *The Parties shall, subject to receipt of approval, consent or no- objection from NHIDCL and its lenders, effect the transfer of Target Shares by 31st March 2021 (or such other extended period as may be communicated by SOMA to the interested party)("Long Stop Date") failing which, the Advance Amount along with applicable interest (if any), cost and charges shall become due and payable by SOMA to the Interested Party immediately, thereof.*

Obligations of SOMA:

SOMA covenants to the Interested Party that: It shall apply for all Governmental Approvals and third party consents, including lenders consents, as may be required under Applicable Law and under any agreement to which SOMA is a party with direction and assistance of the Interested Party, to give effect to the understanding set out in this MOU; Notwithstanding the generality of the obligation set out at Clause 3(a), SOMA undertakes to apply to the National Highway & Infrastructure Development Corporation Limited (NHIDCL) with direction and assistance of the Interested Party obtaining approval for divestment of the Target Shares in favour of the Interested Party; and During the subsistence of this MOU, it shall not entertain any proposal from, or reach out to any third party for the purposes of divestment of the Target Shares or part thereof and shall not create any Encumbrance on the Target Shares or part thereof. Extent of Transfer Subject to Approval, Consent and No Objections It is clearly understood and agreed to by the Parties that the of transfer and sale of Target Shares and the extent thereof, shall be subject to the approval, consent and/or no objection as mentioned at Clause 3 hereinabove("Approval").

5.17.22 From Clauses 2.3, 3 and 4 of MOU, it can be seen that the transfer of target shares is subject to approval, consent and/or no objection of NHIDCL and its lenders both. Also, the amount advanced is liable to be returned immediately back to ITNL if approval is not obtained for transfer of shares. Hence, merely giving the amount of Rs 5.86 crore does not bind the parties to the contract.

5.17.23 It has been stated in Clause 2.2 of MOU that *"immediately upon execution of this MOU SOMA shall, in order to secure its obligations under this MOU, create a pledge on the Target Shares in favour of the Interested Party by executing Pledge agreement in favour of the Interested Party."* But the date of execution of MOU itself is after 31st March2018 (i.e 6th April 2018) and there is no evidence of Audit Firm having verified the Pledge Agreement as it does not form part of audit file.

5.17.24 Clause 2.8 of the said MOU, states that " *It is further agreed to by the Parties that the Target Shares can only be pledged in favour of the lenders to the Project and in such a scenario, the charge on the Target Shares will be shared on a pari passu basis amongst the said lenders and the Interested Party."* Thus Clause 2.8 also clearly shows that ITNL does not have full rights over the shares of SSTL.

5.17.25 As per the condition of Para 7 of Ind AS 110, control is established when all the following conditions are satisfied:

i. Power over the investee (see paragraphs 10–14);

ii. Exposure, or rights, to variable returns from its involvement with the investee (see paragraphs 15 and 16); and

iii. the ability to use its power over the investee to affect the amount of the investor's returns (see paragraphs 17 and 18).

5.17.26 The facts stated above show that according to the MOU, the ownership of shares of SSTL have not been fully transferred to ITNL by SOMA till the end of FY 2017-18 and hence it cannot be said that ITNL has power over the investee since the majority shareholding still exists with SOMA. There is also nothing in the Agreement expressly stating the rights of ITNL over the profits or operating activities of SSTL so as to prove that second and third conditions of Para 7 of Ind AS 110 have been fulfilled. Thus, the contention of Management that SSTL is a subsidiary has not been verified by the Audit Firm diligently and with appropriate audit evidence.

5.17.27 Based on the above NFRA concluded in the DAQRR that the Audit Firm is guilty of:

i. Not carrying out the audit according to standards of auditing;

ii. Not maintaining professional scepticism, and not exercised the professional competence and due care and other ethical requirements mandated during the audit;

iii. Certifying financial statements that are false in material particulars, knowing it to be material.

5.17.28 The Audit Firm has failed to disclose a material fact known to it which is not disclosed in a financial statement, but disclosure of which is necessary in making such financial statement where he is concerned with that financial statement in a professional capacity.

5.17.29 The result of the above is overstatement of investment amount by Rs 190.2 crore (Rs 100 crore plus Rs 90.2 crore deemed equity). SSTL has falsely included cash inflows from ITNL leading to inflation of recoverable amount of SSTL investment and causing profits to be inflated by at least Rs 101.68 crore (given in point c(iii) above).

5.17.30 The Audit Firm should have expressed a qualified opinion or an adverse opinion, as appropriate, in accordance with SA 705(Revised) since the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed. (Para 11 of SA 510).

5.18. NFRA has examined in detail the replies dated 10th July, 2021, and the oral submissions made by the Audit Firm (replies to the DAQRR) regarding the observations in the DAQRR and concludes as follows:

5.18.1 Regarding the advance amount of Rs 100 crore paid by ITNL in 2012-13, the Audit Firm states that "*SRBC cannot comment on the accounting treatment with respect to above amount in earlier years… …. SRBC had performed adequate procedures to obtain sufficient an appropriate audit evidence with respect to areas where SRBC was joint responsible for audit along with joint auditor. Accordingly, opening balance procedures as required by SA 510 with respect to Investments were performed for the year ended March 31, 2017 and documented in the audit file for the year ended March 31, 2017*". The reply makes it clear that the Audit Firm has ignored glaring evidence of a wrong accounting treatment without any valid reasons. As observed by NFRA in the DAQRR, since the above advance of Rs 100 crore was paid in the year 2012-13, it should have been settled by 2017-18, as 5 years had already elapsed. That the transaction had not been completed even in 5 years is something which should have caused suspicion in the mind of the Audit Firm to enquire more about the transaction and verify the whole thing again scrupulously. The Audit Firm's performance of the opening balance procedures is devoid of professional skepticism and professional competency.

5.18.2 The Audit Firm submits that *"As mentioned in clause 2.5 of SPA, ITNL had acquired from SOMA (promoter shareholder), 49% equity stake of which 14.5% was by way of subscription to the shares of SSTL on incorporation and balance 34.5% was acquired subsequently on receiving approvals from regulatory authorities. Further, as can be seen from clause 2.6 of SPA, ITNL had paid Rs.100 crore to SOMA for agreeing to induct ITNL as a shareholder for acquisition of aforesaid stake. Along with this induction ITNL shall control and monitor all the activities relevant to the construction of the project. Accordingly, it is clear from the above, that Rs.100 crores was premium paid to promoter shareholder towards 49% equity stake in SSTL. Accordingly, the said amount was classified as investment in SSTL in the opening balance sheet as at April 1, 2015 on first time adoption of Ind AS."* Such explanations now offered by the Audit Firm based on the SPA agreement etc, are purely afterthoughts and are triggered only after NFRA's observations in the PFC, therefore not admissible as evidence of the due performance of the audit. Without prejudice, the reply makes it clear that the amount of Rs 100 crore is not only for the right to acquire equity shares but also for the right to control and monitor all the activities relevant to the construction of the project. Thus, a deeper examination of this material transaction was warranted to bring clarity to the accounting treatment. In the absence of such an examination, the presumption is that the transaction is not properly reflected in the financial statements.

5.18.3 The above replies also make it clear that the Audit Firm ignored evidence that a material misstatement existed in the prior period financial statements on which an unmodified opinion has been previously issued. In such circumstances, para 12 of SA 710 states that "the auditor shall verify whether the misstatement has been dealt with as required under the applicable financial reporting framework and, if that is not the case, the auditor shall express a qualified opinion or an adverse opinion in the auditor's report on the current period financial statements, modified with respect to the corresponding figures included therein". (Para 5.17.30 above stands deleted).

5.18.4 Regarding 'deemed equity' NFRA's observations in this AQR in chapter 'Reversal of Expected Credit Loss' may be referred to. During its oral hearing also the Audit Firm stated that "Deemed equity is a very well recognized concept under IFRS and Ind AS and is supported by Ind AS 109, Ind AS 113 and conceptual framework on IFRS". In this regard, NFRA asked the Audit Firm to specifically show where this has been mentioned in the above standards/framework. However, the Audit Firm failed to show even a single instance where deemed equity is recognised in the above pronouncements. In this regard, the Audit Firm also submits that *"NFRA has completely ignored SRBC's submission to NFRA's PFC, wherein SRBC had also provided reference to financial statements for the year ended March 31, 2018 of some of the large listed companies in infrastructure segment audited by other large firm of auditor's wherein deemed equity has been accounted and which demonstrates that this is a generally accepted and most appropriate accounting practice"*. It is emphasised that NFRA is not bound to accept any such practices, even if it is widely used and preached when such practices do not have the support of the law/standards as applied in India.

5.18.5 Regarding the inclusion of projected equity infusion of Rs 188 crore in the cash flow projections, the Audit Firm now submits that *"Considering the MOU ITNL had full control and therefore the total value for full 100% is Rs. 200.86 crore (Rs. 195+ Rs. 5.86 crore). Adding to this the future equity investment of Rs.154 crore (Net present value of Rs.188 crore as at March 31, 2018 @9.42%) the total value of investment comes to Rs.354 crore. This then needs to be compared with the net present value of future cash flows of SSTL i.e. Rs.403 crore (discounted @ 9.42%). Accordingly, there was no impairment."*

"SRBC had applied sensitivity to the discount rate and had considered a higher discount rate of 11%. Accordingly, ***the future equity investments work out to Rs.149 crore (Net present value of Rs.188 crore as at March 31, 2018 @11%) and adding to this the value of investment of Rs.200.86 crore, the total value of investment comes to Rs. 349 crores****. This needs to be compared with the net present value of future cash flows of SSTL i.e. Rs.343 crore (discounted @ 11%). The difference of Rs.6 crores was ignored by us as it was based on the sensitivity applied to the discount rate of 1.5% (discount rate considered by SRBC was 11% as against the discount rate considered by ITNL of 9.42%)."*

"Accordingly, ***while the value of equity was considered in the discounted cash flow, it was reduced from the NPV to derive the net value of equity investments.*** *In essence the value of future equity contribution was excluded for the purpose of impairment testing and hence was in compliance with the requirements of Ind AS 36."*

5.18.6. The reply of the Audit Firm is preposterous. To test impairment of investments as on balance sheet date, the Audit Firm has strangely added NPV of future investments and also taken it in future cash inflows in utter violation of Ind AS 36 and then claimed that "SRBC exercised professional competence and due care"! NFRA finds no merits in the arguments of the Audit Firm in this regard. Instead of covering up a mistake, it gives credibility to a professional when it is admitted and corrected. Unfortunately, the Aaudit Firm lacks not only professionalism but also honesty.

5.18.7. Based on the WP references submitted, the paras 5.17.17 to 5.17.19 on <u>cash flow projections</u> of SSTL stands deleted.

5.18.8. Regarding the treatment of SSTL as a subsidiary, the Audit Firm submits that "*ITNL had the right to control and monitor all activities relevant to the construction of the project under the concession agreement. ITNL also had the right to nominate two directors and SOMA had the right to nominate two directors, however, ITNL had the right to appoint the Chairman of the Board of Directors and also the Managing Director / manager of SSTL. Further, the quorum of the board meeting would require at least one director nominated by ITNL. Accordingly, ITNL had the power over SSTL (Ind AS 110.7(a)). ITNL was exposed to and also had rights to variable returns from the Company since it was a holder of 49% of the equity shares and had a call option and had also entered into an MOU to acquire the balance 51% of the equity shares. Thus, its returns were variable and dependent on the financial performance of SSTL (Ind AS 110.7(b)). Further, for quorum of the Board of Directors of SSTL, ITNL's nominee director's presence was necessary and so decisions in Board could not be taken by Soma alone. Based on the above it was concluded by the ITNL management that ITNL had control over SSTL and hence SSTL was a subsidiary of ITNL.* ***The above control evaluation was performed during the audit of March 31, 2017 and the related memo was documented in the audit file for year ended March 31, 2017****. This evaluation was further strengthened by the MOU dated April 6, 2018 between ITNL and SOMA for acquisition of balance 51% held by SOMA in SSTL at face value (clause 2.7). ITNL actually exercised control over SSTL and hence in accordance with Ind AS 110, SSTL was a subsidiary of ITNL."* (Emphasis added)

5.18.9. The above contentions of the Audit Firm are not acceptable because:

i. There is no supporting evidence in the Audit File. The Audit Firm states that this evaluation was performed in the previous year. If that is the case, the Audit Firm shall comply with the provisions of paras 9 and A19 of SA 315. There is no indication either in the reply or in the Audit File that the Audit Firm has complied with these provisions. Para 9 stipulates that the auditor shall determine whether changes have occurred since the previous audit that may affect its relevance to the current audit. Para A19 states that "The auditor is required to determine whether information obtained in prior periods remains relevant, if the auditor intends to use that information for the purposes of the current audit. This is because changes in the control environment, for example, may affect the relevance of information obtained in the prior year. To determine whether changes have occurred that may affect the relevance of such information, the auditor may make inquiries and perform other appropriate audit procedures, such as walk-throughs of relevant systems."

ii. Establishing the three factors described in para 7 of Ind AS 110 require an in-depth analysis of all the underlying facts and circumstances to reassess whether an investor controls an investee. Para B1 to B72 of Ind AS 110 provides application guidance in this regard. Going by this guidance, it can be seen that the reasons mentioned by the Audit Firm are insufficient to establish that the three factors mentioned in para 7 exist. E.g.,

a. Para B9 - To have power over an investee, an investor must have existing rights that give it the current ability to direct the relevant activities. For the purpose of assessing power, only substantive rights and rights that are not protective shall be considered.

b. Para B11- For many investees, a range of operating and financing activities significantly affect their returns. Examples of activities that, depending on the circumstances, can be relevant activities include, but are not limited to: managing financial assets during their life (including upon default); selecting, acquiring or disposing of assets; determining a funding structure or obtaining funding.

c. Para B14 - Power arises from rights. To have power over an investee, an investor must have existing rights that give the investor the current ability to direct the relevant activities.

d. Para B25 - Substantive rights exercisable by other parties can prevent an investor from controlling the investee to which those rights relate. Such substantive rights do not require the holders to have the ability to initiate decisions.

e. Para B26 - In evaluating whether rights give an investor power over an investee, the investor shall assess whether its rights, and rights held by others, are protective rights.

f. Para B 28 - Examples of protective rights include the right of a party holding a non-controlling interest in an investee to approve capital expenditure greater than that required in the ordinary course of business, or to approve the issue of equity or debt instruments.

g. Para B39 - A contractual arrangement between an investor and other vote holders can give the investor the right to exercise voting rights sufficient to give the investor power, even if the investor does not have voting rights sufficient to give it power without the contractual arrangement. **However, a contractual arrangement might ensure that the investor can direct enough other vote holders on how to vote to enable the investor to make decisions about the relevant activities.**

h. Para B41 - An investor with less than a majority of the voting rights has rights that are sufficient to give it power when the investor has the practical ability to **direct the relevant activities unilaterally**.

iii. The assessment of control is a complex process that involves a deeper analysis of multiple factors and circumstances. The Audit Firm failed to do such an assessment and hence failed to provide conclusive evidence that there exists control as stipulated in Ind AS 110.

5.19. Based on the above NFRA, therefore, concludes that the Audit Firm:

iv. failed to carry out the audit according to standards of auditing;

v. failed to disclose a material fact known to it which is not disclosed in a financial statement, but disclosure of which is necessary for making such financial statement where he is concerned with that financial statement in a professional capacity;

vi. failed to report overstatement of investment amount by Rs 190.2 crore (Rs 100 crore in opening balance plus Rs 90.2 crore deemed equity).

vii. failed to report the inclusion of projected equity infusion of Rs 188 crore in the cash flow projections of SSTL leading to inflation of the recoverable amount of SSTL investment and thereby causing profits of ITNL to be inflated by at least Rs 101.68 crore, in gross violation of Ind AS 36.

viii. failed to express a qualified opinion or an adverse opinion, as appropriate, under para 12 of SA 710.

ix. did not maintain professional scepticism, and not exercised the professional competence and due care mandated during the audit;

x. certified financial statements that are false in material particulars, knowing it to be material.

6. REVERSAL OF EXPECTED CREDIT LOSS

6.1. NFRA had conveyed the following prima facie conclusions:

6.1.1. Footnote to Note 5 in the Standalone Financial Statements of the Company for 2017-18 inter alia, states, that:

i. "*As part of normal asset monetisation plan, the company had considered certain SPVs to be transferred to InvIT and fair valued the corresponding financial asset. In view of InvIT not being pursued, during the year the Company has reassessed its business plan for these subsidiaries and reversed the expected credit loss (net of impairment of Rs 293.28 Crore) of Rs 110.55 Crore recognised on its financial asset and included in other income.*"

ii. "*The Company has given loans to these InvIT subsidiaries i.e. Hazaribaug Ranchi Expressway Limited, Sikar Bikaner Highways Limited, Jharkhand Road Projects Implementation Company Limited at zero percent as the Company has committed to senior lenders that it will provide financial support to its subsidiaries in case of cost over runs. Since loans to these subsidiaries are given at zero percent the Company has considered difference between 0% to 8.56%-10.85% as deemed cost of investments. Accordingly, the company has recognised deemed equity contribution of Rs 402.73 Crore. and reversed the expected credit loss of Rs 403.84 Crore created in earlier years. Further the Company has also considered impairment on deemed equity contribution in Jharkhand Road Projects Implementation Company Limited and Hazaribagh Ranchi Expressway Limited of Rs 293.29 Crore*"

6.1.2. On examination of audit work papers NFRA has observed that the reversal of ECL on account of InvIT is not supported by any evidence whatsoever in the Audit File. NFRA has noted that the reversal of ECL on account of loans to these three (InvIT) subsidiaries is accompanied by recognition of "deemed equity" which is not supported by the relevant applicable accounting standards. All the above, cast serious doubts on the audit procedures followed by the Audit Firm. NFRA has the following further observations in this regard.

6.1.3. NFRA has not found sufficient and appropriate audit evidence in relation to decision of the Management about reassessment of the InvIT plan. There is no record of the Audit Firm having examined the minutes of meetings of the Board of the years 2015 and 2018 where relevant decisions were taken.

6.1.4. In NFRA's view, the reassessment of InvIT plan cannot be accepted as a valid reason for reversal of ECL. If at all, the abandonment of the InvIT plan should have led to greater uncertainty about the expected cash flows from these SPVs and therefore should have been reason for increasing the ECL provision.

6.1.5. Further, in terms of Para 5.7.11 of Ind-AS 109, it is clear that irrespective of the business model applicable i.e., to hold the financial assets for sale or to hold till maturity, the amount of ECL would remain same on a particular reporting date. In the instant case, the Company's stated stand that they have reassessed the business plan of their InvIT subsidiaries and therefore, have reversed the amount of expected credit loss is not in line with the provisions of Para 5.7.11 of Ind-AS 109, which the Auditor has failed to point out.

6.1.6. There is no evidence of the Auditors' work to review the prior year working of the fair value of these financial assets, which were to be transferred to InvIT in previous years. This was essential to examine the correctness of reversal of ECL on these entities in the current year.

6.1.7. The Audit Firm failed to question the Management on their assessment of credit risk associated with these SPVs during 2017-18, which was clearly a requirement as per Para 5.5.9 of Ind-AS 109.

6.1.8. Thus, NFRA is of the view that the reversal of ECL of Rs 403. 84 crore given in footnote to Note 5 of the Standalone Financial Statements is completely unjustified by the facts of the case. The Audit Firm has totally failed in questioning the Management with adequate professional scepticism for evidence and justification for the reversal of Rs 403.84 crores. It has thus failed to display the required professional scepticism and also failed to gather appropriate audit evidence. Taken as a whole, the facts given above clearly show that the Management has fraudulently added an amount of Rs 403.84 crores to the profit for the year 2017-18. The Audit Firm is clearly guilty of collusion with the Management by not exercising due diligence and by not performing its duty in this matter as required by the SAs. Both the Management and the Audit Firm have colluded in a deliberate attempt to mislead the users of the financial statements into believing that the Company's loans to the three SPVs were fully recoverable.

6.1.9. Further, NFRA considers the inclusion of "deemed equity" in the books of accounts of the Company as completely illegal as the concept of "deemed equity" is unknown to the Accounting Standards. Instead, the applicable Accounting Standard that should have been adhered to in this case is Para 5.4.3 of Ind-As 109, which states that:

6.1.10. "*When the contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in the derecognition of that financial asset in accordance with this Standard, an entity shall recalculate the gross carrying amount of the financial asset and shall* ***recognise a modification gain or loss in profit or loss. The gross carrying amount of the financial asset shall be recalculated as the present value of the renegotiated or modified contractual cash flows that are discounted at the financial asset's original effective interest rate*** *(or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate calculated in accordance with paragraph 6.5.10. Any costs or fees incurred adjust the carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset"* (Emphasis added).

6.1.11. Ind-AS 109 clearly provides that in case of any modification in the contractual cash flows, the resultant effect shall be recognised as profit or loss. The amount of interest foregone (discounted to present value) was Rs 402.73 crores. This clearly was an amount that was a loss to the Company and should have been taken to profit and loss account as an expense. The Company instead of recognising this loss in the Statement of Profit and Loss in compliance of the provisions of Ind-AS 109 referred above, treated the loss as deemed cost of investment (equity) in contravention to the above provisions. This is clearly an attempt at illegal recognition of a fictitious amount termed as "Deemed Equity" which in turn has resulted in incorrect reduction in the loss of the Company. The Audit Firm is guilty of completely failing to display professional scepticism and due diligence in not questioning the Management, and of gross professional misconduct in allowing this wholesale and blatant violation of the Accounting Standards to take place and failure to qualify and disclose such material facts.

6.1.12. Further, NFRA has noted from the Summary Review Memorandum (SRM), which is part of the Audit File, that the Company is said to have derecognized the loans granted to the SPVs, because of significant changes in the terms of loans. NFRA has observed that neither has this fact been disclosed anywhere in the Financial Statements, nor is the derecognition of loans in compliance with the Accounting Standards.

6.1.13. Ind-AS 109 defines Derecognition as '*removal of a previously recognized financial asset or financial liability from an entity's balance sheet*'. Para 3.2.3 of Ind-AS 109 states the criteria for derecognition as follows:

6.1.14. *An entity shall derecognize a financial asset when, and only when:*

(a) The contractual rights to the cash flows from the financial asset expire; or

(b) It transfers the financial asset as set out in paragraphs 3.2.4 and 3.2.5 and the transfer qualifies for de-recognition in accordance with Paragraph 3.2.6.

6.1.15. In the instant case, it is seen from the SRM that the Audit Firm has stated that loans given to Sikar Bikaner Highway Limited, Hazaribagh Ranchi Expressway Limited and Jharkhand Road Projects Implementation Company Limited were derecognized due to significant change in terms of the loans. This is neither transfer of assets nor expiry of contractual rights. If the assets were to be derecognized, the Company should have completely removed these assets from its balance sheet. However, this was not done, as the loans to the specified entities, continue to appear in the financial statements as on 31 March 2018. The so called derecognition of these assets is a clear violation of IndAS 109 and the Audit Firm has completely failed to perform sufficient appropriate audit procedures to identify such departure from the requirement of the applicable accounting standards.

6.1.16. The incorrect and impermissible treatment given to the transaction of readjusting the interest rates on these loans has led to a reduction in the loss by Rs 402.73 crores. Together with the incorrect and impermissible reversal of ECL of Rs 403.84 crores, it has led to an understatement of loss by Rs 806.57 crores.

6.2. This is proof of serious professional misconduct on the part of Audit Firm, of:

i. Not disclosing complete information to users of financial statements as required under relevant financial reporting framework,

ii. Not reporting material misstatements in financial statements,

iii. Not carrying out the audit according to standards of auditing,

iv. Not maintaining professional scepticism, professional competence and due care and other ethical requirements during the audit (Para 14, 15, 16, A15 of SA 200).

6.3. NFRA had examined in detail the replies submitted by the Audit Firm (replies to the PFC) and observed in the DAQRR as follows.

6.4. NFRA has observed in the preliminary findings:-

6.4.1. that the so called derecognition of the loans given to Sikar Bikaner Highway Limited, Hazaribagh Ranchi Expressway Limited and Jharkhand Road Projects Implementation Company Limited (InvIT subsidiaries) due to significant change in terms of the loans is a clear violation of IndAS 109 and the Audit Firm has completely failed to perform sufficient appropriate audit procedures to identify such departure from the requirement of the applicable accounting standards.

6.4.2. that the reversal of ECL on account of loans to these three InvIT subsidiaries accompanied by recognition of "deemed equity" is not supported by the relevant applicable accounting standards.

6.4.3. that the reassessment of InvIT plan cannot be accepted as a valid reason for reversal of ECL.

6.5. In response to these observations the Audit Firm submitted in page no. 347 of their reply to the PFC that "SRBC submits that during 2016-17 the Company changed the terms of the loan and made them interest free. As per Ind AS 109 para B.5.5.25 this change in interest rate was a significant modification resulting in derecognition of the original financial asset and recognition of a new financial asset at fair value i.e. the interest free loans were required to be recognised at discounted amounts. Difference between the amount lent and the discounted amount was required to be treated as additional investment in subsidiaries and added to cost of equity investment (as mentioned in point 3 above). However, at that point in time, no adjustment toward deemed equity investment was carried out because of management's plan to transfer the

SPVs to InvIT and the fact that equity investments in two subsidiaries were also impaired. Even though the cash flows with respect to one subsidiary had improved compared to year ended March 31, 2016, the Company retained the ECL with respect to loans given to all three subsidiaries and also calculated and charged the additional ECL on loans given during the year ended March 31, 2017 to P&L as ECL impairment since the Company was in process of transferring its investments in accordance with its InvIT plan.

6.6. The proposal, however, had a setback on account of amendments made to the Income Tax Rules in May 2017 and after evaluation, the Company finally decided to keep the InvIT plan in abeyance in March 2018 and the audit committee approved the same in its meeting held on March 29, 2018. Accordingly, in view of InvIT not being pursued, the Company reassessed its business plan for these subsidiaries and reversed the expected credit loss by crediting P&L. Due to proposed divestment to InvIT, the Company had earlier not considered such amount as addition to equity investment. The Company had accordingly added Rs.403 crore to equity investment in subsidiaries. Out of four SPVs, equity investment in two SPVs was already impaired. Accordingly, the Company recognised impairment on deemed equity of Rs. 293 crore and charged to P&L. Hence, net credit to P&L (net of impairment of deemed equity of Rs.293 Crore) was Rs.110 Crore recognised in other income."

6.7. The Audit Firm also cites para 1.1 and B5.1.1 of Ind AS 109, para 8 10(b)(ii) of Ind AS 8 and mentions the Conceptual Framework to IFRS in support of recognition of 'deemed equity'.

6.8. NFRA notes that the Audit Firm has not referred to any WPs to support their claims made in the replies to the prima facie conclusions. None of the WPs available in the Audit File contains such an examination of the accounting treatment of the subject matter. Hence the explanation provided is purely an afterthought having no evidentiary value and deserves to be rejected outright. However, without prejudice to the above fact, NFRA examines the merits of the above submissions made by the Audit Firm in the succeeding paragraphs.

6.9. The flawed submissions of the Audit Firm lack support of accounting principles as laid down in the Indian Accounting Standards read with the Conceptual Framework for Financial Reporting Under Ind AS. The Audit Firm has clearly and vehemently tried to cover up a serious breach of Ind AS 109 which resulted in an overstatement of profit of Rs 806.57 crores on account of the inadmissible reversal of the ECL provision, and the incorrect and impermissible treatment given to the transaction of readjusting the interest rates on loans to three InvIT subsidiaries of ITNL.

6.10. The above-mentioned overstatement of profit is due to the following incorrect accounting entries made in FY 2018 for the underlying transactions made in FY 2017.

i. Change in the terms of the loans by making them interest-free. However, not recognising the modification loss in Profit and Loss Account, thereby violating para 5.4.3 of IndAS 109. The amount of modification loss not recognised is Rs 402.73 crores.

ii. Reversal of ECL on loans to three InvIT subsidiaries amounting to Rs 403.84 crore.

iii. Debiting Rs 402.73 crores, as "deemed equity", in total violation of the applicable Accounting Standards.

iv. Out of (7.9.2) above, Rs 293 crore reduced as impairment loss on deemed equity, without any basis for the same.

v. Non accounting of further ECL on loans (amount not quantified).

6.11. NFRA has arrived at the above conclusions based on the following facts.

Derecognition of Loans – Non-Compliance with Ind AS

6.12. NFRA reiterates right at the outset that the arguments now given by the Audit Firm in support of the treatment of the transactions is completely an afterthought, not documented anywhere in the Audit file. The contention of the Audit Firm based on para B5.5.25 of Ind AS 109 is not acceptable and is fundamentally wrong. Para B.5.5.25 states "In some circumstances, the renegotiation or modification of the contractual cash flows of a financial asset can lead to the derecognition of the existing financial asset **in accordance with this Standard**". Para 3.2.3 Ind AS 109 lays down the criteria for derecognition. It states that "**An entity shall derecognise a financial asset when, and only when**:

(a) the **contractual rights** to the cash flows from the financial asset **expire**, or

(b) it **transfers the financial asset** as set out in paragraphs 3.2.4 and 3.2.5 and the transfer qualifies for derecognition in accordance with paragraph 3.2.6." (Emphasis added)

6.13. In the present case, there is no **transfer** of the financial assets, either in full or part. Also, the contractual rights to the cash flows have not **expired**. The word expire has the meaning "to be no longer valid because **the period of time** for which it could be used has **ended**" (source https://www.oxfordlearnersdictionaries.com). Black's Law Dictionary X Edition gives the meaning of the words 'Expiry' as "The **ending of a fixed period of time** and esp., a formal **termination on a closing date**" and in Ramanath Aiyar's Law Lexicon the word "Expiry" is defined as the "**Termination of a time or period** fixed by law, contract or agreement" (Emphasis added). Thus, within the meaning of para 3.2.3 of Ind AS 109, the reduction of interest rate to 0% (in other terms, waiver of interest) on these loans cannot and shall not be treated as expiry of contractual rights of either in full or a part of the said loans. As this transaction does not meet the criteria for derecognition, the claim of the Audit Firm, by drawing support from para B5.5.25, that "this change in interest rate was a significant modification resulting in derecognition of the original financial asset and recognition of a new financial asset at fair value" is not tenable.

6.14. The above conclusion is further supported by the following.

6.14.1. Ind AS 109 provides derecognition in full or in part, subject to prescribed criteria. In case of a part derecognition, the remaining part of the financial asset continues to exist. However, this is not the case in ITNL as confirmed by the Audit Firm when it states, "change in interest rate was a significant modification resulting in derecognition of the original financial asset and recognition of a new financial asset". In case of derecognition in full the original financial asset ceases to exist. This is also not the case in ITNL, as the original financial asset (right to receive cash as per original agreement) continues to exist in the balance sheet. Thus, the accounting entries created by the Company and concurred by the Audit Firm are violative of IndAS.

6.14.2. The terms of loan agreement were changed in FY 2017 to make it interest free. In this regard the following disclosures were made in the audited financial statements of two InvIT subsidiaries for FY 2017.

6.14.3. Note 14 of SBHL states, "Pursuant to Amendment Agreement dated Oct 13, 2016 entered between the Promoter IL&FS Transportation Limited ("ITNL") and the Company, the subordinate debt given by ITNL to the Company will not carry interest with effect from Oct 1, 2016 and provide the right to ITNL to convert the outstanding debt into equity". Also note to cash flow statements of SBHL states "Pursuant to Amendment Agreement dated Oct 13, 2016 entered between the Promoter IL&FS Transportation Limited ("ITNL") and the Company, the subordinate debt given by ITNL to the Company will not carry interest with effect from Oct 1, 2016 and provide the right to ITNL to convert the outstanding debt into equity on Oct 01, 2016 considering, the conversion being towards the end of the concession period. Hence the said amount is treated as a non cash transaction". (The disclosure lacks clarity; however, it is presumed that the conversion to equity shares will be done only at the end of the concession period)

6.14.4. Note 14 (1) (3) of HREL states "Pursuant to Amendment Agreement dated Oct 13, 2016 entered between the Promoter IL&FS Transportation Limited ("ITNL") and the Company, the subordinate debt Rs 500 million given by ITNL to the Company and Short Term Loans to the extent of Rs 1480 million will not carry interest with effect from Oct 1, 2016 and provide the right to ITNL to convert the outstanding debt into equity".

6.14.5. The above disclosures make it absolutely clear that the contractual rights of ITNL on interest and principal outstanding as on 1st October, 2016 had not expired. There was no change to this position as on 31st March 2018 as well. Hence the financial asset does not meet the criteria for derecognition, either in part or in full, as mentioned in para 3.2.3 of Ind AS 109.

6.15. Thus NFRA reiterates its observation that the alleged derecognition of the said loans, now put forth as an explanation, is not in compliance with the Accounting Standards. The Company is said to have derecognized the loans granted to the SPVs because of significant changes in the terms of loans, but this has not been disclosed anywhere in the Financial Statements.

Deemed Equity – Non-Compliance with Ind AS

6.16. The Audit Firm quotes para B5.1.1 of Ind AS 109 to support the recognition of deemed equity. The said para states "The fair value of a financial instrument **at initial recognition** is normally the transaction price (i.e. the fair value of the consideration given or received, see also paragraph B5.1.2A and Ind AS113). However, if part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument. For example, the fair value of a long-term loan or receivable that carries no interest can be measured as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of income **unless it qualifies for recognition** as some other type of asset." (Emphasis added). In this regard:-

6.16.1. NFRA notes that the Audit Firm has not referred to any WPs to support the above claims made in the replies to preliminary findings. None of the WPs available in the Audit File contains such an examination of the accounting treatment of the subject matter. Hence the explanation provided is purely an afterthought having no evidentiary value and deserves to be rejected outright. However, without prejudice to the above fact, NFRA examines the merits of the submissions made by the Audit Firm in the succeeding paragraphs.

6.16.2. Para B5.1.1 is an application guidance to para 5.1.1 and 5.1.1A, which are applicable on initial recognition. As there is no derecognition in accordance with the conditions laid down therefor under the Ind AS, the principles applicable for initial measurement and recognition are not applicable in the present case. Instead, the applicable Accounting Standard that should have been adhered to in this case is Para 5.4.3 of Ind-AS 109.

6.16.3. Without prejudice to the above, the Audit Firm conveniently ignores Para 5.1.1.A, which states "However, if the fair value of the financial asset or financial liability at initial recognition differs from the transaction price, an entity shall apply paragraph B5.1.2A". Para B5.1.2A states that "The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price (ie the fair value of the consideration given or received, see also Ind AS 113). If an entity determines that the fair value at initial recognition differs from the transaction price as mentioned in paragraph 5.1.1A, the entity shall account for that instrument at that date as follows: (a) at the measurement required by paragraph 5.1.1 if that fair value is evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) or based on a valuation technique that uses only data from observable markets. **An entity shall recognise the difference between the fair value at initial recognition and the transaction price as a gain or loss.**" (b) in all other cases, at the measurement required by paragraph 5.1.1, adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the entity shall recognise that deferred difference **as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability**". Thus even as per this para the difference due to change in interest rate has to be treated as gain or loss, not as equity.

6.16.4. Citing para B5.1.1 and para 1.1 of Ind AS 109, para 8 10(b)(ii) of Ind AS 108 and Conceptual Framework to IFRS, the Audit Firm states in page 339 of the reply that "Commonly, the substance is a capital contribution (as per the Conceptual Framework to IFRS), because the difference arises from the parent acting in its capacity as parent/shareholder, in which case it is reflected as an additional investment in the subsidiary" and in page 339-340 that "The loan was provided by the Company in its capacity as the major shareholder of subsidiaries. Therefore, the difference between the fair value and the amount lent, is required to be considered as an additional equity contribution by the company to its subsidiary."

6.16.5. NFRA notes that the Audit Firm has not referred to any WPs to support the above claims (summarized in (6.16.4 above) made in the replies to preliminary findings. None of the WPs available in the Audit File contains such an examination of the accounting treatment of the subject matter. Hence the explanation provided is purely an afterthought having no evidentiary value and deserves to be rejected outright. However, without prejudice to the above fact, NFRA examines, without admitting, in the succeeding paragraphs, the above submissions made by the Audit Firm.

6.16.6. Without prejudice to the earlier observations, NFRA notes in this regard that the stipulation **"qualifies for recognition"** in para B5.1.1 means qualifies under an applicable accounting standard for recognition. In the absence of any such stipulations regarding interest free loans to subsidiaries in any of the accounting standards, the loss due to the lower fair value as compared to the transaction value on account of zero interest rate does not qualify for recognition as an asset. On the contrary, there is a very clear and specific provision in para 5.1.1A, read with para 5.1.2A, as explained above, according to which the difference between fair value and transaction value has to be charged to profit and loss.

6.16.7. Para 49 of the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards (The Framework), issued by ICAI (which is relevant for the period of audit of ITNL) defines 'Asset' as "a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity". Because of the reduction in interest rate to zero, no future economic benefits are expected to flow to ITNL as this is only a reduction in income. Thus, going by the Framework also, the transaction does not qualify for classification as an asset titled 'deemed equity' as erroneously claimed by the Audit Firm.

6.16.8. In page 356 of their reply the Audit Firm states that "**As a result of the loans being provided at below-market interest rate (in this case, nil),** there will be a difference between the cash paid and fair value on initial recognition. This difference should be accounted for in accordance **with the substance of the transaction**. Reference is drawn from Ind AS 8 10(b)(ii)……. As the loan was provided by ITNL as a sponsor of the project to support the operations of the SPVs, in substance the difference between the fair value of the loan and the amount lent was considered **to be a capital contribution** (as per the Conceptual Framework to IFRS), because the difference arises from the parent acting in its capacity as parent/shareholder, it is reflected as an **additional investment in the subsidiary**". (Emphasis added).

6.16.9. In the first place, para 10 of Ind AS 8 applies only in a case of "**the absence of an Ind AS that specifically applies to a transaction, other event or condition**" (emphasis supplied). As explained in detail above, this transaction of reducing the interest rate on the loans to zero is completely and specifically covered by para 5.4.3 of Ind AS 109. Hence, there is no justification to seek reliance on para 10 of Ind AS 8. Secondly, even if para 10 of Ind AS 8 is to be invoked, management would have to use its judgement in first developing and applying an accounting policy to cover the transaction. There is no evidence of such policy.

6.16.10. Even if the economic substance of the transaction were to be considered, without prejudice to the arguments explained above, the substance of the transaction is not capital contribution (equity) as claimed by the Audit Firm. Para 15 of Ind AS 32 states that "the issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a **financial asset** or an equity instrument **in accordance with the substance of the contractual arrangement** and the definitions of a financial liability, a financial asset and an equity instrument" (Emphasis added). As per para 11 of Ind AS 32, a Financial Asset is "any asset that is: (a) cash; (b) an equity instrument of another entity; (c) a contractual right: (i) to receive cash or another financial asset from another entity; or (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity……." The **contractual arrangement** (Financial Asset) in this case is for providing a subordinated, non-recourse loan with a modified interest rate of zero %. The waiver of interest done in FY 2017 (the transaction) on such a contract does not meet any of the criteria mentioned in Ind AS 32 to qualify itself as another financial asset. Such a transaction does not provide any residual interest to ITNL in the net assets of the subsidiary. To qualify as capital contribution (equity) in the subsidiary a residual interest in the assets of the subsidiary is essential (para 49 of the Framework).

6.16.11. Moreover, reference is made to the submission of the Audit Firm in page 336 of the reply that "These projects take time for the traffic to establish and mature; until such time these projects would show a loss in the statement of profit and loss mainly due to finance costs and amortisation of intangible assets. **The Company has to continue to support the SPV during this phase** for servicing the debts from banks / financial institutions. Once the traffic stabilises and revenue increases, **the loans taken by respective SPVs from the Company are repaid**." (Emphasis added). This makes it clear that the financial support in the form of interest free subordinate debt was extended by ITNL for making good the cash flow shortages during construction/initial operation phase. Since the interest is made zero, the repayment (if at all made) will be of only the principal (and the interest outstanding on the date of modification), at a much-reduced time value of money. As a result of the waiver of interest there is no consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs, as well as no profit margin. The said transaction of waiver of interest is therefore in the nature of a loss (expenditure) which needs to be provided in the accounts in terms of the applicable accounting principles.

6.16.12. Thus the interest forgone on an existing financial asset is in substance an expenditure and need to be charged to profit or loss since this expenditure produces no future economic benefits (para 97 of the Framework), and thus in no way can be construed as investment in subsidiary.

6.16.13. Apart from being illegal, the note to accounts given by the Company in this regard does not disclose the material fact that the underlying transactions leading to the recognition of 'deemed equity' had, in fact, occurred in the previous financial year.

6.17. Therefore, NFRA reiterates its conclusions in para 2.1 (i) and (j) above that as per Ind-AS 109 para 5.4.3, in case of any modification in the contractual cash flows, the resultant effect shall be recognised as modification gain or loss. The amount of interest foregone (discounted to present value) was Rs 402.73 crores (or any other amount calculated in accordance with para 5.4.3 – refer observations in section below for observations regarding credit impaired financial assets). This clearly was an amount that was a loss to the Company and should have been taken to profit and loss account as an expense. The Company instead of recognising this loss in the Statement of Profit and Loss in compliance of the provisions of Ind-AS 109 referred above, treated the loss as deemed cost of investment (equity) in contravention to the above provisions. This is clearly an attempt at illegal recognition of a fictitious amount termed as "Deemed Equity.

Reversal of ECL – Non-Compliance with Ind AS

6.18. As quoted above, the Audit Firm submits that equity investments in two subsidiaries were impaired in FY 2017 itself. Even though the cash flows with respect to one subsidiary had improved compared to year ended March 31, 2016, the Company retained the ECL with respect to loans given to all three subsidiaries and also calculated and debited the additional ECL on loans given during the year ended March 31, 2017 to P&L as ECL impairment since the Company was in process of transferring its investments in accordance with its InvIT plan. However, in March 2018 the Company decided to keep the InvIT plan in abeyance and therefore the Company reassessed its business plan for these subsidiaries and reversed the ECL in FY 2018 by crediting P&L. In this regard NFRA observes the following.

6.19. Re-assessment of business plan for InvIT subsidiaries cannot be a reason for reversal of ECL. ECL is normally reversed with respect to decrease in credit risks of the financial asset in question. As InvIT plan has no impact whatsoever on the operational cash flows of the subsidiaries, this in no way reduces the credit risk.

6.20. Appendix A to Ind AS 109 defines credit impaired assets as "A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred". It also states "Evidence that a financial asset is credit-impaired include observable data about the following events: (a) significant financial difficulty of the issuer or the borrower;…… (c) the lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;….. (f) the purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses."

6.21. Para B5.5.7 of Ind AS 109 states that "Generally, there will be a significant increase in credit risk before a financial asset becomes credit-impaired or an actual default occurs". It is clear from the submissions of the Audit Firm that the loans to the three InvIT subsidiaries had been credit impaired in FY 2018 as well as in FY 2017, because of the following objective evidences: -

6.21.1. The amendments to the loans agreements to convert the loans into zero % interest and providing rights to ITNL for converting the outstanding balance of the debt into equity of the subsidiaries at the end of the concession period is a clear indication of events that must have had a detrimental impact on the estimated future cash flows of the financial asset.

6.21.2. The above also indicates a significant financial difficulty of the borrower, in view of cost overruns (as indicated in the disclosure notes to accounts for FY 2018, quoted above). Cost overruns indicate that the InvIT subsidiaries were not performing as projected initially and hence showed an increase in credit risk.

6.21.3. The interest concession granted by ITNL was for reasons relating to the borrower's financial difficulty which other lender(s) would not otherwise consider. This is evident form the fact that there is cost overruns as disclosed in the financial statements of ITNL.

6.21.4. Modification of a financial asset to a deeply discounted asset (zero percent interest) that reflects the incurred credit losses.

6.21.5. The poor recoverability of loans was highlighted by the Audit Firm itself in its reply in page no. 343 which states that "in 2015, the Company was pursuing an InvIT pursuant to which it was expected that the Company may not be able to recover loans in full with interest". There is no evidence to prove the contrary in subsequent years. The abandonment/implementation of InvIT cannot make any difference since it has no direct impact on the operational cash flows generated by the subsidiaries, which is mainly used for debt servicing.

6.22. As per Ind AS 109, in case of significant increase in credit risk (para 5.5.3) or in the case of credit impaired financial assets (para B5.5.33), lifetime ECL need to recognised at the reporting date. Without prejudice, the financial asset in question being contract asset, lifetime ECL needed to recognised in any case (para 5.5.15).

6.23. Further para 5.5.12 provides that "If the contractual cash flows on a financial asset have been renegotiated or modified and the financial asset was not derecognised, an entity shall assess whether there has been a significant increase in the credit risk of the financial instrument in accordance with paragraph 5.5.3 by comparing: (a) the risk of a default occurring at the reporting date (based on the modified contractual terms); and (b) the risk of a default occurring at initial recognition (based on the original, unmodified contractual terms)". As the Financial Asset is already credit impaired, the principle laid down in Para B5.5.7 of Ind AS 109 comes into play. However, ITNL ignored indications of such significant increase in credit risks and the Audit Firm failed to question the Company in this regard.

6.24. Even assuming, without admitting, for the sake of argument that the derecognition and consequential new recognition of financial assets is in order, the new assets so originated were credit impaired on origination itself and thus called for assessment of lifetime ECL as per para 5.5.13 (however, in which case lifetime ECL are included by default in the estimated cash flows, while calculating the effective interest rate on initial recognition in accordance with para 5.4.1)

6.25. In spite of the above clear stipulations, ITNL reversed the ECL on loans to three InvIT subsidiaries in FY 2018, which is a violation of Ind AS 109. Also by not doing a proper evaluation of credit risk, ITNL has violated provisions of para 5.5.9 of Ind AS 109 which stipulates that "at each reporting date, an entity shall assess whether the credit risk on a financial instrument has increased significantly since initial recognition". Generally, there will be a significant increase in credit risk before a financial asset becomes credit-impaired or an actual default occurs. However, the Company did not determine whether such a significant increase in credit risk had occurred. The Audit Firm did not exercise professional judgment and accepted the management's views without question. Thus, NFRA reiterates its conclusion in the preliminary findings that the reversal of ECL of Rs 403.84 crore given in footnote to Note 5 of the Standalone Financial Statements is completely unjustified by the facts of the case and is in serious violation of the applicable Accounting Standards. The Audit Firm is guilty of serious professional misconduct in agreeing to this violation of the standards, and non-reporting of the same.

Non-Compliance with Auditing Standards

6.26. As explained above, the accounting treatments followed by the company in the areas of Derecognition of loans to InvIT subsidiaries, accounting of deemed equity, reversal of ECL on the said loan and accounting of impairment loss on deemed equity are not in accordance with the accounting principles laid down by Indian Accounting Standards. The company also failed to recognise ECL on loans to InvIT entities. The company failed to disclose material facts in this regard in the annual accounts of FY 2018. The Audit Firm failed to bring out these violations and did not perform any independent evaluations. Instead, it went along with the management in illegal accounting. Thus, NFRA reiterates its preliminary conclusion that the Audit Firm is guilty of completely failing to display professional scepticism and due diligence in not questioning the Management, and of gross professional misconduct in allowing this wholesale and blatant violation of the Accounting Standards to take place and failure to qualify and disclose such material facts.

6.27. Neither the Company nor the Audit Firm considered the fact that the accounting adjustments related to InvIT entities ought to have done in FY 2017, and consequently falls under the category of "Prior period errors" as defined in para 5 of Ind AS 8- Accounting Policies, Changes in Accounting Estimates and Errors. No consequential disclosures/adjustments were made in accordance with Ind AS 8. Thus, while the standalone financial statements of the Company does not comply with the Indian Accounting Standards, the Audit Firm issued an unmodified opinion dated 29-05-2018, certifying that the aforesaid standalone Ind AS financial statements comply with the Accounting Standards specified under section 133 of the Companies Act, 2013.

6.28. The facts being the above, the Audit Firm in their reply tried to cover up facts, cited inappropriate provisions of Accounting Standards and presented bad interpretations of such standards to justify a non-existent claim and to mislead NFRA. This fact itself supports the conclusion made by NFRA above that the Audit Firm is clearly guilty of collusion with the Management by not exercising due diligence and by not performing its duty in this matter as required by the SAs. Both the Management and the Audit Firm have colluded in a deliberate attempt to mislead the users of the financial statements into believing that the Company's loans to the three SPVs was fully recoverable.

6.29. Without prejudice to the observations below, that deals with non-compliance with provisions of the Companies Act, 2013, NFRA examined in detail the contentions of the Audit Firm regarding Audit Procedures performed and the workpapers referred. However, these submissions reveal a pathetic state of affairs and it is observed that the workpapers referred and procedures claimed to have been done did not support even the otherwise erroneous transactions and account balances as reflected in the financial statements. A few instances are detailed below.

6.29.1. Nowhere in the working papers the Audit Firm has meticulously calculated future credit loss on cash flows other than interest loss. The rates applied for discounting cash flows are also not reliable as they are not verified from any working paper. The Audit Firm has mentioned some working papers to verify discount rates namely "hard copy file 5 page no G50- G96 and Cash flow projection summary workpaper in hard copy file 6 page no H49 to H51, Hard File 7 L6 to L11". However, all these working papers show different discount rates. Hence the entire calculation is a sham.

