



# AUDIT QUALITY REVIEW REPORT

NATIONAL FINANCIAL  
REPORTING AUTHORITY

GOVERNMENT OF INDIA

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[www.nfra.gov.in](http://www.nfra.gov.in)

**Auditor**

SRBC & Co. LLP

Audit Firm Registration Number: 324982E/E300003

**Auditee**

Infrastructure Leasing & Financial Services Limited  
(IL&FS)

**Audit Quality Review Report of the Statutory  
Audit for the Financial Year 2017-18, Carried out  
under Rule 8 of NFRA Rules 2018.**

Report Date: 22<sup>nd</sup> June 2022

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### List of Abbreviations

AGM	Annual General Meeting
ACM	Audit Committee Meeting
AS	Accounting Standards
AL	Arm's Length
ANW	Adjusted Net Worth
AQR	Audit Quality Review
BOD	Board of Directors
CA	Chartered Accountant
COD	Committee of Directors
CFS	Consolidated Financial Statements
CLB	Company Law Board
CIC	Core Investment Company
CARO	Company Auditor's Report Order
CAM	Credit Assessment Memorandum
COR	Certificate of Registration
DPL	Dighi Port Limited
DPDCL	Dighi Project Development Company Limited
EYG	Ernst & Young Global Limited
EY	Ernst & Young

EL	Engagement Letter
EP	Engagement Partner
ET	Engagement Team
EQCR	Engagement Quality Control Review
EQR	Engagement Quality Reviewer
EOM	Emphasis of Matter
FY	Financial Year
FCD	Fully Convertible Debenture
FD	Fixed Deposit
GCP	General Contingency Provision
HCPL	Hill County Properties Limited
ICAI	Institute of Chartered Accountants of India
ICFR	Internal Control over Financial Reporting
IFAC	International Federation of Accountants
IL&FS	Infrastructure Leasing & Financial Services Limited
IECCL	IL&FS Engineering and Construction Company Limited
IEDCL	IL&FS Energy Development Company Limited
IMICL	IL&FS Maritime Infrastructure Company Limited
ITPCL	IL&FS Tamil Nadu Power Company Limited
ITUAL	IL&FS Township & Urban Assets Limited

IFIN	IL&FS Financial Services Limited
ITNL	IL&FS Transportation Network Limited
Ind AS	Indian Accounting Standards
IBC	Insolvency and Bankruptcy Code
JE	Journal Entry
JV	Joint Venture
JCE	Joint Control Entity
KYC	Know Your Customer
LOR	Letter of Representation
NFRA	National Financial Reporting Authority
NBFC	Non-Banking Financial Company
NCLT	National Company Law Tribunal
NMR	N.M. Raiji & Co.
NPA	Non-Performing Asset
NCD	Non-Convertible Debenture
OCD	Optionally Convertible Debenture
PPT	Power Point Presentation
PFC	Prima Facie Conclusion
PCAOB	Public Company Accounting Oversight Board
RBI	Reserve Bank of India

RPT	Related Party Transaction
ROMM	Risk of Material Misstatement
RWA	Risk Weighted Assets
SA	Standards of Auditing
SQC	Standard on Quality Control
SFS	Standalone Financial Statements
TCWG	Those Charged with Governance
TOC	Test of Control
WP	Working Paper

# 1. Executive Summary

## 1.1. The Legal Framework of Audit Quality Review

As mandated under Section 132(2)(b) of the Companies Act, 2013, the National Financial Reporting Authority (NFRA) is required, inter alia, to monitor and enforce compliance with auditing standards in such manner as may be prescribed. Rule 8 of the NFRA Rules, 2018, provides that for monitoring and enforcing compliance with auditing standards under the Act, NFRA may–

- (a) review working papers (including audit plan and other documents) and communications related to the audit;
- (b) evaluate the sufficiency of the quality control system of the auditor and the manner of documentation of the system by the auditor; and
- (c) perform such other testing of the audit, supervisory, and quality control procedures of the auditor as may be considered necessary or appropriate.

As per the Standard on Quality Control on Audit (SQC 1), the Audit Quality control system is designed to provide the auditor with a reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements, and that the reports issued by the auditor are appropriate in the circumstances. Accordingly, NFRA in exercise of its powers under Section 132(2)(b) and Rule 8 of NFRA Rules 2018 has made this Audit Quality Review (AQR) of the statutory audit of Infrastructure Leasing & Financial Services Limited (IL&FS) for the Financial Year 2017-18 carried out by SRBC & Co LLP (Firm Registration No. 324982E/E300003) (“**Audit Firm**”/ “Auditor”). The report examines the overall audit quality in terms of compliance with the auditing standards and the effectiveness of the quality control procedures of the audit firm.

The Audit Firm in its preliminary submissions stated that NFRA has no jurisdiction on audits for FY 2018 and the review relates to a period when the NFRA was not in existence and the provisions of Section 132 of the Companies Act, 2013 had not been notified. This has been given due consideration and NFRA notes that the AQRR is made under section 132. Even though Section 132 (2) and NFRA were notified in October 2018, it does not cast any new duties or responsibilities on the auditor in respect of transactions and audit work done prior to the notifications of NFRA and section 132. NFRA is just a new forum introduced, inter alia, to look into the compliance with the law as it stood on the date of audit and this change of forum to NFRA is only procedural and does not affect any substantial rights of any party including the auditor. Hence NFRA is well within its powers to make this AQRR.

The Audit Firm also stated in its preliminary submissions that NFRA has wrongly concluded the auditor as guilty of the violation of the provisions of the Companies Act, ICAI Code of Ethics, and other applicable laws. In this regard, it may be noted that as a part of the AQRR process, NFRA had issued a Prima-facie conclusion and a draft AQRR and as a principle of natural justice, had asked for a response from the Audit Firm. One of the objectives of the AQR, as explained above, is to examine the extent of the compliance with the auditing standards. Section 143(9) of the

Companies Act mandates compliance with Standards on Auditing (SAs) by the auditor. SA 200 mandates compliance with relevant ethical requirements and all applicable laws and regulations<sup>1</sup>. Therefore, NFRA is well within its powers and duty-bound to identify and report violations of applicable laws and code of ethics by the Audit Firm.

## 1.2. Review Approach

1.2.1. **Process followed in the review:** Under the above mandate, NFRA has reviewed the said statutory audit done by SRBC& Co LLP of IL& FS Ltd for the FY 2017-18 following a reference made to NFRA by the Central Government on 25<sup>th</sup> September, 2019 under section 132(4) of the Companies Act, 2013. The IL&FS group consists of around 250 subsidiaries (listed as well as unlisted), associates and joint ventures as on 31<sup>st</sup> March 2018, engaged in the infrastructure sector. As per books of accounts, the group's revenue was around ₹17,672 Crore and it had total assets of ₹115,814 Crore and total external liabilities of ₹106,543 Crore as on the said date. It reported a net loss of ₹1886 Crore (consolidated) and a profit of ₹584 crore (standalone) for the said period. As per the above reference from the government, NFRA has earlier completed the Audit Quality Review of two of the major subsidiaries of IL&FS, i.e., IL&FS Financial Services Ltd for the financial year 2017-18 (joint audit by Deloitte Haskins and Sells LLP, Chartered Accountants and BSR and Associates LLP, Chartered Accountants) and IL&FS Transportation Networks Ltd (Audit by SRBC & Co LLP) for the same financial year. These reports are available on the website of NFRA.

1.2.2. Based on the above reference from the Government, this review is therefore made according to the Companies Act, 2013, and the NFRA Rules, 2018. During the Audit Quality Review (AQR) the audit file submitted by the Audit Firm was examined and additional information was sought from the Audit Firm from time to time. The Working Papers (WP) submitted and the submissions made by the Audit Firm at various stages of the review were also examined. Based on these, NFRA formed a Prima Facie Conclusion (PFC) which was conveyed to the Auditor. The Audit Firm submitted its response to the PFC which was considered by NFRA along with other relevant materials. Then NFRA issued a Draft Audit Quality Review Report (DAQRR) and sent it to the Audit Firm for its response. NFRA gave an opportunity of an oral hearing to the Audit Firm to put forth its views on the observations in the DAQRR. Important dates of this review process are as under.

- a. Date of start of the AQR process by requesting the Audit File – 12<sup>th</sup> February 2019
- b. Issue of the first set of the questionnaire after examination of the audit file – 19<sup>th</sup> November 2019
- c. Issue of the PFC – 21<sup>st</sup> December 2020
- d. Issue of the DAQRR – 23<sup>rd</sup> July 2021
- e. Receipt of the written replies to the DAQRR – 27<sup>th</sup> September 2021
- f. Oral hearing of the Audit Firm – 17<sup>th</sup> May 2022
- g. Issue of AQRR 22<sup>nd</sup> June 2022

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<sup>1</sup> Paras 8, 9, 14 and A14 to A16 of SA 200.

- 1.2.3. Based on the material on record (primarily the Audit File submitted by SRBC), responses submitted by the Audit Firm to NFRA's Prima Facie Conclusion (PFC), responses to the Draft Audit Quality Review Report (DAQRR) and submissions made to NFRA during the oral hearing by the Engagement Partner (EP) and his team on behalf of the Audit Firm, NFRA has prepared this Audit Quality Review Report (AQR).
- 1.2.4. The observations in this AQR are divided into 11 chapters based on the subject matter discussed. Each chapter has three divisions, A, B and C, detailing the observations, evidence and conclusions made at each stage of the AQR process, i.e., the PFC stage, the DAQR stage and the AQR stage respectively. The final observations and conclusions made at the AQR stage (section C) should be read in conjunction with the discussions at the previous stages to understand the evidence and reasoning behind each conclusion. Wherever the Audit Firm has provided satisfactory responses to the conclusions of the PFC or DAQR or has pointed out inaccuracies in the PFC or DAQR, those issues have been either deleted from the respective sections or are expressly stated as withdrawn in the subsequent sections.
- 1.2.5. Please refer to the Chronology of the events and the documents shown in **Annexure 1** for details of communication between NFRA and the Audit Firm and records which form the basis of this AQR.
- 1.2.6. The contentions made by the Audit Firm which are not supported by the evidence present in the audit file (in the form of supporting documentation or information) are unacceptable<sup>2</sup> and NFRA, therefore, discards such claims as afterthoughts. If any of these claims are considered on their merits, it is without prejudice to this conclusion of NFRA.
- 1.2.7. The AQR is designed to identify and highlight non-compliance with the requirements of the SAs, and to bring out insufficiencies in the Quality Control System of the Audit Firm and the shortcomings in the documentation of the audit process and reporting. The AQR also evaluates the quality and adequacy of the audit supervisory procedures of the Audit Firm. The AQR is, therefore, not to be treated as an overall rating tool.

**1.3. Executive Summary of Observations in the AQR:** This Executive Summary describes briefly our findings on the violations by the Audit Firm. The details of each violation are explained in the subsequent chapters of this AQR.

**1.3.1. *Violation of the norms on Auditor's Independence***

- 1.3.2. For an audit engagement, it is extremely critical that an auditor should be independent of the entity (the auditee) under the audit to rule out any potential conflict of interest and threat of independence. Apart from the professional standards, the Companies Act, 2013 mandates Auditor's independence through restrictions and safeguards prescribed in Sections 144 and 141 of the Act. Section 144 prohibits the statutory auditor from providing directly or indirectly certain types of non-audit services to the auditee group of companies. Section 141

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<sup>2</sup> As per SA 230, and further explained in the AQR

of the Act imposes certain disqualifications for being appointed as an auditor. Such disqualifications will be applicable, inter alia, if the proposed auditor has a business relationship with the auditee group of companies, or if the proposed auditor directly or indirectly provides prohibited services as per Section 144 to the auditee. The term directly or indirectly is defined in the Act to include relationships like parent or associate entities of the auditor, entities whose name, trademark or brand is used by the auditor. These restrictions are to ensure that the Auditor does not get into any conflict of interest and is thereby able to perform its functions independently and issue an appropriate report, which will be relied on by various stakeholders such as the shareholders, investors, creditors etc. Lapses in complying with the provisions regarding auditor's independence are viewed seriously internationally by other audit regulators. The US regulator PCAOB, in a case, observed<sup>3</sup> that "For one audit client, Issuer A, PwC violated the auditor independence rules of the Commission and the Public Company Accounting Oversight Board ("PCAOB") by performing prohibited non-audit services, including exercising decision-making authority in the design and implementation of software relating to the company's financial reporting and engaging in management functions for the company during the 2014 audit and professional engagement period."

1.3.3. NFRA observes that the initial appointment of SRBC & Co LLP and the continuation of SRBC & Co LLP as statutory auditor of IL&FS Limited was violative of the norms of independence. This is because its network (Ernst & Young Global Limited/EY) provided prohibited services to the IL&FS group and also had a business relationship with the auditee (IL&FS) group. How closely the Audit firm, i.e. SRBC, is related to EY has been dwelt at length in Chapter 2 of the AQRR. SRBC, its partners and employees have been using the brand, name, email domain, policy documents etc of the EY. SRBC had also admitted before PCAOB that it is a part of the network of EY. Therefore, there is no doubt that SRBC is a network firm of EYG. EYG entities have been earning significant non-audit revenues from the IL&FS which is audited by one of its network firms i.e., SRBC. Even SRBC too has directly earned non-audit revenue from IL&FS group entities. The total non-audit fees of ₹ 4.57 Crore earned by EYG entities, including SRBC, from IL&FS and its group entities (for the relevant period of 4 years up to the financial year 2017-18) was much more than the Audit fee of ₹ 2.3 Crore from IL&FS. The details of the business relationship, revenue earned by the Group from IL&FS group companies for non-audit and prohibited services rendered are given in this report. Such services resulted in the loss of independence and violation of Sections 141(3)(e), 141(3)(i), 141(4) and 144 of the Companies Act 2013. The audit engagement also suffered from self-review and self-interest threats, hence, failed to meet the independence norms and SRBC should not have accepted the appointment as Auditor in the first place. (All these matters have been explained in detail in Chapter 2 of this AQRR). Nevertheless, NFRA has proceeded to examine compliance by the Audit Firm with the SAs, in their performance of this Engagement, without prejudice to the above findings.

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<sup>3</sup> Audit inspection report of Price Waterhouse Coopers LLP (September 23, 2019)

#### 1.3.4. *Lapses in the Audit of Investments*

1.3.5. The total value of investments shown in the standalone financial statements of IL&FS as on 31<sup>st</sup> March 2018 amounts to ₹12,320 Crore, which is almost 50% of its balance sheet size. The Audit Firm failed to properly verify these investments in almost 80% of the cases. The deficiencies are observed in the areas of use of valuation experts, fair valuation, and impairment loss evaluation. Also, there are certain investments (₹1,637 Crore) for which no evidence of verification is available in the audit documentation. There is no evidence that the Audit Firm has ensured that the management had tested each investment individually for impairment<sup>4</sup>. The Audit Firm also failed to notice non-compliance with the provision of Section 177 of the Companies Act, 2013, which requires prior approval of the Audit Committee for the related party transactions, however, the transactions were approved post-facto by the Audit Committee. The Audit Firm's assertion that post-facto approval is sufficient because the word 'prior approval' is not mentioned in the law is misplaced. A full reading of Section 177 of the Companies Act will itself make it clear that the word 'approval' therein means prior approval because the third proviso to the section 177(4)(iv) makes a specific provision, which allows post facto approval only in some classes of cases involving relatively smaller amounts not exceeding Rs One Crore. If the word 'approval' were to mean or include post facto approval for all cases involving amounts even above Rs One crore, then there would have been no need for the legislature to provide the third proviso as above. This has been explained in detail in Chapters 3 and 4 of this AQRR.

1.3.6. In the majority of the cases relating to investments, the Audit Firm simply relied on the management assumptions and assessments regarding the impairment of investments without independently verifying the veracity of such assumptions and assessments and failed in challenging the same. In that process, the Audit Firm ignored the visible impairment indicators such as insolvency proceedings, permanent decline in the market value of investments, the negative net worth of component entities, etc. This has resulted in not testing the provision of impairment loss on investments made by the Company, leading to the Audit Firm's non-reporting of inflated profits (in the stand-alone financial statements) by the company for FY18. Such lapses in challenging the management and absence of professional skepticism are viewed seriously by audit regulators across the world. The UK's audit regulator FRC observes<sup>5</sup> that "On two audits the audit team did not sufficiently challenge the reasonableness of management's assumptions in relation to cash flow forecasts.". The US regulator PCAOB observes<sup>6</sup> that "Grant Thornton failed to exercise due professional care, including appropriate professional skepticism, and failed to obtain sufficient appropriate audit evidence concerning the reported value of Bancorp's net loans, the effectiveness of Bancorp's controls relating to its allowance for loan and lease losses". These lapses have been discussed in detail in chapter 3 of this AQRR.

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<sup>4</sup> Para 32 of AS 13

<sup>5</sup> Audit quality inspection report of Mazars LLP (July 2021)

<sup>6</sup> Disciplinary case of Grant Thornton LLP (order dated 19.12.2017)

### **1.3.7. *Lapses in the Audit of Loans and Advances***

1.3.8. IL&FS had disbursed loans amounting to ₹8,124 Crore to approximately 26 related parties during the FY 2017-18. The related party transactions were made in violation of section 177 of the Companies Act, 2013 under a related party policy of the Company which contains provisions ultra vires the Act. A company's policy dealing with related party transactions cannot override the provisions of the Act. The Audit Firm failed in designing and performing sufficient and appropriate audit procedures to mitigate the risks, including risks of management override of internal controls, associated with the sanction of these loans, and disbursement of loans by the Company. The Audit Firm ignored potential cases of evergreening and rollover of loans and failed to understand its implications on the financial statements of the Company. The details of the potential evergreening of loans by the company which the Audit firm did not sufficiently examine are given in para 4.13.13 and other parts of chapter 4 of this AQRR. The audit documentation in this regard was insufficient, inadequate and largely absent, vis-à-vis the applicable professional standards.

### **1.3.9. *Lapses in the Audit of Revenue from Operations***

1.3.10. Around 93% of the total revenue (₹1,899 Crore in the standalone financial statements) of the Company was from related parties. However, the transactions were made in violation of section 177 of the Companies Act, 2013. The Audit Firm failed to perform enough tests of details to verify the occurrence of revenue, completeness of revenue transactions, and the accuracy of the revenue recorded. The Audit Firm failed to evaluate the management assertion that related party transactions were conducted on terms equivalent to those prevailing in an arm's length transaction. The details of these lapses are given in Chapter 5 of this AQRR.

### **1.3.11. *Failure to Comply with the Basic Requirements of an Audit***

1.3.12. The AQRR details various instances of non-compliances of the Audit Firm with some of the fundamental requirements of a statutory audit. A few instances are as follows:

- a) IL&FS group consists of several<sup>7</sup> subsidiaries, associates and joint ventures (components). The Companies Act, 2013 requires all subsidiaries and associates to be included while preparing Consolidated Financial Statements (CFS) of the holding company, IL&FS. It is observed that two associate companies were excluded while preparing CFS in violation<sup>8</sup> of the Act. The Audit Firm failed to raise any questions to the management in this regard and also regarding the discrepancies in the total number of components. The details of these lapses are given in Chapter 6 of this AQRR.

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<sup>7</sup> As per note 37 of Consolidated Financial Statements the number is 250, but this number is different in different documents of the Company/Auditor.

<sup>8</sup> Para 7 of AS 23 and Section 129 (3) of the Companies Act 2013, as it stands on the date of Audit Report.

- b) Standards on Auditing (SA) require that when establishing the overall audit strategy, the auditor shall determine materiality. This requires establishing an amount below which uncorrected misstatements, individually or in aggregate, will be evaluated as immaterial for the financial statements as a whole. It is further mandated that the auditor shall also determine performance materiality, which involves the auditor setting an amount at less than the materiality level for particular account balances for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures. The Audit Firm determined materiality at ₹100 Crore and the performance materiality at ₹50 Crore. However, there is no evidence in the audit file that the Audit Firm used this materiality while conducting the audit. No workings were shown as to how the Audit Firm determined the performance materiality. The factors considered, and judgement used to arrive at performance materiality are also not documented. The details of these lapses are given in Chapter 8 of this AQRR.
- c) The SAs applicable to a financial statement audit engagement mandate effective two-way communication by the auditor with “Those Charged With Governance” (TCWG) of the Company. TCWG is essentially those persons(s) or organization(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the Company and obligations related to the accountability of the Company. Therefore, the proper identification and subsequent two-way communications with them play a crucial role in the effective and independent carrying out of the audit engagement. However, the Audit Firm failed to determine the persons comprising TCWG. Further, NFRA could not trace any communication with TCWG relating to the auditor’s independence, and the relationships and other matters between the firm and network firms, as mandated by the professional standards. The Audit Firm did not even communicate with TCWG an overview of the planned scope and timing of the audit, significant deficiencies identified during the audit and lapses in the internal controls of the Company. The Audit Firm’s assertion that it made a presentation of its report to the Audit Committee which meets the requirement of ‘effective two-way communication with TCWG’ cannot be accepted, since the audit committee is not synonymous with TCWG. A mere discussion in the audit committee at the stage of approval of the Audit Report cannot substitute the statutory requirement of effective two-way communication by the auditor with TCWG. Lapses in communication with TCWG are viewed seriously internationally as well. The UK audit regulator FRC has noted<sup>9</sup> that “During their audit of Ted Baker’s accounts for FY13 they failed to ensure that those charged with governance of Ted Baker were informed of all significant facts and matters that impacted upon KPMG’s objectivity and independence as auditor, whether on a timely basis or at all.” The details of these lapses are given in Chapter 9 of this AQRR.
- d) One of the basic objectives of the auditor is to identify and assess the Risks of Material Misstatement (ROMM), i.e., the risk that the financial statements contain material errors/discrepancies (materially misstated) before the audit, whether due to fraud or

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<sup>9</sup> Disciplinary order in the case of (1) KPMG Audit PLC (2) Michael Francis Barradell

error, at the financial statement and assertion (i.e., representations by management, explicit or otherwise, that are embodied in the financial statements) levels. This is achieved through understanding the entity and its environment, including the entity's internal controls. A proper understanding of the ROMM will provide the auditor with a basis for designing and implementing responses to the assessed risks of material misstatement. This will help the auditor to reduce the ROMM to an acceptably low level. However, in assessing the ROMM, the Audit Firm failed to appropriately assess the risk of material misstatements due to a lack of performance of adequate risk assessment procedures. It failed to discuss the susceptibility of the financial statements to material misstatement due to fraud. This ultimately has resulted in several instances of non-reporting of violations by the Company like those observed by NFRA in revenue from operations, impairment of investments, related party transactions etc. These omissions have made the audited financial statements unreliable. The details of these lapses are given in Chapter 10 of this AQRR.

- e) The Audit Firm wrongly asserted that the auditing standards are “*not prescriptive but are principle based*” and it is not possible to make “*extensive detailing in work papers on compliance with each para of the standards of auditing*” (Emphasis in italics added by NFRA). Such an understanding and application of the standards of auditing goes against the fundamental and mandatory nature of the standards. This claim of the Audit Firm completely goes against the compulsory and statutory requirements when the relevant standards themselves use the words such as “shall” in the requirement portion of the standards. Section 143 (9) of the Companies Act, 2013 mandates that “Every auditor **shall** comply with the auditing standards”. Para 18 of SA 200 requires that the auditor **shall** comply with all SAs relevant to the audit. It may also be recalled that after the Enron and other such episodes the International Auditing and Assurance Standards Board (IAASB) initiated a Clarity project to improve the clarity of its standards based on revised drafting conventions. The new format, which has been made applicable on 1st April 2008 and is also followed by India, incorporates the fundamental principles of the Standards of Auditing (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” (Reference: ICAI Handbook of Auditing Pronouncements). The above facts and legal requirements clearly underline the mandatory nature of each requirement of the SAs, as the word “shall” denotes unconditionally mandatory responsibilities.

#### 1.3.13. ***Failure to Comply with the Quality Control Norms***

- 1.3.14. Para 7 of SQC 1 stipulates that the Audit Firm's system of quality control shall include policies and procedures to address elements such as leadership responsibilities, ethical requirements, etc. The quality culture of the firm depends inter alia on the requirement to perform work that complies with professional standards and regulatory and legal requirements applicable in India. Despite such a stipulation in the Standards, NFRA observed that the majority of the documents in the quality control policy (the internal

document that sets out rules, policies, procedures, ethics etc. for the functioning of the Audit Firm in compliance with respective laws and professional standards) submitted by the Audit Firm are the policies of the global network entity EY and had not been drafted with reference to Indian laws, rules and regulations. The quality policy is silent on certain matters like details about the actions to be taken by the Audit Firm to mitigate and eliminate the threats to independence, particularly with reference to the prohibited services as per section 144 of the Companies Act, 2013, and the criteria to choose a benchmark for determining materiality. This makes the quality policy at variance with the Indian regulatory framework. The Audit Firm has taken the stand that though it does not have its own policy but it has adopted EY's quality policy which is more stringent than what is required by Indian laws and which meets international standards. Except for this general claim, the firm has not demonstrated how this adopted policy meets the specific requirements of the Indian laws. Therefore, the firm's claim that "*our Firm's policies and procedures, are more stringent*" has no relevance since the Companies Act, 2013 makes it clear that every auditor shall comply with the SAs. The Companies Act, 2013, nowhere does it mention that an auditor can comply with any standards other than those issued by ICAI. Being a statutory body under the Companies Act, 2013, the monitoring functions by NFRA are performed only with reference to standards that are in force in India. The firm's claim of equivalence of International standards is not relevant for the purposes of examination by NFRA of certified financial statements. The quality policy of an Indian audit firm should detail the ethical requirements, including independence norms applicable in India, specific aspects of acceptance and continuance of client relationships, such as the matters covered in sections 139,141 and 144 of the Companies Act etc. Therefore, the quality policy may vary from country to country. For example, independence norms as mandated under Section 144 of the Companies Act are different from those prevailing in many countries. The Audit Firm's quality policy has to address country-specific mandates. Merely stating that the EY's policy is more stringent and meets international standards is not good enough. The details of the Audit Firm's violations are given in Chapter 11 of this AQRR

- 1.3.15. In relation to the practice of the Engagement Quality Control Review (EQCR), which is a mandatory requirement for a listed company audit and wherein a qualified individual, appointed by the Audit Firm, objectively evaluates the works done by the engagement team, NFRA found no evidence of the procedures performed, and conclusions made by the EQC Reviewer. There was no evidence to show that the Audit Firm's EQC Reviewer objectively evaluated the significant judgements and conclusions reached by the engagement team. The EQC Reviewer is required to discuss with the engagement partner the significant matters arising in the audit and is also required to independently evaluate the conclusions reached by the engagement team while conducting the audit. NFRA found that the EQC Reviewer had merely ticked a Yes/No checklist, which is claimed by the Audit Firm as evidence for the works done by the EQC Reviewer. In NFRA's view, this cannot be considered as compliance with the mandatory requirements of the SAs. The superficial nature of the work of the EQC Reviewer is amply demonstrated by the fact that the EQC Reviewer did not find a single issue despite many large-scale violations by IL&FS

and the firm that were subsequently found by NFRA and which have been detailed in this AQR. This compels us to believe that the review work done by the EQCR was a mere formality. Failure to do a meaningful review led to the overlooking of several lapses made by the engagement team thereby compromising the quality of the audit. Such lapses are taken seriously by the international audit regulators as well. The UK's audit regulator FRC observes<sup>10</sup> that "On two of the audits, there was insufficient evidence of the involvement of the Engagement Quality Control Reviewer (EQCR). On one of these audits, there was insufficient evidence of the EQCR's review and challenge, for certain areas of significant risk. In the other audit, the EQCR did not discuss matters arising with the key audit partner of a significant component or clarify why this was not considered necessary, as required by Auditing Standards. While conversations were held between the EQCR and the key audit partner for another significant component (on the same audit), there was insufficient detail of the matters discussed or the extent of evaluation by the EQCR". The details of our findings on the EQCR are given in Chapter 12 of this AQR.

#### **1.4. Conclusion**

- 1.4.1. The above is a summary of the NFRA's important observations in the AQR. Details of the facts and evidence in support of these observations, and the reasoning leading thereto, are provided in the subsequent chapters of this AQR.
- 1.4.2. While reference has been made in most cases to the applicable Standard on Auditing which has a direct bearing on the issues under consideration, it needs to be borne in mind that certain generally applicable requirements of the Standards on Auditing, such as the need to exercise professional scepticism, the need to obtain sufficient appropriate audit evidence, the performance of procedures to address the assessed risks, etc., are integral to all individual cases discussed in this AQR even if they are not specifically mentioned in individual paragraphs of the Report.
- 1.4.3. Based on these AQR observations, NFRA concludes that the Audit Firm has formed an opinion on the financial statements of the Company and issued its audit report without obtaining reasonable assurance about whether the financial statements as a whole were free from material misstatement, whether due to fraud or error and thereby failed to meet the requirements of Standards on Auditing 700 (SA 700). Para 15 of SA 200 requires that the auditor shall plan and perform an audit with 'professional skepticism' recognising that circumstances may exist that cause the financial statements to be materially misstated. The AQR identifies instances such as impairment of investments, evergreening of loans, approval of related party transactions, recording of revenue, violation of capital and leverage ratios, and numerous other instances given in this AQR where the Audit Firm failed to exercise professional skepticism and failed to challenge the management assumptions and claims in key areas of financial reporting. It is needless to emphasise the importance of maintaining professional skepticism throughout the planning and performance of the audit.

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<sup>10</sup> Audit quality inspection report of Deloitte (July 2021)

- 1.4.4. As summarised above, the AQRR identifies lapses in almost all stages of the audit, such as at the planning stage, substantive testing, reporting to TCWG, adherence to independence norms and involvement of EQCR in the audit. Also, the exercise of professional skepticism and adequate challenge of the management assumptions are key to any audit. Further, as detailed in the AQRR, the audit documentation (a basic requirement) maintained by the Audit Firm (such as those relating to Investment Policy, impairment testing of investments, use of materiality etc) failed to provide a clear record of the professional judgements made and significant decisions made. Such lapses are viewed seriously by audit regulators across the world. The FRC observes<sup>11</sup> that *“The breaches of Relevant Requirements occurred in multiple areas of the audit process from planning, through substantive testing to reporting to those charged with governance, disclosures in the Financial Statements and documentation. In certain cases the breaches were of a basic and/or fundamental nature, evidencing a serious lack of competence in conducting the audit work.”* ..... The FRC further observe in the above case that *“Many of the breaches also reflected a failure to challenge management and to exercise professional scepticism (ISA 200), which is at the heart of auditors’ duties in discharging their role. The poor standard of the audit documentation maintained (which is supposed to be a thorough, clear and accurate record of the audit processes and responses taken, and judgments and conclusions reached) is not trivial; it is of particular concern”*.
- 1.4.5. Thus, the aforesaid instances discussed in this report are of such significance that, in NFRA’s view, the Audit Firm did not have adequate justification for issuing the Audit Report asserting that the audit was conducted in accordance with the SAs and the financial statements give a true and fair view. The Audit Quality is thus seriously compromised due to the large-scale non-compliance with professional standards and regulatory and legal requirements, and the inappropriate reporting made by the Audit Firm. These lapses prevented the investors, creditors and stakeholders from knowing on time the true and fair picture of the state of affairs of IL&FS. If the audit firm had been vigilant, shown professional skepticism, sufficiently challenged management assumptions and claims and strictly complied with its audit responsibilities, such lapses by IL&FS perhaps could have been detected much earlier and the tens of thousands of crore of losses and haircuts that the banks, creditors, and investors were ultimately saddled with would have been averted.

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<sup>11</sup> Final decision notice in the case of (1) Ernst & Young LLP and (2) Mr Mark Harvey (audit of Stagecoach Group PLC for the Financial Year ended 29 April 2017)

## 2. Independence

### A. Prima Facie Observations and Conclusions (PFC)

2.1. In Prima Facie Conclusions, NFRA conveyed the following to the Audit Firm:

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

- a) Companies Act, 2013: Section 141 pertaining to eligibility, qualifications and disqualifications of Auditors. Special note is to be taken of clause (i) of sub-section (3).
- b) Companies Act, 2013: Section 144, which lists the non-audit services that an Auditor is prohibited from providing.
- c) Companies Act, 2013: Explanation to Section 144 which provides the exact scope of the meaning of the phrase “directly or indirectly”.
- d) The Chartered Accountants Act, 1949: Sub-section (2) of Section 2, which defines the kind of activities undertaken by a member of the Institute that will result in his being deemed to be in practice. Special note needs to be taken of clause (iv) of subsection (2) of Section 2 which empowers the Council of the Institute to specify what services (other than accountancy, auditing, etc.) can be rendered by a Chartered Accountant in practice.
- e) Regulation 190A of the Chartered Accountants 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 the resolution of the Council.
- f) SQC 1 provides that the SQC is to be read in conjunction with the requirements of the 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:

- a) “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.

- b) There are two interlinked perspectives of independence of auditors, one, independence of mind: and two, independence in appearance.
- c) The Code of Ethics for Professional Accountants, issued by the International Federation of Accountants (IFAC) defines the term ‘Independence’ as follows:

Independence is:

- i. 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
  - ii. 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.”
- d) 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.
  - e) 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.”

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

- a) 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)(i) 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.

- b) The need to maintain independence in mind, and also independence in appearance, is paramount. The provisions of the law should be understood keeping in view this paramount consideration.
  - c) The five categories of threats to independence, as explained by the Code of Ethics, need to be kept in mind. All cases involving the 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.
  - d) 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.
- 2.1.4. 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.
- 2.1.5. 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.
- 2.1.6. 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 such services do not attract any of the threat categories.
- 2.1.7. 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 the 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.

- 2.1.8. 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.
- 2.1.9. NFRA had taken up for examination the cases listed in Appendix 1 to 3 to this AQRR, where services have been provided by the Audit Firm and its related entities (as defined by the Explanation to Section 144) to either IL&FS or its subsidiaries.
- 2.1.10. In its response dated 26th October 2019, the Audit Firm, inter alia, stated that “*SRBC & Co LLP is a member firm of S.R. Batliboi & Affiliates Network which is registered with the Institute of Chartered Accountants of India (ICAI). **SRBC & Co LLP is also an independent member firm of the international network of Ernst & Young Global Limited (EYG).** For the purpose of your complete understanding and as a measure of good disclosure, we are also providing you with the list of other client-serving independent member firms/entities of EYG that are operating in India, though such firms/entities are not covered under explanation (ii) to Section 144 of the Act.*” (Emphasis added)
- 2.1.11. In its communication dated 6th September, 2020, the Audit Firm, inter alia, stated that “*Certain other entities that are not firms of chartered accountants, operating in India are also members of EYG independently, and without recourse to us. However, those independent member firms are not related parties of, or 'directly or indirectly' related to SRBC & Co LLP within the meaning of Explanation (ii) to Section 144 of the Act. **We expressly state that we have no commonality of ownership, control, management, trademark or of any other nature that may be generally considered to establish that they are related to us, except that they are also independent member entities of EYG in their own right.***” (Emphasis added)
- 2.1.12. The Audit Firm’s assertion that EYG members operating in India are not related to SRBC & Co LLP in the manner provided by the explanation under Section 144 is unacceptable considering the following.
- 2.1.13. 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, 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”.*

- 2.1.14. For the provision of any services “indirectly” five different modalities have been included vide the above explanation:
- a) Through a parent.
  - b) Through a subsidiary entity.
  - c) Through an associate entity.
  - d) Through any other entity whatsoever in which the firm or any partner of the firm has significant influence or control; or
  - e) Through any other entity whatsoever whose name or trademark or brand is used by the firm or any of its partners.
  - f) Provision of any non-audit service through any one or more of the five different modes listed above would be the provision of such service “indirectly” by the statutory auditor.
- 2.1.15. The categories used here are not specially defined, and so must be understood according to their common meanings. While doing so, the mischief that is sought to be remedied by the section and its explanation must be kept in mind.
- 2.1.16. Section 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”.
- 2.1.17. 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. 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.
- 2.1.18. 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 the Companies Act, 2013) were in accordance with the recommendations of the Standing Committee Report, 2010, and should therefore be retained.

- 2.1.19. 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 audits and auditors more stringent. The suggestions included:
- a) 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.
  - b) the prohibition should apply not only to the audit client company but also to its holding company, subsidiary company, and associate company; and
  - c) 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.
- 2.1.20. 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.
- 2.1.21. 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.
- 2.1.22. 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 resorting 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.
- 2.1.23. From the description given by the Audit Firm, and for the various reasons explained below, it is clear that:
- a) 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 Section 144 of the Act.
  - b) Also, SRBC Affiliates Network firms use the EY brand and Trademark for obtaining and providing audit services.
- 2.1.24. 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."*

- 2.1.25. 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.”*
- 2.1.26. In the audit file submitted by the Audit Firm to NFRA, it is noticed that the EP, Jayesh Gandhi, other audit team members, namely, Naushad Ali Rangoonwala, Dharmin M Shah and Amit Kanthed have EY email IDs (Reference: SFS Hard Copy File 1 (Part 1 of 2)- Flap AA5- Page A5.17).
- 2.1.27. The e-Audit File submitted by the Audit Firm itself uses the software called “EY Canvas” and displays the logo of EY on the home page of the audit file.
- 2.1.28. Office Addresses of EY in New Delhi, Pune, Kolkata, Mumbai, Gurugram are the same as the office addresses of SRBC & Co LLP in New Delhi, Pune, Kolkata, Mumbai, Gurugram, respectively.
- 2.1.29. 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 has stated 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 the provision of audit services or accounting services; and c) arrangement with EYG through which the Firm employs or leases personnel to perform audit services.
- 2.1.30. The filing shows that SRBC & 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.
- 2.1.31. It is evident that the Audit Firm engaged EY as the auditor’s internal expert and SA 620 defines an auditor’s internal expert as one who is a partner or staff, including temporary staff, of the auditor’s firm or a network firm.
- 2.1.32. A Public Search of Trademarks reveals the following:

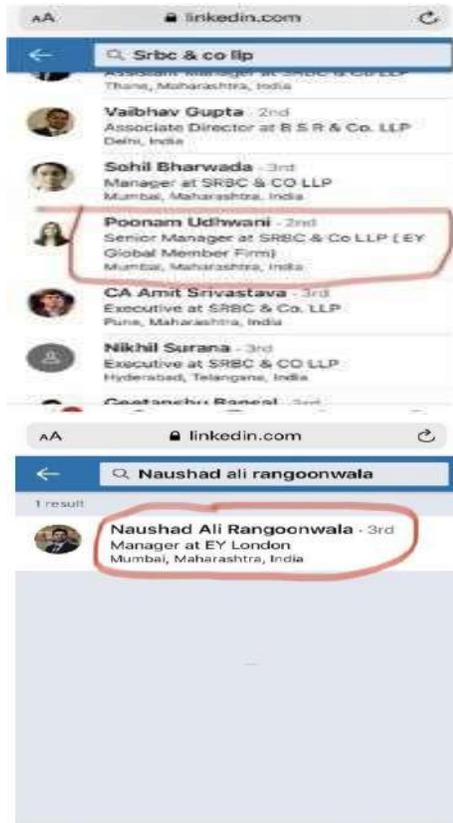


**COMPUTER GENERATED TM-SEARCH REPORT**

Search Criteria - Wordmark		Search String - Ernst		Class - 35		Search Date - 13-Oct-2020	
APPL. NO.	CLASS	CONFLICTING MARK	JOURNAL No	PROPRIETOR NAME	PROPRIETOR ADDRESS	STATUS	Image
1237820	35	ERNST & YOUNG [logo]	1356	EYGN Limited	One Montague Place, East Bay Street, Nassau, Bahamas	Registered	
APPLICATION DATE : 17/09/2003						USER DATE : 01/01/1997	
GOODS/SERVICES : ADVERTISING AND PROMOTIONAL SERVICES, PERSONEL AND RECRUITMENT SERVICES, BUSINESS MANAGEMENT ADVICE, CONSULTANCY, INFORMATION AND RESERCH SERVICES, ACCOUNTING BOOKKEEPING AND AUDITING SERVICE, TAX PREPARATION AND CONSULTING SERVICES, BUSINESS MANAGEMENT CONSULTING SERVICES IN THE FIELD OF INFOMATION TECHNOLOGY, PROVISION OF BUSINESS INFORMATION, INCLUDING THAT PROVIDED ON-LINE FROM A COMPUTER DATABASES BY MEANS OF WEB PAGES ON THE INTERNET.							
1603901	35	ERNST & YOUNG	1427	EYGN Limited	One Montague Place, East Bay Street, Nassau, Bahamas	Registered	
APPLICATION DATE : 20/09/2007						USER DATE :	
GOODS/SERVICES : Advertising, promotional services; personnel and recruitment services; business management; business advice, consultancy information and research services; accounting, bookkeeping and auditing services; tax preparation and consulting services; business management consulting services in the field of information technology; business administration, provision of business information, including all of the aforesaid services provided electronically or online from a computer database or via the Internet, information, advisory and consultancy services relating to the aforesaid services							

Best View in Resolution of 1024x768 or later. Enable Javascript for Better Performance.

- 2.1.33. The EY logo and Trademark are used for Auditing Services also 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.
- 2.1.34. 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 clear proof that SRBC & Co LLP obtained audit assignments under the EY brand name.
- 2.1.35. In fact, in the public perception as well, SRBC & Co LLP is itself a part of EY Group. The employees of SRBC & Co LLP themselves do not buy into the position that the SRBC Affiliates Network, or SRBC and Co LLP, do not use the “EY” name, brand, or trademark. Even Naushad Ali Rangoon Wala, who was part of IL&FS Limited audit team with the designation of Assistant Manager, considers himself to be a part of EY group as is shown by the following information available in the public domain.



2.1.36. It bears recollection that as per Para 3 of Revised Guidelines of Network issued by the ICAI, ***“The judgment as to whether the larger structure is a network shall be made in light of whether a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that the entities are associated in such a way that a network exists. This judgment shall be applied consistently throughout the network”.*** (emphasis added)

2.1.37. The conclusions that emerge from the above analysis are that:

- a) EYG is the parent entity, within the meaning of explanation (ii) to Section 144, of all EYG member entities operating in India, whether they are Chartered Accountants, as in the case of SRBC Affiliates Network, or non-CA entities operating as EYG member entities;
- b) EYG member entities operating in India are, therefore, associate entities of each other, within the meaning of explanation (ii) to Section 144.
- c) Non-audit services provided by either SRBC Affiliates Network entities, or EYG member entities, would come within the meaning of “indirectly” providing such services as covered by explanation (ii) of Section 144.
- d) In all the cases thus covered, the first question to be examined is if the non-audit service concerned is prohibited or not by Section 144. If the answer is that the service in question is

not prohibited, the next point to be examined is if the prior approval of the Audit Committee was obtained before accepting the engagement.

