INSPECTION REPORT
2022

Audit Firm: Price Waterhouse Chartered Accountants LLP
Firm Registration No. 012754/N5000163
Inspection Report No. 132.2-2022-04
December 22, 2023

राष्ट्रीय वित्तीय रिपोर्टिंग प्राधिकरण
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PART A

Executive Summary

Section 132 of the Companies Act 2013 mandates the National Financial Reporting Authority (NFRA), inter alia, to monitor compliance with Auditing Standards, to oversee the quality of service of the professions associated with ensuring compliance with such standards, and to suggest measures required for improvement in quality of their services. Under this mandate, NFRA initiated audit quality inspections of the Chartered Accountant firm Price Waterhouse Chartered Accountants LLP in December 2022. The scope of the inspection included a review of firm-wide quality controls to evaluate Audit Firm's adherence to SQC-1 and review of selected Audit Documentation of the annual statutory audit of financial statements for the year ending 31.03.2021. Three significant audit areas were identified in respect of each audit engagement viz., Revenue, Trade Receivables, and Investments, due to their inherent higher risk of material misstatement. The on-site inspection was carried out between December 2022 and January 2023.

During the inspection, the Inspection Team held discussions with the Audit Firm personnel, reviewed policies and procedures and examined documents to arrive at the prima facie observations. These observations were conveyed to the Audit Firm. After examining the replies, NFRA conveyed a draft inspection report to the Audit Firm. The replies and documents submitted by the Audit Firm have been examined and incorporated as considered appropriate in this report. The key observations in this report are summarised as follows:

a. The Firm, as a policy and practice, identifies the Audit Committee of the audited entities as Those Charged with Governance (TCWG), which is not in compliance with SA 260 (Revised). (Para 20-22)

b. Audit Firm's audit documentation is maintained in electronic format and some documentation like external confirmations, signed financial statements are kept in physical file which should be in one place for better compliance with Para 77-81 of SQC 1 read with SA 230. (Para 26-27)

c. The Audit Firm as part of its internal quality monitoring policy and process, performs inspection of a sample of individual audit engagement files and the Inspection teams select certain audit areas for review. However, there is no document explaining the rationale or criteria for selection of these specific audit areas for review by the inspection team. (Para 30-31)

d. NFRA noted the Audit Firm's policy decision to voluntarily restrict provision of all non-audit services to the NFRA governed clients, its subsidiaries and its material overseas associates. (Para 32-36)

e. In case of an audit engagement file reviewed:

(i) The Engagement Team did not issue a modified opinion on Internal Control over Financial Reporting nor documented the reasons for not modifying the audit opinion despite existence of certain critical inadequacies and deficiencies in the overall IT environment. (Para 40-42)

(ii) The Engagement Team obtained 'Low' level of substantive evidence despite significantly weak IT General Control environment identified by the Information Systems Audit Team of the Audit Firm. (Para 43-47)

(iii) The Engagement Team did not identify a fundamental error in the disclosure of an audited entity's accounting policy for revenue. (Para 50-51)

(iv) Audit in respect of verifying and ensuring the entity's recognition and measurement for impairment loss allowance in accordance with the ECL approach of Ind AS 109[1] was inadequate and inappropriate. (Para 52-53)

(v) Final evaluation of the uncorrected misstatements and sufficiency of the audit work was not evaluated with reference to actual financial results of the financial year under audit but based on average profits of previous years. This is not in compliance with requirements of SA 450[2]. (Para 56-59)

(vi) While evaluating the impact of misstatements identified during the audit, the ET had improperly considered the uncorrected misstatements net of tax instead of gross of tax as a percentage of PBT leading to erroneous conclusion of the impact of uncorrected misstatements and the extent of audit procedures. (Para 60)

f. In case of another audit engagement file review, there was no evidence of a complete list of related parties having been obtained at the start of the audit. Further, there was no audit evidence of the ET having verified the management assertion in the financial statement that the Related Party Transactions (RPT) were conducted on arm's length basis. (Para 61-63)

Inspection Overview

1. Section 132 of the Companies Act 2013, inter alia, mandates NFRA to monitor compliance with Auditing Standards, to oversee the quality of service of the professions associated with ensuring compliance with such standards, and to suggest measures required for improvement in quality of their services. The relevant provisions of NFRA Rules prescribe the procedures in this regard, which includes evaluation of the sufficiency of the quality control system of the auditor and the manner of documentation of the system by the Auditors. Under this mandate, NFRA initiated audit quality inspections in December 2022.

[1] Indian Accounting Standard (Ind AS) 109, *Financial Instruments*

[2] Standard on Auditing (SA) 450, *Evaluation of Misstatements Identified During the Audit*.

The overall objective of audit quality inspections is to evaluate compliance of the Audit Firm/Auditor with auditing standards and other regulatory and professional requirements, and the sufficiency and effectiveness of the quality control system of the Audit Firm/auditor, including:

(a) adequacy of the governance framework and its functioning;
(b) effectiveness of the firm's internal control over audit quality; and
(c) system of assessment and identification of audit risks and mitigating measures

2. Inspections involve a review of the quality control policy, review of certain focus areas, test check of the quality control processes, and test check of audit engagements performed by the Audit Firm during the year.