6.29.2. The Audit Firm did not refer to any document to check the actual weighted average cost of borrowing of SPV at which rate the future cash flows from loans have been discounted to arrive at fair value. The Company has indicated the difference of fair value of "new loan" and the carrying value of loan (amortised cost) as ECL in WP (which should not be called ECL) while it is just a fair valuation gain or loss and not ECL. ("hard copy file 5 page no G50- G96").

6.29.3. Workpaper **"WP_ Binder 5"** states that ECL balance on 31st Mar 2017 was Rs 403 crore (opening ECL). But the "**WP_ Binder 5"** also shows that this was the balance in December 2017 and not that of March 2017. Moreover, out of Rs 403 crore balance on December 2017, Rs 100 crore was created during the year, and thus would not have any impact in Profit & Loss due to reversal of opening balance. Thus, the WP is in contradiction with the disclosure in the financial statement that states "…..reversed the expected credit loss of Rs 403.84 Crore created in earlier years". This shows that Audit Firm did not perform a proper assessment of this matter and simply relied on the Management representations.

6.29.4. The Audit Firm states in page no.345 to 346 of their reply that "We have also verified the discount rate, i.e., the effective interest rate or an approximation thereof used by the Company for calculating the expected credit loss for the selected sample in accordance with SA 500. (Refer ECL working paper in hard copy file 5 page no G50-G96, Cash flow projection summary workpaper in hard copy file 6 page no H49 to H51 and Hard copy file 7 page no L6 to L11)". The discount rate in hard copy file 5 page no G50- G96 for HREL is 8.56% and for SBHL is 10.81% and in HC file 6 page H49 to H51, discount rate for HREL is 10% and for SBHL is 12%. Hard copy File 7 discount rates are 10%, 11%, 12% and 13% applicable to discounting of cash flows for impairment of investments. The basis of the disclosed rates of 8.56% - 10.85% is not clear and not matching with supporting sheets.

6.29.5. ITFG Bulletin 18 provided by SRBC was issued on 7 Feb 2019 which is after issuing the Audit Report of ITNL and hence is an extraneous material not forming part of Audit Evidence. ITFG has given a clarification from the point of view of the borrower and has not quoted any provision of applicable IndAS. The views of the ITFG do not have any authority whatsoever if they directly contradict the provisions of the IndAS, as has been clearly shown to be the case here.

Non-Compliance with provisions of the Companies Act, 2013

6.30. As explained in sections above, the Financial Statements of ITNL do not comply with the requirements of Ind AS 109. While so, the Audit Firm went ahead in certifying the accounts as complying with Ind AS, thus violating section 143 (3) (e) of the Companies Act, 2013. Also, as explained in sections above, the Audit Firm has violated Para 14, 15, 16, A15 of SA 200 by not maintaining professional scepticism, professional competence and due care during the audit. The violation of SA leads to violation of section 143 (9) of the Companies Act, 2013. .

6.31. In view of all the above facts NFRA reiterates its conclusions in the preliminary findings that the Audit Firm is guilty of serious professional misconduct of:-

i. not disclosing complete information to users of financial statements as required under relevant financial reporting framework and standards of auditing,

ii. not reporting material misstatements in financial statements,

iii. not carrying out the audit according to standards of auditing,

iv. not maintaining professional scepticism, professional competence and due care and other ethical requirements during the audit (Para 14, 15, 16, A15 of SA 200).

6.32. The Audit Firm is clearly guilty of collusion with the Management by not exercising due diligence and by not performing its duty as required by the SAs. Both the Management and the Audit Firm have abetted and colluded in a deliberate attempt by the Company to mislead the users of the financial statements through fraudulent accounting practices.

6.33. NFRA has examined in detail the replies dated 10th July 2021 and the oral submissions made by the Audit Firm (replies to the DAQRR) regarding the observations in the DAQRR. NFRA observes that the replies of the Audit Firm are generally a reproduction and reiteration of the earlier replies to the PFC. However, NFRA has again examined the above observations in light of the repeated replies by the Audit Firm and, in the absence of any evidence to the contrary, reiterates all the observations in the DAQRR, except those specifically modified as below.

6.34. Documentation: In reply to para 6.8 above, regarding the absence of documentation in the audit file about the accounting treatment, the Audit Firm states that "the following key audit procedures, amongst other, were performed with respect to verification of expected credit losses and the estimates and judgements applied by the management in accordance with SA 540 Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures with respect to the three InvIT subsidiaries viz. SHBL, HREL and JRPICL" and "SRBC had already provided the relevant workpaper reference as part of response to PFC. The said workpaper reference have been reproduced in point 5 of SRBC's response to NFRA's DAQRR". The Audit Firm has also reproduced its earlier reply and explained again the procedures performed, citing WP references. However as observed by NFRA in above paras, none of the WPs referred in Audit Firm's response contains any workings related to examination of the accounting treatment of the subject matter. In this regard the Audit Firm refers to three instances of audit evidence as below.

6.34.1. The Audit Firm states that "We have discussed the accounting treatment given by the management in the audit committee presentation in the meeting held on May 29, 2018 …. Refer Slide no. 19 of Audit Committee presentation in hard copy binder Part 5 of 6 page no P.5.3". The said slide no. 19 is a statement about investment in 'Kohinoor Property' which has no relation to the matter of ECL reversal. Slide no.14 has a summary statement of reversal of ECL of Rs 740 Crore in respect of two InvIT entities and a reproduction of note No. 5 (with a different amount) of the SFS. Slide no.18 has two summary tables showing ECL reversal on loans and impairment of investments. None of these slides discuss the accounting treatment followed by the company and the related accounting policies.

6.34.2. The Audit Firm also states that they "documented our examination of the accounting treatment with respect to the aforesaid loans in our Summary Review Memorandum". The summary review memorandum states as follows:

"<u>Reversal of Expected Credit Loss with respect to lnVIT entities during the year</u>

The Company had given loans to SBHL, HREL and JRPICL all of which were part of the InVlT that the Company had planned. These loans were given to SBHL at 13.2%, HREL at 12% - 13.5% and JRPICL at 12.95 - 13.95%. **However, during the year, the Company has withdrawn its plan to come out with an InVIT which was approved by the Board of Directors in their meeting on 6 Oct 2015. Consequently, the Company has restructured the significant terms of these loans i.e. these loans would now be at 0% interest since there is more than 10% variation in the cash flows.** The Company has derecognized the existing loans given to the SPVs and reversed the ECL provision on the same and recognized new loans at fair value.

Considering that these loans have been provided by ITNL, the parent, at below market interest rates to its subsidiaries. These loans have been discounted at average cost of borrowings and the difference between the loan amount given and the discounted value has been debited to the value of investment in equity shares as deemed equity contribution to these entities **as per the requirements/guidance under Ind AS 109.** Post increase in equity value of these subsidiaries, the value of investment in these subsidiaries has also been tested for impairment.”. (Emphasis added).

6.34.3. It can be observed from the above that the Audit Firm has made a false statement in the WP. The fact, as admitted by the Audit Firm, is that the restructuring of the loans happened in 2016-17, not during the year 17-18 consequent to the withdrawal of the plan of InvIT – withdrawal of InvIT happened in March 2018. The above workpaper is a deliberate attempt to connect the two separate events that have, in fact, occurred in two different financial years. Also, while there is no guidance in Ind AS 109 regarding accounting of deemed equity, the Audit Firm states in the WP that it has followed such non-existent guidance of Ind AS 109. The concept of deemed equity is an interpretation of the Ind AS by a section of the experts, not a direct guidance in the standard. Besides, it is also prima facie evident, as has already been explained above, that such interpretation is directly contrary to the Standard. There is also no examination of the correctness of derecognition as per Ind AS 109. The above facts shows that the Audit Firm has accepted the stand of the Company without even verifying the basic facts of the case.

6.34.4. Regarding the audit evidence for change in business plan (dropping of InvIT plan) the Audit Firm states that “We read the minutes of the audit committee dated March 29, 2018 wherein **approval was granted to keep the InvIT plan in abeyance** and the accounting treatment thereof…. Refer Minutes of audit committee dated March 29, 2018 in hard copy file 1 page no A2- 108 to A2-110”. (Emphasis added). The said agenda item is titled “Approve the accounting treatment for selected financial assets, which were proposed for inclusion in ITNL Investment Trust”. In the minutes it is recorded as follows.

“The Committee was informed that the proposal for setting up of an Infrastructure Investment Trust (InvIT) ……… was approved by the Board of Directors at its meeting held on October 6, 2015……….. The Equity Investments held by the Company in the following Special Purpose Vehicles (SPVs) were considered for transfer to InvIT:…….

The proposal had a setback on account of amendments made to the Income Tax Rules in May 2017, in relation to valuation of unquoted investments for the purpose of determining gains / losses under the income Tax Act, 1961, which if implemented would have had a large potential tax liability on InviT and the Company.

The Management thereafter evaluated the InvIT proposal considering the tax impact arising on account of the amendment to the Income Tax Rules on InvIT and also the

performance of 2 InvITs already launched by other corporates and had recommended that the same be kept in abeyance and be considered at a later stage for any other assets which may be lucrative to provide a required return as may be considered by the Investors.
In view of the aforesaid circumstances, the Company is now required to fair value the aforesaid 2 SPVs/financial assets considering discounted rate as applicable to borrowed funds which is 9%. If the proposed change is considered for valuation at a discounted rate of 9% the Company will have to reverse the impairment upto ₹740 Crore through Profit and Loss account with a corresponding increase in the value of financial assets as reflected below:…….
After Discussion the Committee considered the recommendation made by the Management and approved the above accounting treatment arising out of the fair valuation of the aforementioned financial assets."

6.34.5. It can be seen from the above that the Audit Committee had not given their approval for keeping InvIT in abeyance. After considering the decision of the management to keep InvIT in abeyance, the Audit Committee had examined the accounting treatment of Investments in two InvIT entities and approved the same. Therefore, the claim of the Audit Firm that "We read the minutes of the audit committee dated March 29, 2018 wherein approval was granted to keep the InvIT plan in abeyance and the accounting treatment thereof" is false. The minutes is not at all concerned with the reversal of ECL on loans or derecognition of loans as clearly evident therefrom.

6.34.6. Therefore, NFRA reiterates its conclusions in the DAQRR that none of the WPs available in the Audit File has an examination of the accounting treatment of the subject matter. Hence the explanation provided is purely an afterthought having no evidentiary value and deserves to be rejected outright. However, without prejudice to the above fact, NFRA has examined the merits of the submissions made by the Audit Firm.

6.35. Regarding the **merits of the submissions**, NFRA observes as follows.

6.35.1. There is no dispute of the fact that the Company had converted the interest-bearing sub-debts extended to the InvIT subsidiaries to interest free sub-debts in the FY 2017. No accounting entries were made in that year. In the FY 2018 the Company has derecognised the loan and recognised new interest free loans at fair value and recognised 'deemed equity' under investments, being the difference between the amount lent and the fair value. The company had also reversed the ECL (Rs 403.84 Crore) on the said loans, after netting impairment (Rs 293.29 Crore) of the 'deemed equity'. The reason stated by the audit firm for not effecting any accounting entries in FY 2017 is because these entities are proposed to be transferred to an InvIT, a proposal initiated in FY 2015. The reason given by the Audit Firm for effecting the above accounting entries in FY 2018 is the withdrawal of the InvIT proposal due to amendments made in the Income Tax rules in May 2017 related to valuation of unquoted investments.

6.35.2. Based on the above facts, NFRA reiterates its earlier conclusion that the transaction does not qualify for derecognition as per Ind AS 109. Instead, the applicable provision is para 5.4.3 (modification) of Ind AS 109 and the company failed to recognise modification loss accordingly. The Auditor supported this incorrect treatment without any examination of the facts of the case. There is neither expiry of rights (the right to the principal amount continues and asset does not qualify for part derecognition) nor transfer of assets (the company cannot do a transfer with itself) in this case as contemplated in para 3.2.2 or 3.2.3 of Ind AS 109. The Audit Firm relies on an analogy of the provisions of derecognition of liabilities to that of assets for proving that there is transfer and expiry in the present case. This is totally out of place as the provisions in the said paras are direct and the Ind AS follows clearly different treatment for derecognition of assets and liabilities. The international literature quoted by the Audit Firm in this regard is also out of place since the fact pattern of the Greek Bonds covered in that literature is not comparable with the present case where an existing loan by a parent to its wholly owned subsidiary is made interest free by the parent, suo motu, due to operational cash losses of the subsidiary, and also to meet covenants in the senior term loan agreements. Moreover, the Greek Bond case was interpreted in the said literature under IAS 39 when there was no specific paragraph like para 5.4.3 in IFRS 9 for financial assets. Since, there is specific provision on modification of financial assets and it does not talk about substantial modification etc, it is not an appropriate analogy to that of modification of financial liabilities. Therefore, in case of de-recognition of financial assets one should follow specific de-recognition requirements applicable to financial assets.

6.36. In addition to the above, NFRA observes the following from the replies of the Audit Firm in this regard.

6.36.1. The Audit Firm contends that the "As per para 3.2.3 of Ind AS 109, an entity is required to derecognise a financial asset when, the contractual rights to the cash flows from the financial asset expire or it transfers the financial asset and the transfer qualifies for derecognition ……. Since Ind AS 109 does not provide clear guidance with respect to what constitutes "expiry" of cash flows in context of derecognition of financial assets, the management can make its own judgment in developing and applying accounting policy. In doing so Ind AS 8, para 11 requires that, in determining an appropriate accounting policy, considerations must first be given to the requirements of Ind AS dealing with similar and related issues. In the given case management had applied its judgment and had drawn analogy from the relevant paras of Ind AS 109 dealing with derecognition of financial liabilities to conclude that the waiver of interest on loans was a substantial modification to the terms of the loan and hence the existing financial asset had to be derecognized and a new financial asset had to be recognized.". If the above contention is agreed (but without admitting the same), then the loan should have been derecognised in FY 2017, the year in which the significant change happened. But since the loan is derecognised in 2018, it should have been disclosed as a prior period adjustment. Moreover, no such accounting policy is seen documented in the Audi File or is seen disclosed in the financial statements in this regard.

6.36.2. However, the Audit Firm, quoting para 5 of Ind AS 8, states in this regard that "The management's decision to keep the InvIT in abeyance was taken in March 2018 and was approved by the audit committee in their meeting held on March 29, 2018. Accordingly, as at March 31, 2017 InvIT plan was in process and management was expecting lower cash flows from transfer of such financial assets to InvIT. Had the InvIT plans not been there in March 2017, the ECL on such loans would have been reversed during the year ended March 31, 2017 based on the then available future cash flow projections of the Company. Hence, the decision of InvIT being in abeyance was taken only in March 2018 and hence it was neither known nor could reasonably be expected to be known in March 2017. Further, the accounting treatment was in accordance with Ind AS and generally accepted accounting principles. Accordingly, the derecognition of loan and reversal of ECL thereon and the accounting of deemed equity on initial recognition of new loan and impairment thereon were not and cannot be considered to be prior period errors."

6.36.3. It is evident that the audit firm's contentions in the paras above are contradictory. On one hand it argues that the loan was derecognised due to the significant change in FY 2017 of making the loans interest free, while on the other hand it says that the accounting adjustments are made in FY 18 due to withdrawal of InvIT plan, which is only a change in a business plan. Both events do not have any relation as already concluded by NFRA in the DAQRR. For the former argument, the Audit Firm rely on para 3.2.3 of Ind AS 109, which does not depend on any change of business plan. In the later argument the Audit Firm brings in the change in a business plan, which has no accounting implications on the event happened in FY 2017.

6.36.4. The Audit Firm's contention that the InvIT proposal was live in FY 2017 is untrue. The Audit Firm itself in their reply related to NFRA's observations on independence matters stated that the services of the valuer (EYMBS, a network firm of EYG) appointed for valuing unquoted investments under SEBI InvIT Regulations has been terminated by the company in FY 2017. The Audit Firm submitted in their reply to PFC That "It is also a fact that as the Company did not wish to avail the services, the engagement was discontinued by EYMBS before the SRBC's appointment date of February 10, 2017 and no report was issued by EYMBS to the Company" The scope of work of EYMBS inter alia includes "to provide an InvIT Report which was proposed to be prepared for inclusion in the draft placement memorandum, placement memorandum and any other documents prepared in connection with the private placement of units by the InvIT.". This termination of the valuation services in FY 2017 is a clear indication that the InvIT proposal would not be pursued by the Company anymore. Thereafter, in FY 2018, the company cited Income Tax rules changes as a reason for dropping InvIT, but this is not factually correct as the steps to stop the InvIT had already been initiated by the Company in FY 2017 itself, much before the notification of the Income Tax Rules. Moreover, the InvIT proposal was approved by the Board in 2015. The Audit Firm claims that the decision to keep it in abeyance was taken by the Audit Committee in 2018. However as explained in para above, the Audit Committee had not taken such a decision. Also, as the original decision was taken by the Board, it is obvious that the Board itself has to take the decision to keep it in abeyance. The Audit Committee minutes in fact only refers to an earlier recommendation of the management to keep the InvIT in abeyance. Thus, it is clear that the Audit Firm's contentions are made-up for effecting an unjustified treatment. This is further evidenced by the false statement (as quoted above in para 6.34.2) in the Audit File where the restructuring that actually happened in 2017 is stated as a consequence of the withdrawal of the InvIT plan that is claimed to have been decided in 2018. A curious case of cause following the effect!

6.37. NFRA, therefore, concludes that none of the accounting treatments made by the company and agreed by the Audit Firm in this regard is supported by evidence in the Audit File. Therefore, NFRA reiterates all its observations in the DAQRR and concludes that:

6.37.1. the derecognition of the loans given to three InvIT subsidiaries is a clear violation of Ind AS 109 and the Audit Firm has completely failed to perform sufficient appropriate audit procedures to identify such departure from the requirement of the applicable accounting standards.

6.37.2. the reversal of ECL on account of loans to these three InvIT subsidiaries accompanied by recognition of "deemed equity" is not supported by the relevant applicable accounting standards,

6.37.3. that the reassessment of InvIT plan cannot be accepted as a valid reason for reversal of ECL.

6.37.4. The above failures resulted in an overstatement of profit of Rs 806.57 crore (modification loss not accounted Rs 402.73 crore and ECL erroneously reversed Rs 403.84 crore).

ECL on Trade Receivables

6.38. NFRA had conveyed the following prima facie conclusions:

6.38.1. As per WP 'E_Debtors_Mar18', the amount of trade receivables as on 31 Mar 2018 was Rs 3145.28 crore.

6.38.2. As presented in Footnote 3 to Note 28 of the Financial Statements an amount of Rs 179.21 crore has been reversed during the year on account of ECL on trade receivables. This is over and above a reversal of Rs 168.58 crore during the previous financial year i.e 2016-17.

6.38.3. Para 35H of Ind-AS 107 Financial Instruments- Disclosures stipulates that quantitative and qualitative information about amounts arising from ECL has to be provided as laid down:

6.38.4. *"To explain the changes in the loss allowance and the reasons for those changes, an entity shall provide, by class of financial instrument, a reconciliation from the* *opening balance to the closing balance of the loss allowance, in a table, showing separately the changes during the period for:*

- ***i.*** *the loss allowance measured at an amount equal to 12-month expected credit losses;*

- **ii.** *the loss allowance measured at an amount equal to lifetime expected credit losses for: (i) financial instruments for which credit risk has increased significantly since initial recognition but that are not credit-impaired financial assets; (ii) financial assets that are credit-impaired at the reporting date (but that are not purchased or originated credit-impaired); and (iii) trade receivables, contract assets or lease receivables for which the loss allowances are measured in accordance with paragraph 5.5.15 of Ind-AS 109.*

- **iii.** *Financial assets that are purchased or originated credit-impaired. In addition to the reconciliation, an entity shall disclose the total amount of undiscounted expected credit losses at initial recognition on financial assets initially recognised during the reporting period."*

6.38.5. NFRA has noted that no such table, as required by Ind-AS 107, has been included in the Financial Statements.

6.38.6. NFRA found no evidence whatsoever in the Audit File in support of any audit procedure being carried out by the Audit Firm to independently verify the amounts and reasons for assumptions used for the reversal of ECL on Trade Receivables by the Management. There is no evidence in the Audit File that the Audit Firm has verified the opening ECL as of 01 Apr 2016 from which the reversal has taken place. The assumptions behind ECL computation model as on 31 Mar 2016, 31 Mar 2017 and 31 Mar 2018 have nowhere been documented. The Auditors have simply relied on the figures supplied by the Management with no independent verification of the ECL models, data on which they are applied and calculations. Needless to say, whether such models and assumptions for computation of ECL on receivables at the end of each year were consistent with each other or not has not been tested by the Audit Firm. This casts a serious doubt on audit methodology adopted.

6.38.7. NFRA is of the view that in the absence of any credible evidence to justify reversal of ECL on trade receivables, the entire amount is incorrectly booked.

6.38.8. This is proof of serious professional misconduct on the part of Audit Firm, of:

- **i.** Not disclosing complete information to users of financial statements as required under relevant financial reporting framework,

- **ii.** Not reporting material misstatements in financial statements,

- **iii.** Not carrying out the audit according to standards of auditing,

iv. Not maintaining professional scepticism, professional competence and due care and other ethical requirements during the audit (Para 14, 15, 16, A15 of SA 200).

6.39. NFRA has examined the contentions of the Audit Firm regarding the above observations and has concluded in the DAQRR as follows:

Disclosures of Financial Instruments as required by Ind AS 107 (This is in continuation to NFRA observation in the PFC).

6.39.1. Para 35H (b)(iii) of Ind AS 107 talks about reconciliation from opening to the closing balance of the loss allowance (ECL), in a table, showing separately the changes during the period for trade receivables, contract assets or lease receivables for which the loss allowances are measured in accordance with paragraph 5.5.15 of Ind AS 109.

6.39.2. NFRA has seen Note 11 of Standalone Financial Statements (FY 2017-18), Disclosure of Trade Receivables as follows:

Movement in the expected credit loss : ₹ in Crore

Particulars	As at March 31, 2018	As at March 31, 2017
Balance at beginning of the year	**288.66**	**361.94**
Adjustment for recognising revenue at fair value	20.93	86.88
Expected credit loss allowance on trade receivables	7.86	8.42
Reversal of Expected credit losses on trade receivables (net)	(179.21)	(168.58)
Balance at end of the year	**138.25**	**288.66**
Pertaining to the ECL Adjustments	117.32	201.78
Pertaining to the adjustment for revenue at fair value	20.93	86.88
Total	**138.25**	**288.66**

6.39.3. Moving further, Para 35I of Ind AS 109, "To enable users of financial statements to understand the changes in the loss allowance disclosed in accordance with paragraph 35H, an entity shall provide an **explanation of how significant changes in the gross carrying amount of financial instruments during the period contributed to changes in the loss allowance.** The information shall be provided separately for financial instruments that represent the loss allowance as listed in paragraph **35H(a)–(c)** and shall include relevant qualitative and quantitative information. Examples of changes in the gross carrying amount of financial instruments that contributed to the changes in the loss allowance may include:

i. changes because of financial instruments originated or acquired during the reporting period;

ii. the modification of contractual cash flows on financial assets that do not result in a derecognition of those financial assets in accordance with Ind AS 109;

iii. changes because of financial instruments that were derecognised (including those that were written-off) during the reporting period; and

iv. changes arising from whether the loss allowance is measured at an amount equal to 12-month or lifetime expected credit losses.

6.39.4. In simple terms Para 35I states that an entity shall provide qualitative and quantitative information of change in ECL from beginning to end of year. It should be provided for each financial instrument under paragraph **35H(a)–(c) which means it should be given for trade receivables also. The examples provided in Section 35I requires a proper disclosure of changes in ECL balance arising due to:**

i. new financial instruments acquired during the year

ii. modification of contractual cash flows that do not result in a derecognition

iii. changes because of financial instruments that were derecognised

iv. significant increase in credit loss due to which measurement of loss allowance changes from 12 month to lifetime expected credit loss.

6.39.5. However, the ECL details for trade receivables do not provide any information in terms of the above four examples. Even from the trade receivables Note 11 of Standalone FS, there is no distinction of quantum of trade receivables where there is significant risk in credit risk and how many are credit impaired.

6.39.6. Further **Para 35M of Ind AS 109**, requires an entity to disclose credit risk rating grades to assess entity's credit risk exposure for trade receivables, contract assets or lease receivables for which the loss allowances are measured in accordance with paragraph 5.5.15 of Ind AS 109. (Para 35M(b)(iii) of Ind AS 109). For trade receivables, contract assets and lease receivables, the information provided in accordance with paragraph 35M may be based on a **provision matrix as per Para 35N**. **However, there is no provision matrix** in the financial statements to understand the credit risk exposure for trade receivables. Hence, Para 35M and 35N have not been complied which the Audit Firm failed to disclose.

Discrepancy observed in Working Papers

6.39.7. Definition of Expected Credit Loss: The weighted average of **credit losses** with the respective risks of a default occurring as the weights.

6.39.8. Para B5.5.28 states that Expected credit losses are a probability-weighted estimate of credit losses (i.e the present value of all cash shortfalls) over the expected life of the financial instrument.

6.39.9. However, the WP hard copy file 5 page no E12-E94, does not show any probability weighted estimate of amounts recoverable from the debtors. Even in certain cases such as NAMEL, WGEL invoices raised in year 2013 and 2012 have not been received till 31st March 2018 and still no assessment of the probability of recovery nor assessment of credit loss was done by the Audit Firm. This shows the lack of due diligence on the part of Audit Firm.

6.39.10. The Audit Firm has stated in its response "*We have discussed with the management and obtained necessary explanation and information as to how they have considered historical and forward-looking information in the cash flow estimates. In cases, where there were material changes in the cash flow estimates **vis-à-vis those at the previous reporting date**, we have enquired reasons for change from the management and verified the same with the underlying papers and documents*." However, from WP_ hard copy file 5 page no E12-E94, there is no evidence of any remarks of Audit Firm documenting the reasons for changes in the expected date of realisation of sale invoices from previous quarters nor supported by any reference to underlying documents.

6.39.11. Audit Firm has stated on Page 328 of 751 "*We verified the assumptions applied in ECL calculation i.e. the discount rate applied for calculating ECL and **the date by which collection was expected and traced the same to the year of collection in the cash flow model".*** This particular statement is not true as NFRA cannot see any type of mapping done of expected date of collection of receivables with the cash flow model. The work paper mentioned in Audit Firm's response is related to loans and not trade receivables.

6.39.12. Audit Firm stated on Page 328 of 751, "We have obtained representation from the management with respect to correctness of accounting treatment for ECL reversal. (Refer Letter of Representation in hard copy binder Part 5 of 6 page no P.5.1)." The Binder 5 states that "*The Company has prepared expected Credit Loss matrix as per Ind AS 109 for trade receivables based on the cash flow model of the respective Project SPVs. The estimated realisation date of the receivables has been taken by considering the cash flow model of the respective project SPV which in the view of the management is the most realistic and appropriate way for estimating the realisation date of the receivables with respect to the project SPV's."* However, on checking individual debtor working in the workpaper "hard copy file 5 page no E12-E94" we cannot find any verification done of the expected date of realisation of receivable from the cash flow models of SPVs. The cash flow projections of SPVs project yearly cash flows and do not contain any information of those receivables which are to be realised less than a year from the reporting date (i.e 31st March 2018). Hence cash flows of the SPVs do not provide useful evidence of expected date of realisation.

6.39.13. In the case of CNTL, the Audit Firm has stated "*Reduction of ECL of Rs.117 crore; whereas during the year ended March 31, 2017, the expected date of collection of dues was ranging from 2018 to 2026 in a staggered manner, during the financial year 2017-18, the management started the process of refinancing existing debt and raising additional debt and hence cash flow projections were updated during the year ended March 31, 2018. As the SPV had commenced commercial operations during the year ended March 31, 2017 and it was an annuity project with assured cash flows, the management was confident of completing the refinancing and raising additional debt by June / July 2018 which would have helped the SPV to clear its dues to the Company. Accordingly, the ECL had been recalculated with revised* *expected collection date resulting in reversal of ECL. ECL balance as at Mar'17 was Rs.129 crore and as at Mar'18 was Rs.12 crore."* This particular response is not documented by Audit Firm in its debtor working paper "hard copy file 5 page no E12-E94" and is an afterthought.

Advisory and Project Management Fees/ O&M Fees/ Supervisory Fees

6.39.14. The policy of Company in Section B.6 of General Information & Significant Accounting Policies states (Page 107 of Annual Report) relates to revenue recognition from Advisory, design, engineering and management services. It states that revenue is recognized when it is realized or **realizable and earned.** Revenue is considered as realized or realizable and earned when it has persuasive evidence of an arrangement, delivery has occurred, the sales price is fixed or determinable and collectability is reasonably assured. Advisory, Design and Engineering fees are billed as services are rendered, however they are due for payment one year from the date of billing.

6.39.15. Further under Section B.22.4 Impairment of Financial assets of Company's policy (consolidated financials), it is mentioned in third para that "for trade trade receivables, the Group measures the loss allowance at an amount equal to lifetime expected credit losses. In cases where the amounts are expected to be realized **up to one year from the date of the invoice, loss for the time value of money is not recognized, since the same is not considered to be material".**

6.39.16. It is further understood from the Programme Management cum O&M Contracts (O&M includes toll operation fee and route operations & maintenance fees) that Operation & Maintenance (O&M) fees is a fixed annual price paid monthly after the Commercial operation date till the end of Concession Period. Further, from the 'WP_ O&M Income & Exp M18', Sheet 'Revenue Schedule' it is clearly evident that advisory & project management, supervision fees & insurance fees, O&M revenue, overlay revenue accrues monthly as and when the services are rendered. Thus, the trade receivables of O&M and supervisory services rendered should not be considered realizable in more than one year and thus they should not contain any significant financing component. Since these are short term receivables they should not be discounted.

6.39.17. But in the case of CNTL and WGEL, there are certain instances where the Company has discounted O&M receivables for the purpose of ECL calculation (WP E_ Debtors_ Mar 18) despite the policy of Company in Section B.22.4 Impairment of Financial Assets stated above. Moreover, the Audit Firm has not identified and distinguished clearly trade receivables from O&M, supervisory, overlay, advisory etc in the working papers which demonstrates insufficient audit procedures and lack of professional skepticism on part of the Audit Firm. No description of the nature of revenue and evidence of realization dates form part of the audit file.

Non-compliance of Ind AS provisions related to Expected Credit Loss on Trade Receivable

6.39.18.Para 5.5.15 Ind AS 109:

i. The expected credit loss for trade receivables is to follow the simplified approach ie measurement of ECL at an amount equal to lifetime expected credit loss if the receivable a) do not contain significant financing component as per Ind AS 115 or b) contain a significant financing component but entity choses as its accounting policy to measure the loss allowance at an amount equal to lifetime expected credit losses. ITNL has also elected to measure ECL on trade receivables at lifetime expected loss as stated in policy of Company (B.22.4)

6.39.19.Para 5.5.17 Ind AS 109:

i. *ECL shall be measured in a way that reflects:*

(a) ***an unbiased and probability-weighted amount*** *that is determined by evaluating a range of possible outcomes;*

(b) the time value of money; and

(c) reasonable and supportable information that is available without undue cost or effort at the reporting date about ***past events****, current conditions and* ***forecasts of future economic conditions****.*

6.39.20. Further Para B5.5.35 states that, "*An entity may use practical expedients when measuring expected credit losses if they are consistent with the principles in paragraph 5.5.17. An example of a practical expedient is the calculation of the expected credit losses on trade receivables* ***using a provision matrix****. A provision matrix might, for example, specify fixed provision rates depending on the number of days that a trade receivable is past due (for example, 1 per cent if not past due, 2 per cent if less than 30 days past due, 3 per cent if more than30 days but less than 90 days past due, 20 per cent if 90–180 days past due etc).*"

6.39.21. Ideally, as stated in Ind AS 109 Para B5.5.35 also, the Company should have adopted the provision matrix for trade receivables to give it a fair idea of recovery based on past trends ascertained for different ageing brackets. Also, this would have helped to set a standard provision rate on the large number of invoices and apply those standard rates uniformly on all the invoices due depending on their ageing bracket. This would have helped the Company to develop a standard policy for provision on trade receivables and avoid changes of management bias as the rates would have been derived based on historical trends of recovery.

6.39.22. However, even if the Company has not adopted the provision matrix and has decided to go for future forecasting of expected date of realisation and discounting the invoices, there is a serious lack of objective and thorough verification of the underlying assumptions used. The Audit Firm has not documented any basis of arriving at the expected dates of realisation nor made any assessment of **probability weights** attached to these recoveries which is a requirement of Ind AS Para 5.5.17(a).

Similarly, Para 5.5.17(c) states that reasonable and supportable information should be obtained about past events and future economic conditions for calculation of ECL. But on perusal of ‘WP_ hard copy file 5 page no E12-E94’, it has been seen that **no information of past events or future economic conditions** has been referred to by ET. The Audit Firm did not analyse expected dates determined in past periods and whether amounts were actually realized on those dates and the management estimates were actually reliable or not. It can be concluded that Audit Firm failed to comply with Para 5.5.17(a) and (c) of Ind AS 109.

Other discrepancies observed in Policy of ECL on Trade Receivables

6.39.23. NFRA has observed certain other deficiencies and inconsistencies in accounting policy:

i. There is no **proper assessment of Management assumption of expected dates of realization** and reason for change from year to year. The Annual Report states credit term of 30 to 90 days only (Note 11 of Standalone Financial Statements) but most of the parties are being given huge relaxation in credit terms with no clearly stated reasons and questioning by Audit Firm. The Audit Firm has failed to question the assumptions of Management and document them properly. There are several invoices in the working sheet of Debtors where no evidence of any underlying documents or reasons have been recorded for the dates expected for realization. This shows the complete lack of professional skepticism and neglect of professional duties by the Audit Firm.

ii. Even very old receivables (3 years or older) are not getting realized and they are **not even being written off nor considered separately for providing loss allowance**. Audit Firm should have challenged the Management and booked 100% ECL on such old outstanding rather than carrying them at gross value and changing the expected dates of realization from year to year. This is an attempt to mislead the users of financial statement and collusion with the management in misrepresentation of financial statements.

ECL reversal of MP Border Check Post Company Limited and Thiruvananthapuram Road Transport Company Limited

6.39.24. NFRA had conveyed the following prima facie conclusions:

i. NFRA has noted from the Audit File that the working of ECL reversal on loans amounting to Rs 152.32 crores, out of the total amount of Rs 556.16 crore ECL reversed during the year, is not found in the Audit File.

ii. Moreover, the amount of ECL created during the year, i.e. Rs 226.35 crore and reversal of ECL was Rs 271.27 crore, as shown in WP ITNL- M18 ECL on Loans and Advances which is part of the Audit File, does not even match with the amount disclosed in the financial statements. This casts serious doubts over the reliability of the audit evidence taken on Audit File, and a serious violation of SA 500.

iii. While there is no evidence in the Audit Files of break-up of ECL reversal of Rs 153.23 crore, the Audit Firm, in their response to question 4 of NFRA questionnaire II, has stated that Rs. 118.73 crore was reversed with respect to loan given to MP Border Check Post Company Limited (MPBDCL). The Audit Firm has further stated that MPBDCL had filed a claim with the authorities during the year ended March 31, 2018 on account of which it was expecting recovery of claim by 31 Mar 2018. Accordingly, there was a reversal of ECL on account of preponement of recovery period. The Audit Firm has further stated that Rs.16.72 crore was reversed in respect of Thiruvananthapuram Road Development Company Ltd (TRDCL). In case of TRDCL the interest on loan which was earlier not expected to be fully recoverable was considered to be fully recoverable by 2019-20 based on the proceeds of claim expected to be received during 2019-20 and accordingly, the ECL was reversed.

Reversal of ECL on Loans to MPBDCL

6.39.25. NFRA has noted from the Audit Files (WP ITNL – M18 ECL on Loans and Advances) that the amount of reversal of ECL in the current year on long term loan given to MPBDCL was indicated as Rs 107.45 crore (Q 2: Rs 105.25 crore and Q 4: Rs 2.2 crore) in same working paper. None of the amounts of reversal match the amount mentioned in the Audit Firm's response.

6.39.26. Further, NFRA has not found any details of the claim filed, which formed the basis of ECL reversal as no evidence such as the copy of the claim and the status of the claim, or counter claims if any, as on the date of the Audit report signed by the Audit Firm is found in the Audit File.

6.39.27. In the absence of any credible evidence the entire ECL reversal of Rs 118.73 crore tantamount to a very material misstatement.

Reversal of ECL on Loans given TRDCL

6.39.28. NFRA has noted from the WP Investment and Cash Flow Models_ TRDCL (Hard copy File no 13, that the amount of reversal of ECL in the current year on long term loan given to TRDC) is shown as Rs 55.37crore (Q 2: Rs 30.15 crore and Q 3: Rs 25.22 crore) whereas, in the Audit Firms' response to NFRA, the Company has shown reversal of ECL of Rs 16.72 crore in respect of TRDCL on the expectation of recovery in 2019-20 of a claim filed with Highway Authority.

6.39.29. NFRA notes from the WP Investment and Cash Flow Models_ TRDCL (Hard copy File no 13) that the Company had filed a claim with the Highway Authority of Rs 307.76 crore on 23rd July 2018.

6.39.30. Since the Audit report had already been signed by the Engagement Partner on 29 May 2018 i.e 55 days before the date of filing of the claim, the Audit Firm's reliance on this claim casts a very serious doubt on the audit methodology and audit evidence.

6.39.31. Clearly, not only has the Audit Firm simply accepted the figure given by the Management without sufficient evidence that can form the basis of such a figure and has thus displayed complete lack of due diligence in verifying the correctness of management's claims, it is also guilty of tampering of the Audit File.

6.39.32. In view of this, the entire claim of ECL reversal of Rs 16.72 crore tantamount to a very material misstatement.

6.39.33. This is proof of serious professional misconduct on the part of Audit Firm, of:

- **i.** Not disclosing complete information to users of financial statements as required under relevant financial reporting framework,
- **ii.** Not reporting material misstatements in financial statements,
- **iii.** Not carrying out the audit according to standards of auditing, (iv) Not maintaining professional scepticism, professional competence and due care and other ethical requirements during the audit (Para 14, 15, 16, A15 of SA 200).

6.40. NFRA has examined the replies of the Audit Firm regarding the above and concluded in the DAQRR as follows:

6.40.1. NFRA has gone through the WP "MPBCDCL – Termination Notice" which was filed on 27th Oct 2017 of amounting to Rs 1,337 crore being Debt due of Rs 1091 crore and 150% of adjusted equity i.e Rs 245.39 crore filed as per Clause 37.3.2 of Concession Agreement with Madhya Pradesh Road Development Corporation. It is also seen from the audit file that a total of 47 letters have been communicated by MPBCDCL to the Highway Authority, the immediately preceding one was filed on 27.07.2017. However, the Company has itself admitted that the Highway Authority did not even reply to the letter dated 27.07.2017. The Company has estimated the date of receipt of 'Termination Claim' and 'Claim for cost overrun' by 31st March 2019. However, on scrutiny of audit file there is no evidence of acceptance from the Highway Authority that the claim will be awarded by 31st March 2019. Neither, the Highway Authority has sent any acknowledgement of having received the claim filed on 27th Oct 2017 as there is no communication from the Highway Authority in the audit file. There is no surety of receipt of amount when the concerned authority has not even accepted the claim. As per Para 14 of Ind AS 11, a claim is included in contract revenue only when negotiations have reached an advanced stage such that it is probable that the customer will accept the claim and the amount can be reliably measured. Thus, the Audit Firm failed to apply requisite professional scepticism and merely accepted the Management's assumption of receipt of claim by end of 2019 without verifying the assertion from sufficient audit evidence. It is clearly an incorrect assumption.

6.40.2. In case of Thiruvananthapuram Road Development Company Ltd. (TRDCL), the claim is itself filed by 23rd July 2018 which is after 31st March 2018 and the Audit Firm is itself stating that there was no evidence available as on 31st March 2018. The explanation given by the Audit Firm in support of the claim amount receivable (Rs 28 crore in Mar-19 and Rs 68 crore in Mar-20) in future cash flows is "*past history of award of recovery of claims from authorities for the same project considering that there were significant delays by the authorities has evident from note 1 of audited financial statements of TRDCL for the year ended March 31, 2018 received from component auditors*". However, no such disclosure could be found in the Financials of TRDCL of March 2018.

6.40.3. This shows the complete reliance of Audit Firm on the management reply. Para 3 of SA 580 states that *"Although written representations provide necessary audit evidence**, they do not provide sufficient appropriate audit evidence on their own** about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfilment of management's responsibilities, or about specific assertions".* In the instant case, Audit Firm was required to perform adequate audit procedures to verify authenticity of the date of claim and amount of claim which it failed to do. Merely accepting the written representation from Management without additional audit procedures is a gross violation of SA 580 (Para 3).

6.40.4. As per Para A53 of SA 315, Audit evidence in the form of **external confirmations** received directly by the auditor from appropriate confirming parties may assist the auditor in obtaining audit evidence with the **high level of reliability** that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error. It also states that the auditor may design external confirmation procedures not only to confirm outstanding amounts, but also to confirm the details of transactions. Hence, had the Audit Firm obtained audit evidence from the Concerned Highway Authority, it would have been a more reliable source of information to vouch for the accuracy of estimated date and amount of claim of TRDCL and the subsequent decision of ECL reversal.

6.40.5. Para 9 of SA 500 states that "When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes, including as necessary in the circumstances:

(a) Obtaining audit evidence about the **accuracy and completeness** of the information; and (Ref: Para and (Ref: Para. A49-A50)

(b) Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes. (Ref: Para. A51)"

6.40.6. Also, as per Para 7 of SA 500, "*When designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence.*" However, in the instant case sufficient and appropriate audit evidence was not obtained by the Audit Firm and thus reversal of ECL of loans of Rs 118 crore (in case of MPBCDCL) and Rs 16.72 crore (in case of TRDCL) due to early repayment of loans out of the claim amounts received in both the cases from NHAI cannot be said to be true and correct. The cash flow projections prepared by Management are not reliable since they are not evidenced with authentic and reliable audit evidence and thus reversal of ECL of TRDCL and MPBCDCL has led to material misstatement in the financial statements.

6.41. NFRA has examined the responses and oral submissions of the Audit Firm to the above observations in the DAQRR and concludes as follows:

6.41.1. Regarding the disclosure of financial Instruments as required by Ind AS 107, the Audit Firm reiterates its earlier replies and submits that *"ITNL management had applied its judgment to determine the disclosure to be provided considering the requirements of the Ind AS 107 and the practices widely followed in industry. Accordingly, the Company had provided disclosure of changes because of financial instruments originated or acquired during the reporting period (Ind AS 107, para 35I, example (a) under the heading "Pertaining to the adjustment for revenue at fair value") and disclosure of changes arising from whether the loss allowance is measured at an amount equal to lifetime expected credit losses (Ind AS 107, para 35I, example (d) under the heading "Pertaining to the ECL Adjustments") in foot note to note 11 on Trade receivables on page 135 of the Annual report for the year ended March 31, 2018. The examples given in (b) and (c) of para 35I of Ind AS 107 were considered to be not applicable as there were modification of contractual cash flows or write offs in case of trade receivables. Further, based on the information and explanation provided to us by the management, the audit procedures performed and the professional judgment applied, SRBC applying its professional judgement and experience and exercising professional skepticism concurred with the management judgment with respect to the adequacy of the disclosure provided by the management in line with the requirements of para 35I of Ind AS 107*" However as explained in detail in the DAQRR, the above disclosure falls short of the qualitative and quantitative aspects of the specific requirements of Ind AS 107. Also, there is no evidence in the Audit File to support the above contentions. Hence NFRA concludes that the Audit Firm has failed to disclose the above non-compliance in their audit report.

6.41.2. Regarding disclosure under para 35M and 35N of Ind AS 109, the Audit Firm cites note 32.10.1of the financial statements and argue that the said note is in line with the disclosure requirements. However, this note is not in accordance with para 35N since it does not give any information about exposure to credit risk/risk categorisation as required by para 35N.

6.41.3. Regarding the discrepancies observed in working papers, the Audit Firm, referring to the cash flow projections of the SPVs, submits that *"As explained in point 1 to 2* *above, the probability of recovery was in-built into the cash flow projections prepared by the management that were reviewed by SRBC on test check basis".* This is not acceptable since the payment of annuity/toll payments may be linked to certain performance/operational criteria also. Probability of compliance with such conditions will have an impact on the cash flows of the SPVs. Even if the SPVs realise payments from the concessionaire as per schedule, the payments to ITNL by the SPVs is governed primarily by the EPC and other contracts between the SPVs and ITNL. There may be a separate set of conditions in these contracts, which will affect the probability of cash flows to ITNL. The outstanding debtors of more than three years appearing in the books of ITNL indicates long pending payments from the SPVs due to various reasons, which are not seen examined by the Audit Firm with respect to the impact on probability of recovery. The reply makes it clear that the Audit Firm had not performed any assessment of the probability of recovery or assessment of credit loss, but instead relied blindly on the projections made by the management on the pretext that these are as per annuity contracts and as per traffic studies. <u>The comment regarding CNTL</u> stands withdrawn in view of the WP reference now provided by the Audit Firm. However, NFRA observes that there is no independent evaluation by the Audit Firm about the proposal of refinancing made by the management. Regarding all other matters related to WPs, the Audit Firm did not provide any clear reference to evidence in Audit File to support their denial of the observations of NFRA.

6.41.4. Regarding advisory and project management fees/ O&M fees/ supervisory fees the Audit Firm simply denies all the observations of NFRA without support of any evidence either from the Audit File or from the Accounting Standards/SAs. Therefore, the conclusions in this regard are reiterated.

6.41.5. Regarding non-compliance of Ind AS provisions related to ECL on Trade Receivables, NFRA reiterates (because of the reasons <u>mentioned above</u>) that there is a serious lack of objective and thorough verification of the underlying assumptions used. The Audit Firm has not documented any basis of arriving at the expected dates of realisation nor made any assessment of probability weights attached to these recoveries which is a requirement of Ind AS 109 Para 5.5.17(a). The Audit Firm submits that "*We have discussed with the management and obtained necessary explanation and information as to how they have considered historical and forward-looking information in the cash flow estimates."*. However, the WP referred by the Audit Firm in this regard contains a statement to the effect that the Audit Firm had compared the actuals with the projections and no discrepancies were found. It is unclear what reasonable and supportable information has been obtained about past events and future economic conditions for calculation of ECL, as required by Para 5.5.17(c) of Ind AS 109. There is no evidence of analysis of expected dates determined in past periods and whether amounts were actually realized on those dates and the management estimates were actually reliable or not.

6.41.6. Regarding MPBDCL, the Audit Firm submits that *"The claim considered by the management based on best estimates of the management considering the past history of claims awarded to the Group for the same and other projects was considered to be* *a reasonable. Based on past experience the claims were awarded in 12 to 18 months.*". However, this is not supported by evidence that there is in fact such a past experience/history. No authority will hold up a claim beyond the legally permitted period for undisclosed reasons. In the absence of any intimations from the authority, the Audit Firm's total reliance on the management estimate without sufficient evidence is not appropriate. Reference to para 14 of Ind AS 11 stands withdrawn as it does not apply to the SPV.

6.41.7. Regarding TRDCL the Audit Firm submits that "*Such estimate of recovery of claim was supported by past history of award of recovery of claims from authorities for the same project considering that there were significant delays by the authorities as evident from note 1 of audited financial statements of TRDCL for the year ended March 31, 2018 received from component auditors (Refer Canvas file name "Signed Financials (Ind AS)_TRDCL_March-2018"). We are surprised that NFRA could not find the same, we are attaching the relevant note by way of Annexure 7 for your reference*.". The delays mentioned in the said two-page note is with respect to delivery of project sites (land acquisition) by the Government authority that happened before the year 2009. It is also stated in the said note that substantial completion certificate was received for more than 22 Km out of 28.60 Km before March 2015 and COD issued for around 4.7 Km. However, how the delay in the said land acquisition has affected the claims for the year 2018 and thereafter is unclear from this note. NFRA is not surprised to see such vague statements from the audit firm as many of the responses by it are proved to be made-up. Other than this false claim, there is no evidence in the Audit File regarding the past history of the payments. The sentence "*and the Audit Firm is itself stating that there was no evidence available as on 31st March 2018*" in <u>para 6.40.2 above</u> stands deleted in view of the explanations.

6.42. In view of the above, NFRA reiterates all its observations in the DAQRR and concludes that the Audit Firm failed to verify the ECL reversal of Rs 16.72 crore and did not carry out the audit according to standards of auditing. The Audit Firm did not maintain professional scepticism, professional competence and due care and other ethical requirements during the audit (Para 14, 15, 16, A15 of SA 200).

7. PROVISION OF INTEREST FREE LOANS TO JOINT VENTURES AND SUBSIDIARIES

7.1. NFRA had conveyed the following prima facie conclusions:

7.1.1. NFRA has observed from WP 'A3-421', that the company had extended loans of Rs 111.20 crore to "Joint ventures" and "not fully-owned subsidiaries" at 0% interest rate, as shown below:

Entity	Loan Amount (Rs)	Effective Holding	Type of Company
Jorabat Shillong Expressway Ltd	31,82,07,331	50%	Joint Venture
Rapid Metrorail Gurgaon Ltd	15,02,68,031	44.12%	Subsidiary
Rapid Metrorail Gurgaon South Ltd	49,63,04,840	89.11%	Subsidiary
Thiruvananthapuram Road Dev Co Ltd	14,72,14,424	50%	Joint Venture
Total	**1,11,19,94,626**		

7.1.2. As per Section 143(1)(a) of Companies Act 2013, it is the duty of the Audit Firm 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". NFRA has examined the following cases and has observed that there is a clear violation of Section 143(1) (a) as the Audit Firm did not satisfy itself that loans to the following financially unstable companies with continuous losses in previous years were not on terms prejudicial to the interests of ITNL.