- e) The Board of IL&FS first took up the matter of appointment of SRBC & Co LLP as concurrent/joint auditor along with DHS for FY 17 initially at its meeting held on 12<sup>th</sup> December 2016 even though the formal appointment as statutory auditors of IL&FS for the FY 18 was approved on 27<sup>th</sup> April 2017 by the Board. It is to be examined if there was any subsisting business relationship of the kind prohibited by Section 141 (3) (e) as on 12<sup>th</sup> December 2016, the date on which the Board considered and examined the proposal. While doing so, the term “directly or indirectly” used in Section 141 (3) (e) will have to be given the same meaning as in explanation (ii) to Section 144, as a matter of logical interpretation, given the objective of these provisions and the mischief they seek to remedy.
- f) The matter of whether there was any violation of Section 141 (3) (i) of the Act will have to be similarly examined. Consequently, the applicability of Section 144 to the facts of the case will also have to be studied.

2.1.38. **Validity of Audit Firm’s Appointment:** NFRA has examined the validity of the Audit Firm’s appointment as Statutory Auditor IL&FS in the context of provision of non-audit services.

2.1.39. NFRA has specifically asked the Audit Firm to submit the details of various audit fee and non-audit fee revenue generated directly or indirectly by them (Audit Firm) and their network firms from IL&FS and its related parties. The Audit Firm has in their response dated 26<sup>th</sup> October 2019, submitted the details of audit and non-audit fees earned by them (Audit Firm and network firms) from IL&FS and 'Related Entities of IL&FS Ltd.' However, the Audit Firm has not provided any details of the basis for the determination of the 'Related Entities'. In the absence of any such details, it is presumed that these 'Related Entities' falls within the definition of Section 2(76) of the Act. Further, it is to be noted that the Audit Firm has not provided the details of Engagement Letters (ELs) despite being asked to, rather the Audit Firm has provided the invoice wise details in an excel sheet. Also, in the absence of those details (ELs), we presume that all these engagements violated the Act.

2.1.40. The Audit Firm has stated that SRBC&CO LLP is also an independent member firm of the international network of Ernst & Young Global Ltd (EYG) and provided the details of non-audit fee revenue generated directly or indirectly by such firms/entities for the financial years from 2013-14 to 2018-19 by other client-serving independent members /entities of EYG that are operating in India though it was contended that such entities are not covered under explanation (ii) to Section 144 of the Act. Due to the reasons mentioned in the previous paragraphs of this PFC, NFRA is of the opinion that all these services provided by the other members/entities of EYG fall under the category of services that are provided indirectly by the Audit Firm as per the explanation (ii) to Section 144 of the Act.

2.1.41. NFRA has examined the invoice details of the non-audit engagements provided by the Audit Firm in detail, which are segregated into three buckets. List 1 contains the details of invoices prior to

the engagement date and NFRA considers them as services provided by the Audit Firm in violation of the Code of Ethics. List 2 contains NFRA's observations on the services provided by the Audit Firm to IL&FS and its related entities, which were subsisting engagements as on 12th December 2016 (the date on which Audit Firm's name was proposed by the Board of Directors to be appointed as concurrent/ joint auditors of IL&FS for FY 2017) and hence were in violation of Sections 141(3)(e) and 141(3)(i). **List 3** contains our observations on services provided by the Audit Firm and its network firms to IL&FS and its related entities after the appointment of the Audit Firm which clearly attracts provisions of Section 141(4) of the Act.

a) For List 1 refer Appendix 1 to this AQR

b) For List 2 refer Appendix 2 to this AQR

c) For List 3 refer Appendix 3 to this AQR

2.1.42. **Threats to independence:** Keeping in view that S.R. Batliboi & Affiliates Network (of which SRBC & Co LLP is a member firm) is related to EYG as already explained in detail above, and not accepting the contentions of the Audit Firm that SRBC & Co LLP is not related to EYG, the following table shows the abridged details of total non-audit revenue generated by S.R. Batliboi & Affiliates Network firms and EYG, taken together, from IL&FS Limited and its related entities from FY14 to FY19:

S. No.	Name of the Entity providing service	FY	IL&FS Limited(A)	Related Entities of IL&FS Limited(B)	Total Non-Audit Revenue Amount (₹) * (A+B=C)
1	Ernst & Young LLP	2015-16	14,92,500	1,20,15,005	1,35,07,505
2	SRBC & Co LLP	2016-17	0	17,00,000	17,00,000
3	Ernst & Young LLP	2016-17	5,17,500	93,86,937	99,04,437
4	Ernst & Young Merchant Banking Services Pvt. Ltd.	2016-17	0	20,00,000	20,00,000
5	Ernst & Young Associates LLP	2016-17	0	2,00,000	2,00,000
6	SRBC & Co LLP	2017-18	0	3,00,000	3,00,000

7	Ernst & Young LLP	2017-18	0	71,97,500	71,97,500
8	Ernst & Young Merchant Banking Services Pvt. Ltd.	2017-18	0	13,75,000	13,75,000
9	SRBC & Co LLP	2018-19	0	20,00,000	20,00,000
10	S.R. Batliboi & Associates LLP	2018-19	0	30,00,000	30,00,000
11	Ernst & Young LLP	2018-19	7,50,000	8,00,000	15,50,000
12	Ernst & Young Associates LLP	2018-19	0	30,00,000	30,00,000
<b>Grand Total</b>			<b>27,60,000</b>	<b>4,29,74,442</b>	<b>4,57,34,442</b>

\*Amount is exclusive of out-of-pocket expenses and applicable taxes.

(Source Data: Annexure III\_A and Annexure III\_B to the response of the Audit Firm dated 26<sup>th</sup> October 2019)

2.1.43. The Audit Firm and its associates received non-audit services fees amounting to ₹4.57 crore in 4 years (commencing from 2015-16), as opposed to audit fee revenue of ₹2.3 crore received for conducting the statutory audit for FY18 which strike at the very root of the independence of the SRBC. This brings out the financial interest of the Audit Firm in the whole IL&FS group and showcases the dependence of the Audit Firm on total fees generated from the IL&FS group. The Audit Firm's compliance with the fundamental principles of independence was completely compromised by the self-interest threat which occurred due to the financial interest and dependence on fees for providing non-audit services as stated above.

2.1.44. As per Paragraph 290.32 of the ICAI Code of Ethics, the Audit Firm should also consider any independence threats created by "*Financial or business relationships with the audit client during or after the period covered by the financial statements, but prior to the acceptance of the financial statement audit engagement; or Previous services provided to the audit client.*"

#### 2.1.45. **Prima Facie Conclusions**

a) The appointment of the Audit Firm as Statutory Auditor of IL&FS Limited was ab initio illegal and void for violation of Section 141 (3) (e) and Section 141 (3) (i) of the Act. The Audit Firm had violated the provisions of Section 144 of the Companies Act, 2013.

- b) The certificate submitted by the Audit Firm in terms of Proviso to Section 139 (1) of the Act read with Rule 4 of the Companies (Audit and Auditors) Rules, 2014, was false and invalid, with full knowledge of such illegality. Hence, this clearly constitutes fraudulent conduct on the part of the Audit Firm.
- c) The engagements discussed in this PFC from Para 10 to 28 were persisting even before the appointment of the Audit Firm. This should have prompted the Audit Firm to decline the engagement.
- d) Notwithstanding the above, the acceptance of certain engagements (as detailed in Para 29 to 35) after its appointment as the statutory auditor of IL&FS Limited by the Audit Firm resulted in a “business relationship” with the auditee company as discussed above from point 13.1 to 21.1 of this PFC. Thus, the Audit Firm violated the provision of Rule 10 (4) of the Companies (Audit and Auditors) Rules, 2014. The engagements covered services prohibited under Section 144 and attracting the provision of Section 141 (4) of the Companies Act, 2013, and accordingly, the Audit Firm should have vacated its office as the statutory auditor and such vacation should have been deemed to be a casual vacancy in the office of the auditor.
- e) The Audit Firm had violated the provisions of Section 144 of the Companies Act, 2013 by the indirect provision of prohibited services. Even assuming for the sake of argument that the provisions of Section provided by the Audit Firm did not cover Section 144, there were serious violations of Section 144 otherwise as:
  - i. Audit Committee approval for providing such services is not obtained and;
  - ii. All the services provided by the Audit Firm very much fall under Explanation (ii) to section 144 of the Companies Act, 2013.
- f) The Audit Firm had been in serious breach of the ICAI Code of Ethics.
- g) 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.
- h) The Audit Firm’s compliance with the fundamental principles of the ICAI Code of Ethics was compromised due to self-interest threat.
- i) Given all of the above, it is clear that the appointment of the Audit Firm as the Statutory Auditor of IL&FS was ab-initio illegal and, thus, void.
- j) The Audit Firm has not complied with the requirements of para 17 of SA 260 (Revised).

**B. Observations Made in the DAQRR**

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

- 2.2.1. In Para 2.1.23 to 2.1.37 above (PFC), NFRA has concluded that EYG is the parent entity, within the meaning of explanation (ii) to Section 144, of all EYG member entities operating in India, whether they are Chartered Accountants, as in the case of SRBC Affiliates Network, or non-CA entities operating as EYG member entities; and SRBC Affiliates Network firms use the EY brand and Trademark for obtaining and providing audit services.
- 2.2.2. In its response dated 14th April 2021, the Audit Firm has not contradicted any of the facts established by NFRA. The Audit Firm has merely given various assertions, to convey their viewpoint. Nonetheless, NFRA notes the following for each of the Audit Firm's key assertions:
- 2.2.2.1 The Audit Firm has stated that since SRBC has no "Name License Agreement" with EYG to use the EY brand name, SRB Network entities do not use the EY brand and trademark for obtaining or providing audit services. NFRA notes that the presence of a Name License Agreement between SRBC and EYG is an internal matter of the EY member firms. The fact that the Audit Firm was using EY brand name has been well established in Para 2.1.23 to 2.1.37 above (PFC) and no other evidence rebutting the conclusions reached based on adequate material information by NFRA has been produced by the Audit Firm. Therefore, NFRA's conclusion on the matter stands as it is.
- 2.2.2.2 The Audit Firm has stated that, simply because the Audit Team was using emails with EY domain, does not mean that EY has operational control over the Audit Firm. NFRA notes that the Audit Firm skipped rebutting the fact that using emails with EY domain, clearly establishes that the Audit Firm was using EY brand name and creating a public perception that SRBC and EY are the same. It may be noted that the email IDs and domain used provide to the sender of the mail the identification and authenticity on behalf of the Audit Firm and its parentage (EY), which has not been denied by the Audit Firm. The issue is whether the Audit Firm is using the brand and trademarks of EY and not that of operational control over the Audit Firm as is raised by the Audit Firm. The main issue is whether the Audit Firm has contravened the provisions of Sec 144 explanation (ii) of the companies Act, 2013 in providing the services excluded under the said section or not. Therefore, by using EY brand name and email id to create a public perception that SRBC is part of EY, the Audit Firm has admitted that it is indirectly providing services as an affiliate of EY. Therefore, the services provided by the affiliates of EY and other member firms of EY (SRBC & CO LLP is a member firm of EY as accepted by them) fall under the category of "services provided indirectly" and fall within the category of prohibited services as provided under Sec 144. The Audit Firm failed to provide any evidence in this regard except mere assertions despite specific issues on the usage of mail IDs (containing the Brand name and Trademark) by their employees and raised by NFRA in its PFC.
- 2.2.2.3 The Audit Firm has asserted that "*The office addresses and physical offices of SRBC and EY LLP in New Delhi, Pune, Kolkata, Mumbai and Gurugram are different.*" (Emphasis added). NFRA notes that the Audit Firm has implicitly agreed that the office address of SRBC and EY are the same. The Audit Firm has only argued that the physical

offices are at different locations. NFRA is unable to understand how a different physical office, but the same official address, negates NFRA's PFC observations. The statement is construed only as an attempt to mislead NFRA.

2.2.2.4 The Audit Firm has asserted that *"If a few individual employees of SRBC have added the reference of EY in their personal social media accounts, then the same is not with authorization or agreement of SRBC."* NFRA notes that the Audit Firm has failed to rebut NFRA's observation that the employees using the EY brand in their public profiles indicate that in the public perception and the perception of their employees as well, SRBC & Co LLP is itself a part of EY Group.

2.2.2.5 Further, the Audit Firm has also asserted that *"the Audit Committee of ILFS in the minutes of its meeting held on February 27, 2017, wherein the proposed appointment of SRBC was discussed, had erroneously made reference to EY in the context of appointing of SRBC as auditor of ILFS, SRBC is not aware why such reference was made"* (emphasis added by NFRA). The Audit Firm has further stated that they were provided with the board resolution passed in the meeting dated April 26, 2017, wherein it was mentioned that SRBC is proposed to be appointed and no reference to EY was made therein. NFRA notes that the Audit Firm has not given any argument rebutting NFRA's observation that in public perception and even in the perception of the Audit Committee of the client, SRBC and EY are the same entity and that they were appointing SRBC/EY as their auditor.

2.2.2.6 The Audit Firm has stated that "SRBC has not made the statements to PCAOB, as alleged in the PFC under reply. Instead, SRBC was required to select the applicable option of "Yes" if complete or part of that statement was applicable to SRBC; or" No" if the entire statement was not applicable to SRBC. In relation to the first item 5.2.a.1 in Form 2, SRBC's response for membership or affiliation, etc. was for EYG and the response was 'Network description as in 5.2.a.1: *S R B C & CO LLP is an Indian member firm of Ernst & Young Global Limited (EYG), a UK private company limited by guarantee. EYG is the central coordinating entity of the global EY organization and does not provide any services to clients. Services are provided by EYG member firms. Each of EYG and its member firms is a separate legal entity.*' In relation to the third item 5.2.a.3 in Form 2 the response was 'Arrangement details as in 5.2.a.3: *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, S R B C & CO LLP employs or leases personnel from other EYG member firms in India, to perform audit services, including S. R. Batliboi & Co. LLP.....* Availing such services from other member firms of EYG does not make such other firms as internal experts of SRBC, as the individuals providing their expertise in such cases are neither the partners nor the staff of SRBC or its network firms".

2.2.2.7 It is intriguing and astonishing to note that a professional Audit Firm has said that they have merely selected a Yes or No against the questions in the submission made to an independent audit regulator (PCAOB). Any submission made to an Independent

Regulator is nothing but an oath of declaration giving out the facts. Hence, the submissions made by the Audit Firm are not acceptable and amount to acceptance of the conclusions reached by NFRA. The questions raised therein are being examined in relation to the Independence of the Audit Firm, its ethical practices and in relation to the applicability of Sec 144 of the Companies Act, 2013. NFRA notes that the Audit Firm has attempted to rebut the facts in the PFC, without providing any supporting evidence for the assertions being made. Further NFRA would like to highlight that SA 620 defines an auditor's internal expert as one who is a partner or staff, including temporary staff, of the auditor's firm or a network firm (emphasis added). Hence the Audit Firm's contentions that availing expert services from other member firms of EYG does not make such other firms or individuals as internal experts of SRBC is also not tenable.

- 2.2.3 Therefore, NFRA re-iterated its conclusions as given in the PFC that 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 Section 144 of the Act.
- 2.2.4 **Management Services:** In its response dated 14th April 2021, the Audit Firm has merely provided its understanding of management services. The Audit Firm has quoted Section 144 of the Act and has stated that *“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 issued by International Federation of Accountants and US Securities and Exchange Council (“SEC”).”* Further, the Audit Firm has quoted Section 2(2) of the Chartered Accountants Act, 1949 and has stated that *“Attention is drawn to Appendix No. 2 of the Chartered Accountants Act, 1949 wherein it has been provided that ‘pursuant to section 2(2)(iv) of the Chartered Accountants Act, 1949, the Council hereby reiterates its opinion that the service that may be rendered by Chartered Accountant in practice include the entire range of Management Consultancy Services’. The distinction between Management Services and Management Consultancy Services is once again stressed here and it is reiterated that a Chartered Accountant is permitted to provide the entire range of Management Consultancy Services as a part of his service while in practice.”*
- 2.2.5 Section 2(2) of The Chartered Accountants Act, 1949 only prescribes the situations when a member shall be deemed to be in practice. It is to be noted that Appendix 2 does not form part of The Chartered Accountants Act, 1949. It is only that the Council of the Institute has passed Resolutions under Section 2(2)(iv) of the CA Act, 1949 permitting CAs in Practice to render Management Consultancy Services. In relation to the interpretation of what is covered under “Management Services”, the interpretation has to be within the boundaries of the applicable act, i.e., The Companies Act, 2013 and not on any other law or international practices. The provisions of the Companies Act, 2013 override even the provisions of the Chartered

Accountants Act, 1949 wherever they are in conflict with the Companies Act, 2013. As established in NFRA's PFC, the term 'Management Services' is not defined in the Act and therefore, it should be understood in its literal meaning. Therefore, the Audit Firm's assertion that reference should be drawn to various regulators including IESBA Code of Ethics issued by the International Federation of Accountants and the US Securities and Exchange Council ("SEC"), is incorrect and invalid. It is to be noted that the Companies Act, 2013 does not differentiate between Management Services and Management Consultancy Services. Thus, even if ICAI Code of Ethics allows such management consultancy services, the provisions of the Companies Act, 2013 override such provisions and the provisions of the Companies Act prevail. As these services are barred by the Companies Act, 2013, these services cannot be provided by the Statutory Auditors of a company. Further, it is to be noted that any such non-audit services provided directly or indirectly by the Audit Firm are prohibited services in terms of section 144 of the Companies Act, 2013. Therefore, the assertions of the Audit Firm are not acceptable.

2.2.6 **Violations of Companies Act, 2013 and ICAI Code of Ethics 2019:** As concluded in Para 2.2.3, any of the non-audit services provided directly or indirectly 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 PFC and concludes as follows.

2.2.7 In its PFC, NFRA has noted that all the engagements discussed in List 1 (Refer to Appendix 1) contain services provided by the Audit Firm and its network entities to the Auditee Company, prior to the engagement date. The Audit Firm has in its response dated 14th April 2021 (Page 31 and 32) provided consolidated replies to all the observations made by NFRA in its PFC. The Audit Firm's response and NFRA's observations are as follows:

- a) *"Section 290.157 of ICAI Code is applicable for services provided by the auditor to the audit client during the audit period. It is reiterated that EY LLP or EY MBS are not network firms of SRBC. Even otherwise, the engagement of EY LLP or EY MBS were completed well before appointment of SRBC as auditor of IL&FS, thus engagement is not covered within the ambit of Section 290.157 of ICAI Code. Section 200.4 of Code of Ethics lists out the examples of circumstances that may create self-interest threats for a professional accountant in public practice, which includes having a close business relationship with a client. SRBC has not provided any of the services in question and never had any business or financial relationship with the audit client. The engagements in question were done prior to appointment of SRBC by separate and independent entities. Section 290.32 of Code of Ethics again covers the engagement period or the period for which financial statements were reported by the Audit Firm and the events that can give rise threat to independence. As per the list of engagements in this section, none of the services have been provided by SRBC. The engagements in question were done prior to the appointment of SRBC by separate and independent entities."*
- b) It is to be noted that Section 290.157 of the ICAI Code of Ethics, 2009 lists out the activities which may create self-review or self-interest threats. Further, Section 290.32 of the Code of Ethics states that in the case of a financial statement audit engagement the engagement period includes the period covered by the financial statements reported on by the firm. When an

entity becomes a financial statement audit client during or after the period covered by the financial statements that the firm will report on, the firm should consider whether any threats to independence may be created by a) Financial or business relationships with the audit client during or after the period covered by the financial statements, but prior to acceptance of the financial statement audit engagement or b) **Previous services provided to the audit client.** On a plain reading of this section, it is clearly evident that this section not only covers the services provided by the Audit Firm during the audit period but also covers the services provided by the Audit Firm prior to the audit period. Since the above-mentioned services were provided by the network entities of the Audit Firm prior to the appointment of the Audit Firm, the self-review threat is very much present in all of the cases covered in List 1 (Refer to Appendix 1). The Audit Firm also has a financial interest in providing these services to the company, which clearly brings out the existence of self-interest threats. Further, as concluded in Para 2.2.3, services provided through SRBC, EY LLP, EYA LLP and EY MBS are services provided directly or indirectly by the statutory auditor, as provided under Explanation (ii) to Section 144 of the Act. Hence, these contentions of the Audit Firm are not tenable.

- c) NFRA observed in the PFC that services provided by the Audit Firm and its network entities to the Auditee company were subsisting engagements as on 12th December 2016 (list 2) (the date on which Audit Firm's name was proposed by the Board of Directors to be appointed as concurrent/ joint auditors of IL&FS for FY 2017) would cause non-compliance with both Sec 141(3)(e) and 141(3)(i) of the Act. To these observations made by NFRA in the PFC, the Audit Firm has submitted consolidated replies on Page 33 of their response dated 14th April 2021. The Audit Firm has stated that *“NFRA has stated that December 12, 2016 is the date on which SRBC’s name was proposed by the Board of Directors to be appointed as concurrent/joint auditors of ILFS for FY 2017. SRBC was never appointed by IL&FS as concurrent/joint auditor for FY 17 and SRBC has never provided any concurrent/joint audit services to ILFS or earned any fee in relation to concurrent/joint audit services from ILFS. Therefore, the date of December 12, 2016 is not relevant for the purpose of concluding on independence of SRBC. Audit committee approval under Section 144 is taken after the Audit Firm gets appointed as an auditor of the firm. In the given case, the SRBC was not appointed as Audit Firm as of December 2016 and neither it had provided subsisting services as of that date. Hence there is no question of taking any audit committee approval in connection with the engagements listed under List 2.”* It is to be noted that the Board of IL&FS first took up the matter of appointment of SRBC & Co LLP as concurrent/joint auditor along with DHS for FY 17 initially at its meeting held on 12th December 2016 even though the formal appointment as statutory auditors of IL&FS for the FY 18 was approved on 27th April 2017 by the Board. Further, the Audit Firm was aware of the fact that they would be appointed as statutory auditors of IL&FS on 12th December 2016. It is to be examined if there was any subsisting business relationship of the kind prohibited by Section 141(3)(e) as on 12th December 2016, the date on which the Board considered and examined the proposal. Further, as detailed in NFRA’s PFC, all the services provided by the Audit Firm and its network entities are prohibited services. Even assuming for the sake of argument, but not admitting, that the services are not prohibited services under Sections 141(3)(e) and 141(3)(i), there is

no approval of the Audit Committee, and so there is a violation of both Sec 141(3)(e) and 141(3)(i) of the Act in all the invoices discussed in List 2. Hence, all the observations made in List 2 (Para 21 to 28 of PFC) stand proven.

- d) NFRA in the PFC (List 3) has observed that services provided by the Audit Firm and its network entities to the Auditee Company after the appointment of the Audit Firm were in violation of both Section 144 and therefore attracted Section 141(4) of the Act. To these observations made by NFRA, the Audit Firm has submitted consolidated replies to observations made by NFRA in Para 29, 30, 31, 32 and 34 of PFC. The Audit Firm has stated that *“in response to engagements referred in item no. 29, 30, 31, 32 and 34, it is submitted that these engagements were executed by EY LLP and not by SRBC or its registered network. At the outset, it is reiterated that there is no ‘direct or indirect’ relationship between SRBC and EY LLP, and therefore, the services provided by EY LLP cannot be construed as ‘management services’ provided ‘directly or indirectly’ by SRBC. Therefore, any service provided by EY LLP cannot be said to have been indirectly provided by SRBC. Further, SRBC does not have any networking relationship with EY LLP under the applicable Networking Guidelines of ICAI and consequently, any services provided by EY LLP cannot be said to have been provided by SRBC.”*
- e) As concluded in Para 2.2.3, services provided through SRBC, EY LLP, EYA LLP and EY MBS are services provided directly or indirectly by the statutory auditor, as provided under Explanation (ii) to Section 144 of the Act. Hence, these contentions of the Audit Firm are not tenable.
- f) On NFRA’s observations made in List 3 (Appendix 3), the Audit Firm has stated that *“SRBA is a network firm and is covered within the meaning of “directly or indirectly” for the purposes of Section 144 of the Act. We further clarify that the services were provided to IECCL which is an associate company of ILFS and not a holding or subsidiary company. Section 144 of the Act prohibits the auditor from directly or indirectly providing the services listed therein to the auditee company and its holding and subsidiary company. Thus IECCL is not covered under the provisions of Section 144 of the Act and the requirement to obtain approval of audit committee was not applicable for this engagement since IECCL was an associate company.... It is pertinent to note that Rule 10(4) of the Companies (Audit and Auditors) Rules, 2014 states that professional transactions which are in the nature of business relationships are permitted to be rendered by the auditor.”* The Audit Firm has further stated that *“In fact services provided by SRBA under this engagement are allowed to be provided by the auditor under Clauses 290.162 to 290.165 of ICAI Code of Ethics 2009.”* Citing para 290.162, 290.163, 290.164 and 290.165 of ICAI Code of Ethics, 2009, the Audit Firm submits in page 37 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 SRBA with IECCL clearly spells out that SRBA will simply provide*

*review comments and provide advice on conversion of consolidated financial statements. SRBA'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, SRBA was not playing any management role or taking any decisions on behalf of the Company".*

- g) In light of the above response of the Audit Firm, NFRA has perused the Company Law Board Order (CP No 63 of 2009) dated 31.8.2009, wherein it was very clearly stated that IL&FS shall appoint four of its nominees including the Chairman on the Board of Directors of the company (IECCL). The CLB Order has also stated that IL&FS will be in control of the management of the affairs of the company. IECCL had 7 directors on its Board as per the Annual Report of FY 2017-18 and as per the Company Law Board Order, the company shall appoint 4 directors on the Board of IECCL. Section 2(87) of the Companies Act, 2013 defines the subsidiary company as a company in which the holding company (i) controls the composition of the Board of Directors; or (ii) exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies. Since IL&FS controls the composition of the Board of Directors of IECCL and also the fact that IL&FS controls the management of the affairs of IECCL, IECCL becomes the subsidiary of IL&FS under section 2(87) of the Act and hence Section 144 of the Companies Act, 2013 is applicable even in the case of services provided to IECCL also. Considering the reasons provided in this Para, the contentions of the Audit Firm that IECCL is an associate company and hence the services provided by the Audit Firm to IECCL are not covered under section 144 of the Act is not acceptable. Further, the assertion that SRBA was providing review comments and advice on the conversion of consolidated financial statements is further proof of the fact that they were providing the "Management Services" as provided under Sec 144. Further, such work by SRBA created a "self-review" threat and the Audit Firm continued with knowing very well the ethical standards required for maintaining the independence of the Audit Firm. The question is as to the rendering of services prohibited and not of who is making the decision on the services rendered. Therefore, the said assertion is not acceptable and the service falls under the prohibited services under Sec 144. Even assuming for the sake of argument, but not admitting, that IECCL is an associate company of IL&FS, the services provided by SRBA have resulted in the creation of 'business relationship', which is disqualified as per Section 141(3)(e) and thereby attracted Section 141(4) of the Companies Act, 2013.
- h) On NFRA's observations made List 3 (Appendix 3), the Audit Firm has stated that "SRBC was engaged by IL&FS Energy Development Company Limited ('IEDCL') to provide technical accounting support services in relation to proposed transaction if IEDCL to merge a subsidiary into itself. As part of its scope of work, SRBC reviewed documentation prepared by IEDCL and provided observations on the same. IEDCL evaluated SRBC's observations and took decisions as it deemed fit. Additionally, SRBC provided technical guidance on IND AS to IEDCL. All decisions as regards selection of accounting policies and accounting for transaction were made by the management of IEDCL with no involvement of SRBC. Further, no changes were made by SRBC in information systems of IEDCL whether financial or non-financial. Thus, it cannot be said that SRBC has provided "accounting and bookkeeping

*services” or “design and implementation of a financial information system” services to IEDCL. Further, it is not a “management service” or any other service as contemplated in Section 144 of the Act.” Citing para 290.162, 290.163, 290.164 and 290.165 of ICAI Code of Ethics, 2009, the Audit Firm submits in page 38 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”.*

- i) The above assertions of the Audit Firm are not acceptable since the ICAI Code of Ethics, 2009 cannot override the provisions of the Companies Act, 2013 and which has already been pointed out in the earlier sections. This appears to be an attempt to gloss over the non-compliance with respect to the services rendered and which are prohibited under Sec 144. Further, it is to be noted that IEDCL is a subsidiary of IL&FS. As concluded in the previous sections, these services provided by the Audit Firm also fall under the category of management services as prohibited under section 144 of the Act. By rendering services pertaining to the Company’s Ind-AS financial statements in connection with the analysis of factors or considerations that are relevant to a specific financial reporting issue or the application of an accounting standard, the Audit Firm put itself in a position where it would audit and evaluate professional judgments that it had previously rendered as a management’s consultant. The accounts of IEDCL have to be consolidated with those of IL&FS under Section 129(3) of the Act. This attracted a serious self-review threat that is prohibited as per the ICAI Code of Ethics. Because of the aforementioned points, the Audit Firm by undertaking this engagement after their appointment as Statutory Auditor of IL&FS has incurred the disqualifications as per Section 141 (3) (e) and 141 (3) (i) of the Companies Act, 2013 and thereby attracted Section 141 (4) of the Companies Act, 2013.
- j) In view of all the above observations, NFRA concludes that the EP and the EQCR Partner have failed to 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.

2.2.8 Thus, NFRA concluded in the DAQRR that:

- a) The appointment of the Audit Firm as Statutory Auditor of IL&FS Limited was ab initio illegal and void for violation of Section 141 (3) (e) and Section 141 (3) (i) of the Act. The Audit Firm had also violated the provisions of Section 144 of the Companies Act, 2013.
- b) The certificate 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.

- c) The engagements discussed in List 1 (refer to Appendix 1) were persisting even before the appointment of the **Audit Firm**. This should have prompted the Audit Firm to decline the engagement.
- d) Notwithstanding the above, the acceptance of certain engagements covered in List 3 (Para 29 to 35 of PFC) after its appointment as the statutory auditor of IL&FS Limited by the Audit Firm resulted in a “business relationship” with the auditee company. Thus, the Audit Firm violated the provision of Rule 10 (4) of the Companies (Audit and Auditors) Rules, 2014. The engagements covered services prohibited under Section 144 and attracting the provision of Section 141 (4) of the Companies Act, 2013, and accordingly, the Audit Firm should have vacated its office as the statutory auditor and such vacation should have been deemed to be a casual vacancy in the office of the auditor.
- e) The Audit Firm had violated the provisions of Section 144 of the Companies Act, 2013 by the indirect provision of prohibited services. Even assuming for the sake of argument that the services provided by the Audit Firm were not prohibited under Section 144, there was a serious violation of Section 144 since Audit Committee approval for providing such services was not obtained.
- f) The Audit Firm had been in serious breach of the ICAI Code of Ethics.
- g) 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.
- h) The Audit Firm’s compliance with the fundamental principles of the ICAI Code of Ethics was compromised due to self-interest threat.
- i) Given all of the above, it is clear that the appointment of the Audit Firm as the Statutory Auditor of IL&FS was ab-initio illegal and, thus, void.
- j) The Audit Firm has not complied with the requirements of para 17 of SA 260 (Revised).

### **C. Final Observations and Conclusions of the AQRR**

2.3 NFRA has examined in detail the written replies to the DAQRR dated 23<sup>rd</sup> July 2021 and the oral submissions made by the Audit Firm on 17<sup>th</sup> May 2022 (together referred to as replies to the DAQRR hereafter). The NFRA has gone through its replies and arrived at the following findings.

2.3.1 NFRA observes that the Audit Firm and its network entities (EY Network) have rendered non-audit services<sup>12</sup> to IL&FS, its subsidiaries and other group companies and thus compromised its independence in mind and independence in appearance. However, the Audit Firm has reiterated its submissions that it is not directly or indirectly related to EY, and the non-audit services provided are not prohibited under section 144. However, there is overwhelming evidence

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<sup>12</sup> Listed in appendix 1 to 3 of this AQRR

(which has already been presented in the DAQRR and is summarised here again in the following paragraphs) to rebut the claim of the auditor.

- 2.3.2 Explanation to Section 144 defines ‘direct or indirect’ relationship as **“in case of auditor being a firm, either itself or through any of its partners or through its parent, subsidiary or associate entity or through any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or whose name or trade mark or brand is used by the firm or any of its partners”**. The emphasised portions make it clear that any type of use of name, trademark or brand is covered under the above definition. There are several indisputable instances of such use of the name, brand etc which are mentioned in this AQRR to prove that there is an indirect relationship with E&Y group. SRBC has refuted this claim and stated that *“Unfortunately, the NFRA has failed to establish how the alleged usage of domain name with EY brand name would result in SRBC creating a public perception that SRBC and EY are one and the same. The Audit Firm further states that “It is reiterated that SRBC does not use the brand name and trademark of EY. It is clarified that SRBC is not aware of any entity by the name of “EY”.”* (Emphasis added).
- 2.3.3 While SRBC claims that it is not related to EY, on the contrary, it has itself disclosed to PCAOB of USA that it is a network entity of E&Y. The defence of the SRBC that it had to choose from Yes or No in the form does not hold water. The screenshot of the form taken from the PCAOB website shows that SRBC has admitted before PCAOB that it is a network entity of E&Y. Therefore, there should not be any doubt on this point.
- 2.3.4 Similarly, SRBC, its partners and employees have been using EY's name and brand on their social media profiles such as LinkedIn. When it was pointed out to SRBC, it has taken the defence that it has not authorised anyone to do so. This defence is not acceptable as the partners themselves have been using EY's name in their LinkedIn profile. Further, they have not submitted any evidence that they have taken any steps to prevent their partners and employees from masquerading as being part of the EY group. The employee's/partners use of the EY name in their public profiles indicates that in the public perception, and in the perception of their employees/partners as well, SRBC & Co LLP and EY are the same. More importantly, this amounts to the use of the name of another entity as stipulated in section 144. The Audit Firm failed to provide any evidence showing that the Firm has made any public announcements/internal action to stop the employees of SRBC from using the EY name. This widespread usage of the EY name by the employees and partners of SRBC has negated the subtle legal differences in form and therefore SRBC is considered part of the EY network for all practical purposes by the public and the staff of EY and SRBC. This is again an indirect relationship as provided in section 144 since the definition used in the said section is wider and inclusive.
- 2.3.5 Further, SRBC partners and employees have been using the email domain of EY while communicating with their clients and others. For example, the EP CA Jayesh Gandhi in this case used jayesh.gandhi@in.ey.com while ET member CA Naushad Rangoonwala used naushad.rangoonwala@in.ey.com. The auditor has admitted this fact (that it has been using the EY email domain) however it has argued that using someone else’s email is not a violation of

any law. This argument is ridiculous and cannot be accepted. The question here is whether the auditor has provided services to the client indirectly through any entity whose name is used by the auditor or its partners as given in explanation to Section 144. The Audit Firm states that *“The domain name identical to the name of EY was used by SRBC employees because SRBC is an independent and separate member firm of EYG, a position which has already been disclosed to/declared with ICAI and other Indian regulators. The said action is not in violation of any laws, regulations or guidelines applicable to chartered accountants, nor is it in violation of any other law of the land.”* Normally every organization uses the email domain name of its brand/name so that the parties know from which organisation the email is coming from or vice-versa. By using the EY domain in emails, SRBC is communicating the EY brand and name to its targeted recipients, which is as good as using the EY brand and name for achieving the intent of the communication. Thus, the Audit Firm’s argument, that using the domain name of EY does not mean that SRBC was using the EY brand/name and creating a public perception that SRBC and EY are part of a network entity, is not acceptable.

- 2.3.6 The Audit Firm has in its defence also made statements like it is *‘not aware of any entity by the name EY’*, which is ridiculous and frivolous. Many of the Audit File documentation carries the name EY, logo of EY, reference to EY and templates and policies supplied by EY and yet the auditor is not aware of EY's name? There are many other SRBC documents (given below) which mention EY’s name and yet SRBC says that it is not aware of an entity called EY!
- a) The SQC policy of SRBC & Co LLP as submitted by the Audit Firm to NFRA 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.”*
  - b) 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.”*
  - c) The e-Audit File submitted by the Audit Firm uses the software called “EY Canvas” and displays the logo of EY on the home page of the audit file. If SRBC is not aware of EY, then the Audit File submitted to NFRA can only be treated as compromised as it has several documents showing the name EY and logo. Similarly, the client and engagement acceptance global policy in the SQC Policy of SRBC displays the following EY brand logo, which is again a use of the EY brand/name by SRBC.



## Client and Engagement Acceptance Global Policy

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d) To the observation of NFRA regarding office address the Audit Firm stated that “SRBC clarifies that the office addresses **as well as physical offices of SRBC and EY LLP in Kolkata and Mumbai are different. In other words, physical offices are different and official addresses are also different.**” The Audit Firm’s reply is about only Mumbai and Kolkata locations. There is no mention of the other three locations i.e. New Delhi, Pune and Gurugram. Further, the entry number 307, 309, 310, 312, 313 and 314 in the screenshot shown below also confirms that the address (Kolkata) of both SRBC and EY are the same.

EY Member Firms and Affiliates at 12 June 2019 - ICAEW Audit Regulation 2.12

	EY Area	EY Country	Company Name	Registered Office address	Country of Incorporation
298	EMEIA	Greece	Platis - Anastasiadis & Partners Law Partnership	8B Chimarras Str., Maroussi , Athens, 15125, Greece	Greece
299	EMEIA	Guinea	FFA-Conseils	BP 1762 , Conakry , Guinea	Guinea
300	EMEIA	Guinea	Fiduciaire France Afrique "FFA"	BP 1762 , Conakry , Guinea	Guinea
301	EMEIA	Hungary	Ernst & Young Konyvvizsgáló Korlátolt Felelősségű Társaság	Váci ut. 20, Budapest, 1132, Hungary	Hungary
302	EMEIA	Hungary	Ernst & Young Tanácsadó Korlátolt Felelősségű Társaság	Váci ut. 20, Budapest, 1132, Hungary	Hungary
303	EMEIA	Hungary	Vámosi-Nagy Ernst and Young Ügyvédi Iroda	Váci ut. 20, Budapest, 1132, Hungary	Hungary
304	EMEIA	Iceland	Ernst & Young ehf	Borgartún 30, 105, Reykjavík, Iceland	Iceland
305	EMEIA	India	Ernst & Young Advisory Services Bangladesh Limited	Lushan Park City, Level 7, Plot # 15, Road # 103, Suites # 6/A, Block- CEN (C), Gulshan Avenue, Dhaka, 1212, 8th Floor, Workmark 1, Asset Area 11,	Bangladesh
306	EMEIA	India	Ernst & Young Associates LLP	Hospitality District, Indira Gandhi International Airport, New Delhi, 110032	India
307	EMEIA	India	Ernst & Young LLP	22 Camac Street, Block 'C', 3rd Floor, Kolkata, 700 016, India	India
308	EMEIA	India	Ernst & Young Merchant Banking Services Private Limited	14th, The Ruby, 29 Senapati Bapat Marg, Dadar (W), Mumbai , 400028, India	India
309	EMEIA	India	EY Actuarial Services LLP	22 Camac Street, Block 'C', 3rd Floor, Kolkata, 700 016, India	India
310	EMEIA	India	EY Restructuring LLP	22, Camac Street, Block-C, 3rd Floor, Kolkata, West Bengal, 700016, India	India
311	EMEIA	India	PDS Legal	14, Mittal Chambers, 1st Floor, Nariman Point, Mumbai, 400021, India	India
312	EMEIA	India	S R B A & Associates LLP	22 Camac Street, Block 'C', 3rd Floor, Kolkata, 700 016, India	India
313	EMEIA	India	S R B C & Associates LLP	22nd Camac Street, Block B, 3rd Floor, West Bengal, India	India
314	EMEIA	India	S R B C & Co LLP	22 Camac Street, Block 'C', 3rd Floor, Kolkata, 700 016, India	India

- e) Therefore, NFRA confirms the observation in the DAQRR except for Mumbai. The contentions of the Audit Firm are unacceptable given the widespread use of the EY name as explained in this AQRR. By communicating the same/identical office addresses, the Audit Firm is adding to the public perception that it is the same as EY or at least a part of EY Network. This again falls under the term “use” of EY's name. It is possible that two independent companies may have the same address and therefore merely based on address one cannot infer that companies are not independent. However, this case is different. Apart from the address, there are many other commonalities between SRBC and EY group which have been explained in this chapter which further establishes the case that SRBC is indeed an EY's network entity having an indirect relationship as contemplated in section 144.
- f) Regarding employees and partners referring to EY in their social media accounts NFRA observes that apart from creating a public perception, this amounts to the use of the name of another entity as stipulated in section 144. The Audit Firm failed to provide any evidence showing that the Firm has made any public announcements/internal action to stop the employees of SRBC from using the EY brand. This widespread usage of the EY brand by the employees and partners of SRBC has negated the subtle legal differences in form and therefore SRBC is considered EY for all practical purposes by the public and the staff and partners of EY and SRBC. This is again an indirect relationship as envisaged by section 144 since the definition used in the said section is wider and inclusive.
- g) The Audit Committee of IL&FS in the minutes of its 73<sup>rd</sup> meeting held on February 27, 2017 (wherein the proposed appointment of SRBC was discussed) has mentioned that *“The Board advised that SRBC & Co LLP (EY), Chartered Accountants, be appointed as Statutory Auditors of Infrastructure Group”*. When this was pointed out to the Audit Firm, it put forth its argument that *“it is not aware why reference to EY was made in the minutes of the meeting of Audit Committee of IL&FS which was held on February 27, 2017.”* The Audit Firm further argued that *“NFRA's assertion that “in public perception and even in the perception of the Audit Committee of the client, SRBC and EY are the same entity” is based on an opinion which NFRA has and a single instance of an erroneous recording in the minutes of audit committee meeting of a client. It is submitted that NFRA has failed to appreciate that “public perception” would need more than an isolated instance to form its basis.”* It must be noted in this regard that NFRA has given various instances such as the use of EY's email domain, social media profiles, disclosure before PCAOB, audit policies etc. where EY's name or brand has been used extensively. These instances prove that SRBC and EY are construed as the same entity and none of these is isolated instances. The Audit Firm's responses that everyone who has referred to SRBC as EY has done it erroneously or without authorization and SRBC is not aware why such references are being made, appear to be very strange and contradictory particularly when they have been using EY's name all over. This is a result of a carefully infused public image built-up by the Audit Firm that it is EY while maintaining in legal terms that it is not EY. In any case, these instances prove beyond doubt that SRBC uses the brand and name of EY and hence the relationship falls under section 144, irrespective of their legal identities, which is not relevant to section 144.