3. Inspections are, however, not designed to review all aspects and identify all weaknesses in the governance framework or system of internal control or audit risk assessment framework and are also not designed to provide absolute assurance about the Audit Firm's quality of audit work. In respect of selected audit assignments, inspections are not designed to identify all the weaknesses in the audit work performed by the auditors in the audit of the financial statements of the selected companies.

4. Inspections are intended to identify areas and opportunities for improvement in the Audit Firm's system of quality control. Inspection reports are also not intended to be either a rating or a marketing tool for Audit Firms.

Audit Quality Inspection Approach

5. Selection of Audit Firms for the 2022 inspections was based upon the extent of public interest involved, as evidenced by the size of the firm, its composition and nature, the number of audit engagements completed in the year under review, complexity and diversity of preparer's financial statements (henceforth, Companies) audited by the firm and other such risk indicators. **M/s Price Waterhouse Chartered Accountants LLP** was one of the Audit Firms selected as per the above parameters.

6. The selection of individual audit engagements of the Audit Firm was largely risk-based, using and based on financial and non-financial risk indicators identified by NFRA. Accordingly, the Audit Files in respect of four (4) Audit Engagements relating to the statutory audit of financial statements for the year ending 31.03.2021 were reviewed during the inspection.

7. The scope of the inspection was as follows:

   a. Review of firm-wide quality controls to evaluate the Audit Firm's adherence to SQC 1, Code of Ethics and the applicable laws and rules. Focus areas for the 2022 inspection related to critical elements of the Firm's quality control system viz. leadership responsibilities within the Firm, auditor independence, acceptance and continuation of audit clients, engagement quality control and the Audit Firm's internal quality inspection program.

b. Review of individual Audit Engagement Files- A sample of four (4) individual audit engagement files pertaining to the annual statutory audit of financial statements for the year ending 31.03.2021 was selected. Three significant audit areas identified in respect of each audit engagement were revenue, trade receivables and investments, due to their inherent higher risk of material misstatement.

The selected sample of four individual audit engagements is not representative of the Audit Firm's total population of the audit engagements completed by the Firm for the year under review i.e.2020-21.

Inspection Methodology

8. The inspection commenced with an entry meeting held with Territory Assurance Leader and other senior partners of M/s Price Waterhouse Chartered Accountants LLP on 29.11.2022 at NFRA office. The Firm presented an overview of its Governance Management Structure and Profile, System of Quality Management and Engagement Documentation and Tools and Resources; SQC 1, Quality and Risk Management; Audit Quality and Methodology; Tools and Technology; and External and Internal Reviews. On-site inspection was carried out during December 2022 and January 2023. Inspection methodology comprised meetings, walkthroughs, presentations, interviews, and examination & review of relevant records of the Firm. After the inspection, observations were issued on 23.05.2023 to which the Firm provided response on 16.06.2023. Discussions in person and through VC were also held.

9. The inspection report lists the areas of weaknesses or deficiencies identified which may be taken up by the Audit Firm for improvement.

Audit Firm's Profile

10. M/s Price Waterhouse Chartered Accountants LLP (PWCA) is a Limited Liability Partnership with 10 offices in India. It was established under the Limited Liability Partnership Act 2008. It is a member of Price Waterhouse & Affiliates', a domestic network of eleven CA firms, which is registered with the Institute of Chartered Accountants of India (ICAI) ("PW&A Network") (refer para 11 below) and which operate from common offices.

11. PWCA is one of the eleven (11) firms of the PW&A Network and is a member of the international network of PricewaterhouseCoopers International Limited. PWCA has ten offices in India and had 75 partners as on 31.03.2021. Several of these partners would be partners in other network firms also. All the network firms had a total of 153 partners as on 31.03.2021.

Professional Staff of PWCA LLP for the year ended 31.03.2021	**Audit**	**Others**	**Total**
(i)No. of Senior Management (Manager and above)	101		101
(ii) Others	1212		1212
Total			1313
Professional Staff of constituents of Price Waterhouse & Affiliates for the year ended 31.03.2021			
(i)No. of Senior Management (Manager and above)	343	464	807
(ii) Others	1849	1150	2999
Total	2192	1614	3806
(i) of Entities in NFRA purview			81
(ii) Other than NFRA			979
No. of Statutory Audits (i)+(ii)			1060
Networks of which Audit Firm is a member:			
(i) India:		Price Waterhouse & Affiliates	
(ii) Overseas:		Price Waterhouse Coopers International Limited	

Name of other members of the network (Entities in the Indian Network):
Lovelock & Lewes Chartered Accountants LLP (FRN 301056E E300265)
Lovelock & Lewes LLP (FRN 116150W/W-100032)
Price Waterhouse, Bangalore (FRN 007568S)
Price Waterhouse LLP (FRN 301112E/E300264)
Price Waterhouse & Co Chartered Accountants LLP (FRN 304026E/E-300009)
Price Waterhouse & Co Bangalore LLP (FRN 007567S/S-200012)
Price Waterhouse & Co. (FRN 050032S)
Dalal & Shah Chartered Accountants LLP (FRN 102020W/W-100040)
Choksey Bhargava & Co LLP (FRN 000059N/N 500010)
Price Waterhouse & Co LLP (FRN 016844N/N500015)