Thiruvananthapuram Road Development Company Limited (TRDCL)

7.1.3. TRDCL, a JV in which ITNL has 50% stake, has been reporting increasing negative net worth of Rs (95.82) Cr in 2017-18, Rs (77.69) Cr in 2016-17, Rs (50.60) Cr in 2015-16, Rs (30.47) Cr in 2014-15. TRDCL had negative net cash flows of Rs (1.22) Cr in 2017-18 and Rs (7.67) Cr in 2016-17. NFRA notes from the Working Papers that the Audit Firm did not question the Management on their decision to extend loans at zero per cent rate of interest, despite the Company's falling net worth in previous three years consecutively.

The casual approach of the Audit Firm is evident from the fact that they were fully aware that the component auditors of TRDCL had given Emphasis of Matter drawing attention to Management's note on of preparing financial statements on Going Concern basis, yet failed to exercise professional scepticism in the matter.

Rapid Metro Gurgaon Limited (RMGL)

7.1.4. ITNL holds majority stake in the subsidiary. RMGL reported a loss of Rs (123.5) Cr in the year 2017- 18, Rs (113.3) Cr in the year 2016-17 and Rs (111.83) Cr in the year 2015-16. The entity has negative cash flows from investing and financing amounting to Rs (43.77) Cr and Rs (34.3) Cr. It is evident that such loss making entity stood high chance of loan default, hence extending interest free loans to it was clearly not in the interest of the Company.

7.1.5. NFRA notes that the Auditor in his opinion stated in Annexure 1- Statement of matters specified in paragraph 3 and 4 of the Companies (Auditor's Report) order, 2016 clause (iii)(a), has stated that the terms and conditions of the loans, amounting to Rs.111.20 crore as stated in S.No.15 to its joint venture companies and also to 'not fully owned subsidiary companies' at 0% rate of interest against the average cost of borrowing for the year at 12.5% p.a, was not prejudicial to the interest of the company. NFRA also notes that the Audit Firm's opinion was based on the opinion obtained by the Management from an external Expert on 28.05.2018, a day before the Report was signed and issued by the Audit Firm.

7.1.6. The External Expert in his opinion has stated that his "opinion was restricted to the facts provided by ITNL and the Expert has not independently examined any facts in relation to the issues raised for their consideration. We have not conducted any independent analysis as to the veracity of information provided by ITNL." In this regard, attention is invited to SA 500 (Para A 48) which requires the Auditor to evaluate the appropriateness of the Management Expert's work as audit evidence. These provisions require the Audit Firm to evaluate the appropriateness of the Management's Expert work by verifying that:

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

7.1.7. Examination of the work papers submitted by the Audit Firm, do not indicate that the Audit Firm had verified the source data provided to the Expert by conducting any independent verification of information provided by ITNL, based on which the opinion of the expert on the issue raised was sought, in utter disregard of the requirements of SA 500. Moreover, it was clearly prejudicial for the Company alone to bear the complete borrowing cost of interest free loans given to Joint Ventures and Not fully owned Subsidiaries.

7.1.8. On scrutiny of the WP 'Page A3-421 of hard file No 2- CARO opinion', NFRA observes that the Expert has mentioned the following two explanations/ assumptions in support of his opinion:

- **i.** "To meet SPV's recurring requirement of funds, ITNL borrow funds from the market @ 10% to 16% p.a. Average cost of borrowing of ITNL is 12%- 12.5%. ITNL's credit rating is dependent on timely honouring of obligations by SPVs i.e. in case SPVs does not honour its obligations, ITNL's credit rating will be impacted, which may affect ITNL's ability to borrow in future and also it may have impact on its borrowing cost."
- **ii.** "Section 186(7) of the Act states that a Company cannot lend at a rate of interest lower than the prevailing yield of one year, three year, five year or ten year Government security closest to the tenor of the loan. However Section 186(11)(a) provides that nothing contained in Section 186 of the Act, except sub- Section (1), shall apply to any loan made, guarantee given or any security provided or any investment made by a Company established with the object of providing infrastructural facilities".

7.1.9. In NFRA's view, the grounds mentioned at (i) above impacting the credit rating of the Company is completely an illogical explanation. The Auditor should have questioned the recoverability of the principal amount itself and associated going concern risk which would certainly affect the credit rating of the Company substantially. This is evident from the fact that the credit rating of the Company has reduced by one notch.

7.1.10. As far as exemptions under Section 186 (11) (a) quoted at point (ii) above is concerned, NFRA is of the view that irrespective of the provisions of Section 186, it was the Auditors' responsibility to comply with the provisions of Section 143(1) of the Company's Act, as has been pointed out already above.

7.1.11. Based on observations made in the previous paragraphs, NFRA concluded that"

- **i.** the Auditor's opinion expressed in <u>Annexure 1</u>- Statement of matters specified in paragraph 3 and 4 of the Companies (Auditor's Report) order, 2016 clause (iii)(a) stating that the terms and conditions of the loans (amounting to Rs.111.20 crore as stated above to its joint venture companies and also to 'not fully owned subsidiary companies' at 0% rate of interest against the average cost of borrowing for the year at 12.5% p.a.), was not prejudicial to the interest of the company, does not appear to be based on appropriate adequate evidence and is without proper examination of the related facts and figures. The Audit Firm is found to have violated the requirements of SA 500 and the Company's Act, 2013.
- **ii.** that the Audit Firm committed serious professional misconduct in terms of Para 15, 16, A15 of SA 200, of: (a) Not disclosing complete information to users of financial statements as required under relevant financial reporting framework,

(b) Not carrying out the audit according to standards of auditing, (c) Not maintaining professional scepticism, professional competence and due care and other ethical requirements during the audit.

7.2. NFRA has examined the replies of the Audit Firm to the above observations and further observes as follows:

7.2.1. At the outset NFRA clarifies that the aim of the AQR is not to arrive at certain conclusions about the Auditee Company based on material available on record or otherwise. The primary aim of the AQR is to assess whether the Audit Firm has reached its conclusions by following the provisions of the SAs in letter and spirit. In the instant case the Audit Firm has reached a conclusion that the terms of interest free loans to certain loss-making subsidiaries and JVs are not prejudicial to the interest of the company. The PFC points out serious non-compliances with SAs in arriving at such a conclusion. The key observation of NFRA in PFC that the Auditor's opinion expressed in Annexure 1- Statement of matters specified in paragraph 3 and 4 of the Companies (Auditor's Report) order, 2016 clause (iii)(a) stating that the terms and conditions of the loans was not prejudicial to the interest of the company **does not appear to be based on appropriate adequate evidence and is without proper examination of the related facts and figures.** The Audit Firm has not provided any evidence to prove to that they have performed adequate audit procedures in arriving at the conclusion.

7.2.2. In order to substantiate its conclusions, the Audit Firm explained in their reply the peculiar nature of infrastructure projects, the business model followed and the contractual obligations of ITNL as sponsor of the projects. The Audit Firm submits in page 380 of their reply that "Hence, it is very clear that the audit conclusion that the loans granted were not prejudicial to the interest of the Company and its members was based on the assessment as mentioned in para 3(a) and (b) above and supported by the legal firms opinions that had confirmed that loans granted at zero percent interest rate were not prejudicial to the interest of the Company in accordance with the Companies Act, 2013".

7.2.3. NFRA cannot take these arguments into cognisance since: -

i. none of these are documented in the Audit File while concluding that the loans are not prejudicial to the interest of the Company. The professional judgements made in this regard are also not seen documented. The Audit Firm may refer to NFRA's observations elsewhere in this DAQRR about documentation of professional judgements. The submissions are hence only an after-thought.

ii. the reply of the Audit Firm implies that the legal opinion was sought to corroborate its conclusion that the loans are not prejudicial. However, this is not factual. There were no conclusions made/documented by the Audit Firm at the time of Audit based on Audit Evidence other than the legal opinion. As per the audit documentation, the legal opinion obtained in the last minute is the only basis on which the Audit Firm has reached its conclusions. The Audit Firm even did not assess the expert opinion as stipulated by the SAs. NFRA's observations regarding compliance with SA 500 should be seen in this background.

7.2.4. In the context of reporting under Clause 3(iii)(a) of CARO-2016, that the terms and conditions of the loans (covered in register maintained under section 189 of Companies Act 2013) are not prejudicial to the interest of the Company, Para 38A(c) of Guidance Note on the Companies (Auditor's Report) Order, 2016 states that the "terms and conditions would primarily include rate of interest, security, terms and period of repayment and restrictive covenants, if any. In determining whether the terms of the loans are prejudicial, the auditor would have to give due consideration to the other factors connected with the loan, including its ability to lend, terms of its borrowings, borrower's financial standing, credit rating, if available, the nature of the security, rate of interest and so on."

7.2.5. Clause (a) of sub-section (1) of section 143 of the Act also 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. The Guidance in the para 38 A(c) quoted above would equally apply in verification of this requirement as well.

7.2.6. From the WP 'ITNL G Lending March 2018', sheet 'G_3_Additions', it is seen that :-

i. Out of total additions made during year 2017-18 of Rs 9,455.24 crores, loans amounting to Rs 2,037.94 crore were verified from the agreements i.e. only 21.5%.

ii. Even in the loans verified from the agreement, no reference to the terms and conditions other than rate of interest and amount have been mentioned. No evaluation has been made by Audit Firm on the terms and conditions, including repayment of principal, to assess if the loans were prejudicial to the Company.

iii. No verification of loans squared up during the year has been seen documented.

iv. there is no evidence of samples verified, containing proper loan repayment schedule showing repayment amounts and due dates. Sheet 'G_4_Deletions' in the WP just contain the amounts repaid and date of receipt. There is no mention and record of due dates and amounts due as per loan agreement.

7.2.7. The Guidance note clearly states in Para 38A(c) that auditor is required to give due consideration to the terms and conditions of loans which includes borrower's financial standing and Company's ability to lend. But there is no evidence in the audit working papers that the Audit Firm has carried out substantive procedures to assess risks associated with the loans outstanding with the borrowers to whom loans were given which are outstanding at year end or are repaid during the year. The borrower's financial standing and repayment capacity can be ascertained from their cash flow statements and net worth. For instance, TRDCL, a JV in which ITNL has 50% stake, had been reporting increasing negative net worth of Rs (95.82) Cr in 2017-18, Rs (77.69) Cr in 2016-17, Rs (50.60) Cr in 2015-16, Rs (30.47) Cr in 2014-15. TRDCL had negative net cash flows of Rs (1.22) Cr in 2017-18 and Rs (7.67) Cr in 2016-17. Similarly, RMGL reported a loss of Rs (123.5) cr in the year 2017- 18, Rs (113.3) Cr in the year 2016-17 and Rs (111.83) Cr in the year 2015-16. It had negative cash flows from investing and financing amounting to Rs (43.77) Cr and Rs (34.3) Cr for 17-18 and 16-17 respectively. RMGL Balance sheet for the FY 17-18 showed current assets of only Rs 1,970 crore to pay current liabilities of Rs 28,941 crore and RMGSL had current assets of only Rs 1,641 crore to pay current liabilities of Rs 69,012 crore at end of FY 17-18. This itself should have raised enough red flags for the Audit Firm to examine and highlight the poor credit worthiness of the borrowers to the management.

7.2.8. There is no examination by Audit Firm on the above negative indicators that will have an impact on the recoverability of the loans given to TRDCL, RMGSL, RMGL and JSEL. The Audit Firm did not obtain sufficient appropriate evidence to verify the repayment capacity of the borrowers, nor had they examined the feasibility of the projects being funded through such loans.

7.2.9. Rather than forming a conclusion based on the facts and figures available on record, the Audit Firm in its response to PFC, has referred to legal opinion of lawyer Cyril Amarchand Mangaldas and Kaushik Laik. In the legal opinion, the expert has given the argument that most of the projects have long gestation period and are unable to meet obligations to its senior lenders and hence ITNL as a sponsor of the project supports its SPVs to meet its working capital requirement. This has no relevance in determining the compliance by the Audit Firm with the relevant sections of the Companies Act.

7.2.10. Para 28 of Guidance Note on Audit of Internal Financial Controls Over Financial Reporting emphasises the objective of auditor in audit of internal financial controls over financial reporting. It states that objective is to express an opinion on the effectiveness of the Company's internal financial controls over financial reporting. It is carried out along with an audit of the financial statements. A material weakness in internal financial controls may exist even when the financial statements are not materially misstated. Para 112 of the Guidance Note states that for each control selected for testing, the evidence necessary to persuade the auditor that the control is effective depends upon the risk associated with the control. The risk associated with a control consists of the risk that the control might not be effective and, if not effective, the risk that a significant deficiency or material weakness would result. Para 90 of Guidance Note states that Entity level controls include (a) Controls related to control environment and (b) Controls over management override.

7.2.11. In light of Para 28 and 112 of Guidance Note, it is well understood that the Audit Firm should have performed a careful and thorough controls testing over loans granted by the Company. On perusal of audit file, evidence for examination of controls over assessment of repaying capacity of borrowers **before granting of loans** were not found. The Audit Firm has documented in the WP 'Lending' containing Control Sheet 'ITNL-TOC Lending M-18' some risks and related controls to mitigate those risks. These risks included unapproved lending, loan balances misstated, non-recoverability of loans and interest accrued, unapproved modification to the terms of the loans, inaccurate calculation of interest. For non- recoverability of loans and interest accrued risk, the control placed is "accounts team prepares monthly MIS report wherein the outstanding status of recoverable are reported to the CFO and MD. Approval from COD is obtained where a provision for bad and doubtful debt is to be created." It is a manual detective control as stated in the WP. However, this control activity is more of post event action. There is no mention of Policy as to how Company evaluates the credit worthiness and financial soundness of the borrower which can lead to a default scenario. Against the risk of unapproved lending, nothing has been documented in audit file except that the loans were sanctioned after approval from Committee of Directors (COD) and minutes of COD have been referred to.

7.2.12. There are no sufficient testing of controls and sufficient audit procedures by the Audit Firm to mitigate the risk of management override of controls as stipulated by para 90 of the Guidance Note. This is especially important in the case of ITNL where major portion of the loans are given to related parties (subsidiaries, associates and joint ventures) and high chance of risk of override of management controls exists.

7.2.13. Hence NFRA observes that the tests of control used by the Audit Firm are clearly irrelevant and inadequate to conclude that controls were in place and operating efficiently for lending activity of Company.

7.2.14. SA 265 requires that if the auditor has identified one or more deficiencies in internal control, the auditor shall determine, on the basis of the audit work performed, whether, individually or in combination, they constitute significant deficiencies. The auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis. (Para 8,9 of SA 265). It is expected that the auditor should have noticed such lacunae in the internal control over credit monitoring and exercised the highest degree of professional due diligence. This lacuna of weak credit monitoring system should have been communicated with the management and those charged with governance as well as the potential effect it could have on the financial statements, if the same is not appropriately addressed. However, no such communication by the Audit Firm is traceable from the audit file.

7.2.15. Based on the observations noted in the above paragraphs, NFRA concludes that Audit Firm has failed: -

i. to design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence. (Para 6, Para 7, Para 10 SA 500).

ii. to communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis. (Para 8,9 of SA 265)

iii. to report under Clause 3(iii)(a) of CARO 2016 correctly after performing appropriate and adequate audit procedures.

7.3 NFRA has examined in detail the replies dated 10th July, 2021 and the oral submissions by the Audit Firm regarding the above observations in the DAQRR. NFRA observes that the replies of the Audit Firm are mostly a reproduction and reiteration of the earlier replies to the PFC. However, NFRA has again examined the above observations in the light of the repeated replies by the Audit Firm.

7.4 The WPs referred by the Audit Firm in its response dated 10th July, 2021 are the same as what was referred by them in their response to the PFC. NFRA formed its DAQRR after examining in detail the referred WPs. As the Audit Firm failed to provide any new/additional evidence in support of their response, NFRA reiterates the conclusion that the Audit Firm has not provided any evidence to prove that they have performed adequate audit procedures in arriving at the conclusion that the loans were not prejudicial to the interest of the Company. The Audit Firm's reliance on the expert opinion, obtained just the day before the signing of the Auditor's Report, is without independently evaluating the work of the expert as per the requirements of SA 500.

7.5 After citing the WPs, the Audit Firm states that "*The above referred documents are an integral part of the audit file documentation submitted to NFRA on March 22, 2019. This is not some afterthought submission as falsely alleged by NFRA. SRBC would like to understand the basis on which NFRA views these as afterthought and take a strong objection to false and baseless allegation that these documents and submissions are afterthoughts"*. NFRA clarifies that the Audit Firm's WPs did not contain adequate evidence that the Audit Firm has examined factors, other than interest on loans, in concluding that the said loans are not prejudicial to the interest of the Company. The Audit Firm's contentions in this regard are as follows. These contentions are stated in their submissions at more than one place, with minor variations.

a) "*The sponsorship agreement with the lenders of SPVs, required the Sponsors to contribute the cash shortfall. Not funding the SPV in terms of sponsorship agreement would have been a breach of contract and the adverse implications would in fact have been prejudicial to the interest of the Company."*

b) *"ITNL's credit rating was dependent on timely honouring of obligations by SPVs i.e. if SPV did not honour its obligations, ITNL's credit rating could have been impacted."*

c) *"Charging interest to aforesaid SPVs would have created an additional burden on the cash flows of the SPVs which could have resulted in the Company having to infuse additional funds"*.

d) *"Further, based on the cash flow projections prepared by the management over the term of concession agreement, management was expecting to recover of the loans so granted to the aforesaid SPVs."*

e) *"Considering the impact of all the above factors which could have adversely affected the Company; accordingly, management was of the view that providing interest free loan to the SPV was not prejudicial to the interest of the Company."*

f) Referring to the Guidance Note on the Companies (Auditor's Report) Order, 2016, the Audit Firm states *"Based on the above the auditors are required to give due consideration to the "other factors" connected to the loan, the list of such factors given in the guidance note is inclusive and not exclusive. Accordingly, SRBC had considered the factors stated stated in 4(c) above to determine and conclude on whether the terms and conditions of the grant of such loans are not prejudicial to the Company's interest."* (The reference '4(c)' points to statements quoted from (a) to (e) above.)

g) "*Considering the above, the explanation and workpaper reference in 4(a) to (c) and the legal opinions obtained from two reputed legal experts, it was concluded that providing loans at zero percent interest to aforesaid SPV was not prejudicial to the interest of the Company."*

h) *"One important aspect which has been ignored by NFRA reviewer due to lack of sector / industry experience and knowledge is that ITNL is not in lending/finance business, it is in infrastructure business where the projects are executed in SPVs where the entire equity / financing obligation is of the sponsor itself and hence the impact on the Company has to be assessed on a holistic basis and not in narrow sense*."

7.6 NFRA's observations on each of the above contentions are as follows.

7.6.1 Contentions at (a) and (b) above are general understanding of the Audit Firm which NFRA has not disputed in the DAQRR. However, whether such matters are in fact factored into the terms of the loans, so that these are not prejudicial to the interest of the Company is a matter that requires documentation. There is no such documentation in the Audit File.

7.6.2 Regarding contention at (c) above, NFRA has not stated anywhere in the DAQRR that the terms of loans are prejudicial because of zero per cent interest. Para 7.2.3 and 7.2.6 may be read in this regard.

7.6.3 The Audit Firm's contention in (d) above that the loans were expected to be fully recovered (based on cash flow projections) is without the support of adequate procedures. For e.g., in the case of TRDCL the projected short-term loan from ITNL is Rs 201.10 crore (it is noted against this line item in the WP, hardcopy file 13, that "ITNL has given a 0% loan to support the SPV to repay the external debt obligation") over a period of 14 years. However, the WP shows no evidence of how the Audit Firm has verified the projections and assumptions to verify the recoverability of the loan.

7.6.4 Contention in (e) above is a general understanding which was not disputed by NFRA. However, there is no evidence that this is in fact the view of the management.

7.6.5 Contention in (f) and (g) above is not acceptable due to the absence of clear evidence as explained above. More importantly, the Audit Firm itself admits that "the impact on the Company has to be assessed on a holistic basis and not in narrow sense" (contention at (h) above). It can be seen from the above explanations that the Audit Firm has not done any holistic assessment as it clearly failed to verify the factors such as negative indicators that will have an impact on the recoverability of the loans, the repayment capacity of the SPVs, the feasibility of the projects etc. as detailed in para 7.2.8 above. Depending on such factors, even a repayment schedule that does not factor in the ground realities could be prejudicial to the interest of the Company, since such conditions may cause unwarranted defaults and repayment pressures on the SPVs, which in turn would increase their market borrowing costs beyond affordable limits. If the term loans have certain conditions similar to that of a financing company, which the SPVs cannot meet because of specific circumstances applicable to each SPVs, even such conditions, which are normal in other cases, could be prejudicial to the interest of the company. The company has stated in its 'Chairman's Message' that *"In the process, the Company's debt position worsened and, the Company also incurred additional interest cost. With the intent to overcome these hurdles, we plan to critically reassess our project portfolio and take appropriate actions, including stake sale, divestment and refinancing*". Such plans may have a dependency on the terms and conditions of the existing financing arrangements. Failure of such plans may not be in the interest of the Company in any case. Even providing a loan, with or without interest, when the situation demands equity, might itself prove prejudicial to the interest of the company depending on the ground realities.

7.7 Thus, it is clear from the replies that the Audit Firm has not done any holistic examination to ascertain whether the terms of the loans are prejudicial to the interest of the Company or not. The company's decision to provide interest-free loans indicates the distress situation of the SPVs. Any failure of the SPVs in honouring the conditions of the loans could prove prejudicial to the Company as a whole. The Audit Firm's examination was based on the general, historical, and theoretical understanding of the company and its business and also based on certain projections provided by the management. There is no examination of the ground realities, i.e., the factors other than the interest rate, to confirm the conclusions apparently reached based on such a high-level understanding. In that context, the contention at 7.5 <u>(h)</u> above is a well-drafted guidance for the Audit Firm itself.

7.8 The Audit Firm in its response has stated that *"SRBC submits that while documentation of professional judgement shall be maintained in accordance with Para 8 of SA 230, however, that does not mean that the auditor needs to write down the entire thought process word by word like a script. To be precise, documentation in respect of mind mapping the process of arriving at professional judgements has never been required. The documents available on the audit file should prove that the auditor had the material on which to apply his mind. The final conclusions should then be documented in accordance with para 8 of SA 230. Para A4 of SA 230 clarifies that documents relating to preliminary thinking and superseded documents need not be retained on the audit file. The final conclusions and the material on which they are based are to be documented on the audit file"*. In this regard:

7.8.1 SA 230 clearly lays down that the Audit File should be capable of speaking for itself without the need for any other aids to interpretation. What has been claimed to have been done by way of audit procedures, or what has been claimed to have been gathered as audit evidence, should be attested/supported by the audit file. No claim that is not so supported can be taken into consideration. It is only such record, backed by pre-existing evidence from the Audit File, that can be accepted for the Audit Quality Review (AQR) by NFRA.

7.8.2 Para 2 of SA 230 clearly states that the nature and purpose of the audit documentation is to provide evidence of the auditor's basis for a conclusion about the achievement of the overall objective of the auditor. Accordingly, merely documenting the final conclusions in the audit file is not sufficient as the auditor is required to document the basis of forming his opinion/conclusions as well.

7.9 The Audit Firm has stated that *"SRBC submits that verification of additions of loans was performed on the basis of SA 500 and SA 530 and Guidance note on the Companies (Auditor's Report) Order, 2016 by selecting samples on random basis to perform test check to obtain a reasonable basis to draw conclusion. SRBC had also tested internal controls over lending process and found them to be effective and hence considered the coverage of substantive testing to be adequate*" and has given reference to a few WPs in support of their assertion. On perusal of the WPs referred by the Audit Firm, NFRA notes that there is no WP that provides evidence that any calculation was done by the Audit Firm to analyse the negative indicators and repayment capacity of the SPVs to whom

ITNL provided the loan. Instead, the Audit Firm has given reference of valuation report of experts of RMGL and RMGSL for cash flow projections of SPVs to check whether the loan/interest would be repaid. As already stated by NFRA in its DAQRR, the Audit Firm failed to verify the competence, objectivity, and work of the expert; hence the valuation report referred by the Audit Firm cannot be relied upon.

7.10 In view of the explanations provided above, NFRA concludes that the Audit Firm has failed:

7.10.1 to design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence. (Para 6, Para 7, Para 10 SA 500),

7.10.2 to communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis. (Para 8,9 of SA 265), and

7.10.3 to report under Clause 3(iii)(a) of CARO 2016 correctly after performing appropriate and adequate audit procedures.

8. DE-RECOGNITION OF BORROWINGS

8.1. NFRA had conveyed the following prima facie conclusions:

8.1.1 During the year 2017-18, the Company had assigned loans of Rs.1,000 crore, receivable from six specified SPVs, against the outstanding borrowings of the Company from IndusInd Bank, and derecognised the financial assets (loans to SPVs) and corresponding liabilities (borrowings from the IndusInd bank) to that extent.

8.1.2 The de-recognition of assets (loan to SPVs) and liabilities (borrowings from IndusInd Bank) was based only on the sanction letters dated 27 Mar 2018 (for Rs.250 crore) and 29 Mar 2018 (for Rs.750 crore) received from the IndusInd Bank. The assignment of loans to the Bank and reduction of corresponding liabilities of borrowings was subject to fulfilment of certain specified conditions important amongst which was the Tripartite Agreement between the SPVs, ITNL, and IndusInd Bank.

8.1.3 Though the Audit Procedures performed as recorded in SRM (P-000317- 000318) in audit file stated that the following had been done:

i. Assessing the accounting treatment based on the provisions of Ind AS 109 according to Paragraph B 3.3.1.

ii. Verifying the agreements entered into by the Company with IndusInd Bank and read that the said assignments have been done without recourse option available and the Company is legally released from these borrowings.

iii. Discussed with the management and additionally obtained representation that the said assignment is done without recourse to Company and

iv. Obtained confirmation from IndusInd Bank at the year end in respect of loans outstanding at the year end. Further, IndusInd Bank has also confirmed that these loans are to the account of respective SPVs and not of the Company.

v. the balance confirmation certificate dated 17 May 2018 issued by the IndusInd Bank to the Company (WP-Q319-320 Hard Copy file No 8) for the position as on 31 Mar 2018, clearly showed that the borrowings from the Bank had not been transferred to the concerned SPVs and were till outstanding against the Company. Besides, audit evidence for the fulfilment of the other conditions precedent was also not found in the audit file.

8.1.4 NFRA concluded, prima facie, that in the absence of sufficient and appropriate Audit evidence in the Audit file in support of fulfilment of the above conditions laid down in the sanction orders, the de-recognition of assets and corresponding liabilities from the financial statements was not acceptable.

8.1.5 The Audit Firm in its responses dated 3rd July, 2020 has denied NFRA's conclusions on the basis of the following submissions:

Fulfilment of Specified Conditions and Audit evidence verified by ET:
The following evidence was obtained and verified by the ET:

i. The fee and expenses were to be paid by the borrower, which as per the tripartite agreement was the SPV.

ii. Information provided, by the management that the Deed of assignment had been executed.

iii. Tripartite Agreement between ITNL, IndusInd Bank and respective SPVs dated 29th March 2018 (Refer canvas file name Agreements and credit ratings zip for file name "Tripartite Agreement")

iv. The put option agreement was to be executed between IndusInd Bank and SPVs. ITNL was not party to the put option agreement.

v. Email confirmation with respect to assignment of loan from IndusInd Bank (Hard copy file 8 page no Q321)

vi. Resolution passed at the meeting of committee of directors held on March 22, 2018 approving the assignment (Hard copy file 1 page no A2-32 to A2-58)

vii. Representation from the management (Refer hard copy binder Part 5 of 6 page no P.5.1)

viii. Discussions with TCWG viz. audit committee (Refer Audit Committee Presentation in hard copy binder Part 5 of 6 page no P.5.3)

ix. Balance Confirmation Certificate: SRBC had received balance confirmation dated May 17, 2018 from the IndusInd Bank that showed the loan of Rs 1000 crores as outstanding from ITNL only as on Mar 31, 2018. The Audit Firm says that "*The management contended the said balance confirmation and arranged a call with the authorised person of the bank on May 28, 2018. The said personnel of the bank confirmed that the loans had been assigned to the SPVs on March 31, 2018 which was evidenced by the Tripartite agreement and notice of assignment of loans dated March 31, 2018, he also confirmed that the SPVs were liable to repay these loans by virtue of tripartite agreement. SRBC's discussion with the bank personnel was followed up with an email confirmation from the bank listing out the loans that had been assigned to the SPVs as at March 31, 2018. Accordingly, it was concluded that the borrowings from the Bank had been transferred to the concerned SPVs and were outstanding against the said SPVs*".

x. Lack of Sufficient and Appropriate Audit Evidence: Based on audit evidences obtained and verified by us (as mentioned in above point (a)) which support the fulfilment of the conditions laid down in the sanction letter of IndusInd Bank, representation from the management, and discussions with audit committee forming part of our workpapers, the de-recognition of assets and corresponding liabilities from the financial statements was in accordance with the principles of Ind AS 109 para B3.3.1.

5.17.31 NFRA had conveyed the following in its DAQRR:

Fulfilment of specified conditions and audit evidence verified by the ET

Deed of Assignment

8.2.1 The Audit Firm has failed to produce any documentary evidence from the Audit File of the Deed of Assignment, based on which the Tripartite Agreement had been signed.

8.2.2 In fact, the claim of the Audit Firm is not that they had examined the Deed of Assignment. They merely state that "**we were informed by the management that it has been executed** and were referred to the tripartite agreement wherein in the two paragraphs before para1 it is clearly stated that the assignment deed had been executed. The assignment deed is executed first followed by the Tripartite agreement for notice of assignment, accordingly, the tripartite agreement for notice of assignment could have been executed only when the assignment deed was executed" (emphasis supplied).

8.2.3 The above statement goes to conclusively prove the complete lack of due diligence and gross negligence on the part of the Audit Firm. As admitted by the Audit Firm itself, even the Tripartite Agreement would not be effective without the Deed of Assignment. Such an important document was not examined by the Audit Firm. Apparently, even the information that the said Deed had been executed was probably only oral, since there is neither any management representation in the Audit File that the Audit Firm cites, nor any contemporaneous record made by the ET.

8.2.4 In the absence of any evidence, NFRA concludes that no such Deed of Assignment was executed.

8.2.5 The above conclusion is confirmed by the fact that the date of execution of Deed of Assignment is kept blank in the "Tripartite Agreement" (Canvas file name Agreements and credit ratings zip in EY Canvas referred by Audit Firm in its response).

Tripartite Agreement

8.2.6 The document "Tripartite Agreement" in EY Canvas is dated 31st March (whereas in the Audit Firm's response it is stated as 29th March 2018). It is signed only by the

Company and ITNL. It does not contain any names of authorised signatories. Without being signed by the original lender, Indus Ind Bank, the said document is to be taken only as a worthless scrap of paper.

8.2.7 Even if, for argument's sake, the "Tripartite Agreement" available in Canvas is accepted as a valid document, it covers an amount of only Rs 750 crore, instead of Rs 1,000 crore of loans to SPVs assigned to Indus Ind Bank. The SPV covered by this Agreement is Chenani Nashri Tunnelway Ltd.

8.2.8 In addition to the above, there exists no Date of Assignment Deed and Power of Attorney in such Tripartite agreement referred to by ET, rendering the agreement incomplete to be accepted as a legally valid document.

8.2.9 The "Tripartite Agreement" in EY Canvas, mentions the name of Company in events of default as follows:

8.2.10 "*Clause 14(i)- The Borrower agrees and confirms that in the case of the occurring of any* event *of default as mentioned in Clause 14(ii) below and failure to cure the said Event of default(except Payment related Event of Default for which no cure shall be available) within a period of 30 days, then the entire amount of Loan shall become due and payable at once and the Assignee shall be entitled to proceed further to recover its dues as the Assignee may deem fit and proper."*

8.2.11 Clause *14(ii)- Events of Default: means an event of default committed either by the* Assignor*, or any of the Borrowers as enumerated below:*

8.2.12 Failure *to service debt or any other amount under the Facility Agreement/Deed of Assignment by the Borrower (SPV) and/or the Assignor (ITNL).*

8.2.13 Assignor *and/or Borrower default under any loan availed from the Purchaser/Assignee or any of its lenders.*

8.2.14 Clause *16- The Borrower & the Assignor, jointly and severally, agrees and undertakes to* indemnify *and keep indemnified the Assignee from and against any and all claims, losses, liabilities, damages, costs, charges and expenses that the Assignee may incur as a result of entering into the Assignment Deed and purchasing the Loans dues by the Borrower to the Assignor and as a result of any acts of commission or omission by the Assignor/Borrower."*

8.2.15 Clearly, the liability of ITNL as Assignor, to IndusInd Bank, the Assignee, was not diminished in any way even if the Tripartite Agreement had been valid after signature of the same on behalf of IndusInd Bank. The condition in para 3.3.1 of Ind AS 109 for derecognition of the financial liability to IndusInd Bank was not satisfied in this case.

Put Option

8.2.16 The response of the Audit Firm stating that "*The put option agreement was to be* executed *between IndusInd Bank and SPVs. ITNL is not party the put option agreement*", is patently a wrong and misleading argument.

8.2.17 Section 5 of "Put Option Agreement" available in EY Canvas states that "*The assignment is with recourse to IL&FS Transportation Networks Ltd". IndusInd Bank shall have the right to exercise Put Option as defined in section 2.1 of the Agreement"* Section 2.1 states that "*the Purchaser (Bank) shall have the option to call upon the Borrower(SPV) to prepay/purchase the Defaulted Loans on occurrence of any Event of Default."*

8.2.18 It is clearly stated in above statement that the ultimate liability rests with ITNL as the assignment is with recourse to ITNL. Hence, in effect ITNL is not relieved of the obligation to repay the loans to IndusInd Bank.

Email Confirmation

8.2.19 Email confirmation (Page Q-321 in Hard copy 8 of audit file) sent by IndusInd Bank to ET as referred to by the Audit Firm, states as follows. *Please find details of SPVs for assignment of loans:*

Loan ID	***Receivable From (Company Name)***	***Amount***
516003439124	*Baleshwar Kharagpur Expressway Ltd*	*37.00*
	ITNL Road Infrastructure Development Company Ltd	*62.50*
	Rapid Metrorail Gurgaon Ltd	*52.50*
	Rapid Metrorail Gurgaon South Ltd	*62.50*
	Thiruvananthapuram Road Development Company Ltd	*35.50*
	Total	*250.00*
512003480708	*Chenani Nashri Tunnelway Limited*	

8.2.20 The above email is not an acceptable evidence as it refers to loans of only Rs "250" [crores?] to five SPVs of ITNL out of total Rs 1,000 crore.

8.2.21 It can be clearly seen that email confirmation did not confirm any date of outstanding loan balances.

8.2.22 No effort has been made by ET to verify the authenticity of the Email received from Bank and the authorised person sending such an email.

Balance Confirmation Certificate

8.2.23 The Balance Confirmation Certificate (Q319 to Q320 of Hard copy 8 of audit file) issued on 17 May 2018 by IndusInd Bank confirmed loan balances outstanding from ITNL as the Borrower. This certificate was signed by two authorised signatories namely Mr Rakesh Babu Velayutham and Mr Sundararaman Vembu.

8.2.24 The contention of Audit Firm that this Balance Confirmation was superseded by Email Confirmation dated 28 May 2018 sent by IndusInd Bank to ET does not suffice as email was sent by a person other than the authorised signatories of Bank already mentioned above. The superseding signatory should have been same for the sake of authenticity and reliability of bank confirmation. On the other hand, the purported email was from some other person whose status and authority in the Bank was not confirmed and authenticated by anybody. In any event, even this email did not confirm the assignment which was required for the derecognition. There is only a handwritten note on the print-out of the email, supposedly recorded by "*Mr Nikhil Padte and Mr Abhishek Batra"*, two persons claiming to be employees of the Audit Firm to the effect that "*Based on the Joint call/discussion dated 28th May 2018 at 5:30pm with SRBC & Co LLP and IndusInd Bank it is confirmed that the loans will be repaid by the SPVs"*. The Audit Firm is oblivious of this fact and accepted the audit evidence as is given by Management. Further, the email did not confirm the date of outstanding loan balances and the amount of loans seen in email was only Rs 250 crore and for one SPV (Chenani Nashri Tunnelway Limited) amount of loan was blank.

8.2.25 Under usual balance confirmation process followed by banks, the previous Balance Confirmation dated 17 May 2018 in name of ITNL for Rs 1,000 crore should have been revoked and a new confirmation with the total amount of loans assigned, date of outstanding loan balances and the party/parties in whose name these loans were outstanding should have been obtained. The Audit Firm should have taken extra care, in the light of the details given above, to check the authority of the person signing such revised balance confirmation certificate to do so. This is absolutely basic to the procedure of audit. This would have ensured that the assignment of loans had also been completely recorded by Bank in its books. On the contrary, the Audit Firm placed complete reliance on management's false assertions and representations and failed to question the Company to obtain audit evidence through a reliable and proper procedure.

Lack of critical evaluation of audit evidence by ET

8.2.26 The Audit Firm failed to consider the below significant aspects in the assessment of Derecognition of Borrowings and Loans from financial statements of ITNL:

8.2.27 DSRA Agreement: On perusal of Audit File, NFRA observes that the DSRA Support Undertaking which was executed between ITNL, SPV i.e Chenani Nashri Tunnelway Limited and IndusInd Bank on 31st March 2018. According to it, ITNL and the SPV (obligors) shall, jointly and severally ensure that DSRA amount (Principal DSRA falling due in next 3 months and Interest DSRA equivalent to interest obligation falling due in next 3 months) shall be created and maintained by the Borrower and/or ITNL at all times until the Facilities and amounts due are repaid to the Lender to its satisfaction (Clause 1). In the event of default by Borrower, Bank shall have the right to utilize the DSRA towards such unpaid amount under the Facility (Clause 3).

8.2.28 Clause 5(a) of DSRA states that "*Obligors shall, jointly and severally, ensure that the* Borrower *is discharging his obligation and is repaying the interest and/or Installments on its due dates(s). During the currency of the Facility, Obligors, jointly and severally, shall support the Borrower in the form and on terms acceptable to/prescribed by the Lender, including if required by the Lender by bringing in additional equity capital/preference capital/interest free unsecured loans or another method acceptable to the Lender.*"

8.2.29 Clause 13 states that *"*This undertaking and liability of the Obligors hereunder is absolute, unconditional, independent, jointly and severally and irrevocable and shall be in full force and effect until all amounts due, payable and/or outstanding under the Facility/Facility Documents/Deed of Assignment are paid in full to the satisfaction of the Lender and till the Borrower is discharged in writing by the lender."

8.2.30 Thus, on reading the DSRA it is seen in many places that ultimately ITNL was jointly and severally liable for the obligation to the Bank. Thus, the condition of derecognition mentioned in Para B 3.3.1 of Ind AS 109 that the debtor is legally released from the primary responsibility for the liability by law or by creditor was not met.

8.2.31 A Power of Attorney is mentioned in "Tripartite Agreement" as having been executed but without any date. Power of Attorney is a written authorization to represent or act on another's behalf in business and legal matters. But on perusal of audit file by NFRA, no Power of Attorney was found in audit file.

8.2.32 The Audit Firm's contention that it obtained sufficient appropriate audit evidence is false as they relied solely on enquiries with, and representations by, the Management. The letter of representation was also obtained on **29th May 2018 by ET i.e on date of audit report.**

8.2.33 The Audit Firm failed to highlight inconsistencies/incompleteness of facts in supporting documents and was ignorant of significant clauses in agreements discussed above. This cast doubt on the correctness of transaction and its accounting in books of accounts. It demonstrates lack of professional scepticism, and due diligence on the part of Audit Firm and proof of its gross negligence.

8.2.34 Disclosures: According to Para 17 of Ind AS 1, "Presentation of a true and fair view also requires an entity to provide additional disclosures when compliance with the specific requirements in Ind ASs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance. [Part (c)]". No disclosures have been made in Notes to Account to bring a material transaction of assignment of loans to SPVs to the knowledge of the users.

8.2.35 NFRA's examination of the audit file and response of the Audit Firm to NFRA's prima facie conclusions, clearly shows the Audit Firm's complete failure to exercise due diligence and their gross negligence regarding the collection and examination of appropriate audit evidence, correctness of balance confirmation, and reliability of email confirmation obtained from Bank. The conclusions drawn by the Audit Firm on the derecognition of assets and corresponding liabilities above were not based on sufficient appropriate audit evidence, as detailed above, and hence were in gross violation of the SAs.

i. Thus, the Audit Firm did not exercise due diligence, was grossly negligent in the conduct of their professional duties; and 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.
ii. The Audit Firm did not maintain professional scepticism during audit which is evidenced through instances stated above. Management representations were accepted as such by ET and audit opinion was formed based on them without challenging Management assertions.
iii. The Audit Firm colluded with the management in removing liabilities of the very significant and material amount of Rs 1000 crores (the materiality amount for the audit was fixed at Rs 2.2 crores) from the Balance Sheet of the company with the intention of misleading users of the financial statements. This would amount to fraud in terms of Sec 448 of the Companies Act, 2013, read with Sec 447.

8.3. NFRA has examined in detail the replies dated 10th July, 2021, and the oral submissions made by the Audit Firm (replies to the DAQRR) regarding the observations in the DAQRR. These are essentially a repetition of the earlier responses that had already been very carefully examined before concluding as in the DAQRR. NFRA has, nevertheless, again examined the above observations in light of the repeated replies by the Audit Firm and, observes as follows.

8.3.1. Regarding the tripartite agreement, the Audit Firm states that "*SRBC submits that copies of the signed (bank, ITNL and SPV) Tripartite agreement also available on the audit file (Refer canvas file name "Agreements and credit ratings*" for zip folder and within it refer file name "Notice of Assignment"). SRBC clarifies that the said agreement was dated March 31, 2018." Given the explanations, <u>para 8.2.6</u> above stands deleted.

8.3.2. The Audit Firm further submits that *"SRBC submits that there were six other agreements with six different subsidiaries aggregating to Rs.1,000 crore. As part of* *our audit, we had verified all agreement and as a sample we retained one high value agreement of Rs.750 crores on the audit file. SRBC submits that as per para A7 of SA 230 (Revised) it is not required to keep all documents / agreements on file and reference of the same is also sufficient. NFRA can exercise its rights and power to call for the other records and verify the same with the ITNL's management to corroborate the matters as mentioned above"* and has claimed that the auditor's ability to obtain audit evidence has a practical and legal limitation as he relies on management to provide information. However, there is no evidence in the Audit File to confirm that the Audit Firm has verified all the agreements.

8.3.3. Further, the Audit Firm has failed to provide any **valid evidence** to refute the observation of NFRA stated in DAQRR that the liability of ITNL as Assignor, to IndusInd Bank, the Assignee, was not diminished in any way even if the Tripartite Agreement had been valid after the signature of the same on behalf of IndusInd Bank. The condition in para 3.3.1 of Ind AS 109 for derecognition of the financial liability to IndusInd Bank was not satisfied in this case.

8.3.4. Regarding the Put Option, the Audit Firm submits that "*SRBC submits that NFRA has verified the Put Option agreement and acknowledges that the Put Option Agreement is only between the bank and the SPV and ITNL is not a party to the said agreement."* This is not factually correct as NFRA has never made any such acknowledgement. The Audit Firm further states that *"As mentioned by NFRA, even if the Put Option Agreement states that the assignment is with recourse to ITNL, ITNL is not a signatory and has not accepted the terms of such agreement and hence it cannot be legally implemented against ITNL. Further, section 5 of Put Option Agreement states that the bank shall have the right to exercise Put Option as defined in section 2.1 of the Agreement. Further, section 2.1 of the Put Option Agreement gives the bank the option to call upon the SPV (and not ITNL) to prepay the defaulted loans on occurrence of any event of default. Nowhere, in section 2.1, does the bank have any right against ITNL"*. These contentions are baseless and arise out of the frantic efforts of the Audit Firm to find excuses for its omissions. The above contentions are not acceptable due to the following reasons:

i. The Sanction letter dated March 29, 2018 (for assignment of Rs 750 crore to CNTL) from Indus Ind Bank prescribes in serial no. 8 one of the conditions precedent to the drawdown as "Put option agreement between ITNL, SPV and IBL". The sanction letter has been accepted and acknowledged by ITNL. Clause 13 of the tripartite agreement also underlines the above condition as jointly and severally agreed by ITNL and SPV. Thus, ITNL should be a party to the Put Option agreement as per the sanction conditions.

ii. This being the fact, the signing of the Put Option only by two other parties is a violation of the sanction condition. The Audit Firm should have checked this aspect and should have documented the same as it means that the loan conditions are not satisfied and so the loan is non-existent.

iii. Even if the Put Option is not signed by ITNL, the Company acknowledges it in both the sanction letter and in the tripartite agreement. Both these documents are cross-referred in the Put Option agreement. As the Put Option agreement is subordinate to the other two agreements, the conditions in the other two documents shall prevail.

iv. Also, as ITNL did not sign the Put Option Agreement and still the agreement states obligations of ITNL, who is legally the third party, this makes such an agreement not enforceable. As such, NFRA concludes that the Audit Firm ignored the clause written in the Put Option Agreement that says, *"The assignment is with recourse to IL&FS Transportation Networks Ltd"*. The Audit Firm also ignored the loan sanction conditions (which is the fundamental document for any credit facility) and tripartite agreement conditions. This shows the absence of professional skepticism needed from the Audit Firm.

8.3.5. Regarding the email confirmation, the Audit Firm states that *"The email referred to by NFRA provides an SPV wise break-up of Rs.250 crores which was assigned to five SPV. The balance Rs.750 crore was assigned to one SPV i.e. Chenani Nashri Tunnelway Limited (CNTL). Though the amount has not been mentioned against the same, it is can be corroborated with the account number mentioned in the email confirmation, from the Tripartite Agreement as discussed above and also from Note 18 to the audited financial statements for the year ended March 31, 2018 wherein the loan from banks of Rs.750 crore"*[sic]. The email confirmation dated 28-05-2018 (hard copy file 8 page no. Q321) cannot be accepted as convincing proof since:

i. It does not mention any amount against CNTL. The heading of the email states, *"Please find the details of SPVs for assignment of loans*:" and it then lists Rs 250 [crore?] against 5 SPVs and no amount against CNTL. This cannot be taken as an omission from the bank or something that needs to be interpreted by the readers.

ii. Nowhere in the email, it is stated that the repayment obligation is on the SPVs. It is to be seen in the background that the discussion with the bank and the Audit Firm where it is confirmed orally that "*the loans will be repaid by the SPVs*" is stated as happened at 5.30 PM on 28th May 2018 and the email on the same day is at 6.41 PM. Even though the email immediately followed the discussion, the email does not contain the information claimed as discussed between the Audit Firm and the bank.

8.3.6. Further, the Audit Firm has also stated that *"As the copy of emails from Ajitesh Jaiswal dated May 18, 2018 and email dated May 28, 2018 (3:04 pm) were not considered necessary for documentation and hence not documented on the audit file. Considering the serious allegations by NFRA, SRBC finds it necessary to bring these to the notice of NFRA and attached herewith as Annexure 8 and Annexure 9 respectively"*. As already explained in Para 8.3.5 above that the audit file should be capable of speaking for itself, the said contention of the Audit Firm that it was not necessary to document the email confirmations is unacceptable. As per Para 2 of SA 505, external confirmation received by the Audit Firm is more reliable when it exists in documentary form, whether paper, electronic or other media. Also, it is unheard of in audit parlance that an external balance confirmation obtained is not documented in the Audit File. Nevertheless, NFRA has examined the above-stated annexures and observes that:

i. Annexure 8- *IndusInd Bank Balance confirmation 18.05.18:* The only line mentioned in the email is *"Hi pleas find attached balance confirmation for itnl"* Further, even in the trail of the given email there is no confirmation of the balance mentioned.

ii. *Annexure 9- IndusInd Bank Balance confirmation 28.05.18:* Regarding balance confirmation received on May 28, 2018 at 3:04 PM, it consists of only the bank account numbers without the corresponding names of the companies to whom they have been assigned and the amounts.

8.3.7. Thus, the above Annexures referred by the Audit Firm do not contain any information regarding balance confirmation which could be considered as a shred of valid audit evidence.