- h) Regarding the observation of NFRA that availing the services from other member firms of EYG makes them internal experts of SRBC the Audit Firm states that *“Availing such services from other member firms of EYG does not make such other firms as internal experts of SRBC, as the individuals providing their expertise in such cases are neither the partners nor the staff of SRBC or its network firms. SRBC denies NFRA’s observation that availing expert services from other member firms of EYG makes such other firms or individuals as internal experts of SRBC. It is further submitted that NFRA has failed to provide instances of how such hiring of experts has resulted in lack/compromise of independence.”* NFRA observes that in its response the Audit Firm has skipped the second half of the definition of auditor’s internal expert (as per SA 620) which states that, an auditor’s internal expert is one who is a partner or staff, **including temporary staff, of the auditor’s firm or a network firm** (emphasis added). Hence the Audit Firm’s contentions that availing expert services from other member firms of EYG does not make such other firms or individuals as internal experts of SRBC are not tenable. Though such hiring in the normal circumstances (other than those covered in sections 144 and 141) may not amount to a compromise of independence, in this case, the hiring arrangement shows the use of common resources and a direct or indirect relationship between SRBC and EY. The chapter on ‘SQC 1 Compliance’ of this AQRR may be referred to for further evidence of use of EY name and brand by the Audit Firm.
- i) The fact, that SRBC, EY LLP and EYMBS are the network firms of EY, alone makes them fall under the ambit of the explanation in section 144, as the definition of ‘direct or indirect’ is wider and inclusive. Also, there is no evidence submitted by the Audit Firm to disprove the use of the name, trademark and brand of EY by the Audit Firm and its partners.

2.3.7. There is no evidence in the submission of the Audit Firm to disprove NFRA’s conclusion that 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 indirectly by SRBC.

2.3.8. SRBC in its submission has claimed that EYG is not its parent entity. However, it is clear that even though whether EYG may be a parent or not as per legal terms, it is established that EYG is definitely an associate entity of SRBC as among other things EYG’s name, trademark, email domain or brands are used by the Audit Firm and its partners and its employees. All EYG member entities in India including SRBC are therefore deemed associate entities of each other. Because of these reasons as explained above, these entities fall within the meaning of the term ‘directly or indirectly’ as provided in explanation (ii) to Section 144 of the Act.

### **Provision of Prohibited non-audit Services<sup>13</sup>**

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<sup>13</sup> Section 144 of the Companies Act 2013

- 2.3.9. The Audit Firm has asserted through its responses that the services provided by it do not fall into the category of ‘management services’ mentioned in Section 144(g) of the Companies Act, 2013. The list of the non-audit services provided by the EY group is given in Appendix 1 to 3.
- a. Appendix 3 lists all the services provided by the Audit Firm and its network entities to the Auditee group of companies after its appointment as Auditor. Even assuming for the sake of argument that the services are not prohibited services under Section 144, there is no approval of the Audit Committee, and so there is a violation of both Section 144 and Section 141(4) in all these cases. In addition, services listed in sl. no. 1 in this appendix (Services for assistance in Certified Emission Reduction units (CERs) verification) clearly falls under “Management Services” since the scope of services includes works related to verification, training, implementation, and addressing queries of DOE, which are all management functions. Services/responsibilities. Services listed in sl. no. 5 (Accounting support and assistance with the conversion of IECCL’s standalone and consolidated financial statements for the year ended 31 March 2017 from IGAAP to Ind AS, including diagnosis, solution development and implementation) of this appendix includes accounting services, such as review of accounting memoranda, drafting of accounting policies, calculation of balances, reconciliations and suggesting journal entries, that are prohibited under Section 144(a). Services are also in the nature of providing management decisions/implementation, and hence are management services as per Section 144(h).
  - b. The remaining services provided by the network firms listed in Appendix 1 and 2 falls under Sections 290.157<sup>14</sup>, 200.4<sup>15</sup> and 290.32<sup>16</sup> of the Code of Ethics and Para 17(a)<sup>17</sup> of SA 260 and hence there exists a self-interest threat.
  - c. It will require a detailed examination of each of the above engagements including the scope of the work, deliverables etc to determine whether some of these aforesaid non-audit services fall into the category of management services. There is no evidence that the auditor has done any such examination before accepting this audit work. Further, even if one were to accept the claim of the auditor that these were not management services, it should have at least seen

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<sup>14</sup> Section 290.157 of Code of Ethics provides the list of activities which may create self-review or self-interest threat. The listed activities include preparing source documents or originating data, in electronic or other form, evidencing the occurrence of a transaction.

<sup>15</sup> Section 200.4 of the Code of Ethics lists the examples of circumstances that may create self-interest threats for a professional accountant in public practice, which includes having a close business relationship with a client.

<sup>16</sup> Section 290.32 of the Code of Ethics provides inter alia that the firm should consider whether any threats to independence may be created by Financial or business relationships with the audit client during or after the period covered by the financial statements, but prior to acceptance of the financial statement audit engagement or Previous services provided to the audit client.

<sup>17</sup> Para 17(a) of SA 260 (revised) states that in the case of listed entities, the auditor shall communicate with those charged with governance a statement that the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms have complied with relevant ethical requirements regarding independence; and all relationships and other matters between the firm, network firms, and the entity that, in the auditor’s professional judgment, may reasonably be thought to bear on independence.

whether these non-audit services provided to IL&FS and its subsidiaries by the EY group including SRBC were approved by the audit committee under Section 144. As none of these services is approved by the audit committee these services are provided in contravention of section 144.

- d. Regarding the services provided by SRBA to IECCL the Audit Firm states that *“It is submitted that IL&FS did not have substantial control over the Board of Directors of IECCL as alleged. At the relevant time, the composition of the Board of IECCL consisted of 8 Directors and a Chairman, out of which IL&FS had 2 nominee Directors.”* The Audit Firm further states that *“NFRA has not provided any basis in the DAQRR to show how it has been concluded the said engagement resulted in a “business relationship” with the auditee company which is disqualified as per section 141(3)(e) of the Act. It is pertinent to state that Rule 10(4) of the Companies (Audit and Auditors) Rules, 2014 states that professional transactions which are in the nature of business relationships are permitted to be rendered by the Auditor.”* The Audit Firm also states that *“NFRA has also not explained how it has concluded that the services in this engagement are prohibited under section 144 of the Act. Therefore, the conclusion drawn against SRBC for services provided by SRBA as being services prohibited under section 144 of the Act to IL&FS and for having a prohibited business relationship that attracted the disqualifications as per Section 141(3)(e) of the Act is not made out at all.”* The Audit Firm quotes sections 290.162 to 290.165 of ICAI Code 2009 stating 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 SRBA with IEECL clearly spells out that SRBA will simply provide review comments and provide advice on conversion of consolidated financial statements. IEECL’s financial statements were prepared by IECCL itself. SRBA’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.”*
- e. In this regard, the Audit Firm has ignored the Company Law Board Order (CP No 63 of 2009) dated 31.8.2009, wherein it was stated that IL&FS shall appoint four of its nominees including the Chairman on the Board of Directors of the company (IECCL). The CLB Order has also stated that IL&FS will be in control of the management of the affairs of the company. Thus, the Audit Firm’s response in this regard is without any substantial proof.
- f. NFRA has very clearly stated in the observations in Appendix 3 how the above-mentioned engagement resulted in a business relationship. Further, the Audit Firm’s contention that NFRA has not explained how it has concluded that the services in this engagement are prohibited under section 144 of the Act is also untrue. NFRA has clearly explained this in the DAQRR. The Audit Firm’s assertion that SRBA was providing review comments and advice on the conversion of consolidated financial statements is further proof of the fact such work by SRBA created a “self-review” threat which the Audit Firm continued with.

- 2.3.10. Given all the above observations, NFRA concludes that all EYG member entities in India including SRBC fall within the meaning of the term ‘directly or indirectly’ as provided in explanation (ii) to Section 144 of the Act. However, SRBC, the EP, and the EQCR have not complied with the requirements of Para 11 and Para 21 of SA 220 which required them to evaluate threats to the independence. There is no evidence that they have done so.
- 2.3.11. Section 143(9) of the CA, Act 2013 requires that every auditor shall comply with auditing standards. Para 14 of SA200 requires an auditor to comply with ethical requirements. Code of Ethics 2009 - para 210.5 and 210.6 require auditors to decline their audit engagement in case of threats to their independence. The Code of Ethics list the various threats namely self-interest threats, self-review threats, familiarity threats, advocacy threats, and intimidation threat and advise the auditors to evaluate such threats before accepting any audit work. The auditor has not presented any evidence to show that it did any such evaluation, having regard to the true relationship among the EYG group entities. Even if one were to accept the contention of the auditor that some of these services were not management services and were some kind of management consultancy services, it should have at least done a threat analysis to evaluate whether the aforesaid non-audit engagement posed any such threats. Such evaluation was necessary because many of the engagements possibly may have self-interest and self-review threats. Similarly, since revenue earned from the audit fees was much less than the revenue from the combined revenue from non-audit services, it was the duty of the auditor and engagement partner to evaluate self-interest threat appropriately. However, the Audit Firm failed to do so. Without doing such evaluation they should not either have accepted or continued the audit work. Any such engagement in contravention of the independence norms, as it has happened in this case is unlawful as they run afoul of Section 141.
- 2.3.12. Such lapses in independence norms are viewed seriously by the international audit regulators. The US regulator PCAOB –in the audit inspection report of Price Waterhouse Coopers LLP (September 23, 2019) observes that “For one audit client, Issuer A, PwC violated the auditor independence rules of the Commission and the Public Company Accounting Oversight Board (“PCAOB”) by performing prohibited non-audit services, including exercising decision-making authority in the design and implementation of software relating to the company’s financial reporting and engaging in management functions for the company during the 2014 audit and professional engagement period.”
- 2.2.1. Thus, NFRA concludes that:
- a) SRBC cannot be considered independent as it provided non-audit services directly or indirectly in violation of section 144 of the Companies Act. These non-audit services also posed threats to independence, which the Audit Firm did not consider at all.
  - b) SRBC should not have accepted the audit engagement which posed threats to the independence. The engagements discussed in Appendix 2 were persisting even before the appointment of the Audit Firm. This should have prompted the Audit Firm to decline the engagement as an auditor.

- c) The Audit Firm's compliance with the fundamental principles of the ICAI Code of Ethics was compromised due to the self-interest and self-review threats.
- d) 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. Thus, the Audit Firm failed to comply with Para 14 of SA 200 and SQC 1.
- e) Notwithstanding the above, the acceptance of certain engagements covered in Appendix 3 after its appointment as the statutory auditor of IL&FS Limited by the Audit Firm resulted in a "business relationship" with the auditee company. Thus, the Audit Firm violated the provision of Rule 10 (4) of the Companies (Audit and Auditors) Rules, 2014. The engagements covered services prohibited under Section 144 and attracting the provision of Section 141 (4) of the Companies Act, 2013, and accordingly, the Audit Firm should have vacated its office as the statutory auditor.
- f) The Audit Firm had violated the provisions of Section 144 of the Companies Act, 2013 by indirectly providing prohibited services. Even assuming for the sake of argument that the services provided by the Audit Firm were not prohibited under Section 144, there was a violation of Section 144 since Audit Committee approval for providing such services was not obtained. Due to the provision of such non-audit services referred to in section 144, the audit firm was disqualified as per sections 141 (2) (e) and 143 (2) (i) to be appointed as auditor hence the acceptance of the appointment by the Audit Firm was illegal.
- g) The Audit Firm thus violated the Companies Act by accepting and continuing with this engagement. Therefore, the Audit Firm has not complied with the requirements of para 17 of SA 260 (Revised), Para 14, 18, A1, A16, and A56 of SA 200 and SA 220, and thus has failed to conduct the Audit in accordance with the SAs and failed to achieve the objectives of the Audit.

### 3. Investments

#### A. Prima Facie Observations and Conclusions (PFC)

- 3.1 NFRA in its Prima-facie Conclusions conveyed the following:
- 3.1.1 As investments comprise almost 50% of the total balance sheet, it was required that the Audit Firm should have exercised the highest degree of due diligence with respect to measurement, presentation and disclosure of such investments to conclude that these are as per the prescribed Accounting Standards and present a true and fair view.
- 3.1.2 The claims/assertions made by the Audit Firm without support from the audit file (in the form of supporting documentation) are unacceptable and NFRA discards the same as afterthoughts and false claims. If any of these claims are considered as to their merits, it is without prejudice to this conclusion of NFRA. NFRA has examined the audit WPs in respect of Investments provided by the Audit Firm and has identified significant deficiencies which have resulted in overstatement of profit. The Audit Firm has failed in its professional duties to perform the audit procedures required to obtain sufficient appropriate audit evidence regarding the correct valuation of investments made by IL&FS Limited in its component entities.

#### *Investment Policy*

- 3.1.3 Prudential Regulations for Accounting of Investments under Master Direction – Core Investment Companies (Reserve Bank) Directions, 2016, states that- (i) The Board of Directors of every applicable NBFC shall frame investment policy for the company and shall implement the same; (ii) The criteria to classify the investments into current and long-term investments shall be spelt out by the Board of the company in the investment policy.
- i. Vide its letter dated 19<sup>th</sup> November 2019, NFRA specifically asked the Audit Firm to provide the reference of Board approved investment policy placed in the audit file submitted to NFRA, which the Audit Firm must have obtained as part of audit evidence while performing audit procedures related to the valuation of investment.
- ii. Vide its response dated 30<sup>th</sup> December 2019, the Audit Firm stated that “*The Company had a board approved investment policy, which sets out the procedure of approval, documentation, annual review of investments, etc. This policy was approved by the Board of Directors in 2016*”. The Audit Firm failed to provide any reference to the said policy being in the audit file despite being specifically asked by NFRA.
- iii. Thus, the Audit Firm failed to obtain the board approved investment policy as important audit evidence to understand and verify whether the investments made by the company were as per the company’s policy or not.

- iv. It is also important to note that it creates a significant doubt on the reliability of the audit procedures performed by the Audit Firm in respect of investments which were examined and audited by the Audit Firm without even looking at the company's investment policy.

***Valuation of Investment and Impairment Analysis***

3.1.4 As per the accounting policy mentioned in the notes forming part of the accounts, it is mentioned that the aggregate carrying value of assets of **each** cash generating unit at **each balance sheet date** are reviewed for impairment. There is no evidence in the audit file which shows that the Audit Firm had verified if the management had tested **EACH** investment for impairment. Thus, the Audit Firm did not bother to check whether the management had complied with its accounting policy. Further, there is no evidence available in the audit file to show that the Audit Firm had communicated anything related to the non-performance of impairment testing by the management to the TCWG, based on its examination.

3.1.5 The WP “M18 Impairment Summary Analysis” shows only the workings done by the Audit Firm to assess the impairment of investment made by IL&FS Limited. There is no information available in the WP in respect of the total quantum of investments for which IL&FS Limited had done impairment analysis. The following table shows the **scope of work** done by the Audit Firm and the **methodology** adopted by them to assess the impairment of investment made by IL&FS Limited as at 31<sup>st</sup> March 2018:

S. No.	Name of the Entity	Investment in Equity ₹ in crore)	Investment in Debenture (₹ in crore)	The basis used to assess impairment of investment
1.	IL&FS Maritime Infrastructure Company Ltd	565	385	Use of Management Expert- N.M. Raiji
2.	IL&FS Infrastructure Incubation Trust - Class B-1 Scheme Railway Metro	510	-	
3.	Dighi Port Ltd	297	-	
4.	New Tirupur Area Development Corporation Ltd	89	-	
5.	Sealand Ports Pvt Ltd	86	-	
6.	IL&FS Airports Ltd	73	-	
7.	IL&FS Township & Urban Assets Ltd	70	627	
8.	ISSL Settlement & Transaction Services Ltd	31	-	Use of Management Expert- Shah Modi Katudia & Co. LLP
9.	IL&FS Global Pte Ltd	29	-	

10.	IL&FS Energy Development Company Ltd	4,674	247	Based on business model
11.	IL&FS Paradip Refinery Water Ltd	97	80	Internal Valuation
12.	IL&FS Environmental Infrastructure and Services Ltd	293	-	
13.	Gujarat International Finance Tec-City Company Ltd	33	-	
14.	IL&FS Engineering and Construction Company Ltd	243	-	Quoted Price
15.	IL&FS Transportation Networks Ltd	1,363	-	
16.	IL&FS Investment Managers Ltd	68	-	
17.	For another 30 entities	1,637	-	No workings are shown in the WP regarding any audit procedures if performed by the <b>Audit Firm</b>
<b>TOTAL</b>		<b>10,158</b>	<b>1,339</b>	

(Source data: SFS Canvas- WP “M18 Impairment Summary Analysis”)

- 3.1.6 From the above table, it is clear that the Audit Firm has used the work of a management expert for the valuation of investment and impairment analysis for a total investment of ₹2,762 crore (forms 27% of total investment) in component entities by IL&FS Limited. The Audit Firm had also used the work of the auditor’s expert (EY) (in the case of three entities namely, IL&FS Maritime Infrastructure Company Ltd, IL&FS Infrastructure Incubation Trust - Class B-1 Scheme Railway Metro, Dighi Port Limited) to evaluate the work of the management expert.
- 3.1.7 The Audit Firm had relied on the valuation reports issued by the management experts as audit evidence to value the investments. For investments, other than where the work of the management expert was relied upon by the Audit Firm, the Audit Firm has documented the conclusion- “As book value exceeds carrying value, no trigger for impairment of investment” in the WP “M18 Impairment Summary Analysis”.
- 3.1.8 Further, there is an interest income from fixed deposits/certificate of deposits amounting to **₹59 crore**. NFRA could not trace any work done by the ET in respect of this income. In WP “Fixed Deposits Working”, the Audit Firm has done workings up to 30<sup>th</sup> September 2017, only. According to the said WP, there were FDs amounting to ₹997 crore as at 30<sup>th</sup> September 2017. However, NFRA could not trace any WP in the audit file where the principal amount of FDs/CoDs outstanding as at 31<sup>st</sup> March 2018, is available. Also, NFRA could not trace any external confirmations in the audit file obtained by the Audit Firm in

respect of FDs/CoDs. As such, the Audit Firm did not comply with Para 5, the basic objective of SA 505.

3.1.9 Also, there is a balance with banks in demand deposits amounting to ₹247 crore under the head “cash and cash equivalents”. The nature of these demand deposits is nowhere mentioned in the audit file. NFRA could not trace any workings pertaining to this amount if done by the **Audit Firm**. Also, NFRA could not trace any external confirmations in the audit file obtained by the Audit Firm in respect of the outstanding balance of these demand deposits as at 31<sup>st</sup> March 2018. As such, the Audit Firm did not comply with Para 5, the basic objective of SA 505.

3.1.10 On perusal of various WPs “SFS Hard Copy File- File 3 (Part 1 of 2) – Flap H: Management Specialist (Page. no. MS.1- MS.9.8), SFS Canvas - M18 130GL(R)-Mgmt specialist, SFS Canvas –H-04-GL Impairment testing – Investments” placed in the audit file, it is concluded that the Audit Firm simply relied on the work of the experts and the management assumptions for valuation of investment without appropriate justification and logic, and failed to evaluate the clearly visible impairment indicators to provide for impairment loss which consequently resulted in overstatement of profit. The deficiencies found by NFRA while reviewing a sample of the work of the auditor are explained as follows:

***Evaluating the Competence, Capabilities and Objectivity of Management Expert-N.M. Raiji & Co. (NMR)***

3.1.11 From the above table, it is clear that NMR has done the valuation for seven component entities of IL&FS Limited covering a total investment of ₹2,703 crore which is almost 26% of the total non-current investment for FY18. Also, it is evident that NMR had accepted and worked on both audit and non-audit assignments for several entities of the whole IL&FS Group. Therefore, it was the duty of the statutory auditor to check the quantum and type of work done by NMR and to verify whether NMR had any conflict of interest arising out of these engagements or not. The Audit Firm failed to obtain the complete list of all audit and non-audit engagements for the IL&FS Group that NMR worked on and the fees paid to NMR in this context to evaluate the objectivity of the expert.

3.1.12 Instead, regarding objectivity, in the WP “SFS Hard Copy File- File 3 (Part 1 of 2) – Flap H: Management Specialist (Page. no. MS.1- MS.9.8)”, the Audit Firm has simply mentioned that “*We have also inquired with the management, that the specialist is not related to the entity in any manner*” and it did not perform an independent evaluation of objectivity of the expert in order to verify whether the management experts were free from any sort of management’s influence. In fact, the Audit Firm did not examine the objectivity of NMR separately for each of the seven entities. For the entire set of seven entities, only one aforementioned WP is available in the audit file.

3.1.13 Further, the WP “SFS Canvas - M18 130GL(R)-Mgmt specialist”, referred by the Audit Firm in support of the evaluation of the competence and capabilities of the experts merely has a one-line statement. For instance, in the case of N.M. Raiji & Co. (NMR), it is stated that “*N.M. Raiji & Co. is a partnership firm who qualified as a Chartered Accountant in year 1942. With more than 75 years of rich professional experience specialized in banking and financial services*”. This is in fact copied from NMR’s website. The Audit Firm did not check the qualification and capability of the team members who performed the valuation of seven different entities. In fact, it is nowhere evident if Audit Firm even identified the NMR teams who performed the valuation of seven different entities. As such, it is clear that the Audit Firm did not put any effort into independently evaluating the competence and capabilities of the expert, NMR.

3.1.14 There is no record in the audit file of any objective evaluation with respect to the work assigned in the audit file and as to whether the competence of the Expert was examined vis-à-vis his previous experience in dealing with such subjects. Also, no discussion of the Audit Firm with the expert or any specific item which evaluates the management expert’s competence and capabilities as per Para A37 and A38 of SA 500 is available in the audit file.

***Obtaining an understanding of the work of the Management Expert***

3.1.15 The Audit Firm referred WP “SFS Hard Copy File- File 3 (Part 1 of 2) – Flap H: Management Specialist (Page. no. MS.1- MS.9.8), SFS Canvas - M18 130GL(R)-Mgmt specialist” as the documentation used to obtain an understanding of the work of NMR. However, there are no Engagement Letters or written agreements in the audit file to understand the nature, scope, and objective of the expert’s work as required in Para A46 of SA 500.

3.1.16 There is no documentation providing for the objectives and scope of the expert’s work, methods and assumptions used, as mentioned in their own “applicable methodology” to understand the work of the expert.

3.1.17 In WP “SFS Hard Copy File- File 3 (Part 1 of 2) – Flap H: Management Specialist (Page. no. MS.1- MS.9.8), SFS Canvas - M18 130GL(R)-Mgmt specialist”, there is no audit evidence to show how the Audit Firm evaluated the information provided by IL&FS Limited to NMR as to whether it is sufficiently reliable for the auditor’s purpose or not..

3.1.18 Therefore, the Audit Firm has failed to fulfil the requirements of Para 9 read with Paras A49 to A51 of SA 500 in the light of the question raised before the Audit Firm Thus, the Audit Firm failed in its performance of professional duty as an auditor.

3.1.19 The evidence shows only a paperwork formality done by the Engagement Team led by the Engagement Partner without performing relevant and required audit procedures according to the prevailing law and standards.

### *Evaluating the appropriateness of the Management Expert*

3.1.20 In WP “SFS Hard Copy File- File 3 (Part 1 of 2) – Flap H: Management Specialist (Page. no. MS.1- MS.9.8), SFS Canvas - M18 130GL(R)-Mgmt specialist”, the management expert has mentioned the sources of information used by him for valuation purposes in his report, but at the same time, he also clearly mentioned in the report that- “*This document has been prepared based on the information made available by IL&FS. In rendering this information, we assumed and relied, **without independent verification**, upon the accuracy and completeness of all the data that was provided by the Company/IL&FS or was publicly available to us*” (emphasis added). Therefore, it is evident that the expert did not independently verify the sources of information used by them but has solely relied on what was provided to him by the management.

3.1.21 Moreover, the Audit Firm involved an auditor’s internal expert (EY) to evaluate the work of the management expert. In the impairment review document prepared by the auditor’s internal expert, the Auditor’s expert had clearly mentioned that they have not reviewed any accounting/ non-valuation related matter and also the objective of their inquiries (for the purpose of overall consistency and reasonableness) was not to independently verify the information so provided, or trace them to the source documents, rather that may need to be **verified by the Audit Team**. The objective of the auditor’s internal expert as per them was to understand the scope of work **performed by the valuer**, comment on valuation methodology, identify, verify and test significant assumptions, arithmetic accuracy of the valuation workings and evaluate the estimate considering the calculations in aggregate. However, there is no evidence in the audit file as to the verification of the source data provided to NMR by the Audit Firm. Thus, the Audit Firm failed in its professional duties to perform audit procedures and obtain sufficient and appropriate audit evidence as per the requirements of Para A38 of SA 620.

3.1.22 Therefore, the Audit Firm failed to fulfil the requirements of Para A48 of SA 500 to verify the relevance, completeness and accuracy of the source data used by the expert.

### *Using the Work of Auditor’s Expert*

3.1.23 The WP “M18 131GL(R)-EY specialist-1” referred by the Audit Firm does not mention anything related to the respective roles and responsibilities of the auditor’s expert (EY) and the Audit Firm as per the requirement of Para A28 and A29 of SA 620.

3.1.24 There is no agreement found in the audit file between the Audit Firm and auditor’s expert (EY) which describes the respective roles and responsibilities of both.

3.1.25 In fact, which entity of EY Group worked as an auditor’s expert is nowhere mentioned in the audit file.

- 3.1.26 Para A30 of SA 620 focuses on effective two-way communication between the Audit Firm and the expert to facilitate proper integration of the nature, timing, and extent of the auditor's expert's procedures with other work on the audit. There is no evidence as to whether any such communication took place between the Audit Firm and the expert in the audit file.
- 3.1.27 Therefore, the Audit Firm has failed to comply with the requirements of SA 620 in this respect.
- 3.1.28 In the impairment valuation review report issued by EY, under the heading "Overview", EY had, inter alia, mentioned that "*N.M. Raiji & Co. ("the valuer") has performed an analysis to estimate the fair value of the Company for financial reporting purposes as of 31 March 2018 (Valuation Date) consistent with the guidance of the applicable Accounting Standards (Indian GAAP). We, the Valuation and Business Modeling Team (the Auditor's Specialist), were asked to provide support to the Audit Team, as an auditor's specialist serving as part of the audit team. Specifically, we were asked to gain understanding of, and comment on, the methodologies and/ or assumptions in the valuation. This memorandum was created to summarize the context of the valuer's analysis and to summarize our findings. **In completing our work, we considered:** (i) the completeness of the material presented to us, (ii) the adequacy and relevance of this material, (iii) the nature and basis for valuation adjustments and calculations, (iv) **the reasonableness of the valuation methods and assumptions used in the analysis, and (v) whether our findings support valuer's overall conclusions given the scope of work performed**". (Emphasis Added)*
- 3.1.29 In the case of DPL, EY supported the overall methodology assumed by the Valuer. EY had also mentioned in their report that "*Based on the discussions with the Audit Team/Management, we understand that DPL's recorded estimate was consistent with the draft analysis and no significant differences in assumptions or conclusions of value were expected in the final analysis of the valuer*". As such, it is clear that EY agreed in toto with whatever NMR had done in valuation.

***IL&FS Energy Development Company Limited (IEDCL)***

- 3.1.30 It is important to note that investment in IEDCL comprises 40% of the total non-current investment made by IL&FS Limited. Therefore, it becomes the responsibility of the statutory auditor to apply a high level of professional scepticism while performing audit procedures to ensure that the investment is valued correctly, and the financials depict a true and fair view.
- 3.1.31 In WP "M18 Impairment Summary Analysis", the Audit Firm has noted their observation as "Based on business model" under fair valuation method used for valuation of the investment, and has made reference to WP "M18 IEDCL impairment testing file" for impairment analysis done by the Audit Firm in respect of IEDCL without any reference to actual calculations done or specific tests performed.

3.1.32 In WP “M18 IEDCL impairment testing file”, the Audit Firm has merely noted a one-line conclusion- *“Since the fair value per share exceeds the carrying value in the books of IL&FS, there is no trigger for impairment”*, and actual working done to arrive at this conclusion is nowhere documented in the audit file.

3.1.33 WP- “M18 IEDCL impairment testing file” contains a zip folder which includes the document pertaining to the Company Valuation of IEDCL but that relates to valuation as at 31<sup>st</sup> March 2017 and not for 31<sup>st</sup> March 2018. Apart from the said document, the zip folder also contains documents that state the equity valuation of various component entities of IEDCL. It appears that the ET obtained the said documents for the sake of keeping them in the audit file and did not perform any audit procedure to verify the accuracy and authenticity of the said documents.

3.1.34 The above-mentioned WPs do not contain any evidence of the work done by the Audit Firm in respect of the valuation of investment for IEDCL. It is nowhere evident in the WPs whether the Audit Firm assessed any impairment indicators. Therefore, NFRA concludes that the Audit Firm failed to perform appropriate audit procedures related to the valuation of investment and its impairment analysis for investment in IEDCL for ₹4,921 crore. The Audit Firm valued the investment at its cost without any justification and without complying with the provisions of Para 17 of AS 13 and Para 6 of AS 28.

3.1.35 The above clearly shows the unprofessional conduct of the Audit Firm towards the work.

#### ***Dighi Port Limited (DPL)***

3.1.36 First and foremost, it was noticed that while the valuation report of N.M. Raiji (NMR) is dated 27<sup>th</sup> May 2018, and the auditor’s internal expert’s report (memorandum to impairment valuation review of DPL as of 31<sup>st</sup> March 2018, – Dighi port signed the memo - M18 DPL Valuation – NMR, SFS Canvas - M18 Dighi Port analysis backup documents, SFS Canvas) was dated 25<sup>th</sup> May 2018. Hence, the Audit Firm’s assertion that they had involved the auditor’s expert to perform tests to validate the reasonableness and appropriateness of the underlying assumptions in ascertaining the fair value of assets arrived at by the management expert is incorrect. It shows that the whole exercise related to DPL was done just like a paper formality and that no work was done by the ET themselves for establishing the true and fair picture.

3.1.37 Moreover, in its report, NMR had stated that they had taken into consideration the audited financials for FY16 and unaudited financials for FY17, due to the non-availability of financials for FY18 for the purpose of valuation of DPL as at 31<sup>st</sup> March 2018, which definitely does not reflect the true and fair position of DPL.

3.1.38 It is important to note that a petition against DPL under Insolvency and Bankruptcy Code, 2016 (IBC) was filed and accepted by NCLT and the proceedings as per IBC are sub judice

at NCLT. In spite of this fact, the Audit Firm did not obtain any management representation specifically in this respect at the initial stage of the audit. The Audit Firm's assertion that- "We had obtained specific representation from the management with respect to the matters relied upon for analysis of impairment of Dighi Port Limited" is redundant as the same was obtained on 30<sup>th</sup> May 2018, i.e., on the date of signing of the SFS. This is clear evidence that this LOR was obtained just as a formality rather than to evaluate the true and fair picture with respect to the financials of DPL.

3.1.39 Further, as per the audit file, the Audit Firm did not ask the management as to the likely amount that can be recovered by the equity holders upon settlement, in view of the fact that the case is before NCLT. Moreover, the ET did not discuss this matter with the management as there is no record of this in the audit file. Merely informing the Audit Committee about the status of impairment through a presentation made just a day before the date of signing of the Audit Report cannot be considered a discussion of the matter with TCWG as it is a one-sided communication without any written record of the views of both the parties and is a violation of provisions of SA 260 (Revised).

3.1.40 It has been noted that management did not provide any basis for the following assumptions to the Audit Firm:

- *"Although, the project is currently facing tough times due to funding and NCLT issues, IL&FS believes that the business value of the project is still intact and with the completion of balance infrastructure and improvement in connectivity and with the induction of credible investors, the Dighi Port can emerge as one of the attractive ports.*
- *IL&FS together with identified investor will bid in the IBC. IL&FS has assessed that it has a high probability of winning the bid due its control over Berth 4 & 5 and its earlier expertise.*
- *After IBC resolution, IL&FS Group shall continue to hold minority stake of 26-24% in DPL as a part of IV with new investor. This shall adequately protect the IL&FS investment so far."*

3.1.41 Given the fact that DPL was facing insolvency proceedings, the aforementioned assumptions of the management are questionable and clearly, it is unlikely that IL&FS Limited would receive or safeguard its equity exposure in DPL, even though it is one of the bidders for DPL. This is in view of the fact that for any resolution process to succeed before NCLT, the outstanding debts owed by DPL to financial and operational creditors have to be paid first and if any remaining balance is left, the same goes towards the equity investors. In effect, IL&FS as a bidder has to make fresh investments of a very high order towards all the debts owed by DPL to others in order to save their equity investment in DPL which is comparatively small. The Audit Firm did not question these assumptions of the management and instead, relied on them without obtaining sufficient appropriate audit evidence in this regard as per Para 17 of SA 200. In fact, in such a scenario where DPL was facing bankruptcy proceedings under IBC and also a case for liquidation before NCLT,

NMR's valuation falls flat on the fair value determination of DPL. The Audit Firm's reliance on such valuation report of NMR shows a clear lack of due diligence and professional scepticism on the part of the Audit Firm.

3.1.42 In respect of investment made by IL&FS Limited in DPL, RBI in its inspection report dated 15<sup>th</sup> November 2016, inter alia, stated that *"The investee was continuously making losses for the past few years. Therefore, a diminution of Rs. 105.89 crore was suggested (book value minus breakup value) for this investment. The total diminution identified was Rs. 299.30 crore. The company already had made a provision of Rs. 49.27 crore against these assets. Therefore, a diminution of Rs. 250.03 crore was suggested."* In spite of such observations and suggestions made by RBI in its inspection report, the Audit Firm did not perform adequate audit procedures to provide for impairment loss.

3.1.43 It seems that the Audit Firm ignored the fact that the account of DPL was declared NPA in accordance with the guidelines issued by RBI in March 2016, and failed to evaluate the going concern status of DPL and to perform appropriate audit procedures.

3.1.44 In the light of the above-stated points, it is reasonable to conclude that the diminution in value should have been 100% and the **provision for diminution should have been made by the company to recognise the decline in the value of the entire investment of ₹297 crore in DPL from its books** as per Para 32 of AS 13.

3.1.45 Therefore, the Audit Firm failed to identify and assess the risk of material misstatement in the financial statement as per the requirements of Para 25 of SA 315.

#### ***IL&FS Maritime Infrastructure Company Limited (IMICL)***

3.1.46 In WP "M18 Investment leadsheet and analysis", total exposure towards the account is ₹1,757 crore whereas in the WP "M18 IMICL Impairment summary analysis", total exposure is shown as ₹1,749 crore. This shows the casual attitude of the EP and ET towards preparing these WPs as the amount in both the WPs does not match.

3.1.47 As per the valuation report issued by NMR, fair value was determined at ₹65.30 per share as at 31<sup>st</sup> March 2018, whereas the Audit Firm in WP "M18 IMICL Impairment summary analysis" had noted ₹41.80 per share as the "fair value as per latest report". It is nowhere documented by the Audit Firm as to how they arrived at the fair value of ₹41.80 per share and the reason for considering such an amount while performing impairment analysis.

3.1.48 The Audit Firm failed to verify the compliance with the requirements of Para 17 of AS 13 which provides different impairment indicators to be analysed by the Audit Firm. The investee's assets and results are one of the impairment indicators. For assessment of impairment loss as of 31<sup>st</sup> March 2018, the Audit Firm has completely ignored the fact that IMICL had a negative net worth as at 31<sup>st</sup> March 2018, and is continuously incurring losses for the past several years.

- 3.1.49 The Expert had used the unaudited financial statements of IMICL and all its subsidiaries and associate companies for the year ended 31<sup>st</sup> March 2018, for valuation purposes which indeed has been relied on by the statutory auditor without applying professional scepticism as to whether such unaudited financial statements depicts the true and fair financial position of the Company.
- 3.1.50 The Audit Firm had relied upon the Valuation Report issued by NMR without undertaking any independent analysis of the same to verify the assumptions and estimates considered by the Valuer. Also, there is no separate WP where the Audit Firm has noted its observations related to the work assessment of the management expert and auditor expert.
- 3.1.51 It is important to note that despite the qualification clause mentioned by the expert in his report which says, “*This document has been prepared based on the information made available by IL&FS. In rendering this information, we assumed and relied, **without independent verification, upon the accuracy and completeness of all the data that was provided by the Company/IL&FS or was publicly available to us***”, the statutory auditor considered the valuation report as a sufficient appropriate audit evidence and solely relied on the work of experts. (Emphasis Added)
- 3.1.52 Therefore, in spite of all the aforementioned facts, the Audit Firm did not calculate the diminution in the value of the company’s investment and concurred with the management in not providing the impairment without objectively evaluating the position.
- 3.1.53 Further, the company had given a loan of ₹585 crore to IMICL in the previous years and the same was converted into advance towards Fully Convertible Debenture (FCD) during FY18 which subsequently would be converted into fully paid equity shares before the maturity of these FCDs.
- 3.1.54 In this regard, NFRA asked the Audit Firm to provide the company’s policy for such restructuring of assets vide its letter dated 19<sup>th</sup> November 2019. In its response dated 30<sup>th</sup> December 2019, the Audit Firm, inter alia, provided reference to WP “SFS Canvas- SFS M18 Credit SOP” which does not seem to be an official document of the Company as it is not signed by any company official. Therefore, it is concluded that the Audit Firm effectively failed to verify the company’s policy for restructuring of assets.
- 3.1.55 Also, in this regard, the Audit Firm was asked to provide the procedures adopted by them to analyse the cash flows of the borrower and the valuation of the restructured assets. In their response, the Audit Firm solely referred to the valuation report issued by NMR and no independent work done by the Audit Firm has been cited by the Audit Firm.
- 3.1.56 Therefore, the Audit Firm failed to identify and assess the risk of material misstatement in the financial statement as per the requirements of Para 25 of SA 315 and failed to professional scepticism expected from a qualified professional auditor.

***IL&FS Engineering and Construction Company Ltd (IECCL)***

- 3.1.57 On a perusal of the WP “Impairment summary analysis”, it is noticed that for valuation of investment made in IL&FS Engineering and Construction Company Ltd (IECCL), the method used by the management was ‘300-day average of the closing price for the last three years which is against the Audit Firm’s assertion that they have considered the market value of the average price of 6 months for the quoted shares in its response dated 30<sup>th</sup> December 2019. In fact, in the WP “Impairment summary analysis”- tab “Work Done” the Audit Firm had itself mentioned that *“For quoted investments, we will compare carrying value of investment with the average quoted investment in order to ascertain if there is any requirement for provision for impairment”*. Consequently, the value of the investment was overpriced by ₹38.48 crore. However, the Audit Firm’s workings on the matter have been made in such a manner to arrive at the same value of impairment, supporting the management without offering sufficient justification based on accounting or auditing standards.
- 3.1.58 Management’s decision to consider the 300-day moving average closing price of the last 3 years for the impairment testing was without any appropriate justification and evidence. The Audit Firm’s reliance on such management decisions clearly indicates that the Audit Firm failed to apply professional scepticism in agreeing with the management.
- 3.1.59 Further, a detailed note is given on the impairment of IECCL vide WP “C 236.1 to C 236.46” dated 19<sup>th</sup> April 2017, wherein the top management with certain reasons and assertions (though the logic given is not acceptable) states that even though the market value is less than the carrying cost (acquisition cost), based on the probable recoveries and value creators, there is no impairment. Herein, they considered a 200-day moving average. The WP is very detailed in nature and had gone through the valuation at length highlighting the various factors that they consider would bring in value even though the same is very much contestable owing to the very nature of the factors like probable recoveries, the value of Pass-Through Certificates (PTCs) etc. being included to arrive at a fair value. Also, important to note is that for FY18, the Audit Firm had not even worked out the actual impairment, the justification for arriving at the 6-month moving average value of the stock which is taken for valuation purposes and the provisioning cited in the work papers.
- 3.1.60 In view of Para 32 of AS 13, the Audit Firm altogether neglected the continuous decline in the share price in the market from ₹87.70 as on 31<sup>st</sup> March 2015, to ₹45.15 as 31<sup>st</sup> March 2016, ₹54.20 as on 31<sup>st</sup> March 2017, and ₹29.20 per share as on 31<sup>st</sup> March 2018, i.e., almost a decline of 66.70% over a period of three years. **This continuous decline in share price cannot be treated as temporary.**
- 3.1.61 When the market price of the share of IECCL was declining for the past few years, considering the 300-day moving average closing price of the last 3 years for the impairment testing was inappropriate. The latest available market price i.e. price as on 31<sup>st</sup> March 2018,

should have been considered by the management in such a case. The Audit Firm, rather than relying on management decisions, should have discussed this with the management and TCWG.

3.1.62 Moreover, the WP “M18 IECCL Impairment Testing File” only contains the arithmetical calculation of the average price for IECCL for the past three years. The said WP nowhere indicates any sufficient audit procedures performed by the Audit Firm to verify the management decision of not impairing the investment. This brings out the fact that the Audit Firm solely relied on the management decision and ended by overstating the value of the investment.

***Non-Compliance regarding the restructuring of assets***

3.1.63 Answer to question 12 of CIC FAQs states that CIC-ND-SI is not exempt from the Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015. They are only exempt from norms regarding submission of Statutory Auditor Certificate regarding continuance of business as NBFC, capital adequacy and concentration of credit/investments norms.

3.1.64 On 1<sup>st</sup> September 2016, RBI issued Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 (“Master Directions – NBFC-ND-SI”) in supersession of the

- a) Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007
- b) Infrastructure Finance Companies
- c) Infrastructure Debt Fund-Non-Banking Financial Companies (Reserve Bank) Directions, 2011
- d) Non-Banking Financial Company -Micro Finance Institutions (Reserve Bank) Directions, 2011
- e) Non-Banking Financial Company –Factor (Reserve Bank) Directions, 2012
- f) Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015

3.1.65 Therefore, to the extent that Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015 were applicable to a CIC-ND-SI, Master Directions – NBFC-ND-SI are also applicable.

3.1.66 As per the Prudential Regulations mentioned in Para 16 (2) of Master Direction- Core Investment Companies (Reserve Bank) Directions, 2016, and Para 12 (2) of Non-Banking Financial Company- Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016, the class of assets, namely, standard assets, sub-standard assets, doubtful assets and loss assets shall not be upgraded merely as a result of rescheduling unless it satisfies the conditions required for the upgradation.