12. Besides the above, there are the following other entities in the PWC Global Network, operating in India, that provide services other than audit but are part of the PricewaterhouseCoopers International Limited.

    a. PricewaterhouseCoopers Services LLP (LLPIN: AAI-8885)
    b. PricewaterhouseCoopers Professional Services LLP (LLPIN: AAK-9305)
    c. PwC Business Consulting Services LLP (LLPIN: AAO-9288)
    d. PricewaterhouseCoopers Private Limited (CIN: U74140WB1983PTC036093)

13. It was further informed that PW&A Network is not a separate legal entity and only acts as a facilitator for the constituent member firms and does not by itself carry out any professional practice. All the constituent firms of the PW&A Network have entered into an agreement for cooperation, including, knowledge sharing and resource sharing. There are resource sharing agreements between the various constituent firms. Each constituent firm of the PW&A Network is also member firm of global network of PricewaterhouseCoopers International Limited. Each member firm of the global network is a separate and distinct legal entity. Each member firm does not act either as the agent of PricewaterhouseCoopers International Limited or any other member firm nor is it responsible or liable for the acts or omissions of any other member firm. Each constituent firm of the PW&A Network has signed relevant admission / license documentation to become part of the global network, namely an accession agreement, a name license agreement, and a firm services agreement. Membership of the global PwC network -provides access to specialised resources, capabilities, methodologies and expertise and inputs on quality management system and international practices.

14. The Assurance Leadership Team for PW&A Network is as under: -

No	Role
1	Territory Assurance Leader
2	Risk and Quality Leader, QR Leader
3	North and East Regional Assurance Leader (RAL)
4	South RAL (also the Ethics & Business Conduct Leader until 27 Jan 2021)
5	West RAL
6	Assurance Clients and Industries Leader
7	Technology Risk Assurance Leader
8	Assurance Transformation Leader (also the Assurance Chief Operating Officer)
9	Capital Markets and Accounting Advisory Services (CMAAS) Leader
Invitee to the Assurance Leadership Team: •Assurance Human Capital Leader •Compliance & Finance Partner	

15. PWCA network has also the following functional specialist units:

No.	Function
1	Risk and Quality (R&Q)
2	Indian GAAP & Auditing Standards
3	IFRS, Ind-AS
4	US GAAP/GAAS
5	Audit Methodology and Aura Implementation
6	Learning & Development
7	Assurance Risk Management Leader

8	Quality
9	Ethics and Business Conduct (E&BC)
10	Assurance Ethics and Compliance
11	Independence
12	CIO, CISO

Advisory Committee:

16. The Advisory Committee comprises the Non-Executive Chair, Territory Assurance Leader, Tax Leader and at least two members, who are practicing Chartered Accountants registered with ICAI and partners in PW&A Network firms).

17. The Advisory Committee is responsible to assist / advice / provide inputs to the Non-Executive Chair on various matters including relating to compliances, regulations, regulatory developments, reviews, and other related aspects like audit quality, risk management and all assurance/audit/certification related activities.

Partner Oversight Committee:

18. The Partner Oversight Committee (POC) is a common oversight body across all the constituent firms of the PW&A Network as well as other Indian member firms of the global PwC network.

    POC is intended for effective coordination and alignment with the global network standards and policies. While the POC makes recommendations and provides guidance to the constituent firms of the PW&A Network, it is not intended to nor does it exercise any management control over them.

Acknowledgement

19. NFRA acknowledges the cooperation extended by M/s Price Waterhouse Chartered Accountants LLP.

PART B

Review of Firm-Wide Audit Quality Control System

A. Audit Committee is by default considered Those Charged with Governance

20. The Firm, as a policy and practice, identifies the Audit Committee of the audited entities as Those Charged with Governance (TCWG), which is not in compliance with SA 260 (Revised)[3]. This standard requires the auditor to determine TCWG considering the legal framework governing the entity, who are responsible for overseeing the strategic direction of entity and obligations relating to accountability of the entity. The audit committee is a subgroup of Board of Directors and therefore a subgroup of TCWG mentioned in SA 260 (Revised).

[3] Standard on Auditing (SA) 260 (Revised), *Communication with Those Charged with Governance*

21. The Audit Firm stated that keeping in mind the role and responsibility of overseeing the financial reporting process as prescribed under the Companies Act, 2013 and SEBI (LODR) Regulations, 2015, the Audit Committee had been considered as TCWG; that their engagement letters addressed to the Board of Directors contain a clause that they will communicate with them only if the audit committee's oversight over the financial reporting process is ineffective. However, the Audit Firm added that since March 2023 they have amended their process to keep the Board of Directors informed of their communication with Audit Committee.