8.3.8. Regarding the DSRA agreement the Audit Firm states that *"As seen from Clause 1 and 5(a) of DSRA Agreement, the DSRA requirement was that the obligors i.e. ITNL and SPV shall, jointly and severally, "**ensure that the SPV**" is discharging his obligation. ITNL being a parent Company was required to ensure that its SPV discharges its obligation on due dates."* The Audit Firm further states that *"Thus it is clear that it is support extended to SPV by virtue of entering into DSRA agreement by ITNL and nowhere assumed any obligation with respect to the assigned loans."* It must be noted that each clause of the agreement cannot be read in isolation, the agreement has to be read as a whole and then interpreted to derive the purpose of the document as a whole. Thus, by going through the whole agreement any reasonable person would interpret what NFRA has pointed out in the DAQRR that, *"on reading the DSRA it is seen in many places that ultimately ITNL was jointly and severally liable for the obligation to the Bank. Thus, the condition of derecognition mentioned in Para B 3.3.1 of Ind AS 109 that the debtor is legally released from the primary responsibility for the liability by law or by creditor was not met."*

8.3.9. The Audit Firm has stated that *"SRBC submits that preparation of financial statement including disclosure therein is the responsibility of the management. As an auditor we do not participate in any decisions with respect to preparation of financials statements…. in our professional judgment, the assignment of loans to SPV by ITNL to bank was akin to SPV's borrowing amounts from banks and repaying the loans to ITNL. The said assignment is in accordance with applicable accounting standards and has been appropriately dealt while preparing financial statements of the Company. This does not distort the true and fair view of the financial position or financial performance of the Company. Hence, the assignment of loan is not considered as an unusual or extra-ordinary transaction which require additional disclosures"*. In this regard, it is important to note that the statutory auditor is duty-bound to verify if the financial statements as prepared by the Management comply with the relevant accounting standards. In the present case of derecognition, there is substantial evidence, based on the Audit Firm's own documentation, to suspect whether the loan sanction, documentation and assignment had been completed in the FY 2017-18 itself. The sanction letter has been received on March 29, 2018 only and all the loan documentation and assignment has been stated as completed in the next two days. However, there are many flaws to this contention as detailed in the above paragraphs, which should have invoked professional skepticism and hence called for careful examination. There are no such efforts from the Audit Firm. Therefore, the said arguments of the Audit Firm cannot be acceptable.

8.3.10. Also, as explained earlier, the derecognition of borrowings was not in conformity with Ind AS 109. The Audit Firm failed to point out the non-compliance of Ind AS by the management while preparing its financial statements. In fact, in its Independent Auditor's Report, the Audit Firm has stated that *"In our opinion and to the best of our information and according to the explanations given to us, the standalone Ind AS financial statements give the information required by the Act in the manner so required and give a true and fair view* ***in conformity with the accounting principles generally accepted in India****, of the state of affairs of the Company as at March 31, 2018, its profit including other comprehensive income, its cash flows and the changes in equity for the year ended on that date"* (Emphasis Added). As such, NFRA concludes that the Audit Firm made this statement without performing adequate audit procedures as per SAs.

8.4. Given the above, NFRA reiterates its conclusion that the Audit Firm did not exercise due diligence and required professional skepticism regarding the collection and examination of appropriate audit evidence, the correctness of balance confirmation, and reliability of email confirmation obtained. The conclusions drawn by the Audit Firm on the derecognition of assets and corresponding liabilities were not based on sufficient appropriate audit evidence, as detailed above, and hence were in gross violation of the SAs.

8.4.1. Thus, the Audit Firm failed to obtain sufficient information which is necessary for the expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion.

8.4.2. The Audit Firm did not maintain professional skepticism during the audit which is evidenced through the instances stated above. Management representations were accepted as such by ET and audit opinion was formed based on them without challenging Management assertions, despite evidence to suspect its authenticity.

9. FINANCIAL GUARANTEES

9.1. NFRA conveyed the following prima facie conclusions:

9.1.1. The Company has prepared their financial statements for the year 2017-18 in accordance with the Indian Accounting Standards ("Ind AS") notified under the Companies (Indian Accounting Standards) Rules, 2015 with 01 Apr 2015 as the date of transition and FY 2016-17 being the first year of IND AS adoption. Therefore, the company was required to follow the accounting treatment, presentation and disclosure of financial instruments in accordance with Ind-AS 109, 107 and 32.

9.1.2. In line with the definition of "Financial Guarantee" under Ind-AS 109, the company has defined the same in their accounting policy as "A Financial Guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor failed to make payment when due in accordance with the terms".

9.1.3. The Guidance Note on Division II – Ind-AS Schedule III to the Companies Act 2013 issued by ICAI (July 2017 Edition) differentiates the disclosure on Contingent Liabilities under Division I and Division II as: a) Contingent Liabilities under Division I: "Contingent liabilities includes all guarantees". b) Contingent Liabilities under Division II: "Contingent liabilities pertaining to guarantees excluding financial guarantees". Also Para 8.2.14.2 of the said Guidance Note clarifies that Ind-AS Schedule III requires guarantees other than financial guarantees to be disclosed as a part of contingent liabilities, since financial guarantees are recognised on the balance sheet in accordance with Ind AS 109.

9.1.4. The Ind AS Technical Facilitation Group of ICAI in their 12th Bulletin has clarified that "If an entity is contractually obliged to make good the loss in case the other party fails to make the payment, then such comfort letter would be considered to be financial guarantee contract and will be accounted for in accordance with Ind AS 109".

9.1.5. Further Ind-AS 109 provides as below:

a. Para 5.1.1 from Chapter 5 "Measurement" of Ind-AS 109: "5.1.1 Except for Trade Receivables within the scope of paragraph 5.1.3, at initial recognition, an entity shall measure a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability."

b. Para 5.5.6 of Ind AS 109: "5.5.6 For loan commitments and financial guarantee contracts, the date that the entity becomes a party to the irrevocable commitment shall be considered to be the date of initial recognition for the purposes of applying the impairment requirements."

c. Para 4.2.1 (c) "Classification of financial liabilities" of the Ind-AS 109: "4.2.1 An entity shall classify all financial liabilities as subsequently measured at amortised cost, except for: (b) Financial guarantee contracts. After initial recognition, an issuer of such a contract shall (unless paragraph

4.2.1(a) or (b) applies) subsequently measure it at the higher of: (i) the amount of the loss allowance determined in accordance with Section 5.5 and (ii) the amount initially recognised (see paragraph 5.1.1) less, when appropriate, the cumulative amount of income recognised in accordance with the principles of Ind-AS 115."

9.1.6. On consideration of the abovementioned facts, NFRA has observed as below:

a. Note 36 of the Company's Financial Statements of 2017-18 states that the Company has issued letter of comfort, letter of awareness and letter of financial support or guarantees amounting to Rs.2654.51 Crore as at 31 Mar 2018 (Rs. 2535 Crore as at 31 Mar 2017) in respect of loans availed by some of its subsidiaries. However, the Audit Firm failed to question the Management regarding their failure to treat such letters of comfort/awareness/financial support as financial guarantees, as discussed above.

b. Note 35 of the financial statements reflects a reduction in the amount of guarantee from Rs.1389.05Cr (FY 2016-17) to Rs.680.74Cr (FY 2017-18). The Audit Firm has failed to document the basis on which it had satisfied itself that the company had indeed been discharged from its liabilities under those guarantees.

c. The Auditors have failed to perform any audit procedures to differentiate the Financial Guarantees and Guarantees excluding Financial Guarantees for the accounting treatment, presentation and disclosure of Financial Guarantees in accordance with Ind-AS 109, 107 and 32.

d. Presuming that the disclosures stated in Note 36 pertain to financial guarantees, the treatment of the same does not seem to be in accordance with the applicable accounting standard, as the effect of these financial guarantees has not been taken into the balance sheet, as required by Ind-AS 109. The accounting treatment in accordance with Ind-AS 109 requires the company to initially recognise the financial guarantees at fair value and subsequently measure in accordance with Para 5.1.1 and Para 4.2.1(c) of the Ind-AS 109 whereas the same has just been presented as a part of notes to the accounts in the instant case. The Auditors have thus failed to report the non-compliance of the applicable accounting standards (i.e., Ind AS) in accordance with requirements of Section 143(3) (e) of the Page 90 of 119 Companies Act 2013, which has resulted in a very material misstatement of financial statements on account of financial guarantees not being reflected as a part of liabilities.

e. The Auditor has failed to comply with the requirement of Para 25 read with Para A123 of SA 315 which inter alia deals with the identification and assessment of risk of material misstatement at the assertion level about the existence, rights and obligations, completeness, valuation and allocation of account balances at the end of the period in order to identify the potential misstatements that may occur due to the understatement of liabilities in the financial statements on account of the accounting treatment of financial guarantees and letter of comfort/financial support presented as contingent liabilities under notes 35 and 36 of the standalone financial statements.

9.1.7. It is therefore concluded that the Audit Firm had been grossly negligent in conduct of their professional duties to perform the audit in accordance with Standards of Auditing and reporting on the compliance of the applicable accounting standards u/s 143 (3) (e) of the Companies Act 2013.

9.2. NFRA has examined the responses of the Audit Firm to the above and concludes as follows:

Financial Guarantee - ITFGC Clarification and Audit Evidence in Audit file

9.3. Note 36 of Standalone Financial Statements, states that, "Letter of financial support has been issued to ITNL Road Infrastructure Development Company Limited, West Gujarat Expressway Limited, Vansh Nimay Infraprojects Limited, ITNL International Pte. Ltd., Singapore, ITNL Offshore Pte. Ltd., Singapore, ITNL Africa Projects Ltd., Nigeria, ITNL International DMCC, Dubai, Sharjah General Services Company LLC, Dubai IIPL USA LLC, MP Border Check posts Development Company Limited and Thiruvananthapuram Road Development Company Limited to enable them to continue their operations and meet their financial obligations as and when they fall due." However, the amounts of Letters of financial support have not been disclosed in the Notes to Account.

9.4. According to Ind AS Technical Facilitation Group of ICAI in their 12th Bulletin, Issue 3: As per Para B2.5 of Ind AS 109, states that, *"*Financial guarantee contracts may have various legal forms, such as a guarantee, some types of letter of credit, a credit default contract or an insurance contract. **Their accounting treatment does not depend on their legal form. In accordance with the above, it may be noted that a significant feature of a financial guarantee contract is the contractual obligation to make specified payment in case of default by the credit holder. As such the contract may not necessarily be called as financial guarantee contract and it may take any name or legal form, however the treatment will be same as that of a financial guarantee contract**. If a contract legally meets these requirements, then it would be accounted for as the financial guarantee contract as per Ind AS 109*"* (emphasis added).

9.5. Hence, it is clear that the nature of the obligation undertaken under a document has to be carefully studied and evaluated. The question to be asked and answered in each case is whether the document requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor failed to make payment when due in accordance with the terms. This can be assessed only on **careful study of terms and conditions** of Letters of Comfort, Letters of Awareness etc totalling to Rs 2654.51 crores. Clearly this was not done by the Audit Firm. They have admitted this by not being able to produce any evidence that they have done any such examination. On the contrary, all that they say is: "*As explained by the management, the purpose of providing LOA was to provide an acknowledgement to the counter parties that the SPV has borrowed from them and that ITNL is holding majority shares in these SPVs and would not dilute stake in such SPVs. Further, ITNL as the principle shareholder would on best endeavour basis ensure that the SPV would repay all their dues. In case of all these LOC/LOA it is clearly mentioned in the last para of*

LOC/LOA that the same should not be treated as guarantee and thus there was no obligation on ITNL to pay in case the SPV defaults. Hence, none of these LOC/LOA would meet the definition of financial guarantee / financial liability and would not require accounting and disclosure as per the Ind AS 107, Ind AS 109 or Ind AS 32". No verification of these assertions of the Management has been undertaken by the Audit Firm. Even the so-called explanation of the Management quoted above by the Audit Firm in support of their position has not been supported by any evidence in the Audit.

9.6. On perusal of WP W-138 in Hard copy File 9 of Audit File (referred by the Audit Firm in its response), NFRA has come across a tabular detail of Letter of Awareness/ Comfort totalling to Rs 2,654.5 Cr as on 31st March 2018. The said WP states work done as "*verified the exchange rates applied from RBI site*" and "*obtained listing from client and confirmation that no LOA/LOC has skipped assessment for being included in Notes to Accounts".*

9.7. This documentation of procedures is a clear indicator that the Audit Firm has not **displayed the requisite professional skepticism and** exercised the necessary **due diligence to adequately verify the terms and conditions of letters of comfort/awareness** before forming its conclusion that the LOCs were not financial guarantees. The Audit Firm has clearly been guilty of gross negligence in performing its duties in this matter.

Audit procedure to verify accounting and disclosure of Financial Guarantees/ Letters of Comfort in Financial Statements

9.8. The Audit Firm has referred to point 44 of Letter of Representation (Binder 5 of 6 of audit file) in its response which states that "*The standalone financial statements disclose the impact of pending litigations on the financial position of the Company in Note 35 and 36. In the assessment of the Management, in respect of these claims/litigations, the possibility of an outflow of resources is remote as envisaged in the Ind AS 37 and hence these have not been recorded."*

9.9. Para 7(b) of SRBC response to NFRA PFC (Page 409 of 751) states that "*As per the cash flow projections of the SPV's provided by the management, there were no defaults expected in repayment of loans to banks / financial institutions. As per management evaluation**, there was a remote possibility** that there would be any defaults by the SPVs in respect to their obligation. In the past, there has been no defaults in any of the loan obligation taken by the SPVs. Notwithstanding the remoteness of default, the LOAs or Comfort letters did not create any financial obligation or liability whatsoever."*

9.10. From the above it is clear that the Audit Firm has relied only on management representations regarding the completeness of disclosures of Letters of Comfort in the financial statements and no independent verification of the claim of the management that these letters were not in the nature of Guarantees requiring evaluation of possible obligations to make specified payments to the holder under Ind AS 109 was undertaken.

9.11. Para 3 of SA 580 states that, the fact that Management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfilment of management's responsibilities, or about specific assertions (Para 3 – SA 580). The Audit Firm by failing to performing adequate audit procedures has grossly violated the provisions of Para 3 of SA 580.

9.12. WP W113 to W127 of Hard File 9 (mentioned on Page 410 of 751 of SRBC response to NFRA PFC) discloses the factual details of Bank guarantees and Corporate guarantees/LCs issued to Outsider and Domestic Group Companies as on 31st March 2018. It was clearly stated by NFRA by quoting Guidance Note on Division II- Ind AS Schedule III to Companies Act 2013 issued by ICAI (July 2017 edition) in the PFC that the financial and non-financial guarantees have to be distinguished and Financial Guarantees have to be recognized in the Balance Sheet according to Ind AS 109. (Refer Para 5.1.1 of Ind AS 109 for Initial Recognition and Para 4.2.1 for subsequent recognition of financial liabilities.). The Audit Firm should have questioned the Management on its failure to disclose these guarantees as financial liabilities according to provisions of Ind AS 109 mentioned above.

9.13. The working paper does not contain any documentary evidence of classification of guarantees into financial and non-financial guarantee contracts nor identification of guarantees on which guarantee commission was paid as stated by Audit Firm in its response.

Conclusion

9.14. NFRA therefore concluded in the DAQRR that:

9.14.1. Audit Firm failed to obtain sufficient and reliable audit evidence which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion.

9.14.2. The conclusions drawn by Audit Firm that letters of comfort do not constitute financial guarantees was not based on thorough analysis of sufficient appropriate audit evidence required by Para 9 of SA 500.

9.14.3. The conclusions drawn by Audit Firm that letters of comfort or financial guarantees do not require any recognition of possible obligation according to provisions of Ind AS 109 was based only on Management representation. This is despite the fact that Management representation is obtained to support other audit evidences and cannot be fully relied upon to arrive at auditor's conclusions (Para 5(b) of SA 580).

9.14.4. From the explanations discussed above, Rs 2,654.51 crore should have been recognised as a liability in the financial statement as on 31st March 2018 which the Audit Firm failed to do. This has led to overstatement of profits by Rs 2,654.51 crore in the year of audit.

9.14.5. NFRA therefore concluded in the DAQRR that Audit Firm is guilty of

a. Not exercising professional scepticism, professional competence and due diligence in exercise of its duties;

b. Gross negligence in not carrying out the audit according to standards of auditing;

c. Not disclosing material information to users of financial statements.

9.15. The Audit Firm, in its written response dated July 10th, 2021, has responded to the above observations of NFRA. The replies clearly show that the Audit Firm has not done required testing of the guarantees or letters of comforts issued by the Company. While NFRA has pointed out deficiencies in the audit documentation and audit procedures, the Audit Firm's reply running into 11 pages does not provide any explanation regarding these issues. Instead, the Audit Firm explains at length regarding the legal differences between a guarantee and a support letter, to establish that a support letter is not a guarantee in legal terms. However, NFRA has not raised any such issues in the DAQRR.

9.16. In the DAQRR paras above, NFRA has pointed out the following:

9.17. Para 9.3: The amounts of Letters of financial support have not been disclosed in the Notes to Account.

9.17.1. In reply to this, the Audit Firm submits that "*With respect to NFRA's DAQRR para 9.3, SRBC submits that Note 36(b) is with respect to financial support that ITNL had agreed to provide to the SPVs listed therein to enable them to continue their operations and meet their financial obligations as and when they fall due. The said letters are issued by ITNL in their capacity as a parent company, to the board of directors of SPV, to support the SPVs by way of investment in SPV, as and when required, should such a need arise in future. The support letter is not a guarantee issued to the SPV or a third party on behalf of SPV and is not a legally binding document. It is an assurance that ITNL being a parent company shall provide financial support to the SPVs to meet their financial obligations for the smooth conduct of business. Further, the letter of financial support does not state an any amount since its purely dependent on the operational requirements of the SPV. Hence, no amount can be quantified and disclosed in note 36(b). However, considering the nature of the letter being a financial support, it was considered prudent by the ITNL management to provide an additional disclosure of the same in financial statements based on best practices. There is no auditing standard which debars additional best practices disclosures as done in the present case by ITNL management.*"

9.17.2. Based on the submission that "*the letter of financial support does not state an any amount since its purely dependent on the operational requirements of the SPV*", the observation in para 9.3 stands modified as "*The fact that the amount that may become payable on account of each of those letters of financial support is dependent on the operational requirements of the SPV has not been disclosed in the Notes to Account. Without such disclosure the said note is incomplete and misleading*".

9.18. Paras 9.4 to 9.7: The nature of the obligation undertaken under letters of comfort can be assessed only on **careful study of terms and conditions** of Letters of Comfort, Letters of Awareness etc totalling to Rs 2654.51 crores. This was not been done by the Audit Firm.

9.19. Para9.8 to 9.11: The Audit Firm has relied only on management representations regarding the completeness of disclosures of Letters of Comfort in the financial statements and no independent verification of the claim of the management that these letters were not in the nature of Guarantees requiring evaluation of possible obligations to make specified payments to the holder under Ind AS 109 was undertaken.

9.19.1. Regarding the above observations, the Audit Firm proceeds to explain the legal aspects of guarantees. After citing three case laws, the Audit Firm states that "*Ind AS 109/ Ind AS 32 requirements with respect to financial guarantee/ financial liability would apply to the Letter of Comfort ("LOC") / Letter of Awareness ("LOA") if the company has legal/ contractual obligation to compensate the lender and/ or make payment to it. As explained by the ITNL management, the purpose of providing LOA was to provide an acknowledgement to the counter parties that the SPV has borrowed from them and that ITNL is holding majority shares in these SPVs and would not dilute stake in such SPVs. ………In case of all these LOC/LOA it is clearly mentioned in the last para of LOC/LOA that the same should not be treated as guarantee and thus there was no obligation on ITNL to pay in case the SPV defaults. Hence, none of these LOC/LOA would meet the definition of financial guarantee / financial liability and would not require accounting and disclosure as per the Ind AS 107, Ind AS 109 or Ind AS 32*.".

9.19.2. The Audit Firm further submits that "*With respect to LOC/LOA issued during the year, performed test check of LOC/LOA aggregating to Rs.1,000 crore issued against the SPV loans assigned by ITNL to IndusInd Bank along with verification of assignment related documents. We evaluated the terms of LOC/ LOA as per Ind AS 109 based on which it was concluded that these LOC/LOA were not legally binding. (Refer hard copy file no.9, W-138)*". "*Reviewed the minutes of committee of directors and board meetings to ensure completeness of LOC/LOA (Refer hard copy file 1, A2-1 to A2-11)". "Obtained Representation letter from management (Refer hard copy Binder 5 of 6, P.5.1)".*

9.19.3. It is emphasised that NFRA has not stated anywhere in the DAQRR that these financial guarantees are legally binding on the Company or not. The observation was limited to the fact that the legal nature of these letters of comfort can be assessed only on careful study of terms and conditions. All the present submissions of the Audit Firm with respect to legal nature of the letters of comfort are not at all documented in the Audit File. NFRA has already examined the WPs referred by the audit firm (Para 9.6 above). The said WP is a table listing 18 letters of comfort, showing the parties, purpose, date, currency, amount etc. It is noted in the WP under the heading "*Works Done*" that "*Verified the exchange rates applied from RBI site. Obtained listing from client and confirmation that no LOA/LOC has skipped assessment for being included in notes to accounts.*" It is also stated that "*There are no adverse observations" and "The balances are fairly stated*".

9.19.4. Thus, it is confirmed that the audit firm has not evaluated the terms and conditions of these LOA/LOC. The audit firm's conclusion that these are not in the nature of guarantees is thus without any examination and hence not acceptable. Rather than the title the substance of the letter matters. Having known that there is no absolute rule as to whether a letter of comfort can or cannot create a legal obligation, it is necessary for the Audit Firm to examine the nature of all such instruments to reach a conclusion. The Audit Firm has cited "Yes Bank Limited v Zee Entertainment Enterprises Limited" and states that "The court held that in order for a Letter of Comfort to be interpreted as a guarantee, it must be read in its entirety in a commercially reasonable manner and must depend **on the exact terms under which the guarantor bound itself**. Further, the Court warned against foisting liability beyond what the issuer has undertaken **and noted the conduct of the parties as an essential factor in the construction of Letter of Comforts**." (emphasis added). Thus, the Audit Firm knows clearly what is required from the auditor. Still there is no evidence that the Audit Firm in this case has checked the exact terms and the conduct of the parties to ascertain the legal nature of these letters of comfort.

9.19.5. The WP 'hard copy file 1, A2-1 to A2-11' is a summary of all the minutes of various meetings of the board/directors. There is no work documented in the Audit File regarding verification of the completeness of the letters of comfort.

9.20. Para 9.12-9.13: The financial and non-financial guarantees have to be distinguished and Financial Guarantees have to be recognized in the Balance Sheet according to Ind AS 109. The Audit Firm should have questioned the Management on its failure to disclose these guarantees as financial liabilities according to provisions of Ind AS 109 mentioned above. The working paper does not contain any documentary evidence of classification of guarantees into financial and non-financial guarantee contracts nor identification of guarantees on which guarantee commission was paid as stated by Audit Firm in its response.

9.20.1. The Audit Firm submits in this regard that *"in the guarantees as disclosed in serial no. (i)(b) in Note 35 on contingent liabilities in the financial statements for the year ended March 31, 2018 only comprises of non-financial guarantees. The workpaper on guarantees clearly states the terms and conditions of guarantee documents were verified. Further, the purpose of guarantee has also been specified therein (Refer Hard copy file no.9, W-113 to W127). Accordingly, SRBC is unable to understand NFRA's allegation in NFRA's DAQRR para 9.12 above, that SRBC did not question the management on its failure to disclose these guarantees as financial liabilities according to provisions of Ind AS 109 mentioned above.*"

9.20.2. The above contention of the Audit Firm is incorrect. Note 35 shows an amount of Rs 680.74 crore under contingent liabilities as "*Guarantees/counter guarantees issued to outsider in respect of group companies (Net)*". Whereas the WP shows an amount of Rs 2180.74 crore as "*Guarantees/counter guarantees issued to outsider in respect of group companies*". There is no explanation about the difference. Out of the above, the said WP in page No. W125 shows three guarantees totaling to around Rs 12 crore classified as type "Financial". However, no further reason why these are not accounted as liability in accordance with Ind AS 109 is explained by the Audit Firm. Similarly, the WP does not mention the purpose and type of corporate guarantees/letter of credits amounting to Rs 1964 crores (as mentioned in the WP) issued in favour of various banks on behalf of the foreign subsidiaries. The WP also identifies Rs 234 crore of domestic guarantees as "*To be disclosed in contingent liability note*". However, no such disclosure is seen in the notes to accounts of the standalone financial statements. The above facts make it clear that the Audit Firm did not question the management on its failure to disclose these guarantees as financial liabilities according to provisions of Ind AS 109, as there is no evidence that these are not financial guarantees.

9.21. Para 9.14.4: In the absence of any information as detailed above, Rs 2,654.51 crore should have been recognised as a liability in the financial statement as on 31st March 2018. This has led to overstatement of profits by Rs 2,654.51 crore in the year of audit.

9.21.1. The contention of the Audit Firm that *"The conclusions drawn by SRBC that letters of comfort do not constitute financial guarantees was based on the evaluation of terms of the LOC/LOA in compliance with the requirements of Para 9 of SA 500 i.e. verified the accuracy and completeness of information provided by the management and evaluated whether the information is sufficiently precise and detailed for the auditor's purposes"* is not supported by evidence and hence not accepted.

9.21.2. Moreover, the Audit Firm knows very well that these letters of comfort were issued to the SPVs to enable them to continue their operations and meet their financial obligations as and when they fall due. Also, the Audit Firm is aware that 8 out of the 11 SPVs in favour of whom these letters were issued were having serious going concern issues as highlighted in their financial statements/by auditors. These instances are quoted below (with emphasis supplied).

a. ITNL Africa Projects Ltd - Notes to accounts: "During the year ended March 31, 2018, the Company has incurred losses aggregating Equivalent ₹ 15,195,910, resulting in accumulated losses of Equivalent ₹ 183,775,974 as on March 31, 2018. In spite of these accumulated losses eroding the net worth fully, the special purpose **financial statements have been prepared on going concern basis due to the following** reasons: (i) **The Company is assured of continuing operational and financial support from its intermediate Holding Company vide its letter dated May 02, 2018 which is effective for the period of 12 months**.
b. ITNL International DMCC - Notes to accounts: During the Year ended March 31, 2018, the Company has incurred losses aggregating ₹ 171,386,234 resulting in accumulated losses of ₹ 726,738,704 as on March 31, 2018. In spite of these accumulated losses eroding the net worth fully, the financial statements have **been prepared on going concern basis due to the following reasons**: ……..
c. **The Company is assured of continuing operational and financial support from its Intermediate Holding company, vide its letter dated May 2, 2018 which is effective for the period of 12 months**.
d. Sharjah General Services Company LLC: Notes to accounts: "During the year ended, the Company has incurred losses aggregating

Equivalent Rs.4,905,453 resulting in accumulated losses of Equivalent Rs. 89,845,663 as on March 31, 2018. In spite of these accumulated losses eroding the net worth fully, the Special Purpose **financial statements have been prepared on going concern basis due to the following reasons: (i) The Company is assured of continuing operational and financial support from its parent company, ITNL vide its letter dated May 2, 2018 and as evidenced by the working capital facility extended to the Company.**"

e. TRDCL – Notes to accounts "…….**The promoter of the Company has agreed to provide financial support to the Company. Based on the foregoing, the Financial Statements are prepared on a going concern basis**."
f. ITNL Road Infrastructure Development Company Limited - Auditor has given EOM regarding Going Concern.
g. Vansh Nimay Infraprojects Limited - EOM by Auditor – Accounts are not prepared on a going concern basis.
h. ITNL International Pte. Ltd. – Notes to accounts: "**The Company is assured of continuing operational and financial support from its parent company, vide its letter dated May 02, 2018 which is effective for the period of 12 months……**
   The Company continues to grow its operations. **The Company is therefore being viewed as a going concern** and financial statements have been prepared under the going concern basis."
i. MP Border Check posts Development Company Limited – Auditor has given EOM on Going concern. Notes to account refers to financial support from promoters.

9.21.3. Based, at least, on the above facts, the Audit Firm should have assessed the likely legally binding financial liability that would inevitably arise from these letters of comfort. This is further reinforced by the submission of the Audit Firm in Page 614 of their reply to section on interest free loan that "The sponsorship agreement with the lenders of SPVs, required the Sponsors to contribute the cash shortfall. Not funding the SPV in terms of sponsorship agreement would have been a breach of contract and the adverse implications would in fact have been prejudicial to the interest of the Company and its member. ……... This fact has also been reiterated by the management expert Cyril Amarchand Mangaldas which is a very highly reputed legal firm. …… ITNL's credit rating was dependent on timely honouring of obligations by SPVs i.e. if SPV did not honour its obligations, ITNL's credit rating could have been impacted, which could have affected ITNL's ability to borrow in future and its borrowings costs which would in fact have been prejudicial to the interest of the Company and its members."

9.21.4. Thus, there is ample evidence in the Audit File that these letters of comfort possessed all the characteristics of financial guarantees. If the Audit Firm had to accept the management's contention that these were not financial guarantees, the Audit Firm should have put the management to the test of strict proof, and recorded the evidence in the Audit File. As shown clearly, this has not been done in any measure at all.

9.21.5. The above facts show the absence of professional scepticism as required from the Audit Firm. Under the above circumstances, the Audit Firm should have examined these guarantees/letters of comfort in detail to ascertain whether they amount to financial liability/contingent liability. However, no such attempts have been made by the Audit Firm.

9.22. In view of the above, NFRA concludes as follows:

9.22.1. Audit Firm failed to obtain sufficient and reliable audit evidence in the area of guarantees/letters of comforts which is necessary for expression of an opinion, or its exceptions are sufficiently material to negate the expression of an opinion.

9.22.2. The conclusions drawn by the Audit Firm that letters of comfort do not constitute liabilities/contingent liabilities was not based on thorough analysis of sufficient appropriate audit evidence as required by Para 9 of SA 500. The disclosure note provided in this regard was misleading and incomplete.

9.22.3. The conclusions drawn by the Audit Firm that letters of comfort or financial guarantees do not require any recognition of possible obligation according to provisions of Ind AS 109/Ind As 37 was based only on Management representation. This is despite the fact that Management representation is obtained to support other audit evidence and cannot be fully relied upon to arrive at auditor's conclusions (Para 5(b) of SA 580).

9.22.4. From the explanations discussed above, letters of comfort amounting to Rs 2,654.51 crore should have been appropriately recognised as a liability/contingent liability in the financial statements as on 31st March 2018 in accordance with Ind AS 109 or Ind AS 37 which the Audit Firm failed to examine. This has led to a material misstatement in the financial statements.

10. ASSESSMENT OF REVENUE FROM OPERATIONS

10.1. NFRA has conveyed the following observations in the PFC.

Evaluation of Revenue from Operations

10.1.1. Note no 21 of the Financial Statements of ITNL for FY 2017-18 discloses Rs 3,536.83 crore as ITNL's revenue from operations, of which Rs 2,667.93 crore (75%) is on account of construction income, Rs 444.22 crore (13%) from profit on sale of investments and balance from advisory, design and engineering fees, operation and maintenance income, supervision fees.

10.1.2. Para B.6.2 "Revenue from Construction Contracts" of Note 1 on "General Information & Significant Accounting Policies" of the Standalone Financial Statements of the Company for the Financial Year 2017-18 states that

10.1.3. *"The Company recognizes and measures revenue, costs and margin for providing construction services during the period of construction of the infrastructure in accordance with Ind-AS 11 Construction Contracts".* It is further stated that "*the percentage of completion of a contract is determined considering the proportion that contract costs incurred for work performed up to the reporting date bear to the estimated total contract costs."*

Para 25 of Ind-AS 11 states that, "recognition of revenue and expenses by reference to the stage of completion of a contract is often referred to as **the percentage of completion method**. Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion of work completed."

Para 30 of Ind-AS 11 states that, "The stage of completion of a contract may be determined in a variety of ways. The entity uses the method that measures reliably the work performed. Depending on the nature of the contract, the methods may include:

(a) the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs;

(b) surveys of work performed; or

(c) completion of a physical proportion of the contract work.

Progress payments and advances received from customers often do not reflect the work performed."

Para 31 of Ind-AS 11 states that "the stage of completion on the basis of which construction revenue is recognised is determined by reference to contract costs incurred to date. Only those contract costs that reflect work performed are included in such costs incurred to date. Contract costs that relate to future activity such as cost of materials that have been delivered to contract site or set aside for use in a contract but not yet used or installed and similar cases are excluded in cost calculation. Further payments made to subcontractors in advance of work performed under the subcontract are also excluded in determining stage of completion as per the provisions."

Para 20 of Ind-AS 11 states that some costs such as *general administration costs for which reimbursement is not specified in the contract, selling costs, research and development costs for which reimbursement is not specified in the contract* are not included in the construction costs. Similarly, Auditor should ensure that no capital expenditure is expensed off in the form of construction cost.

10.1.4. Based on the perusal of Audit File NFRA has made the following observations:

Unsubstantiated Percentage of Completion

10.1.5. There exists no evidence in the Audit File that the Audit Firm has obtained sufficient appropriate evidence to verify the correctness of stage of completion of work, based on which revenue has been recognised by the Management. NFRA notes that though the substantive procedures mentioned in WP*, "UA Revenue & Cost- Work Steps", Step no. 1* states *"Nature- Substantive- verification of management estimates for cost to completion of project and compare with monthly progress report submitted to NHAI by independent engineer.",* there are no **Independent Engineer** (IE) reports in the Audit File certifying the POC submitted to NHAI. There is no working in the Audit File which shows that the Audit Firm has verified completion of physical progress of work to satisfy itself of the correctness of proportion of contract costs to the total estimated costs.

10.1.6. NFRA has observed **that construction rates mentioned for different construction activities did not match with the rates mentioned in BILL OF QUANTITY Section of Construction Agreements** between ITNL and Contractor. For example, in the case of Kiratpur Ner Chowk expressway Limited (KNCEL), ***WP "KNCEL cost to completion" it is seen that ITNL has costed as "new item"*** *gravity wall (M20 concrete)* with a rate of Rs 6,095 per unit cost for 51,168 units, total cost of which comes to Rs 31.19 crore. Similarly, another "***new item"*** RCC crash barrier M-40 has been included with a rate of Rs 3,092.6 per unit for 555 units. Both these activities have been carried out by the contractor GHV. However, there is no evidence in the Audit File that the Auditor has verified working papers regarding agreed costs between ITNL and GHV for these "new items". Thus, it is evident that the Audit Firm has failed to obtain assurance regarding completeness and authenticity of construction costs (including changes if any) recorded in the books of ITNL.

10.1.7. In another case of **Rapid Metro Gurgaon South Limited (RMGSL),** the estimated POC jumped from 96% to 100% in last quarter due change in total estimated contract cost from Rs 1606 crore to Rs 1586 crore. However, there are no working papers in the Audit File to explain the reason for change in the estimated costs, nor has the Auditor documented the revised agreement in support of change of scope of work, if any. As a result of decrease in estimated cost, the POC calculated as per the accounting policy of the Company increased to 100%. NFRA has observed from the WP *M18 UA Revenue and Cost – Cumulative Costs incurred till March 18 as per RA Bills,* that the actual costs incurred on work increased only marginally during the year from Rs 1546 crore to Rs 1586 crore, showing little progress in physical work. The Audit Firm has not verified the supporting amendments in construction contract between the two parties to justify such a change in estimated contract cost nor has obtained the completion certificate from IE to support the fact of physical completion of the project.

10.1.8. In case of **Pune Sholapur Rail Development Company Limited** (PSRDCL) the contract cost has increased during the year from Rs 1,163 to Rs 1,180 crore which is not supported by any approval/authorisations.

10.1.9. NFRA has further observed from the WP '*M18 UA Revenue and Cost- Project Summary*' that contains POC figures on the reporting date as per the IE and POC considered for calculation of revenue in the respective, as shown below:

Project	**POC % as per IE**	**POC % considered for calculation of revenue**
KSEL	81%	89%
BAEL	74%	79%
FSEL	51%	53%
KNCEL	56%	66%

10.1.10. As has already been pointed out in the previous paragraph, the POC as assessed by the IE is not supported by the progress reports **duly signed by the IE in the Audit File.** Assuming that IE figures were indeed available, even then the POC percentage considered for revenue calculation does not match with the IE figures, and there is no explanation of the discrepancy between IE figures and POC considered for revenue recognition in the Audit File.

10.1.11. From the Audit File, NFRA did not find any evidence of Auditor having evaluated the construction costs for erroneous inclusion of general administration costs, research and development costs, selling costs etc, which are prohibited from inclusion in construction costs as per the requirement of Para 20 of Ind AS 11.

10.1.12. NFRA is of the view that the Audit Firm has failed in documenting sufficient appropriate evidence of percentage of completion used for revenue recognition based on total contract cost incurred to date, thus rendering the entire revenue recognised on account of construction projects highly doubtful.

Unverified Claims

10.1.13. Para 14 of Ind-AS 11 states that a claim is an amount that the contractor seeks to collect from the customer or another party as reimbursement for costs not included in the contract price. It may arise due to delays, errors in specifications or design, etc. Claims should be recognised as contract revenue only when:

i. *Negotiation have reached an advanced stage such that it is probable that the customer will accept the claim; and*

ii. *the amount that it is probable will be accepted by the customer can be measured reliably.*

10.1.14. **Para A14 of SA 500** states that *"***Inspection of records and documents** provides audit evidence of varying degrees of reliability, depending on their nature and source". This may be used by the auditor as risk assessment procedures, test of controls or substantive procedures to draw reasonable conclusions on which to base auditor's opinion (*Para A11 and A10 of SA 500).*

10.1.15. NFRA has noted from the WP '*M18 UA Revenue & Cost*', that the estimated construction revenue for few projects has been revised during the current financial year on account of "claims". In WP '*M18 UA Revenue & Cost –Summary***', *it is observed that in case of Barwa Adda Expressway Limited (BAEL), the Estimated Contract Revenue has increased to Rs 363 crore from the previous year*** (FY 2016-17: Rs 1,969.35 crore, FY 2017-18: Rs 2,332.88 crore). The same WP*, sheet "Est Revenue & Cost Analysis 12m*" mentions the reason for increase of only Rs 242 crore on account of claims from EPC contractor due to idling of P&M fees, non-availability of land etc**. No evidence is available in the Audit File to assess whether the claims recognised by the management meet the requirement of Para 14 of IndAS 11. T**he Audit File does not contain any documentary evidence of Auditor's inspection performance as per guidance of Para **A14 of SA 500** to verify Management's contention regarding the claim amounts, such as the **stage of negotiation** or **acceptance of claim or tentative date of receiving the claim from the Customer** before recognising revenue. In NFRA's view, the Auditor has merely relied upon the Management's contention of recognising claims as revenue of the Company without verifying whether such claims will actually be paid by NHAI to the SPV.

Unbilled revenue

10.1.16. NFRA has observed from the WP '*M18 UA Revenue & Cost- Unbilled & Unearned Revenue*' that **ITNL's unbilled revenue from construction activities, increased by more than 110%** from Rs.399.29 Crores in year ended 31st March 2017 to Rs.841.48 Crores in year ended 31st March 2018, which is about 30% of the total Construction revenue of Rs. 2,667.93 crore.

10.1.17. NFRA has observed from the WP '*M18 UA Revenue & Cost- Unbilled & Unearned Revenue*' that of total unbilled revenue for the year ended 31st March 2018, unbilled revenue of BAEL and KNCEL projects constitute 59% i.e Rs 179 crore and Rs 319 crore respectively. On the contrary, in the annual report of ITNL for FY 2017-18, *Page 36 heading Cost overruns,* stated that "*Progress at many projects, namely, Kiratpur Ner Chowk and Barwa Adda, had been affected due to delay in land acquisition, which increased the cost of these projects thus straining cash flows. In Kiratpur Ner Chowk project, delay on account of land acquisition has resulted in cost overrun, which the bankers are reluctant to fund due to which drawdown of loan has been put on hold."*

10.1.18. In such a situation, the Audit Firm should have been highly sceptical of the unbilled revenue recognised in the books of the Company in respect of BAEL and KNCEL. However, there is no evidence in the Audit File of any audit procedures that have been carried out to verify the existence, rights, completeness and valuation of unbilled revenue in case of these projects.

Discrepancies in Working Papers

10.1.19. NFRA has observed that the data captured in the different working papers submitted by the Audit Firm are inconsistent to each other. Some are listed below:

i. As per Note no.6 on Other Financial Assets in the standalone financial statements of FY 2017-18 of the Company, unbilled revenue is stated as Rs. 841.48 crore as at 31st March 2018 whereas as per the working paper WP '*M18 UA Revenue & Cost*' the amount of unbilled revenue as on 31st March 2018 is shown Rs. 788.80 crores. ('*Refer Tab 'Unbilled Revenue & Unearned Revenue')*, which casts a doubt on the verification of figures by the Auditor.

ii. In the WP '*M18 UA Revenue & Cost*' the construction revenue for the 12 months ended on 31st March 2018 was Rs.2594.31 Crores (Refer Tab "Lead"), **whereas** the construction revenue as per the GL of Construction Revenue from April 2017 to March 2018 enclosed in the WP '*UA_ITNL-TOD Construction Revenue M18*' during the year amounts to Rs. 2,393.28 Crores (Refer Tab "UA_5.1").

iii. As per the GL of Construction Revenue from April 2017 to March 2018 in tab UA_5.1 of the working paper WP '*UA_ITNL-TOD Construction Revenue M18*' an amount of Rs.386.89 Crores have been booked as unbilled revenue for Mar 2018 whereas as per the financial statements the unbilled revenue stands at an amount of Rs. 841.48 Crores as at 31 Mar 2018.

iv. On examination of WP '*M18 UA Revenue & Cost'*, NFRA has observed that the sheet *"Summary",* presents the estimated contract revenue of project BAEL as "2,332 Crores" the same figures has been mentioned as "Rs.2.211 Crores" in the *"Project Summary"*.

v. NFRA has examined development agreements entered into with the SPV's and observed that the "**Original Estimated Revenue**" as mentioned in the tab "*Project Summary*" of the WP '*M18 UA Revenue & Cost*' differs from the development agreements signed with the SPVs. Some of the examples have been reproduced below:

Project Name	**Original Estimated Revenue as per WP "M18 UA Revenue & Cost"**	**Contract Amount as per Development Agreement**
CNTL	Rs.3,124 Crores	Rs. 2,740 Cr (Original Agreement) Rs. 2,710 Cr (Amendment #1)
BKEL	Rs.507 Crores	Rs.520 Crores
PSRDCL	Rs.1,399 Crores	Rs.964.59 Cr (Original 01- Oct-09)

		Rs.1,422 Cr (Revised 11-Sep-15) Rs.1528.57 Cr (Revised 4-May-16)

10.1.20. NFRA is of the view that various discrepancies highlighted above are indications of the casual manner in which the audit documentation has been prepared, as well as making Audit Firm guilty of violation of the objectives of audit documentation as required under SA 230.

10.1.21. Based on the observations in preceding paragraphs, NFRA concludes that the Audit Firm is guilty of violating the requirements of SA 200, by :

i. Not carrying out the audit according to standards of auditing,

ii. Not obtaining sufficient appropriate audit evidence,

iii. Not maintaining professional scepticism, professional competence and due care and other ethical requirements during the audit.

10.2. NFRA examined in detail the responses of the Audit Firm to the above observations in the PFC and further observes as follows.

Unsubstantiated Percentage of Completion

10.3. Regarding this subject the Audit Firm responds as follows:

10.3.1. In page 423 of their reply that "*The comparison of IE's report with the financial progress is an additional procedure performed to determine whether work has been physically performed at the site and percentages are within reasonable range. ……. ……. SRBC has verified completion of physical progress of work to ensure reasonableness of proportion of contract costs to the total estimated costs and is in line with the substantive procedure designed to address the significant risk identified by SRBC*".

10.3.2. Regarding the case of KNCEL the Audit Firm submits the details of the general procedures done in verifying the **cost** and after quoting from SA 500 states in page 425 of their reply that "*Based on the above para of the auditing standard it is clear that SRBC was not required to check each and every line and transaction. Further, the Management Committee had approved the revised BoQ of which contained the new line items and hence these new line items have also been approved by the management. The invoice containing the above line items was not part of the sample tested by SRBC………… We also obtained certified cost of completion approved by the Chief Executive - Head of Implementation as at March 31, 2018 according to which there was no change in the overall cost estimates of the project for the year ended March 31, 2018*".

10.3.3. Regarding RMGSL the Audit Firm submits in page 426 of their reply that "*HUDA* *had already verified the completion of project activities and announced commercial operation date as March 31, 2017 based Independent Engineer's report. As there was only ancillary work being carried out, we have performed audit procedures in the form of test of controls and test of details and other substantive procedures*".

10.3.4. Regarding PSRDCL the Audit Firm submits in page 426 of their reply that "*the final commercial operation date was in February 2016. The cost incurred during the year pertain to small ancillary work which had been carried out during the year. We have documented the reason for increase in cost in revenue workpaper (Refer hard copy file 9 page reference no. UA6, UA9, UA 20)*".

10.4. In this regard NFRA's observation in this DAQRR regarding failure to identify revenue recognition as fraud risk may be recalled. The substantive audit procedures claimed to have been done by the Audit Firm suffers from the wrong classification of ROMM in revenue recognition. The replies make it clear that in all cases the Audit Firm has relied only on internal evidence such as management certified cost estimates, that too incomplete in some cases as detailed in subsequent paragraphs. For the contracts which are stated to be commissioned in the previous years, there is no evidence in the Audit File to confirm that the contract is in fact not declared as completed and any booking of expenses and revenue after the commissioning date is in line with the contract conditions and Ind AS 11.

10.5. The replies indicates that the Audit Firm has missed the crux of the matter which is **unsubstantiated percentage of completion** (POC). As POC is an accounting estimate which is further based on the estimated cost of completion (which changes from period to period for the long gestation infrastructure works undertaken by ITNL) the Audit Firm shall follow and apply the principles of SA 540 scrupulously in verifying the estimated cost. Any arbitrary calculation of the estimated cost may have a substantial impact on the revenue booked by the Company. Though the Audit Firm has listed all the procedures performed by it, the only submissions regarding verification of estimated cost is found in page 425 of their reply which states that "SRBC has obtained certified cost of completion approved by the Chief Executive - Head of Implementation….. SRBC has verified Management Committee Approval (MCA) with respect to material changes in project costs estimates". These procedures fall short of the requirements of SA 540. It is stated in sheet 'Work steps' in WP 'M 18 UA Revenue & Cost' that "For all the changes in the plan cost for any project under construction, verify the changes and read the minutes for approval of cost increase". However, the 'verification' done by the ET is limited to obtaining some reasons from the management for the variation in cost. It is also observed that the analytical procedures performed is limited to variance analysis and the reasons for variations are noted in a few cases as provided by the management without any objective testing by the Audit Firm.

10.6. In this regard SA 540 stipulates the following, none of which is complied by the Audit Firm.

10.6.1. Para 12 - "Based on the assessed risks of material misstatement, the auditor shall determine……….(b) Whether the methods for making the accounting estimates are appropriate and have been applied consistently, and whether changes, if any, in accounting estimates or in the method for making them from the prior period are appropriate in the circumstances. (Ref: Para. A57-A58)"

10.6.2. Para A57 - "The auditor's consideration of a change in an accounting estimate, or in the method for making it from the prior period, is important because a change that is not based on a change in circumstances or new information is considered arbitrary. Arbitrary changes in an accounting estimate result in inconsistent financial statements over time and may give rise to a financial statement misstatement or be an indicator of possible management bias".

10.6.3. Para A58 – "Management often is able to demonstrate good reason for a change in an accounting estimate or the method for making an accounting estimate from one period to another based on a change in circumstances. What constitutes a good reason, and the adequacy of support for management's contention that there has been a change in circumstances that warrants a change in an accounting estimate or the method for making an accounting estimate, are matters of judgment".

10.7. From the work sheet 'Est Revenue & Cost Analysis 12m' in the WP 'M 18 UA Revenue & Cost', it is seen that the estimated contract revenue (which should be the contract price between the SPV and ITNL) is increased in five cases amounting in total to Rs. 621 crore (see Table 1 below). As these are fixed price contracts, the increase in contract price could be either due to variations or claims. In this regard, Ind AS 11 stipulates as follows.

10.7.1. Para 13 – "A variation is an instruction by the customer for a change in the scope of the work to be performed under the contract. A variation may lead to an increase or a decrease in contract revenue. Examples of variations are changes in the specifications or design of the asset and changes in the duration of the contract. A variation is included in contract revenue when:

i. it is probable that the customer will approve the variation and the amount of revenue arising from the variation; and

ii. the amount of revenue can be reliably measured".

10.7.2. Para 14 – "A claim is an amount that the contractor seeks to collect from the customer or another party as reimbursement for costs not included in the contract price. A claim may arise from, for example, customer caused delays, errors in specifications or design, and disputed variations in contract work. The measurement of the amounts of revenue arising from claims is subject to a high level of uncertainty and often depends on the outcome of negotiations. Therefore, claims are included in contract revenue only when:

(a) negotiations have reached an advanced stage such that it is probable that the customer will accept the claim; and

(b) the amount that it is probable will be accepted by the customer can be measured reliably".

10.7.3. Para 38 - "The percentage of completion method is applied on a cumulative basis in each accounting period to the current estimates of contract revenue and contract costs. Therefore, the effect of a change in the estimate of contract revenue or contract costs, or the effect of a change in the estimate of the outcome of a contract, is accounted for as a change in accounting estimate (see Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors). The changed estimates are used in the determination of the amount of revenue and expenses recognised in profit or loss in the period in which the change is made and in subsequent periods".