- 3.1.67 As per the Prudential Regulations mentioned in Para 16 (4) (ii) (b) of Prudential Regulations of Master Direction- Core Investment Companies (Reserve Bank) Directions, 2016, and Para 12 (3) (ii) (b) of Non-Banking Financial Company- Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016, the sub-standard asset shall mean an asset where the terms of the agreement regarding interest and/or principal have been renegotiated or rescheduled or restructured after commencement of operations, until the expiry of one year of satisfactory performance under the renegotiated or rescheduled or restructured terms.
- 3.1.68 Provisioning requirements as per Para 17 of Prudential Regulations of Master Direction- Core Investment Companies (Reserve Bank) Directions, 2016, says- *“An asset which has been renegotiated or rescheduled as referred to in paragraph 16.3(ii)(b) and 16.4(ii)(b) of these Directions shall be a sub-standard asset or continue to remain in the same category in which it was prior to its renegotiation or reschedulement as a doubtful asset or a loss asset as the case may be. Necessary provision shall be made as applicable to such asset till it is upgraded.”*
- 3.1.69 Provisioning requirements as per Para 13 of Prudential Regulations of Non-Banking Financial Company- Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016, says- *“An asset which has been renegotiated or rescheduled as referred to in paragraph 12 (3) (ii) (b) of these Directions shall be a sub-standard asset or continue to remain in the same category in which it was prior to its renegotiation or reschedulement as a doubtful asset or a loss asset as the case may be. Necessary provision shall be made as applicable to such asset till it is upgraded.”*
- 3.1.70 Para 19 (1) of Prudential Regulations of Master Direction- Core Investment Companies (Reserve Bank) Directions, 2016, says- *“Every CIC-ND-SI shall separately disclose in its balance sheet the provisions made as per paragraph 17 above without netting them from the income or against the value of assets.”*
- 3.1.71 In light of the above, the conversion of the loan of ₹585 crore given to IMICL by IL&FS Limited into Fully Convertible Debentures (FCDs) is definitely tantamount to restructuring and the FCDs should not have been classified as standard assets in the financial statements by the management and the Audit Firm failed even to question the management on this count.
- 3.1.72 The Audit Firm has not questioned the Company on non-compliance with the RBI Prudential Regulations on loan restructuring. As per Para 4 (4.1.4), Para 7 (7.4) of Annexure VII of Non-Banking Financial Company- Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016, restructuring:
- a) has to be based on financial viability and reasonable assurance of repayment from the borrower;

- b) shall be treated as attempt at evergreening a weak credit facility if done without assessment of viability of the projects and shall invite supervisory concern;
  - c) shall be based on acceptable viability benchmarks;
  - d) Promoters' personal guarantee shall be taken.
- 3.1.73 The Audit Firm failed to highlight and insist upon this transaction to be categorised as NPA when there was no proof forthcoming of the account meeting the required viability benchmarks.
- 3.1.74 No disclosure of this restructured asset was made in the Financial Statements, though required by Para 8 of Annexure-VII of Non-Banking Financial Company- Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.
- 3.1.75 Moreover, the disclosure made by the Company in the balance sheet of such restructuring is wrong. The said restructuring should have been shown as loans and not assets. Even assuming but not accepting that such restructuring is shown as investment, impairment on the same should have been considered similar to investment in equity. As such, the Audit Firm failed to identify the wrong disclosure of the restructuring.
- 3.1.76 Thus, the RBI Directions relating to restructuring were flouted and the Audit Firm did not raise this issue at all.

#### ***Investment in Debentures***

- 3.1.77 IL&FS Limited in Standalone Financial Statement (SFS) for FY18 has categorized unquoted Non-Convertible Debenture (NCDs), Fully-Convertible Debenture (FCDs) and Optionally Convertible Debenture (OCDs) of subsidiaries amounting ₹1,962.60 crore, under the Non-Current Investments.
- 3.1.78 WP "133.1 to 133.7 M18 Provision leadsheet" that provides the work performed by the Audit Firm on standard asset provisions of the SFS as at 31<sup>st</sup> March 2018, notes the following breakup:

Particulars	FY18	FY17
Loan	5,736.77	3,886.49
Optionally/Non-Convertible Debenture & Bonds (Including Advance)	157.20	160.80
FCD having interest payment Schedule	2,297.00	537.00
Project Development Advances	0.001	10.00
Loans to Staff	0.56	0.98
<b>Sub Total</b>	<b>8,191.54</b>	<b>4,595.27</b>
Provision @ 0.40% on SA	32.77	18.38
<b>Provision required in FY 2018</b>		<b>14.38</b>

- 3.1.79 NFRA notes that the OCDs/NCDs amounting to ₹157.2 crore and FCDs amounting to ₹1,809 crore, along with advances on investments amounting to ₹488 crore, are considered standard assets. The debentures (NCDs/OCDs/FCDs) constituted approximately 24% (₹1,966.2 Crore) of the classified standard assets of the Company.
- 3.1.80 Note to Para 14 (“Accounting of Investments”) of the Master Direction - Core Investment Companies (Reserve Bank) Directions, 2016 (“CIC Directions”) states that “*Unquoted debentures shall be treated as term loans or other type of credit facilities depending upon the tenure of such debentures for the purpose of income recognition and asset classification.*” (Emphasis Added).
- 3.1.81 It is evident from the CIC Directions that for the purpose of accounting investments, unquoted debentures are required to be treated as term loans or other types of credit facilities, as the case may be. However, the Company had classified the investment of ₹1,962.6 crore in unquoted debentures as Non-Current Investments. This classification, in itself, is tantamount to a material misstatement in the financial statements of the Company. Thus, the Audit Firm was required to modify its opinion in accordance with SA 705 (Revised).
- 3.1.82 Para 16 (4) (i) of the CIC Directions states that “*Standard asset shall mean the asset in respect of which, no default in repayment of principal or payment of interest is perceived and which does not disclose any problem or carry more than normal risk attached to the business*” (emphasis added). Thus, for these unquoted debentures to be classified as standard assets, the pre-requirements of no default and normal risk should have been met.
- 3.1.83 Thus, to understand the basis of the classification of debentures as standard assets, NFRA has examined the following high-value investments in debentures:
- IL&FS Township & Urban Assets Ltd’s (ITUAL) FCDs and OCDs worth ₹477 crore and ₹150 crore, respectively.
  - IL&FS Tamil Nadu Power Company Ltd’s (ITPCL) FCDs worth ₹500 crore.
  - IL&FS Maritime Infrastructure Company Ltd’s (IMICL) FCDs worth ₹385 crore.

- 3.1.84 On perusal of the agreements of the above-stated debentures, NFRA notes that in these cases, the interest, being accrued annually, was payable/convertible along with the principal, only at the time of maturity of the FCDs and NCDs/OCDs. For example, the letter of allotment by ITPCL (WP “C 391.1.11.1 TO C 391.1.11.5 Revenue agreement-FCD\_4.1 Tamil Nadu Power LOA - 40 - FCDs - Dec 10 2015 - Rs 300 mn”) for the issue of unsecured 500 FCDs of ₹1,00,00,000/- each at par (₹500 crore) stated the following with respect to the conversion of debentures on maturity, “*The entire outstanding FCDs, together with interest accrued and due and payable on Maturity Date shall be compulsorily converted into fully paid-up equity shares of the Company on the Maturity Date, at a conversion price in the range of Rs 100.00 to Rs 400.00 for each equity share of face value Rs 10,00 fully paid up, based on equity valuation of the Company, arrived at by an Independent Valuer as mutually agreed by the Subscriber and the Company prior to the Maturity Date of the FCCD*”. These FCCDs carried interest @ 16.00% per annum, plus interest tax thereon, if applicable, till the maturity date. Similarly, the issue of 1,00,000 OCDs at the issue price of ₹15,000, amounting to ₹150 crore, by ITUAL (WP “C 391.1.12.1 TO C 391.1.12.2 Revenue agreement-FCD\_5 OCD Cert - 1 of 100000 OCDs”) stated the following redemption terms, “*Unless converted earlier, the Debenture shall be repaid and redeemed along with accrued interest at the end of 7 years from the Deemed Date of Allotment of the respective tranche of Debenture.*”
- 3.1.85 Therefore, in the light of the fact that the interest for these debentures will not get due until the date of maturity, there was no point to check for the default in repayment of principal or payment of interest, in the case of these instruments before their actual maturity. **The risk attached to the business should have been the primary criteria to classify these assets as standard assets.**
- 3.1.86 However, NFRA was unable to trace any work done by the Audit Firm in the audit file that indicated that they had considered the risk attached to the business to confirm the correctness of the classification of standard assets. Rather, on perusal of the WP “133.1 to 133.7 M18 Provision leadsheet”, NFRA notes that the Audit Firm had concurred with the management that these debentures are standard assets, just based on the fact that the interest accrued on debentures as at 31<sup>st</sup> March 2018, was in the nature of interest accrued but not due. No consideration was given to understanding the risk profile attached to these debentures, i.e. the creditworthiness of the companies to whom loans were granted.
- 3.1.87 NFRA notes that companies including ITUAL, ITPCL and IMICL provided strong indications reflecting more than normal risk. The indicators, as discussed below, should have been red flags for the **Audit Firm**.
- i. WP “C 61\_M18 ITUAL Financials - CFS” – ITUAL, the subsidiary of the Company that has been mandated to spearhead the development of new cities, affordable housing and other urban assets of the Group, had incurred losses of ₹184.9 crore and ₹115.1 crore in FY 2017-18 and FY 2016-17, respectively and had a negative net

worth of ₹4,811.9 crore as at 31<sup>st</sup> March 2018. The auditor of ITUAL had also provided an EOM paragraph in his audit report stating “*We draw attention to Note No. 45 forming part of financial statement, the Company has negative net worth of ₹4,811,956,148 as at 31st March 2018, however based on the Letter of Commitment for the **necessary operational support from the ultimate holding company** and management's business plans and in the opinion of the management, no adjustment is required to the carrying value of the assets and liabilities of the Company as on the Balance Sheet date and accordingly these financial statements have been prepared on a going concern basis.*” (emphasis added)

- ii. WP “C 370.1 M18 ITPCL Note” – ITPCL, an SPV incorporated by IL&FS Group for the implementation of the Thermal Power Project, had total borrowings of ₹8,485.6 crore as against its net worth of ₹3,069.4 crore. Further, ITPCL, in a letter dated 27<sup>th</sup> April 2018, wrote to the Company regarding the delay in payment of the brand fee outstanding. ITPCL mentioned that it has gone for the 5:25 scheme on account of insufficiency in its cash flows and structured its re-payment schedule for term loans to align with its cash flows. Since ITPCL does not have a long term PPA for Unit 2, they are planning to re-finance their term loan with new lenders once PPA is executed. ITPCL thus requested to bear in till their cash flow situation improved, which was expected in FY 2020.
- iii. WP “C 802.1 to C 802.42 M18 IMICL financials CFS traced” – IMICL, a subsidiary of the Company, set up with the object of creating a value-added business platform in the maritime and logistics sector, had a negative net worth of ₹1.6 crore. For FY 2017-18, IMICL reported a loss of ₹305 crore. Further, the auditor of IMICL had also provided an EOM paragraph in his audit report stating the uncertainty related to the outcome of the insolvency resolution process of Dighi Port Limited (DPL) and the consequential impact on the impairment of investment in Balaji Infra Project Limited (Investment of ₹50 crore) and loan and interest receivable from DPL (₹158.7 crore). Further, as enumerated in the section on Loans and Advances in the PFC, IMICL had also requested for rollover of loans on account of credit weakness.

3.1.88 However, even with the above-stated indicators, the Audit Firm did not exercise any professional scepticism or tried to verify if the debentures were fit to have been classified as standard assets.

3.1.89 Para 16 (4) (iv) of the CIC Directions states that “*loss asset shall mean:*

- a. *an asset which has been identified as loss asset by the CIC-ND-SI with asset size of Rs. 500 crore and above or its internal or **external auditor** or by the Bank during its inspection, to the extent it is not written off by it; and*
- b. *an asset which is adversely affected by a potential threat of non-recoverability due to either erosion in the value of security or non-availability of security or due to any fraudulent act or omission on the part of the borrower”* (emphasis added).

3.1.90 However, the Audit Firm failed to identify these assets as loss assets and failed:

- a. to report material misstatement of ₹1,962.6 crore on the classification of unquoted debentures as investments;
- b. to identify investment in unquoted debentures as loss assets;
- c. to report material misstatement on the inadequacy of provision on loss assets of ₹1,962.6 crore in the financial statements; and
- d. to provide an adverse opinion pursuant to SA 705 (Revised)

***Compliance regarding Related Party Transactions***

3.1.91 Conversion of loan of ₹585 crore into Fully Convertible Debenture (FCD) during FY18 attracts the compliances related to related party transactions as IMICL is a subsidiary of IL&FS Limited. Section 177 (4) (iv) of the Companies Act, 2013 says, “*every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall inter alia, include approval or any subsequent modification of transactions of the company with related party.*

*[Provided that the Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions as may be prescribed.]*

*[Provided further that in case of transaction, other than transactions referred to in section 188, and where Audit Committee does not approve the transaction, it shall make its recommendations to the Board.]”*

3.1.92 Vide its communication dated 19<sup>th</sup> November 2019, NFRA asked the Audit Firm that the Company had given a loan of ₹585 crore to IMICL in previous years and the same was converted into advance towards FCDs during FY18 and will subsequently be converted into fully paid equity shares before the maturity of these FCDs. In this connection, please state with reference to the working papers placed in the audit file submitted to us: the Company’s policy in regard to such restructuring, the reasons for such restructuring and what procedures were adopted by the auditor to analyse the cash flows of the borrower.

3.1.93 The Audit Firm in its response dated 30<sup>th</sup> December 2019, inter alia, stated that the conversion of the loan was a decision of the management and as the auditors, it verified that the procedures mentioned in the policy were followed. It further stated that the conversion of the loan was approved by the audit committee on 8<sup>th</sup> November 2017, 21<sup>st</sup> February 2018 and 29<sup>th</sup> May 2018. On perusal of the said audit committee meeting minutes, it was observed that there is no such approval related to the restructuring of assets **specifically**. Rather, in the audit committee meeting minutes dated 21<sup>st</sup> February 2018, there is a clause that states that- “*Pursuant to the Companies Act, 2013, all the transactions of a Company with its related parties were required to be approved by the Audit Committee. The Company placed the RPT for the period October 1, 2017 to*

*December 31, 2017 before the Audit Committee for approval. All the transactions placed for approval by the Audit Committee were in the ordinary course of business and at arm's length basis as per the approved related party framework. As required by the RPT framework all the transactions had been reviewed by the Audit Committee of Directors (COD). The committee subsequently noted and approved the foregoing."*

- 3.1.94 Details related to what all related party transactions were placed before the audit committee and approved are nowhere mentioned in the audit committee meeting minutes. Therefore, the Audit Firm failed to verify whether the requirement of section 177 of the Companies Act, 2013, in respect of related party transactions was duly complied with. As such, the auditor's statement- *"According to the information and explanations given by the management, transactions with the related parties are in compliance with section 177 and 188 of the Companies Act, 2013 where applicable and the details have been disclosed in the notes to the financial statements, as required by the applicable accounting standards"* as per the requirements of Companies (Auditor's Report) Order, 2016, in terms of Section 143 (11) of the Companies Act, 2013, is a certificate that is not correct in material particulars and has been provided knowing the same to be not reflecting the facts. This certificate, therefore, is in violation of the SAs, and CARO.
- 3.1.95 Further, the Audit Firm failed to obtain audit evidence that the related party transactions have been appropriately authorised and approved and hence, failed to comply with the requirements of Para 23 (b) of SA 550.

#### **B. Observations made in the DAQRR**

- 3.2 NFRA in its DAQRR conveyed the following:
- 3.2.1 Vide its response dated 14<sup>th</sup> April 2021, the Audit Firm has stated that *"At the outset, we would like to point out that NFRA has made a sweeping allegation about the work performed by us in respect of investments, without giving any basis to support the said allegation which is contrary to the facts."* NFRA rejects the said statement of the **Audit Firm** in light of the reasons explained in the further paras.
- 3.2.2 In Para 7 of the response of the Audit Firm pertaining to investments, the Audit Firm has listed in detail the procedures performed by them in respect of investments. On analysis of the response, NFRA finds that the WPs referred by the Audit Firm in support of their assertions were already examined in detail by NFRA at the stage of forming its Prima Facie Conclusions (PFC). As nothing new/additional to what was provided earlier is now submitted by the Audit Firm, NFRA concludes that no further examination is required and NFRA reiterates its conclusions provided in the PFC in this regard.
- 3.2.3 The Audit Firm, in reference to Para A3 and A7 of SA 230 has repeatedly stated in their response that *"it is not necessary to retain all the documents checked during the time of audit as part of audit documentation."*

- 3.2.4 It has to be noted that SA 230 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. Given this position in the SAs, there is virtually no scope for purely oral submissions or discussions. All oral representations have also to be reduced to writing so as to form part of the record, and to eliminate the scope for disputes. 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.
- 3.2.5 In reference to Para 5 and 6 of SA 230, Para 5 (c) and 9 of SA 500, it is clear that the Audit Firm is required to obtain audit evidence about the accuracy and completeness of the information. There is no evidence in the audit file where the Audit Firm has noted their observations, comments or conclusions about the investment policy of the Company.
- 3.2.6 In its response dated 14<sup>th</sup> April 2021, the Audit Firm has mentioned that the investment policy was provided by the Company to RBI and the same is being mentioned by RBI in its inspection report dated 15<sup>th</sup> November 2016. As such, the existence of the policy is not doubtful. It is important to note that NFRA in its PFC concluded that the Audit Firm did not obtain the Investment Policy as the same was not available in the audit file. Hence, it created doubt about whether the Audit Firm had even seen the investment policy. There was a significant doubt that the Audit Firm performed the audit procedures in respect of investments without even looking at the company's investment policy.
- 3.2.7 NFRA perused the response of the Audit Firm and concludes that mere provision of the investment policy to the RBI by the Company does not establish or prove that the investment policy was seen by the Audit Firm and that it had checked that the investments being done in terms of the investment policy. The investment policy was provided to RBI in May 2016 for the inspection of the Company for the year ended 31<sup>st</sup> March 2015. The Audit Firm conducted the statutory audit of the Company for FY18. It is nowhere noted in the audit file that the Audit Firm had seen the Investment policy and whether the policy was the same as what was provided to the RBI in May 2016 or if any changes were made to the policy by the Company for FY18.
- 3.2.8 Further, the Audit Firm has stated that while performing the test of controls, they had checked the compliance of investment policy by the Company and have referred to WPs "*IL&FS - Standalone Canvas Files Folder - 174.1 to 174.14 M18 Investments – TOC, 175.1 to 175.11 M18 Sale of Investment TOC.*" On perusal of the said WPs, NFRA notes that neither does the WP contain the investment policy regarding controls pertaining to investments nor does it document what the investment policy says pertaining to controls regarding investment.

- 3.2.9 The Audit Firm has mentioned in their response that “*NFRA conclusion was purely on the ground that investment policy was not forming part of the audit workpapers, though there is evidence in workpapers of verifying compliance to the investment policy and its existence.*” In support of this assertion, the Audit Firm has referred to WPs “IL&FS-Standalone Canvas Files Folder -170.1 to 170.8 M18 Investments Walkthrough and IL&FS – Standalone Canvas Files Folder - 171.1 to 171.6 M18 Sale of Investments Walkthrough”. NFRA perused the said WPs and notes that the WPs contain the process followed by the Company for making investments. But the WPs do not show or mention anywhere that the auditor has verified the investments made by IL&FS Limited in terms of the investment policy of the Company. There is no comment from the Audit Firm on whether the process of investment complies with the investment policy of the Company or not.
- 3.2.10 The Investment Policy was a crucial document to identify and check as to whether the investment made and valued by the Company is as per the policy of the company or not. Had the Audit Firm seen the Investment Policy of the Company, the same should have been documented as part of the audit file.
- 3.2.11 As such, NFRA reiterates its conclusion that the Audit Firm failed to exercise professional scepticism in verifying the Investments.
- 3.2.12 The point raised by NFRA in its PFC was that the Audit Firm failed to verify if the management had tested **EACH** investment for impairment. In its response dated 14<sup>th</sup> April 2021, the Audit Firm has stated that “*As per the Investment policy, the Company was to carry out Annual Review of Investments for all investments exceeding Rs 100 crore of investment in subsidiaries, associates and joint venture. For the purpose of testing impairment of investment, the Company had prescribed in its risk control matrix that Annual Review evaluation of investments was performed by Project Finance team (Senior Vice President) as per investment framework and same was evaluated by the Investment Review committee, based on which diminution / impairment impact (if any) in the investments is given in the financial by Accounts.*”

NFRA notes that the Audit Firm failed to provide reference to any WP placed in the audit file in support of the aforesaid assertion. Therefore, there is no proof that the Audit Firm had seen the investment policy of the Company. In fact, instead of verifying adherence to the accounting policy, the Audit Firm has stated the investment policy of the Company. Notwithstanding, NFRA has examined the assertion of the Audit Firm and the observations noted are in below paras.

- 3.2.13 Para 18 of AS 13 says, “*Long-term investments are usually of **individual importance** to the investing enterprise. The carrying amount of long-term investments is therefore determined on an **individual investment basis.**” (Emphasis Added)*

- 3.2.14 The carrying amount of individual long-term investment needs to be determined irrespective of the amount of investment. The company's policy of reviewing investments exceeding ₹100 crore is in violation of its own accounting policy as well as the Accounting Standards. The Audit Firm, in fact, failed to point out these violations and material misstatements in the financial statements by the Company.
- 3.2.15 Further, the Audit Firm has itself stated that *"We would like to mention that compliance of accounting policy was the responsibility of the management of the Company and as an auditor we need to satisfy that the accounting policy was followed by the management for all material items."*
- 3.2.16 The Audit Firm failed to assess and verify whether the accounting policy of the Company is in compliance with the relevant accounting standard.
- 3.2.17 In Para 3 (b) of PFC, NFRA concluded that there is no information available in the WP in respect of the total quantum of investments for which IL&FS Limited had done impairment analysis. The Audit Firm failed to provide any explanation regarding the same.
- 3.2.18 Further, NFRA also concluded that no workings were shown in the WP regarding any audit procedures if performed by the Audit Firm for investments amounting to ₹1,637 crore. In response to this conclusion of NFRA, the Audit Firm has stated that *"the total quantum of equity investments for which investment impairment analysis carried out was documented in WP 'IL&FS - Standalone Canvas Files Folder - 215.1 to 215.8 M18 Impairment summary analysis'. Investment amounting to Rs.1,561 crores are those investments wherein book value exceeds its carrying value and thus there was no trigger for impairment. Since there was no trigger for impairment, no further work was performed for such investments."*

The WP referred by the Audit Firm was examined in detail by NFRA at the time of forming its PFC. NFRA had observed that there is no calculation shown by the Audit Firm in the WP as to how they verified the carrying value and book value of the investments calculated by the Company. Simply stating that as book value exceeds its carrying value and thus there was no trigger for impairment is unacceptable.

- 3.2.19 As such, NFRA reiterates its conclusion that the Audit Firm failed to show any workings regarding any audit procedures if performed by them regarding investments amounting to ₹1,637 crore.
- 3.2.20 In respect of observations made by NFRA in para 3 (c) and 3 (d) of PFC, the Audit Firm has stated that *"we had not merely relied valuation report issued by management expert but had performed further appropriate audit procedures to ascertain impairment in value of investment if any."* NFRA rejects this statement of the Audit Firm and the reasons for the same are explained in Paras below.

- 3.2.21 In Para 3 (e) of its PFC, NFRA specifically mentioned that the external confirmations pertaining to FDs amounting to ₹997 crore (as on 30<sup>th</sup> September 2017) were not traceable in the audit file. Vide its response dated 14<sup>th</sup> April 2021, the Audit Firm, in respect of confirmations of FDs, has given reference to the WPs ““CB 4” tab of “IL&FS-Standalone Canvas Files Folder – 341.1 to 341.17 M18 Cash & Bank Lead”, ILFS Standalone canvas files – From 351.1.1.1.1 To 351.1.2.68.1 - M18 Direct Confirmations and IL&FS-Standalone Hardcopy Files Folder - 25\_Direct Confirmations”. On perusal of the audit file, NFRA finds that though the confirmations pertaining to FDs are available in the audit file due to numerous documents, total amount of confirmations available cannot be reconciled by NFRA.
- 3.2.22 Further, in Para 3 (f) of its PFC, NFRA concluded that external confirmations pertaining to balance with banks in demand deposits amounting to ₹247 crore were also not traceable in the audit file. Not providing reference to any WP placed in the audit file in this respect is conclusive proof that the Audit Firm failed to obtain external confirmations from the bank as per the requirement of SA 505.
- 3.2.23 The Audit Firm has stated that they had checked the background and capabilities of the experts from their website. There is no such evidence available in the audit file where the Audit Firm had noted their observations in this regard.
- 3.2.24 Para A43 of SA 500 says, “*When evaluating the objectivity of an expert engaged by the entity, it may be relevant to discuss with management and that expert any interests and relationships that may create threats to the expert’s objectivity, and any applicable safeguards, including any professional requirements that apply to the expert; and to evaluate whether the safeguards are adequate. Interests and relationships creating threats may include: • Financial interests. • Business and personal relationships. • Provision of other services.*” (Emphasis Added)
- 3.2.25 The Audit Firm has stated that “*valuation report issued by N.M Raiji & Co clearly discloses that the firm was independent to carry out valuation work. SRBC does not understand the basis of NFRA expectation with regards to checking of independence of NMR by it. There was no reason for SRBC to doubt the independence confirmed in the report by NMR.*”

The above-said statement of the Audit Firm clearly shows that the Audit Firm simply relied on what management expert mentioned in their report regarding their objectivity. The Audit Firm did not put any effort to evaluate the statement of the management expert regarding their objectivity. There is no evidence in the audit file that the Audit Firm had any discussion with the management and N.M. Raiji & Co. regarding interests and relationships that may create threats to the expert’s objectivity as required by Para A43 of SA 500.

- 3.2.26 The Audit Firm submitted that *“only one firm i.e. NMR has issued different valuation reports for each entity and therefore it was sufficient to document evaluation of objectivity of NMR only once. Performing the task of evaluation of objectivity again and again for the same firm would lead to duplication of same work paper and in our view does not make any sense.”*

The said argument is untenable. In the WP “IL&FS-Standalone Canvas Files Folder - SFS Canvas - 441.1 M18 130GL(R)-Mgmt specialist- N.M. Raiji & Co. (Investment Valuation)”, it is mentioned that *“The firm is registered with the Institute of Chartered Accountants of India. We have also inquired with the management, that the specialist is not related to the entity in any manner.”* This is a general statement and is not specific to any entity for which NMR had issued a valuation report.

Also, it was possible that NMR could be related to one or more entities. So, it was required by the Audit Firm to evaluate the objectivity of individual entities of the IL&FS Group.

- 3.2.27 The Audit Firm has stated that *“we had verified the qualification and capability of the team members who had performed the valuation of seven different entities i.e Vinay D. Balse, Chartered accountant, which was also documented in our audit working paper.”* On perusal of the WP “IL&FS-Standalone Canvas Files Folder - SFS Canvas - 441.1 M18 130GL(R)-Mgmt specialist- N.M. Raiji & Co. (Investment Valuation)”, NFRA observes that only a single name of the expert i.e., “Vinay D. Balse” is mentioned in the said WP. His designation in NMR, qualifications, areas of expertise, experience etc. is nowhere mentioned in the WP. This clearly shows that the Audit Firm failed to evaluate the competence and capabilities of the personnel who worked over the valuation of seven different entities.
- 3.2.28 The WPs referred by the Audit Firm in support of their assertions were already examined in detail by NFRA at the stage of forming its PFC. Hence, NFRA concludes that no further examination is required and NFRA reiterates its conclusions provided in this regard in its PFC.
- 3.2.29 As such, on the basis of the aforementioned reasons, NFRA reiterates its conclusion that the Audit Firm simply relied on the work of the management expert and failed to comply with the requirements of Para 8 of SA 500.
- 3.2.30 The Audit Firm has stated that *“we had obtained report and read nature, scope and objective of the expert work from valuation report provided by NMR. We did not consider it necessary to obtain engagement agreement, which is not a mandatory requirement, between management and NMR since nature, timing and extent of work done by expert was covered in valuation report itself and we had no reasons to believe that it was incorrect. In effect the purpose of paragraph A46 of SA 500 was met.”*

3.2.31 NFRA notes that the valuation report only discloses the objective of valuation, caveats, limitations and disclaimers given by the expert. As stated in Para A46 of SA 500, the Audit Firm is required to determine the appropriateness of the respective roles and responsibilities of management and the expert, the nature, timing and extent of communication between management and the expert. Such information is not available in the report.

3.2.32 As such, the Audit Firm's assertion that it was not necessary for them to obtain an engagement agreement as the purpose of Para A46 of SA 500 was met with the report itself is not true. NFRA, therefore, reiterates its conclusion that the Audit Firm failed to comply with the requirements of para A46 of SA 500.

3.2.33 In Para 73 of the response provided by the Audit Firm dated 14<sup>th</sup> April 2021, the Audit Firm has given reference to various WPs in support of the assertion that *"we had documented all our work procedures relating to purpose and scope of the management expert's work, methods and assumptions used in the valuation."*

The WPs referred by the Audit Firm in support of their assertions were already examined in detail by NFRA at the stage of forming its PFC. Hence, NFRA concludes that no further examination is required and NFRA reiterates its conclusions provided in the PFC in this regard.

3.2.34 Vide their response dated 14<sup>th</sup> April 2021, the Audit Firm in Para 86 of their response has listed out the procedures performed by them to assess and verify the source data used by the expert for valuation along with reference to various WPs.

3.2.35 The WPs referred by the Audit Firm in support of their assertions were already examined in detail by NFRA at the stage of forming its PFC. Hence, NFRA concludes that no further examination is required and NFRA reiterates its conclusions provided in its PFC in this regard.

3.2.36 The Audit Firm has stated that *"SRBC would like to state that scope of work procedures performed along with their roles and responsibilities were agreed with the auditor's expert which was forming part of valuation memo signed by auditor's expert. Refer Section "Scope of work procedures performed" in valuation memo which states roles and responsibilities of auditor's expert agreed with audit team. The valuation memo was signed by auditor's expert after having discussion with audit team."*

3.2.37 The said assertion of the Audit Firm is untenable. In the valuation memo, under the heading "scope of work: procedures performed", the auditor's expert had clearly stated that *"the scope of work was determined by the Audit Team, and in direction with the Audit Team, we completed the following activities"*.

As such, it is clear that the audit team itself decided the scope of work to be done by the auditor's expert and the auditor's expert adhered to the same.

- 3.2.38 Further, the Audit Firm also states that *“All valuation memo provided by auditor's expert contains details of roles and responsibilities of auditor's expert, discussion with audit team and management as well as conclusion of auditor's expert.”* On perusal of the valuation memos, NFRA could not find roles and responsibilities of the auditor's expert or any discussion of the auditor's expert with the audit team.
- 3.2.39 Moreover, Para 11 of SA 620 says, *“The auditor shall agree, **in writing** when appropriate, on the following matters with the auditor's expert: (Ref: Para. A23-A26) (a) The **nature, scope and objectives** of that expert's work; (Ref: Para. A27) (b) The **respective roles and responsibilities** of the auditor and that expert; (Ref: Para. A28-A29) (c) The **nature, timing and extent of communication** between the auditor and that expert, including the form of any report to be provided by that expert; and (Ref: Para. A30) (d) The need for the auditor's expert to observe confidentiality requirements. (Ref: Para. A31)”* (Emphasis Added)
- 3.2.40 In the audit file, there is no such document that provides all the information as required by Para 11 of SA 620. Neither the **respective roles of both** auditor's expert and the Audit Firm are mentioned anywhere in the audit file nor **nature, timing and extent of communication** between the Audit Firm and the auditor's expert are mentioned.
- 3.2.41 The Audit Firm tried to mislead NFRA by giving false assertions in their response. As such, NFRA concludes that the Audit Firm failed to comply with Para 11 of SA 620.
- 3.2.42 In its PFC, NFRA made an observation that the entity of "EY Group" which had worked as an auditor's expert is not mentioned in the audit file. In response to this observation, the Audit Firm has stated that *“Mr. Sorabh Kataria who had signed the valuation report was partner of Ernst & Young LLP (EY LLP).”* The said assertion of the Audit Firm is not supported by any document nor is it evident from the audit file.
- 3.2.43 In its PFC, NFRA had observed that there is no evidence as to whether any two-way communication took place between the Audit Firm and the auditor's expert in the audit file and thus Audit Firm failed to comply with the requirements of Para A30 of SA 620.

In response to this observation of NFRA, the Audit Firm has stated that *“We had also identified audit engagement team member who liaised with auditor's expert which facilitated timely and effective communication. Sample mails are attached herewith for your reference Appendix 2 (Page No. A28).”*

The document referred by the Audit Firm cannot be considered as it does not form part of the audit file. Even assuming for the sake of argument, but not accepting, that the referred document is valid, NFRA finds that the sample mail as referred by the Audit

Firm (Appendix 2 Page A28) is communication between the auditor's expert and the Management of IL&FS Limited. As such, NFRA concludes that the Audit Firm tried to mislead NFRA by providing wrong information.

- 3.2.44 Further, the Audit Firm has also stated that *"As per requirement of Para A7 of SA 230, it was not necessary to document communication between auditor's expert and audit engagement team if the other papers demonstrate such discussion. The valuation memo clearly demonstrates such discussion."* None of the valuation memo available in the audit file contains any such discussion held between the auditor's expert and the Audit Firm. As such, NFRA reiterates its conclusion that the Audit Firm failed to comply with the requirements of Para A30 of SA 620.
- 3.2.45 The Audit Firm also states that *"The external experts report and auditor's expert 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 valuation report from an external expert and had also involved auditor's expert to validate the reasonability of assumptions and estimates."* The said assertion of the Audit Firm is not supported by any audit evidence.
- 3.2.46 The WPs referred by the Audit Firm in support of their assertions were already examined in detail by NFRA at the stage of forming its PFC. Hence, NFRA concludes that no further examination is required and NFRA reiterates its conclusions provided in its PFC in this regard.
- 3.2.47 The Audit Firm has stated that *"The management has used the valuation model as per the valuation report of December 31, 2016 by management expert. Further, as documented in our workpaper, we had enquired with the management to confirm that there was no material change in the business for the quarter ended March 31, 2018 and hence it was used for making an impairment analysis as of March 31, 2018."*

As stated by the Audit Firm that they enquired with the management to confirm that there was no material change in the business for the quarter ended 31<sup>st</sup> March 2018, NFRA notes that the Audit Firm has not referred to any WP where such enquiry with the management has been done.

- 3.2.48 In Para 118 of their response dated 14<sup>th</sup> April 2021, the Audit Firm has given a list of procedures performed to ascertain the impairment of investment in IEDCL and has given reference to WP "IL&FS-Standalone Hardcopy Files Folder - 32\_Investment Impairment Analysis of IL&FS Energy Development Company Limited - Page no. IEDCL 1.1". On perusal of the said WP, NFRA notes that there are no workings done by the Audit Firm as stated in their response. For instance, the Audit Firm has stated that *"We had verified the reasonableness of the growth of revenue, capital expenditure, Interest Rate, Repayment schedule and WACC and as the valuation of projects were based on the discounted cash flow method, we had applied principles of AS 28 to verify correctness of*

*valuation model. Accordingly, the fair value of IEDCL was worked at Rs. 48.04 per share.” In the WP, there exists no evidence of how the Audit Firm verified the reasonableness of the growth of revenue, capital expenditure and how the Audit Firm calculated the fair value and carrying value of the share of IEDCL to arrive at the conclusion that “since the fair value per share exceeds the carrying value in the books of IL&FS, there is no trigger for impairment”.*

- 3.2.49 Merely obtaining the valuation reports, valuation model, and letter of representation (dated 30<sup>th</sup> May 2021, which is exactly the signing date of the auditor’s report) from the Management cannot prove that the Audit Firm had conducted the statutory audit with due professionalism. The Audit Firm is required to analyse and verify the valuation reports/models, and calculate the fair value and carrying value of the share being considered by the Company to arrive at a conclusion.
- 3.2.50 There are no workings of the Audit Firm available in the referred WP to ascertain the impairment of investment in IEDCL. As such, NFRA refutes the statement of the Audit Firm that *“we had performed adequate work procedures and had conducted audit professionally.”*
- 3.2.51 The aforementioned reasons clearly show that the Audit Firm failed to perform its duties with due care and a professional attitude.
- 3.2.52 The Audit Firm has stated that *“NFRA has observed that final signed management report of DPL was dated 27th May, 2018 whereas auditor’s expert report was dated 25th May, 2018. In this regards, SRBC would like to state that we had obtained draft report from management expert for purpose of performing our audit procedures which was also used by auditor’s expert for ascertaining fair value of DPL. Final valuation report was signed by NMR on 27th May, 2018 which was in line with a draft report earlier shared with us. Refer Appendix 3 (Page No. A29).”*

The above-said assertion of the Audit Firm is not supported by any audit evidence placed in the audit file. The “draft report” as mentioned by the Audit Firm is not available in the audit file to verify whether the same was in line with the final signed valuation report of NMR. The referred document “Appendix 3 Page A29” does not form part of the audit file and hence, cannot be considered by NFRA for examination.

- 3.2.53 The WPs referred by the Audit Firm in support of their assertions were already examined in detail by NFRA at the stage of forming its PFC. Hence, NFRA concludes that no further examination is required and NFRA reiterates its conclusions provided in its PFC in this regard.
- 3.2.54 The above paras of this DAQRR conclusively prove that the Audit Firm simply relied on the valuation reports of the management expert. NFRA, therefore, refutes all the arguments of the Audit Firm in Para 139 and 140 of their response dated 14<sup>th</sup> April 2021.

3.2.55 The Audit Firm has made an assertion that *“We had conducted meetings and had detailed discussion on the DPL matter during the course of audit with the management for which e-mails are available with us. Refer Appendix 4 (Page No. A30 to A31).”* The document referred by the Audit Firm cannot be considered valid as it does not form part of the audit file. Even assuming for the sake of argument, but not accepting, that the referred document is valid, NFRA finds that the referred document is just the email communication regarding the setup of a meeting between the Audit Firm and the Management. There is no evidence that such meeting took place and what matters were discussed between the Audit Firm and the Management.

3.2.56 On the basis of the above explanations, NFRA reiterates its conclusion that the Audit Firm failed to identify and assess the risk of material misstatement in the financial statement as per the requirements of Para 25 of SA 315.

3.2.57 The Audit Firm has stated that *“SRBC would like to state that there was regular interaction and meetings with audit committee members i.e. Arun Saha, Hari Sankaran and K. Ramchand wherein there was detailed discussion regarding diminution in the value of investment in DPL. Further, it can be seen from the minutes of ACM held on Nov 8, 2017, ACM 21Feb18 and May 29, 2018 that the investment in DPL was discussed throughout the audit.”*

NFRA perused the said audit committee meeting minutes and finds that no such discussion is documented in the minutes. In the audit committee meeting minutes dated 8<sup>th</sup> November 2017, under the heading “Presentation made by the auditors”, it is only mentioned that the Investment impairment assessment of Dighi Port Limited was discussed with the management. Details of what was discussed are nowhere mentioned in the minutes.

3.2.58 As such, NFRA reiterates its conclusion that the Audit Firm did not discuss the matter with the management and had only informed the Audit Committee about the status of impairment through a presentation made just a day before the date of signing of the Audit Report and it is a one-sided communication.

3.2.59 The WPs referred by the Audit Firm in Para 155 of their response, claiming that based on their professional judgement they had concluded on the reasonability of assumptions as required by Para A80 of SA 540, were already examined by NFRA in detail while forming its PFC. As such, there arises no need for re-examination of the same WPs and NFRA reiterates its conclusion given in Para 3 (V) (B) of its PFC.

3.2.60 The Audit Firm tried to mislead NFRA in the name of typographical error for the difference in amounts shown in both the WPs “M18 IMICL Impairment summary analysis” and “M18 Investment lead sheet and analysis”. Whether the difference of ₹8

crore had any impact on the financial statements or not, such a causal attitude while preparing and reviewing the WPs by the ET is unacceptable.

- 3.2.61 From Para 183 to 218, the WPs referred by the Audit Firm in support of their assertions were already examined in detail by NFRA at the stage of forming its PFC. Hence, NFRA concludes that no further examination is required and NFRA reiterates its conclusions provided in its PFC in this regard.
- 3.2.62 The Audit Firm has stated that *“it is not practically possible to obtain, all the audit data on the letterhead of the Company and signed by the officials of the Company, as voluminous information is received from the Company to assist us in obtaining sufficient and appropriate audit evidence. WP “IL&FS – Standalone Canvas Files Folder - 233.1 to 233.22 M18 Credit SOP” was initialed by Company personnel on every page and thus on basis of initials and having discussion with management we had accepted the policy as an audit evidence.”* There is no proof that the initials on the WP are of the Company personnel as neither there exists any Company stamp nor name of the individual whose initials were placed. The Company’s policy is a vital document for assessment of the financials of the Company and hence, the authenticity of the same is important.
- 3.2.63 In view of the explanation given in the above paras, NFRA reiterates its conclusion that the Audit Firm failed to identify and assess the risk of material misstatement in the financial statement as per the requirements of Para 25 of SA 315 and failed to exercise professional skepticism expected from a qualified professional auditor.
- 3.2.64 Para 17 of AS 13 says, *“Long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long term investment, the carrying amount is reduced to recognise the decline. **Indicators of the value of an investment are obtained by reference to its market value, the investee’s assets and results and the expected cash flows from the investment. The type and extent of the investor’s stake in the investee are also taken into account. Restrictions on distributions by the investee or on disposal by the investor may affect the value attributed to the investment.**”* (Emphasis Added)

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

- 3.2.65 In its PFC, NFRA mentioned that there was a continuous decline (almost 66.70%) in the share price of IECCL in the market from 31<sup>st</sup> March 2015 to 31<sup>st</sup> March 2018. As per Para 17 of AS 13 cited above, the decline in the market value of the share is one of the important impairment indicators. As such, NFRA refutes the Audit Firm's assertion that the closing market price was not an appropriate reflection of permanent diminution.

- 3.2.66 Therefore, in view of the above observations, NFRA reiterates its conclusion that the Audit Firm solely relied on the management decision and ended by overstating the value of the investment. Also, the Audit Firm failed to report a material misstatement in the financial statements.
- 3.2.67 Vide its response dated 14<sup>th</sup> April 2021, the Audit Firm has stated that *“SRBC states that conversion of loan into fully convertible debentures was not a restructuring but mere conversion as it was forming part of one of the terms and condition of loan agreement. SRBC had obtained from management credit approval memorandum for conversion of loan of Rs. 585 crores wherein management had analysed the proposal and had obtained approval as per delegation matrix. Refer IL&FS - Standalone Canvas Files Folder - 203.1 to 203.6 S17 IMICL-Conversion of FCDs - 3850 mn and IL&FS - Standalone Canvas Files Folder - 281.1 to 281.5 IMICL\_Convrsn of Loans to FCCDs Rs 200 crs\_appvd COD memo\_26-Mar-2018”*.
- 3.2.68 Also, vide its response dated 30<sup>th</sup> December 2019, the Audit Firm had stated that *“the conversion of loan was decision of the management and as the auditors we verified that the procedures mentioned in the policy were followed.”*
- 3.2.69 Both the above assertions of the Audit Firm imply that the Audit Firm merely relied on the terms and conditions for conversion of the loan to FCDs as decided by the management in the policy. The Audit Firm failed to assess and verify whether the terms decided by the management were in compliance with the RBI Directions.

It was the professional duty of the Audit Firm to assess and point out if the policies of the Company were in compliance with the relevant law, guidelines, and directions of the relevant regulators.

- 3.2.70 Further, the Audit Firm has also stated that *“SRBC also read the RBI inspection report and the management responses thereon and noted that RBI has not raised any observation for not classifying unquoted debentures as term loans in financial statement.”* This statement of the Audit Firm implies that the Audit Firm did not apply professional scepticism. Since RBI did not point out the misstatement, similarly the Audit Firm also did not bother to point out the misstatement.