22. According to Para 10 (a) of SA 260 (Revised), the TCWG has the following functions:

    - Overseeing the strategic direction of the entity,
    - Overseeing the obligations related to the accountability of the entity, and
    - Overseeing the financial reporting process.

    The Audit Committee constituted under Section 177 (4) of the Companies Act, 2013 is entrusted with the functions relating to the financial reporting process, including monitoring of the statutory audit, The Audit Committee does not have all the functions of a TCWG envisaged in SA 260 (Revised). Therefore, Audit Committee is not synonymous with TCWG prescribed under SA 260 (Revised), rather it is a subgroup of TCWG as mentioned in para 12 of SA 260 (Revised). Similarly, the Chief Executive Officer or the Managing Director of the Company is also not equal to or synonymous with TCWG. In this regard, detailed explanation available in para A1 to A16 of SA 260 (Revised) may be referred to.

    As the entire Board of the Company in India constitutes its TCWG for the purpose of SAs. The Audit Firm is advised to align its policies and practices with SA 260(Revised) accordingly.

B. EQCR Eligibility Criteria

23. According to SA 220 & SQC 1, EQCR is defined as a partner, or other person in the firm, who should be a member of the Institute of Chartered Accountants of India. However, the EQCR Policy of the Audit Firm does not explicitly specify that the EQCR shall be a member of the ICAI.

24. The Audit Firm stated that the R and Q leader ensures that QRP /EQCR is a member of the ICAI before assigning EQCR responsibilities to a partner.

25. The Audit Firm is advised to incorporate this requirement specifically in the Qualification and Assignment of QRP section of the policy.

C. Assembly and Archival of Files

26. It was noted that the Audit Firm's audit documentation is maintained in electronic format and some documentation like external confirmations, signed financial statements are kept in physical file, with appropriate linkages/references in the electronic file. Ideally, all documentation relating to the Audit File should be in one place for better compliance

with Para 77-81 of SQC 1 read with SA 230 and robust procedures should be implemented to ensure the integrity of the Audit File.

27. The Audit Firm stated that they had noted the recent NFRA orders on the concerns around the integrity of engagement files of other audit firms and had updated their policy mandating scanning the entire physical file and including the same in the electronic file before archiving the same. This is further to their existing policy of indexing and retaining the physical file for future reference where required.

D. Sample Selection Methodology

28. The Audit Firm uses standard templates for sample selection for test of transaction and test of details. This template uses the following formula:

$$\text{Sample Size} = \frac{(SP \times AF)}{(TM - EM)}$$

where;
SP = Sample Population
AF = Assurance Factor
TM = Maximum Tolerable Misstatement
EM = Estimated Misstatement

The assurance factor ranges from 0.8 to 3.0. However, the persons interviewed by the inspection team did not have much clarity on how to choose the value for the Assurance Factor for the desired level of testing. However, the Firm's Audit Guide contains a section explaining the concepts behind sample selection.

29. The Audit Firm stated in their response that the method of determining the sample size used by the Firm is in accordance with the internationally acceptable standards and guidance which are aligned with the relevant auditing standards (SA 530[4]) and ET is aware of the 'relevant inputs' used in the Standard template. It stated that the engagement teams are by and large trained on various critical factors in the Firm's audit tools and techniques, but it would reiterate some of these in their forthcoming training program.

E. Internal Inspection Approach

30. The Audit Firm as part of its internal quality monitoring policy and process, performs inspection of a sample of individual audit engagement files and the Inspection teams select certain audit areas for review. However, there is no document explaining the rationale or criteria for selection of these specific audit areas for review by the inspection team.

31. The Audit Firm stated that as the Internal Inspection reviews are performed by the partners and staff from the network, they are familiar with the requirements of the Firm's

[4] Standard on Auditing (SA) 530, *Audit Sampling*

internal policy. The review efforts are focused on aspects involving higher risk areas after understanding the background of the client, client financial statements, risk assessment, regulatory inspection observations, if any, on the engagement or on other engagements etc. after necessary discussion with the International Team Leader. Going forward, the firm stated in their response that they will consider documentation of the rationale for selection of areas for review. It would be appropriate that rationale and criteria is properly documented for future internal inspections.

F. Independence Policy and Practices

32. PW India's local supplement as amended in February 2020 explicitly states that PwC network firms may continue to provide Non- Audit Services to the overseas holding companies of NFRA governed audit clients, as permitted under Global Independence and their local Independence Rules; e.g. PwC UK can provide Non-Audit Services to XYZ Plc UK, the holding company of XYZ India Limited, which has potential to compromise the independence of the audit in India if the Indian company was an audit client of PWCA. Para 7.1.1 is reproduced below:

"*7.1-1 Non-Assurance Services Where an audit client is governed by The National Financial Reporting Authority (NFRA), non-audit services to the audit client, its subsidiaries and material overseas associates (20% of consolidated income or consolidated net worth of the NFRA audit client) by all PwC network firms would be prohibited. In respect of the overseas holding companies of NFRA governed audit clients in India, PwC Network firms may continue to provide non-audit services as permitted under Global Independence and their local independence rules. PwC India firms are prohibited from providing non-audit services to overseas holding companies* of NFRA governed audit clients.*"