10.8. There is no testing of the above conditions made by the Audit Firm to ensure that the increase in contract revenue is recognised fully in line with Ind AS 11. It is not even ascertained by the ET whether the increase is due to variations or claims. The work sheet 'OAR sub' of the said WP gives some reasons for the increase but none of these reasons are in conformity with para 13 and 14 of Ind AS 11. These are simply reproduction of the reasons provided by the management without any objective analysis for confirmation by the Audit Firm. For e.g. in the case of CNTL, the estimated revenue of the project increased by Rs 134.44 crore in FY 2018. The reason stated in the WP UA 9 is that the increase is due to additional work to be carried out. The additional estimated cost of work is Rs 130.39 crores and the company had the increased the estimated revenue by Rs 134.44 crores without examining any of the conditions mentioned in para 13 and 14 of Ind AS 11. There is not even any approval for the cost by the SPV or NHAI. One approval memorandum of the management committee dated 04.07.2017 is seen attached in the Audit File in which approval for the additional cost of Rs 130.39 crores is sought by the ITNL from the SPV. But no such approval has been seen documented in the Audit File. There are also discrepancies in the numbers noted by the Audit Firm in different WPs. In the WP M18 UA in worksheet 'Revenue and Cost summary', the POC stated as 96% and in worksheet 'OAR sub' it is stated as 98%. The cost incurred till March 2018 is stated in in worksheet 'summary' for quarter ending March 31, 2018 as Rs 3018 crore and in under '12 Months Revenue and Cost' it is stated as Rs 3045 crores. An amount of Rs 2.00 crores on account of purchase of machinery which is a capital expenditure, is also seen included in the estimated cost without any evidence that it will be reimbursed by the SPV.

10.9. The total unbilled revenue for these five contracts is Rs 340 crore, which shows that the claims are not due and are not agreed by NHAI.

10.10. The revenue ought to be booked based on the incremental POC in these 5 cases is Rs 233 crore only, against the revenue actually booked in the accounts amounting to Rs 689 crore, leaving a difference in revenue of Rs 456 crore (See Table 1 below) viz-a-viz the expected revenue. It can also be seen that in order to offset the cost increase in these contracts, the Company has booked 73% (456/621) of the increase in costs as revenue in FY 18 itself.

Table -1 **(All Rs in crore)**

Sr. NO	**Project**	**POC-Mar-18 (A)**	**POC-Mar-17 (B)**	**Incremental POC (C=A-B)**	**Estimated Revenue, excluding variation/ claims added in FY 18) (D)**	**Incremental Revenue E= C*D**	**Revenue Booked in FY 18**	**Excess Revenue Booked**	**Variation/ Claims added to revenue in FY 18**	**Unbilled revenue - March 2018**
1	BAEL	79 %	67 %	12%	1969	236	530	294	363	179
2	CNT	98	100	-2%	3123	-62	40	102	134	35

	L	%	%							
3	JSEL	98 %	96 %	2%	1023	20	52	32	29	20
4	KSE L	89 %	87 %	2%	1955	39	53	14	75	83
5	PSR DCL	100 %	100 %	0%	1379	0	14	14	20	23
	Total					**233**	**689**	**456**	**621**	**340**

10.11. In view of the above facts the Audit Firm should have analysed the excess revenue and should have ensured that the possible excess revenue of Rs 456 crore, booked in FY 2017-18, fully in order. The Audit Firm also should have verified that this booking of revenue in FY 2018 is fully in line with Ind AS 11. By not doing so, the Audit Firm has thus violated para 17 of SA 540 which states that "For accounting estimates that give rise to significant risks, the auditor shall obtain sufficient appropriate audit evidence whether the following are in accordance with the requirements of the applicable financial reporting framework: (a) management's decision to recognise, or to not recognise, the accounting estimates in the financial statements; and … (b) the selected measurement basis for the accounting estimates". The Audit Firm has also violated para 18 of SA 330 which stipulates "Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure***"***. The Audit Firm also failed in maintaining the professional skepticism as required by the SAs.

10.12. In the WP 'Format_CTC final 08.05.18_FSEL_ revised'**,** the BOQ (Bill of Quantity) items of the subcontracts are reproduced. The total estimated cost to complete the FSEL contract is Rs 1683.93 crore as per the WP. The cost incurred (billed by the sub-contractors) up to 31.03.2018 is shown as Rs 626.84 crore. Considering this work done of Rs 626.84 crores, the percentage of completion comes out to be 37% (626.84/1683.93). However, the POC calculated by the company for recognising the revenue is 53% (896/1683.93). There is no explanation in the Audit File regarding the basis of arriving at Rs 896 crore as the estimated cost of works done. Apparently, there is an excess revenue of Rs 309 crores booked by the company due to incorrect calculation of cost incurred.

10.13. In the FSEL contract, Rs 95.72 crore of estimated cost is shown under ITNL scope (not that of sub-contractors) which is in contradiction to the Audit Firm's statement in page 428 of their reply (in response to another observation in PFC) that "as per the business model of the Company, the construction activities were being outsourced to subcontractors **and the construction costs comprised on only the construction bills received from such subcontractors**. Further, the estimated costs of the contract is based on the EPC agreements entered with sub-contractors and **there is no additional cost in the nature of administration costs or other expense added to the same**. Further still, during our testing of administration and other expenses **we have not come across any such costs being transferred to Construction costs**. Accordingly, as per audit teams professional judgement there was no need to design specific audit procedures for this purpose" (Emphasis added). This makes it clear that the Audit Firm has not done any verification of the contract costs and has simply relied on the management numbers in gross negligence of their duties. Moreover, as this amount is not part of a discovered price (like that in sub-contracts), the basis of arriving at this cost shall be subjected to scrutiny by the Audit Firm, which is not found in the Audit File.

10.14. Para 22 of Ind AS 11 stipulates that when the outcome of a construction contract can be estimated reliably, contract revenue associated with the construction contract shall be recognised by reference to the stage of completion of the contract activity at the end of the reporting period. Para 23 stipulates that "**In the case of a fixed price contract**, the outcome of a construction contract can be estimated reliably **when all the following** conditions are satisfied:

i. total contract revenue can be measured reliably;

ii. **it is probable that the economic benefits associated with the contract will flow to the entity**; (emphasis added)

iii. both the contract costs to complete the contract and the stage of contract completion at the end of the reporting period can be measured reliably; and

iv. the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates".

10.15. As per Ind AS 18, Revenue is recognised when it is probable that future economic benefits will flow to the entity and these benefits can be measured reliably.

10.16. According to the above principles of Ind AS, ensuring that the future economic benefits will flow to the entity and these benefits and costs can be measured reliably **is a prerequisite before applying POC method of recognising revenue**. Without first verifying the conditions laid down as per para 22 and 23, the Company has applied the POC method on all the contracts and whatever be the difference between the amount so arrived and amount billed, the same is invariably booked as unbilled revenue.

10.17. There is no WPs showing that the Audit Firm has in fact checked the conditions laid down in para 22 and 23 of IndAS before relying on the numbers of revenue arrived at by applying POC method. In page 417 to 419 of their reply, the Audit Firm lists down the audit procedures related to revenue recognition performed by them. However, none of the WPs referred by the Audit Firm shows any examination of the recoverability and measurability aspects of the billed or unbilled revenue. This factor is not even mentioned by the Audit Firm anywhere in their reply to PFC as well.

10.18. Assuming, but not admitting, that the conditions in para 23 are met in all cases, the second step in estimating POC is the verification of estimated cost. As all the major contracts of the company are long gestation projects and many of them had several indications of cost escalation, the revised cost of the project shall be estimated reliably before the applying the POC method. The Company and the Audit Firm had only considered the awarded subcontract cost and the variations and claims made by the subcontractors, in arriving at the estimated cost. There is no testing done by the Audit Firm to ensure that these are the only costs and no other possible additional costs (such as borrowing cost, price variations allowed in the sub-contract, escalation due to inflation, escalation due to contract failures, penal charges, impact of GST, etc) are attributable to the estimated cost.

10.19. The list of audit procedures in page 417 to 419 of their reply shows no examination of the verification of the estimated cost taken for POC method. This factor is not even mentioned by the Audit Firm anywhere in their reply to PFC as well.

10.20. Regarding the variations between physical progress and financial progress the Audit Firm submits that the IE reports are available in the Audit File. However, NFRA observes that a signed IE report is available only in the case of KNCEL. In all other case the reports available are monthly progress reports prepared by the SPV, without any signature or covering letter from IE. These report does not have any indication of acceptance by the NHAI. In the absence of any verification of the authenticity of these documents, the contentions of the Audit Firm are not acceptable. The Audit Firm also submits that in the case of KNCEL the physical progress is 72% instead of 56% noted by NFRA. This is accepted and the line regarding KNCEL stands withdrawn from the observation in the PFC.

10.21. Regarding BAEL and FSEL the Audit Firm submits that "there appears to be a typographical error in the sheet referred to by NFRA and the POC as per the IE report in case of BAEL is 80% instead of 74% and in case of FSEL it is 57% instead of 51%". Regarding KSEL the Audit Firm submits that "the difference is on account of weighted given to BoQ items based on physical progress being different from the cost of those items; also the IE report is dated March 17, 2018 and the measurement by IE would have been performed prior to that resulting in difference in progress achieved in the balance 15 days of March i.e. from March 17 to March 31, 2018". The replies indicate that there has been no verification done by the Audit Firm with respect to physical progress compared with financial progress. The reasons given in the case of KSEL is not acceptable since this is neither recorded in the Audit File, nor supported by any evidence. It is clear that in all the three cases, the Audit Firm is in fact looked into these number only after getting the PFC from NFRA and whatever is submitted are all afterthoughts and hence rejected. The Audit Firm has simply accepted the numbers and documents provided by the Company without even bothering to understand the documents and record these numbers correctly.

10.22. It can be seen from the above and from the replies of the Audit Firm that the above requirements of SA 540 and SA 330 as stated above has not been complied by the ET in verifying the POC. The ET also failed to obtain sufficient appropriate Audit Evidence in accordance with para 6, 7 and 11 of SA 500. Therefore, NFRA reiterates its conclusion in the PFC and concludes that the Audit Firm has failed in obtaining sufficient appropriate audit evidence of percentage of completion used for revenue recognition, thus rendering the entire revenue recognised on account of construction projects highly doubtful.

Unverified Claims

10.23. Regarding the unverified claim relating to BAEL, the Audit Firm submits in page 434 of their reply that "*the amount of Rs.363 crore claimed by ITNL from its SPV viz. BAEL was approved by the Management Committee (MC)… as per the terms of the development agreement and legal considering the claim filed by BAEL and recognised in BAEL's financial statements based on the legal opinion obtained by BAEL, ITNL recognised the claim in its financial statements… …..Accordingly, as per Para 14 of Ind-AS 11 the claim was recognised when all approvals were in place and the SPV had accepted the same and was measured reliably and based on the legal opinion obtained it was also probable of recovery*". NFRA observes that this contention of the Audit Firm confirms the blatant violation of para 14 of Ind AS 11 and the SAs. There is absolutely no evidence in the Audit File to prove compliance with para 14 which require that negotiations have reached an advanced stage such that **it is probable that the customer will accept the claim**; and the amount that it is probable **will be accepted by the customer can be measured reliably.** There is not even an acknowledgement (let alone acceptance by NHAI) from the SPV regarding the claims made. Not a single communication exists at the date of signing the Audit Report that indicates that an amount has been at least considered by NHAI, who is the ultimate authority sanctioning the claim, towards the claims made by ITNL. To the contrary there is ample evidence in the Audit File itself to prove that there is uncertainty, both in the amounts as well as in accepting the claim by the SPV which eventually is a pass-through mechanism for NHAI. A few such instances are details below.

i. There are no documents in the Audit File which reflects that the claim of Rs 363 crore is accepted by the SPV or NHAI.

ii. In WP UA 79 it is mentioned that ***"****In BAEL an interim relief of Rs 102 crores has already been provided to ITNL by the SPV, approval is sought for the balance amount of Rs 139.64 crores*". In WP UA 102 it is stated that the "approval is sought for the balance amount of Rs 120.65 crores which is yet to be received from the SPV".

iii. In the Special Purpose Financial Statements of BAEL, attached in WP "BAEL_March_2018" in EY canvas, note 44 states that, "During the year, the management based on its assessment of the realisability of claims filed with NHAI, has recognised claims aggregating to Rs 370.57cr which have been accounted for as a reduction in the carrying value of its intangibles assets under development or credited to Statement of Profit and Loss depending upon whether the claims were of capital or revenue nature. The scheduled completion of the project was due on September 26, 2016 but due to conditions not attributable to the Company the completion has been delayed for which company has already preferred claims with NHAI/ IE for appropriate relief by way of Extension of Time which is under their consideration". This statement shows that only an Extension of Time (EOT) is under consideration by the NHAI which is yet to be accepted. Normally, acceptance of financial claims if any will only be considered after considering EOT.

iv. The statement, "*During the year, the management based on its assessment of the realizability of claims filed with NHAI"***,** shows that the SPV had estimated the probable realisable value at Rs 370.57 crore and recognised it in the books. The Audit Firm should have verified the basis of this estimate before concluding that it is inclusive of claims made by ITNL.

v. The disclosure note does not mean that the whole of the claim of Rs 370.57 crores is on account of claims from ITNL. BAEL has a total claim of Rs 740 crores as per the legal opinion and from which Rs 363 crores will be provided to ITNL as per the reply furnished by the Audit Firm.

vi. In WP UA Revenue and Cost, in page number UA 9 it is stated that "*As of now claims have been submitted by subcontractors to ITNL. ITNL has correspondingly* *submitted claims to SPV and* ***SPV is also in the process of filing a claim with NHAI***." (Emphasis added).

10.24. The above facts clearly demonstrates that in spite of knowing the fact the management had violated the provisions of Ind AS 11, the Audit Firm went along with the management in recognising unsubstantiated claims in the accounts in violation of Ind AS 11. The requirements of SA 540 and SA 330 as stated above has not been complied by the ET in verifying the claims. The ET also failed to obtain sufficient appropriate Audit Evidence in accordance with para 6, 7 and 11 of SA 500. Therefore, NFRA reiterates its conclusion in the PFC and concludes that the Audit Firm has merely relied upon the Management's contentions of recognising claims as revenue of the Company without verifying whether such claims will actually be paid by NHAI to the SPV.

Unbilled Revenue

10.25. Regarding verification of unbilled revenue the Audit Firm submits in page 436 and 437 of their reply that the unbilled revenue is recognised as per Ind AS 11. It states that "As per the cash flow projection of the project provided by management the amount of unbilled revenue was considered to be recoverable". The Audit Firm has referred workpaper in hard copy file 9 page reference no.UA1 – UA28, hard copy file 13 page no 680-728 and WP 'valuation memo' in hard copy file 6 page no H 286 to H300 in this regard.

10.26. NFRA has gone through the said WPs. The first WP mentioned is excel sheets showing break up of revenue and cost. The second and third WPs have a projected cash flow statement prepared for valuation of these SPVs. Nowhere in these WPs it is mentioned that the unbilled revenue is recoverable, as claimed by the Audit Firm. Moreover, these valuations have nothing to do with the accounting of construction revenue by ITNL in accordance with Ind AS 11. The references to these irrelevant WPs and the baseless contentions submitted by the Audit Firm are clear evidence that absolutely no efforts have been made by the Audit Firm in assessing the recoverability of the unbilled revenue estimated. As all the WPs cited by the Audit Firm fail to provide any evidence of verification of unbilled revenue, none of the contentions of the Audit Firm are acceptable.

10.27. NFRA observes from evidence in WP that the recoverability of the unbilled revenue booked in the case of KNCEL is highly doubtful, because of the prolonged delay in the project, unaccepted claims and reluctance of lenders to provide money for the project. Audit Firm has not done any verification of assumptions used by the management in showing that the estimated unbilled revenue meets the criteria mentioned in Ind AS 11. Similar is the case with BAEL.

10.28. The Audit Firm's reliance on the irrelevant projections (with respect to billed or unbilled revenue from construction contracts) used by the management is without complying the requirements of para 18 of SA 540 which states, "The auditor shall evaluate, based on the audit evidence, whether the accounting estimates in the financial statements are either reasonable in the context of the applicable financial reporting framework, or are misstated." Further as per Para A2 of SA 500, "Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, reperformance and analytical procedures, often in some combination, in addition to inquiry. **Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level**, nor of the operating effectiveness of controls." (Emphasis Added).

10.29. Reference is also drawn to the observations above regarding verification of conditions laid down in para 22 and 23 of Ind AS 11.

10.30. Therefore, NFRA reiterates its conclusion that the Audit Firm had not been sceptical at the time of recognising unbilled revenue in the books of accounts. There is no evidence in the Audit File of any audit procedures that have been carried out to verify the existence, rights, completeness, recoverability and valuation of unbilled revenue in case of these projects.

Discrepancies in Working Papers

10.31. Regarding the discrepancies in working papers the Audit Firm has provided explanations/reconciliations and states in page 442 of their reply that "Discrepancies, as noted by NFRA, are clerical and administrative in nature for which the relevant workpapers were updated and are available on the audit workpaper file and workpaper references have been provided above. Further, these have been adequately considered in performing our audit and there is no impact of these differences on SRBC's audit procedures or our audit report on the financial statements for the year ended March 31, 2018". The explanations and reconciliations show that the Audit Firm was not aware of such discrepancies at the time of reviewing the Audit File before archival as these are remining unrectified at any point of time. This has to be read with the other similar discrepancies observed by NFRA in above paragraphs. This shows the inferior quality of the reviews done by the EP and the EQCR Partner. This also shows the casual manner in which the audit documentation has been prepared and non-verification of documented data while signing the Audit Report.

10.32. Based on the observations in preceding paragraphs, NFRA reiterates its observations in the PFC and concludes that the Audit Firm is guilty of violating the requirements of SA 200, SA 330, SA 500 and SA 540 by

i. Not carrying out the audit according to standards of auditing,

ii. Not verifying accounting estimates as required by the SA.

iii. Not obtaining sufficient appropriate audit evidence,

iv. Not maintaining professional scepticism, professional competence and due care and other ethical requirements during the audit.

10.33. NFRA examined in detail the responses of the Audit Firm, dated July 10, 2021, and the oral submissions on the above observations in the DAQRR and further observes as follows:

Unsubstantiated Percentage of Completion

10.34. Regarding the observations in <u>para 10.3 to 10.6</u> the Audit Firm states as follows:

10.34.1. The Audit Firm states on page no 684 of their reply that, *"In addition to other procedures performed with respect to revenue, SRBC would like to specifically* *emphasize the following procedures where external evidence was also verified by SRBC:*

a) *"Monthly project progress was monitored and approved with verification of RA bill. SRBC has verified and reviewed the construction contracts with sub-contractors, the RA bills from subcontractors and the BoQ rates and quantities corroborated the same with cost of construction (Refer test of controls in File 9 Page UA 211 to UA 217 and test of details in File 9 Page UA 1 to UA 28, UA 38 to UA 124, UA 212 to UA 217, UA 224 to UA 326) which was taken as a base to calculate the revenue accounted by the Company in accordance with Ind AS 11 on Percentage of Work Completed (POC) basis."*

b) *"Reports from the Independent Engineer (IE) were obtained and physical percentage of work completed was compared to the financial completion. IE being a third-party independent engineer appointed by NHAI (regulator) provides a high-level assurance towards the progress of the project."*

10.34.2. For KNCEL, RMGSL, and PSRDCL the Audit Firm has repeated its responses at the PFC stage stating that, *"NFRA has not considered the full submissions made by SRBC made on page 422 to 427 of SRBC's response to NFRA PFC and has for reasons best known to the NFRA reviewer only quoted selective paras in NFRA's DAQRR para 10.3.2 to 10.3.4. In our response to NFRA's PFC we had clearly stated that SRBC had obtained an understanding of the process and performed walkthrough, performed test of controls and test of details for Revenue and underlying cost of construction along with the audit work paper references from out audit files as submitted to NFRA on March 22, 2019."* The Audit Firm further states that, *"SRBC submits that it is a common knowledge and practice which should ideally be known to a NFRA's experienced file reviewer that in case of large infrastructure projects, once major part of the work is completed the commercial operation date is announced. However, it does not mean that the project is 100% complete and ancillary work is carried out even after the commercial operations date. In case of RMGSL and PSRDCL also, the ancillary work was carried out which is a fraction of the total revenue / cost of the project (in case of RMGSL – 5% and in case of PSRDCL – 1%). During the previous year itself the engagement team had verified that in case of RMGSL while HUDA had announced commercial operation date as March 31, 2017, the percentage of work complete was only 94%. The work / construction activity was fully completed during the year ended March 31, 2018, which as explained above, has been approved by quality surveyor, section incharge and the project director and accordingly, revenue had been appropriately recognized. In case of PSRDCL, there was very minor work i.e.1% of total project cost that was executed in March 31, 2018 which was also approved by quality surveyor, section incharge and project director."*

10.34.3. The Audit Firm states that, "Further, an Audit Quality Reviewer has to undertake the exercise simulating the circumstances as existed during the course of the audit and never use the benefit of the hindsight, which invariably exists during the period Audit Quality Review is undertaken. SRBC submits that the Audit Quality Reviewer has erred in law and in applying the audit quality review procedures by overlooking the salutary principles set forth above."

10.34.4. The Audit Firm states that *"SRBC has scrupulously applied principles of SA 540 in performing the audit which is evident from the procedures and workpaper references provided in point 3(a) and (b) above."* It further states that, *"Based on the aforesaid procedures, it is evident that SRBC has also objectively validated the estimated cost of completion with external evidence to confirm that these are no arbitrary calculations and has not just relied on management representations as alleged by NFRA. SRBC had applied due care and diligence at relevant time throughout the audit in view of the procedures explained above."*

10.35. In this regard NFRA observes as follows:

10.35.1. There is no additional evidence produced by the Audit Firm to prove that the percentage of completion has been properly verified with external evidence. The development agreement, RA bills and BoQ rates cannot be considered as external evidence, as claimed by SRBC. Regarding the reports from the Independent Engineer (IE), NFRA has already observed that a signed IE report is available only in the case of KNCEL. In all other cases, the reports available are monthly progress reports prepared by the SPV, without any signature or covering letter from IE. These reports do not have any indication of acceptance by the NHAI/IE. In the absence of proper evidence of verification of the authenticity of these documents, the contentions of the Audit Firm that external evidence was verified are not acceptable. Also, NFRA has not raised any observations regarding commercial operation dates.

10.35.2. Regarding NFRA's comments that *"for the contracts which are stated to be commissioned in the previous years, there is no evidence in the Audit File to confirm that the contract is in fact not declared as completed and any booking of expenses and revenue after the commissioning date is in line with the contract conditions and Ind AS 11",* the Audit Firm has given vague replies stating that cost estimates were not only approved by the Management Committee but were also backed up with construction contracts and BOQs. It is very clearly known that there is a high risk of management override of controls in the case of cost estimates. Thus, the Audit Firm's reliance on the cost approved by the Management Committee, without any objective examination shows the casual approach with which the audit has been carried out.

10.35.3. As already noted by NFRA at the PFC stage that there is no WP in the audit file in which the Audit Firm has recorded its verification of completeness of construction cost (including changes if any) recorded in books of ITNL. Running Account bills alone cannot give such an assurance unless it is backed by evidence of actual physical completion. However, in verifying physical completion the Audit Firm relied only on internal evidence. The Audit Firm has not referred to any new WP or explanations regarding the observations in the three SPVs (KNCEL, RMGSL and PSRDCL) as noted by NFRA. Thus, the Audit Firm's contention that NFRA is taking the benefit of hindsight to come up with the conclusions is absolutely baseless, as NFRA has pointed out above that the Audit Firm has not carried out sufficient appropriate audit procedures as required by the SAs. Had the Audit Firm carried out the audit as per the requirements of the SAs and collected adequate evidences regarding the matters stated above it would have also reached the same conclusions at the time of conducting audit.

10.35.4. Thus, NFRA reiterates its DAQRR conclusions that the Audit Firm has missed the crux of the matter which is the **unsubstantiated percentage of completion** (POC). As POC is an accounting estimate which is further based on the estimated cost of completion (which changes from period to period for the long gestation infrastructure works undertaken by ITNL) the Audit Firm shall follow and apply the principles of SA 540 scrupulously in verifying the estimated cost. Any arbitrary calculation of the estimated cost may have a substantial impact on the revenue booked by the Company. The procedures performed by the Audit Firm fall short of the requirements of SA 540. The Audit Firm has failed to assess whether the reason given by the management for changes in estimated cost is justified or not and whether the management assumptions and rates adopted are reasonable or not.

10.36. Regarding paras 10.7 to 10.11 above the Audit Firm states as follows:

10.36.1. *"The Company had a management committee which took decisions and approved modifications to contracts and changes in cost and revenue estimates including variations and claims. The Management Committee comprised of the Managing Director, Executive Directors, Chief Executive – Head of Implementation, Technical Director, Chief Financial Officer and Company Secretary & Legal head who were responsible for the oversights of both, the Company and its SPVs. Accordingly, the decisions taken by the Management Committee were followed by ITNL and the SPVs. As an additional fact for NFRA, during the quarter ended June 2018, we had verified that ITNL had billed the unbilled revenue to aforesaid SPVs."*

10.36.2. Regarding NFRA's comment on CNTL, the Audit Firm states that *"The POC stated in the workpaper referred to by NFRA, is 98% for March 31, 2018 across the file, the 96% POC mentioned at one place is as at December 31, 2017 quarter as can be clearly seen from the column heading (Refer hard copy file 9, UA 23). Hence, there is no discrepancy in workpapers as stated by NFRA."* It further states that, *"With respect to the cumulative cost upto March 31, 2018 the correct number is Rs.3,018 crore, however, in the 12 month Revenue and Cost Analysis table there is a typographical error."*

10.36.3. *"The amount of Rs.2 crore on account of Purchase of Machinery was included in the estimated cost as these were specifically purchased for tunnel operations and hence recoverable as part of revenue from the SPV and hence not a capital cost. This is explained in the MCA approval referred to by NFRA."*

10.37. NFRA examined the above responses of the Audit Firm and observes as follows:

10.37.1. For all the cost estimates the Audit Firm has simply mentioned that the costs and changes were approved by the management committee and that the decisions taken by the management committee were followed by ITNL and the SPVs. Thus, verification of management committee approvals is the only procedure performed by the Audit Firm to verify the cost estimates. In doing so the Audit Firm has not considered the risk of management override of controls in cost estimation. Also, the substantive audit procedures claimed to have been done by the Audit Firm suffers from the inappropriate classification of ROMM in revenue recognition. Refer to the ROMM para of the AQR for further details regarding this matter.

10.37.2. Based on the evidence, NFRA's observation regarding discrepancy of difference in POC of CNTL stands deleted. The difference in cumulative cost up to 31st March, 2018 shows the casual approach with which the audit documentation has been maintained as are many such instances of discrepancies observed (read section 'Discrepancies in Working Papers' above).

10.37.3. Regarding the inclusion of the amount of Rs. 2 crores in cost estimation, the Audit Firm's response is not acceptable as it is contradictory to what is stated in the MCA approval. WP *'MCA' (page UA61)* states that, *"Following equipment have been purchased for construction and operation phase of the project. The cost of these equipment have not been considered as it is a part of Capex/Asset of ITNL which is used in Tunnel Operation or remoibilse to some other project."* Thus, the Audit Firm failed to perform audit procedures to verify the estimated cost and is now giving misleading responses to NFRA.

10.37.4. The Audit Firm has referred to the following WPs about the 5 projects for which NFRA has made the observations:

SRBC's submission	**Workpaper reference**	**NFRA's Comments**
a. With respect to Estimated Revenue, SRBC had verified the Development Agreements entered between ITNL and the SPVs	Refer hard copy file no.9, UA19 to UA20	The Audit Firm did not verify whether the basis on which revenue has been estimated by the management is justified or not and is in accordance with the requirements laid down in Ind AS 11.
b. For variations / claims, verified the Management committee approval and the revised / amendment to Development Agreement	Refer hard copy file no.9, UA19 to UA20 and UA38 to UA107	Verification of variations and claims is required to be carried out in accordance with the conditions laid down in Para 13 and 14 of Ind AS 11. This has not been done.
c. Obtained an explanation from the management for variations/claims made by ITNL	Refer hard copy file no.9, UA19 to UA22	The explanation documented in the WP like the change in cost is due to additional cost to be incurred (PSRDCL and CNTL) is very vague and does not explain anything.
d. Verified the legal opinion towards the probability of	Refer legal opinion in	NFRA has done a detailed analysis regarding BAEL claim

recovery of such claims by SPV from the authorities.	canvas file name "BAEL Opinion"	in the section *'Unverified Claims'* of this AQR. Please refer to that section.
e. Verified the future cash flow projection of the SPV's to ascertain the revenue recorded is recoverable during the term of the project.	Refer hard copy file no.13	The Audit Firm has not evaluated the assumptions and the basis on which the management has made the cash flow projections of the SPVs.
f. Examined the calculations for revenue to be recognized during the year in accordance with Ind AS 11.	Refer hard copy file no.9, UA17	It is just a calculation of revenue. There is no verification of the figures used to calculate the revenue recognised.

10.37.5. In its response on page no. 695 the Audit Firm has made a table according to which it has calculated the excess revenue booked in the FY18. Column *'H'* of the table states the estimated revenue, including variations/claims for FY 18. The Audit Firm has just mechanically calculated the excess of revenue booked without verifying whether the figures of estimated revenue including variations and claims are recorded as per the requirements of Ind AS 11 or not. The Audit Firm has simply accepted the estimate of the management without any objective analysis being carried out.

10.37.6. The WPs referred by the Audit Firm are irrelevant. There is no WP that clearly documents the reason for the increase in revenue. Even if reasons are documented they are incomplete and are not in conformity with para 13 and 14 of Ind AS 11. The Audit Firm also did not comply with the requirements of SA 540 and SA 330 and thus failed to conduct the audit with professional skepticism.

10.38. Regarding paras 10.12 and 10.13 the Audit Firm states that:

10.38.1. *"With respect to para 10.12 of NFRA's DAQRR, NFRA has only considered the work completed during the period July 2017 to Mar'2018 amounting to Rs.626.84 crore. NFRA has not considered the work completed upto June 2017 which is in column N of the Summary Sheet of file 'Cost to Completion Format_CTC final 08.05.18_FSEL_ revised". The aggregate amount incurred comes to Rs.896 crores basis which the 53% work completed has been derived. Accordingly, revenue has been appropriately calculated @53% POC and there is no excess revenue recognized as alleged by NFRA. Accordingly, SRBC refutes and denies NFRA's baseless allegation in para 10.2 of NFRA's DAQRR."*

10.38.2. *"The amount of Rs.95.72 crores as referred to by NFRA, relates to the work yet to be subcontracted by ITNL which mainly includes construction/installation of Toll Plaza, Toll System, Traffic Signages, Electrification etc. This work comes towards the end of construction activity which is sub-contracted to various local sub-contractors which are grouped under ITNL Scope of Work. As can be seen, in the given case, the aggregate amount grouped under ITNL Scope of work is only ~5.7% of the total* *project cost which was considered to be reasonable based on other projects where similar activities were carried out."*

10.38.3. *"Further, based on the information and explanation provided by the management and the audit procedures performed, there were no administration and other expenses that were required to be included in total estimated cost for calculation of Revenue in accordance with Ind AS 11."*

10.39. NFRA examined the above responses of the Audit Firm and observes as follows:

10.39.1. NFRA's observation in para 10.12 stands deleted based on the explanation provided by the Audit Firm.

10.39.2. About NFRA's observations in para 10.13, the Audit Firm has not referred to any WP where it has documented its analysis of the amount of Rs. 95.72 crores included as a part of the estimated cost of the project. Since the Audit Firm's explanation regarding the cost is not supported by evidence it is considered as an after-thought and hence not acceptable. NFRA thus reiterates its DAQRR conclusion that the Audit Firm has not done any verification of the contract costs and has simply relied on the management numbers in gross negligence of their duties. Moreover, as this amount is not part of a discovered price (like that in sub-contracts), the basis of arriving at this cost shall be subjected to scrutiny by the Audit Firm, which is not found in the Audit File.

10.40. Regarding paras 10.14 to 10.22 the Audit Firm has stated as follows:

10.40.1. Regarding compliance with para 22 and 23 of Ind AS 11, the Audit Firm states that *"The Company had Development Agreements with SPVs and Management Committee approvals based on which estimate of construction revenue could be reliably measured. Similarly, the Company had Construction contracts with sub-contractors based on which the estimated construction cost could be reliably measured."*

10.40.2. Regarding IE reports the Audit Firm states on page no. 707 of its response that, *"Further, as per SRBC's understanding, there is no requirement of specific acceptance by NHAI as IE is appointed by NHAI itself. SRBC would like to understand if NFRA reviewer has come across or is aware of a practice of specific acceptance of MPR by NHAI. Basis the standard practice there is no reason to doubt such IE reports shared by management with us for the purpose of audit."*

10.40.3. *"As we understand as per Industry practice, IE do not generally sign the MPR and it is forwarded to the SPV under a cover letter which may be signed in some cases."*

10.40.4. *"We are unable to understand the basis of NFRA's comment that the MPR's were prepared by SPV. It seems that NFRA has assumed so, just because the MPR is not signed by IE or does not have a cover letter signed by IE. If NFRA reviewer has doubt about the same then they may exercise their powers and right to confirm the same with the Company. SRBC would like to submit here that it has only carried out a statutory audit of the financial statement under the Companies Act and not conducted an investigation."*

10.40.5. Regarding variation in physical progress and financial progress in the case of KNCEL the Audit Firm states on page no. 708 of its response that, *"Further, in case of KSEL the difference is on account of weighted given to BoQ items based on physical progress being different from the cost of those items; also the IE report is dated March 17, 2018 and the inspection by IE was performed on March 13, 2018 and March 14, 2018 resulting in difference in progress achieved in the balance 15 days of March i.e. from March 17 to March 31, 2018 (Refer Canvas for zip folder "MPR_March 18" and within that file named "KSEL IE Letter No. 2176- Inspection Report(Construction Length of IE for the month of March2018.pdf").*

10.41. NFRA examined the response of the Audit Firm and observes as follows:

10.41.1. Para A58 of SA 540 states that *"Management often is able to demonstrate good reason for a change in an accounting estimate or the method for making an accounting estimate from one period to another based on a change in circumstances. What constitutes a good reason, and the adequacy of support for management's contention that there has been a change in circumstances that warrants a change in an accounting estimate or the method for making an accounting estimate, are matters of judgment".*

10.41.2. Thus, the Audit Firm was required to examine whether the estimates of cost and revenue made and approved by the management committee were correct or not in its professional judgment by performing sufficient appropriate audit procedures and collecting adequate support for management's contentions. Whereas the Audit Firm has not performed any such analysis and just accepted the estimates made by management without any kind of verification. Thus, the Audit Firm's contention that since the estimates were approved by the management committee it shows that it complies with the requirements of para 22 and 23 of Ind AS 11 is not acceptable.

10.41.3. Regarding the IE reports, NFRA observes the following from WP 'MPR_March 18' in Canvas:

i. Monthly Progress Report (MPR) dated 05-04-2018 for KNCEL is submitted by the IE directly to the Project Director, NHAI with a covering letter from IE NHAI, on IEs letterhead. Hence it is clear that the IE has prepared and submitted the MPR, as rightly observed by NFRA in <u>para 10.20</u> above.

ii. In the case of JIICL, it is written on page 1 of the report that it is prepared by JIICL and submitted to the IE. The covering letter attached to this MPR is on the letterhead of JIICL addressed to the IE and signed by the project director JIICL. This makes it clear that the MPR is prepared by the SPV.

iii. Some of the other MPRs shows the logo and name of ITNL as the header on all pages, without any indication of who prepared it. If it is prepared by an external IE how it can use the logo and name of ITNL on all pages of its report?

iv. There is no covering letter of the IE or no forwarding letter to the NHAI available in any of the MPRs except as mentioned above.

v. The above facts make any person having common sense suspicious about the involvement of IE in the preparation of those reports. If it is not the case the Audit Firm has to substantiate their assertions with evidence.

10.41.4. The above evidence is as plain as daylight and does not require any forensic or investigative angle to observe. The replies of the Audit Firm quoted above and the evidence available in the audit file confirms that the Audit Firm approached this critical area with a casual approach and without the required professional skepticism. The Audit Firm's response that the IE's reports are acceptable without a signature is not acceptable. There should be proper authentication of the documents used as evidence in an audit. Para 9 of SA 500 states that *'when using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes, including as necessary in the circumstances: (a) Obtaining audit evidence about the* ***accuracy and completeness*** *of the information; and (Ref: Para. A49-A50) (b) Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes. (Ref: Para. A51)* (Emphasis added) Thus, the Audit Firm was required to assess the authenticity of the information used as per the above para.

10.41.5. The Audit Firm has repeated its response regarding the variation in physical progress and financial progress in the case of KNCEL. The WPs referred by the Audit Firm do not document the reason given by it for such variation, thus it is not acceptable. The Audit Firm has simply accepted the numbers and documents provided by the Company without even bothering to understand the documents and record these numbers correctly.

10.41.6. Therefore, NFRA reiterates its conclusion in the DAQRR stage and concludes that the Audit Firm has failed in obtaining sufficient appropriate audit evidence of the percentage of completion used for revenue recognition, thus rendering the entire revenue recognised on account of construction projects highly doubtful.

Unverified Claims

10.42. The Audit Firm states as follows regarding the above matter:

10.42.1. *"SRBC submits that the claim of Rs.242.64 crore by ITNL on BAEL was raised by ITNL after approval from Management Committee vide MC no. 81A dated March 21, 2018. Subsequently, the management also approved a claim of Rs.120 crore by ITNL on BAEL. (Refer hard copy file 9 page reference no. UA 78 to UA 82 and UA99 to UA 104 respectively for the two approvals). Further, the claim was also recoverable by ITNL from SPV based on clause 7 of Development Agreement dated April 1, 2014 between ITNL and the SPV (Refer Canvas for zip file "Development Agreement" and refer file name "BAEL_(A)Development Agreement_01.04.2014" within the zip file). SRBC had verified the development agreement and the MCA approvals (Refer Canvas file "MCA")."*

10.42.2. *"SRBC submits that the claim filed by ITNL on BAEL was as per the terms of development agreement and also approved by the Management Committee. This claim was not dependent on the recovery of claim filed by BAEL on NHAI.*

Irrespective of the amount of claim approved by NHAI, BAEL was bound to settle the entire claim raised by ITNL. SRBC applied professional skepticism and questioned the management with respect to recoverability of claim in the event that BAEL's claim is partly approved or rejected by NHAI. Management had shared the future cash flow projections of the SPV for impairment testing purposes and as per the future cash flow projections of the SPV, it had sufficient surplus cash flows in future years to pay the claim to ITNL in the event the SPV's claim is rejected by NHAI. SRBC had reviewed the said future cash flow projections and exercised its professional judgment to concur with the management."

10.43. The Audit Firm has not referred to any new WPs or provided any new explanations other than those already addressed by NFRA at earlier stages. Nevertheless, NFRA has gone through the response of the Audit Firm and observes as follows:

10.43.1. As observed by NFRA, out of the total claim of Rs. 363 Crores (claimed by ITNL from BAEL) only Rs. 242 Crores was approved by the Management Committee. In the WP referred by the Audit Firm (*Refer hard copy file 9 page references no. UA 78 to UA 82 and UA99 to UA 104 respectively for the two approvals),* page no. UA 78 to UA 82 contains the MC no. 81A dated March 21, 2018, in which the Management Committee has approved Rs. 242 Crores. Page UA99 to UA104 contains a letter dated March 28, 2018, from ITNL. It is not an approval from the Management Committee. Further, page no. UA 102 states that *"As mentioned earlier, separate MCA (MC/81-A/2017-18) approval has already been sought to claim the idling expenses from BAEL amounting Rs. 241.64 approval is sought for balance amount of Rs. 120.65 Cr. as mentioned under the head in above table (except C iii in table above)."* Thus, it is clear from the above that MC approval was sought only for Rs. 242 Crores and the balance amount of Rs. 120 Crores was not yet approved even by the Management Committee. The Audit Firm is just trying to mislead NFRA by ignoring the facts.

10.43.2. The Audit Firm's contention that the settlement of the claim filed by ITNL on BAEL was not dependent on the recovery of claim filed by BAEL on NHAI is not backed with any WP reference. The letter dated March 28, 2018, attached in the WP *'MCA'* (Hard Copy file folder, File 9 Flap UA, page no. UA99 to UA 104) mentions that the ITNL's claim to BAEL is a part of SPV's claim to NHAI. It is nowhere mentioned that BAEL is bound to settle the claim whether it recovers it from NHAI or not. Also, it is a common understanding that the amount is due from the authority, i.e., NHAI. Therefore, until and unless NHAI approves the payment of such a claim, its recoverability cannot be ascertained. Thus, the Audit Firm's response is considered as an after-thought and is not acceptable. Further, in the future cash flow projections of BAEL also the cash flow is positive only because the claim amount has been considered as an inflow. Thus, BAEL will be able to settle the claim of ITNL only if the claim amount gets paid by NHAI. The Audit Firm has given all baseless explanations regarding the recoverability of the claim amount without verifying the same and is thus grossly negligent in the conduct of the audit.

10.43.3. As observed by NFRA in the DAQRR the Audit Firm failed to verify the basis of the recognition of Rs. 370 crores of claims disclosed in the Special Purpose Financial Statements of BAEL, before concluding that it is inclusive of claims made by ITNL. The Audit Firm has not given any relevant response or referred to any relevant WP regarding this observation.

10.43.4. The Audit Firm has given no clear replies with the support of WPs. There is absolutely no evidence in the Audit File to prove compliance with para 14 which require that negotiations have reached an advanced stage such that it is probable that the customer will accept the claim, and the probable amount will be accepted by the customer and can be measured reliably. There is not even an acknowledgement (let alone acceptance by NHAI) from the SPV regarding the claims made. Despite knowing the fact the management had violated the provisions of Ind AS 11, the Audit Firm went along with the management in recognising unsubstantiated claims in the accounts in violation of Ind AS 11. The requirements of SA 540 and SA 330 have not been complied with by the ET in verifying the claims. The ET also failed to obtain sufficient appropriate Audit Evidence as per para 6, 7 and 11 of SA 500. Therefore, NFRA reiterates its conclusion in the DAQRR and concludes that the Audit Firm has merely relied upon the Management's contentions of recognising claims as revenue of the Company without verifying whether such claims will actually be paid by NHAI to the SPV.

Unbilled Revenue

10.44. Audit Firm states as follows regarding the above matter:

10.44.1. *"As an experienced auditor would know that future cash flow projections of the SPVs are to be reviewed to determine whether there is adequate cash flow available with the SPV to be able to settle the unbilled revenue once it is billed. Accordingly, workpaper references for future cash flow projections / valuation memos were provided to NFRA in our response to PFC so that NFRA can appreciate that SRBC had applied professional skepticism and corroborated the recoverability of unbilled revenue with the future cash flow projections of the SPVs."*

10.44.2. *"In case of KNCEL, as explained by the management and as stated in IE MPR, (Refer Canvas for zip folder "MPR_March 18" for file name "MPR IE KNCEL MAR '18.pdf"), the Independent Engineer had recommended an extension of tenure for the project considering delays by NHAI in providing right of way / hindrance free land for construction to ITNL. Pending receipt of extension of tenure from NHAI, the bankers were reluctant to fund the project due to which drawdown of loan had been put on hold. However, considering that the Independent Engineer had recommended an extension of tenure to NHAI, based on past experience it was considered to be highly probable at that point of time and as per facts prevailing then that NHAI would approve the said recommendation. Further, the IE was a third party appointed by NHAI, the IE report was an external evidence for audit purposes and SRBC did not have any reasons then to disregard the same."*

10.44.3. *"In case of BAEL, as explained above in SRBC's response to NFRA's DAQRR para 10.23 to 10.24, the EOT had been recommended by the Independent Engineer vide letter dated February 5, 2018 and based on the same NHAI had approved EOT vide letter dated April 10, 2018. Further, BAEL had filed a claim of Rs.740 crore with NHAI on March 26, 2018 and legal opinion dated March 31, 2018 was obtained to support the said claim."*

10.45. NFRA examined the responses of the Audit Firm and observes as follows:

10.45.1. As observed in the PFC the unbilled revenue from construction activities increased by more than 110% from Rs.399.29 Crores in the year ended 31st March 2017 to Rs.841.48 Crores in the year ended 31st March 2018, which is about 30% of the total Construction revenue of Rs. 2,667.93 Crores. Thus, the Audit Firm was first of all required to design and perform procedures to verify whether the unbilled revenue was rightly recognised or not. Only after the Audit Firm verifies the recognition assertion of unbilled revenue then the question of recoverability arises. If the amount of unbilled revenue has not been recognised properly then the question of recoverability testing does not arise at all. Further, as seen from the WP 'valuation memo' (in hard copy file 6 pages H 286 to H 300) in the cash flow statements of the SPVs the assumptions and their basis are not mentioned. It was evident from the Audit File that the said cash flow has been used for the valuation of the SPVs. Had the Audit Firm intended to use it for verifying the unbilled revenue, then there should have been some examination of the reasonability and timing of the amounts shown as inflows from the Authority. Such an examination is not possible without validating the assumptions, contract conditions, status of previous claims etc. In this regard Para 9 of SA 500 states that *"When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes, including as necessary in the circumstances:*

(a) Obtaining audit evidence about the accuracy and completeness of the information; and (Ref: Para. A49-A50)

(b) Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes. (Ref: Para. A51)"

The Audit Firm has simply accepted whatever information the management has provided without performing any procedures to verify the accuracy, completeness and reasonability information contained in them. Thus, the Audit Firm has failed to obtain sufficient appropriate audit evidence as required by SA 500.

10.45.2. Regarding the case of KNCEL and BAEL, the Audit Firm has not referred to any new WPs or explanations other than what has already been examined by NFRA at the earlier stages. As mentioned by NFRA in the other parts of this AQR, the Audit Firm has completely failed to design and perform sufficient appropriate audit procedures regarding the verification of construction revenue as per the requirements of Ind AS 11. Thus, the Audit Firm's contention that *"The verification of unbilled revenue is covered along with the verification of construction revenue as per Ind AS 11 since unbilled revenue is only a difference between the construction revenue recognised as per the percentage of completion method and the billing done as per the milestones.",* is not acceptable in the absence of relevant evidence regarding a proper verification of the construction revenue, and the estimated cost of completion.

10.45.3. Therefore, NFRA reiterates its conclusion that the Audit Firm had not been sceptical at the time of recognising unbilled revenue in the books of accounts. There is no evidence in the Audit File of any audit procedures that have been carried out to verify the existence, rights, completeness, recoverability and valuation of unbilled revenue in case of these projects.

Discrepancies in Working Papers

10.46. Regarding the above matter the Audit Firm has repeated its earlier responses at the PFC stage stating that, *"Discrepancies, as noted by NFRA, are clerical and administrative in nature for which the relevant workpapers were updated and are available on the audit workpaper file and workpaper references have been provided above. Further, these have been adequately considered in performing our audit and there is no impact of these differences on SRBC's audit procedures or our audit report on the financial statements for the year ended March 31, 2018."* The Audit Firm further states that, *"Considering the size and complexity of audit, such clerical and administrative discrepancies for which the updated workpaper reference were already shared by SRBC with NFRA, SRBC strongly refutes and denies NFRA's allegation that this shows the inferior quality of the reviews done by the EP and the EQCR Partner and that this also shows the casual manner in which the audit documentation has been prepared and non-verification of documented data while signing the Audit Report."*

10.47. NFRA observes that even if these discrepancies are considered as clerical and administrative in some instances (as observed at the PFC stage) the difference in the figures is so substantial that it would create a glaring mismatch in some cases, which is unnoticed by the EP and EQCR even at the time of their reviews if any. Thus, such errors cannot be ignored as mere clerical errors. NFRA reiterates its conclusion at the DAQRR stage that the explanations and reconciliations show that the Audit Firm was not aware of such discrepancies at the time of reviewing the Audit File as these are remaining not rectified at any point in time. This shows the inferior quality of the reviews done by the EP and the EQCR Partner. This also shows the casual way the audit documentation has been prepared and is also evidence of non-verification of documented data by the ET.

10.48. Based on the observations in the preceding paragraphs, NFRA reiterates its observations in the DAQRR and concludes that the Audit Firm has failed to ensure that the financial statements comply with Ind AS 11. The Audit Firm has also violated the requirements of SA 200, SA 330, SA 500 and SA 540.

11. EVALUATION OF ENGAGEMENT QUALITY CONTROL (EQC) REVIEW

11.1. NFRA conveyed the following observations in the PFC.

11.1.1. Requirements from SAs:

- **i.** The firm should establish policies and procedures requiring an engagement quality control review for all audits of financial statements of listed entities. (Para 60, SQC 1)
- **ii.** Paras 2 and 3 of SA 230 defines the nature and purposes of audit documentation. Paras 8 to 11 of SA 230 deals with the form, content and extent of audit documentation of the audit procedures performed and audit evidence obtained.
- **iii.** Para 3 of SA 230 clearly states that Audit documentation serves a number of additional purposes including "enabling the conduct of quality control reviews and inspections in accordance with SQC 1". The footnote to Para 3 gives references to Paragraphs 60, 63 and 65 of SQC 1. Paragraph 60 of SQC 1 relates to policies and procedures regarding EQCR. Para 63 is about the criteria for eligibility of EQCR. Para 65 brings out matter to be included in the EQCR including evaluation of firm's independence, significant risk identified during the engagement, judgments made particularly with respect to materiality and significant risk etc.
- **iv.** The definition of "Auditor" as given in SA 200 states that the term is used to refer to the person or persons conducting the audit, usually the EP or other members of the ET or, as applicable, of the firm.
- **v.** The EQC Reviewer is required to document, for the audit engagement reviewed, that: (Para 25, SA 220)
- **vi.** The procedures required by the firm's policies on engagement quality control review have been performed;
- **vii.** The engagement quality control review has been completed on or before the date of the auditor's report; and
- **viii.** The reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the ET made and the conclusions they reached were not appropriate.