The statutory auditor is expected to apply professional scepticism and accordingly is supposed to point out the misstatements in the financial statements of the Company. In this case, the Audit Firm had blindly conducted the audit.

- 3.2.71 In Para 282 of the response of the Audit Firm, the Audit Firm has referred a few WPs in support of their assertion that the *“Audit team had obtained sufficient audit evidence by way of impairment testing of investment that standard asset provision must be made for FCD, OCD and NCD. Thus, we had obtained audit evidence and there was no material*

*misstatement of financial statement merely by classifying FCD, NCD and OCD as investment and not term loan, hence no separate disclosure was required in the financial statements and in auditor's report as per para 6 of SA 705.*"

On analysis of the response, NFRA finds that the WPs referred by the Audit Firm in support of their assertion was already examined in detail by NFRA at the stage of forming its PFC. There was no audit evidence in the audit file that the Audit Firm had even examined the strong indications reflecting more than normal risk of the companies including ITUAL, ITPCL and IMICL as was explained in detail in PFC of NFRA. Hence, NFRA concludes that no further examination is required and NFRA reiterates its conclusions provided in its PFC.

3.2.72 The Audit Firm has stated that *"SRBC would like to state that we had verified the approval of audit committee for all related party transactions undertaken during each quarter, which was forming part of the agenda papers of the meeting circulated by the secretarial department. The same can be verified from the secretarial records of the Company. The details for approval in respect to conversion of loans into FCD of Rs. 585 crores also form part of agenda sent to Audit Committee members, which was verified by SRBC."* The said assertion of the Audit Firm is not supported by any audit evidence placed in the audit file.

3.2.73 The Audit Firm has further stated that *"SRBC would like to state that there is sufficient documentation in our working papers and it is not expected to retain all documents as audit working paper as per requirement of Para A3 and A7 of SA 230. SA 230 does not necessarily require SRBC to retain agenda as part of audit documentation because audit file cannot be treated as substitution of company's accounting records and Audit Firm cannot be expected to document every matter considered or professional judgement made."*

It is important to note that the agenda of the audit committee meeting neither contain approvals nor states that the transaction was approved in the meeting. It only provides information that what is scheduled to be presented in front of the audit committee in a particular meeting. As such, the agenda of the meeting cannot be considered as sufficient appropriate audit evidence in support of the Audit Firm's assertion that the transaction was approved in the audit committee meeting.

3.2.74 Also, in Para 3.2.3 and 3.2.4 above, NFRA has explained that the audit file should be capable of speaking for itself without the need for any other aids to interpretation. In view of the said explanation, the claim of the Audit Firm that it is not necessary to document the agenda of the audit committee in the audit file is unacceptable.

3.2.75 Further, the Audit Firm has provided the extract of the Audit Committee Agenda for the meeting with their response in form of an Appendix. The same cannot be taken into consideration as the same does not form part of the audit file.

3.2.76 Rule 6A (4) of the Companies (Meetings of Board and its Powers) Rules, 2014, says, “The omnibus approval shall contain or indicate the following:

- (a) Name of the related parties;
- (b) Nature and duration of the transaction;
- (c) Maximum amount of transaction that can be entered into;
- (d) The indicative base price or current contracted price and the formulae for variation in the price, if any; and
- (e) Any other information relevant or important for the Audit Committee to take a decision on the proposed transaction:

**Provided** that where the need for related party transaction cannot be foreseen and aforesaid details are not available, audit committee may make omnibus approval for such transactions subject to their value not exceeding rupees one crore per transaction.”

As the audit committee meeting minutes do not specifically mention anything about approval of the transaction pertaining to conversion of loan into FCDs, it is a violation of the aforesaid Rule by the Company. The Audit Firm failed to point out such a violation and did not raise this to the Management or TCWG.

3.2.77 It was required by the Audit Firm to obtain sufficient appropriate audit evidence to be able to base its conclusion that the transaction of conversion of loan into FCDs was approved by the audit committee. The Audit Firm failed to comply with the basic objective of SA 500.

3.2.78 The aforesaid observations of NFRA conclusively prove that the Audit Firm did not do what they were professionally expected to do as per the requirement of the Companies Act, 2013 and SAs. As such, NFRA reiterates its conclusion that the Audit Firm failed to verify and obtain audit evidence that the related party transactions were appropriately authorised and approved by the audit committee as per the provision of Section 177 of the Companies Act, 2013. Further, NFRA also concludes that the Audit Firm, therefore, provided a false certificate against the requirements of Para 3 (xiii) of the Companies (Auditor’s Report) Order, 2016, in terms of Section 143 (11) of the Companies Act, 2013.

3.2.79 As such, NFRA refutes the Audit Firm’s conclusion that “SRBC had performed audit procedures in compliance with Section 177 of the Companies Act 2013 and reporting under clause 3 (xiii) of CARO, 2016 in terms of Section 143 (11) of the Companies Act, 2013” as it is baseless.

3.2.80 After examining in detail all the responses of the Audit Firm to the PFC, NFRA concluded in the DAQRR as follows:

- i. In Para 3.2.3 and 3.2.4 above, NFRA has explained that the audit file should be capable of speaking for itself without the need for any other aids to interpretation. As such, in view of the said explanation, the claim of the Audit Firm that it is not

necessary to retain all the documents checked during the time of audit as part of audit documentation is inadmissible.

- ii. The Investment Policy was a crucial document to identify and check as to whether the investment made and valued by the Company is as per the policy of the company or not. The Audit Firm failed to see, document and verify the compliance of the investment policy of the Company.
- iii. The Audit Firm failed to assess and verify whether the accounting policy of the Company is in compliance with the relevant accounting standard.
- iv. In the PFC, NFRA concluded that there is no information available in the WP in respect of the total quantum of investments for which IL&FS Limited had done impairment analysis. The Audit Firm failed to provide any explanation regarding the same.
- v. The Audit Firm failed to show any workings regarding any audit procedures if performed by them regarding investments amounting to ₹1,637 crore.
- vi. Not providing reference to any WP placed in the audit file in respect of balance with banks in demand deposits amounting to ₹247 crore is conclusive proof that the Audit Firm failed to obtain external confirmations from the bank as per the requirement of SA 505.
- vii. The Audit Firm simply relied on the work of management expert and auditor's expert as explained in Paras above. The Audit Firm did not even bother to assess the competence, capabilities, objectivity and appropriateness of the expert.
- viii. The Audit Firm failed to comply with Para 11 of SA 620 and tried to mislead NFRA by giving false assertions in their response.
- ix. The Audit Firm failed to comply with the requirements of Para A30 of SA 620 as there is no evidence in the audit file as to whether any two-way communication took place between the Audit Firm and the auditor's expert.
- x. The Audit Firm failed to identify and assess the risk of material misstatement in the financial statement as per the requirements of Para 25 of SA 315.
- xi. The Audit Firm solely relied on the management decision and ended by overstating the value of the investment made in IECCL.
- xii. The Audit Firm merely relied on the terms and conditions for conversion of the loan to FCDs as decided by the management in the policy. The Audit Firm failed to assess and verify whether the terms decided by the management were in compliance with the RBI Directions.

- xiii. The Audit Firm failed to assess that the classification of unquoted debentures as investments was tantamount to a material misstatement in the Financial Statements of the Company.
- xiv. The Audit Firm failed to comply with the basic objective of SA 500 as the Audit Firm failed to obtain sufficient appropriate audit evidence to be able to base its conclusion that the transaction of conversion of loan into FCDs was approved by the audit committee.
- xv. The Audit Firm failed to verify and obtain audit evidence that the related party transactions were appropriately authorised and approved by the audit committee as per the provision of Section 177 of the Companies Act, 2013.

### **C. Final Observations and Conclusions of the AQRR**

- 3.3 NFRA has examined in detail the submissions made by the Audit Firm in response to the above observations in the DAQRR and concludes as follows:
  - 3.3.1 On perusal of the response of the Audit Firm dated 27<sup>th</sup> September 2021, NFRA notes that the Audit Firm has mostly repeated its earlier responses submitted in reply to the PFC. NFRA formed its conclusions in the DAQRR after a detailed examination of the response of the Audit Firm. As nothing significant new/additional to what was submitted earlier is now being produced by the Audit Firm, NFRA reiterates all its conclusions provided in its DAQRR subject to the specific modifications in the below paragraphs.
  - 3.3.2 SA 230 requires 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 by audit file 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 by NFRA as per SA 230.
  - 3.3.3 Para 2 of SA 230 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 conclusions in the audit file is not sufficient as the auditor is required to document the basis of forming his opinion/conclusions as well. In further explaining para 8 of SA 230, para A10 states that *"Some examples of circumstances in which, in accordance with paragraph 8, it is appropriate to prepare audit documentation relating to the use of professional judgment include, where the matters and judgments are significant: The rationale for the auditor's conclusion when a requirement provides that the auditor 'shall consider' certain information or factors, and that consideration is significant in the context of the*

*particular engagement*". Therefore, documentation as explained above is a mandatory requirement of the SAs.

- 3.3.4 In response to the observations in the DAQRR, the Audit Firm submits in its reply to the DAQRR that *"SRBC submits that our entire audit file is fully supported by audit evidence for the work performed and the conclusions reached during the audit"*.
- 3.3.5 Audit Firm further submitted in its reply to the DAQRR that *"SRBC submits that as per para A7 of SA 230, **Audit documentation provides evidence that the audit complies with SAs. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit.** Further, it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file."* [Emphasis applied]

*As can be seen from the above, SA 230 acknowledges that it is neither necessary nor practical for the auditor to document every matter considered, or professional judgment made, in an audit. Certain well established accounting practices are applied by the management and evaluated and if found appropriate, accepted by the auditors. NFRA reviewer's expectation of audit documentation is much more and beyond what is required and expected as per SA 230 (Revised). One has to keep in mind that this is an audit documentation file for statutory audit done and it is not a documentation file for some investigation carried out by SRBC."*

- 3.3.6 The contentions of the Audit Firm are not acceptable in the context of documentation of the investment policy, which is the subject matter here. On examination of the Audit File at the PFC stage, NFRA found no evidence in the Audit File which proves that the Audit Firm had examined the Investment Policy of the Company whether it was in consonance with the applicable laws and whether the investment made pursuant to such investment policy was actually as per the policy. Understanding the policy is critical in verifying investments which is a material amount in the financial statements. The Audit Firm also failed to point out any information or WPs evidencing such a verification. Hence, the first statement of the Audit Firm quoted above is false. The examination of Investment policy and its implementation is a very critical part of the job of an auditor. How critical is this lapse can be gauged from the fact that lack of proper examination in this regard resulted in serious lapses in the audit of investments including impairment on investment which ultimately resulted in the audit firm failure to report a serious default by the company that it did not report the fact that IL&FS had inflated its profits. This has been further explained in the subsequent paragraphs.
- 3.3.7 It is in the above context that NFRA observed the absence of Investment Policy in the Audit File. Though there are no specific requirements in SA as to what documents should be retained in the Audit File, in the absence of ANY evidence to confirm the verification of such a basic requirement, the onus is on the Audit Firm to supply adequate evidence

that it had verified the same. The Audit Firm failed to provide any such evidence and in the absence of such evidence, NFRA can only point out the basic document required to evidence the works done by the Audit Firm.

3.3.8 The Audit Firm in its submissions to NFRA stated that it had verified the investment policy. To explain the non-availability of any evidence of such verification, the Audit Firm resorts to para A7 of SA 230 as quoted above. Para A7 is the application and other explanatory material for the substantive requirement in Para 8(a) which requires that the auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the nature, timing, and extent of the audit procedures performed to comply with the SAs and applicable legal and regulatory requirements. Apart from having an understanding of the investment practices of the company, the verification of investment policy is fundamental in complying with the following specific requirements of the SAs.

- a. Para 5 and 6 of SA 230, Para 5 (c) and 9 of SA 500, wherein the auditor is required to obtain audit evidence about the accuracy and completeness of the information.
- b. Para 11 (b) of SA 315 – Understanding the nature of the entity having regard to the types of investments that the entity is making and plans to make, including investments in special-purpose entities.
- c. Para 10 of Appendix 1 to SA 315: To understand the control activities around Investments that depend on the existence of appropriate higher-level policies established by management or those charged with governance.

3.3.9 Accordingly, the audit documentation of SRBC does not provide evidence that the audit complies with SAs. It also does not enable an experienced auditor having any previous connection with the audit, to understand the nature, timing, and extent of the audit procedures performed to comply with the SAs. No other documents in the Audit File demonstrate that the Audit Firm has verified the Investment Policy. Hence the Audit Firm has violated para 8 (a) and para A7 of SA 230. NFRA, therefore, concludes that the Audit Firm has failed in its professional duties to perform the audit procedures required to obtain sufficient appropriate audit evidence regarding the correct valuation of investments made by IL&FS Limited in its component entities.

3.3.10 Also, there is no evidence that the management had tested each investment for impairment. There is no satisfactory reply regarding the observation that the Audit Firm has failed to point out the violation/non-compliance with accounting standards of the Companies policies and practices. The Audit Firm further submits that they have tested for impairment the 99% of the value of investments. Regarding the observation of NFRA that “there is no calculation shown by the Audit Firm in the WP as to **how they verified** the carrying value and book value of the investments calculated by the Company” the Audit Firm submits that “*NFRA has erroneously observed that no calculation shown by*

*the Audit Firm in the WP as to how they verified the carrying value and book value of the investments calculated by the Company. SRBC submits that carrying value is arrived at working as referred in column 'T' of Population tab of WP "M18 Impairment Summary Analysis". Book value is based on net worth of the Companies based on March 31, 2017 or September 30, 2017 whichever is available"* (emphasis added). The said "column 'T' of Population tab" the WP contains only a remark "As book value exceeds carrying value, no trigger for impairment of investment" against the subject matter items! This remark in no way throws any light on how the Audit Firm has arrived at the carrying value and book value provided by the company. This kind of reply from the Audit Firm shows the unprofessional methods the Audit Firm is resorting to misleading the regulator. In the absence of any credible submissions, NFRA reiterates its observations in paras 3.2.12 to 3.2.20 above. Also, based on the replies furnished NFRA withdraws the observations in para 3.2.21 and 3.2.22 above. However, NFRA observes that the WPs referred by the Audit Firm do not offer any explanations for the difference between the amount as per confirmation and the amount as per books (amounting to Rs 2.90 crore). The tab "work done" in the WP referred by the Audit Firm is silent about any reconciliations done in the case of fixed deposits.

***Regarding the use of work of the Management Expert***

- 3.3.11 The Audit Firm had repeatedly (including oral hearing) referred to the WP "IL&FS Standalone Canvas Files Folder - SFS Canvas - 441.1 M18 130GL(R)-Mgmt specialist-N.M. Raiji & Co. (Investment Valuation)" which was examined by NFRA at the stage of forming its PFC and also at DAQRR stage. The Audit Firm has merely repeated its submissions without any additional evidence. The referred WP does not contain a proper examination of background, capabilities and objectivity of the valuation expert (other than a sentence copied verbatim from the website of the valuation expert) So, NFRA reiterates its observations that the Audit Firm failed to evaluate the objectivity, competence, and capabilities of the management expert for the reasons mentioned in the DAQRR paras above.
- 3.3.12 In Para 89 of their response to DAQRR, the Audit Firm has submitted the details of all procedures done by it to evaluate the objectivity, competence, and capabilities of the management expert, without any supporting evidence. None of the WP in the audit file shows that the Audit Firm has done any work to comply with the requirements of SA 500 regarding the management experts.
- 3.3.13 In Para 96 of their response to DAQRR, the Audit Firm has referred to a few WPs claiming that the valuation reports have the details about nature, timing, and extent of work done by the expert which was agreed with management. The referred WPs were already examined in detail by NFRA while forming its conclusions/opinions at the stage of PFC and DAQRR. Nevertheless, NFRA re-examined the WPs and found that no such information is available in the valuation reports as claimed by the Audit Firm. As already

stated above in the DAQRR, the valuation report does not contain any information which fulfils the requirements of Para A46 of SA 500.

***Regarding the use of Auditor's Expert***

- 3.3.14 All the responses and WPs referred by the Audit Firm regarding the evaluation of the work of the auditor's expert are a repetition of its earlier submissions. Also, there are assertions of the Audit Firm which are made without any supporting evidence, like the submission during oral hearing that *"SRBC would like to point out that auditor's expert had commenced its work in respect of Dighi Port Limited based on the draft valuation report submitted to us via mail dated 9th May 2018. All the work procedures were performed on basis of draft report of the management expert and it can be seen that there is no change in the value in the final report"*. NFRA formed its conclusions after a detailed examination of the responses of the Audit Firm at the stage of PFC and DAQRR. As nothing new has been produced by the Audit Firm now NFRA reiterates its conclusions drawn in DAQRR in this matter.
- 3.3.15 Regarding the observations on non-compliance with para A30 of SA 620, in respect of the discussion by the auditor's expert with the audit team, and the nature, timing and extent of communication between the Audit Firm and the auditor's expert, the Audit Firm has stated that *"SRBC would like to submit that auditor's expert had discussion with audit team and management post which they had prepared final valuation memo"* and has attached a screenshot from the valuation memo wherein it is written that *" We also held discussions with the Management and Audit Team"*. In this regard, the Audit Firm is advised to read para A30 of SA 620 which talks about ***"effective two-way communication"*** and which is an explanation of the substantial requirement in para 11 (c), which states *" The auditor shall **agree, in writing when appropriate**, on the following matters with the auditor's expert .....(c) The nature, timing and extent of communication between the auditor and that expert, including the form of any report to be provided by that expert; and (Ref: Para. A30)....."*(Emphasis added). It is already made clear in the DAQRR that the Audit Firm did not demonstrate any evidence showing compliance with these requirements. Even then the insistence on the part of the Audit Firm repeatedly, citing inadequate and irrelevant matters, shows the lack of understanding and reluctance to follow the requirements of the SAs in conducting an audit. The Audit Firm is strongly advised to study and implement the requirements of the SAs in letter and spirit, including at the beginning of the statutory audits, at the time of audit documentation and also while replying to the regulator.
- 3.3.16 The Audit Firm has further stated that *"NFRA has erroneously commented that the entity of "EY Group" which had worked as an auditor's expert is not mentioned in the audit file. SRBC would like to reiterate response of PFC (Page No. 74) that Mr. Sorabh Kataria who had signed the valuation report was partner of Ernst & Young LLP ('EY LLP'). SRBC further submits that Mr. Sorabh Kataria has signed the valuation memo itself provides evidence that he has the authority to sign the valuation memo as he was designated as a*

partner of EY LLP. Accordingly, there is no separate document in the valuation memo wherein entity name is mentioned as the same is evidenced by signature of Partner". The submission makes it clear that the name of the entity which had worked as an auditor's expert is not mentioned in any of the WPs. The explanation also makes it clear the audit documentation is not self-explanatory, as the internal matters such as who is the partner of which EY entity is only known to the network firms such as SRBC. Further, the mere signature of a person on the document does not reveal its entity name as EY has several network entities. It is a basic requirement that the designation and the entity name be made available in a document signed by someone in a professional capacity.

### ***Regarding IEDCL, DPL, IMICL and IECCL***

- 3.3.17 The Audit Firm submits that *"the procedures performed with respect to enquiry with the management for material change in the business for the quarter ended 31st March, 2018 was documented in IL&FS-Standalone Hardcopy Files Folder - 32\_Investment Impairment Analysis of IL&FS Energy Development Company Limited - Page no. IEDCL 1.1"*. On perusal of the said WP, NFRA notes that the WP only mentions the list of the procedures. There is no supporting evidence that the Audit Firm had performed those procedures mentioned in the list. There is no evidence that the Audit Firm enquired with the management to confirm that there was no material change in the business for the quarter ended 31<sup>st</sup> March 2018, as claimed by the Audit Firm. Another WP 'IL&FS-Standalone Hardcopy Files Folder - 32\_Investment Impairment Analysis of IL&FS Energy Development Company Limited - Page no. IEDCL 1 to IEDCL 15.7' referred by the Audit Firm does not show how SRBC had verified the reasonableness of the growth of revenue, capital expenditure, valuation model used for the valuation and how SRBC had calculated the fair value and carrying value of the share. While the Audit Firm refer WP 'L&FS-Standalone Hardcopy Files Folder - 33\_Valuation report of IL&FS Energy Development Company Limited' (which is a valuation report dated 30<sup>th</sup> Sep 2016) in support of their claims, another WP 'IL&FS - Standalone Canvas Files Folder - 215.1 to 215.8 M18 Impairment summary analysis, referred in support of the same claim mentions the basis of valuation as *"Based on business model"* instead of the valuation report. It does not even consider the valuation report for the workings noted therein. This makes it clear that the Audit Firm is trying to convince NFRA based on evidence which even the ET did not consider during their audit.
- 3.3.18 The Audit Firm has stated that *"we had obtained draft report from management expert for purpose of performing our audit procedures which was also used by auditor's expert for ascertaining fair value of DPL. Para A3 and A7 of SA 230 does not necessitate auditors to retain each and every document referred by it during the audit. SRBC was not required to retain all the draft report verified during audit, as part of audit documentation because Audit Firm cannot be expected to document every matter considered or professional judgement made"*. Given the reasons in Para 3.3.2 and 3.3.3 above, the said contention of the Audit Firm is unacceptable.

- 3.3.19 NFRA formed its opinion at the stage of PFC and DAQRR after duly examining the responses submitted and WPs referred by the Audit Firm. Repeated responses of the Audit Firm without additional/new submissions/WPs are merely an attempt of the Audit Firm to mislead NFRA. Nevertheless, NFRA examined the responses of the Audit Firm at every stage of forming its opinion. As nothing new is found NFRA reiterates its conclusion drawn in its DAQRR.
- 3.3.20 The Audit Firm has stated that *“We would like to point out that meeting invite for discussion of Dighi Port Limited between Audit Firm and the Management, was attached with our response to PFC. SRBC would like to state that emails have digital footprints that cannot be artificially related, nor can be denied. This confirms beyond doubt that meeting was held, though email invite were not forming part of our audit file”*. Given the reasons Para 3.3.2 and 3.3.3 above, the said contention of the Audit Firm is rejected.
- 3.3.21 In respect of NFRA’s observation regarding the one-sided communication with the Audit Committee, please refer to Chapter on Communications with TCWG of this AQRR.
- 3.3.22 In the case of observations of NFRA about IMICL, the Audit Firm has repeated its earlier submissions. As nothing new is now submitted by the Audit Firm, NFRA reiterates its earlier conclusions drawn in DAQRR.
- 3.3.23 Regarding the diminution in value of the Investments in IECCL, the Audit Firm states that *“it was not proper to take market value at a point of time, as the same may be reflective of general market condition. To avoid the impact of any market fluctuations, it was practice to take weighted average market price over a longer period of time. We would like to point out here that for buyback of shares even SEBI (Listing Obligation and Disclosure Regulation (LODR) provides for considering six months average price to arrive at the price at which buy back can be carried out. Accordingly, we had also considered weighted average price of 6 months, for ascertaining impairment”*. The contention of the Audit Firm is rejected as baseless due to the following facts.
- a. The analogy to the SEBI circular is an afterthought not documented in the Audit File. More importantly, (and without prejudice to the above) this analogy is not applicable in the present case of IECCL as the companies covered under the SEBI regulation and IECCL are not identical/comparable in terms of parameters and logic detailed in the said regulation. The objective of the SEBI regulation and the objective of para 17 and 32 of AS 13 is entirely different. Drawing such analogies shows the lack of understanding of the Audit Firm on both the SEBI regulation and AS 13.
  - b. The market value of shares of IECCL showed a continuous declining trend from the year 2015 onwards and the same trend continued even on the date of the signing of the audit report. There were no observable indicators of long-term trend reversal documented in the WPs as on 31<sup>st</sup> March 2018 or on the date of signing the audit report. In this context, the Audit WPs do not show why the market price as on 31<sup>st</sup>

March 2018 is not an indicator of a permanent decline in value. The Audit Firm did not challenge the management why the trend of poor performance was not forecast to continue. This shows the absence of professional scepticism on the part of the Audit Firm.

- c. No other indicators of impairment such as the negative net worth of the company, incurring continuous losses from the past several years, the decline in the market price of the share from the past several years etc. also underline the fact that the market price on the closing date is an indicator of permanent diminution in value. There is no evidence in the WPs to prove the contrary.

3.3.24 Therefore, NFRA concludes that the Audit Firm solely relied on the management decision and ended by the non-reporting the overstatement in the value of the investment. Also, the Audit Firm did not exercise professional scepticism in the conduct of its professional duties.

#### ***Compliance regarding the restructuring of assets***

3.3.25 In this regard, NFRA observed in the DAQRR that the replies of the Audit Firm imply that *“the Audit Firm merely relied on the terms and conditions for conversion of loan to FCDs as decided by the management in the policy. The Audit Firm failed to assess and verify whether the terms decided by the management were in compliance with the RBI Directions.”* The Audit Firm did not provide any replies to this observation. Instead, it still states that the conversion was not restructuring as per RBI Master Circular. The Audit Firm repeats their earlier reply that *“SRBC had obtained from management credit approval memorandum for conversion of loan of Rs. 585 crores wherein management had analysed the proposal and had obtained approval as per delegation matrix. Refer IL&FS - Standalone Canvas Files Folder - 203.1 to 203.6 S17 IMICL-Conversion of FCDs - 3850 mn and IL&FS - Standalone Canvas Files Folder - 281.1 to 281.5 IMICL\_Convrsn of Loans to FCCDs Rs 200 crs\_appvd COD memo\_26-Mar-2018”*. The said documents are internal approvals of the Company regarding conversion. There is no evidence of verification of the sanction conditions to decide *whether the terms decided by the management were in compliance with the RBI Directions*. Therefore, NFRA reiterates its conclusion drawn in its DAQRR that the Audit Firm failed to assess and verify whether the terms decided by the management complied with the RBI Directions.

#### ***Investments in Debentures***

3.3.26 Based on the reply of the Audit Firm NFRA has deleted the DAQRR observations regarding the classification of unquoted debentures. Regarding provisioning of these debentures, the Audit Firm has not offered any evidence to support that the Audit Firm had examined the strong indications reflecting more than normal risk of the companies, including ITUAL, ITPCL and IMICL, as explained in detail in para 3.1.87 above.

Therefore, NFRA concludes that the Audit Firm did not exercise professional scepticism in testing the NPA provisioning of unquoted debentures.

### ***Compliance regarding RPTs***

- 3.3.27 The Audit Firm has stated that *“Paragraphs of SA 230 referred below, does not necessitate auditors to retain each and every document referred by it during the audit. SRBC was not required to retain agenda or minutes of meeting wherein omnibus approval for transactions place at audit committee minutes as part of audit documentation because audit file cannot be treated as substitution of company’s accounting records and Audit Firm cannot be expected to document every matter considered or professional judgement made”*. Given the reasons in Para 3.3.2 and 3.3.3 above, the said statement of the Audit Firm is rejected.
- 3.3.28 Further, the Audit Firm has stated that *“We are surprised that NFRA based on limited understanding of our workpapers has framed the DAQRR conclusion that SRBC had not complied with requirements of basic objective of SA 500, Section 177 of the Companies Act, 2013 and reporting under clause 3 (xiii) of CARO, 2016 in terms of Section 143 (11) of the Companies Act, 2013. All the workpapers submitted to NFRA and mentioned above in para 250 to 256 concludes that SRBC had performed audit procedures in compliance with Section 177 of the Companies Act 2013 and reporting under clause 3 (xiii) of CARO, 2016 in terms of Section 143 (11) of the Companies Act, 2013”*. As mentioned by NFRA in its DAQRR that as per Section 177 (4) (iv) of the Companies Act, 2013, the Company is required to take the **approval** of RPTs. The omnibus approval is for transactions **proposed to be entered into by the Company**. However, as confirmed by the Audit Firm in their response, the Company was taking only post-facto approvals which is a violation of the Companies Act, 2013. As the Audit Firm did not raise any concerns regarding the said violation of the Act, the above-said statement of the Audit Firm is false and misleading.
- 3.3.29 Thus it can be seen that in the majority of the cases relating to investments, the Audit Firm simply relied on the management assumptions and assessments regarding the impairment of investments without independently verifying the veracity of such assumptions and assessments and failed in challenging the same. In that process, the Audit Firm ignored the visible impairment indicators such as insolvency proceedings, permanent decline in the market value of investments, the negative net worth of component entities, etc. This has resulted in not testing the provision of impairment loss on investments made by the Company, leading to the auditor’s non-reporting of inflated profits (stand-alone financial statements) by the company for FY18. Such lapses in challenging the management and absence of professional skepticism are viewed seriously by audit regulators across the world. The UK’s audit regulator FRC observed in an audit quality inspection report of Mazars LLP (July 2021) that *“On two audits the audit team did not sufficiently challenge the reasonableness of management’s assumptions in relation to cash flow forecasts.”*. The US regulator PCAOB in the disciplinary case of

Grant Thornton LLP (order dated 19.12.2017) observed that “Grant Thornton failed to exercise due professional care, including appropriate professional skepticism, and failed to obtain sufficient appropriate audit evidence concerning the reported value of Bancorp's net loans, the effectiveness of Bancorp's controls relating to its allowance for loan and lease losses”.

- 3.4. After examining in detail all the responses of the Audit Firm to the DAQRR, NFRA concludes as follows:
- i. In Para 3.2.4 above, NFRA has explained that the audit file should be capable of speaking for itself without the need for any other aids to interpretation. Given the said explanation, the claim of the Audit Firm that it is not necessary to retain all the documents checked during the time of audit as part of audit documentation is inadmissible.
  - ii. The Investment Policy was a crucial document to identify and check as to whether the investment made and valued by the Company is as per the policy of the company or not. The Audit Firm failed to see, document and verify the compliance of the investment policy of the Company in violation of SA 230.
  - iii. The Audit Firm did not assess and verify whether the accounting policy on Investments of the Company complies with the relevant accounting standard.
  - iv. In the DAQRR, NFRA concluded that there is no information available in the WP in respect of the total quantum of investments for which IL&FS Limited had done impairment analysis. The Audit Firm failed to provide any explanation regarding the same.
  - v. The Audit Firm failed to show any workings regarding any audit procedures performed by them regarding investments amounting to ₹1,637 crore.
  - vi. The Audit Firm ignored the visible impairment indicators such as insolvency proceedings, negative net worth etc. of component entities and did not report any non-provision of impairment by the Company. This has resulted in the non-reporting of the overstatement of profit of the company for FY18.
  - vii. The Audit Firm blindly relied on the work of management experts and auditor's experts as explained in the above paragraphs in violation of SA 500. The Audit Firm did not even bother to assess the competence, capabilities, objectivity and appropriateness of the expert though required by SA 620.
  - viii. The Audit Firm did not comply with Para 11 of SA 620 and tried to mislead NFRA by giving false assertions in their response.
  - ix. The Audit Firm did not comply with the requirements of Para A30 of SA 620 as there is no evidence in the audit file as to whether any two-way communication took place between the Audit Firm and the auditor's expert.
  - x. The Audit Firm did not identify and assess the risk of material misstatement in the financial statement as per the requirements of Para 25 of SA 315.
  - xi. The Audit Firm solely relied on the management decision and ended by non-reporting the overstating of the value of the investment made by IL&FS in IECCL.

- xii. The Audit Firm merely relied on the terms and conditions for conversion of loans to FCDs as decided by the management. The Audit Firm failed to assess and verify whether the terms decided by the management complied with the RBI Directions.
- xiii. The Audit Firm did not verify the provisioning of unquoted debentures.
- xiv. The Audit Firm did not verify and obtain audit evidence that the related party transactions were appropriately authorised and approved by the audit committee as per the provision of Section 177 of the Companies Act, 2013.
- xv. It may be noted that above failures are very serious as they led to serious lapses in the audit of investments including impairment on investment which ultimately resulted in non-reporting of the fact of Company's inflating its profits. In other words, the company had overstated the profits in standalone financial statements. Since the audit firm, solely and blindly relied on management decisions, reports of management experts, external valuers and did not challenge these assumptions and management actions adequately by show professional skepticism which it was required to do so under SA 200, real financial position of the company went unreported.

## **4. Loans & Advances**

### **A. Prima Facie Observations/Conclusions (PFC)**

4.1. In Prima Facie Conclusions, NFRA conveyed the following:

#### ***Related Party Compliances***

4.1.1. Section 177 (4) of the Companies Act 2013 states that, “*Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include,*

- i. *examination of the financial statement and the auditors’ report thereon;*
- ii. *approval or any subsequent modification of transactions of the Company with related parties;”*

[Provided that the Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the Company subject to such conditions as may be prescribed;]

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

4.1.3. The conditions prescribed for Omnibus Approval for RPTs clearly state that omnibus approval for related party transactions shall be valid for a period not exceeding one financial year and shall require fresh approval after the expiry of such financial year. The act also prescribes the contents of the omnibus approvals including

- (i) name of the related parties;
- (ii) nature and duration of the transaction;
- (iii) maximum amount of transaction that can be entered into;
- (iv) the indicative base price or current contracted price and the formula for variation in the price, if any; and
- (v) any other information relevant or important for the Audit Committee to take a decision on the proposed transaction.

4.1.4. Para 49 (m) of the Guidance Note on CARO, 2016, inter-alia, states that the auditor is required to perform appropriate procedures to satisfy himself as regards compliance with Section 177 and 188 of the Act to appropriately report under this clause. Therefore, the Audit Firm was required to satisfy itself that the Company has received audit committee approval for all the related party transactions (individually or in an omnibus manner).

4.1.5. NFRA observes that the Audit Firm has, in compliance with Clause 3(xiii) of the Companies (Auditor's Report) Order, 2016, in Annexure to the Independent Auditors' Report on the Company's standalone financial statements for FY 2017-18, reported that *"According to the information and explanations given by the management, transactions with the related parties are in compliance with section 177 and 188 of the Companies Act, 2013 where applicable and the details have been disclosed in the notes to the financial statements, as required by the applicable accounting standards."*

4.1.6. On perusal of the "Related Party Transaction Policy and Framework" of the Company for FY 2017-18, NFRA notes that the policy bifurcates RPTs into two types:

- (a) Exempt RPTs: that is in Ordinary Course of Business (OCB) and on Arm's Length (AL). The OCB in the policy is stated as *"The Act has not provided definition of this term. However, all types of payments, services availed and/or rendered to Related Parties for a period preceding three years or more should be considered as in OCB"*
- (b) Non-Exempt RPTs: RPTs which are not in the OCB and/or not on AL basis are referred to as the *"Non-Exempt RPTs"*.

The policy states that as a part of the internal control and governance framework, all exempt RPTs will be approved by the CoD. The Internal Auditors of the Company shall review all RPTs approved by CoD on a periodic basis and report their observations to the Audit Committee. For non-exempt RPTs, the policy states that CoD will put up the RPTs to the audit committee for approval.

4.1.7. NFRA notes that Section 177 does not provide any relaxation with regard to the transaction in the ordinary course of business or at arm's length. Section 177 (4) clearly states that every related party transaction shall be approved by the Audit Committee. The Act further states that an Audit Committee may grant omnibus approval for RPTs, provided that such approval shall specify (i) the name/s of the related party, nature of the transaction, period of transaction, the maximum amount of transaction that can be entered into, (ii) the indicative base price / current contracted price and the formula for variation in the price if any and (iii) such other conditions as the Audit Committee may deem fit. Such omnibus approval shall be valid for a period not exceeding one year and shall require fresh approvals after the expiry of one year.

Thus, considering the fact that the Act has provided a provision for an omnibus approval, it is evident that all RPTs must be referred to the Audit Committee of the Company for prior approval, irrespective of the type of transaction (OCB/AL) and its materiality. This even applies to any subsequent modification in the RPTs. Therefore, the use of exempt and non-exempt RPTs to bypass the provision of Section 177 (4) (which requires the audit committee to approve all the RPTs) is a violation of the Companies Act, 2013.

4.1.8. The Audit Firm has, ab initio, failed to point out this lacuna in the policy and failed to question the management and bring the same to the notice of TCWG. Instead, the Audit

Firm reported that the Company has complied with Section 177 under clause 3 (xiii) of CARO, 2016 without any basis.

4.1.9. NFRA observes that the Company has disbursed loans amounting Rs.8,123.7 crore to approximately 26 related parties during the FY 2017-18. These related parties include nine SPVs of ITNL to whom the ITNL's outstanding loans worth Rs.2,703.6 crore were transferred. Further, approximately 91% of these loans were disbursed to related parties other than wholly-owned subsidiaries of the Company. On perusal of the audit committee meeting minutes referred by the Audit Firm throughout its reply dated 30th December 2019, NFRA notes that the meeting minutes do not disclose the details of the related party transactions that were subsequently reported to the Audit Committee. The minutes only state that a report on the RPTs for the period was placed by Internal Auditors of the Company before the Committee for its review and the Committee approved those transactions. This clearly implies that, in accordance with the Company's RPT policy, the Audit Committee was only ratifying the RPTs.

4.1.10. Further, on perusal of the internal auditor reports (WP 'SFS Canvas - M\_18\_Internal Audit Report Summary'; WP 'SFS Canvas - M18\_Internal Audit Report - Q1'; and WP 'SFS Canvas - M18\_Internal Audit Report - Q2'), NFRA notes that the WPs only contain the certificate from the internal auditor stating that the related party transactions were confirmed by CoD of the Company as being in the normal course of business and on an arm's length basis and in accordance with the policy framework approved by the Audit Committee. There is no reference to the list of transactions that was presented before the Audit Committee. NFRA tried to trace WPs with reference to the list of RPTs approved by the Audit Committee, but could not find any such audit evidence in the audit file. Therefore, NFRA construes that the Audit Firm did not exercise professional skepticism and completely relied on the work done by the Internal Auditor. The Audit Firm did not perform any audit procedure to confirm if Audit Committee approval for these transactions was received prior to the transactions (individually or in an omnibus manner).

4.1.11. As against the requirements of Para 49 (m) of the Guidance Note on CARO, 2016, the Audit Firm did not obtain sufficient appropriate audit evidence and did not perform appropriate procedures to satisfy itself, regarding compliance with Section 177 of the Act, to appropriately report under clause 3 (xiii) of CARO, 2016.

## **B. Observations made in the DAQRR**

4.2. NFRA has examined in detail the replies submitted by the Audit Firm on the above observations and concluded as follows in the DAQRR:

4.2.1. Compliance with Section 177 of the Act (PFC [Para 4.1.1](#) to [4.1.7](#) Above)

4.2.1.1. **Summary of Audit Firm Response (Ratification of RPT by Audit Committee is in Compliance with Section 177 of the Companies Act, 2013):** In its reply to NFRA PFC dated 14<sup>th</sup> April 2021, the Audit Firm referred various extracts of the Audit Committee meeting during the year FY 2017-18, quoted Section 177 (4) and stated that "*SRBC would*

*like to state that it is important to understand that during the year under audit IL&FS was registered with the Reserve Bank of India (RBI) as a Systemically Important Non Deposit Accepting Core Investment Company (CIC- ND-SI). As per the RBI CIC framework, the Company's objective was to invest and also provides loans to its group companies. This led to Company having majority of transactions with the group companies i.e. related parties. These related party transactions include loans given, investment made, premise rental, other services to group companies, etc.*

***It was the responsibility of management to obtain Audit Committee approval for related party transactions, to ensure compliance with Section 177 of the Companies Act, 2013. Considering the voluminous transactions with group companies, it was not practicable for the management to reach out to Audit Committee for approval on a day to day basis i.e. whenever Company enters a transaction with related parties. Also, Companies Act, 2013 provides an option and not mandatory for the Company to take omnibus approval of Audit Committee. Accordingly, management of IL&FS obtained Audit Committee approval for all the transactions undertaken in a quarter, in the subsequent quarter Audit Committee meeting. We had obtained the audit committee minutes to verify approval of audit committee was in compliance with Section 177(4)(iv) of Companies Act, 2013.*** (Emphasis added by NFRA)

4.2.1.2. **NFRA Observations:** Para A5 of SA 230 states that “*Oral explanations by the auditor, on their own, do not represent adequate support for the work auditor performed or conclusions the auditor reached*”. NFRA notes that the assertions made by the Audit Firm that:

- (a) Considering the voluminous transactions with group companies, it was not practicable for the management to reach out to Audit Committee for approval on a day to day basis i.e. whenever Company enters a transaction with related parties;
- (b) Also, Companies Act, 2013 provides an option and not mandatory for the Company to take omnibus approval of Audit Committee. Accordingly, management of IL&FS obtained Audit Committee **approval for all the transactions undertaken in a quarter, in the subsequent quarter** Audit Committee meeting

are not supported by any reference to the WPs in the audit file. The assertions are thus, without any basis and can be considered only as an afterthought.

4.2.1.3. Notwithstanding the above, NFRA notes that these assertions are also not maintainable since Section 177 (4) (iv) of the Act mandates **prior approval** for every RPT. Though, in the case where the RPTs are of repetitive nature and where an omnibus approval is in the interest of the company, the Act provides an option of obtaining an “Omnibus” approval from the Audit Committee. Therefore, in case “*it was not practicable for the management to reach out to Audit Committee for approval on a day to day basis*”, the Company should have taken an omnibus approval and the Audit Firm should have obtained sufficient appropriate audit evidence to verify it. Further, in case an omnibus approval was not

available (since it is only “*an option and not mandatory*”), the Audit Firm should have rather verified if the Company takes a “**prior approval**” for every RPT.

4.2.1.4. As established in [Para 4.1.7 \(PFC\)](#) above, Section 177 (4) (iv) stipulates a **prior approval** of the Audit Committee (either individually or in an omnibus manner) for every RPT. Further, NFRA notes that this was also a fact of common knowledge, since even the compliance report on Corporate Governance by all the listed entities, as stipulated by the Securities and Exchange Board of India (SEBI), required a specific disclosure stating that “*Whether **prior approval** of audit committee obtained*” (emphasis added). As per the provisions of Regulation 27(2) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“Listing Regulations”), a listed entity was required to submit a quarterly compliance report on corporate governance in the format specified by the Board from time to time to recognised Stock Exchange(s). The format for compliance report on Corporate Governance by listed entities had been specified, as per the following annexures, vide Circular No. CIR/CFD/CMD/5/2015 dated September 24 2015 and which was followed by all listed entities.

- (a) Annexure - I - on a quarterly basis;
- (b) Annexure-II - at the end of the financial year (for the whole of the financial year);
- (c) Annexure - III - within six months from the end of the financial year. This may be submitted along with the second quarter report.

Annexure-I at point no. V on related party transactions, clearly stated that this information has to be mandatorily given to the audit committee. The first question required disclosure as to “*whether prior approval of the audit committee obtained*”. The listed entity had to provide the status as Yes/No, with “Yes” meaning that it has been complied with and “No” meaning not complied with. The details of such non-compliance were also to be provided.