* *The firm's implementation guidance excludes holding companies in the form of investment funds and trusts of transient and limited horizon.*

33. The Audit Firm stated that they had amended their policy in February 2020, voluntarily restricting the provision of all Non-Audit Services to the holding companies of NFRA governed entities (including overseas holding companies) by Price Waterhouse Chartered Accountants LLP, other members of Price Waterhouse & Affiliates (the network of firms registered with the ICAI, of which Price Waterhouse Chartered Accountants LLP is also a member), as well as entities that provide services to clients in India that are members of the PricewaterhouseCoopers International Ltd network of firms to address any perception of proximity and threats arising therefrom. However, the overseas member firms of the PwC Network are permitted to provide those services to the overseas holding companies of NFRA governed audit clients that are permitted under the IESBA[5] Code of Ethics and the applicable local Independence Rules. The Audit Firm stated that in view of the limited permissibility of provision of Non-Audit Services in the IESBA Code, in instances where an Indian listed entity is material to the group, it is

[5] International Ethics Standards Board for Accountants

likely that they will not propose/accept appointment as auditors of the Indian entity if significant Non-Audit Services are provided/proposed to be provided by an overseas PwC firm to an overseas parent. In this regard, the Firm cited the example of one case where the Indian Firm declined to accept appointment of an Indian material subsidiary with overseas parent.

34. While we appreciate the above-mentioned steps taken by the Firm to ensure compliance with Indian Law, we advise the Firm to take further steps to avoid potential non-compliances with Indian Law due to provision of non-audit services to overseas holding company of a subsidiary that is under regulatory purview of NFRA and is audited by PW&A firm in India by a overseas PWC network firm.

35. We also observed that PW's Independence Policy paragraph 3.1.1 has a clause permitting the Non-Audit Service of representing before any authority, which has potential conflict with Section 144 of the Companies Act, 2013 which prohibits non audit services. The Audit Firm stated that given their voluntary decision not to provide Non-Audit Services to NFRA governed entities, no representation services are permissible to such entities as per their policy. The firm should formalize this.

36. The Audit Firm is advised to incorporate in its Independence Policy Manual the mitigating measures discussed above in order to remove any ambiguity and avoid any unintentional non-compliance with the Statutory Framework in India.

PART C

Review of Individual Audit Engagement Files Focusing on Selected Areas of Audit

37. In this section, we report the deficiencies observed in respect of the selected key audit areas. We report instances where the audit firm did not obtain sufficient appropriate audit evidence supporting its audit opinion about the true and fair view of financial statements and the adequacy and operating effectiveness of the internal controls over financial reporting (IFCoFR).

38. We selected four (4) individual audit engagement files of the audited entities denoted as Entity A, Entity B, Entity C and Entity D.

39. We reviewed the audit work performed by the Engagement Team (ET) in respect of 3 areas viz: Revenue, Trade Receivables, and Investments. Our review focused on certain critical audit procedures viz. Identification and Assessment of Risk of Material Misstatement, Internal Controls including Information Technology Control environment, Design and Execution of Audit Procedures in response to assessed risk (Test of Controls, Transaction Tests, Test of Details, Sample sizes, Analytical Reviews), Accounting Estimates, Accounting Policies/Disclosures and Evaluation of Identified Misstatements.

Entity A

A. Internal Financial Control over Financial Reporting (IFCoFR)

40. The entity uses an Enterprise Resource Planning (ERP) System for transaction processing and accounting of its revenue and related account balances. The Audit Firm's Information System Audit Team identified certain deficiencies in the IT Control environment i.e., Access to Programs and Data, Entity level controls and Period-end Financial Reporting.

41. However, the Audit Firm did not issue a modified opinion on IFCoFR despite these critical inadequacies and deficiencies existed in the overall IT environment[6]. Moreover, the Audit File did not contain any working paper analyzing and concluding that a modified opinion was not required.

42. When pointed out, the audit firm stated that the ET had involved its Information Technology specialist team for testing all 4 domains of IT General Controls (ITGC) i.e., Policy & Procedures, Access to Programs & Data, Change Management and Computer Operations, and noted observations in only 1 out of 4 domains i.e., Access to Programs & Data. The ET and IT Specialist Team evaluated and tested the compensating controls to gather sufficient appropriate audit evidence and obtained comfort on the IT General Controls to issue the audit opinion without modification. The Audit Firm, however, agreed to enhance the documentation to articulate it better in the work papers.