11.1.2. NFRA had conveyed the following prima facie conclusions:

- **i.** The workpapers do not identify or document any discussion about significant matters between EQCR team and the EP. EQCR Partner has merely acted as an ordinary member of the ET and did not perform any independent and objective evaluation of significant judgments based on the discussions with the EP. For example:
- **ii.** WP '*Minutes of ITNL Team Planning Event'*- Statutory Audit for the year ended 31 March 2018" on 20 November 2017 (Page A186 of File 1) – No comments/inputs from EQCR partner were recorded.

iii. WP '*Audit Strategy Memorandum'*, reviewed by the EQCR partner but no comments/discussions/inputs from EQCR partner were recorded in the document.

iv. WP "*Post Interim Meeting*" (PIE), for meeting held on 20th April 2018, it has been recorded in the minutes that the inputs of EQCR partner were taken by the ET on significant key risk matters. However, there is no evidence in the Audit File as to what inputs were given by the EQCR partner and how they were dealt with by the ET.

v. The documentation is required to include specific reference to the facts of the case, observations made given the facts of the case by EQCR Partner and record independent verification procedures performed by the Reviewer to prepare a meticulous and well explained document objectively recording the matters as stated in SA 220.

vi. 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 Partner has carried out independent analysis or review. It has been shown clearly above that SA 230 is applicable to the EQCR. Therefore, EQC Partner should have documented its working properly and separately from the working of the Audit team.

11.1.3. Thus, the Audit Firm has completely failed to maintain documents as per SA 230. The EQCR partner 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 date without any kind of independent analysis and work papers show that the evidence of EQC Partner's involvement is false and has been created subsequently.

11.1.4. Thus, NFRA concludes that EQCR Partner has:

i. Failed to report material misstatements known to him to appear in a financial statement with which he is concerned in his professional capacity.

ii. Not exercised due diligence to obtain sufficient information to objectively evaluate the significant judgments of the ET and conclusions reached by them.

iii. The exaggerated claims of the Audit Firm about involvement of EQCR Partner are clearly unsupported by evidence and the Audit Firm has failed in complying with various provisions of SQC 1, SA 220 and SA 230.

11.2. NFRA has examined in detail the replies dated 03-07-2020 submitted by the Audit Firm on above matters and observes as follows:

11.2.1. In page 455 of the reply, the Audit Firm submits that "EQCR review of audit file is clearly documented in the Program for engagement quality review – Part A with respect to review of audit strategy by EQCR and Program for engagement quality review – Part B with respect to review of workpapers pertaining to execution of audit." The Audit Firm further states that the involvement of EQCR can be proved from the signed working papers. In this regard NFRA observes that:

11.2.2. EQCR has claimed to have reviewed multiple audit work papers (WP P.6.3 Program for Engagement Quality Review in hard copy binder), but there is not a single paper in the Audit File where there is any evidence that the EQCR has carried out objective analysis or review.

11.2.3. 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. No such independent evaluation has been done by the EQC reviewer.

11.2.4. In view of the above stipulation in SA, the Audit Firm's contention that EQCR's signing of work papers is sufficient proof of his involvement and documentation of the review performed by him is clearly unacceptable. Moreover, it is also clearly contradictory to SRBC's own documentation policy which states that **"Signing off on an audit procedure or task may not be sufficient documentation that a procedure was performed, evidence was obtained or a conclusion was reached.** As we prepare our documentation, we choose our words carefully and ask ourselves whether **what we write would be clear to an auditor who has no previous connection to the audit**." (Emphasis added). (Refer page 521 of 1152 of GAM DOC+ARC- India (Version December 2018).

11.2.5. The word "document" cannot be interpreted to mean mere 'yes' or 'no' responses to a set of standard questions prepared as a general all purpose template. The documentation needs to have specific reference to the facts of the case in question, the factors evaluated, and must provide the evidence as required by the SAs, all taken together.

11.2.6. The only indication of EQC review is the standard sentence in the WPs that, "I have evaluated the team's documented judgements and conclusions in relation to these matters and have assessed them as appropriate", as the conclusion to each of the questions in the checklist (WP 'Program for Engagement Quality Review'). Such an assertion has no value unless supported by documents/WP to show that actual evaluation has been done by the EQC reviewer, discussions were held between the EP and EQCR, and resolutions were reached. Without such evidence, the documentation will not "enable an experienced auditor having no previous connection with the audit" to understand, the work that has been performed by the EQCR Team.

11.2.7. The documentation policy of the Audit Firm recognises the above position of the SAs when it states that "The engagement quality control reviewer signs the applicable Review and Approval Summary (RAS) and further documents review procedures in the Program for Engagement Quality Control Review." (Page 615 of 1152 of DOC + ARC policy). This makes it clear that the practices actually followed by the Audit Firm with respect to EQCR are contradictory to its own policies, which stipulates that the EQCR should document his review procedures.

11.2.8. In page 454 of the reply, the Audit Firm states that "SRBC further submits that, SRBC is not aware of any SAs that require documentation of review comments by EQCR or EP on the audit workpapers file since all review comments are required to be resolved before issuance of audit report and the EP and EQCR ensure that they do not signoff the audit documentation until such review comments have been resolved." It further states that EQCR is required to maintain documents as per the requirements of SA 220 only and SA 230 is not applicable to EQCR. In this regard NFRA observes that:

11.2.9. The mandatory requirements of the SAs have to be considered holistically and harmoniously. It is not acceptable to look at any single extract from the SAs in a manner that ignores the overall context. It is, therefore, necessary to consider the "Nature and Purpose of Audit Documentation" (Para 2 and 3 of SA 230) as providing the overall context for audit documentation. Furthermore, Para 8 to 11 of SA 230 dealing with the Form, Content and Extent of Audit Documentation will also have to be considered.

11.2.10. Para 3 of SA 230 clearly states that Audit documentation serves several additional purposes including "enabling the conduct of quality control reviews and inspections in accordance with SQC 1". The footnote to Para 3 gives references to Paragraphs 60, 63 and 65 of SQC 1. Paragraph 60 of SQC 1 relates to policies and procedures regarding EQCR. Para 63 is about the criteria for eligibility of EQCR. Para 65 brings out matters to be included in the EQCR including evaluation of firm's independence, significant risk identified during the engagement, judgments made particularly with respect to materiality and significant risk etc. Hence the argument of the Audit Firm that EQCR is not required to retain the inputs/observations/comments is misleading.

11.2.11. Further, the implementation guide to Standard on Auditing for SA 230 specifically states that the specific documentation requirements of other SAs **do not limit the application of SA 230**. Thus, the **documentation requirements mentioned in other SAs are in addition to what is required by SA 230**. The guide also states that the absence of documentation requirements in any particular SA is not intended to suggest that there is no documentation that needs to be prepared as a result of complying with that SA. Documentation appropriate to the SA needs to be maintained. Thus, the contention of the Audit Firm that only the documentation requirements of SA 220 need to be complied with is wrong.

11.2.12. Further, even if the convoluted logic of the Audit Firm that SA 230 is not applicable to EQCR is accepted, the documentation of discussions between the EQCR team and EP is also required from the perspective of the ET.

11.2.13. Para 25 of SA 220, states that the engagement quality control reviewer shall document, for the audit engagement reviewed:

i. *The procedures required by the firm's policies on engagement quality control review have been performed;*

ii. *The engagement quality control review has been completed on or before the date of the auditor's report; and*

iii. *The reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the ET made and the conclusions they reached were not appropriate.*

11.2.14. Thus, Para 25 of the SA requires documentation of the EQCR process and other various requirements. Mere confirmation relating the issues covered by Para 25 in a yes/no format is not sufficient compliance of the SA. EQC reviewer should have documented its working properly and separately from the working of the Audit team.

11.2.15. The argument made by the Audit Firm that "after resolving the review comments the previous copies and superseded documents are not required to be retained on the final audit documentation" is not tenable. It has already been made clear in the above paras that the EQC reviewer is required to do objective evaluation of the significant judgments of the ET for which separate working and documentation is required to be done by EQC reviewer, which is not available in any of the WP provided by the Audit Firm. The Audit Files does not provide any evidence of the proper and complete performance of EQC reviewer's work.

11.2.16. Moreover, the EQC reviewer failed to point out the deficiencies noted by NFRA in the other paras of this DAQRR (assessment of going concern, deficiencies in assessment of Risk of Material Misstatements, Proper valuation of investments and loans, Reversal of ECL, Interest free loans provided by ITNL to JVs and Subsidiaries, Derecognition of borrowings, Disclosure of Financial Guarantees, Assessing revenue from operations, matter of Khed Sinnar Expressway Limited (KSEL)). The EQC reviewer has not pointed out even a single deficiency and there is no evidence in the audit working papers of the EQC reviewer being at least aware of such matters. NFRA's observations in other portions of this DAQRR are substantive evidence of the inadequacy of the EQCR system.

11.3. On consideration of all the above evidence, NFRA therefore reiterates its conclusions made in the PFC that:

i. 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.

ii. The EQCR partner failed to report material misstatements known to him to appear in a financial statement with which he is concerned in his professional capacity.

iii. The EQCR partner did not exercise due diligence to obtain sufficient information to objectively evaluate the significant judgments of the ET and conclusions reached by them.

iv. The exaggerated claims of the Audit Firm about involvement of EQCR Partner are clearly unsupported by evidence and the Audit Firm has failed in complying with various provisions of SQC 1, SA 220 and SA 230.

11.4. NFRA has examined in detail the replies dated 10th July, 2021 and the oral submissions made by the Audit Firm (replies to the DAQRR) regarding the observations in the DAQRR. The Audit Firm has denied all the observations of NFRA by repeating their earlier replies to the PFC and the DAQRR. The Audit Firm has not referred to any new WP where EQCR has documented the works done by it. All the WPs referred by the Audit Firm have already been examined by NFRA.

11.5. The Audit Firm's contention that an objective evaluation of significant judgments made and conclusions reached by the engagement team is possible by simply reading the WPs prepared by ET, without leaving any documented evidence of the specific nature of the review undertaken by the EQCR, shows the casual manner in which the EQC review process has been carried out by the Audit Firm. In such an approach, there is no room for ensuring that the reviewer's objectivity and independence is not compromised. In this regard para 70 and 71 of SQC 1 may be recalled where the importance of objectivity of the EQC Reviewer is emphasized. Also, if the work of the EQCR is not separately identifiable from that of the ET then the accountability of the EQCR becomes non-measurable.

11.6. In case of such large, listed companies like ITNL, whose audit involves dealing with very complex accounting matters and adjustments, an objective review process is impossible by just going through the WPs prepared by the ET alone. Ticking a yes/no checklist and signing on the WPs of the ET are not sufficient evidence to prove that the EQCR has done an objective evaluation of the significant judgments the ET made and the conclusions they reached in formulating the report. A checklist can only be taken as a means to ensure that no significant matter is overlooked or ignored, and not as final evidence of the actual review performed by the EQCR. Simply signing some of the documentations of the ET also does not provide evidence that the EQCR has in fact performed an independent examination.

11.7. The work of EQCR also involves application of professional judgment in several significant matters. It is most unlikely that in all cases the EQCR also reached at the same professional judgment as that of the ET (had it been in fact the case of an objective evaluation). Once the work involves making professional judgments, documentation of such judgments separately from that of the ET is obvious and is mandated in the SAs. In this context, as already explained by NFRA, documentation requirements of SA 230 become important for the EQCR as well. Thus, it is clear enough that the documentation of an engagement quality control reviewer also should contain sufficient information to enable an experienced auditor, having no previous connections with the engagement to understand the procedures performed by the EQCR. This does not mean that the EQCR should reproduce all the documentation made by the ET. However, the EQCR shall clearly document how he used the data of ET and what are the factors he considered in his evaluation to agree or dispel the conclusions reached by the Audit Firm. The EQCR team is required to document reasons and the bases for its conclusions, the review procedures adopted, the professional judgments it made, areas in which the EQCR challenged the audit team, the significant matters the EQCR discussed with the audit team, areas of disagreements, the resolutions reached, and the additional evidence/documents/explanations considered in such cases. Merely providing check box "Yes or "No" responses and signing the WPs of ET does not give any such evidence.

11.8. Notwithstanding the above, NFRA has examined in detail all the replies of the Audit Firm. NFRA reiterates that the exaggerated claims of the Audit Firm about involvement of EQCR Partner are unsupported by evidence and the Audit Firm has thus failed to comply with the various provisions of SQC 1, SA 220 and SA 230. Because of the reasons explained clearly in the above paras, NFRA rejects all the contentions of the audit firm, some of which are reproduced below. Additional grounds are provided wherever required.

11.8.1. On page no. 738 of their reply, *"SRBC submits that the objective evaluation of significant judgements made, and the conclusions reached by engagement team can also be done by review of the workpapers prepared by the engagement team and does not necessarily entail preparation of separate workings."*

11.8.2. *"SRBC submits that the extracts of DOC+ARC policy quoted by NFRA in para 11.2.4 of DAQRR is applicable to the documentation prepared by audit engagement team and is not applicable in case of EQCR. For EQCR, SRBC has a separate* *policy with respect to Engagement and Other Quality Control Reviews extract from which have been quoted by NFRA in para 11.2.7 of DAQRR."* Quoting the extracts from policy the Audit Firm states that, *"Thus an EQCR signs off the RAS only when, based on his evaluation he is satisfied that the audit procedures performed, judgements made and conclusions reached by the engagement team are adequate and sufficient appropriate audit evidence has been obtained by the engagement team to support the audit opinion. Accordingly, SRBC had complied with the requirements of the EQCR policy and is unable to understand NFRA's comment that the practices actually followed by SRBC with respect to EQCR are contradictory to its own policies."* The Audit Firm's contention that by signing off the *Review and Approval Summary (RAS)* and other WPs the involvement of the EQCR can be proved is not tenable. There is no record of any discussion the EQCR held with the ET, and no evidence of independent analysis carried out by the EQCR team. There is no proper documentation of review procedures in the WP *'Program for Engagement Quality Review'*. A single statement is repeated throughout the WP that, *"I have evaluated the team's documented judgments and conclusions in relation to these matters and have assessed them as appropriate."* Such an assertion has no value unless supported by documents/WP to show that actual evaluation has been done by the EQC reviewer. Further, it must be noted that the extract of DOC+ARC policy that, *"Signing off on an audit procedure or task may not be sufficient documentation that a procedure was performed, evidence was obtained or a conclusion was reached"* is a general understanding and not limited only, or specific, to the Engagement Team's documentation.

11.8.3. On page no. 741 to 743 the Audit Firm has referred to various WPs stating that the EQCR has reviewed all these WPs in detail and has thus complied with the requirements of para 64 and 65 of SQC 1 and para 25 and A 29 of SA 220. Also it states that, *"Accordingly, the EQCR's time logs along with his signoff on audit workpaper file demonstrate that EQC review was appropriately performed by EQCR."* However, the Audit Firm has not referred to any new WP where EQCR has documented any of its review procedures.

11.8.4. On page no. 746 of its response the Audit Firm states that, "SRBC submits that while mandatory requirements of the SAs have to be considered holistically and harmoniously, it should not lead to requirements that are not intended/ not envisaged/ not mandatorily required by the SAs to be superimposed on the auditor. As a firm, SRBC has adopted and practiced compliance with internal policies that raise the bar way above what the Standards require. However, we strongly object to the fact that NFRA reviewer has been making disparaging remarks about the quality of work of SRBC based on his conjectures, surmises and imaginative requirements."

11.8.5. The Audit Firm states that the requirements of SA 230 are not applicable on EQCR and the only documentation requirements applicable for EQCR are as per para 25 of SA 220. It further states that, *"Since NFRA reviewer was unable to demonstrate any specific requirements with respect to documentation of procedures performed by EQCR within the realms of SQC 1 and SAs, vague reasons have been provided based on incorrect interpretations of SAs and footnotes to achieve a predetermined and biased conclusion."* The Audit Firm quotes various paras of SQC 1 and other SAs and states in page no 750 of its response that, *"In accordance with the above* *requirements of SA, the engagement team documented in relevant workpapers the nature, timing and extent of audit procedures, the results of audit procedures performed and the audit evidence obtained and significant matters and conclusions reached thereon and the significant professional judgements made in reaching those conclusions. Further, the audit workpapers also contain details of audit workpapers reviewed, who reviewed and when." … "With respect to EQCR review, the audit workpaper includes Program for Engagement Quality Reviews (Refer hard copy binder Part 6 of 6 page no P.6.3.1, P.6.3.2 and P.6.3.1) which summarized what was reviewed by the EQCR and when it was reviewed. Further, the EQCR's signoff on RAS (Refer hard copy binder Part 4 of 6, P.4.4 and P.4.5) evidences completion of all reviews and closure of review notes to the satisfaction of the EQCR."* It also states that, *"In case of EQCR, there is specific audit requirement under SA 220 and hence there is no "absence" of a documentation requirement as being interpreted by NFRA."* The Audit Firm further states that even if one were to implement Q&A 18 (of Implementation Guide to Standard on Auditing for SA 230) which states that *Documentation appropriate to the circumstance needs to be maintained, "SRBC submits that it has maintained sufficient appropriate documentation as required by the polices framed by SRBC with respect to EQCR and which is considered to be appropriate with respect to the then prevailing circumstances up to the date of issuance of the audit report."* In page no. 735 of its response the Audit Firm states that, *"there is no requirement in SQC 1 or SAs for the EQCR to have separate working and documentation with respect to his evaluation. Further reference to workpapers reviewed and evaluated by EQCR have been provided to NFRA which NFRA has failed to appreciate."*

11.8.6. Read with para 11.4 to 11.7, it is reiterated that it is not acceptable to look at any single extract from the SAs in a manner that ignores the overall context. It is, therefore, necessary to consider the "Nature and Purpose of Audit Documentation" (Para 2 and of SA 230) as providing the overall context for audit documentation. Furthermore, Para 8 to 11 of SA 230 dealing with the Form, Content and Extent of Audit Documentation will also have to be considered. Thus, the Audit Firm's contention that SA 230 is not applicable on EQCR is a limited narrow reading of the SAs and hence not tenable. The Audit Firm's contention that it has considered the requirements of the SAs holistically and harmoniously is absolutely baseless.

11.8.7. The Audit Firm's contention that it has maintained documentation appropriate to the circumstance as required by the *'Implementation Guide to Standard on Auditing for SA 230'* is absolutely baseless. The Audit Firm has out rightly denied the applicability of SA 230 on EQCR. Further, even with regard to the requirements of para 25 of SA 220 mere confirmation relating the issues covered by Para 25 in a yes/ no format is not sufficient compliance of the SA. EQC reviewer should have documented its working properly and separately from the working of the Audit team. Without such evidence, the documentation will not "enable an experienced auditor having no previous connection with the audit" to understand the work that has been performed by the EQCR Team. Further, even though there are separate documentation requirements in SA 220 with regard to EQCR, still documentation appropriate to the circumstances needs to be maintained, it cannot be restricted to only those that are specifically listed in the SA.

11.8.8. Regarding NFRA's observations on EQCR's failure to point out deficiencies observed in other paras of the DAQRR (assessment of Going Concern, deficiencies in assessment of Risk of Material Misstatements, Proper valuation of investments and loans, Reversal of ECL, Interest free loans provided by ITNL to JVs and Subsidiaries, Derecognition of borrowings, Disclosure of Financial Guarantees, Assessing revenue from operations, matter of Khed Sinnar Expressway Limited (KSEL)) the Audit Firm has simply repeated its replies of the PFC, stating that EQCR reviewed and objectively evaluated all the WPs, the significant judgments made and conclusions reached by the engagement team.

11.9. On consideration of all the above points, NFRA therefore reiterates its observations made in the DAQRR and concludes that:

i. 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.

ii. The EQCR partner failed to perform his duties and also failed to report material misstatements known to him to appear in a financial statement with which he is concerned in his professional capacity.

iii. The EQCR partner did not obtain sufficient information to objectively evaluate the significant judgments of the ET and conclusions reached by them.

iv. The exaggerated claims of the Audit Firm about involvement of EQCR Partner are clearly unsupported by evidence and the Audit Firm has failed in complying with various provisions of SQC 1, SA 220 and SA 230.

12.

12. EVALUATION OF COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE (TCWG)

12.1. NFRA has conveyed the following prima facie conclusions:

12.1.1. Requirements from SAs

i. The Audit Firm is required to determine the appropriate persons within the entity's governance structure with whom to communicate. (Para 11, SA 260 Revised)

ii. Requirement of matters to be communicated to TCWG by the auditor includes, inter alia, planned scope and timing of audit, significant risks identified by the auditor (Para 15, SA 260 Revised), qualitative aspects of the entity's accounting policies including what is acceptable under the applicable financial reporting framework but not appropriate to circumstances of the entity, and any other significant matters arising during the audit that are relevant to the oversight of the financial reporting process (Para 16, SA 260 Revised).

iii. In the case of listed entities, the auditor shall communicate a statement that the engagement team and others in the firm as appropriate, the firm and the network firm have complied with relevant ethical requirements regarding independence. The auditor is also required to communicate all relationships and other matters between the firm, network firms, and the entity that may reasonably be thought to bear on independence, and related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level. (Para 17, SA 260 Revised).

iv. The auditor is required to communicate with TCWG on a timely basis. (Para 22, SA 260 Revised)

v. Where matters are communicated orally, the auditor is required to document the same in the audit file. (Para 23, SA 260 Revised).

12.1.2. The Audit Firm has not determined the persons comprising TCWG. It is noted that the Audit Firm have identified and communicated with the same three persons as management and TCWG.

12.1.3. NFRA has not found any communication relating to Auditor's independence, and the relationships and other matters between the firm, network firms, and the entity that may reasonably be thought to have a bearing on the independence as was mandatorily required in case of listed companies as referred above.

12.1.4. NFRA notes that the Audit Firm has not communicated the planned scope and timing of audit in any of the workpapers as referred. Further, following significant matters as identified by the auditor have not been communicated:

i. Investment in Srinagar Sonmarg Tunnelway Limited by Company: The cost of investment of Rs 195crore included deemed equity of Rs 90crore. As evident from the Hard File No 13(Cash flow-"Srinagar Sonmarg Tunnelway Limited) the Audit Firm not only failed to communicate its concern on use of "deemed equity", a nonaccounting concept, it did not even enquire or communicate to the TCWG regarding the reason for including deemed equity in the cost of investment, authenticity of cash flows and the appropriateness of impairment testing process performed by the Management.

ii. Investment in ITNL International Pte Ltd: The Company has investment worth Rs 779.92 crore in the Standalone Financial Statements as on reporting date. No inquiry has been made by the Audit Firm to understand the nature of business of the foreign entity and safety of the Company's funds invested in such overseas entity was done by the Audit Firm with the TCWG. Neither, any cash flows in foreign currency were found in the Audit file for the purpose of impairment testing.

iii. Financial Guarantee Valuation and Disclosure: There is no communication between TCWG and Audit Firm regarding the valuation and measurement of financial liabilities under the Liabilities Section of the Balance Sheet as required by provisions of Ind AS 109.

12.1.5. The Audit Firm has neither evaluated qualitative aspects of the entity's accounting policies including what is acceptable under the applicable financial reporting framework (FRF) but not appropriate to circumstances of the entity, nor communicated the same with the TCWG.

12.1.6. As observed by NFRA in Risks of Material Misstatements and Investments above, the Audit Firm has not communicated other significant matters arising during the audit that are relevant to the oversight of the financial reporting process such as:

12.1.7. Going Concern Issue - Two members of TCWG explained that the management has a plan to address liquidity issue which comprises of:

i. Rights issue of Rs.1500 crore;

ii. Monetisation of 8-10 assets (unidentified) - Rs.800 crores;

iii. Realisation of claims including termination payments – Rs.3,000 crore

iv. Cash flows from an EPC project – Rs.644 crore;

v. Other initiatives like working capital rationalisation etc.

12.1.8. It has been recorded in the minutes, which has not been signed by the participants, that these members of the TCWG were very confident of achieving the management plan and raising funds through above the strategic initiatives.

12.1.9. Based on the discussion held with the TCWG alone , the Audit Firm has formed its opinion on the Going Concern assumption of preparation of financial statements. The Audit Firm, however, failed to document appropriate records, including the cash flow projections of the Management, as required by Para A14 of SA 230, relating to the management plan based on which the TCWG was confident of addressing the liquidity/ Going Concern issue which was agreed to and considered by the Audit Firm for forming its opinion on the issue.

12.1.10. Company's Exposure in investments in Noida Toll Bridge Company Limited: It is noted that two of the members of TCWG explained that the SPV had sought legal opinion based on which management was confident that the underlying value of the investment was not impaired. Agreeing to the discussion, the Audit Firm had decided to continue with the Emphasis of Matter paragraph in the audit report.

12.1.11. The Audit Firm, however, failed to communicate and document its assessment/evaluation of legal opinion based on which the TCWG was confident that the underlying value of the investment was not impaired which was agreed to and considered by the Audit Firm for forming its opinion on the issue as required.

12.2. Prima facie conclusion: The Audit Firm is found to have:

i. not exercised due diligence, or are grossly negligent in the conduct of their professional duties;

ii. 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.

12.3. The Audit Firm has responded to the prima facie conclusions of NFRA in its written response dated July 3rd, 2020. This has been examined by NFRA in detail and NFRA's conclusion on each of the issues are as follows:

Identification of the persons comprising TCWG

12.4. On this subject the Audit Firm states in page 491 to 493 of their reply that "In accordance with SA260 (Revised), SRBC has determined following members as those charged with governance" and then provides a list of 8 officers of the Company (the same list of persons provided in written response to PFC dated July 3rd, 2020). The Audit Firm refers to presentation and discussions with the Audit Committee as compliance with the requirements of SA 260. NFRA observes in this regard that:

12.4.1. The Audit Firm has provided the list of persons comprising TCWG as a response to the prima facie conclusions of NFRA, without being supported by any evidence, and hence it is an afterthought and not acceptable. No WP reference has been given by the Audit Firm with respect to the given list of purported TCWG. Hence the Audit Firm has completely failed to determine the persons comprising TCWG as required by para 11 of SA 260 (Revised) which stipulates under the heading "Those Charged with Governance" that "The auditor **shall determine** the appropriate person(s) within the entity's governance structure with whom to communicate". (Emphasis added).

12.4.2. Communications with Audit Committee falls under "Communications with a subgroup of TCWG" as per Para 12 and A7 of SA 260 (Revised). Further Para A7 of SA 260 (Revised) states that communication with Audit Committee where one exists, has become a key element in determining auditor's communication with TCWG. It is pertinent to note the requirements of Para A5 of SA 260 (Revised) wherein it is clearly stated that when considering communication with a subgroup of TCWG the auditor may take into account matters such as **whether the subgroup has the authority to take action in relation to the information communicated, and can provide further information and explanations the auditor may need.** The Audit Committee Meetings, as referred by the Audit Firm in their response to the PFC, were for reviewing the Interim Financial Information and the presentations made in those Audit Committee Meetings, can in no way be construed as communications with TCWG, wherein the auditor communicates significant findings from the audit with TCWG so that the TCWG may take timely action. More importantly SA 260

(Revised) envisages written communication and proper documentation of such communication (Paras 19, 20 and 23). Thus, the Audit Firm's claims that they had fulfilled the requirements of SA 260 (Revised) are not true to the facts.

12.4.3. Therefore, the Audit Firm has **failed to identify the persons comprising TCWG**, in terms of requirements of Para 11 of SA 260 (Revised). Further, in order to determine the TCWG, the Audit Firm should have determined the governance structure of the auditee Company and the respective responsibilities of the subgroup (Audit Committee) and its Governing body. However, WPs, as referred by the Audit Firm, do not give any information as to the auditor's understanding of the governance structure or its understanding of the responsibilities of the Audit Committee and the Governing body.

12.4.4. By not identifying, and not communicating effectively with, TCWG, the Audit Firm failed to comply with the basic and fundamental requirement of SA 260 (Revised), resulting in failure to achieve all the objectives of SA 260 (Revised) as stated in paras 9 (a) to 9 (d) of the said SA.

Communication of the planned scope and timing of audit

12.5. The Audit Firm has referred to WPs (Refer WP 'ITNL TPE Minutes March 2018', hard copy file 1 - pages A1-86 to A1-89) in support of their communications of the planned scope and timing of the Audit. NFRA has examined the referred WPs and found that these are details of internal team planning meeting attended by the Engagement Partner, Engagement Quality Review Partner, Engagement Team members along with Direct & Indirect Tax, Valuation and ITRA Team Members of SRBC, and **no member of TCWG from the Auditee Company were in fact present in the meeting**. Further Para 15 of SA 260 (Revised) requires the auditor to communicate with TCWG an overview of the planned scope and timing of audit, which includes communications about the significant risks identified by the auditor. Since no member of the TCWG from the Auditee company were present and no written communication is documented in the Audit File, the requirements of Para 15 of SA 260 (Revised) are not complied by the Audit Firm.

12.6. Para 9(a) of SA 260 (Revised) states the objective of the SA wherein it is mentioned that the objective of an auditor is to communicate clearly with those charged with governance the responsibilities of the auditor in relation the financial statement audit, and an **overview of the planned scope and timing of the audit.** Since there is not any WP having the details as required to be communicated as per para 15 of SA 260 (Revised), which supports the claim that planned scope and timing of audit was in fact communicated **to TCWG by the Audit Firm,** NFRA concludes that the Audit Firm has failed to meet the objectives of SA 260 (Revised) and hence is grossly negligent in discharge of its duties.

Evaluation of qualitative aspects of the entity's accounting policies including what is acceptable under applicable Financial Reporting Framework

12.7. On this subject the Audit Firm submits that the accounting policies followed by the Company were in accordance with Indian Accounting Standards ("Ind AS") and based on the audit procedures performed, the Audit Firm had not come across any non-compliance with respect to application of Ind AS and requirements of Companies Act, 2013. Further, the reply states in page 501 that "*we have also not observed any qualitative aspects of the entity's accounting policies that are acceptable under Ind AS but not appropriate to circumstances of the entity*". In this regard Para 16(a) of SA 260 (Revised) stipulates that the auditor **shall** communicate with TCWG his views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. Further Para A19 read with Para A20 of SA 260 (Revised) require that the auditor's views on the subjective aspects of the financial statements may be particularly relevant to TCWG in discharging their responsibilities for oversight of the financial reporting process. Hence, on a plain reading of the requirements of Para 16(a), A19 and A20 of SA 260 (Revised), it is clear that irrespective of whether there is any non-compliance with respect to application of Ind AS and the requirements of Companies Act, 2013, or not, the Audit Firm is required to communicate with TCWG about the significant qualitative aspects of entity's accounting practices. However, as seen from the Section regarding ECL in this DAQRR, the Audit Firm has failed to discuss the accounting policy of interest free loans and ECL in accordance with provisions of Ind AS 109. NFRA has also observed that there is no discussion of qualitative aspect of revenue recognition policy with the TCWG (section dealing with 'Revenue Recognition' in this DAQR).

12.8. Therefore, the response of the Audit Firm is not acceptable and NFRA concludes that the Audit Firm has neither evaluated qualitative aspects of the entity's accounting policies nor communicated the same with the TCWG, as required by Para 16(a) of SA 260 (Revised).

Communication on timely basis significant matters arising during the audit

12.9. On this subject the Audit Firm has made the following submissions in page 502 to 505:

i. Audit Firm had multiple rounds of discussion with management and a final discussion with Chief Financial Officer on May 28, 2018 wherein the management mitigation plan including cash flow projections were discussed. The above meeting was followed by meeting with TCWG i.e. non-executive directors of ITNL (who was also the executive director of the parent Company i.e. IL&FS), the Managing Director and the Chief Operating Officer and the Vice Chairman & Managing Director of the parent Company IL&FS who was also a member of Board of Directors of ITNL on May 28, 2018 wherein they had detailed discussions with them with respect to the management mitigation plan including the cash flow projections.

ii. SRBC also had a detailed discussion with the audit committee members in the meeting held on May 29, 2018 with respect to the management's assessment of going concern and the management mitigation plan including the cash flow projections.

iii. The minutes of the meeting with TCWG on May 28, 2018 is part of their audit workpaper which was in accordance with the requirements of para 23 of SA 260 (Revised). There is no requirement to obtain signoff from all participants.

12.10. NFRA has examined the above contentions of the Audit Firm and observes that:

12.10.1. Para 16(c) of SA 260 (Revised) requires that, the auditor **shall** communicate with those charged with governance, the significant matters arising during the audit with management. Para 21 of SA 260 (Revised) requires the auditor to communicate with TCWG on a **timely basis**. Further, para A50 of SA 260 (Revised) makes it clear that the timely communication means the communication at the time at which the auditor identifies certain matters for preventive actions to be taken.

12.10.2. The objective of the auditor as mentioned in Para 9(c) of 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 had stated that they had discussed the significant observations with Management and TCWG on May 28, 2018 and further discussed them with Audit Committee members on May 29, 2018 in Audit Committee Meeting.

12.10.3. However, in Audit Committee Presentation Slides, under "Management Estimates and Judgements", NFRA had found that none of the slides have Audit Firm's observations or significant findings on their evaluation of judgements and estimates provided by the management of the company. These presentation slides only have details/ information about Management's Estimates and Management's views thereon. Therefore, the contention of the Audit Firm that it has communicated the significant observations in Audit Committee Meeting held on May 29, 2019 is not acceptable.

12.10.4. Further, as detailed above, timely communications mean the communication at the time at which the auditor identifies certain matters for preventive action to be taken and not at the date of the Audit Committee Presentation (May 29, 2018) or Discussion with Management (May 28, 2018) when the Audit Report was signed on May 29, 2018. Hence, the Audit Firm, is found to have violated Para 16(c), 21 and A50 of SA 260 (Revised) and has also failed to meet the objectives of SA 260 (Revised) as stipulated in Para 9(c).

12.11. NFRA therefore, reiterates all its conclusions in the PFC and concludes that the Audit Firm has not complied with SA 260 (Revised) and hence:

i. Failed to achieve any of the objectives of SA 260 (Revised).

ii. Not exercised due diligence and are grossly negligent in the conduct of their professional duties.

iii. The Audit Firm neither determined the persons comprising TCWG nor communicated the matters which are required to be communicated to TCWG and grossly failed to discharge its professional duties.

12.12. The Audit Firm, in its written response dated July 10th, 2021, has responded to the above observations of NFRA. This has been examined in detail and NFRA's conclusion on each of the issues are as follows:

Identification of the persons comprising TCWG

12.13. In this respect the Audit Firm states as follows in page no. 770 to 777 of its response to DAQRR:

12.13.1. The Audit Firm has again provided the same list of 8 officers of the Company that it submitted in its reply to PFC stating that it had identified these 8 people as TCWG. The Audit Firm has further referred to WP (Refer hard copy file no. 1 A1-58 to A-1-61 and Canvas file "Organisation Chart.pdf") where it has claimed to have obtained an understanding of the business and organisation structure and governance structure.

12.13.2. "SRBC further submits that para 11 of SA 260 (Revised) merely requires auditor to determine the appropriate person(s) within the entity's governance structure with whom to communicate. SA 260 (Revised) does not require any specific documentation to be maintained in audit file with respect to determination of TCWG by the auditor."

12.13.3. Further, the Audit Firm has referred to various WPs and submits that, "From the Understanding the Business form, Organization structure, Audit Committee Meetings, Managing Director and CFO discussions it is very much implied that there is a proper identification and communication with TCWG. (Refer 102GL UTB in hard copy file 1 page no A1-46 to A1-64, refer zip file in canvas "ITNL Entity Level Controls – Policies March 2018" and within that file "Organisation Chart", refer summary of minutes hard copy file 1, A2-1 to A2-11, refer Canvas file "MCA", refer minutes of CFO meeting in hard copy binder Part 6 of Binder page no P.6.4.3, refer minutes of meeting with directors in hard copy binder Part 6 page no P.6.4.2)"

12.13.4. "SRBC submits that the year-end audit commenced from November 2017 and up to the conclusion of the audit i.e. date of signing of the audit report May 29, 2018, SRBC had communicated continuously with TCWG throughout the audit period which includes initial client planning meeting, team planning event, discussion with CFO and Company Secretary & Legal head for discussion on accounting and auditing matters, meetings with Managing Director and meeting with Audit committee and non-executive directors." The Audit Firm has referred to various WPs related to meetings with various Company officials.

12.13.5. Audit Firm further states that, "SRBC is shocked at NFRA's outright rejection of SRBC's submission without giving it a thought and without explaining why those meetings cannot be considered for the purpose of communication with TCWG. It also indicates NFRA reviewer's lack of experience and knowledge about how the audit committees' function and discussions and communications take place with them and is evidence of a premeditated bias."

12.14. NFRA has examined the Audit Firm's responses and all the WPs referred by it in this regard and observes as follows:

12.14.1. As already observed, the list of 8 officials provided by the Audit Firm in its response is nowhere documented in the audit file. Thus, without the supporting documents NFRA considers the reply of the Audit Firm as an afterthought. Further, the Audit Firm's response that "SA 260 (Revised) does not require any specific documentation to be maintained in audit file with respect to determination of TCWG by the auditor" clearly shows the lack of understanding of the Audit Firm. Para A3 of SA 260 (Revised) states that it is not possible for this SA to specify for all audits the persons with whom the auditor is to communicate particular matters, therefore the auditor may need to discuss and agree with the engaging party the relevant persons with whom to communicate. In this regard para 2 and 3 of SA 230 may also be recalled. Unless the basic matters such as identification of TCWG, which is a mandatory requirement of SA 260, is documented, then it is as good as there being no evidence that the audit was planned and performed in accordance with SAs (para 2 of SA 230). Such documentation will not serve some of the additional purposes of documentation as given in para 3 of SA 230.

12.14.2. The WP 102GL UTB.pdf (Hard copy file no. 1, A1-58 to A1-61) documents the shareholding pattern of ITNL and an introduction of various officers of the Company. The WP 'Organisation Chart.pdf' does not contain even the names of all of the 8 officers mentioned by the Audit Firm in its list. Besides, it was approved in May 2016, thus it is not an updated version of the document. Moreover, the Audit Firm has not identified any person as TCWG in the WPs mentioned. Further, as evident from the succeeding paras, none of the other WPs referred by the Audit Firm demonstrate compliance with the requirements of Para 11 of SA 260 (Revised). Thus, in the absence of relevant WPs the Audit Firm's contention that it is in compliance with the requirements of SA 260 Revised is not acceptable.

12.14.3. With reference to the submission in para. 12.13.3 above, NFRA examined all the WPs referred to by the Audit Firm and observes that there is no documentation of identification and communication with TCWG in all those WPs. The WP '102GL UTB' and 'ITNL Entity Level Controls – Policies March 2018' are the internal documents of the Audit Firm documenting the understanding of the entity and the entity level controls. The WP 'ITNL-Summary of Minutes' is only a synopsis of minutes of meetings of different committees of ITNL held during the year ended March, 2018. The WP 'MCA' is a Management Committee Approval memorandum regarding various projects.

12.14.4. The table below shows the other WPs referred by the Audit Firm and NFRAs analysis of those WPs:

<table>
<tr><th>Audit Phase</th><th>Particulars</th><th>Date</th><th>WP reference</th><th>NFRAs Comments</th></tr>
<tr><td rowspan="4">Planning</td><td>Client planning meeting</td><td>November 1, 2017</td><td>Hard copy file 1, Page No A1-68 to A1-71</td><td>This is a document in which the Audit Firm has documented the preliminary information gathered about the company to plan the audit (i.e. before the audit planning was done)</td></tr>
<tr><td>Team Planning Event</td><td>November 20, 2017</td><td>Hard copy file 1, pages A1-86 to A1-89</td><td>This is an internal meeting held among the engagement team members. None of the officers/employees of ITNL were present in this meeting.</td></tr>
<tr><td>Meeting with CFO</td><td>February 1, 2018 and February 5, 2018</td><td rowspan="2">Minutes of the meeting with CFO/ MD and presentation to the Audit committee</td><td rowspan="2">These minutes of meeting referred by the Audit Firm are not available in the Audit File.</td></tr>
<tr><td>Meeting with MD</td><td>February 8, 2018</td></tr>
</table>

	Audit committee meeting	February 8, 2018	documented in limited review file for quarter ended December 31, 2017	
Execution / Conclusion	Meeting with CFO	Meeting on various dates throughout the audit to discuss the accounting and auditing matters including the final meeting on May 28, 2018	Refer Minutes of CFO meeting in hard copy binder Part 6 of Binder page no P.6.4.3	Refer point no. 12.20 of this AQR for NFRA's analysis of this WP.
	Meeting with MD and non-executive Directors	May 28, 2018	Minutes of meeting with TCWG in hard copy binder Part 6 of Binder page no P.6.4.2	Refer point no. 12.20 of this AQR for NFRA's analysis of this WP.
	Audit committee meeting	May 29, 2018	Audit Committee Presentation in hard copy binder Part 5 of 6 page no P.5.3	Refer point no. 12.20 of this AQR for NFRA's examination of this WP.

12.14.5. After examining all the WPs mentioned by the Audit Firm, NFRA concludes that none of the WPs are relevant for establishing the fact that there was timely and a two way communication with TCWG of all the significant matters identified by the Audit Firm. Further, as observed by NFRA in point no 12.14.1 above, the Audit Firm has not referred to any relevant WPs where it has taken a full-fledged understanding of the governance structure of the Company in order to determine the TCWG. The Audit Firm's futile reliance on such random WPs, to somehow establish that the audit was performed in accordance with SA 260 (Revised), is itself a proof that the audit is not conducted as per SAs. There is no proper documentation of communication with TCWG as required by para 19, 20 and 23 of SA 260 Revised.

12.14.6. Communications with Audit Committee falls under "Communications with a subgroup of TCWG" as per Para 12 and A7 of SA 260 (Revised). Para A7 of SA 260 (Revised) states that communication with Audit Committee where one exists, has become a key element in determining auditor's communication with TCWG. But it must be noted that communication alone with Audit Committee does not imply that the requirements of SA 260 Revised are complied with. The Audit firm should have obtained a "**proper and correct**" understanding of the role of the Audit Committee, in the sense that it is not

TCWG, that it is much "smaller" and "much less empowered" than TCWG. NFRA has pointed out that the **respective responsibilities of the Audit Committee and the Governing Body were not understood**. One cannot take out one portion of this sentence and make it stand alone. So, any communication with the Audit Committee, which alone has been done, and stressed by the Audit firm, is not equal to communication that is required to be done with TCWG. In fact, for companies with the ITNL kind of management structure, the most important part of TCWG would have been outside the company, in the parent company ILFS. However, WPs, as referred by the Audit Firm, do not give any information as to the auditor's understanding of the responsibilities of the Audit Committee and the Governing body in the sense as explained above.

12.14.7. Thus, NFRA reiterates its conclusion in the DAQRR that by not identifying, and not communicating effectively with TCWG, the Audit Firm failed to comply with the basic and fundamental requirements of SA 260 (Revised), resulting in failure to achieve all the objectives of SA 260 (Revised) as stated in paras 9 (a) to 9 (d) of the said SA.

Communication of the planned scope and timing of audit

12.15. In this regard the Audit Firm submits in page no. 778 of its response (referring to the same WPs as mentioned in the table in para. 12.14.4 above) that, "It is important for NFRA to understand that meetings with TCWG is carried out at appropriate milestones during the phase of audit cycle to discuss and communicate the matters. The overall summary of significant accounting and auditing matters including management estimates and judgement are communicated to the audit committee before the financial statements are approved by the Board of Directors." Para 15 of SA 260 (Revised) requires the auditor to communicate with TCWG an overview of the planned scope and timing of audit, which **includes communications about the significant risks identified** by the auditor (emphasis added). None of the WPs referred by the Audit Firm document any such communication with TCWG. Further, the audit committee presentation and draft audit report referred by the Audit Firm which were presented to the audit committee on May 29, 2018 i.e. on the date of signing of the audit report cannot be regarded as a proper communication made in line with the requirements of para 21 and 22 of SA 260 (Revised) as it is neither timely nor a two way communication and is thus ineffective. Further, the presentation made to Audit Committee does not even contain the significant risks identified by the Auditor. Thus, NFRA reiterates its conclusion that the Audit Firm has failed to meet the objectives as per para 9(a) of SA 260 (Revised).

Evaluation of qualitative aspects of the entity's accounting policies including what is acceptable under applicable Financial Reporting Framework

12.16. In this regard the Audit Firm in page nos. 781 to 783 of its response quotes para 16(a), A19 and A20 of SA 260 (Revised) and states that in the Audit Committee meeting held on 29th May, 2018 the draft audit report and financial statements which includes the accounting policies, accounting estimates and financial statement disclosures were discussed with TCWG. The Audit Firm further states that the key matters were communicated to TCWG as a part of audit committee presentation, interest free loans and ECL accounting on slide 5 and 18 and revenue recognition policy was discussed on slide 19 and 16. The Audit Firm also states that, "SRBC submits that the qualitative evaluation of the accounting policies was performed by SRBC which is documented in the audit file (Refer hard copy file no.1, A1-61 to A1-62)."

12.17. NFRA examined the above contentions of the Audit Firm and observes as follows:

12.17.1. NFRA has already explained that for communication to be effective it has to be done on a timely manner. The contention of the Audit Firm that by making a presentation to the Audit Committee on the last day of the audit, it has complied with the requirements of SA 260 (Revised) shows the narrow understanding of the Audit Firm of the requirements of the SA. Para 16 (a) of SA 260 states that the auditor **shall** communicate to TCWG, "The **auditor's views** about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures." (Emphasis added). Para A20 of SA 260 Revised states that, "the auditor's views on the subjective aspects of the financial statements may be particularly relevant to those charged with governance in discharging their responsibilities for oversight of the financial reporting process." Even ignoring the fact that the communication to the Audit Committee was not made timely it must be noted that what has been communicated in the presentation to Audit Committee are the details/information about management estimate and management's views thereon and not the auditor's views regarding such facts. For example, regarding ECL on slide no. 18 the Audit Firm has just presented the details of ECL reversed on loans receivable and impairment of investments. Similarly, regarding revenue recognition policy, on slide 16 the Audit Firm has presented the construction margin for different projects for the year FY 2016-17 and FY 2017-18. There is no documented discussion around auditor's views regarding any of the matters presented.

12.17.2. From the analysis of the WP '102GL UTB' (page A1-61 to A1-62) referred by the Audit Firm, NFRA has noted that neither any qualitative evaluation of accounting policies documented in the WP nor has anything been communicated to TCWG. This WP is only an internal form/document in which the Audit Firm documents its understanding of the entity and its environment.

12.17.3. Further, refer to the section on ECL in this AQR, for NFRA's observation regarding the Audit Firm's failure to discuss the accounting policy of interest free loans and ECL in accordance with provisions of Ind AS 109. Also refer to the section dealing with 'Revenue Recognition' in this AQR for NFRA's observation regarding absence of discussion of qualitative aspect of revenue recognition policy with the TCWG.

12.18. Thus, NFRA reiterates its conclusions in the DAQRR that the Audit Firm has neither evaluated qualitative aspects of the entity's accounting policies nor communicated the same with the TCWG, as required by Para 16(a) of SA 260 (Revised).

Communication on timely basis significant matters arising during the audit

12.19. In this regard quoting Para 9(c), 16(c), A49 (b), and A50 of SA 260 (Revised), the Audit Firm states that, "The auditing standard setter has considered that any matter has to be first understood, discussed with management, analyzed/evaluated/assessed before communicating to TCWG and stated that communication needs to be "as soon as practicable" in SA 260

(Revised) and not immediately as interpreted by NFRA. Accordingly, SRBC is unable to understand NFRA's basis of interpretation of the above para that timely communication **means** the communication at the time at which the auditor identifies certain matters for preventive actions to be taken."

12.20. The Audit Firm has not provided any new explanation or referred to any new WP other than those already examined by NFRA. Nevertheless, NFRA has again examined the above contentions of the Audit Firm. As per Para 9(c) of SA 260 Revised, the auditor is required to provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process. The Audit Firm's contention, that its discussion with management/TCWG on May 28, 2018 and Audit Committee on May 29, 2018, i.e. on the same date when the Audit Report was signed, amounts to timely communication, is stretching the meaning of "timeliness" to a ludicrous extent. Even if it were assumed, but not admitted, that "timely" means "as soon as practical" and not "immediately", the purpose of the communication, which should be corrective action, cannot be ignored. Surely, communication to the Audit committee on the date of signing the Audit Report is not the time when corrective actions required, if any, can be taken. NFRA therefore reiterates its observations in para 12.10 above and concludes that as detailed therein, timely communications mean the communication at the time at which the auditor identifies certain matters for preventive action to be taken and not at the date of the Audit Committee Presentation (May 29, 2018) or Discussion with Management (May 28, 2018) when the Audit Report was signed on May 29, 2018. Hence, the Audit Firm, is found to have violated Para 16(c), 21 and A50 of SA 260 (Revised) and has also failed to meet the objectives of SA 260 (Revised) as stipulated in Para 9(c).

Conclusion

12.21. NFRA therefore, reiterates its observations in the DAQRR and concludes that the Audit Firm has not complied with SA 260 (Revised) and hence:

i. Failed to achieve any of the objectives of SA 260 (Revised).

ii. The Audit Firm neither determined the persons comprising TCWG, nor communicated the matters which are required to be communicated to TCWG, in total disregard of its professional duties.

13. CARO REQUIREMENT: PHYSICAL VERIFICATION OF INVENTORY

13.1. NFRA has conveyed the following prima facie conclusions:

13.1.1. There is no evidence in the audit file submitted to NFRA to conclude that the management had conducted physical verification of inventory. The working papers referred to by the Audit Firm are only the stock statements of inventory and not the physical count of the various items of inventory. As such the Audit Firm's conclusion that 'the management has conducted physical verification of inventory at the year-end during the year and no material discrepancies were noticed on physical verification' is not supported by any valid evidence.