Accordingly, the said SEBI circular also demonstrates and evidences that the approvals for all related party transactions have to be “**prior**” approvals and not post-facto approvals.

4.2.1.5. However, NFRA notes that the Audit Firm has stated that “*IL&FS obtained Audit Committee approval for all the transactions undertaken in a quarter, in the subsequent quarter Audit Committee meeting*”. This proves NFRA’s prima-facia observation that the Company was not in compliance with Section 177 (4) (iv) of the Companies Act, 2013, since RPTs, without prior approval, either individually or in an omnibus manner, are in the contravention of the provision of Section 177 (4) of the Companies Act, 2013.

4.2.1.6. Therefore, NFRA concludes that

- (a) The Audit Firm failed to communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis and thus failed to comply with the requirements of Para 9 of SA 265.
- (b) The Audit Firm reported that the Company was in compliance with Section 177 of the

Companies Act, 2013 (under clause 3 (xiii) of CARO, 2016), which was false, knowing it to be false. Therefore, the certificate issued is not only in violation of the SAs, and CARO, 2016, but also attracts action under Section 448 of the Companies Act, 2013.

4.2.2. The issue with the RPT Policy (PFC Para 4.1.8 above)

- 4.2.2.1. **Summary of Audit Firm Response:** The Audit Firm quoted section 188 (1) of the Companies Act, 2013 and stated that Related Party Transactions Policy and Framework ('RPT Policy'), referred by NFRA in their Prima Facie comments/observations/conclusions, is to comply with the provisions of Section 188 of the Companies Act, 2013 and **is not related to Section 177 of the Companies Act, 2013** (emphasis added by NFRA). This is evident from Para II of the RPT Policy, relevant extract is reproduced below: "*Transactions Covered under RPTs: All transactions with Related Parties as per the list of identified transactions availed from and provided to Related Parties are provided in Annexure-I. The scope used for determining the Related Party Transactions is as per that given in Section 188 (1) of the Companies Act, 2013.*" ... [Emphasis Added by the Audit Firm]

Further Section 188(1) of the Companies Act, 2013 provides exemption to obtain Board approval for related party transactions which are in ordinary course of business and the transaction is on arm's length basis and this is similar to what is written in the Company's RPT Policy.

Based on the above response, "*SRBC would like to state that there was no lacuna in the RPT Policy, which was approved by the Board of Directors and was in compliance with Section 188 of Companies Act, 2013. Accordingly, there was no requirement to highlight this to TCWG.*"

- 4.2.2.2. **NFRA Observations:** Para A5 of SA 230 states that "*Oral explanations by the auditor, on their own, do not represent adequate support for the work auditor performed or conclusions the auditor reached*". NFRA notes that the assertions made by the Audit Firm are not supported by any of the WPs in the audit file. The assertions are thus without any basis and can be considered only as an afterthought.
- 4.2.2.3. Without prejudice to [Para 4.2.2.2](#), NFRA further notes that the assertion of the Audit Firm that the **RPT Policy and Framework** "*is to comply with the provisions of Section 188 of the Companies Act, 2013 and is not related to Section 177*", is factually incorrect.

The initial "Background" part of the policy itself states that the "*The Companies Act, 2013 read with the Companies (Meeting of Board and its Powers) Rules, 2014 (the Act) introduced specific provisions relating to Related Party Transactions (RPTs). The Board of Directors of Infrastructure Leasing and Financial Services Ltd (the Board) has adopted the following policy and procedures with regard to Related Party Transactions upon recommendation of the Audit Committee. The Audit Committee will review and may amend this policy from time to time. This policy will be applicable to*

*the Company. This policy is to regulate transactions between the Company and its Related Parties based in terms of applicable laws and regulations applicable on the Company”* (emphasis added by NFRA).

The policy was thus designed to regulate the RPT in terms of all the applicable laws and regulations applicable to the Company, and not specifically Section 188 of the Act.

Further, NFRA notes that the para quoted from the RPT policy, by the Audit Firm (in its response dated 14<sup>th</sup> April 2021 to NFRA’s PFC), is just with reference to the list of transactions provided in Annexure-I of the policy document. Therefore, the assertion of the Audit Firm that the RPT Policy is just to comply with the provisions of Section 188 of the Companies Act, 2013 and is not related to Section 177 of the Companies Act, 2013, can only be construed as a deliberate attempt to mislead NFRA.

- 4.2.2.4. Even notwithstanding the observation noted in [Para 4.2.2.3](#) above, NFRA notes that the assertion of the Audit Firm, rather, indicates that the RPT policy of the Company was not comprehensive, **since as per the Audit Firm, it did not consider the provisions of Section 177 of the Companies Act, 2013.** The fact that the RPT policy itself neglects the provisions of Section 177 (4) (iv) of the Act, should have rather made the Audit Firm question whether the Internal Controls of the Company, with regard to the transaction with the related parties, are designed effectively.

**Para 63 of the Guidance Notes on Internal Financial Controls (“GN-IFC”)** states that *“Evaluating the design of a control involves considering whether the control, individually or in combination with other controls, is capable of effectively preventing, or detecting and correcting, material misstatements. Implementation of a control means that the control exists and that the entity is using it. **There is little point in assessing the implementation of a control that is not effective, and so the design of a control is considered first.** An improperly designed control may represent a material weakness or significant deficiency in the entity’s internal control.”* (emphasis added by NFRA).

**Para 8 of SA 265** states 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.”*

**Para 9 of SA 265** states that *“The auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis.”*

However, the Audit Firm did not exercise professional scepticism and did not identify the deficiency in the RPT Policy and Framework of the Company.

- 4.2.2.5. In [Para 4.2.1](#) above, NFRA has already concluded that the Company was not in compliance with Section 177 (4) (iv) of the Companies Act, 2013. Therefore, NFRA reiterates the conclusion drawn in the PFC that the Audit Firm has, ab initio, failed to

point out this lacuna in the policy and failed to question the management and bring the same to the notice of TCWG. NFRA concludes that the Audit Firm failed to comply with the Para 63 of the GN- IFC and Para 8 and Para 9 of SA 265.

4.2.3. Sufficient Appropriate Audit Evidence (PFC [Para 4.1.9](#) to [Para 4.1.11](#))

- 4.2.3.1. Summary of Audit Firm Response: In its reply to NFRA PFC, the Audit Firm further stated that the Company is a CIC-ND-SI and asserted that *“As per the RBI CIC framework, the Company’s objective was to invest and also provides loans to its group companies. This led to Company having majority of transactions with the group companies i.e. related parties. These related party transactions include loans given, investment made, premise rental, other services to group companies, etc. Accordingly, the list of transactions with related parties were put before Audit Committee, by management of IL&FS, as an agenda item. Once audit committee approved all the transactions, the list of related party transactions was not included by Company Secretary of the Company in the minutes of meetings for the sake of brevity, however same was comprehensively included in agenda circulated to Audit Committee.”*

The Audit Firm also stated that they *“had verified the approval of audit committee for all related party transactions undertaken during each quarter, which was forming part of the agenda papers of the meeting circulated by the secretarial department. The same can be verified from the secretarial records of the Company. The details for approval in respect to assignment of loans also forms part of agenda sent to Audit Committee members, which was verified by SRBC.”*

Quoting Para A3, and A7 of SA 230, the Audit Firm continued to assert that *“SRBC was not required to retain agenda as part of audit documentation because audit file cannot be treated as substitution of company’s accounting records and Audit Firm cannot be expected to document every matter considered or professional judgement made. However, while extensive search of our records for the purpose of this response, we have found the Audit Committee agendas which contain Audit Committee approval for related party transactions undertaken during the year. These agendas had been obtained by us from secretarial department of the Company and verified by us during the audit for the year ended March 31, 2018*

*We are attaching extract of Audit Committee Agenda for the meeting dated May 29, 2018, verbatim as received from Company via email, for NFRA’s reference. Refer Appendix 6 (Page No. A33 to A57). Further, SRBC would like to state that emails have digital footprints that cannot be artificially related, nor can be denied. This reflects that we had obtained sufficient appropriate evidence and had understood the backdrop of the business transactions.”*

- 4.2.3.2. NFRA Observations: NFRA notes that the document (contained within Appendix 6) provided by the Audit Firm does not form part of the Audit File and thus cannot be considered.

4.2.3.3. Without prejudice to the above, and after a detailed perusal of the referred document

Appendix 6 (Page A33 to A57) – “Extract of Audit Committee Agenda for Meeting Dated May 29, 2018”, NFRA notes that the Company was not just in violation of Section 177 of the Act (since, as part of the agenda, the Audit Committee was merely required to ratify the related party transaction that had been approved by the Board of Directors), but also in violation of its own defined policy (Audit Committee approval for all the transactions undertaken in a quarter, in the subsequent quarter Audit Committee meeting) since the Audit Committee was even ratifying RPTs that were 8 months old. NFRA notes that the RPTs, that were approved by the Audit Committee on March 29, 2018, included two RPTs of 19<sup>th</sup> Sep 2017 and 26<sup>th</sup> Dec 2017.

4.2.3.4. However, the Audit Firm had failed to even note this and communicate deficiencies in internal control to TCWG.

### **C. Final Observations and Conclusions of the AQRR**

4.3 NFRA has examined in detail the replies submitted by the Audit Firm on the above observations and concludes as follows:

#### **4.3.1. Compliance with Section 177 of the Act**

4.3.1.1. Summary of Audit Firm’s Response: The Audit Firm states as follows:

- a. *“With respect to NFRA’s interpretation of Section 177(4)(iv) of Companies Act, 2013, we reiterate that the said section does not mandate prior approval for related party transactions.”* The Audit Firm further quotes various case laws explaining the meaning of approval and states that *“From the above, it would be clear that the word “approval” as it appears in Section 177(4)(iv) of the Companies Act 2013 includes the power to ratify (or approve subsequently) the transactions of the company with related parties. Notwithstanding the above, merely because the Audit committee may grant a prior omnibus approval of certain transaction as per the first proviso to Section 177(4)(iv) of the Companies Act 2013, it does not take away the power of the Audit Committee to grant approval (including subsequent approval or ratification) of a transaction under the main provision of Section 177(4)(iv).”*
- b. *“We would like to inform that during our audit, we had verified the compliance with Section 177 of Companies Act, 2013 and our documentation was based on the premise that approval under the said section could be at any point of time and there is no restrictions on taking post-facto approval.”*
- c. The Audit Firm further states that *“the provisions of Regulation 27(2) of SEBI (Listing Obligations and Disclosure Requirements) Regulations,*

2015 (“Listing Regulations”) are applicable to entities which has specified securities i.e. equity shares and convertible securities listed. IL&FS’s Secured Non-Convertible Debentures as well as Non-Convertible Redeemable Cumulative Preference Shares are only listed. Since they are debt securities, Regulation 27(2) of Listing Regulations does not apply to IL&FS.”

- d. “We are surprised seeing the unrealistic and impractical expectations of NFRA as IL&FS being a CIC Company and being the Holding Company of the group, had most of the transactions with the group companies and one cannot expect the Company of such nature and size to call for the Audit Committee meeting twice or thrice in a week, it is neither practicable nor sensible to have done so. And one should take into account whether calling a meeting for initiating each and every transaction is feasible. Management had adopted practical approach of listing down the transactions conducted during each quarter and obtaining the approval of the audit committee in the first meeting held after the end of each quarter.”

4.3.1.2. NFRA Observations: The Audit Firm has not given any new explanations other than those given earlier. NFRA has examined the replies of the Audit Firm and observes as follows:

- a. NFRA has very clearly established in point no. 4.1.7 above that all RPTs should be referred to the Audit Committee for prior approval irrespective of the type of transaction or materiality. The terms *post facto approval* or *ratification* is nowhere mentioned or implied in section 177. Further Rule 6 A of The Companies (Meeting of Board and its Powers) Rules, 2014 specifically prescribe that “All related parties transactions **shall** require approval of the Audit Committee....” (Emphasis Supplied). Therefore this rule requires mandatory ‘Approval’ because of presence of ‘shall’ word in the said rule. Approval is the action of approving the transactions proposed and the transactions become effective only after approval. Had the legislature intended ratification or post-facto approval, which are different from approval, the same words would have been used in the sections (refer for example section 139 as it stood before 7<sup>th</sup> May 2018 and section 173). Thus, the Audit Firm’s contention that it is not mandatory to take prior approval for Related Party Transactions from the Audit Committee is not tenable.
- b. Further, the third proviso to the same section i.e. section 177 (4)(iv) provides clear legislative intent that approval therein means prior approval only and not ratification or post-facto approval. Section 177(4)(iv) states that:

*“Provided also that in case any transaction involving any amount not exceeding one crore rupees is entered into by a director or officer of the company without obtaining the approval of the Audit Committee and it is not ratified by the Audit Committee within three months from the date of the transaction, such transaction shall be voidable at the option of the Audit Committee and if the transaction is with the related party to any director or is authorised by any other director, the director concerned shall indemnify the company against any loss incurred by it.”* (Emphasis added)

The above proviso authorizes the Audit Committee to ratify only relatively small value transactions in the case prior approval is not obtained, and also the time limit within which ratification can be done and also the liability of officers for losses suffered in the event of non-ratification. Thus, if the Act had intended ratification of RPTs of bigger value transaction too then it would have mentioned the likewise and also the time within which such ratification had to be done. If we accept the Auditor’s explanation that approval means blanket post-facto approval, it will lead to ridiculous interpretation that while small value RPTs are required to be ratified within three months and officers will be liable for losses in the event of non-ratification, ratification of big value transactions will have no such time limit and there will be no liability on officers for losses in the event of non-ratification. Similar provision for ratification is provided in section 188 as well. Audit Firm’s contention that the Audit Committee can ratify all RPTs without any specified time limit is not as per the Act and hence not tenable. In view of reasonings given above, the word ‘approval’ used in section 177(4)(iv) can only mean prior approval, as the company is forbidden to enter into the transaction if it is not approved, subject only to the exception provided in the proviso.

- c. Clause 3(xiii) of CARO, 2016 requires the auditor to give a statement whether the companies has complied with Section 177 of the Act. As discussed above, obviously the company has not complied the requirements of Section 177 of the Act relating to RPT transactions. Yet the audit firm gave a statement that the company has complied with this requirement which is obviously a false statement.
- d. Prior approval of RPT transactions is also an essential component of the internal control system. That is why the legislature mandated approval under section 177 of the Companies Act, 2013. By not reporting to the TCWG the breach of internal control system i.e. failure to obtain prior approval of RPT transactions, the audit firm has also violated para 9 of SA 265, that requires timely communication of such deficiencies to the TCWG.
- e. The audit firm’s contention that since it was not practically possible to call

audit committee meetings every two three days to approve RPT transactions, all RPT transactions were bunched and post facto approval was taken en masse in the next quarter and has quoted the provision of omnibus approval in Section 177(4) of the Act in support of this practice. This contention of the audit firm is not correct because omnibus approval can be given only pursuant to an omnibus policy approved by the company. The Companies (Meeting of Board and its Powers) Rules, 2014 lays down the requirement for such policy which includes various the criteria as to what kind of RPT transactions can be covered under the omnibus policy. There is no evidence that Board ever approved any such Omnibus policy and therefore we reject this contention of the audit firm that audit committee had given omnibus approval.

- f. Therefore, NFRA concludes that:
- i. The Audit Firm failed to communicate in writing the aforesaid significant deficiencies in internal control and violation of the Law in related party transactions to those charged with governance on a timely basis and thus failed to comply with the requirements of Para 9 of SA 265.
  - ii. The Audit Firm reported that the Company complied with Section 177 of the Companies Act, 2013 (under clause 3 (xiii) of CARO, 2016). Obviously, as demonstrated above, the Company had not complied the requirements of Section 177 of the Act. Therefore, the report issued under CARO 2016 is false and misleading and violates the SAs.

#### 4.3.2. The issue with the RPT Policy

4.3.2.1. Summary of Audit Firm's Response: The Audit Firm has repeated its response that it gave at the PFC stage stating that *"If NFRA would have gone through the RPT Policy in entirety they would have realized that entire policy has been implemented by the Company to comply with the provisions of Section 188 of Companies Act, 2013."* The Audit Firm further states that *"Even a lay man, after comparing Section 188(1) of the Companies Act, 2013 and RPT Policy, will come to the conclusion that RPT Policy was framed to comply with Section 188(1) of the Companies Act, 2013."*

The Audit Firm also states that *"It is also important to note that when audit committee had approved all the related party transactions without any exception, there cannot be any question of design or operating effectiveness of the control over the said process and SRBC has applied professional skepticism to comply with Para 63 of the Guidance Notes on Internal Financial Controls ('Guidance Note on Audit of IFC'), Para 8 and Para 9 of SA 265."*

#### 4.3.2.2. NFRA Observations

- a. NFRA reiterates its DAQRR conclusion that as already explained in para no. 4.2.2.3 above the policy was designed to regulate the RPT in terms of all the applicable laws and regulations relevant to the Company, and not specifically Section 188 of the Act. Therefore, the assertion of the Audit Firm that the RPT Policy is just to comply with the provisions of Section 188 of the Companies Act, 2013 and is not related to Section 177 of the Companies Act, 2013, is without any substance.
- b. Further, even assuming but not admitting that the RPT policy of the Company was just to comply with section 188, this implies that the RPT policy of the Company was not comprehensive, since as per the Audit Firm it did not consider the provisions of Section 177 of the Companies Act, 2013. The fact that the RPT policy itself neglects the provisions of Section 177 (4) (iv) of the Act, should have rather made the Audit Firm question whether the Internal Controls of the Company, regarding the transactions with the related parties, are designed effectively. However, the Audit Firm did not identify this deficiency in the RPT Policy and Framework of the Company and hence did not exercise professional scepticism.
- c. In para 4.2.1 above, NFRA has already concluded that the Company was not in compliance with Section 177 (4) (iv) of the Companies Act, 2013. Therefore, NFRA re-iterates the conclusion drawn in the DAQRR that the Audit Firm has failed to point out this lacuna in the policy and failed to question the management and bring the same to the notice of TCWG. NFRA concludes that the Audit Firm failed to comply with Para 63 of the Guidance Note on Audit of IFC and Para 8 and Para 9 of SA 265.

#### 4.3.3. **Lack of Sufficient Appropriate Audit Evidence of examination of RPT transactions**

- 4.3.3.1. Summary of Audit Firm's Response: The Audit Firm states that *"SRBC would like to reiterate that we had verified the approval of audit committee for all related party transactions undertaken during each quarter, which was forming part of the agenda papers of the meeting circulated by the secretarial department...NFRA has refused to take into cognizance the document submitted by us in Appendix 6 attached with our response to PFC, which consisted of Extracts of AGM agenda."*

The Audit Firm states that *"With respect to two transaction highlighted by NFRA in Para 4.2.3.3 of DAQRR, at the outset, we would like to highlight that the dates mentioned by NFRA in the said paragraph is incorrect. Audit Committee approved the said two transactions on May 29, 2018 (instead of*

*March 29, 2018 mentioned in DAQRR). Further, those transactions were entered on July 19, 2017 and December 12, 2017 respectively (instead of September 19, 2017 and December 26, 2017 mentioned in DAQRR).” The Audit Firm states that, “only 2 transactions were approved by the Audit Committee after a period of 8 months as these transactions were inadvertently missed by the management while preparing the list of transactions for the concerned period. However, Company rectified this and got the approval along with 4th quarter related party transactions in the Audit Committee Meeting dated May 29, 2018.”*

- 4.3.3.2. NFRA Observations: NFRA has already concluded that since the document (contained within Appendix 6) provided by the Audit Firm does not form part of the Audit File it cannot be considered. Without prejudice, NFRA examined the minutes and agenda again and observes that there is no proof in the minutes regarding the list of transactions approved by the committee. In this regard, the Audit Firm even failed to understand the difference between minutes and agenda notes, because, on seeing the ambiguity in the minutes, the Audit Firm should have either raised questions or properly documented its conclusions in the audit file. It is not always necessary that the entire content of the agenda is approved by the audit committee. The minutes should properly record what is considered and approved. There is nothing in the audit file to understand the same.

Para A5 of SA 230 states that “*Oral explanations by the auditor, on their own, do not represent adequate support for the work auditor performed or conclusions the auditor reached*”.

The Audit Firm’s response that the two transactions which were rectified after 8 months were inadvertently missed by the management while preparing the list of transactions for the concerned period is not documented in any WP and hence not acceptable. Even the Audit Firm itself did not notice this issue, which proves the inadequacy of the procedures done by the audit firm. The corrections in the dates as noted by the Audit Firm are accepted, though this has no bearing on the above conclusions.

Thus the Audit Firm has failed to obtain sufficient appropriate audit evidence to conclude that the company has an adequate internal financial controls system in place and such controls are operating effectively regarding the related party transactions.

- 4.3.4. Based on the above, NFRA concludes that:

- (a) The Audit Firm has failed to point out the lacuna in the RPT policy and failed to question the management and bring the same to the notice of TCWG.

- (b) As against the requirements of Para 49 (m) of the Guidance Note on CARO, 2016, the Audit Firm did not obtain sufficient appropriate audit evidence and did not perform appropriate procedures to satisfy itself, regarding compliance with Section 177 of the Act, to appropriately report under clause 3 (xiii) of CARO, 2016.
- (c) This has resulted in the Audit Firm issuing a false report under clause 3 (xiii) of CARO, 2016 that claimed compliance of Section 177(4) relating to approval of RPT transactions.
- (d) The Audit Firm has failed to obtain sufficient appropriate audit evidence to conclude that the company has an adequate internal financial controls system in place and such controls are operating effectively regarding related party transactions.

**Credit Policy, Walkthrough and Test of Controls Performed**

**A. Prima Facie Observations/Conclusions (PFC)**

4.4. In its Prima Facie Conclusions, NFRA conveyed the following:

4.4.1. In response to NFRA query Part B- 4.3.viii.a, b and d of the questionnaire, the Audit Firm, inter-alia, has stated that *“We had obtained the credit policy from the Company and performed walkthroughs to familiarise with the process for loans and advances. We also performed test of controls on loans and advances to verify the compliance with the credit policy. Refer · SFS Canvas - M18 Loan Walkthrough (For relevant extract refer Attachment 19, Page no. A335 to A347) · SFS Canvas - M18 Credit SOP (For relevant extract refer Attachment 67, Page no. A1113 to A1134) · SFS Canvas- M18 Loans TOC (For relevant extract refer Attachment 20, Page no. A348 to A379) SFS Canvas- M18 Loan disbursements workpaper (For relevant extract refer Attachment 35, Page no. A561 to A576)”*.

4.4.2. NFRA perused each of the referred WP and notes the following:

Sr. No.	WP	NFRA’s Observations
1	SFS Canvas - M18 Loan Walkthrough (Attachment 19, Page no. A335 to A347)	The WP contains loan walkthrough performed by the Audit Firm based on one Credit Approval Memorandum (CAM). The CAM was pertaining to loan of ₹150 crore to IL&FS Securities Services Limited (ISSL), a <b>subsidiary of the Company</b> providing depository services. NFRA notes that this was the only loan disbursed by the Company to ISSL in FY 2017- 18 and was disbursed for meeting intraday fund requirement (subsequently repaid

		<p>by ISSL on the same day).</p> <p>The Audit Firm, itself, in its reply had stated “As per the RBI CIC framework, the Company’s objective is to invest and also provides loans to its group companies which are engaged primarily in infrastructure activities.” (Emphasis added). However, NFRA notes that the selected transaction (loan to a depository service provider to meet intraday fund requirement) was neither a representative transaction nor a material transaction since the Company had zero loan exposure in ISSL at the end of FY 2017-18. Also, the walkthrough seems to have been done as a mere formality, since the Audit Firm had just</p> <ul style="list-style-type: none"> <li>a) Summarized the process laid down in the Credit SOP. Instead of understanding every process, and the controls set up at each important point, the Audit Firm limited its scope to only note the hierarchy followed for credit approval, steps of disbursement and that a credit review process exists in the Company. The Audit Firm did not even note that no approval from the Audit Committee was required/received. The loan was solely approved by the Committee of Directors and upon receipt of intimation of the next Board meeting CAM summary was prepared and sent to Secretarial for noting to the Board. (Refer Compliance regarding Related Party Transactions sub- section of this section for our detailed comments.)</li> <li>b) Included AXAPTA (IT) system screenshots of the Credit Approval Process with no note of the understanding/observations on the same.</li> </ul>
2	<p>SFS Canvas - M18 Credit SOP (Attachment 67, Page no. A1113 to A1134)</p>	<p>WP contains “Credit Standard Operating Procedures (SOP)” for Project Finance Department of the Company. Even though the Audit Firm has referred to it as the credit policy of the Company, the document cannot be construed as <b>the duly approved credit policy</b> or substitute of it since</p> <ul style="list-style-type: none"> <li>a) It is not a comprehensive document and does not include the policy for pricing of credit. In turn, it refers to the credit policy (that is not available in the audit file) for details of the pricing policy of loans. Even the</li> </ul>

		<p>referred walkthrough WP ‘SFS Canvas - M18 Loan Walkthrough (Attachment 19, Page no. A335 to A347)’ states that “Pricing of the loan is guided by the Credit Policy of the Company. For a detailed discussion on Pricing refer to the approved Credit Policy.” (Emphasis added). From a plain reading of the above facts, it is evident that Credit SOP and Credit Policy are two different documents.</p> <p>b) In a rather perplexing statement on credit exposure review, page 13 of the Credit SOP states that “Reporting to the Audit Committee and Board on the IL&amp;FS credit portfolio has been discontinued effective quarter ended June 2016.” The SOP does not shed any light on the alternative arrangements, so far as the credit exposure review is concerned. Considering the fact that there was no risk management committee meeting held during FY 2017-18 (source: Annual Report 2017-18) and the reporting of credit exposure risk is not done to Audit Committee and Board, the Credit SOP leaves the control design for review of credit exposure in ambiguity.</p> <p>c) The document does not even seem to be an official document of the Company, as it is neither on the Company’s letter head nor is it signed by any company official.</p> <p>Nevertheless, on further perusal of the Credit SOP, NFRA notes that even though the Credit SOP states “<i>Since IL&amp;FS is a CIC, sanction of loans by IL&amp;FS is confined to IL&amp;FS Group Companies only</i>”, it does not lay any pre-condition for approval of related party transaction from Audit Committee. The SOP simply notes that after the credit evaluation is done by Project Finance Department, the loan is approved by Committee of Directors and disbursed. For our detailed observations, refer Compliance regarding Related Party Transaction sub-section of this section</p>
3	<p>SFS Canvas - M18 Loans TOC  (Attachment 20, Page no. A348)</p>	<p>The WP contains Test of Controls (TOC) performed by the Audit Firm on the loan disbursement dump from April 2017 to September 2017. The WP further refers to M18 Loan disbursements workpaper for TOC on disbursement from October to March, 2018.</p>

	to A379)	<p>The WP lays down the following audit procedure used for testing the controls:</p> <ul style="list-style-type: none"> <li>a) Obtain party wise disbursal dump.</li> <li>b) Select samples and verify selected samples.</li> <li>c) Verify uniformity of the dump with approved memorandums and agreements.</li> <li>d) Verify approval authority matrix.</li> <li>e) Verify loan agreements.</li> <li>f) Verify letter requesting disbursal, demand promissory notes, KYC documents and board resolution passed.</li> <li>g) For secured loans, verify amount of security, security cover and details of security.</li> <li>h) Verify bank statements</li> </ul> <p>NFRA notes that although the Audit Firm has stated “<i>We also performed test of controls on loans and advances to verify the compliance with the credit policy.</i>”, the WP in itself does not give any reference to the fact that these procedures were designed considering the Credit Policy of the Company. The WP also does not consider any tests to verify if the RPTs are approved by the Audit Committee. NFRA also noted other serious deficiencies that are further detailed in Para 4 of this PFC.</p>
4	SFS Canvas- M18 Loan Disbursals workpaper (Attachment 35, Page no. A561 to A576)	- Do (For Disbursal from October 2017 to March 2018) -

4.4.3. Para 6.23 of the Technical Guide on Audit of Non-Banking Financial Companies (TG-NBFC) states that the auditor should review the lending policies and consider whether

those charged with governance have approved the policies and whether the NBFC is in compliance. However, NFRA notes that, even though NFRA asked specifically for the duly approved credit policy, the Audit Firm has given reference to WP ‘SFS Canvas - M18 Credit SOP (Attachment 67, Page no. A1113 to A1134)’. As detailed in the table above (S.No. 2), the Credit SOP cannot be considered as the duly approved Credit Policy of the Company. Therefore, the Audit Firm failed to meet the requirements of Para 6.23 of TG- NBFC and failed to obtain sufficient appropriate audit evidence, as required by Para 6 of SA 500. NFRA, prima facie, also concludes that since the Audit Firm had failed to obtain the Credit Policy that should have been basis of the assurance about whether material weakness exists in internal financial controls, therefore, its reporting under Clause (i) of Sub-section 3 of Section 143 of the Companies Act, 2013 is also without sufficient appropriate audit evidence.

4.4.4. Para 103 of the Guidance Notes on IFC states the importance of performing walkthroughs and the manner in which an effective walkthrough is performed. Para 104 further states that *“In performing a walkthrough, at the points at which important processing procedures occur, the auditor questions the company's personnel about their understanding of what is required by the company's prescribed procedures and controls. These probing questions, combined with the other walkthrough procedures, allow the auditor to gain a sufficient understanding of the process and to be able to identify important points at which a necessary control is missing or not designed effectively. Additionally, probing questions that go beyond a narrow focus on the single transaction used as the basis for the walkthrough allow the auditor to gain an understanding of the different types of significant transactions handled by the process”* (emphasis added). NFRA notes that even through the very basic purpose of a walkthrough is to be able to identify important points at which a necessary control is missing or not designed effectively, the Audit Firm:

- a. Failed to exercise professional skepticism while performing the walkthrough and did not perform it in detail to understand every step of the transaction.
- b. Failed to note important areas in the credit appraisal process where a control is missing, and if credit worthiness/repayment capacity of the borrowers was appropriately considered before disbursement of loans.
- c. Did not document any understanding relating to whether there were appropriate controls to ensure that loans disbursed are not prejudicial to the interest of the Company.
- d. Did not even record any probing questions, or observations thereafter, to go beyond the narrow focus of the single transaction that was not a representative transaction. Further, the Audit Firm also did not verify/record any conclusion

Therefore, NFRA concluded in the PFC that the entire loan walkthrough is a complete sham since the Audit Firm had failed to verify that they had identified the points within

the company's credit processes at which a misstatement, including a misstatement due to fraud, could arise. The Audit Firm had failed to meet the requirements of the guidance note on ICFR.

## **B. Observations made in the DAQRR**

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

### **4.5.1. Credit Policy (PFC – S.No. 2 of Table in Para 4.4.2 and Para 4.4.3)**

4.5.1.1. Audit Firm Response: The Audit Firm agreed that the Credit SOP it referred, in response to NFRA query Part B- 4.3.viii.a, b and d of the questionnaire (where NFRA specifically asked for Credit Policy), while stating that it understood the Company's *compliance with the credit policy*, was not the duly approved credit policy of the Company.

The Audit Firm asserted that *“Paragraphs of SA 230 referred below, does not necessitate auditors to retain each and every document referred by it during the audit. SRBC is not required to retain Credit Policy as part of audit documentation because audit file cannot be treated as substitution of company's accounting records and Audit Firm cannot be expected to document every matter considered or professional judgement made.”* The Audit Firm although stated that on extensive search of documentation *“we have found Credit Policy approved by those charge with governance, obtained by us from CRMG department of the Company and verified by us during the audit for the year ended March 31, 2018. We are attaching credit policy, verbatim as received from the Company, for NFRA's reference. Refer Appendix 7 (Page No. A58 to A116). As the document is part of Company records, if required can be verified from the Company.”*

4.5.1.2. NFRA Observations: NFRA notes that the document (Credit Policy) provided by the Audit Firm **did not form part of the Audit File**, and thus cannot be considered. Therefore, NFRA's re-iterates its prima facie conclusion that the Audit Firm failed to comply with the requirement of [Para 6.23 TG-NBFC](#).

4.5.1.3. Nevertheless, on perusal of the document that the Audit Firm has attached in its reply dated 14<sup>th</sup> April 2021, NFRA notes that the Audit Firm's assertion that *“we had also obtained updated Credit Policy to ensure that the credit policy was updated by management with changing market conditions.”* is false. The referred Credit Policy (“August 2011”) was never updated since 27<sup>th</sup> July 2011. In fact, if this was actually the most updated policy, it had become redundant and indicates that the control designed had serious deficiencies with regard to the compliance with the existing regulatory framework, because of the below stated reasons:

- (a) the definition section of the Credit Policy continues to refer to the RBI's Regulatory Framework for Core Investment Companies (CICs) or Non-Banking Financial (Non - Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) **Directions, 2007** or the **Companies Act, 1956 (1 of 1956)**.
- (b) Credit Policy gives no cognizance to the fact the Master Directions – CIC-ND-SI, do not allow any rollover/rescheduling of loans. The Master Directions – NBFC-ND-SI although, specifically states that *“In the cases of roll-over of short term loans, where proper pre-sanction assessment has been made, and the roll-over is allowed based on the actual requirement of the borrower and no concession has been provided due to credit weakness of the borrower, then these shall not be considered as restructured accounts. However, if such accounts are rolled-over more than two times, then third roll-over onwards the account shall be treated as a restructured account.”* But the Credit Policy does not recognize any such pre-condition for rollover of loans. The implication and issues related with rollovers have been covered in detail in [Para 4.13](#) of this section.
- (c) The Policy continues to recommend a provision of 0.25% on standard assets, even when the RBI guidelines for FY 20117-18 required a provision of 0.40% on standard assets.

4.5.1.4. Therefore, NFRA concludes that

- a. the Audit Firm had failed to obtain sufficient appropriate audit evidence to meet the requirements of Para 6.23 of TG-NBFC that states that the auditor should review the lending policies and consider whether those charged with governance have approved the policies and whether the NBFC is in compliance.
- b. The Audit Firm had failed to comply with the requirements of Para 9 of SA 265.

4.5.2. **Walkthrough** (PFC [Para 4.4.4](#) and [S.No. 1 of Table in Para 4.4.2](#))

4.5.2.1. Audit Firm Response: In response to NFRA's PFC on the loan walkthrough performed, the Audit Firm quoted Para 103 & 104 of Guidance Note on Audit of Internal Financial Controls Over Financial Reporting, Para IG12.1 – IG12.8 of Guidance Note on Audit of Internal Financial Controls Over Financial Reporting and definition of professional scepticism of SA 200 and asserted the following:

- (a) *“SRBC had performed the walkthrough to obtain the understanding of flow of transaction related to loans and identify the controls relevant to the process. Refer IL&FS-Standalone Canvas Files Folder - 230.1*

to 230.13 M18 Loan Walkthrough.

- (b) Walkthrough is generally carried out based on a single transaction. SRBC had selected the transaction of loan given IL&FS Securities Services Limited to understand the flow of transaction and identify controls. Refer IL&FS-Standalone Canvas Files Folder - 230.1 to 230.13 M18 Loan Walkthrough.... Since walkthrough was to be performed using a single transaction, we had selected this sample based on our professional judgement. For detailed review of controls based on the samples selected, refer IL&FS-Standalone Canvas Files Folder - 236.1 to 236.12 M18 Loan disbursements workpaper and IL&FS-Standalone Canvas Files Folder - 235.1 to 235.22 M18 Loans TOC
- (c) The purpose of walkthroughs is to help in validating the auditor's understanding of how transactions are initiated, authorised, recorded, processed, and recorded – SRBC had obtained the understanding of process and documented the process and the same has been divided across various stages i.e. Initiation, Authorization (i.e. Credit Approval Process and Credit Approval by IL&FS Committee of Directors), Processed and Recorded (i.e. Disbursement, Credit Review and Monitoring of Loans/ Credits, Rollover / Modification/ Release of Securities/ Security Classification/ Transfer of Borrower Account and Miscellaneous). Refer IL&FS-Standalone Canvas Files Folder - 230.1 to 230.13 M18 Loan Walkthrough.
- (d) Steps addressed in walkthroughs would correspond to the process narratives of the Company – SRBC obtained the Loan standard operating procedure from the Company and ensured that the process followed for the disbursement of loan corresponds to company's process narratives. Refer IL&FS Standalone Canvas Files Folder - 233.1 to 233.22 M18 Credit SOP.
- (e) Walkthrough helps in identifying controls relevant to the process and audit – SRBC had identified various controls embedded in the process. The controls identified during the walkthrough are referenced as C:1, C:2, etc. The respective control can be identified from our workpaper IL&FS Standalone Canvas Files Folder - 235.1 to 235.22 M18 Loans TOC.
- (f) To perform walkthrough auditor should inquire with the individual who perform the procedure and corroborate the same by obtaining relevant document and observation of individuals performing the procedure – SRBC had inquired with the officer in Project Finance Department, who handles the

(g) *flow of transaction related to loans. Further SRBC corroborated their inquiry with the documents such as CAM, Legal Ok and Disbursement Memo and also observed the procedures by obtaining screenshots of AXAPTA where transaction was authorized and approved. Refer IL&FS Standalone Canvas Files Folder - 230.1 to 230.13 M18 Loan Walkthrough and IL&FS-Standalone Canvas Files Folder - 231.1 to 231.9 ISSL Walkthrough.zip.”*

(h) With regard to controls related to oversight of Audit Committee, the Audit Firm quoted Para 90 of Guidance Note on IFC and stated that “*We have verified the controls related to monitoring by Audit Committee, as part of our ELCs testing to obtain sufficient and appropriate evidence regarding oversight of Audit Committee as part of IL&FS Control Environment. We verified that approving related party transactions form part of responsibilities of audit committee. Refer IL&FS- Standalone Canvas Files Folder - 28.1 to 28.3 M18 111GL-ELCs testing and IL&FS-Standalone Canvas Files Folder - 54.1 to 54.279 ILFS Annual Report 2016-17. Further by way of one sample (i.e. Audit Committee meeting minutes of one quarter), we have verified that audit committee approves the related party transactions. Refer IL&FS-Standalone Canvas Files Folder - 28.1 to 28.3 M18 111GL-ELCs testing and IL&FS-Standalone Canvas Files Folder - 45.1 to 45.25 M18 ACM 23 August 2017.”*

- 4.5.2.2. NFRA Observations: NFRA notes that apart from WP ‘28.1 to 28.3 M18 111GL-ELCs testing’ that is referred to assert that they had *verified the controls related to monitoring by Audit Committee*, the Audit Firm has not referred any new audit evidence, that was not examined by NFRA in its PFC. Nevertheless, NFRA has re-examined all the WPs, in the context of the Audit Firm’s assertions.
- 4.5.2.3. The Audit Firm’s ([Para 4.5.2.1 \(b\)](#)) assertion that the selection of this transaction (loan given to ISSL) was based on its professional judgement, is not supported by audit documentation.
- 4.5.2.4. Given the facts established in S.No. 1 of the table in [Para 4.4.2 \(PFC\)](#), (that such an outlier transaction was selected for a walkthrough, which was not even a representative transaction based on the Company’s business), NFRA concludes that the Audit Firm has failed to comply with the requirements of Para 8 (c) of SA 230 and the assertion is construed only as an afterthought.
- 4.5.2.5. Para 103 of GN-IFC states that walkthrough procedures usually include a combination of inquiry, observation, an inspection of relevant documentation, and re-performance of controls. Given the information available from the Audit File, it seems that the loan was disbursed before the enhancement was approved

by the delegated authority. This indicated operating weakness in the controls. However, even with the red flags (as noted above) that should have been noted by the Audit Firm, there is no documentation, whatsoever, available in the audit file about the inquiry/observation/inspection/re-performance of controls. The Audit Firm failed to test the sample with professional scepticism.

Therefore, in line with NFRA’s PFC, it is thus appropriate to conclude that the entire walkthrough was a complete sham. The Audit Firm has merely “*summarized the process laid down in the Credit SOP. Instead of understanding every process, and the controls set up at each important point, the Audit Firm limited its scope to only note the hierarchy followed for credit approval, steps of disbursement and that a credit review process exists in the Company.*”

NFRA notes that there are no conclusions, regarding control design or the control implementation, are documented in the walkthrough. Let alone using the Walkthrough to test the design and operating efficiency of the Controls, the Audit Firm did not even identify the issues/deficiencies in operating efficiency of the Controls, in the selected transaction. Even the deficiencies, which are indicated by the AXAPTA screenshots, had been ignored by the Audit Firm. Rather, the Audit Firm simply stated that they have “*included AXAPTA (IT) system screenshots of the Credit Approval Process*” with no note of the understanding/observations on the same.

4.5.2.6. With regard to the Audit Firm’s assertion that “*We have verified the controls related to monitoring by Audit Committee, as part of our ELCs testing to obtain sufficient and appropriate evidence regarding oversight of Audit Committee as part of IL&FS Control Environment.*” NFRA perused the WP ‘28.1 to 28.3 M18 111GL-ELCs testing’ (the only new evidence referred by the Audit Firm) and noted the following:

Part A: Evaluation of design and implementation of ELCs			Part B: Select ELCs to test and design tests of ELC			Part C: Execute and evaluate on tests of ELC					
Number	Direct or Indirect	Control Category	Name	Designed to prevent or detect	Select to test	Description of the nature, timing, and extent of procedures designed to test the entity	Tested by	WP ref or description of procedure performed	Operative effectiveness	Deficiency	Additional information
9	Indirect	Control Environment	The Audit Committee operates under a defined rules and responsibilities approved by the Board of Directors	Yes	Yes	As confirmed by Amit Bondre (Manager - Secretarial Dept.), the roles & responsibilities of Audit Committee is as per Section 177 of the Companies Act.	SRB	MIR Section 177 of CA 2013	Effective	No	

As evident from the above screenshot, the extent of audit procedures for verification of controls related to monitoring by the Audit Committee was limited to a single inquiry that “*As confirmed by Amit Bondre (Manager - Secretarial Dept.), the roles & responsibilities of Audit Committee is as per Section 177 of the Companies Act, 2013 and there is no modification in it.*”. (The referred document in the screenshot is simply a pdf containing Section 177 of the Companies Act, 2013).

No further audit procedures were performed by the Audit Firm to understand if

the Audit Committee was in compliance with Section 177 of the Companies Act, 2013. As concluded in [Para 4.2](#), the Company (along with its RPT Policy) was in contravention of the provision of Section 177 (4) (iv) of the Companies Act, 2013.

Therefore, NFRA concludes that the Audit Firm failed to obtain sufficient appropriate audit evidence to conclude that the control was designed and operating effectively.