B. Revenue -Audit Procedures in response to Risk of Material Misstatement (RoMM)

43. Occurrence, Completeness, Cut-off, and Accuracy of revenue transactions were dependent upon the ERP system, where the IT Control environment was found to have many weaknesses indicating higher inherent risk of material misstatement. The planned level of expected reliance on controls was high and the sample size used by the ET in its control testing was 25. As per Factor 1 in the Appendix 2 to SA 530, the more assurance the auditor intends to obtain from the operating effectiveness of controls, the lower the auditor's assessment of the risk of material misstatement will be, and the larger the sample size will need to be. The Audit firm's internal policy guidance suggests sample sizes of 25, 40 or 60. The Firm's policy provides guidance to test number of items near the high end of the range i.e., 60 or near thereto in certain conditions such as where the inherent risk and/or fraud risk, associated with account or assertion is higher or the design of control has changed or it is concluded that it was not properly designed or operating effectively in the prior years. Appendix VI of *ICAI's Guidance Note on Audit of Internal Financial Control over Financial Reporting* suggests sample of 25 or 40 depending upon the assessment of risk of failure of control as low or high, respectively. However, the ET had selected a sample size of only 25 which was not commensurate with the risk level.

[6] Para 128-136, Para 161-162, and Para IG 20.1 of ICAI *Guidance Note on Audit of Internal Financial Controls over Financial Reporting*

44. The ET had planned to obtain 'Low' level of substantive evidence despite significantly weak IT General Control environment identified by the Information Systems Audit Team of the Audit Firm. The sample sizes for test of details were in the range of 10 to 28 only, which was too small to provide sufficient appropriate audit evidence vis-à-vis the level of expected reliance on controls i.e., high, and higher inherent risk of material misstatement due to weak IT General Control environment. The total monetary value of transaction testing was ₹ 19.5 crores, which was 2.09% of Total Revenue of ₹ 930.14 crores.

45. As a result, the ET did not have sufficient appropriate audit evidence to support its unmodified opinion on the financial statements.

46. The Audit Firm responded that as mentioned in observation relating to control deficiencies in IFCoFR, the ET had evaluated and tested compensating controls. As the ET got comfort on the IT General controls the ET determined that there was no reason to change the planned audit strategies including 'high' level of reliance from controls and 'low' substantive procedures to test Revenue.

47. The Audit Firm's response is not acceptable in view of the provision of SA 530 referred to above, the ICAI Guidance Note on IFCoFR and the Firm's own policy. The Audit Firm should ensure that ET adequately assess their audit strategy for substantive audit procedure and select appropriate sample sizes.

C. Testing of accuracy of the amount of Revenue recorded.

48. The ET did not perform any substantive audit procedure to check the accuracy and correctness of the 'price details' applied to the actual invoices generated.

49. The Audit Firm stated that the ET had performed tests of controls and substantive tests to verify the price details in sales transactions in both streams of revenue of the auditee entity and therefore, audit procedures were responsive to the level of RoMM . The Audit Firm, however, admitted that they could have documented the approach followed for testing clearly in the Audit File and that they will take care of the documentation enhancements in future.

D. Testing compliance with the applicable financial reporting framework for Revenue

50. The ET did not identify a fundamental error in the disclosure of the audited entity's accounting policy for revenue. The Entity's significant accounting policy in respect of recognition and measurement of revenue at the fair value of consideration received or receivable was not in accordance with the Ind AS 115[7] requirements, which requires the revenue to be recognized and measured at the Transaction Price (Para 46 of Ind AS 115).

[7] Indian Accounting Standard (Ind AS) 115, *Revenue from Contracts with Customers*

51. The Audit Firm acknowledged the NFRA observation and submitted that the audited entity had now updated its accounting policy for the financial year ended 31.03.2023, considering the guidance in NFRA circular dated 29.03.2023.

E. Trade Receivables

Controls to ensure impairment loss allowance is computed as per the applicable financial reporting framework

52. The ET's audit in respect of verifying and ensuring the entity's recognition and measurement for impairment loss allowance in accordance with the ECL approach of Ind AS 109[8] was inadequate and inappropriate (para 8(a), A13, para 8(c), A24, A25 and para 19 of SA 540[9]).

   a) The accounting policy followed was not in accordance with the accounting policy disclosed in the entity's Financial Statements. The policy disclosed was use of a provision matrix based on historical default rates and adjusted for forward-looking estimates. However, no provision matrix was used e.g., having provisions based on past due buckets of Trade Receivables, and the provision was based on management estimates of percentages of bad debt written off to the entity's revenue.

   b) The ET did not check how the management had adjusted the historically observed default rates to forward-looking estimates.

   c) The entity had not made the disclosures required as per para 35M and 35N of Ind AS 107[10] in respect of the credit risk exposure of Trade Receivables.

53. The Audit Firm stated that the ECL method followed by the entity was in accordance with the principles of Ind AS 109. However, they will suggest to the audited entity to refine its accounting policy to elaborate how the provision matrix is applied to ensure that accounting policy disclosed in the financial statements reflects the actual policy followed by the audited entity.

Inadequate testing of controls over accounting for collections of Trade Receivables

54. The ET had noted that the auditee entity's customers intimate the Account Receivable Team about the invoice reference for which the payment had been made by them. The ET had selected a manual control in the entity for verification of collection from customers in the ERP system. However, the ET did not check whether the Internal Auditor had verified that the debtors' collections had been correctly credited against individual invoices specified by the debtors. The ET also did not, on its own, test this

[8] Indian Accounting Standard (Ind AS) 109, *Financial Instruments*
[9] Standard on Auditing (SA) 540, *Auditing Accounting Estimates, including Fair value Accounting Estimates, and Related Disclosures*
[10] Indian Accounting Standard (Ind AS) 107, *Financial Instruments: Disclosures*

important control of checking invoice-wise matching of customer collections which had a direct impact on the 'ageing report' considered for computing impairment loss allowances for Trade Receivables.