13.1.2. As per the provisions contained in Para A1 to A8 of SA 501, the Auditor is required to attend the physical count of inventory in order to:

i. Inspect the inventory to ascertain its existence and evaluate its condition and perform test counts;

ii. Observe compliance with management's instructions and the performance of procedures for recording and controlling the results of the physical inventory count, and

iii. Obtain audit evidence as to the reliability of management's count procedures.

13.1.3. Para A12 and A13 of SA 501 states that in some cases where it is impracticable to attend the physical inventory counting, alternate audit procedures may provide sufficient appropriate audit evidence about the existence and condition of inventory.

13.1.4. There exists no evidence in support of the fact that it was impracticable for the Auditor to attend the physical counting of inventory or that any alternate audit procedure to provide sufficient appropriate audit evidence about the existence and condition of inventory was, in fact, performed.

13.1.5. Prima Facie Conclusion: NFRA concludes that the Audit Firm has failed to obtain sufficient appropriate audit evidence in the manner and of the kind required by SAs, regarding the inventory of the Company at the year end.

13.2. The Audit Firm has responded to the prima facie conclusions of NFRA in its written response dated July 3rd, 2020. This has been examined by NFRA in detail and NFRA concludes as follows.

13.3. The Audit Firm submits in page 508 of their reply that "*As per the EPC contract entered with the subcontractors, the material, labour and construction equipment is the responsibility of the subcontractors and accordingly no high value inventories are procured by ITNL. As at March 31, 2018, the inventories in the nature of stores and spares amounting to Rs. 19.90 crores (below our audit materiality threshold) had been kept at Chenani Nashri Tunnelway Limited (Rs. 11.60 crores) and Kiratpur Ner Chowk Expressway Limited (Rs. 8.30 crores)"*. However, there is no proof in the Audit File to substantiate the above statement. There is no evidence in the Audit File to confirm the completeness of the inventories so as to ensure that these are the only inventories held by the Company. Hence the above contention of the Audit Firm cannot be taken into cognizance. As NFRA observes in the succeeding paragraphs, there is no evidence in the Audit File to confirm that the Company has complied with the requirement. In this regard, para 28 of the Guidance Note on Companies (Auditor`s Report) Order, 2016 states that "Where a requirement of the Order is not complied with but the auditor decides not to make an adverse comment, in view of the immateriality of the item, he should record rationale for the same in his working papers". There is no such documentation available in the Audit File.

13.4. The Audit Firm cites para 37 (d) of the Guidance Note on Companies (Auditor`s Report) Order, 2016 and states in page 509 of their reply that "as seen from the above para 37(d), the words used are, the auditors "may" (and not "shall") examine the documents relating to physical verification conducted by the management. Accordingly, in case of locations where SRBC had not attended / observed the stock count, since the total value of inventory was less than the tolerable error and materiality, SRBC has obtained and examined the documents relating to physical verification of inventory by the performed management that were more than what is expected by the aforesaid Guidance Note." However, on an examination of the related workpapers referred by the Audit Firm, it is seen that no documentation which supports the Audit Firm's contention that proper physical verification was in fact conducted by the management is available, as is evident from the following:

i. There was no reconciliation made between the books to physical verification records.

ii. No documentation was found for appropriate cut-off procedure to ensure the completeness of inventories related to (a) materials purchased but not received have been included in the inventories and the liability has been provided for; (b) materials issued and are in transit have been excluded from the inventories and has been debited to capital works/expenditure.

iii. There was no evidence of any assessment for internal controls relating to inventories. The Audit Firm has not documented any evidence regarding control activities established by the Company to ensure that the Company personnel are properly counting and recording the physical inventory.

iv. No audit remarks/ observations found for adjustment in inventories after the physical verification.

v. No Sampling was made by auditor in workpaper "Inventory Verification Sheet_31.03.18 Stock Report -Dogra Store – CNTL" where physical verification was conducted by management and audit team member was present.

vi. No evidence found that engagement team has done test count to satisfy himself about the effectiveness of the count procedures.

vii. No verification done by the Audit Firm about adequacy of physical safeguards over inventory.

viii. No evidence of reconciliation of inventory between items issued, consumed, returned, damaged and obsolete to ensure that the physical balance represents the actual quantity as per books.

ix. No evidence regarding the cut-off procedures.

x. No documentation of the inventory receipt and issue procedures.

xi. No evidence of examining the manner in which the goods are stacked or labelled, and the quality and nature of items that require expert knowledge for recognition and whether any experts were involved in such cases.

xii. There is no evidence of samples selected for physical verification and quantity verified physically by the ET as the audit workpapers are merely stock statements signed by management and audit team member.

xiii. In workpaper "Inventory Verification Sheet_ITNL stock KNCEL" and "Inventory Verification Sheet_ITNL Stock CMRL March 18", the location at which asset was present is not mentioned which raises doubt about the physical verification. Further, no procedure was carried out which supports that physical count was conducted.

13.5. As per Para 37(d) of the Guidance Note on Companies (Auditor`s Report) Order, 2016, physical verification of inventory is the responsibility of the management of the company which should verify all material items at least once in a year and more often in appropriate cases**. It is, however, necessary that the auditor satisfies himself that the physical verification of inventory has been conducted at reasonable intervals by the Management and that there is adequate evidence on the basis of which the auditor can arrive at such a conclusion**. NFRA observes that the Audit Firm has failed to obtain appropriate audit evidence that proper physical verification of inventory was conducted.

13.6. Para 6 of SA 500 states that "The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence". Para A1 of SA 500 inter alia states that "Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions". The documentation in the Audit File does not demonstrate compliance with the report made by the Auditor under clause (ii) of CARO, 2016 and hence does not meet the requirements of para 6 and para A1 of SA 500.

13.7. Thus, NFRA reiterates its conclusion in the PFC that the Audit Firm has failed to obtain sufficient appropriate audit evidence in the manner and of the kind required by SAs, regarding the inventory of the Company at the year end. The report made by the Audit Firm under clause (ii) of CARO, 2016 is without performing due procedures and without adequate audit evidence.

13.8. The Audit Firm has responded to the above observations vide its response dated July 10th 2021. This has been examined in detail and NFRA observes as follows:

13.8.1. In page 797 of their reply to the DAQRR the Audit Firm states that, *"Our workpaper on inventories provides a location-wise break-up of inventories (Refer hard copy file no.5, F-1 to F-2) which matches with financial statements for the year ended March 31, 2018. As per note 10 on Inventories and Note 23 Cost of material consumed the opening inventory at March 31, 2017 was Rs.22.59 crore, purchases during the year were Rs.9.48 crore and closing inventory was Rs.19.90 crore. Accordingly, our explanation in above statement is corroborated with audit evidence from our audit file. The break-up of inventories provided in above referred workpaper is further corroborated with the workpaper for physical verification of inventories performed by SRBC (Refer hard copy file no.5, F-4 and F-59). Accordingly, SRBC has obtained sufficient appropriate audit evidence to confirm the completeness of inventories."*

13.8.2. NFRA examined the WPs referred by the Audit Firm. In the WP '*hard copy file no.5, F-1 to F-2'* (WP *'ITNL_Inventory March 18 Work paper'* contains pages from F-1 to F-44*)* on page F-1, Note 10 and Note 23 to the financial statements is reproduced. On page F-2 the Audit Firm has documented a year-on-year and quarter-on-quarter variance analysis of inventory. Further, page F-4 to F-44 is the statement of inventory at CNTL as on March 31, 2018. The last column in this stock statement indicates whether the line item is 'Verified from Physical Verification Document' or not (having a tick mark in this column against very few line items). This statement does not have the inventory at KNCEL. There is no evidence that this is the complete list of inventories available with ITNL. Moreover, the Audit Firm has referred to page F-59 which is not present in the WP while the WP consists of only pages till F-44. The Audit Firm's contention that it has obtained sufficient appropriate audit evidence to confirm the completeness of inventory is therefore without any basis.

13.8.3. The Audit Firm states that the management has conducted physical verification at two locations in the presence of the members of the ET. However, there is no mention in the stock statements that it is verified physically and found correct. Also, the date of actual physical verification is not seen recorded. It is unlikely that all the items (running into more than ten thousand items at one location alone) are tallied with the books as on 31st March 2018, the date shown in those statements.

13.8.4. NFRA also examined WP *'Z CARO WP ITNL March 2018.pdf' (which contains the page numbers referred by the Audit Firm: A3-288 to A3-300 for KNCEL and A3-301 to A3-417 for CNTL).* The WP again contains the stock statements for CNTL and KNCEL. Further, the Audit Firm's statement that it "*physically verified 50 samples* ***on a surprise basis*** *to take additional comfort on existence of inventory"* also is not supported by any evidence (Emphasis added). There is no documentation of how the samples were selected and on what basis. Since the Audit Firm states that it was a surprise check it should have been conducted on a day other than the day when management conducted the physical verification. However, no evidence of such a surprise check is available in the Audit File. In the absence of any supporting documents NFRA concludes that the response of the Audit Firm is just an afterthought.

13.8.5. Further, assuming but not admitting that the Audit Firm did attend the physical verification, signing of the stock statement does not amount to sufficient appropriate audit evidence as required by Para 6 of SA 500 regarding the basis of conclusion on physical verification of inventory. There is no evidence to demonstrate that the Audit Firm has performed other procedures like cutoff procedures, assessment of internal controls relating to inventories, verification of adequacy of physical safeguards over inventory, documentation of inventory receipt and issue procedures etc. Documenting just the signed stock statement does not in any way prove that the management conducted a proper physical verification.

13.9. The table below shows the response of the Audit Firm to the observations in the DAQRR and NFRA's further observations thereon, regarding other inadequacies in verification of inventory.

Observations in DAQRR	**SRBC response**	**NFRA's Conclusions**
There was no reconciliation made between the books to physical verification records.	"Refer hard copy file no.5, F4 to F46 for CNTL site and hard copy file no.5, F47 to F59 for KNCEL towards reconciliation between books to physical verification records."	As already stated above, page F45 to F59 is not available in the WP '*ITNL_Inventory March 18 Work paper'*. Further, from F-4 to F-44 is just a stock statement. Thus, there is no documentation of reconciliation made between books to physical verification records.
No documentation was found for appropriate cut-off procedure to ensure the completeness of inventories related to (a) materials purchased but not received have been included in the inventories and the liability has been provided for; (b) materials issued and are in transit have been excluded from the inventories and has	"Refer hard copy file no.2, A3-290 to A3-300 for KNCEL and hard copy file no.2, A3-301 to A3-417 for CNTL for movement in inventory during the month of March 31, 2018 clearly demonstrating that all material purchased / issued were appropriately recorded and closing inventory was considered for physical count. SRBC submits that the evidences produced by the management and reviewed by the Audit Team depicted the existence, condition and value of inventories."	The WPs referred by the Audit Firm are merely stock statements of CNTL and KNCEL. The Audit Firm failed to perform and document the cut-off procedures.

been debited to capital works/expenditure.		
There was no evidence of any assessment for internal controls relating to inventories. The Audit Firm has not documented any evidence regarding control activities established by the Company to ensure that the Company personnel are properly counting and recording the physical inventory.	"Physical verification of inventory was conducted by the management at above mentioned two locations and SRBC team was present at these locations between March 30, 2018 to April 1, 2018 to observe controls around physical verification of inventory by the management and also to assess the evidence around the fact that physical verification of inventory was being conducted at reasonable intervals. SBRC has reviewed the physical inventory sheets duly authenticated by field staff and responsible officials of the Company. (Refer hard copy file no.2, A3-288 to A3-300 for KNCEL and hard copy file no.2, A3-301 to A3-417 for CNTL). Additionally, engagement team examined the complete documentation and physically verified 50 samples on a surprise basis to take additional comfort on existence of inventory (Refer hard copy file no.5, F4 to F46 for CNTL site and hard copy file no.5, F47 to F59 for KNCEL). Based on the procedures performed the engagement team did not have any reportable matters. Based on the audit procedures performed, and considering the nature, value and volume of inventories, SRBC concluded that the internal controls relating to physical verification of inventories were sufficient and appropriate."	The Audit Firm has not provided any WP with regard to assessment of internal controls relating to inventories. The WPs referred by the Audit Firm is only stock statement of KNCEL and CNTL. Further, the Audit Firm's reply that it physically verified 50 samples on a **surprise basis** is contradictory to its response that management conducted physical verification between March 30, 2018 to April 1, 2018 and SRBC was present on these dates to observe physical verification of inventory by management. NFRA is unable to understand how this visit would be considered as a surprise visit. Further, there are no WPs regarding this surprise visit documented in the Audit File.
No audit remarks/ observations found for adjustment in inventories after the Physical verification.	"Management had performed 100% physical verification of inventories. Based on such procedures performed by the management, there were no material discrepancies observed by the management. SRBC had performed a count on test check basis and did not identify any material discrepancies. (Refer hard copy file no.2, A3-288 and A3-290 to A3-417 and hard copy file no. 5, F4 to F59)."	Refer to NFRA's replies in other points of this table with regard to the WPs referred by the Audit Firm.
No Sampling was	"As none of the items of inventory were	There is no documentation,

made by auditor in workpaper "Inventory Verification Sheet_31.03.18 Stock Report Dogra Store – CNTL" where physical verification was conducted by management and audit team member was present.	individually material, SRBC had selected samples on monetary unit / high value basis. (Refer hard copy file no. 5, F4 to F59)."	in the audit file, of the basis on which samples were selected by the Audit Firm. Para 4 of SA 530 *'Audit Sampling'* states that *"The objective of the auditor when using audit sampling is to provide a reasonable basis for the auditor to draw conclusions about the population from which sample is selected.*"
No evidence found that engagement team has done test count to satisfy himself about the effectiveness of the Count procedures.	"As none of the items of inventory were individually material, SRBC had selected samples on monetary unit / high value basis to obtain reasonable assurance with respect to the effectiveness of the count procedures. (Refer hard copy file no. 5, F4 to F59)."	Refer to NFRA's reply for point no. *i.* and *v.* above.
No verification done by the Audit Firm about adequacy of physical safeguards over inventory.	"SRBC team members had visited both the sites where inventory was stored and observed management's physical count. Management had performed 100% physical verification of inventories (Refer hard copy file no.2, A3- 288)."	There is no documentation available in the audit file with regard to verification of physical safeguards over inventory. Documenting just the stock statement is not a proof of any audit procedures performed.
No evidence of reconciliation of inventory between items issued, consumed, returned, damaged and obsolete to ensure that the physical balance represents the actual quantity as per books.	"Refer hard copy file no.5, F4 to F46 for CNTL site and hard copy file no.5, F47 to F59 for KNCEL towards reconciliation between books to physical verification records. Management had performed 100% physical verification of inventories. Based on such procedures performed by the management, there were no material discrepancies observed by the management in relation to returned, damaged and obsolete. SRBC had performed count on test check basis and did not identify any material discrepancies based on the review of physical records. (Refer hard copy file no.2, A3-288 and A3-290 to A3-417 and hard copy file no. 5, F4 to F59)."	Refer to NFRA's replies in other points with regard to the WPs mentioned by the Audit Firm. In the absence of relevant WPs in the audit file, the replies of the Audit Firm are unacceptable.
No evidence regarding the cut-off procedures.	"Refer hard copy file no.2, A3-290 to A3-300 for KNCEL and hard copy file no.2, A3-301 to A3-417 for CNTL for	Refer to NFRA's reply in point no. *ii* above.

	movement in inventory during the month of March 31, 2018 clearly demonstrating that all material purchased / issued were appropriately recorded and closing inventory was considered for physical count. SRBC submits that the evidences produced by the management and reviewed by the Audit Team depicted the existence, condition and value of inventories."	
No documentation of the inventory receipt and issue procedures.	"Refer hard copy file no.2, A3-290 to A3-300 for KNCEL and hard copy file no.2, A3-301 to A3-417 for CNTL for movement in inventory during the month of March 31, 2018 clearly demonstrating that all material purchased / issued were appropriately recorded and closing inventory was considered for physical count. As these are store and spare items, there was no movement during the stock count. SRBC submits that the evidences produced by the management and reviewed by the Audit Team depicted the existence, condition and value of inventories."	The WPs referred by the Audit Firm are merely stock statements. There is no documentation of procedures performed and conclusions reached in these WPs.
No evidence of examining the manner in which the goods are stacked or labeled, and the quality and nature of items that require expert knowledge for recognition and whether any experts were involved in such cases.	"Management had performed 100% physical verification of inventories. Based on such procedures performed by the management, there were no material discrepancies observed by the management in relation to returned, damaged and obsolete. We wish to reiterate that SRBC had performed count on test check basis and did not identify any material discrepancies based on review of the physical records. (Refer hard copy file no.2, A3-288 and A3-290 to A3-417 and hard copy file no. 5, F4 to F59). The goods were appropriately, stacked and labelled to enable identification of material. Further, as these are Stores and Spares items with individually low value and identifiable based on labelling, accordingly, expert involvement was not required."	The Audit Firm has not verified the manner of labeling and stacking even for the samples selected for physical verification of inventory as there is no evidence available in the audit file with regard to the same.
There is no evidence of samples selected for physical verification and quantity verified	"As none of the items of inventory were individually material, SRBC had selected samples on monetary unit / high value basis to obtain reasonable assurance. (Refer hard	Refer to NFRA's reply to other points in this table.

physically by the ET as the audit workpapers are merely stock statements signed by management and audit team member.	copy file no. 5, F4 to F59).”	
In workpaper “Inventory Verification Sheet_ITNL stock KNCEL” and “Inventory Verification Sheet_ITNL Stock CMRL March 18”, the location at which asset was present is not mentioned which raises doubt about the physical verification. Further, no procedure was carried out which supports that physical count was conducted.	“The inventory is used for construction / maintenance of infrastructure facilities and hence these inventories were located at respective project sites. Accordingly, the location is obviously to be considered as project site. Management had performed 100% physical verification of inventories. Based on such procedures performed by the management, there were no material discrepancies observed by the management in relation to returned, damaged and obsolete. SRBC had performed count on test check basis and did not identify any material discrepancies. (Refer hard copy file no.2, A3-288 and A3-290 to A3-417 and hard copy file no. 5, F4 to F59). The goods were appropriately, stacked and labelled to enable identification of material at the location.”	In the absence of any evidence the explanations given by the Audit Firm are not acceptable.

Conclusion

13.10. In view of the above facts, NFRA reiterates its earlier conclusion that the Audit Firm has failed to obtain sufficient appropriate audit evidence in the manner and of the kind required by SAs, regarding the inventory of the Company at the year end. The report made by the Audit Firm under clause (ii) of CARO, 2016 is without performing due procedures and without adequate audit evidence.

14. INTEGRITY OF AUDIT FILE AND AUDIT FIRM'S IT CONTROLS REVIEW

14.1. NFRA had conveyed the following observations in the PFC:

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

14.1.2. 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 conclusions 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:

a. 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.

b. Enabling the ET to be accountable for its work.

c. Retaining a record of matters of continuing significance to future audits.

d. Enabling the conduct of quality control reviews and inspections in accordance with SQC.

e. 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:

a. The identifying characteristics of the specific items or matters tested;

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 13 – If, in 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:

a. The circumstances encountered;

b. The new or additional audit procedures performed, audit evidence obtained, and

c. Conclusions reached, and their effect on the auditor's report; and

d. When and by whom the resulting changes to audit documentation were made and reviewed.

vii. Para 14 – The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.

viii. 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.

ix. 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.

x. 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).

xi. 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.

xii. Para A21 – SQC 1 (Para 74) requires firms to establish policies and procedures for the timely completion of the assembly of audit files.

xiii. Para A22 – The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions.

14.1.3. SQC 1

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

ii. Para 77 – The firm should establish policies and procedures designed to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation.

iii. Para 79 – 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 designs and implements appropriate controls for engagement documentation to:

   a. Enable the determination of when and by whom engagement documentation was created, changed or reviewed;

   b. 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;

c. Prevent unauthorized changes to the engagement documentation; and (d) Allow access to the engagement documentation by the engagement team and other authorized parties as necessary to properly discharge their responsibilities.

iv. Para 80 – Controls that the firm may design and implement to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation include, for example:

a. The use of a password among engagement team members to restrict access to electronic engagement documentation to authorized users.

b. Appropriate back-up routines for electronic engagement documentation at appropriate stages during the engagement.

c. Procedures for properly distributing engagement documentation to the team members at the start of engagement, processing it during engagement, and collating it at the end of engagement.

d. Procedures for restricting access to, and enabling proper distribution and confidential storage of, hardcopy engagement documentation.

v. Para 81 – For practical reasons, original paper documentation may be electronically scanned for inclusion in engagement files. In that case, the firm implements appropriate procedures requiring engagement teams to:

a. Generate scanned copies that reflect the entire content of the original paper documentation, including manual signatures, cross- references and annotations;

b. Integrate the scanned copies into the engagement files, including indexing and signing off on the scanned copies as necessary; and

c. Enable the scanned copies to be retrieved and printed as necessary. The firm considers whether to retain original paper documentation that has been scanned for legal, regulatory or other reasons.

iv. 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.

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

i. The Audit Documentation provides evidence of auditor's basis for conclusions drawn and evidence that the audit was planned and performed in accordance with SAs. Such Audit

ii. 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.

iii. The Audit Documentation shall be completed in a timely manner without performing any further Audit Procedures or changes other than administrative changes.

iv. 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.

v. Any such Audit File shall provide evidence to ensure that:

v.a) 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.

v.b) Documentation of who has performed the Audit Work and the date such work was completed is done.

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

v.d) The integrity of audit workpapers is maintained after the audit report date, and none of the audit documents is deleted or discarded before the end of its retention period.

v.e) 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.

v.f) The audit documentation is completed in a timely manner without performing any further audit procedures or changes other than administrative changes, such as 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 engagement team before the date of the auditor's report.

14.1.5. 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.

14.1.6. 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 above. This involves basically defining a change management process and adhering to the process flow in the electronic platform.

14.1.7. Keeping inbuilt records for system logs and their monitoring. This is required to monitor:

i. Audit File integrity. Retention of all the logs along with the Audit File will ensure the requirements mentioned above, 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.

ii. 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 mentioned above, particularly regarding proper evidence for accountability, tampering of records, deletion of records, review, subsequent changes to the audit documents and regulatory verifications.

iii. To assess the extent of compliance with SQC 1 and SA 230 for the requirements discussed above, NFRA wrote to the Audit Firm on 17- Oct-2019 seeking clarifications and proof of authenticity of date of preparation of WPs.

The Audit Firm was asked to provide NFRA the following:

iv. 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

v. 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.

14.1.8. The Audit Firm responded to NFRA's letter dated 17-Oct-2019 vide their letter dated 21-Oct-2019. The key responses were that,

i. "These are complex IT related matters for which we are seeking suggestions from the Information and Technology team and also from the global teams dealing in IT, as we use the online audit documentation tool, Canvas, under license from Ernst & Young Global."

ii. "Our documentation and archival policy clearly demonstrates the minimum requirement documentation and archival of the audit file. Please refer to documentation and archival policy document."

14.1.9. NFRA conveyed the following discrepancies through its prima facie conclusions:

i. Contrary to the policies quoted in the response of the Audit Firm, NFRA has observed the following discrepancies:

ii. Two instances of audit evidence dated after the date of Auditor's Report.

iii. Mismatches between soft copy (EY Canvas files) and hard copies of WPs provided by the Audit Firm. Eleven such instances from WP 'ITNL TPE Minutes March 2018' (soft copy) and WP 'ITNL TPE M18 (ppt)' (hard file) have been found.

iv. Four instances of mismatch between the signoff dates mentioned in EY Canvas File with workpaper document properties and the dates mentioned within the documents were identified.

14.1.10. Further, NFRA observed the following from examination of the Audit Firm's working papers in CANVAS, and the Audit File:

i. 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, NFRA could not satisfy itself that the audit procedures had been performed, documented and reviewed before the date of Audit Report from an inspection and comparison of the audit file logs of signoff dates with document properties and time-sheets.

ii. 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 concludes that the Audit documentation cannot identify, beyond doubt, about 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.

iii. There is no monitoring or control over the policy of modifications that can be made to 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 concludes that the Audit Firm has no controls that can ensure that the audit documentation has been completed in a timely manner without performing any further audit procedures or changes, other than administrative changes, after the audit report date.

iv. 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.

14.1.11. 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 to Supplementary PFC, for which the Audit Firm's team requested time to come back. Subsequently the Audit Firm had provided replies to the queries vide their emails dated 25-Feb-2020 and 13-Mar-2020.

14.1.12. During the review, and after examining the replies furnished, the NFRA's IT consultants observed the following vulnerabilities in the electronic platform (EY Canvas Application):

i. The details of changes made within a document/ form in the Audit 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. This indicates absence of attributes mentioned above, i.e., version history and security and 1.3(b) system logs and its monitoring.

ii. No logging and monitoring of EY Canvas server and database (DB) events.

The Audit Firm has not clearly answered how access was limited to ensure segregation and access only on a as per need basis, what is the process of maintaining generic IDs, can the server/DB administrators access EY Canvas Audit Files, etc.

iii. The Security testing reports, specific to EY Canvas 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 above, i.e., version history and security, and 3(b) system logs and its monitoring]

iv. EY development team follows ITIL processes for development and maintains a change management process for all changes to the EY infrastructure globally. The change management process uses a controlled release process with appropriate testing and validation processes.

v. However, the SDLC Process document was not shared for review to sufficiently conclude if security tests such as secure code review and dynamic testing were part of the SDLC process. Further, infrastructure change management process document was also not shared for review. 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 above, i.e., version history and security]

vi. 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. 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.

vii. 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 altogether. 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.** The issues under the above-mentioned categories are not addressed, and archival can be completed without performing the above reviews. [Indicating absence of attribute mentioned above, i.e., authentication and access control protocols]

viii. Audit Files within EY Canvas Application, and their contents, can be modified post release of Audit Report till the Audit File is archived. There is no record of the changes made to the audit documents i.e. document modification post sign-off, and no version control for the documents, therefore there is no way to assess if the changes made were authorized or not.

ix. 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 above.

[Indicating absence of attribute mentioned above, i.e., version history and security].

x. No logging and monitoring of end user or administrator activities in the Audit 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.

xi. 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 above, i.e., authentication and access control protocols]

xii. 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 above, i.e., authentication and access control protocols.

xiv. Above all, there is no mechanism to scan and sync the hard copy files to prevent or track any changes made to hard copy files post the archival date. This vulnerability alone is sufficient to totally compromise the entire objective of audit file integrity.

13.1. NFRA had examined in detail the replies submitted by the Audit Firm vide its letter dated 3rd July 2020 (reply to the PFC) on the above matters and further observed in the DAQRR as follows.

13.1.1. In page 516 of their reply the Audit Firm states that "neither SQC1 nor any of the auditing standards prescribe separate / additional requirements with respect to change management process, maintenance of system logs and their monitoring and standard authentication and access control protocols with respect to the Information Technology (IT) tools and database system used by the Audit Firm for their audit documentation". Quoting para 80 of SQC, the Audit Firm further states in page 517 of their reply that "With respect to the above para of SQC1, SRBC has a **password policy to restrict unauthorised access** and only authorised engagement team members can have access to Canvas documentation tool and Archival database to ensure **confidentiality, safe custody and integrity**. Further, **data back-ups** are maintained at pre-defined frequencies **to ensure safe custody, accessibility and retrievability of data.** Further, **Canvas is a documentation tool** wherein all audit documentation is maintained and updated from creation to finalisation of audit. Further, **the access to workpapers is restricted only to authorized team members**". (Emphasis added). However, as NFRA had observed in the PFC and as detailed further in subsequent paras of this DAQRR, none of the contentions of the Audit Firm is factually correct. The password policy is compromised due to enabling concurrent access from different locations, the confidentiality, safe custody and integrity are compromised due to uncontrolled editing and deleting features and features enabling deletion or modification of fully completed audit documentation without any system level checks. Instead of ensuring accountability and integrity, the audit documentation tool gives unwarranted flexibility for the Audit Firm to play fast and loose with the audit evidence by not ensuring that the Audit Documentation is completed on a timely manner concurrent with the Audit procedures performed.

13.1.2. It has been made clear in the PFC what comprise the key requirements of Audit Documentation as per SAs and SQC 1. After having a documentation tool that does not provide a reasonable assurance that such requirements of the SQC 1 and SAs are met in an electronic environment, the Audit Firm's contentions that the system level attributes ensuring such reasonable assurance, as noted by NFRA in the PFC, are not prescribed in SAs/SQC (in any case, the software level best practices are not expected in SQC-1/SAs) shows that the Audit Firm is reluctant to adhere to professional standards in electronic audit documentation. It is evident that the firm does not want to build system level controls to the audit documentation tool for compliance with the documentation principles in the Standards of Auditing. The responses to the observations in PFC show an aggressive unwillingness to correction. The practices followed lack transparency and seriously compromise integrity of the Audit Evidence and Audit Documentation in electronic form.

13.1.3. The reply of the Audit Firm in page 524 to 542 of their reply to the PFC regarding the two instances of documents dated after the Auditor's Report found in the Audit File indicates lack of integrity of the Audit File. The replies of the Audit Firm in this regard makes it clear that these documents were placed in the Audit File even after the normal period of archival time and hence indicates that there is no effective archival of audit documentation.

13.1.4. With regard to the instances of mismatches observed between hard copy and soft copy of WP 'ITNL TPE Minutes March 2018, the Audit Firm submits in page 543 of their reply that "final copy was documented in hard copy file and was also required to be updated in Canvas. However, the changes made to the file in Canvas, were inadvertently not saved and the draft superseded version that had to be updated / deleted continued to be retained in Canvas". The reply again clearly indicates no control over the documents in the Canvas as well as in hard copy. There is no effective review or checking while documenting important pieces of audit evidence. Further, it must be noted that there are various important points that were mentioned in the soft copy file which were not present in the hard copy version of WP 'ITNL TPE Minutes March 2018'. For example, discussions around Fraud Risk, Human resource policies and Risk assessment and mitigation process followed by the management, investment in subsidiaries and their impairment etc. are all omitted in the final hard copy file. As stated by the Audit Firm in its reply, if the hard copy version is final, then important points should not have been omitted from it. Thus, NFRA is of the view that the explanation given by the Audit Firm is only an afterthought and hence not admissible. (Refer Appendix 3 to DAQRR for details of mismatches observed between hard copy and soft copy of WP 'ITNL TPE Minutes March 2018).

13.1.5. Regarding the inconsistencies in the sign off dates and modified dates, the Audit Firm states in pp 544 – 545 of their reply that the mismatch between the signoff dates mentioned in EY Canvas File with workpapers document properties and the dates mentioned within the documents is due to last minute administrative changes made in the documents which are allowed as per the requirements of the SAs. However, in the absence of any logs or other documentation, there is no proof for such a modification after the audit report. Hence NFRA could not accept that these changes were in the nature of administrative changes only. The Audit Firm also states in two instances, where the sign off date precedes the document creation dates, that "At the time of archival it was noticed that the file was corrupted and hence had to be recreated and replaced with a new file. However, information was obtained and reviewed before the audit report date and only documentation of the said work had to be redone". The reply again confirms the findings of NFRA regarding integrity of Audit File. The reply clearly shows that completed audit documentation can be deleted/destroyed/modified and a new one can be created without affecting the original sign offs and without leaving any indications of changes or reviews made. These facts corroborate NFRA's conclusion in the PFC that the Audit Firm has no controls that can ensure that the audit documentation has been completed in a timely manner without performing any further audit procedures or changes, other than administrative changes, after the audit report date.

13.1.6. Regarding tracking the changes made to a document in the Audit File, the Audit Firm submits in page 550 of their reply that "neither SQC1 nor SA 230, requires the auditor to maintain details /logs of changes made within a document/form or older versions of documents/forms for an ongoing audit file". NFRA agrees with the Audit Firm that only final audit documentation is required to be preserved. So, incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of documents, discarded drafts, etc. need not be preserved. However, the observation of NFRA in PFC is not about the preservation of such documents. The comment refers to maintenance of audit logs, and notes that in the absence of either logs or the older versions of the document, tracking changes made to a document is impossible. The reply of the Audit Firm is silent on the aspect of tracking changes made to a document which is completed and made part of the Audit File during the audit. Also, the examples of inconsistencies in Audit Documentation detailed above in the DAQRR underlines the need for systemic controls over changes made to a completed audit documentation. This also makes the Audit documentation vulnerable for tampering and repudiation. Even the security control statement in EY Global information security policy submitted by the Audit Firm (in page 703 of their reply) under the category 'operations' states as a must meet criteria that "Generate audit logs that record user activities, system administrator and system operator activities, system exceptions and information security events, and retain the logs for a minimum of one year or shorter where required under applicable law".

13.1.7. The reply of the Audit Firm is silent regarding the observation in the PFC that "No logging and monitoring of EY Canvas server and database (DB) events".

13.1.8. Regarding the observation in the PFC regarding security testing reports and security assessments, the Audit Firm states in page number 553 of its reply that "It is not possible for ARC or EY Canvas deployment to happen without completing the security requirement and without approval from EY Change Approval Board (CAB)." The Audit Firm has submitted the CAB approval checklist attached in Annexure 7 to their reply dated 3rd July, 2020. The CAB approval checklist only lists the security tests that have been conducted and the date on which each test was conducted. The results/reports of such security tests have not been shared by the Audit Firm. Moreover, the SDLC process document was not shared for review to sufficiently conclude if security tests such as secure code review and dynamic testing were part of the SDLC process. Further, infrastructure change management process document was also not shared for review. 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.

13.1.9. Regarding the observation of replacement of a signed-off document and bypassing maker-checker authorisations as detailed in the PFC, the Audit Firm submits totally irrelevant matters in pp 554 to 556 of their reply. The reply states the reasons for providing full access of Canvas to all team members of the engagement team during the audit, sign off procedures and administrative changes to the documentation made after the Audit Report. Similar are the explanations regarding the observation that the Audit Files within EY Canvas Application, and their contents, can be modified post release of Audit Report till the Audit File is archived, without leaving any tracks. Similarly, the replies regarding concurrent logins makes it clear that the system can be accessed from multiple locations using the same login credentials. Replies also confirm the observation regarding definition of roles and responsibility matrix for all roles of ET members, including access and the level of access is not defined completely. Regarding scanning of physical documents, the Audit Firm submits that this is not a mandatory requirement of SQC- 1. The Audit Firm further states in page 563 of their reply that *"apart from the firm policy, it is the trust and person`s* *ethics and integrity which is relied upon to ensure that nobody alters/modify/edit/remove/discard any work paper from audit file*". Such reliance of the Audit Firm on personal attributes, when they have a full-fledged documentation tool capable of documenting the audit evidence in a system-controlled environment, indicates an intention of keeping the audit documentation loose and flexible to accommodate changes as desired from time to time. The observations elsewhere in the DAQRR and the replies by the Audit Firm regarding documents dated after the audit report date found in the archived Audit File clearly shows that there is no control over the physical audit documents maintained. In such circumstances NFRA rejects the statement of the Audit Firm in page 564 of their reply that "SRBC has control over hard copy file which is kept in file storage as per DOC + ARC policy. An archived file cannot be modified after archival date and the engagement team is required to complete form 400GL and obtain the regional PPD approval prior to adding any documentation after the files are archived". Therefore, in the absence of satisfactory explanations and in view of the observations above, NFRA concludes that the integrity, accountability and reliability of Audit Documentation is seriously compromised because of the vulnerabilities listed in the said para.

13.1.10. The general argument of the Audit Firm is that the SQC-1 or SAs do not mandate any of the IT requirements observed by NFRA in the PFC. The PFC made it clear what are the requirements of the SAs and SQC-1 regarding audit documentation and how the vulnerabilities identified by NFRA (which are systemic in nature) in the IT tool of the Audit Firm contributes to the non-adherence to these requirements. The argument of the Audit Firm that SA 230 permits a virtual free-for-all in the maintenance of the audit file up to the time of its archival is an amazing display of complete disregard for all the principles of integrity of audit evidence. The need for proper documentation logs of corrections, deletions, additions etc. to the audit file is so fundamental to the integrity of the audit file that this would not need specific and explicit elucidation to anyone other than persons interested in ensuring that the audit evidence is continuously tampered with till final archival.

13.1.11. The contention of the Audit Firm that assembly of final audit file is considered to be completed on archival of the audit file (page 518 of their reply) is wrong and contradictory to its own documentation policy. The documentation policy of SRBC mentions as "The term 'documentation completion date' has been changed to 'archive date'. This change was made to emphasize that documentation is completed on or before the date of our auditor's report" (page 613 of the reply). The policy emphasizes (pages 606 to 608 of the reply) the requirement of completing, signing and reviewing the Audit documentation on or before the date of Audit Report, in line with the mandate given in SA 230. The IT tool and the physical documentation practices of the Audit Firm are operating in grave disregard of SA 230 and its own documentation policies. The position taken by the Audit Firm is a clear violation of para 77, 79 and 80 of SQC 1 and throws disturbing signals that the Audit Firm wants to keep the Audit Documentation loose and flexible to accommodate unwarranted changes and possible tampering and repudiation at any time before archival. This makes their entire electronic audit documentation unreliable.

13.1.12. Apart from SA 230, several other SAs stipulate documentation requirements specific to those SAs. Neither SA 230 nor any other SAs specify that the documentation is only required to be completed at the end of the audit or at the time of archival. Instead, audit documentation is a concurrent activity with the engagement. Moreover, the documentation policy of the Audit Firm itself says that, **"**Documentation is generally more accurate when it is prepared when the audit work is performed rather than when it is prepared later"

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

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

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

13.1.16. 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 Canvas after a specific procedure based on the document is completed by the engagement team and after it is duly reviewed, Canvas permits such deletions and leaves no traces of the deleted records. Technically, the IT platform design is such that any or all of the documents in an electronic audit file could be deleted or modified after the signing of the Audit Report, without providing any recourse to a subsequent reviewer, such as NFRA, to examine the earlier documents.

13.1.17. Also when such a completed document is deleted or replaced after completion of the Audit, it is again tampering with the evidence of the significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions [Para 8 (c) of SA 230]. Though it has been stated by the Audit Firm that the changes made after the signing of the audit report **before its archival** are done in close supervision of a senior member of the engagement team and with the knowledge of the engagement partner, and such changes are mainly of administrative nature, in this regard it may be noted that:-

i. There are no system level checks in the Canvas platform to ensure that such changes to a completed document are either not made, or if made, then it is either logged permanently in the Canvas or the old version of the document is retained to understand the changes. Thus, it is not possible to determine whether such changes are actually of administrative nature as permitted by para A22 of SA 230. As there is no mechanism to mark a document as completed, all documents are vulnerable to unauthorized changes till the day it is archived. As acknowledged in SA 315, IT platforms can be programmed to address such vulnerabilities through application controls. However, the Audit Firm has chosen to leave this gap unplugged. Under such circumstances, the objective of enabling the conduct of external inspections [para 3 of SA 230] for regulatory and other matters is not met by Canvas platform.

ii. The work paper "Memo on Canvas Hand-Offs M'18" (in Canvas files and folders; conclusion) referred by the Audit Firm is only a statement stating "Some of the documents/screens in the Canvas were signed off post May 29, 2018, the reason for the same was standardization of work papers (including linking and referencing) and consequent refinement of work papers and related documentation to address the same." It does not have a log of what changes were made to such work papers.

iii. The entire engagement team is accountable for the due performance of the engagement. By enabling deletion/alteration 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].

iv. The permission in SA 230 to delete or discard superseded documentation does not imply permission for deletion of a completed audit documentation. This permission only means retention of a final document in place of a redundant or discarded old document. However, Canvas is capable of deleting altogether any document in the audit file irrespective of whether it is an old superseded document or a final document in Canvas at the time of audit. There is no system level check to verify the status of the document before deletion.

v. Attention is drawn to para 17 of SA 220, which requires that on or before the date of the auditor's report, the engagement partner shall, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. As, technically, the IT platform allows modification or deletion of documents after such review and discussion by the engagement partner, the original review undertaken by the engagement partner may lose its relevance. It is as good as not meeting the requirement of SA 220.

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

vii. In Canvas, 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 archival. There are several documents that serve as evidence for various decisions of the Auditor such as acceptance or continuance of the engagement, disclosure of interest by the engagement team members, engagement letters, minutes, etc. which forms the very foundations of starting an engagement. Even such documents, though captured in the Canvas platform at the beginning, remain in an open position, and hence vulnerable to unwarranted alterations. Hence apart from para 79 of SQC 1, the requirements of para 7 of SA 230 (the auditor shall prepare audit documentation on a timely basis) and Para 8 of SA 230, (the auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the nature, timing, and extent of the audit procedures performed to comply with the SAs and applicable legal and regulatory requirements) are also not fully met by the Canvas platform.

viii. In the cases where the audit work papers in hard copy are scanned and made part of the audit working file in electronic format, the integrity of the former also has to be maintained in the same manner as is required for the latter. (Para 81 of SQC). All the requirements as enumerated above in this section of the DAQRR should be present for such scanned hard copy files as well. The documentation policy of the Audit Firm mentions that **"Unless prohibited by Auditing Standards, laws or regulations, or a document preservation order, we destroy the paper documentation when the electronically-converted document is included in our electronic documentation tool."** Thus, the scanned soft copy only is available for future references as per Firm's policy. The contention of the Audit Firm implying that, it can leave such audit documentation in hard copy open for changes clearly shows that the integrity of the audit file is questionable.

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

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

13.3. As discussed above, NFRA had pointed out several discrepancies in audit documentation that raised doubts, even at a prima facie level, about the integrity, authenticity and reliability of the audit documentation. The details given above show that the deficiencies are systemic and structural in nature and arise substantially from a complete disregard for SQC 1 and SAs and basic principles of IT security in the software used. This renders the audit documentation completely unfit for the intended purpose. In not rectifying these deficiencies, the Audit Firm is guilty of serious professional misconduct.

13.4. NFRA has examined in detail the replies dated 10th July 2021 and the oral submissions made by the Audit Firm (replies to the DAQRR) regarding the observations in the DAQRR. It is clear from these replies that the Audit Firm does not want to adhere to professional standards in electronic audit documentation and does not want to build system level controls to the audit documentation tool for compliance with the Standards of Auditing. The Audit Firm has denied all the observations of NFRA by repeating their earlier replies to the PFC. NFRA reiterates that the responses of the Audit Firm show an aggressive unwillingness to correction. The practices followed lack transparency and seriously compromise integrity of the Audit Evidence and Audit Documentation in electronic form.

13.5. Notwithstanding the above, NFRA has examined in detail all the replies of the Audit Firm. Wherever new explanation is provided to support the claims, such matters are addressed as follows:

13.5.1. In response to <u>para 14.2.1</u> the Audit Firm states that "the Auditing Standards are a set of "principles" and not "rules". The Auditing Standards require the auditor to establish practices which are commensurate with the facts of each case and situation of an auditee. The Audit Firm further states that, "The reading of the DAQRR makes SRBC believe that the NFRA is attempting to construe 'standards' and 'principles' under Auditing Standards to be the "rules". It is humbly submitted that if the standards were 'rules' and not 'principles', there would be no room for professional judgement to be applied by the auditor and the entire audit exercise will be a mere mechanical activity. Needless to emphasize that this is not true." The Audit Firm's contention that since the auditing standards are principle based, the Audit Firm can use its professional judgement to choose on a case to case basis for implementing the basic controls for maintaining integrity and confidentiality of the engagement documentation is a baseless argument. The need to implement IT controls for documentation is not engagement based and it does not change with the facts of each case. Further, it must be noted that the auditing standards use the word "shall" and it is mandatory to follow them, as clarified by the ICAI, and in view of section 143(10) of the Companies Act, 2013. NFRA has already made clear, at the PFC stage, the requirements of SQC 1 and SAs for the maintenance of integrity of the audit file. The need for proper maintenance of logs is so fundamental to the integrity of the electronic audit file that this would not need elucidation to anyone other than persons interested in ensuring that the audit evidence is continuously tampered with even after the date of signing of the audit report.

13.5.2. With regard to password policy the Audit Firm states that, "*Password policy is not compromised by the fact that one account can be concurrently accessed from multiple devices, rather this the conscious decision aimed towards increasing productivity and the way modern workplace wants to operate*" [sic]. NFRA already stated at PFC stage that logging and monitoring of end user or administrator activities in the Audit Application, to detect and prevent unauthorized activities inbuilt into the system, does not exist. Since concurrent logins using the same user credentials on different devices are possible and there is no mechanism in place to detect, alert or prevent such events (such as double factor authentication), this may lead to serious accountability issues. The situation here is not comparable to other cases where concurrent logins are permitted, such as personal email accounts or of business organisations. As each member of the ET is accountable for their actions, and the auditor is discharging a statutory responsibility affecting public interest, the integrity levels expected should be of the highest standards. Thus, the Audit Firm's contention that password policy is not compromised due to concurrent access from multiple devices is not acceptable as the practice followed seriously compromises accountability.

13.5.3. With respect to the confidentiality, safe custody and integrity being compromised due to uncontrolled editing and deleting feature the Audit Firm has quoted para 6(b), para 15, and para 16 of SA 230 and states that *"*SRBC states that as per the policies and procedures established by it, control is maintained on the final audit file that is archived and no changes are permitted to be made to such file. In case changes have to be made as per para 16 of SA 230, a defined change management process is required to be followed. This necessitates obtaining appropriate approvals for carrying out any changes. Further, in case of such changes, separate version of electronic file is maintained by SRBC and the original file is kept intact.*"* With respect to features enabling deletion or modification of fully completed audit documentation without any system level checks the Audit Firm states that, *"As mentioned earlier, **the system is not designed to track and record any document version change.** This is not the intended purpose for which the tool has been build and therefore cannot be treated as* *the design defect. The system does have required functionality for logging & audit trail as per our audit requirements.* ***Any files changes are allowed / approved as per SA 230 and our documentation policy before archival.*** *Once engagement is archived no modifications can be done. With respect to changes made after the sign-off by a user (e.g., engagement partner) and the report release date, there are filters in Canvas to allow the users (engagement team members) to find those easily and perform the action that they believe are required. With respect to deletion of documents, part of the archive procedures are to verify the documents discarded from evidence and ensure appropriateness."* (Emphasis added).

13.5.4. The Audit Firm has stated the controls and procedures that are in place for changes made after the archival of the Audit File. However, NFRA's observation is not about the preservation of such documents. The comment refers to the fact that 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. 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. Further, there is no track of what has been modified in the audit file documentation **post the audit report signoff.** The logs enabling review of audit documentation available are deleted at the time of archival. Thus by reading the archived electronic audit file, an external reviewer like NFRA can never get an exact picture of what happened during the course of audit.

13.5.5. As already stated at the PFC stage, 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. Further, as the Audit Firm has already agreed that the system does not track and record any document version change, 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 authorisations altogether. 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. The issues under the above-mentioned categories are not addressed, and archival is technically possible without performing the above reviews.

13.5.6. Further, the Audit Firm's contention that **any file changes** are allowed before archival as per SA 230 shows its lack of understanding and its complete unwillingness to even make the appropriate changes in its audit tool for future audit documentation. As per para A22 of SA 230, only administrative changes are allowed to be made after signing of the auditor's report. The reply of the Audit Firm confirms that the completed audit documentation can be deleted/destroyed/modified and a new one can be created without affecting the original sign offs and without leaving any indications of changes or reviews made. These facts corroborate NFRA's conclusion in the PFC that the Audit Firm has no system level controls that can ensure that the audit documentation has been completed in a timely manner.

13.5.7. In response to para 14.2.2 the Audit Firm states that, "We maintain that we use Canvas for documenting the working papers and Canvas is not intended to work like an ERP or a sophisticated audit documentation system which is neither a requirement of the SA 230 or SQC 1 nor is feasible to be used. To that extent, we appreciate the software level best practices as recommended by NFRA, which are not practicable for implementation without making major changes in the software through the service provider, Ernst & Young Global Limited, which has developed the Canvas and has the right to make changes in the software. As submitted in the past, SRBC uses Canvas as license holder by paying requisite fee and has user rights with confidentiality of the data but has no right to make any change in the software." The Audit Firm further states that, "by using the electronic documentation tool, we comply with the requirements of the SA 230 and SQC1. However, the system level attributes as noted by NFRA in the PFC are not prescribed in the SAs/SQC."

13.5.8. In this regard, NFRA has made it clear in the DAQRR that the Audit Firm was required to comply with the documentation requirements of the SAs and SQC 1 and accordingly design and implement appropriate controls in order to protect the integrity, accountability and reliability of the audit documentation. As the Audit Firm has chosen to use an electronic audit file system, the software level best practices and the appropriate controls needed to protect the documentation at all stages are required at system level and such specifications cannot be expected in SQC 1/SAs. The system level attributes noted by NFRA are minimum requirements to be complied with in order to protect the integrity of the audit documentation, which the Audit Firm failed to implement. NFRA has already explained in detail why the integrity of the documentation is compromised. Thus, the Audit Firm's contention that by using the audit documentation tool they are in compliance with all the requirements of SQC 1 and SA 230 is not acceptable. It is the responsibility of the Audit Firm to ensure that they use an audit documentation tool that has the functional requirements sufficient enough to ensure the integrity of the Audit File.