#### 4.5.3. Test of Control (PFC – [S. No. 3 & 4 of Table in Para 4.4.2](#))

- 4.5.3.1. Audit Firm Response: The Audit Firm stated that “*To clarify NFRA’s understanding regarding the risk and control related to loan disbursal process, SRBC would like to state that, it is the management’s responsibility to ensure proper controls were designed and were operating effectively to cover all the what could go wrongs.*”

*SRBC as an auditor was required to verify that management’s process was adequate by obtaining sufficient and appropriate audit evidences, to conclude that controls were designed properly and operating effectively during the year ended and as on March 31, 2018.*

*We provide below the table containing the key controls established by the management and the audit procedures performed by us to verify the same. Further the controls, can be bifurcated into operating controls and monitoring controls.” [The Table has been included along with NFRA’s Observations in the next para– [4.5.3.3](#)]*

- 4.5.3.2. NFRA Observations: Para 108 of GN-IFC states that “*The auditor should test the design effectiveness of controls by determining whether the company's controls, if they are operated as prescribed by persons possessing the necessary authority and competence to perform the control effectively, satisfy the company's control objectives and can effectively prevent or detect errors or fraud that could result in material misstatements in the financial statements. This would also enable the auditor to conclude if the company has an adequate internal financial controls system over financial reporting in place.*” Para 110 of GN-IFC states that “*The auditor should test the operating effectiveness of a control by determining whether the control is operating as designed and whether the person performing the control possesses the necessary authority and competence to perform the control effectively.*” Para 111 of GN-IFC states that “*Procedures the auditor performs to test operating effectiveness include a mix of inquiry of appropriate personnel, observation of the company's operations, with inspection of relevant documentation, and re-performance of the control.*”

- 4.5.3.3. Therefore, the Audit Firm was not just required to observe if control exists and

if it is being performed but was required to verify and understand the effectiveness of the control design in a manner that indicates that the controls *satisfy the company's control objectives* and verify the operating effectiveness of the control. In view of these requirements and on perusal of the WP '235.1 to 235.22 M18 Loans TOC.xlsx', along with the key assertions made by the Audit Firm, NFRA notes the following:

<b>Controls established by Management</b>	<b>Audit Procedures performed by SRBC</b>	<b>NFRA Observations</b>
<p><i>“Operating Controls- Before sanction and disbursement of loan, credit analysis was done by Project Finance Department and approval had been taken from the authorized signatories as per Unified Approval Framework approved by Board of Directors.”</i></p>	<p><i>“We had verified the Credit Approval Memorandum and Disbursement Memorandum, which was approved by the authorized signatories and contained the credit analysis, for the sample selected. Refer IL&amp;FS-Standalone Canvas Files Folder - 236.1 to 236.12 M18 Loan disbursements workpaper and IL&amp;FS Standalone Canvas Files Folder - 235.1 to 235.22 M18 Loans TOC.”</i></p>	<p>The stated audit procedures themselves indicate that no tests of controls were performed on the credit analysis function of the Project Finance Department. The Audit Firm was required to test the design effectiveness and operating effectiveness of the stated Operating Control.</p> <p>The above is also evident on perusal of the referred WPs, NFRA notes that for the risk <i>“Possibility of loans disbursed without adequate evaluation”</i>, the Audit Firm stated the following controls</p> <p><i>“-All lending transactions are authorized by the Legal, Secretarial, CRMG, Accounts department before the same are submitted for approval to Unified Approval Framework members</i></p> <p><i>- All CAMs are approved by designated authorities as per Unified Approval Framework”</i>. Further, the work done statement states that <i>“We have taken 14 samples and on the basis of the</i></p>

		<p><i>samples, we have verified that CAM's are duly approved by authorised personnel. Refer Sample Testing”.</i></p> <p>It is evident that the Audit Firm merely checked that the CAM's were approved by the 'authorised personnel'. No audit procedures were conducted to test the design effectiveness and operating effectiveness of the Controls. In fact, the assertion of the Audit Firm nowhere indicates that they checked the effectiveness of the design, and more importantly checked its operating effectiveness <i>through a mix of inquiry of appropriate personnel, observation of the company's operations, inspection of relevant documentation, and re-performance of the control.</i> The Audit Firm was required, not just to review if the authorized signatories have signed the CAMs but, to determine if there has been adequate evaluation before the loan disbursal and if it was appropriate, based on the audit evidence obtained.</p> <p>However, no such documentation is available in the WPs referred. In fact, the CAM Approvals tab of the WP '235.1 to 235.22 M18 Loans TOC' clearly indicates that the Audit Firm only verified that the CAM is signed by all the</p>
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		<p>required signatories.</p> <p>Further, NFRA's observations on a CAM, which is covered in Para (Credit Worthiness) clearly indicate that there were sufficient red flags for the Audit Firm to question the operating effectiveness of the controls.</p>
<p><i>Operating Controls –Management obtained the bank details of the borrower and transfers the money into that bank account post obtaining disbursement approval.</i></p>	<p><i>We had verified on sample basis, the date on which payment had been made and verified from Disbursement Memorandum that approval had been obtained before disbursement. Refer IL&amp;FS Standalone Canvas Files Folder - 236.1 to 236.12 M18 Loan disbursals workpaper and IL&amp;FS Standalone Canvas Files Folder - 235.1 to 235.22 M18 Loans TOC.</i></p>	<p>The walkthrough transaction (that is also covered as a sample for the test of controls), for loan disbursement, was requested by the borrower on 27<sup>th</sup> June 2017 (an urgent requirement for intraday margin &amp; M2M money). However, based on disbursement mail, Mr Arun Saha approved the loan only on 02 Aug 2017. On perusal of the 'Sample Testing' &amp; CAM Approval of the WP '235.1 to 235.22 M18 Loans TOC', NFRA notes that CAM document is dated 11<sup>th</sup> Jan 2017 and does not relate to the intraday facility applied on 27<sup>th</sup> June 2017.</p> <p>There is no mention of the approval of the enhancement date in the audit documentation. Prima-facie it seems that the amount was disbursed by the Company before the enhancement was approved. Yet no observations/conclusions have been noted or documented by the Audit Firm.</p> <p>The Audit Firm failed to test</p>

		the design and operating effectiveness of the Control.
<p><i>Monitoring Control – A system report called ‘Legal Ok’ generated from their IT system ‘AXAPTA’ which confirms that all the documents related to a loan such as end use certificate, other post disbursement documents, etc. had been obtained by the Company.</i></p>	<p><i>We had obtained and verified the Legal Ok report on sample basis. Refer IL&amp;FS-Standalone Canvas Files Folder - 236.1 to 236.12 M18 Loan disbursements workpaper and IL&amp;FS-Standalone Canvas Files Folder - 235.1 to 235.22 M18 Loans TOC.</i></p>	<p>No testing was done by the Audit Firm, either in the Walkthrough or in the test of controls (WPs referred), about the effectiveness of the Legal Ok report and the stated documents “related to a loan such as end use certificate, other post disbursement documents,”</p> <p>For the risk identified “Disbursement made without necessary documents may lead to non-recovery of funds and possible NPAs” the Control is stated as follow: “List of documents, modified as per terms and client of each transaction is created into AXAPTA out of exhaustive list already available in AXAPTA by Assistant Manager (Legal Department). The list distinguishes between documents to be collected pre-disbursement and post-disbursement. Project Finance Department collects all documents, marks the receipt of documents in AXAPTA and handovers the documents including loan agreement to Legal Department for vetting. Legal department vets the documents, marks the receipt in AXAPTA and generates a Legal Ok. Documents are handed over to CRMG for safekeeping.”</p>

		<p>The Audit Firm, about sample testing, has only noted the CAM dates for the selected sample. No further observations/comments have been noted.</p> <p>The work done column further states “1. We have taken sanction loans from April to March, 2018; 2. We have obtained screenshots of Legal Ok for the samples taken out from EY Random; Refer Legal OK”</p> <p>NFRA notes that the Audit Firm, for the risk that <i>Disbursement made without necessary documents may lead to non-recovery of funds and possible NPAs</i>, has merely relied on a legal ok report (that simply specifies dates on which documents were received by the respective department). NO test of control with regard to the documents, per se, has been done by the Audit Firm.</p>
<p><i>Monitoring Control – Loan sanctioned and Loan disbursed are also notified to board of directors in board meetings. Further, these related party transactions are placed before Audit Committee for their approval and to confirm that these</i></p>	<p><i>We had noted that management’s control is operating effectively by verifying the minutes of meetings of Audit Committee and Board of Directors. We had also verified the Audit Committee Agenda on sample basis to ensure that the transactions and reports are placed before Audit Committee. Refer CFS Canvas - Read minutes of meetings of</i></p>	<p><i>As noted in Para 4.2, the control established by the Company that RPTs are only placed before the Audit Committee for ratification is against provision of Section 177 of the Companies Act, 2013. The Audit Firm failed to obtain sufficient appropriate audit evidence to test the effectiveness of the control design itself.</i></p>

<p><i>transactions are undertaken at arm's length and in ordinary course of business. Company had also appointed internal audit or to verify and confirm that the related party transactions are undertaken at arm's length and in ordinary course of business.</i></p>	<p><i>shareholders, those charged with governance and important committees' task and Appendix 6 (Page No. A33 to A57) for Audit Committee Meeting agenda.</i></p>	
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Based on the above observations, NFRA concluded in the DAQRR that the Audit Firm failed to comply with the requirements of GN-IFC.

**C. Final Observations and Conclusions of the AQRR**

4.6. NFRA has examined in detail the replies to the DAQRR and the oral explanations submitted by the Audit Firm and concludes as follows:

4.6.1. **Credit Policy**

4.6.1.1. Audit Firm Response: The Audit Firm states as follows:

- a. *“We reiterate that, paragraphs of SA 230 referred below, does not necessitate auditors to retain each and every document referred by it during the audit. SRBC is not required to retain Credit Policy as part of audit documentation because audit file cannot be treated as substitution of company’s accounting records and Audit Firm cannot be expected to document every matter considered or professional judgement made.”* The Audit Firm also states as follows:
- b. *“Further, reference of the credit policy is also available in the audit working papers. Refer IL&FS Standalone Canvas Files Folder - 230.1 to 230.13 M18 Loan Walkthrough. Relevant extract from our workpaper is reproduced below and these extracts supports SRBC assertion that we had obtained and verified Credit Policy during our audit for the year ended March 31, 2018.”*
- c. *“We would like to point out that Definition Section of the Credit Policy mentions that in case of change in regulation, Credit Policy will be assumed to be updated with those changes and those updated regulations will prevail over the old Credit Policy. It must be noted that Company had complied with the then existed*

*regulations for instance provision for standard asset were made at 0.40% instead of 0.25% as mentioned in the policy document and hence designing of control had no serious deficiencies.”*

- d. *“We would also like to highlight that Reserve Bank of India (RBI), apex regulator for Core Investment Companies, had also completed the inspection for the year ended March 31, 2015 and they had not raised any query with respect to Credit Policy. Refer IL&FS - Standalone Canvas Files Folder - 456.1 to 456.3 M18 RBI inspection and responses. Further, we had communicated to TCWG to highlight the fact that Company’s credit policy with respect to rollover of short-term loans, was required to be updated, to bring in line with the RBI guidelines. We had also communicated to TCWG that Company’s documentation with respect to rollover needs to be strengthened. Extract of audit committee presentation is reproduced below. Refer IL&FS-Standalone Hardcopy Files Folder - 20\_ACM PPT.”*

4.6.1.2. NFRA Observations: NFRA notes that:

- a. Regarding the Credit Policy, the Audit Firm has repeated its response that it is not required to retain the Credit Policy as part of audit documentation and at the same time produce a copy of the outdated Credit Policy, claiming it as part of the Audit Documentation. NFRA observes that since the document (Credit Policy) provided by the Audit Firm did not form part of the Audit File it cannot be considered valid audit evidence. As explained in detail in the DAQRR, neither the document produced nor the argument that it is not required to document credit policy in no way support the claims of the Audit Firm that sufficient appropriate audit evidence is obtained. Therefore, NFRA re-iterates its conclusion that the Audit Firm failed to comply with the requirement of [Para 6.23 TG-NBFC](#).
- b. Notwithstanding the above NFRA examined the document (credit policy) referred by the Audit Firm and notes that the incorporation of a statement in the definition section of the policy that, *“Subsequent changes in these will automatically entail changes in policy. If definitions vary between these, the latest promulgated definition will prevail as the context may require”* does not mean that the policy need not be updated at all and all the changes over the years will automatically get incorporated in the policy. This only pertains to the definition section, i.e. in case any changes happen in the definitions as per laws then the updated/new definition should be considered. The attempt of the Audit Firm, to draw support for their false claims based on such irrelevant matters, only indicates the precarious state in which the Audit Firm finds itself and also the deterioration of professionalism and honesty expected from the Auditor of a Public Interest Entity.

c. The Policy further states as follows:

*“Various policies and standard practises related to credit management which have been adopted by the Company have been annexed herewith within a comprehensive framework. **The same are subject to periodic review and will be applicable as amended from time to time.** In case of any inconsistency between the Credit Policy and the applicable laws, rules regulations, then prevalent laws, rules, regulations shall prevail.”*  
(Emphasis added)

d. The above statement clearly shows that the policy needs to be reviewed and updated from time to time. The policy was last updated last in July 2011. There have been major changes in the provisions of the Acts which needed to be incorporated as the policy has become outdated. Thus, the Audit Firm’s response that the policy is assumed to be automatically updated as per the changes in the Acts and there is no need to update it is a baseless and unprofessional statement and hence not acceptable.

e. Para 6.23 of the Technical Guide on Audit of Non-Banking Financial Companies (TG-NBFC) states that the auditor should review the lending policies and consider whether those charged with governance have approved the policies and whether the NBFC is in compliance. The Audit Firm failed to do so. Further, regarding the Audit Firm’s response that “we had communicated to TCWG to highlight the fact that Company’s credit policy with respect to rollover of short-term loans, was required to be updated, to bring in line with the RBI guidelines. We had also communicated to TCWG that Company’s documentation with respect to rollover needs to be strengthened” NFRA observes that simply communicating the above cannot be construed as reporting a serious lacuna in the credit policy. For NFRA’s further comments in this regard refer to the Rollover section of this AQRR.

f. NFRA, therefore, reiterate its DAQRR conclusions that:

- i. The Audit Firm had failed to obtain sufficient appropriate audit evidence to meet the requirements of Para 6.23 of TG-NBFC.
- ii. The Audit Firm did not comply with the requirements of Para 9 of SA 265.

#### 4.6.1. Walkthrough

4.6.1.1. Audit Firm Response: The Audit Firm has stated the following responses:

- a. “With respect to NFRA’s comment in Para 4.5.2.3 of DAQRR, we submit that as regards to the conduct of an auditor’s mind, there is no *procedure formulated in the world that can record the mental processes that justify the*

*exercise of professional judgements.”*

- b. The Audit Firm quotes Para 90 and 91 of GN on IFC and states that, *“We have verified the controls related to monitoring by Audit Committee, as part of our ELCs testing to obtain sufficient and appropriate evidence regarding oversight of Audit Committee as part of IL&FS Control Environment. We verified that approving related party transactions form part of responsibilities of audit committee.”*
- c. *“As part of our walkthrough we documented that ‘the need based Credit Appraisal is carried out on an arm’s length basis...’. Further, the Credit Assessment Memo attached as supporting evidence of this walkthrough, contain the assessment done by management to conclude that the transaction with ISSL is at arm’s length and in ordinary course of business. It is important to note that since the transaction to provide finance to ISSL was intraday transaction and hence no interest was charged as there was no interest cost to the Company. The Company had charged transaction fee from ISSL with respect to this transaction. Refer IL&FS-Standalone Canvas Files Folder - 231.3.1 to 231.3.11 ISSL Walkthrough\_ISSL\_Axapta CAM\_Rs 1500 mn.”*
- d. Regarding NFRA’s conclusion in Para 4.5.2.4(b), the Audit Firm states that *“as per Delegation of Authority, approval of Mr. Maharudra Wagle and Ms. Sabina Bhavnani was sufficient for disbursing a loan. Refer IL&FS-Standalone Canvas Files Folder - 33.1 to 33.25 M18 DOA-August 22 2016. Accordingly, required approval was available at the time of disbursement and there was no delay in obtaining approval from authorized signatories. Approval from Ms. Sabina Bhavnani is evident from the mail she had sent and approval from Mr. Maharudra Wagle had been received on July 27, 2017. Hence, there is no delay in obtaining approval from authorized signatories.”*
- e. The Audit Firm quotes Para IG 17.1 to IG 17.3 of GN on IFC and states that *“we disagree with NFRA remarks that ‘the document is dated 11 Jan 2017 and does not seem to indicate that it relates to approval on the intraday facility applied on 27th July 2017’. Credit Assessment Memo (CAM) dated January 11, 2017 was approved for sanction of intraday facility, though the amount approved was Rs. 1,000 million and accordingly for additional disbursement of Rs. 500 million, management had obtained following approvals and we had also verified the same during our audit: a) Approval from Ms. Sabina Bhavnani, Mr. Maharudra Wagle and Mr. Arun Saha for providing an incremental sanction of Rs. 500 million with the same terms as that for the approved intraday facility of Rs. 1,000 million. b) CAM modification memo was floated in AXAPTA on August 10, 2017 and was approved by the members of Committee of Directors on November 7, 2017. SRBC would also like to highlight that the general practice of the Company was to document approvals in AXAPTA post facto, to keep it on records that the transaction was*

authorized.”

“Refer *IL&FS-Standalone Canvas Files Folder - 231.7.1 ISSL Walkthrough\_ISSL\_Manual Disb Memo\_AKS Approval\_Rs 1500 mn, IL&FS-Standalone Canvas Files Folder - 231.8.1 to 231.8.2 ISSL Walkthrough\_ISSL\_Manual Disb Memo\_MW Approval\_Rs 1500 mn and IL&FS-Standalone Canvas Files Folder - 231.1.1 to 231.1.16 ISSL Walkthrough\_ISSL\_Axapta CAM Modi Memo\_Rs 1500 mn.*”

- f. The Audit Firm quotes Para IV of Overview Section of GN on IFC and states that “*auditor is required to express an opinion on the effectiveness of the entity’s internal control as at the balance sheet date and if any deficiency has been remediated before the year end date then auditor can still express an unqualified opinion. SRBC noted this and accordingly obtained and verified subsequent approvals. This proves that SRBC had applied professional skepticism and obtained sufficient appropriate audit evidence to understand the process of loan disbursement.*”
- g. Regarding NFRA’s conclusion in Para 4.5.2.6 of DAQRR, the Audit Firm states that “*14 controls (13 key controls and 1 non key control) are designed by the Company, included in Entity Level Controls, to comply with requirements of Section 177 of the Companies Act, 2013 and to establish oversight of Audit Committee. SRBC had obtained sufficient appropriate evidence to verify operating effectiveness of all the key controls. Refer IL&FS-Standalone Canvas Files Folder - 28.1 to 28.3 M18 111GL-ELCs testing. Accordingly, NFRA’s comment that ‘the extent of audit procedures for verification of controls related to monitoring by Audit Committee was limited to a single inquiry’ is incorrect and leads us to believe that the conclusion of NFRA is premeditated and biased.*”

4.6.1.2. NFRA Observations: NFRA examined all the responses by the Audit Firm in detail and observes as follows:

- a. Para 8(c) of SA 230 states that the auditor shall document the “*Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.*” The Audit Firm was required to document the basis of professional judgment of selecting the transaction (loan given to ISSL) for performing the walkthrough, which it failed to do. The Audit Firm’s assertion that the selection of this transaction was based on its professional judgement is thus unsupported by evidence.
- b. The WP ‘*IL&FS-Standalone Canvas Files Folder - 231.3.1 to 231.3.11 ISSL Walkthrough\_ISSL\_Axapta CAM\_Rs 1500 mn.*’ States as follows regarding the question “**Whether transaction in ordinary course of business and Arm’s length**” :

*“The intraday facility shall be subject to a nominal transaction fee of 0.01% of the facility amount. The proposal of charging a fee of 0.01% vis a vis the 0.10% currently being charged to other Group companies is in context of the fact that ISSL has provided loans aggregating Rs.5,610 million to various companies in the IL&FS Group. There has been a significant delay in servicing part of these loans including interest which continue to be overdue and outstanding; this has led to an opportunity loss for ISSL. Once the group outstandings are paid off, ISSL would pay a transaction fee in line with that being charged to the other Group Companies.”*

Further, there are four RPT assessors amongst which one named ‘Avinash Bagul’ has reported in the WP that the transaction is not at arm’s length.

The Audit Firm did not care for any such observation. The audit procedures performed were limited to verifying if necessary documents are available. Even though the red flag is visible as noted above the Audit Firm did not question the management, rather it accepted the management’s assertion without any further procedures being performed.

Also in the entire Walkthrough WP there is no documentation where the Audit Firm identifies the process/or the part where the audit committee approves the transaction.

Therefore, NFRA concludes that the Audit Firm failed to meet the requirements of Para 6 of SA 500 and Para 103 of GN-IFC

- c. As explained earlier, Para 103 of GN-IFC states that walkthrough procedures usually include a combination of inquiry, observation, an inspection of relevant documentation, and re-performance of controls. Given the information available from the WPs, the transaction does not appear to be on arm's length price. However, even with the red flags (as noted above) that should have been noted by the Audit Firm, there is no documentation, whatsoever, available in the audit file about the inquiry/observation/inspection/re-performance of controls. The Audit Firm failed to test the sample with professional scepticism.
- d. Thus, NFRA reiterates that there are **no conclusions, regarding control design or the control implementation**, are documented in the walkthrough. Let alone using the Walkthrough to test the design and operating efficiency of the Controls, the Audit Firm did not even identify the issues/deficiencies in operating efficiency of the Controls, in the selected transaction. Even the deficiencies, which are indicated by the AXAPTA screenshots, had been ignored by the Audit Firm. Rather, the Audit Firm simply stated that they have ‘*included AXAPTA (IT) system screenshots of the Credit Approval Process*’ with no note of the understanding/observations on the same. it is thus appropriate to conclude that the entire walkthrough was a complete sham.

- e. As observed from the WP '28.1 to 28.3 M18 111GL-ELCs testing' the Audit Firm has not made any inquiry regarding the responsibility of the Audit Committee for approving the related party transactions. This has to be read with the fact that, as concluded in Para 4.2, the Company (and its RPT Policy) had contravened the provision of Section 177 (4) (iv) of the Companies Act, 2013. Therefore, NFRA concludes that the Audit Firm did not obtain sufficient appropriate audit evidence to conclude that the control was designed and operating effectively.

#### 4.6.2. Test of Control

4.6.2.1. Audit Firm Response: The Audit Firm states as follows:

- a. Regarding point no. 1 of the table given in Para 4.5.3.3, the Audit Firm states that *“SRBC would also like to highlight that auditors are not expected to reperform the credit assessment which has been performed by the experts who have been entrusted with the specific job. Nowhere it is written in the Guidance Note on Audit of IFC and Guidance Note on Audit of NBFC, that the auditor is required to reperform the credit assessment. However, NFRA expects auditors to perform operation analysis, which is not in realm of statutory auditors.”*
- b. Regarding point no. 2 of the table given in Para 4.5.3.3, the Audit Firm states that *“required approval was available at the time of disbursement and there was no delay in obtaining approval from authorized signatories. Approval from Ms. Sabina Bhavnani is evident from the mail she had sent and approval from Mr. Maharudra Wagle had been received on July 27, 2017. Hence, there is no delay in obtaining approval from authorized signatories.”*
- c. Regarding point no. 3 of the table given in Para 4.5.3.3 the Audit Firm states that *“SRBC had verified following documents to conclude that disbursement was made after obtaining certain important documents: a) Signed Loan Agreement / Term Sheet b) KYC Documents such as PAN, Phone Bill, Memorandum of Association, Article of Association, etc. c) Demand Promissory Note d) Charge Documents such as CHG 1 and Deed of Hypothecation e) Board Approval authorizing borrower to borrow from IL&FS.”*

*“Apart from the documents mentioned above, SRBC had also obtained a system report called 'Legal Ok' generated from IL&FS IT system 'AXAPTA' which confirms that all the documents related to a loan such as pre-disbursement documents, end use certificate and other post disbursement documents were obtained by the Company.”*

- d. Regarding point no. 4 of the table given in Para 4.5.3.3, the Audit Firm

states that “*NFRA’s interpretation of law that prior approval of Audit Committee is required for related party transaction is based on conjecture, which was countered by SRBC in PFC. We reaffirm our position to conclude that the Companies Act, 2013 only specify approval is required for related party transactions and it can either by prior or post-facto approval.*”

4.6.2.2. NFRA Observations: The Audit Firm has not referred to any new WPs other than what has already been examined by NFRA. NFRA has examined the replies of the Audit Firm and observes as follows:

- a. The Audit Firm was not just required to observe if control exists and if it is being performed, but was required to verify and understand the effectiveness of the *control design* in a manner that indicates that the controls *satisfy the company's control objectives* and verify the operating effectiveness of the control. Nothing in this regard is documented in the Audit File. Thus the audit procedures documented by the Audit Firm in its WPs fall short of sufficient and appropriate evidence. Thus, NFRA reiterates its DAQRR conclusion that the Audit Firm failed to follow the guidance of GN-IFC.
- b. Regarding the Audit Firm’s response to point no. 1 of the table given in Para 4.5.3.3 NFRA observes that Para 5.26 of TG-NBFC states that “*in establishing the nature, extent and timing of the work to be performed, the auditor should consider the inter-alia, following factors: credit approval process including authorisation; loan documentation obtained from the existing/prospective borrower, **test check the documents for borrower’s financial position/credit worthiness**; internal credit rating assigned to borrower; and credit monitoring by credit committee.* (Emphasis added). The Audit Firm failed to perform sufficient appropriate audit procedures to test the design effectiveness and operating effectiveness of the stated Operating Control. The Audit Firm merely checked that the CAM’s were approved by the ‘*authorised personnel*’. The Audit Firm failed to check the effectiveness of the design, and more importantly failed to check its operating effectiveness *through a mix of inquiries of appropriate personnel, observation of the company's operations, an inspection of relevant documentation, and re-performance of the control.*
- c. Regarding the Audit Firm’s response to point no. 3 of the table given in Para 4.5.3.3, NFRA observes that the Audit Firm has repeated its reply and NFRA reiterates its DAQRR conclusion that the Audit Firm, regarding the risk that *Disbursement made without necessary documents may lead to non-recovery of funds and possible NPAs*, has merely relied on the legal ok report (that simply specifies dates on which documents were received by the respective department). No test of controls about the documents, per se,

has been done by the Audit Firm.

- e. The Audit Firm has stated in response to point no. 4 of the table given in Para 4.5.3.3 i.e. requirement of prior approval of Audit Committee for related party transaction that “NFRA’s interpretation of law that prior approval of Audit Committee is required for related party transaction is based on conjecture, which was countered by SRBC in PFC. We reaffirm our position to conclude that the Companies Act, 2013 only specify approval is required for related party transactions and it can either by prior or post-facto approval.” NFRA has dealt with this requirement of prior approval of RPT transactions lapse in detail in the Related Party Compliance section of this AQR wherein it clearly established by giving detailed reasonings that prior approval of RPT transactions was required under Section 177 of the Act and Rule 6A. Therefore contention of the audit firm that Audit committee’s post -facto approval of RPT transactions meets the requirement of law is completely rejected.
- d. Therefore, NFRA reiterates its DAQRR conclusion that the control established by the Company (RPTs are only placed before the Audit Committee for ratification) is not in accordance with the provision of Section 177 of the Companies Act, 2013.

## **Credit Evaluation**

### **A. Prima Facie Observations/Conclusions (PFC)**

4.7. In its Prima Facie Conclusions, NFRA has conveyed the following:

- 4.7.1. In its reply to NFRA query Part II Section B-3: Q3 (iii) the Audit Firm has stated that “The Company had a process of credit evaluation. The Credit evaluation was performed by Project Finance Department of the Company. Credit Assessment memorandum (CAM) was used by the management for documenting the credit assessment for the purpose of loan. On the basis of CAM, credibility of the borrower is assessed and thereby disbursement memo was initiated. Audit team had verified that the Company’s policy was followed for loan granted by verifying CAM, Disbursement memo, term sheets on sample basis. For procedures in detail refer Para 4.81 to Query in Part I – Section B 4.3.viii (Page no. 60 of this response)” Para 4.81 of the response re-iterated the above contentions and further referred to Para 3.1 to 3.24 of the response to query in Part I Section E-3 (a). Para 3.1 to 3.24, inter-alia, stated that “The Company did not grant loans (A) which were not supported by current and complete financial information and analysis of repayment ability, (B) for which exposure and collateral documentation are deficient, and (C) which were improperly structured. Refer · SFS Canvas - M18 Loans TOC (For relevant extract, refer Attachment 20, Page no. A348 to A379) · SFS Canvas- M18 Loan disbursals workpaper (For relevant extract refer Attachment 35, Page no. A561 to A576) for our documentation of work done on loan

*disbursal samples”*

- 4.7.2. Para 63 of Guidance note on Internal Financial Controls states that “*Evaluating the design of a control involves considering whether the control, individually or in combination with other controls, is capable of effectively preventing, or detecting and correcting, material misstatements. Implementation of a control means that the control exists and that the entity is using it. There is little point in assessing the implementation of a control that is not effective, and so the design of a control is considered first. An improperly designed control may represent a material weakness or significant deficiency in the entity’s internal control.*” (Emphasis added).
- 4.7.3. Further, since the loans were disbursed only to group companies the auditor was required to give due consideration to the factors connected with the loan, including the borrower’s financial standing and credit rating, among others (Para 38 (a) (c) of the Guidance Note on the Companies (Auditor’s Report) Order, 2016).
- 4.7.4. However, on perusal of the WPs referred (WP ‘SFS Canvas - M18 Loans TOC (For relevant extract, refer Attachment 20, Page no. A348 to A379)’, test of disbursal dump for April 2017 to September 2017, and WP ‘SFS Canvas- M18 Loan disbursals workpaper (Attachment 35, Page no. A561 to A576)’, test of disbursal dump for October 2017 to March 2018), NFRA observes that the Audit Firm did not consider the financial standing of the borrowers. The work procedures of the Audit Firm in these WPs (as stated in detail in the table in Para 3 – S.No. 3) were limited to verification of the uniformity of the dump with approved memorandums and agreements. The Audit Firm did not consider the fact that the majority of loans disbursed by the Company were to loss-making entities with net worth either near to, or far below, the loan exposure that the Company had in them (refer to Annexure 4 of this PFC for details). The reporting by the Audit Firm under Clause 3 (iii) (a) of CARO (2016) is without sufficient appropriate audit evidence.
- 4.7.5. The Audit Firm has asserted that they had verified the CAMs and stated the fact that the Company has not “*grant loans (A) which were not supported by current and complete financial information and analysis of repayment ability, (B) for which exposure and collateral documentation are deficient, and (C) which were improperly structured*”. However, NFRA is unable to trace any work done by the Audit Firm based on which the above conclusion is drawn. There are no observations/comments/findings noted on CAMs by the Audit Firm. The Audit Firm has merely collected various CAMs without verifying if the Company has considered the financial standing of the borrowers. On perusal of CAMs on a sample basis, NFRA notes that the Company had sanctioned loans to group companies even though the CAM in itself indicated credit weakness. For example, CAM for a loan of ₹40 crore (WP ‘C 40.2.1 to C 40.2.6 Opening Samples CAMs\_IECCL Manual CAM 400 MN’) states that the loan was sanctioned to the IECCL to service its debts and for general corporate purposes (no further details were available regarding the end use of loans – refer end use of loans sub-section of this section of the PFC). The loan was sanctioned given the below facts:

- (i) IECCL portrayed huge financial losses since FY 2012. The cumulative amount of profit/loss from FY 2012 to 9M FY 2017 was ₹625 crore. In FY 2016 alone IECCL had a loss of ₹189 crore. However, in FY 2017 (the only projected year in the financial summary) IECCL expected a profit of ₹0.5 crore.
- (ii) There has been a huge gap between the actual performance and the projections.
- (iii) Gross Margins (GM) of IECCL have remained subdued on account of the cost and time overruns of the project. There has been a significant variation in the GM between the time of the bidding and the project execution/closure stage. Hence, the GM has been inadequate to service the corporate overloads and interest commitments.
- (iv) IECCL has a negative net worth of ₹22.8 crore and a borrowing of ₹1,983.2 crore.
- (v) In the context of continuous losses of the IECCL and the delayed turnarounds, external funding was difficult.

4.7.6. The Audit Firm’s reply that “*Credit Assessment memorandum (CAM) was used by the management for documenting the credit assessment for the purpose of loan. On the basis of CAM, credibility of the borrower is assessed and thereby disbursement memo was initiated. Audit team had verified that the Company’s policy was followed for loan granted by verifying CAM, Disbursement memo, term sheets on sample basis.*” clearly indicates that CAMs were the only controls, put in place by the management, to evaluate the creditworthiness of borrowers. However, the Audit Firm did no audit procedures to verify if the controls were operating effectively and were sufficient. NFRA notes that as against the contentions of the Audit Firm, they had not done any analysis whatsoever, to confirm if the internal controls were operating effectively.

4.7.7. Para 5.26 of TG-NBFC enumerates that the major audit concern is the adequacy of the recorded provision for loan losses. It also states that in establishing the nature, extent and timing of the work to be performed, the auditor should consider, inter-alia, the following factors: credit approval process including authorisation; loan documentation obtained from the existing/prospective borrower, test check the documents for borrower’s financial position/ creditworthiness; internal credit rating assigned to the borrower; and credit monitoring by credit committee.

4.7.8. NFRA has examined the various contentions made by the Audit Firm in reply to NFRA’s query Part I Section E-3: Q3 (a), along with the WPs referred, and observes as follows:

S No	WP	Audit Firm Response in Reference to WP	NFRA’s Observations on examination of the WP

1	SFS Canvas - M18 Loan Walkthrough (Attachment 19, Page no. A335 to A3 7)	Obtained knowledge and understanding of the Company's method of controlling credit risk.	The Audit Firm failed to verify that they had identified the points within the company's credit processes at which a misstatement, including a misstatement due to fraud, could arise. Refer Para 4.3 and Para 4.4 for our detailed comments.
2	SFS Canvas- M18 Credit SOP (Attachment 67, Page no. A1113 to A1134)	Had reviewed the lending policies of the Company and understood that the policies were reviewed and updated periodically to ensure they are relevant with changing market conditions	The Audit Firm failed to obtain a duly approved credit Policy of the Company. Refer to our comments in para 4 and the subsection on rollovers of this PFC for our detailed comments.
3	SFS Canvas – Quarterly Compliance Report (Attachment 100, Page no. A1560 to A1569)	Had examined the loan review reporting system of the Company and noted that it was designed appropriately and operating effectively.	The WP simply holds two quarterly compliance reports till September 30, 2017, signed by the executive management of the Company. There is no trace of any examination done by the Audit Firm. The Credit SOP of the Company states that “post disbursement documents are to be obtained within a period of 45 days from the date of disbursement”. However, the annexure forming part of the compliance report states there were over 30 exceptions, with some evidencing a delay of over 90 days. NFRA also notes from the WP that the Company had disbursed loans without receiving the “Post-sanction Stage”

			documents including loan agreements, end use of loan certificates, NOC of first charge holders, resolutions passed by the Board of Directors of the borrowers, accepted offer letters, among other key documents. The Audit Firm did not exercise any professional scepticism and did no test of controls over the effectiveness of controls over the loan disbursement process.
4	SFS Canvas - M18 Impairment summary analysis (Attachment 57, Page no. A1059 to A1063)	Had prepared a summary of the exposure to each group company of IL&FS including its loans and investments and set forth the nature and extent of our work procedures.	The WP only relates to the analysis done on the investment of the Company. Simply noting the loan exposure in the worksheet column does not support the Audit Firm's contentions. There is no trace of how this WP was used to "set forth the nature and extent of our work procedures"
5	SFS Canvas - M18 Loans TOC (Attachment 20, Page no. A348 to A379)	The Company did not grant loans (A) which were not supported by current and complete financial information and analysis of repayment ability, (B) for which exposure and collateral documentation are deficient, and (C) which were improperly structured.	Controls were grossly ineffective and insufficient and should have led the Audit Firm to question the effectiveness of the control design. Refer to our comments in para 5.5 to 5.7 above and the sub-section on collateral documentation.
6	SFS Canvas - Quarterly Compliance Report (Attachment 100, Page no. A1560 to A1569)	The Company prepared detailed and complete of credit monitoring reports.	Even though there were enough red flags questioning the loan disbursal process of the Company, no independent analysis/examination was

			done by the Audit Firm. Refer to point 3 of this table.
7	SFS Canvas - M18 Loan Walkthrough (Attachment 19, Page no. A335 to A347)	Did not observe any doubt on the competency of senior management and credit department personnel during our walkthrough of loans	The Audit Firm failed to verify that they had identified the points within the company's credit processes at which a misstatement, including a misstatement due to fraud, could arise. Refer to point 1 of this table.
8	SFS Canvas - M18 Impairment summary analysis (Attachment 57, Page no. A1059 to A1063)	We considered the extent of management's knowledge of the NBFC's own credit exposure and reviewed the loan companies. There were no borrowers which displayed the characteristics such as (A) Modified audit report, (B) Failure to comply with terms of agreements and covenants and (C) accounts where reviews not performed by NBFC management on a timely basis.	<p>The contention substantiates NFRA's conclusions that the Audit Firm did not exercise any professional scepticism and did not, at all, question the management regarding the loan disbursement process and creditworthiness of the borrowers. Further, merely relying on the fact that no borrowers had a modified audit report to review the loan companies, shows a complete lack of due diligence on part of the Principal Auditor. Further, NFRA also notes that the Audit Firm had noted the following in the workbook</p> <ul style="list-style-type: none"> <li>• "Nature of Investments" Tab – Noted one-liner business description of each Group Company.</li> <li>• "FS Check" – Noted auditor's opinion for each of the group Companies and the total equity value. For some Companies, the Audit Firm has considered SFS equity value and for some CFS equity value. No</li> </ul>

			<p>further analysis on the financial position or the basis for considering CFS or SFS is provided.</p> <p>Regarding the contentions of the Audit Firm that there were no borrowers who displayed the characteristics such as failure to comply with terms of agreements and covenants, refer to our comments in the sub-section “Rollovers and Evergreening”</p>
9	SFS Hard Copy File - File 3 (Part 1 of 2) - Flap H - W – HCPL (Page no. HCPL.1 to HCPL.4	We had considered whether the fair value of the security appears adequate to secure the exposure, including evaluation of collateral appraisals, including the appraiser's methods and assumptions for one sample loan where security valuations had been obtained	Refer to points 5 and 6 of this table and sub-section on collateral documentation for our detailed comments.
10	SFS Canvas - M18 Investment lead sheet and analysis.	We had evaluated the collectability of the exposure and considered the need for a provision against the loan	Refer to point 4 of this table.
11	NA	We reviewed periodic financial statements of the borrower and noted significant amounts and operating ratios	Oral explanations by the auditor, on their own, do not represent adequate support for the work auditor performed or conclusions the auditor reached.

4.7.9. 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. In light of the NFRA’s observations noted in the table above, the tests of control used by the Audit Firm were clearly irrelevant and inadequate to conclude that controls were in place and operating efficiently to determine the process of credit evaluation /creditworthiness of

the borrowers.

## **B. Observations made in the DAQRR**

4.8. NFRA has examined in detail the replies submitted by the Audit Firm on the above observations in the PFC and concluded in the DAQRR as follows:

4.8.1. Audit Firm's Response (Para 4.7.1 to Para 4.7.6): On pages 168 & 172 of the reply to NFRA's PFC, the Audit Firm asserted that *"SRBC submits that we had exercised reasonable care and skill in conduct of audit of IL&FS and that they were neither involved nor expected to be involved in the business decisions. It is not in the realm of the auditors to ascertain correctness of business decisions taken by the management. As an auditor, we had evaluated whether the loans disbursed during the year ended March 31, 2018, were prejudicial to the interests of the Company or not. Based on our evaluation, we did not find any specific case which required reporting in our audit report on SFS of IL&FS. For audit procedures performed and document references, refer Para 46 below."*

The Audit Firm quoted Para 23, 30, 31, and 32 of the Guidance Note on CARO, 2016 and specifically with respect to credit evaluation stated in its reply that

a. *"the Company had a process of credit evaluation. The Credit evaluation was performed by Project Finance Department of the Company. Credit Assessment memorandum (CAM) was used by the management for documenting the credit assessment for the purpose of loan. On the basis of CAM, credibility of the borrower is assessed and thereby disbursement memo was initiated. Audit team had verified that the Company's policy was followed for loan granted by verifying CAM, Disbursement memo, term sheets on a sample basis*

*SRBC is surprised on NFRA's prima facie comments / observation / conclusions that since no observation / comments / findings are noted on CAMs by SRBC, SRBC had merely collected various CAMs. We would like to bring to NFRA's notice we had verified the CAMs and it is not necessary that each and every documents obtained during the audit process has some observation / comments / findings. Refer IL&FS-Standalone Canvas Files Folder – 244.1 to 244.8 CAM.zip, IL&FS- Standalone Canvas Files Folder – 240.1 to 240.6 Disbursal CAM.zip and IL&FS-Standalone Canvas Files Folder – 238.1 to 238.10 Term sheets and offer letter.zip."*

b. *"With respect to workpaper 'C 40.2.1 to C 40.2.6 Opening Samples CAMs\_IECCL Manual CAM 400 MN', this CAM was obtained for verifying opening balance in compliance with SA 510 and does not pertain to loan disbursed during the year. Accordingly, it was not relevant for reporting under this clause as the reporting is on loans disbursed during the year"*

c. *"We had also factored in financial standing which was demonstrated by our workpaper "M18 Investment leadsheet and analysis", as we have considered total*

*exposure i.e. investments made and loans given to group companies. Based on their financial statements and valuation report, we have determined if any impairment was required on equity investments and if there was no impairment required on equity investments, which come last in the hierarchy for payment at the time of liquidation, then that implies no impairment on loans. Refer IL&FS-Standalone Canvas Files Folder - 215.1 to 215.8 M18 Impairment summary analysis and IL&FS- Standalone Canvas Files Folder - 207.1 to 207.14 M18 Investment leadsheet and analysis.”*

- 4.8.2. NFRA Observations: NFRA notes that the Audit Firm has not referred any new WP that was not examined by NFRA in its PFC, in its response dated 14<sup>th</sup> April 2021. Nevertheless, NFRA has re-examined the audit file with respect to the Audit Firm’s assertions.
- 4.8.3. As established in Para 4.7.2 and Para 4.7.3 above, the Audit Firm was required to give due consideration to the financial standing of the borrowers, for reporting under clause 3 (iii) (a) of CARO, 2016, and to evaluate the design and operating effectiveness of controls.
- 4.8.4. However, as noted in NFRA’s PFC, the Audit Firm did not consider the financial standing of the borrowers. Rather, even when the audit evidence indicated that the loans granted were prejudicial to the Company’s interest, the Audit Firm did not exercise professional scepticism. With regard to the Audit Firm’s assertion, as noted above (Para 4.8.1), NFRA notes the following:

- (a) The Audit Firm did not test the operating effectiveness of the control in place (CAM’s) for the risk identified by the Audit Firm that the “*Possibility of loans disbursed without adequate evaluation*”. In the WP ‘M18 Loans TOC’, the Audit Firm has only noted that

*“We have taken 14 samples and on the basis of the samples, we have verified that CAM's are duly approved by authorised personnel. Refer Sample Testing”.*

NFRA notes that the only test of control performed by the Audit Firm was to verify that the CAM is approved by the authorised personnel, under the Company’s Unified Approval Framework (UAF).