55. The Audit Firm maintained that the Internal Auditor verifies the correctness of crediting the debtors' collections against individual invoices specified by the debtors in their bank advice and that the ageing report is accurate; and that the ET checked this by inquiry with internal auditor and by re-performing. However, acknowledging the observation of NFRA, the Audit Firm agreed to be more descriptive in relation to the nature of supporting documents tested.

F. Revision to Materiality and Evaluating Misstatements identified during audit

56. As part of the Planning phase of the Audit, ET had determined materiality levels based on the average Profit before Tax (PBT) from continuing operations of the past 3-5 years. Actual PBT for the year under audit was significantly lower (₹ 1,800 Mn) than the estimated chosen benchmark (₹ 3,991 Mn), but ET did not revise overall materiality and performance materiality based on actual PBT, resulting in inadequate audit work and non-compliance with para 10 read with para A11-12 of SA 450[11], to support the opinion expressed on the financial statements.

57. It is important to note that the auditor expresses his opinion on the financial statements of a particular year and not on the average position based on financials of the past few years. Therefore, final evaluation of the uncorrected misstatements and sufficiency of the audit work must be evaluated with reference to actual financial results of the financial year under audit. The auditor should be alert throughout the audit for any possibility of the actual financial results being significantly different, which was the case in this audit, from the estimates made during planning phase and revise the materiality thresholds and the extent of audit tests.

58. The Audit Firm stated that they had reviewed the prescriptions of SA 450, the ICAI Guidance Note ''*Implementation Guide to Materiality in Planning and Performing an Audit' and Other International Prescriptions and* do not believe that the SA requires change of the chosen benchmark used for determining materiality at the planning stage and in the performance of the audit. They further stated that if one has to change the materiality based on actual profits of the year while evaluating the impact of the identified misstatements, this will mean they need to redo the audit by changing the benchmark from 'Average profit' to 'Current year profit' (or for that matter any benchmark) which is not in line with the requirement of SA 320[12] / SA 450.

59. The Audit Firm's contentions are not acceptable in view of the clear provision of SA 450, cited above. Para A12 of SA 450 clearly states that if the auditor's reassessment of materiality determined in accordance with SA 320 gives rise to a lower amount (or

[11] Standard on Auditing (SA) 450, *Evaluation of Misstatements Identified During the Audit*
[12] Standard on Auditing (SA) 320, *Materiality in Planning and Performing an Audit*

amounts), then performance materiality and the appropriateness of the nature, timing, and extent of the further audit procedures, are reconsidered to obtain sufficient appropriate audit evidence on which to base the audit opinion.

60. While evaluating the impact of misstatements identified during the audit, the ET had, while computing the uncorrected misstatements as a percentage of PBT, considered the amount of uncorrected misstatements net of tax instead of gross of tax, leading to erroneous computation of the impact of uncorrected misstatements and the extent of audit procedures.

Audited Entity B & Audited Entity C

G. Related Parties

61. The Audit File did not have a copy of the audited company's policy on Related Party Transactions (RPT) and there was no evidence of a complete list of related parties having been obtained at the start of the audit. Further, there was no audit evidence of the ET having verified the management assertion in the financial statement that the RPTs were conducted on arm's length basis. As this is a requirement under para 24 of SA 550[13], the ET was in non-compliance thereof. The ET stated that they had looked at transfer pricing assessment reports under Income Tax Act, 1961 to verify the management assertions but had not retained adequate documentation.

62. The Audit Firm stated that on an overall basis, transactions with related parties were not significant (sales and purchase individually and in the aggregate being less than 10% of the respective overall sales and purchase). Additionally, with respect to Entity B, the large majority of RPTs were with subsidiaries of the company. Therefore, in both cases, RPT did not pose a significant elevated risk. The Audit Firm further stated that the ET did review the company's RPT policy published on its website and noted that there were no transfer pricing litigations. The Audit Firm stated that they had advised all their audit teams to maintain robust documentation around understanding the process followed by the auditee for the identification/ completeness of related parties/RPT, review of testing and assessment of arm's length pricing and separate documentation for substantive testing of RPT.

63. While noting the Audit Firm's response assuring more robust documentation, we add that the presumption of RPTs with subsidiaries being risk-free or of low risk is not appropriate. NFRA's orders in different cases establishing wide-spread misuse of RPTs in subsidiaries may be taken note of by the Audit Firm.