13.5.9. Regarding the two instances of documents dated after the Auditor's Report found in the Audit File the Audit Firm submits that "while dealing with the documents relating to the same entity, and more specifically while referring to the hard copy of the audit file of an engagement recently completed, an inadvertent filing (in the statutory audit working file by a genuine human oversight) does not mean that there is a grave professional misconduct by SRBC, that SRBC tampered the file or connived with the management." The replies of the Audit Firm in this regard makes it clear that documents can be placed in the Audit File even after the normal period of archival time and hence indicates that there is no effective archival of audit documentation. NFRAs observation is limited to what is expressly stated in this paragraph in this regard.

13.5.10. Further, regarding the mismatch between soft copy and hard copy, the Audit Firm repeats the reply to the PFC. Regarding the fact that there were several important points that were mentioned in the soft copy but missing in the final hard copy (indication that the replies provided by the audit firm are afterthoughts) the Audit Firm states that, "all the points were appropriately considered during the team planning event and was documented in relevant workpapers and hence based on SRBC's professional judgment, the above items were not required to be again included in the TPE minutes.." It must be noted that the WP 'ITNL TPE Minutes March 2018' (dated 20th Nov, 2017) is a WP that is prepared at the very beginning of the audit, before performing any audit procedures for the year. Thus, it documents the preliminary discussions held among the engagement team members on the basis of preliminary understanding of the Company. In order to explain the reasons for omitting certain discussions (as mentioned by NFRA in Appendix 3) documented in the soft copy, the Audit Firm reasons that these points were incorporated in some other WPs or the initial considerations were rebutted based on some factors. For e.g., the Audit Firm states that the entity level controls were already documented in the WP 'Testing of entity level controls'. Similarly, "The initial consideration of considering revenue and construction cost as a fraud risk was rebutted considering that: ……..there were various other controls relating to revenue and cost of construction …..The percentage of work completed was also being compared with the physical completion report from Independent Engineer appointed by National Highway Authority of India (NHAI) on a monthly basis……the procedures suggested by the valuation experts were incorporated in the audit procedures (Refer hard copy file 7 page no L9 – under heading Toll/Annuity Revenue). …. Accordingly, this was not required to be documented in the final TPE minutes".

13.5.11. The above replies make it clear that the entire story of "**inadvertent error**" is an afterthought as rightly pointed out by NFRA in the DAQRR. This also makes it clear that the practices followed by the Audit Firm in documentation are inappropriately flexible and misused by the ET. The TPE minutes, dated 20th Nov, 2017, which should have been prepared at the beginning of the audit, is modified based on the progress of the audit and is made "final" only at an advanced stage of the audit. This is evident from the above replies because the WP 'Testing of entity level controls' is prepared after testing certain controls during the audit and a conclusion is seen documented in this WP that all controls are effective. Similarly, the other factors based on which fraud risk is stated to be rebutted and valuation matters are all matters that emerge during audit only. If based on such subsequent developments, the audit firm wanted to edit the minutes of the initial planning meeting, the obvious way is to edit the hard copy document. Thus, NFRA rejects the cooked-up replies of the Audit Firm and reiterates that there is no effective review or checking while documenting important pieces of audit evidence and that the explanations given by the Audit Firm are only an afterthought and hence not admissible.

13.5.12. Regarding the inconsistencies in the sign off dates and modified dates mentioned in para 14.2.5 the Audit firm has repeated its reply given at the PFC stage. It further states that, “Whereas we believe that we have answered all the queries appropriately, it is extremely unfortunate that NFRA appears to be probing purely technical issues relating to the digital platform while performing the quality review; and in doing so, NFRA has gone ahead to such inconsequential technical intricacies which would be meaningless, and in respect of which there are no requirements (specifically under the standards), in case of such firms that do not use comprehensive digital tools. We believe that the approach being adopted in respect of this review is biased and prejudiced, and in absolute derogation of the principles of a fair and equal treatment.”

13.5.13. The Audit Firm has not given any new information or explanation regarding NFRA’s observations. Thus, NFRA reiterates its conclusion given at the DAQRR stage that the reply of the Audit Firm confirms the findings of NFRA regarding integrity of Audit File. Further, NFRA observes that the quality and integrity of audit documentation is a fundamental factor, without ensuring which the audit quality review is meaningless.

13.5.14. With regard to “No logging and monitoring of EY Canvas server and database (DB) events” (para 14.2.7) the Audit Firm has referred to Annexure 10 and Annexure 11 for monitoring and DB event alerts from Splunk Enterprises Security. The Audit Firm further states that, *“As logs are not client dedicated hence cannot be shared as such and Splunk logs represents that activity has taken place and the corresponding action has been taken.”* NFRA analysed Annexure 10 and 11 referred by the Audit Firm. Under Annexure 10 only the heading is mentioned as ‘Canvas App Logs feeding Splunk (Redacted)’. There is nothing else written below the heading. There are two Annexure 9. Under one of the Annexure 9 there is a screenshot with the head ‘canvas logs’, but absolutely nothing is visible in that screenshot. Similarly, under Annexure 11 (Splunk alerts and proof of triaging those alerts (Redacted)) there are two screenshots with the headings (i). Splunk Admin account/ service account alerts and (ii). Proof of triaging those alerts respectively, but they are so blurred that they are not readable.

13.5.15. With respect to the observations regarding security testing reports and security assessments the Audit Firm has referred to Annexure 12, 13 and 14 of their reply. With respect to SDLC and Infrastructure change management process documents, the Audit Firm has referred to Annexure 15 and 16. NFRA reviewed all the above-mentioned annexures referred by the Audit Firm and observes as follows:

Security testing reports and security assessment:

(i). Annexure 12: Canvas v2.1 Release- Core Security Review (Redacted). As per the document the review started on July 19, 2019 and was closed on Feb 5, 2021. There is one exception observed.

(ii). Annexure 13: Canvas v2.2 Release – CAH Security Review (Redacted). This document was published on Nov 1, 2019 for testing of v2.2 changes in canvas Automation Hub. There is one failed issue which has not been addressed.

(iii). Annexure 14: ARC v13.1 – Application Security Review. This document was published on Nov 20, 2019 for enhancement review of the application. There are three failed issues which have not been addressed.

As visible from the above information these security testing reports are of a later time period and do not pertain to the time period of audit. Further, there were issues observed at the time of security testing which had to be addressed and resolved. No information is provided in the reports for resolution of the issues observed. Further, it is still not clear that what is the frequency at which security assessment is carried out.

SDLC and Infrastructure change management process:

(i). Annexure 15: Change management Policy

(ii). Annexure 16: Contains Secure Application and System Policy which was effective from 30 April, 2021.

Thus, the SDLC process document is still not shared for review to sufficiently conclude if security tests such as secure code review and dynamic testing were part of the SDLC process.

13.5.16. Regarding <u>para 14.2.9</u> on the replacement of a signed-off document and bypassing maker-checker authorisation, and that the contents of the audit files can be modified post release of the Audit Report till the audit file is archived, the Audit Firm has repeated its replies to the PFC report. 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. NFRA reiterates its conclusions that reliance of the Audit Firm on personal attributes, when they have a full-fledged documentation tool capable of documenting the audit evidence in a system-controlled environment, indicates intentions of keeping the audit documentation loose and flexible to accommodate changes as desired from time to time. Therefore, in the absence of satisfactory explanations and in view of the observations NFRA concludes that the integrity, accountability and reliability of Audit Documentation is seriously compromised.

13.5.17. In reply to <u>para 4.2.10</u> the Audit Firm states that, "SRBC prays to NFRA to consider the compliance of audit documentation requirements in light of this expectation of SA 230 **instead of expecting arbitrary and unnecessary IT requirements not envisaged in the professional standards** from SRBC as SRBC is an audit firm using the electronic documentation tool to store the working papers and is not using this tool as ERP or a sophisticated IT software to provide services to its clients like an IT company." (Emphasis added) The Audit Firm's contention that the very basic and necessary IT requirements mentioned by NFRA are arbitrary and unnecessary goes to show the casual approach of the Audit Firm towards maintaining the integrity and authenticity of the audit file. The need for proper documentation logs of corrections, deletions, additions etc. to the audit file is so fundamental to the integrity of the audit file that this would not need specific and explicit elucidation to anyone other than persons interested in ensuring that the audit evidence is continuously tampered with till final archival.

13.5.18. In reply to <u>para 4.2.11</u> the Audit Firm states that, "Whereas the DOC+ARC policy uses the term 'documentation completion date' to be the date before which the audit file should be archived. This documentation completion date is the same date in principle to be the date when final audit file should be assembled as per paragraph 14 of SA 230.” The Audit Firm further states that, “However, the term “documentation completion date” was changed to “archive date” for better understanding in July 2019. This was after the audit of ITNL was completed. This was only a change in term, while the intent, meaning and application is unchanged.” NFRA analysed the reply of the Audit Firm in this regard and observes that the contention of the Audit Firm that documentation completion date and archival date are the same is wrong and the same has been made even clearer by the changes made in its DOC+ARC policy where the term ‘documentation completion date’ was changed to ‘archive date’. This change was made in order to emphasize the fact that documentation completion date is different from archival date. Documentation completion date is before signing of the auditor’s report, whereas archival date is after signing of the auditor’s report wherein only administrative changes are allowed to be made. Thus, even though this change was made in July 2019 i.e. after the audit of ITNL was completed, it is in line with the requirements of SA 230 and was made only to emphasise the requirement of completing, signing, and reviewing the audit documentation on or before the date of auditor report and to make it clear that audit documentation date is different from archival date, unlike the argument of the Audit Firm. Thus, the Audit Firm’s contention that the audit file is open for changes until it is archived even without proper logs being maintained is in clear violation of para 77, 79 and 80 of SQC 1 and throws disturbing signals that the Audit Firm wants to keep the audit documentation loose and flexible to accommodate unwarranted changes and possible tampering and repudiation at any time before archival. This makes their entire electronic audit documentation unreliable.

13.5.19. The Audit Firm has quoted various paras of SA 230 and SQC 1 and states that, “SRBC has provided reference to all the above paras of SA / SQC to support the explanation that there is no requirement to maintain a log of changes made to audit file until after archival of the audit file.” The Audit Firm also states that, “Expecting SRBC to use principles of SA 315 for assessing its own audit documentation requirements is meaningless and totally irrelevant in the context of expectations from SRBC. Such purported association of SA 315 and the observations on SRBC’s audit tool indicates that the NFRA’s observations result from its ignorance with the requirement of professional standards including understanding of SA 230 and SA 315. Also, such alleged non-compliances with SA 315 are misguided and mischievous to prove deficiencies in SRBC’s audit tools when no such weaknesses exist.” NFRA has already explained the necessity of maintenance of integrity of audit documentation elsewhere in this AQR. Regarding the requirements of SA 315, the Audit Firm has unnecessarily misinterpreted the observations of NFRA, which are self-explanatory. Reference to SA 315 is an indication of the importance of IT controls for the Audit Firm. Thus, by stating that “*such alleged non-compliances with SA 315 are misguided and mischievous”* the Audit Firm is only trying to divert attention from the critical matters.

13.5.20. With regard to internal and external inspection (para 14.2.18) the Audit Firm states that both internal as well as external reviewers are required to review a completed audit file i.e. audit file for which assembly is complete. The Audit Firm also states that there is no requirement to maintain logs of changes made during the audit upto the date of archival. NFRA has already made it very clear at PFC and DAQRR stage that logs of changes are required to be kept and reiterates its conclusion that both internal as well as external inspections are ineffective since the evidence of compliance by the ET is capable of being modified at a later stage without making available the details of the alterations in the archived file, which is the only record available for inspections.

13.6. In view of the above, NFRA reiterates all its observations made in the DAQRR and concludes that:

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

13.6.2. As discussed above, NFRA had pointed out several discrepancies in audit documentation that raised doubts, even at a prima facie level, about the integrity, authenticity and reliability of the audit documentation. The details given above show that the deficiencies are systemic and structural in nature and arise substantially from a complete disregard for SQC 1 and SAs and basic principles of IT security in the software used. This renders the audit documentation completely unfit for the intended purpose.

Approved by the Executive Body of NFRA for issue

Vivek Narayan

(Vivek Narayan)

Secretary, NFRA.

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सचिव/Secretary
राष्ट्रीय वित्तीय रिपोर्टिंग प्राधिकरण
National Financial Reporting Authority

15. APPENDICES

Appendix 1

List of EL provided by the Audit Firm, examined by NFRA:

(a) EL Date: July 19, 2016 with addendum dated September 15, 2016 and March 31, 2017 (FY 2016-17 and 2017-18).

- EL Amount: Rs.20 lakh + OPE & Administrative surcharge (10% of OPE) + Service tax Engagement Servicing Firm: SRBC & Co LLP
- Client Company: ITNL
- Services as per the Engagement Letter ("EL") submitted by the Audit Firm:
- Conversion of consolidated financial statements to Ind AS.
- Discuss and advise on accounting policy options available and their implications.
- Advise, review and provide observations on proposed accounting policies and results of calculations of specific adjustments.
- Advise and comment on Ind AS financial statements and disclosures prepared.

(b) EL Date: September 1, 2016 with addendum dated October 10, 2016 (FY 2016-17 and 2017-18)

- EL Amount: Rs.45 lakh + OPE & Administrative surcharge (10% of OPE) + Service tax Engagement
- Servicing Firm: Ernst & Young Merchant Banking Services Private Limited
- Client Company: ITNL
- Services as per the Engagement Letter ("EL") submitted by the Audit Firm:
- Valuation services for valuation of subsidiaries.
- Act as a Valuer under SEBI InvIT Regulations or Applicable Law.

(c) EL Date: October 15, 2015 (FY 2015-16 and 2016-17)

- EL Amount: Rs.20 lakh + OPE (Rs.1.5 lakh), Administration Surcharge (10% of OPE) &taxes, Success fee of Rs 1.50 crore on award of project
- Engagement Servicing Firm: Ernst & Young LLP
- Client Company: ITNL
- Services as per the Engagement Letter ("EL") submitted by the Audit Firm:
- Corporate finance advisory in bidding for a highway project.
- Highlight financial issues in Concession Agreement.
- Development of financial model and undertake financial analysis for the project including cash flow projections and return analysis.
- Identification of key value drivers and conduct return analysis and sensitivity analysis.
- Assist in Shareholders Agreement amongst consortium/JV members.

(d) EL Date: February 24, 2016 (FY 2015-16 and 2016-17)

- EL Amount: Rs.10.75 lakh + OPE & Administrative surcharge (10% of OPE) + Service tax Engagement
- Servicing Firm: Ernst & Young LLP
- Client Company: IL&FS
- Services as per the Engagement Letter ("EL") submitted by the Audit Firm:
- Audit the implementation of Environmental & Social Policy Framework (ESPF) in select

companies (including ITNL) of IL&FS Group.
- Provide limited assurance in accordance to ISAE 3000;
- Deliver a 'Management Letter' and an 'Assurance Statement'
- Environmental and Social Risk Assessment Review.

(e) EL Date: April 7, 2017 (FY 2017-18)
- EL Amount: Rs.11.5 lakh + OPE & Administrative surcharge (10% of OPE) + Service tax
- Engagement Servicing Firm: Ernst & Young LLP
- Client Company: ITNL
- Services as per the Engagement Letter ("EL") submitted by the Audit Firm:
- Audit the implementation of Environmental & Social Policy Framework (ESPF) in select companies (including ITNL) of IL&FS Group.
- Provide limited assurance in accordance to ISAE 3000;
- Deliver a 'Management Letter' and an 'Assurance Statement'.

(f) EL Date: April 20, 2018 (FY 2018-19)
- EL Amount: Rs.7.5 lakh + OPE & Administrative surcharge (10% of OPE) + GST
- Engagement Servicing Firm: Ernst & Young LLP
- Client Company: IL&FS
- Services as per the Engagement Letter ("EL") submitted by the Audit Firm:
- Audit the implementation of Environmental & Social Policy Framework (ESPF) in select companies (including ITNL) of IL&FS Group.
- Provide limited assurance in accordance to ISAE 3000;
- Deliver a 'Management Letter' and an 'Assurance Statement'.

(g) EL Date: March 7, 2016 (FY 2016-17)
- EL Amount: Rs.8.29 lakh Engagement
- Servicing Firm: Ernst & Young LLP
- Client Company: ITNL International Pte. Ltd
- Services as per the Engagement Letter ("EL") submitted by the Audit Firm:
- Pre-bid support services
- Detailed bid assessment and implementation services.

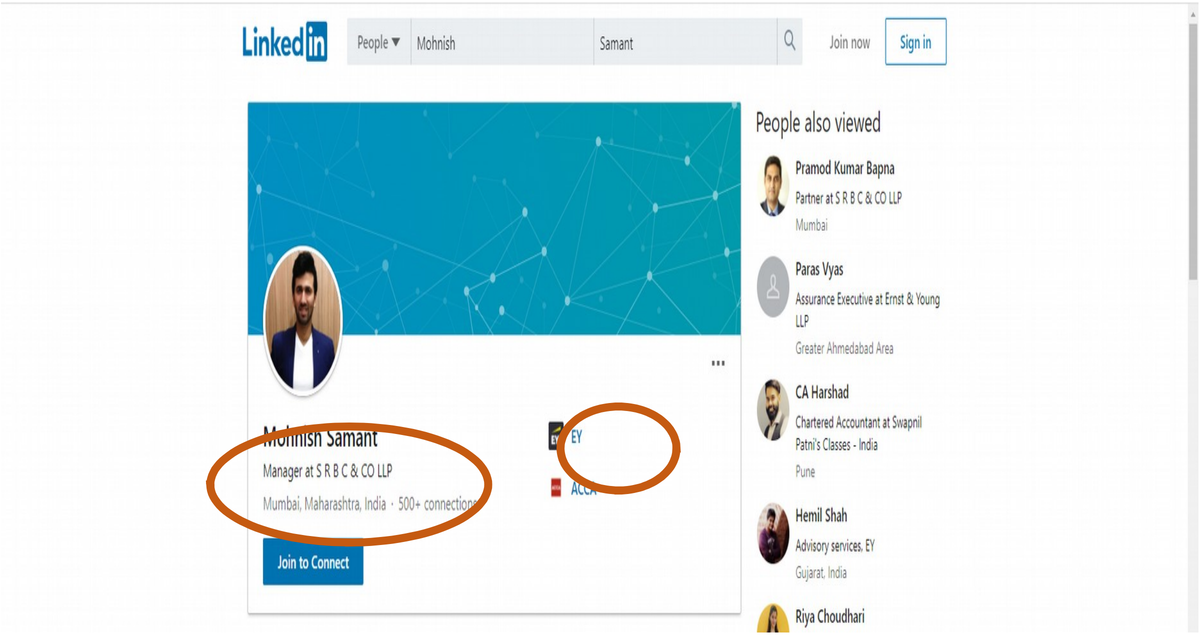
(h) EL Date: May 16, 2016 (FY 2016-17)
- EL Amount: Rs.34 lakh + OPE & Administrative surcharge (10% of OPE) + Service tax Engagement
- Servicing Firm: Ernst & Young LLP
- Client Company: ITNL International Pte. Ltd
- Services as per the Engagement Letter ("EL") submitted by the Audit Firm:
- Conduct internal audit for three of its subsidiaries.
- Review of compliances.

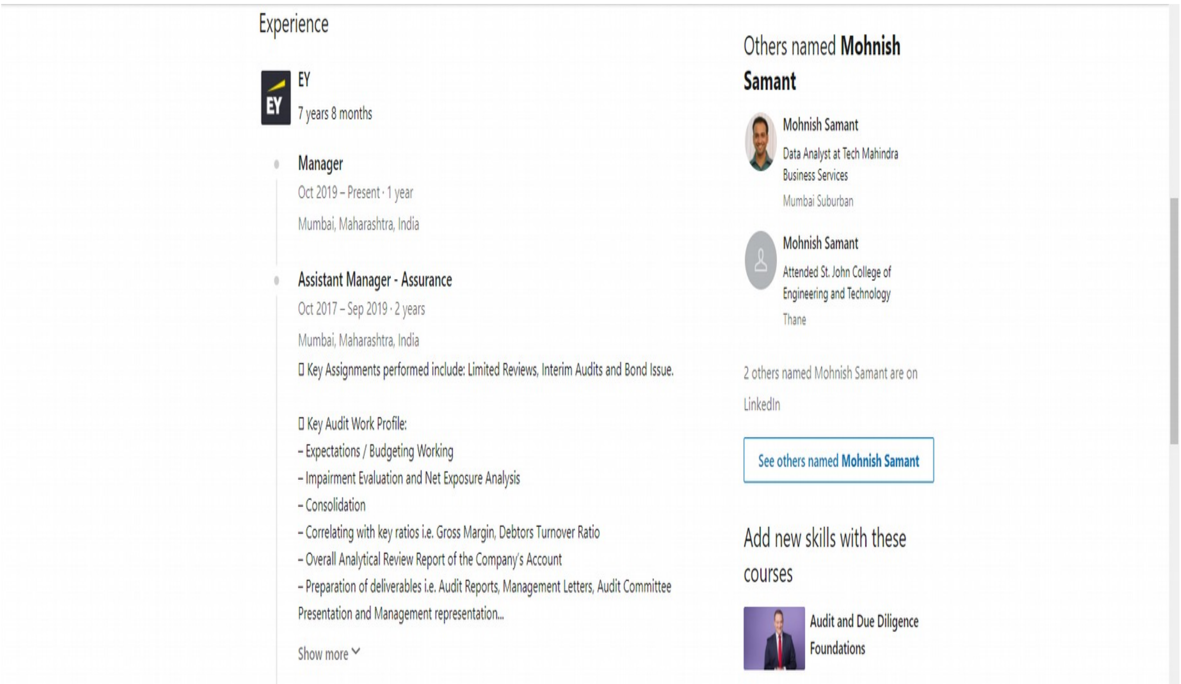
Appendix 2

Evidence/details of direct/indirect relationship of SRBC, EYLLP and EYMBS

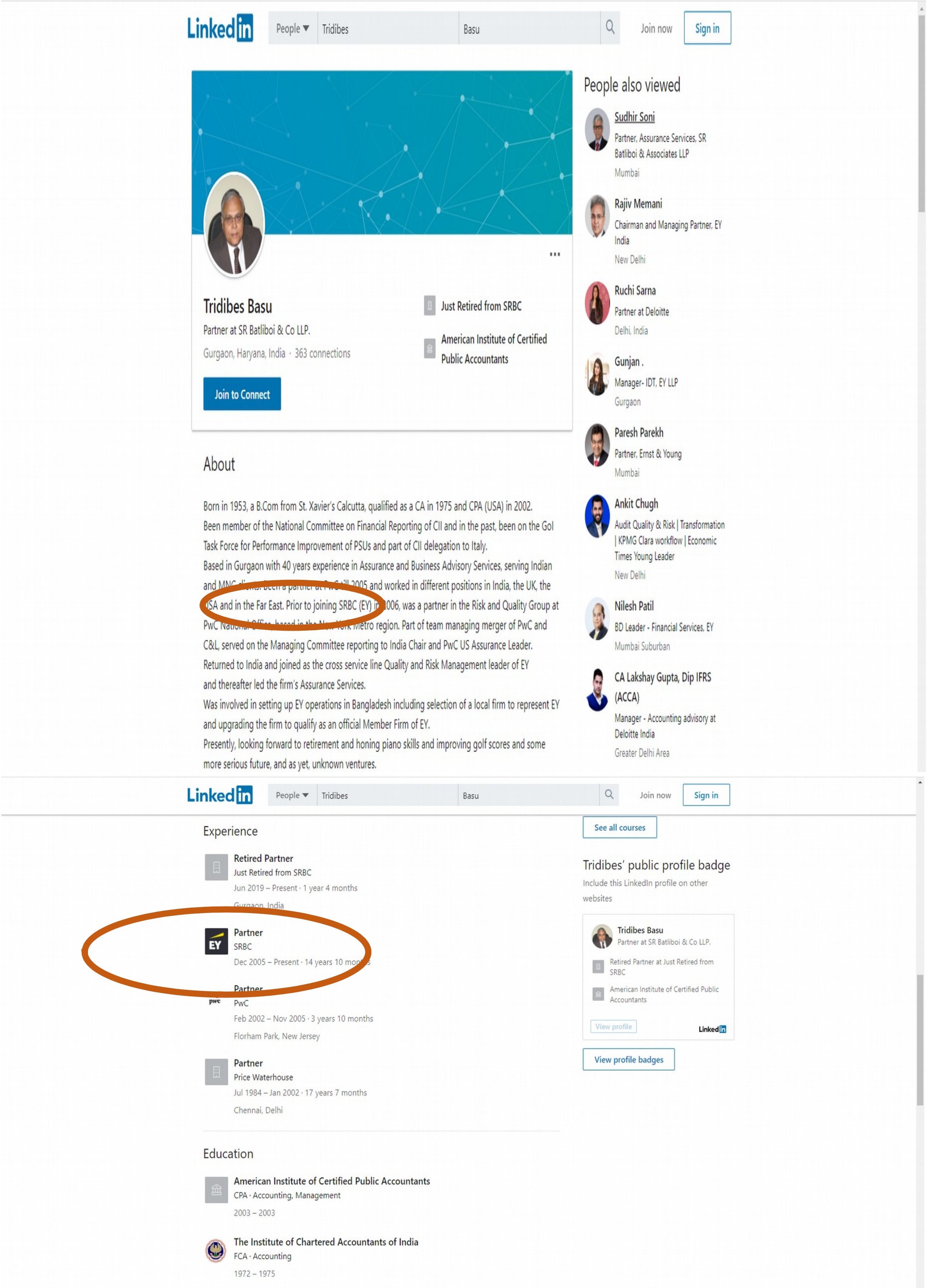
1. The employees of SRBC & Co. LLP use the brand name and the logo of EY on public domain evident as follows:

(a).





(b).


LinkedIn
People
Tridibes
Basu
Join now
Sign in
People also viewed
Sudhir Soni
Partner, Assurance Services, SR Batliboi & Associates LLP
Mumbai
Rajiv Memani
Chairman and Managing Partner, EY India
New Delhi
Ruchi Sarna
Partner at Deloitte
Delhi, India
Gunjan .
Manager- IDT, EY LLP
Gurgaon
Paresh Parekh
Partner, Ernst & Young
Mumbai
Ankit Chugh
Audit Quality & Risk | Transformation | KPMG Clara workflow | Economic Times Young Leader
New Delhi
Nilesh Patil
BD Leader - Financial Services, EY
Mumbai Suburban
CA Lakshay Gupta, Dip IFRS (ACCA)
Manager - Accounting advisory at Deloitte India
Greater Delhi Area
Tridibes Basu
Partner at SR Batliboi & Co LLP.
Gurgaon, Haryana, India · 363 connections
Join to Connect
Just Retired from SRBC
American Institute of Certified Public Accountants
About
Born in 1953, a B.Com from St. Xavier's Calcutta, qualified as a CA in 1975 and CPA (USA) in 2002.
Been member of the National Committee on Financial Reporting of CII and in the past, been on the GoI Task Force for Performance Improvement of PSUs and part of CII delegation to Italy.
Based in Gurgaon with 40 years experience in Assurance and Business Advisory Services, serving Indian
2005 and worked in different positions in India, the UK, the
SA and in the Far East. Prior to joining SRBC (EY) in 2006, was a partner in the Risk and Quality Group at
metro region. Part of team managing merger of PwC and
C&L, served on the Managing Committee reporting to India Chair and PwC US Assurance Leader.
Returned to India and joined as the cross service line Quality and Risk Management leader of EY and thereafter led the firm's Assurance Services.
Was involved in setting up EY operations in Bangladesh including selection of a local firm to represent EY and upgrading the firm to qualify as an official Member Firm of EY.
Presently, looking forward to retirement and honing piano skills and improving golf scores and some more serious future, and as yet, unknown ventures.
Experience
Retired Partner
Just Retired from SRBC
Jun 2019 – Present · 1 year 4 months
Gurgaon, India
Partner
SRBC
Dec 2005 – Present · 14 years 10 months
Partner
PwC
Feb 2002 – Nov 2005 · 3 years 10 months
Florham Park, New Jersey
Partner
Price Waterhouse
Jul 1984 – Jan 2002 · 17 years 7 months
Chennai, Delhi
Education
American Institute of Certified Public Accountants
CPA · Accounting, Management
2003 – 2003
The Institute of Chartered Accountants of India
FCA · Accounting
1972 – 1975
See all courses
Tridibes' public profile badge
Include this LinkedIn profile on other websites
Tridibes Basu
Partner at SR Batliboi & Co LLP.
Retired Partner at Just Retired from SRBC
American Institute of Certified Public Accountants
View profile
View profile badges

(c)

Contact

www.linkedin.com/in/dinesh-agarwal-905341b1 (LinkedIn)

Top Skills

Tax
Management
Business Strategy

Languages

English (Full Professional)
Hindi (Full Professional)
Bengali (Full Professional)

Publications

Taxing times - The Indian financial system needs to rethink its regulatory norms

Made in India - This budget is the first step to realise Modi's manufacturing dream, says EY

Tax impact - EY analyses how the changes in taxation policy will affect individuals and corporates

Dinesh Agarwal

Partner at EY
Kolkata

Summary

Dinesh is a Partner with Ernst & Young Pvt. Ltd., Kolkata and leads the Tax and Regulatory Services in Kolkata. He is a Chartered Accountant and Cost Accountant by qualification. He has more than 23 years of experience in the fields of Domestic and International Taxation. In his career as a Tax Advisor, he has provided extensive tax and regulatory advisory consulting on diverse domestic and international corporate tax issues.

He has always been interested in sports. He is a member of The Lake Rowing Club, Royal Calcutta Golf Club (RCGC) and Dakshin Kalikata Sansad.

Experience

EY
Partner
2004 - Present (16 years)

Partner of Tax & Regulatory Services at Ernst & Young LLP, India.

2. SRBC uses the email Id having ey.com as domain name (naveen.kapur@in.ey.com) as registered email id in LLP registration details.

Ministry of Corporate Affairs
Government of India

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  - View Company / LLP Master Data
  - View Index of Charges
  - View Signatory Details
  - View Director Master Data
  - View Director / Designated Partner Details
  - Advanced Search
- LLP Services
- LLP Services For Business User

Company/LLP Master Data

LLPIN	AAB-4318
LLP Name	S R B C & CO LLP
Number of Partners	30
Number of Designated Partners	2
ROC Code	RoC-Kolkata
Date of Incorporation	01/04/2013
Registered Address	22, Camac [illegible] Block-B, Kolkata Kolkata WB 700016 IN
Email Id	naveen.kapur@in.ey.com
Previous firm/ company details, if applicable	
Total Obligation of Contribution	69500000
Main division of business activity to be carried out in India	74
Description of main division	Other Business Activities
Date of last financial year end date for which Statement of Accounts and Solvency filed	31/03/2019
Date of last financial year end date for which Annual Return filed	31/03/2020
LLP Status	Active

3. Addendum to agreement dated 19th July 2016.

S R B C & CO LLP
Chartered Accountants

14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (West)
Mumbai-400 028, India
Tel : +91 22 6192 0000
Fax : +91 22 6192 1000

15 September 2016

IL&FS Transportation Networks Limited
The IL&FS Financial Centre,
Plot C-22, G Block,
Bandra Kurla Complex,
Mumbai – 400 051

Dear Sir,

Re: Addendum to Agreement dated 19 July 2016

Thank you for continuing to choose S R B C & Co LLP to perform professional services for IL&FS Transportation Networks Limited. We appreciate the opportunity to continue to work with you.

This is the addendum to the previously agreed Agreement dated 19 July 2016. Other than the details mentioned below all other terms continue to remain the same as the Statement of Work dated 19 July 2016.

Scope of Services:
Our Scope of Services referred to in the Agreement dated 19 July 2016 is updated to include:
Fees:
"We estimate the fees for our services will be INR 1,000,000." is replaced with "We estimate the fees for our services will be INR 1,700,000."

Please sign this letter in the space provided below to indicate your agreement with these arrangements and return it to *S R B C & Co LLP* at your earliest convenience. If you have any questions about any of these materials, please do not hesitate to contact Jigar Parikh so that we can address any issues.

Yours sincerely

Jigar Parikh
Partner
For and on behalf of S R B C & Co LLP (324982E/E300003)

Specific additional terms and conditions

Notwithstanding anything to the contrary in the Agreement or this SOW, we do not assume any responsibility for any third-party products, programs or services, their performance or compliance with your specifications or otherwise.

We will base any comments or recommendations as to the functional or technical capabilities of any products in use or being considered by you solely on information provided by your vendors, directly or through you. We are not responsible for the completeness or accuracy of any such information or for confirming any of it.

To facilitate performance of Services, [illegible] terms and conditions, including license agreements, [illegible] your authorized representatives to) use, certain software [illegible] that allow us to collaborate with you electronically, including *Ernst & Young Online eRoom* (collective[illegible] "Collaboration Tools"). You shall not, [illegible] not permit third parties to, copy or modify [illegible] Tools, decompile, reverse engineer, or in any way derive any source code from, or create any derivative work of, any Collaboration Tools.

Collaboration tools are provided "as is," and none of SRBC or any other party involved in the creation, production or delivery of any Collaboration Tool makes any warranties, express or implied, with respect to any engagement tool, including, without limitation, any implied warranty of merchantability or fitness for any particular purpose or use, non-infringement, title, or that the operation of any Collaboration Tool will be uninterrupted, error free or that it will be compatible with any of your hardware or software. SRBC will not support, maintain or upgrade any Collaboration Tool. You assume sole responsibility for the use of any Collaboration Tool and the results thereof. Your use of Collaboration Tools (or use on your behalf) is not a substitute for any documentation or system of records you must create or maintain pursuant to law. You alone are responsible for maintaining separate copies of any documentation you input into any Collaboration Tool.

After the Services have been completed, we may disclose or present to prospective clients, or otherwise in our marketing materials, that we have performed the Services for you, and we may use your name solely for that purpose, in accordance with applicable professional obligations. In addition, we may use your name, trademark, service mark and logo as reasonably necessary to perform the Services and in correspondence, including proposals, from us to you.

You shall not, while we are performing the Services hereunder and for a period of 12 months after they are completed, solicit for employment, or hire, any SRBC personnel involved in the performance of the Services, provided, that you may generally advertise available positions and hire SRBC personnel who respond to such advertisements or who come to you on their own initiative without direct or indirect encouragement from you.

4. PACE form of SRBC uses logo of EY. The email Id of all the ET members has in.ey.com as the domain name.

EY

PACE

PACE ID 22212637.2.0 (Completed)
IL&FS TRANSPORTATION NETWORKS LIMITED
GFIS CID 60675240
EP Ravi Bansal

Client Continuance/Engagement Continuance
India/India
Engagement Name Limited Review/Statutory Aud18
Valid Until 19 Apr 2019

There are no discrepancies between PACE and GIS.

Team Members

Role	Team Member	Preparer	Date Added
Engagement Partner	Ravi Bansal (Ravi.Bansal@in.ey.com)	N	07 Jun 2017
Team Member	Puran Singh (Puran.Singh@in.ey.com)	N	07 Jun 2017
Team Member	Parmod Kumar (Parmod.Kumar@in.ey.com)	N	07 Jun 2017
Team Member	Vijay Kumar (Vijay6.Kumar@in.ey.com)	N	07 Jun 2017
Team Member	Maulik Satra (Maulik.Satra@in.ey.com)	N	07 Jun 2017
Team Member	Mrudula Deshpande (Mrudula.Deshpande@in.ey.com)	N	07 Jun 2017
Team Member	Nishant Mankodi (Nishant.Mankodi@in.ey.com)	N	07 Jun 2017
Team Member	Falguni Parmar (Falguni.Parmar@in.ey.com)	Y	07 Jun 2017
Team Member	Sharad Sharma (Sharad.Sharma@in.ey.com)	N	07 Jun 2017
Team Member	Archa Jivrajka (Archa.Jivrajka@in.ey.com)	N	07 Jun 2017
Team Member	Viral Shah (Viral6.Shah@in.ey.com)	N	24 Jun 2017
Team Member	Murtuza Bookwala (Murtuza.Bookwala@in.ey.com)	N	24 Jun 2017
Team Member	Murtuza Bookwala (Murtuza.Bookwala@in.ey.com)	N	10 Jul 2017
Team Member	Nikhil Padte (Nikhil.Padte@in.ey.com)	N	10 Jul 2017
Team Member	Antriksh Bomb (Antriksh.Bomb@in.ey.com)	N	10 Jul 2017

5. Questions in PACE form of SRBC that clearly prove that SRBC itself believes that it is an EY entity.

Generated on 10 Apr 2018
Generated by Antriksh Bomb

PACE
PACE ID 22212637.2.0 (Completed)
IL&FS TRANSPORTATION NETWORKS LIMITED
GFIS CID 60675240
EP Ravi Bansal

Client Continuance/Engagement Continuance
India/India
Engagement Name Limited Review/Statutory Aud18
Valid Until 19 Apr 2019

List/describe other auditing standard(s). Indian GAAS
*Answer Required

4. Will there be another (non-EY) auditing firm involved in the engagement?

- [x] Yes, the engagement will involve our reporting on financial statements for which a portion of the components or investees is to be audited by another (non-EY) auditing firm(s).
- [ ] Yes, our audit relates to an entity that is significant for the group and will be included in a consolidated/group audit report to be signed by another (non-EY) auditing firm(s).
- [ ] Yes, this will be a joint audit in cooperation with another (non-EY) auditing firm(s).
- [ ] No, there will not be another (non-EY) auditing firm(s) involved in the engagement.

4.3 What banding does the aggregate of the components audited by other (non-EY) firms fall into? *(The aggregate component percentage should be the highest of total net income, total assets or total revenues.)*

- ( ) Under 10%
- ( ) 10%-50%
- (•) More than 50%

Regional Assurance Leader and Area PPD approval is required according to 2.7.8 of GAPM.

5. Do we have any concerns regarding the reputation of the other audit firm?

( ) Yes (•) No

Please select "Yes" to question 1 if:

a. this entity is an audit client (including all affiliates of the audit client under the EYG Independence Policy), or

b. you are aware that EY is targeting this entity as an audit client and the "audit and professional engagement period" has started.

1. Is EY required to be independent of the entity being evaluated?

(•) ( )

Page 7 of 35

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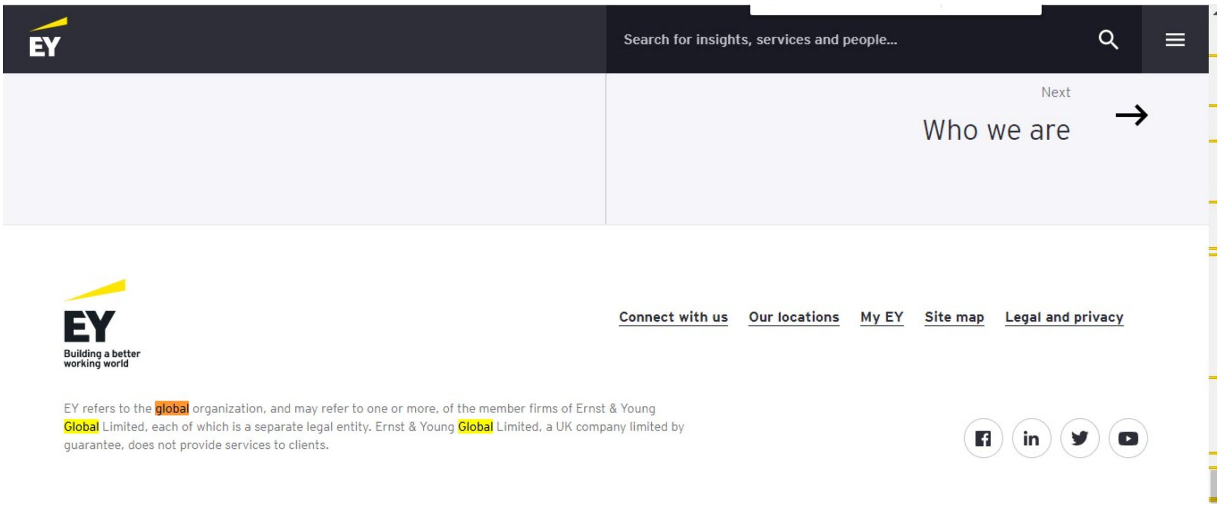
PACE
PACE ID 22212637.2.0 (Completed)
IL&FS TRANSPORTATION NETWORKS LIMITED
GFIS CID 60675240
EP Ravi Bansal

Client Continuance/Engagement Continuance
India/India
Engagement Name Limited Review/Statutory Aud18
Valid Until 19 Apr 2019

Yes No

6. EY News letter (https://info.ey.com/index.php/email/emailWebview)



EY

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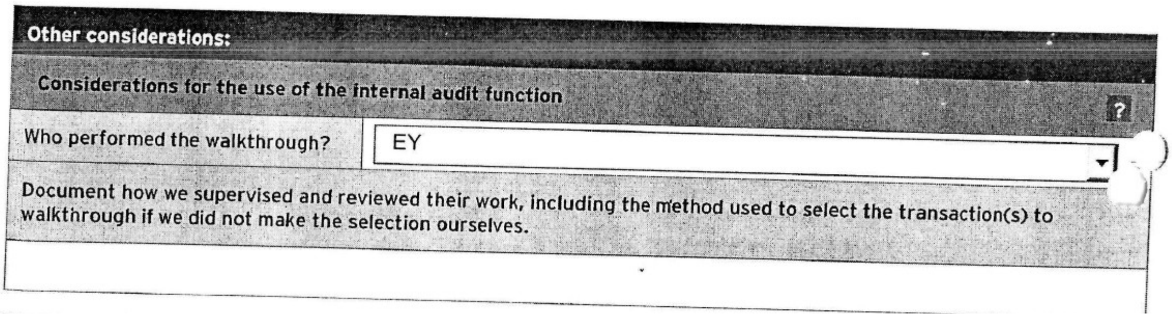
EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients.

7. WP ‘Financial statements and closure process’

-



Other considerations:	
Considerations for the use of the internal audit function	
Who performed the walkthrough?	EY
Document how we supervised and reviewed their work, including the method used to select the transaction(s) to walkthrough if we did not make the selection ourselves.	

Appendix 3

Instances of mismatches observed between hard copy and soft copy of *WP 'ITNL TPE Minutes March 2018'*

Sl.	Para Number	WP *"ITNL TPE Minutes March 2018"* **(Hard Copy)**	WP *"ITNL TPE Minutes March 2018"* **(Soft Copy)**
1	Para 3	d. "*Further he emphasised to all team member to design procedures to evaluate the going concern assumption of the entity at the year end and thereby to maintain professional scepticism throughout the execution of audit."*	Point (d) is not present in the soft copy
2	Para 5	"*He further updated team that client is expecting all controls to operate effectively and they did not find any significant observations in the internal audit reports issued by internal auditors so far and thus asked team members to understand processes from each process owner and then only to proceed with walkthrough and testing of controls."*	This particular portion is not present in Para 5 of soft copy.
3	Para 7	*"From next year onwards we may also be the auditors for some of the material subsidiaries of ITNL, which have toll revenue in its books of accounts. We may consider using data analytics' team help for testing of toll revenue."*	This particular portion is not present in Para 7 of soft copy.
4	Para 8	Omitted	"*Nikhil informed that our FAAS team will also be involved and consulted for IndAS conversion matters*".
5	Para 10	Omitted	"*Murtuza discussed about the Entity Level control and code of*

			conduct. He also discussed on the Human resource policies and Risk assessment and mitigation process followed by the management."
6	Para 11	"*Engagement Team member updated the team about the business risk, significant risk.*" He discussed that, "*we should be skeptical about revenue and construction cost since it involves element of judgement.*"	"*Nishant updated the team about the business risk, significant **FRAUD** risk. He also discussed with the team that we should be sceptical about revenue and construction cost since these are identified as fraud risk.* *The fraud risk and significant risk were discussed and deliberated and detail and there was agreement between EP, EQR and the engagement on the identified **fraud risk related to revenue recognition** and the significant risk related to impairment of investments as well as on the planned procedures to address these risks."*
7	Para 12	Fully omitted	"*Nikhil briefed Nilesh Jain from the valuations team about the investment in subsidiaries and other group companies made by ITNL and the help the audit team will require from the valuations team with respect to impairment testing for carrying amounts of the material investments in books of ITNL. Nilesh informed the team that the traffic data based on which expected passenger car units(PCU) over the life of the project are calculated is one of the most important assumption to be checked in the financial model of the road asset and assured the audit team that valuation team can help the audit team to give them*

			assurance on the reasonableness of key assumptions made for the projected cash flow calculations. He suggested that for ongoing projects one of the better technique to get a comfort the projected PCUs is use actual data of past period and extrapolate the PCUs based on trend analysis. It will also be relevant to see actuals versus budgeted cash flow of the past periods. It was proposed that a joint meeting alongwith Nilesh and the client be held in the coming week to kick start the work."
8	Para 13	Fully omitted	"*Prashant Agarwal along with their finance team joined the meeting for a round of introduction. Prashant also gave a brief overview about the business of the Company-* *He informed us that ITNL is one of the largest BOT operator in India. As on date around 50% of its project are operational and the balance are under development phase. He informed that of around 60% of the projects undertaken were on BOT basis while the balance 40% were on Annuity basis. Prashant also talked the processes they follow in order to close their books of accounts and make the financial statements."*
9	Para 14	Fully omitted	"*Ravi discussed about the margin of ITNL on the construction contracts it gets from the SPVs and reasons for the fluctuations in the margins. Prashant explained that normally ITNL keeps a margin*

			of around 10% of cost (subcontract cost) on all the projects. However the margins can also vary on a case to case basis due to various reasons like project cost escalations may result in lower actual margins, some projects may (especially larger ones) may not have a scope for a high margin. Prashant also informed us some of the key SPVs from audit perspective could be Moradabad Bareilly expressway Limited, Sikar Bikaner Highway Limited, Khed Sinar Expressway limited, Chenani Nashri Tunnelway Limited, Rapid Metrorail Gurgaon South Limited etc."
10	Para 15	Fully omitted	*"The practice of revenue recognition of construction contracts only after completion of 10% the project was discussed. Prashant explained that since there is high level of uncertainty involved in these projects, the Company is following the above mentioned accounting policy based on conservative approach."*
11	Para 18	Fully omitted	*He also explained the key IndAS issues i.e accounting treatment of government grant, valuation of impairment testing etc.*

Annexure 1

16. CHRONOLOGY OF THE EVENTS LEADING TO DAQRR OF THE STATUTORY AUDIT OF IL&FS TRANSPORTATION NETWORKS LIMITED FOR THE FINANCIAL YEAR 2017-18, CARRIED OUT BY SRBC & CO LLP.

S.No	Date	Event / Correspondence
1.	22.02.2019	Email of NFRA sent to ILF&S Transportation Networks Limited requesting for the Audit file of ILF&S Transportation Networks Limited for the Financial Year 2017-18.
2.	22.03.2019	Submission of Audit File vide letter dated 22 March 2019
3.	17.05.2019	EMAIL of NFRA to SRBC seeking details of: 1. List of Related Parties of ITNL 2. List of Related Parties of M/s SRBC & Co LLP 3. Details of audit and non-audit fee
4.	14.06.2019	SRBC letter to NFRA providing details sought in NFRA's Email dated 17.05.2019 (Related parties of ITNL, Related Parties of M/s SRBC & CO LLP and audit & non audit fee)
5.	03.07.2019	NFRA's Questionnaire 1 to SRBC.
6.	17.07.2019	NFRA's EMAIL seeking Affidavit relating to the information received by NFRA dated 14.06.2019
7.	19.07.2019	NFRA's Questionnaire 2 to SRBC
8.	22.07.2019	SRBC response to NFRA Questionnaire 1 dated 03.07.2019
9.	23.07.2019	SRBC submitted Affidavit dated 23.07.2019 in support of information sent on 14.6.2019
10.	29.07.2019	SRBC response to NFRA Questionnaire 2 dated 19.07.2019

11.	09.08.2019	NFRA's Email to SRBC seeking audit file references and page numbers for hard files
12.	19.09.2019	SRBC letter providing details as sought by NFRA in its Email dated 09.08.2019 along with SQC 1 Policy, 3 Limited Review Files
13.	17.10.2019	NFRA's letter to SRBC for verification of dating of audit files and procedures pertaining to integrity of dating
14.	23.12.2019	NFRA's letter seeking engagement letters for audit and non-audit services to ITNL for the FYs 2014-15 to 2018-19
15.	10.01.2020	SRBC's Letter providing the details sought by NFRA on 23.12.2019
16.	22.01.2020	Request for submission of Memorandum, analysis, presentations and other material incorporating the impact of transition from IGAAP to Ind AS from NFRA to Audit Firm.
17.	29.01.2020	SRBC's submission of details as requested by NFRA on 22.01.2020
18.	24.03.2020	Prima Facie Conclusions (PFC) on AQR of Statutory audit of ITNL
19.	17.04.2020	Supplementary PFC (SPFC) on Integrity of audit file and Audit Firm's IT Controls Review
20.	03.07.2020	Response to PFC and SPFC
21.	28.12.2020	Additional documents asked from Audit Firm- copy of audit committee and Board Meeting minutes for appointment of SRBC & Co LLP for FY 2016-17, Audit Engagement Acceptance Letter 2016-17, Minutes of Audit committee 29 May 2018, Underlying agreement 2012-13.
22.	02.01.2021	Response to information sought on 28.12.2020 with five annexures.
23.	08.03.2021	Issuance of Draft Audit Quality Review Report (DAQRR)
24.	10.07.2021	Written replies furnished by SRBC NFRA's observations in the DAQRR

25.	08.09.2021	Presentation to NFRA by the engagement team members of SRBC.
26.	23.09.2021	Issuance of AQR Report by NFRA