[13] Standard on Auditing (SA) 550, *Related Parties*

PART D

Chronology of events

Sr. No.	Date	Event/Correspondence
1.	11.11.2022	Intimation of On-site Inspection from NFRA to the Audit Firm.
2.	29.11.2022	Pre-Inspection Meeting with PWCA held at NFRA office.
3.	01.12.2022-23.12.2023 & 09.01.2023-13.01.2023	On-Site Inspection
4.	23.05.2023	Communication of Inspection Team's Observations to Firm
5.	08.06.2023	Discussion between PWCA and NFRA Inspection Team at NFRA office
6.	16.06.2023	Response received from PWCA to observations made by NFRA
7.	06.10.2023	Draft Inspection Report sent
8.	06.10.2023 & 19.10.2023	Discussion between PWCA and NFRA Inspection Team through VC
9.	04.11.2023	Response to Draft Inspection Report
10.	08.12.2023	Communication of final Inspection Report to PWCA
11.	20.12.2023	Comments on the final Inspection Report by PWCA
12.	22.12.2023	Publication of Inspection Report on the website of NFRA as per Rule 8 of NFRA Rules 2018.

Appendix A: Audit Firm's Response to the Inspection Report

Pursuant to Section 132(2) of the Companies Act, 2013 and Rule 8 of NFRA Rules, 2018, the Authority is publishing its findings relating to non-compliances with SAs and sufficiency of the Audit Firm's quality control system. As part of this process, the Audit Firm provided a written response to the draft Inspection Report, which is attached hereto. NFRA based on the request of the Audit Firm has excluded the information from this report which was considered proprietary.

Price Waterhouse Chartered Accountants LLP

December 20, 2023

The Secretary
National Financial Reporting Authority
7th-8th Floor, Hindustan Times House
Kasturba Gandhi Marg
New Delhi – 110 001

Kind Attn.: Ms. Vidhu Sood, Secretary, National Financial Reporting Authority

Dear Madam,

Subject: Response to the 2022 inspection report of Price Waterhouse Chartered Accountants LLP – Firm Registration Number 012754N/N500016

We refer to the inspection report dated December 8, 2023. We appreciate the time and effort devoted by your team, and for providing us with your written observations and valuable inputs during the inspection.

As a firm, we are committed to performing high-quality audits and maintaining trust with our relevant stakeholders. Consequently, we remain focused on making continuous improvements and enhancements to our system of quality management as well as on strengthening our service delivery on audit engagements.

We provide our comments on the observations as follows:

1. As communicated by us during the inspection and as also indicated in the inspection report, we have voluntarily insisted that no non-audit services (NAS) be provided by any of the global network entities to an NFRA audit client, its subsidiaries and material overseas associates. We have also addressed any perception of proximity among the Indian constituent firms of the global network by additionally obtaining their concurrence that they will not provide NAS to holding companies of the NFRA audit clients. The above, along with enhanced requirements of the IESBA Code of Ethics (to which all constituents of global network comply) as applicable to Public Interest Entities in relation to NAS (regardless of materiality and safeguards considerations) if such services might create self-review threats to auditor independence, should address any residual perception around independence. We believe that our independence policies comply with extant regulations and IESBA requirements.

2. We have noted your observations on the individual audit engagements and acknowledge that there is an opportunity for enhancing our documentation and articulation in the audit work papers, however, we do believe the audits themselves followed the applicable professional standards.

Price Waterhouse Chartered Accountants LLP LLPIN AAC-5001 FRN 012754N / N500016 Chennai

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Price Waterhouse Chartered Accountants LLP

3. We have noted your observations relating to revision to materiality and evaluation of misstatements identified during our audits. We reiterate that the same be revisited given the present guidance available to audit practitioners and submit that NFRA consider suitable codification and implementation guidance updates to enable consistent application by audit practitioners as to these concepts.

4. We appreciate NFRA's emphasis on areas of particular significance and are focusing our own efforts on those same topics:

    - **Auditor independence**. We remain committed to ensuring that we have appropriate and rigorous controls over the provision of non-audit services to public interest entities.

    - **Audit file documentation**. As part of our continuing enhancements, we are considering how to enrich our audit file documentation, including with respect to testing of arm's length transactions as part of our related party transaction testing, and our evaluation of internal financial control deficiencies (including the role of relevant compensating controls and mitigated deficiencies) and substantive procedures.

    - **Archival processes**. We are continuously updating our systems for the assembly and archival of audit engagement files with appropriate protections for the security, integrity, and retention of such files in accordance with all applicable auditing standards.

    - **External communications**. We have expanded our policies to call greater attention to communications with those charged with governance (TCWG) and whether there may be instances in which additional reporting is required.

    - **Financial statement disclosures.** We are further emphasizing to our teams the importance of critically reviewing disclosures in the financial statements.

    - **Regulatory developments**. Given the pace of change in regulatory and professional standards, we are focused on timely updating our practice guides, educational materials, and other resources to reflect applicable requirements. Moreover, we are committed to updating and distributing educational materials to ensure that relevant members of our staff are always apprised of relevant guidance.

We remain committed to further enhancing overall audit quality. We look forward to working with the NFRA, our clients and other stakeholders to identify opportunities to continuously augment our processes, policies, and training. We would be pleased to discuss any aspects of our response or any other questions you may have.

Yours sincerely,

S. Vivek.

Subramanian Vivek
Partner
Price Waterhouse Chartered Accountants LLP
Firm Registration Number: 012754N/N500016