On referring to a few of the CAMs, for the sample selected, NFRA further notes that the CAMs referred to in the excel workbook against each of the loans do not include any analysis of the financial standing of the borrowers. The 10-15 page document (each CAM), includes the security details, repayment structure and options, purpose of loans, billing details, option for prepayments details, special conditions, details of exposure to borrower and RPT assessor details.

Therefore, the CAMs of the sample selected does not align with the Audit Firm’s assertion (Para 4.8.1 (a)) that “*Credit Assessment memorandum (CAM)*

was used by the management for documenting the credit assessment for the purpose of loan”.

(b) Para A18 of SA 200 states that “Professional skepticism includes being alert to, for example:

- *Audit evidence that contradicts other audit evidence obtained.*
- *Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.*
- *Conditions that may indicate possible fraud.*
- *Circumstances that suggest the need for audit procedures in addition to those required by the SAs.”*

Therefore, NFRA notes that the assertions of the Audit Firm (Para 4.8.1(b)) are misleading. The Company disbursed loans worth Rs. 450.5 Crores to IECCL during the FY 2017-18. Considering the fact that the audit evidence obtained by the Audit Firm clearly indicated credit weakness of IECCL, and the Company continued disbursing loans to the borrower, the Audit Firm should have questioned its conclusion that the controls of the Company, with regard to adequate evaluation, are operating effectively.

(c) As noted in [Para 4.7.8](#) (PFC), the WPs are only focused on impairment testing of the equity investments. The assertion ([Para 4.8.1 \(c\)](#)) of the Audit Firm that “we have considered total exposure i.e. investments made and loans given to group companies” with respect to WP ‘M18 Investment leadsheet & analysis’, is misleading. The Audit Firm had merely noted the loan exposure and the fact that all the Companies have positive equity value. No consideration was given to the quantum of existing borrowings of the borrowers (not just from the Company), their Credit ratings/past record of timely repayments, financial performance, expected cash flows, historical trends of actual performance v/s the projections, among other such factors, that were necessary for considering the financial standing of the borrowers.

The fact that this assertion is also factually incorrect is evident since the Work Done tab of the WP ‘M18 Investment leadsheet and analysis’ states the following:

- (i) *“Obtain a schedule of investments and agree the same with the financial statements. (Refer TB tab)*
- (ii) *Obtain list of purchase and sale of investments and verify all supporting documents such as Investment approval memorandum, noting in board minutes ,bank tracing for redemption or sale of*

*investment (Refer M18 Investment TOC)*

- (iii) *We have verified existence of investment through physical verification and have reconciled with DP statement (M18 Investment Existence)*
- (iv) *We have obtained brief summary of nature of investment made by company (Refer tab Nature of Investment)*
- (v) *We have ensured valuation of Investment as per accounting standard 13 i.e for Short term Investment at lower of net realisable value or carrying cost and for long term investment at carrying cost.*
- (vi) *Obtain direct balance confirmation for related party and compare the same with financial statements, inquire about exceptions, if any.”*

Even the conclusion section of the WP only states that “*Investment is appropriately (sic) stated in financial statement as on March 31, 2018*”.

- 4.8.5. Therefore, the reporting by the Audit Firm under Clause 3 (iii) (a) of CARO (2016) is without sufficient appropriate audit evidence.

#### **C. Final Observations and Conclusions of the AQRR**

- 4.9. NFRA has examined in detail the replies to the DAQRR and the oral explanations submitted by the Audit Firm on the above observations in the DAQRR and concludes as follows:

4.9.1. Audit Firm’s Response: The Audit Firm states that:

- a. *“Considering the nature of business of IL&FS, as evident from Para 40 of Memorandum of Association of IL&FS [Refer IL&FS-Standalone Canvas Files Folder - 70.1 to 70.234 Annexure-1-IL&FS MOA AOA-Final - Sept 2], **IL&FS is required to support its group companies to manage their cash flows.** The verification of terms of agreement was a general audit procedure which was planned and performed. Disbursement of loan to group companies had not been considered as a significant risk of material misstatement with respect to SFS of IL&FS in the professional judgement of the engagement team, however, the required audit procedures have been performed. Disbursement of loans to group companies is the primary objective of IL&FS as a CIC and **there was sufficient control on disbursement.**” (Emphasis added).*
- b. *“It is pertinent to note that the general practice of the Company was not to reperform the credit assessment, in the cases where limit of loans were approved and disbursement has been made against those limits. Also in cases where credit assessment was already done by the management during manual approval process, at the time of CAM regularisation in AXAPTA,*

*only reference of manually approved document was given.*

*Further, the credit assessment was done by management after considering credit rating, financial standings, value of assets, etc., as considered deem fit. It is not in realm of auditor to determine what all factors should be considered by management while doing such assessment or whether decision by the management of sanctioning the loan is right decision.”*

- c. *“For the disbursement made to IECCL during the year, the management had prepared a separate CAM and the same was approved by authorized signatories and was also approved by the Audit Committee and Board of Directors of the Company. SRBC would also like to reiterate that auditor are not expected to perform the credit assessment which has been performed by the experts who have been entrusted with the specific job. NFRA should also appreciate the fact that credit assessment and decision to lend to the group companies was a business decision taken by the management and SRBC as statutory auditors of the Company, had no role to play in these decisions.”*
  - d. *“We would like to point out that impairment assessment for loans given and investment made to each parties, was done together. We would like to reiterate that in our workpaper “M18 Investment leadsheet and analysis”, we had considered total exposure i.e. investments made and loans given to group companies. Based on the assessment carried by us for each company, we concluded that wherever there was a value for equity instruments, there was no impairment of loans as value of equity instrument is a residual value after considering payment to be made against outstanding borrowings of that Company. Refer IL&FS Standalone Canvas Files Folder - 215.1 to 215.8 M18 Impairment summary analysis and IL&FS Standalone Canvas Files Folder - 207.1 to 207.14 M18 Investment leadsheet and analysis.”*
  - e. *“Reporting under clause 3(iii)(a) of CARO 2016, requires the auditor to comment whether the terms and conditions of loans granted during the year are prejudicial to the interest of the Company. Accordingly, we had performed following procedures to conclude that the terms and conditions such rate of interest, security, terms and period of repayment and restrictive covenants, if any, is not prejudicial to the interest of the Company. Hence, it is pertinent to note that for reporting on this clause, verifying end use of loan, impairment assessment and credit evaluation by auditor is not required.”*
- 4.9.2. NFRA Observations: NFRA notes that the Audit Firm has not referred to any new WP. Nevertheless, on the Audit Firm’s assertion, as noted above (Para 4.9.1), NFRA observes the following:

- a. As explained in the DAQRR the Audit Firm failed to perform sufficient appropriate audit procedures in this regard. After examining the WPs referred by the Audit Firm NFRA has already concluded in the DAQRR that the tests of control used by the Audit Firm were inadequate to conclude that controls were in place and operating efficiently to determine the process of credit evaluation /creditworthiness of the borrowers. The Audit Firm has failed to prove otherwise. Thus, the Audit Firm’s contention that, “Disbursement of loans to group companies is the primary objective of IL&FS as a CIC and **there was sufficient control on disbursement**” (emphasis added) is not acceptable in the absence of evidence. The Audit Firm was required to give due consideration to the financial standing of the borrowers, for reporting under clause 3 (iii) (a) of CARO, 2016, and to evaluate the design and operating effectiveness of controls which it failed to do.
- b. As already noted by NFRA the CAMs referred to in the excel workbook against each of the loans, do not include any analysis of the financial standing of the borrowers. The 10-15 page document (each CAM), includes the security details, repayment structure and options, purpose of loans, billing details, option for prepayments details, special conditions, details of exposure to the borrower, and RPT assessor details. Thus, the Audit Firm’s assertion that credit assessment was performed by the management is not supported by any WP. Also, as per Para 5.26 of TG-NBFC the Audit Firm was required to *test check the documents for borrower’s financial position/ credit worthiness; internal credit rating assigned to the borrower; and credit monitoring by the credit committee*, which the Audit Firm failed to perform. Thus, the Audit Firm’s contention that it is not required to check the credit assessment of the borrowers is incorrect.
- c. The only procedure performed by the Audit Firm was verifying the approval of authorized signatories. Even though the credit weakness of IECCL was very clearly visible from the evidence obtained by the Audit Firm, it failed to question the management about the decision to disburse further loans and also failed to reconsider its decision that the controls of the Company, on adequate evaluation, are operating effectively.
- d. NFRA would like to reiterate that no consideration was given to the quantum of existing borrowings of the borrowers (not just from the Company), their Credit ratings/record of timely repayments, financial performance, expected cash flows, historical trends of actual performance v/s the projections, among other such factors, that were necessary for considering the financial standing of the borrowers. The Audit Firm has not given any reply to the above observation of NFRA.
- e. The Audit Firm’s contention that reporting under clause 3 (iii) (a) of CARO

credit evaluation is not required shows its lack of understanding. If the management is issuing new loans to entities that do not have creditworthiness, then this is also a possible situation that is prejudicial to the interest of the Company, which the auditor has to rule out based on the evidence before giving a clean report under CARO. Thus, NFRA reiterates its conclusion that the Audit Firm reported under the clause without sufficient appropriate audit evidence and hence failed in conducting the Audit as per SAs.

- f. 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 new loans indicates the distressed situation of the group companies. Any failure of such companies 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 information provided by the management. There is no examination of the ground realities to confirm the conclusions reached based on such a high-level understanding. Examination of all factors is of paramount importance as **IL&FS is required to support its group companies to manage their cash flows**, but at the same time, it is not always necessary that such support should only be in the form of a loan to a group company which is already under distress.

#### A. Prima Facie Observations/Conclusions (PFC)

##### End-Use of Loans

4.10. In its Prima Facie Conclusions, NFRA conveyed the following:

- 4.10.1. In response to NFRA's query Part B- 4.3.viii.e the Audit Firm stated that "*In TOC we had verified that management monitors the end use of loan disbursed by obtaining end use certificate from the party. The same was evident through a system report called 'Legal Ok' generated from their IT system 'AXAPTA' which confirms that conditions of loan documents had been met. Refer · SFS Canvas- M18 Loans TOC (For relevant extract refer Attachment 20, Page no. A348 to A379) · SFS Canvas- M18 Loan disbursals workpaper (For relevant extract refer Attachment 35, Page no. A561 to A576)*"
- 4.10.2. On perusal of the stated WPs and the Audit File, on the whole, NFRA could not trace any end-use certificates as has been stated by the Audit Firm.
- 4.10.3. NFRA further notes that both the referred WPs (SFS Canvas- M18 Loans TOC and SFS Canvas- M18 Loan disbursals workpaper) contain test of controls performed by the Audit Firm on a sample of loans disbursed during FR 2017-

18. On perusal of the disbursal sample, as documented by the Audit Firm, NFRA noticed that, in a majority of the cases, the purpose of the loans disbursed was to service the debts, among other general corporate purposes. In two of the samples, there was no purpose stated altogether.

- 4.10.4. Para 5.26 of TG-NBFC requires the Audit Firm to “verify whether there has been any window dressing, i.e., sanction of new loans to repay an existing doubtful loan. This method may be resorted to by the NBFC to cover up bad loans.”
- 4.10.5. In spite of practices, as enumerated in the Rollovers and Evergreening section of this PFC, NFRA did not find any evidence in the audit working papers that the Audit Firm had carried out substantive procedures to assess risks associated with the existing loans of the borrowers, which were purported to be repaid by the borrowing companies out of loans from the Company. The Audit Firm had thus failed to meet the requirements of Para 6 of SA 500.

#### **B. Observations made in the DAQRR**

- 4.11. NFRA has examined in detail the replies submitted by the Audit Firm on the above observations and concluded in the DAQRR as follows:
- 4.11.1. Audit Firm’s Response: The Audit Firm asserted that “*we had verified that management monitors the end use of loan disbursed by obtaining end use certificate from the party. The same was evident through a system report called ‘Legal Ok’ generated from their IT system ‘AXAPTA’ which confirms that conditions of loan documents had been met. We had verified the ‘Legal Ok’ report on sample basis as documented in our workpaper IL&FS- Standalone Canvas Files Folder - 236.1 to 236.12 M18 Loan disbursements workpaper and IL&FS-Standalone Canvas Files Folder - 235.1 to 235.22 M18 Loans TOC.*” Further, the Audit Firm quoted Para A3 and A7 of SA 230 and stated that “*Basis the above-mentioned procedure, SRBC had observed that the Company’s control over obtaining end-use certificate from the borrower is operating effectively. Paragraphs of SA 230 referred below, does not necessitate auditors to retain each and every document referred by it during the audit. **SRBC was not required to obtain and retain end use certificate** as part of audit documentation because audit file cannot be treated as substitution of company’s accounting records and Audit Firm cannot be expected to document every matter considered or professional judgement made. As the end use certificates are part of Company records, if required can be verified from the Company.*”
- 4.11.2. NFRA Observations: NFRA notes that the Audit Firm has failed to provide any reference to end-use certificates from the Audit File. The assertion of the Audit Firm that “*we had verified that management monitors the end use of loan*

*disbursed by obtaining end use certificate from the party” is without any basis and can be considered only as an afterthought since the Audit Firm had only obtained the “Legal Ok” reports that merely list down the date of receipt of each document by the respective departments. Para 108 read with Para 110 and Para 111 of GN-IFC states that the auditor should test the design effectiveness of controls and if they satisfy the company's control objectives and can effectively prevent or detect errors or fraud. The auditor was required to test the operating effectiveness of control through a mix of inquiries of appropriate personnel, observation of the company's operations, inspection of relevant documentation, and re-performance of the control and conclude the reliability of the “Legal Ok” report.*

- 4.11.3. Therefore, NFRA notes that merely obtaining the ‘Legal Ok’ report is not sufficient to conclude that monitoring control *that confirms that all the documents related to a loan such as end use certificate, other post disbursement documents, etc. had been obtained by the Company*, is operating effectively is not as per the requirements of the GN-IFC and SA 230.
- 4.11.4. Further, for a Company, whose majority loans are to related parties, and are for the purpose of servicing the debts, among other general corporate purposes (Refer [Para 4.10.3](#) for details), the Audit Firm was required to “*verify whether there has been any window dressing, i.e., sanction of new loans to repay an existing doubtful loan. This method may be resorted to by the NBFC to cover up bad loans.*” (Para 5.26 of TG-NBFC). However, the Audit Firm failed to obtain sufficient appropriate audit evidence to conclude that controls were designed effectively and were operating effectively.
- 4.11.5. Therefore, NFRA re-iterates its PFC conclusion that the Audit Firm had not carried out substantive procedures to assess risks associated with the existing loans of the borrowers, which were purported to be repaid by the borrowing companies out of loans from the Company. The Audit Firm had thus failed to meet the requirements of Para 6 of SA 500.

### **C. Final Observations and Conclusions of the AQRR**

- 4.12. NFRA has examined in detail the replies to the DAQRR and the oral explanations submitted by the Audit Firm on the above observations and concludes as follows:
  - 4.12.1. Audit Firm Response: The Audit Firm states as follows:
    - a. “*SRBC is of the view that verification of end use certificate is a routine operating matter to be carried out by the management. It is not required for auditors to verify end use certificates for loans disbursed by the Company. However, as documented for our Test of Control (TOC) audit procedures, we had verified the management’s monitoring process for end use of loan given. The same was evident through a system report called*

*‘Legal Ok’ generated from their IT system ‘AXAPTA’ which confirms the monitoring by the management of end use of loan given.”*

- b. *The Audit Firm further states that “regarding NFRA’s comment on non-verification of window dressing by SRBC, we would like to state that the decision of sanctioning a loan for a particular purpose, was that of the management and was approved by the Committee of Directors. As statutory auditors of the Company, we had no role to play in the business decision taken by the management to manage day to day affairs of the Company. The role of auditor is to perform appropriate auditing procedures to ascertain that management has a control framework for sanctioning and monitoring of loans given. We as an auditor had verified, on a sample basis, that term sheets contain monitoring of end use of the loans and also verified the control through which Company monitors the end use.”*
- c. *“SRBC would like to highlight that while performing our audit for the year ended March 31, 2018, we had not noted any incidence of window dressing. Even NFRA has not provided any specific instance leading to window dressing in the paragraph of DAQRR referred above. It seems that NFRA’s comment regarding window dressing is based on conjecture. The comment of NFRA that the Company had sanctioned new loans to repay existing doubtful loans cannot arise as the management had not identified any existing loans as doubtful. It also appears that NFRA, rather than understanding and considering the facts prevailing at the time of the issuance of the audit opinion on the financial statements, has applied facts prevailing in hindsight to form conclusion.”*
- d. *“NFRA assumes that the auditor should assess the risks of window dressing without any indication of risk at the time of assessment, is not a correct proposition. The auditor is required to assess the risks for material misstatements and fraud, and if during the performance of audit procedures he comes across cases of window dressing, he need to take appropriate steps to deal with the situation. NFRA’s allegation is thus not sustainable in view of what the auditor is required to do at risk assessment stage.”*

#### 4.12.2. NFRA Observations

- a. *Regarding the Audit Firm’s response that, “verification of end use certificate is a routine operating matter to be carried out by the management. It is not required for auditors to verify end use certificates for loans disbursed by the Company” NFRA observes that controls are operating effectively or not is also a routine matter but that does not mean that the auditor is not required to verify the same. Thus, NFRA finds that the response of the Audit Firm is not satisfactory. Merely obtaining the*

'Legal Ok' report is not sufficient to conclude that the monitoring control is operating effectively. It is also not as per the requirements of the GN-IFC and SA 230 as explained in the DAQRR.

- b. As per Para 5.26 of TG-NBFC, the Audit Firm was required to “*verify whether there has been any window dressing, i.e., sanction of new loans to repay an existing doubtful loan. This method may be resorted to by the NBFC to cover up bad loans.*” However, the Audit Firm failed to perform sufficient appropriate audit procedures and obtain audit evidence to conclude that controls were designed and operating effectively. The reply of the Audit Firm quoted in para ‘b’ above is sufficient evidence that the aspect of window dressing is not at all verified by the Audit Firm. As there is no audit evidence available in this regard, the submissions in para ‘c’ above do not have any merits. It is not the job of NFRA to find out instances of window dressing. NFRA examines the Audit File for evidence that the auditor has done so. In the absence of any evidence to prove such a verification, NFRA can only presume that window dressing is present in the Company and the Auditor Failed to verify the same.
- c. Notwithstanding, NFRA has provided various instances in point no. 4.13.13 below whereby the borrowers repaid loans just after fresh loans were disbursed to them by IL&FS. It must be noted that in the process of evergreening loans entities **revive a loan on the verge of default by granting further loans to the same firm**. Some of the consequences of evergreening are a reduction in reported defaults in the short run, followed by an eventual explosion in default rates. Evergreening is done to hide the default in loans. The Audit Firm’s response that, “*The comment of NFRA that the Company had sanctioned new loans to repay existing doubtful loans cannot arise as the management had not identified any existing loans as doubtful*” has no merits in the absence of any checks done by the Audit Firm. Professional scepticism demands that the Audit Firm be required to verify the creditworthiness of the borrowers who repaid loans just after fresh loans were disbursed to them by IL&FS which the Audit Firm did not do. The evergreening/window dressing has an impact on the accounting entries as well since the transactions do not reflect the actual substance.
- d. Thus, various indicators should have made the auditor assess window dressing of loans as a risk of material misstatements and thus the auditor was required to perform sufficient appropriate procedures to address the risk. Also, Para 18 of SA 330 states that “*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 failed to assess and address the risk appropriately.

- e. Therefore, NFRA re-iterates its PFC conclusion that the Audit Firm had not carried out substantive procedures to assess risks associated with the existing loans of the borrowers, which were purported to be repaid by the borrowing companies out of loans from the Company. The Audit Firm had thus failed to meet the requirements of para 6 of SA 500.

## **Rollovers and Ever-Greening**

### **A. Prima Facie Observations/Conclusions (PFC)**

- 4.13. In its Prima Facie Conclusions, NFRA conveyed the following:
  - 4.13.1. Master Direction - Non-Banking Financial Company - Systemically Important Non- Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 (NBFC-ND-SI Direction) states that, “*A restructured account is one where the NBFC, for economic or legal reasons relating to the borrower's financial difficulty, grants to the borrower concessions that the NBFC would not otherwise consider. Restructuring shall normally involve modification of terms of the advances / securities, which shall generally include, among others, alteration of repayment period / repayable amount / the amount of installments / rate of interest (due to reasons other than competitive reasons).*” The norms further state that “*In the cases of roll-over of short term loans, where proper pre-sanction assessment has been made, and the roll-over is allowed based on the actual requirement of the borrower and no concession has been provided due to credit weakness of the borrower, then these shall not be considered as restructured accounts. However, if such accounts are rolled-over more than two times, then third roll-over onwards the account shall be treated as a restructured account.*” (Emphasis added). Therefore, it is evident that the RBI only allows the rollovers of short term loans to be considered as standard accounts when no concession has been provided due to the credit weakness of the borrower. Also for these accounts to be considered standard accounts, RBI states that they should not have been rolled over more than two times. By definition, there cannot be any rollover in the case of long term loans. Any concession on long term loans, to a borrower, which normally involves modification of terms of the advances/securities, which shall generally include, among others, alteration of repayment period/repayable amount/the amount of instalments/ rate of interest is to be considered as restructured accounts.
  - 4.13.2. However, NFRA notes that the Credit SOP, with regard to policy on rollovers, does not take into account any such pre-condition and simply states that
    - a. “*A rollover constitutes an extension of a satisfactory credit, secured or unsecured, beyond existing maturity at the request of the client and where continuation of assets is desired by IL&FS*”

The Credit SOP does not even define if the rollover is available for only short-

term loans, or long-term loans, as well.

4.13.3. On perusal of the WP ‘274.1 to 274.29 M18 Closing Loans outstanding’, NFRA notes that the Audit Firm had noticed the above-stated lacuna in the rollover policy of the Company and had noted the following observations:

- (a) *“During the year ended March 31, 2018, IL&FS has rolled over loans of Rs 928 cr (no of parties: 9) of which Rs 114 cr (no of parties: 3) is outstanding as at March 31, 2018.*
- (b) **IL&FS has not considered the above accounts as sub-standard accounts and accordingly not created provision of 10% as per CIC Directions (i.e. provision of Rs 11.4 crore on the outstanding amount of Rs 114 crore)” (emphasis added)**

4.13.4. The WP also noted that rollovers were granted on both long term loans (66% of the rollovers) and short term loans (34% of the rollovers). However, the Audit Firm noted that based on management’s reply and their analysis of RBI guidelines, the rollovers are to be treated as standard accounts since

- (a) *“There is no specific guidelines for rollover of loans for CIC companies*
- (b) *Internal company policy and NBFC ND SI guidelines permits the same*
- (c) *RBI has not raised any negative observations in its inspections*
- (d) *We have verified that the entire outstanding amount of rollover loans has been recovered post balance sheet date*
- (e) *We have however recommended to the management and the audit committee that the documentation on the same needs to be strengthened.” (Emphasis added)*

4.13.5. At the outset, NFRA notes that the above reasoning, with respect to RBI guidelines, noted in the WP is factually incorrect. Master Directions – NBFC-ND-SI, which are applicable to CIC-ND-SI, only permit rollover of short term loans (not more than two times) to not be considered as restructured accounts. Any concession offered otherwise, including rollover of short term loans for more than two times is a restructured account. Since RBI Master Directions – NBFC-ND-SI does not define any rollover of long term loans, any changes/modifications/concessions in the terms and conditions of long term loans will result in their treatment only as restructured accounts. Therefore, the Audit Firm’s statement that “NBFC ND SI guidelines permits the same”, raises a question as to whether the Audit Firm indulged in a deliberate effort with the Management to whitewash the accounts of the Company, since in the case of

long term loans, any concession offered is only restructuring, and these restructured accounts do not remain standard assets. However, the Audit Firm failed to question the management and bring the same to the notice of TCWG. Simply communicating that the “*documentation on the same needs to be strengthened*” cannot be construed as reporting a serious lacuna in the credit policy.

4.13.6. Master Direction - Core Investment Companies (Reserve Bank) Directions, 2016, Para 16 (4) states, “sub-standard asset” shall mean:

(a) “*an asset which has been classified as non-performing asset for a period not exceeding 12 months;*

(b) *an asset where the **terms of the agreement regarding interest and / or principal have been renegotiated or rescheduled or restructured** after commencement of operations, until the expiry of one year of satisfactory performance under the renegotiated or rescheduled or restructured terms”* (emphasis added).

Therefore, NFRA concludes that the rolled over long term loans were required to be classified as sub-standard assets. Even for the short term rollovers, the pre-condition regarding the grant of the rollover (i.e. no concession was provided due to credit weakness of the borrower) and the maximum number of two rollovers, should have been considered to classify them as standard accounts.

4.13.7. Para 18 of SA 250 states that “*If the auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the auditor shall obtain: (a) An understanding of the nature of the act and the **circumstances in which it has occurred**; and (b) Further information to evaluate the possible effect on the financial statements”* (emphasis added).

4.13.8. It is evident from the Auditor’s observation, as noted in para 7.3 of this section of the PFC, that the Audit Firm was aware of information concerning an instance of non-compliance/suspected non-compliance with the RBI’s direction. However, instead of understanding the circumstances in which the rollover transactions occurred, including the initial rollover and subsequent repayments, the Audit Firm confined its audit procedures focused to support the management’s view that:

(a) “*IL&FS has a defined credit policy which it follows for rollover of loans (refer WP M18 Credit SOP). This policy defines the circumstances under which loans due can be rolled over. As per this policy, a loan which is rolled over for a period of 6 months is not considered as a sub-standard asset.*

(b) *This policy has been reviewed by RBI at the time of their inspection of FY 2015 accounts and there have been no negative observations from RBI in this regard.*

(c) *Further, since the above loans have been recovered post balance sheet date there is no risk of credit deterioration perceived by the management.*

The only test of controls/audit procedures adopted by the Audit Firm to understand the rollover transaction and its impact (WP ‘274.1 to 274.29 M18 Closing Loans outstanding.xlsx’) was limited to verifying management’s stand that the repayments on the rolled over accounts have been received.

4.13.9. To understand the circumstances under which the rollovers were granted, NFRA examined various “Rollover Memos”, forming part of the audit file, and observed that many of the rollovers were granted because of the credit weakness of borrowers. These rollovers, therefore, constituted the corresponding loans into sub-standard assets. The stated rollovers used for examination, are summarized in the table below.

<b>Borrower</b>	<b>Loan Details</b>	<b>Rollover Tenure</b>	<b>Justification Provided in the Memo</b>
IMICL	89 crore Infra Term loan	6 Months	<p>a) The Company is currently going through a liquidation constraint and in context of the same, has request for a rollover of the facility</p> <p>b) The Company has identified a few assets/investments for liquidation in next 3/4 months. The Company has issued mandates to IFIN for the liquidation of its preference shares in ITNL. Further, the Company is in discussion with investors for part liquidation of their stake in IPTF, Fujairah</p> <p>c) The proceeds would be used by the Company to repay the debts in the next six months.</p>

ISSL Market Services Limited	0.5 Short Term Loan Crore	3 Months	<p>a) IMarkServ anticipated the liquidation of certain financial assets/investments, which has been delayed and is expected in the near future</p> <p>b) The liquidation proceeds would be utilized by the Company to repay the debt</p>
IEDCL	288 crore	6 Months	<p>a) The Company has a short term liquidity mismatch due to postponement of certain cash flows</p> <p>b) The Company proposes to repay the installment within a period of six months through its internal accruals/refinance</p>
PSRDCL	31 crore	6 Months	<p>a) Toll collection has commenced on the Pune Sholapur project in August 2013. However, the same is inadequate to service the debt. PSRDCL is still looking to tie up long tenor funds for the project to ease the cash flow mismatch</p> <p>b) In view of the above, PSRDCL has requested for extension in repayments of the outstanding loan of Rs. 31 crore by 6 months</p>

4.13.10. Para 5.26 of the TG-NBFC states that the major audit concern is the adequacy of the recorded provision for loan losses. In establishing the nature, extent and timing of the work to be performed, the auditor should, look at KYC procedures performed, credit approval process, loan documentation, internal credit rating assigned to borrower, credit monitoring by credit committee, scope and extent of work performed by internal audit, collateral coverage and verify window-dressing/ever greening, etc. However, NFRA notes that the Audit Firm did not consider credit approval process

and internal credit rating of the borrowers as part of its audit procedures. The Audit Firm also did not consider window dressing as a risk and did no test of controls to confirm the repayment source/accounts, even in the case of rolled over assets. Further, NFRA was even unable to trace any of the bank statements, as noted by the Audit Firm in the WP, through which the Audit Firm confirmed the repayment of the rollover facilities.

- 4.13.11. Clause b of the sub-section (1) of Section 143, of the Companies Act, 2013 states that the auditor should look into “*whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company.*”
- 4.13.12. As per Annexure VII of the Master Directions – NBFC-ND-SI titled “RBI Norms on Restructuring of Advances by NBFC”, no account shall be taken up for restructuring by the NBFCs unless the financial viability is established and there is reasonable certainty of repayment from the borrower, as per the terms of restructuring package. Any restructuring done without looking into cash flows of the borrower and assessing the viability of the projects/activity financed by NBFCs shall be treated as an attempt at evergreening a weak credit facility and shall invite supervisory concerns/action.
- 4.13.13. On a detailed perusal of WP ‘C 272.1 to C 272.12 M18 Loan disbursements workpaper’, for total loans disbursement details, WP ‘274.1 to 274.29 M18 Closing Loans outstanding’, for loans repayment details, and WP ‘C 332.1 to C 332.19 M18 Interest Income’, for loans outstanding and their maturity, rollover and due dates details, NFRA notes that there were multiple instances, a few of which are listed in the table below, whereby the borrowers repaid loans just after fresh loans were disbursed to them by IL&FS.

<b>Borrower</b>	<b>Total Loan Disbursed in FY 2017-18</b>	<b>Total Loan Repayment in FY 2017-18</b>	<b>Total Loans Outstanding</b>	<b>Observations</b>
IL&FS Engineering and Construction Company Limited	450.5	114.9	1,348.5	On 27 <sup>th</sup> March, 2018, IL&FS disbursed a loan of Rs.169.0 crore. On 28 <sup>th</sup> March, 2018, IECCCL made various repayments aggregating to Rs.114.0 crore. Based on the WP – C 332.1 to C 332.19 M18 Interest Income (UA 1.1 Interest Recomp - tab), Rs. 84.0 crore of this repayment was towards instalments that were overdue and Rs.30.0 crore towards loans that were

				initially rolled over.
IL&FS Maritime Infrastructure Company Ltd	658.7	739.6	584.1	<ul style="list-style-type: none"> <li>• On 14th Sep 2017, IL&amp;FS disbursed two loans, worth Rs.51.0 crore and Rs.38.3 crore, and on the same date, IMICL made repayments worth Rs.57.8 crore.</li> <li>• On 27th Sep 2017, IL&amp;FS disbursed a loan of ₹130.0 crore. On the same date, IMICL repaid a loan worth Rs.100.0 crore (3 days prior to its maturity).</li> <li>• On 26th March 2018, IL&amp;FS disbursed loans of Rs.85.4 crore, Rs.13.0 crore and Rs.3.0 crore to IMICL. During the next 5 days, IMICL repaid the entire Rs 150.0 crore, and Rs.31.0 crore facilities. IMICL also repaid Rs.7.8 crore and Rs.3.0 crore towards two other separate facilities.</li> </ul>
IL&FS Energy Development Co Ltd	1,881.9	1,921.3	499.9	On 22nd February 2018, IL&FS disbursed loan of Rs.130.0 crore and on the very next day, IEDCL repaid its loan worth Rs.130.0 crore.

4.13.14. Para 18 of SA 330 states that “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”. 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.”

4.13.15. Apart from multiple cases, as noted in the table above, wherein the Company had disbursed loans to the borrowers, on the same date or just a few days before repayment of existing loans, there were ample other red flags including credit appraisals, collateral, and end use of loans, that should have alerted the Audit Firm to consider the risk of

window dressing / ever greening of loans being done by the Company. However, there is no evidence in the WP that the Audit Firm had carried out any substantive procedures to assess risks associated with the existing loans of the borrowers, which were clearly seen to be repaid by the borrowing companies out of loans from IL&FS. The Audit Firm had failed to obtain sufficient appropriate evidence to verify the credit ratings of the borrowers, repayment capacity of the borrowers and understand the end use of loans. Thus, the Audit Firm failed to meet the requirement of para 18 of SA 330, para 6 of SA 500 and para 17 of SA 200.

## **B. Observations made in the DAQRR**

4.14. NFRA has examined in detail the replies submitted by the Audit Firm on the above observations and observed in the DAQRR as follows:

### **4.14.1. Rollovers (PFC – [Para 4.13.1](#) to [Para 4.13.10](#))**

- a. **Audit Firm Response:** With respect to Para 11.1 to 11.6, the Audit Firm asserted that *“SRBC would like to highlight the fact that, when there are two regulations on same subject, the regulation which is specifically for the subject will prevail over the regulation which generally applies on the subject. Accordingly, Master Direction - Core Investment Companies (Reserve Bank) Directions, 2016 issued by Reserve Bank of India (‘RBI’) on August 25, 2016 and as amended subsequently (hereinafter referred as ‘CIC Direction’) which applies to Core Investment Companies (‘CIC’) specifically, will prevail over the Master Direction - Non- Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 issued by RBI on September 01, 2016 and as amended subsequently (hereinafter referred as ‘NBFC Direction’) which applies specifically to certain types of NBFCs but not CICs.”* The Audit Firm further asserted that *“SRBC would like to state that terms of loan agreement being renegotiated or rescheduled or restructured is not similar to rollover. Since there is no specific requirement in CIC Direction to treat rollover accounts as restructured accounts, SRBC concurred with management’s view to not treat rollover accounts as sub-standard assets. Further, the analysis from workpaper ‘Internal company policy and NBFC ND SI guidelines permits the same’ is in the context that there is a provision relating to rollover in NBFC Direction and it allows NBFC companies to rollover loan accounts, either by treating them as standard asset or sub-standard asset subsequently. Accordingly, SRBC strongly refutes NFRA’s comment that ‘At the outset, NFRA notes that the above reasoning, with respect to RBI guidelines, noted in the WP is factually incorrect’.”*
- b. **NFRA Observations:** In its PFC, NFRA had already established that Master Directions – NBFC-ND-SI were applicable on the CIC-ND-SI, specifically since Master Direction – CIC-ND-SI, did not cover the treatment of rollovers of loan assets. Master Direction – NBFC-ND-SI stated that rollovers of only short term loans, where *no concession has been provided due to credit weakness of the borrower* and only up to

two times, *shall not be considered as restructured accounts*. Therefore, all other rollovers should have been treated as restructured accounts by the Company and NFRA re-iterates its PFC conclusions that the Audit Firm failed to comply with para 18 of SA 250, para 6 of SA 500 and para 17 of SA 200.

- c. Nevertheless, even assuming, but not admitting, that Master Directions – NBFC- ND-SI were not at all applicable to the Company (CIC-ND-SI), NFRA notes that this would rather mean that the rollovers were not at all permitted for a CIC- ND-SI.

Para 16 (4) of Master Direction – CIC-ND-SI states that a “sub-standard asset” shall mean “*an asset where the terms of the agreement regarding interest and/ or principal have been **renegotiated or rescheduled or restructured** after commencement of operations, until the expiry of one year of satisfactory performance under the renegotiated or rescheduled or restructured terms.*” (emphasis added). This implied that any loan asset that is rescheduled (rollover) after commencement of operations, should be classified as a sub-standard asset. Therefore, NFRA’s prima-facia conclusions that the Audit Firm failed to comply with para 18 of SA 250, para 6 of SA 500 and para 17 of SA 200 stand valid.

- d. In its response dated 14<sup>th</sup> April 2021, the Audit Firm has asserted that “*even if we consider that these rollover falls into the category of restructured accounts, the rollovers done by the Company were short term in nature as these rollovers pertain to shifting of due date of single installments and not the overall loan. Further, the rollovers were maximum for a period of six months, which also is short term in nature. Accordingly, the exemption provided to rollovers of short-term nature, was applicable to rollovers done by IL&FS. Since other conditions of actual requirement by the borrower, no concession was given due to credit weakness of borrower and rollover not more than two times, also met, there was no requirement to treat these accounts as restructured accounts. Refer IL&FS-Standalone Canvas Files Folder – 276.1.1 to 276.2.4 Rollover Docs.zip*”.

NFRA notes that these assertions of the Audit Firm are not substantiated by the Audit File and are only an afterthought. Further, NFRA notes that the assertions are also incorrect and an attempt to mislead NFRA. The Master Directions – NBFC- ND-SI does not allow standard asset categorization for a rollover that is **on a short term basis**. Master Directions – NBFC-ND-SI only allows rollover **of short term loans** (up to two times) to be classified as standard assets.

However, the Company rolled over both short term and long term loan accounts without categorizing them as sub-standard assets. NFRA notes that the Company rolled over Rs 532.3 Crores of long term loans during the FY 2017-18, of which Rs.71.8 Crores were outstanding as on 31<sup>st</sup> March 2018. The outstanding rolled over accounts were of IECCL and IL&FS Renewable Energy Ltd.

Clearly, the rollover of long term loans was to be classified as sub-standard assets. Even for rollover of short term loans, it was important to establish that no concession

was given due to the credit weakness of the borrower and rollover was not more than two times.

However, the only test of controls/audit procedures adopted by the Audit Firm to understand the rollover transaction and its impact (WP '274.1 to 274.29 M18 Closing Loans outstanding.xlsx') was limited to verifying management's stand that the repayments on the rolled over accounts had been **received as of the audit report date**. NFRA did not find any documentation of audit procedures that can be construed as a basis for their reply that "*Since other conditions of actual requirement by the borrower, no concession was given due to credit weakness of borrower and rollover not more than two times, also met, there was no requirement to treat these accounts as restructured accounts*". The Audit Firm failed to even refer to any bank statements, as noted by the Audit Firm in the WP, through which the Audit Firm confirmed the repayment of the rollover facilities.

Therefore, NFRA's prima facie conclusion that the Audit Firm failed to obtain sufficient appropriate audit evidence and failed to meet the requirements of Para 5.26 of TG-NBFC is proved.

- e. In its response, the Audit Firm also asserted that "*we had also communicated to TCWG to highlight the fact that Company's credit policy with respect to rollover of short-term loans, was required to be updated, to bring in line with the RBI guidelines. We also communicated TCWG that Company's documentation with respect to rollover needs to be strengthened. Extract of audit committee presentation is reproduced below. Refer IL&FS-Standalone Hardcopy Files Folder - 20\_ACM PPT.*

*"- Consider strengthening of documentation (loan conversion / rollover / new conversion) (Continuing)*

- *Consider alignment of credit policy for rollover of short term loans, to bring in line with the RBI guidelines"*

*Based on the response above, SRBC strongly refutes NFRA's observation that 'the Audit Firm failed to question the management and bring the same to the notice of TCWG. Simply communicating that the "documentation on the same needs to be strengthened" cannot be construed as reporting of a serious lacuna in the credit policy'."*

NFRA notes that the Audit Firm has not replied to the NFRA's observation that "*Simply communicating that the "documentation on the same needs to be strengthened" cannot be construed as reporting of a serious lacuna in the credit policy"*". The Audit Firm has only restated the facts that were observed by NFRA in its PFC. In fact, the statement does not include rollover of long term loans that are not permitted by Master Direction – NBFC-ND-SI. Master Directions – NBFC-ND- SI, which are applicable to CIC-ND-SI, only permit rollover of short term loans (not more

than two times) to not be considered as restructured accounts. Any concession offered otherwise, including rollover of short term loans for more than two times is a restructured account. Since RBI Master Directions – NBFC-ND-SI does not define any rollover of long term loans, any changes/modifications/concessions in the terms and conditions of long term loans will result in their treatment only as restructured accounts.

4.14.2. **Ever-Greening (PFC – [Para 4.13.11](#) to [4.13.15](#))**

- a. **Audit Firm Response:** The Audit Firm stated that *“as money is fungible in nature and it cannot be proven that the companies mentioned in the table i.e. IECCL, IMICL and IEDCL (‘Enlisted Companies’) has utilized the same money which was obtained from IL&FS as loan, to repay the outstanding loan of IL&FS. Further, SRBC was auditor of IL&FS and does not have access to books of accounts of all the group companies.”*

It further stated that the Companies stated by NFRA in [Para 4.13.13](#) had credit ratings indicating adequate to moderate degree of safety regarding timely servicing of financial obligations.

The Audit Firm also asserted that *“There were no cases of “evergreening loans” or “window dressing” that the auditor identified as a result of his verification. Further the compliance in respect of assessment of risks of material misstatements, whether due to error or fraud, and assessment of risks of fraud was documented. NFRA assumes that the auditor should assess the risks of e-evergreening and window dressing without any indication of risk at the time of assessment, is not a correct proposition. The auditor is required to assess the risks for material misstatements and fraud, and if during the performance of audit procedures he comes across cases of evergreening and money laundering, he need to take appropriate steps to deal with the situation. NFRA’s allegation is thus not sustainable in view of what the auditor is required to do at risk assessment stage. SRBC, therefore, requests that the same may please be deleted or withdrawn.”*

- b. **NFRA Observations:** NFRA notes that the Audit Firm has not replied to NFRA observations specifically. The Audit Firm’s assertion that *“NFRA assumes that the auditor should assess the risks of evergreening and window dressing without any indication of risk at the time of assessment, is not a correct proposition.”* is also incorrect. Clause b of the sub-section (1) of Section 143, of the Companies Act, 2013 and Annexure VII of the Master Directions – NBFC-ND-SI titled “RBI Norms on Restructuring of Advances by NBFC”, requires the Audit Firm to look into the risk of the transaction represented by mere book entries and were without looking into cash flows of the borrower and assessing the viability of the projects/activity financed.

- c. NFRA notes that the Audit Firm could not provide any WP reference in response to [Para 4.13.13 to 4.13.15](#), whereby the Audit Firm identified the risk of window dressing/evergreening of loans being done by the Company. The credit rating quoted by the Audit Firm also does not form part of the Audit File.

Even with the facts, as stated in [Para 4.13.14](#), the Audit Firm failed to design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence. Therefore, the contentions of the Audit Firm are considered an afterthought due to the absence of any audit evidence to support the assertions made.

- d. Therefore, NFRA re-iterates its conclusion in the PFC that The Audit Firm had failed to obtain sufficient appropriate evidence to verify credit ratings of the borrowers, repayment capacity of the borrowers and understand the end use of loans. Thus, the Audit Firm failed to meet the requirement of para 18 of SA 330, para 6 of SA 500 and para 17 of SA 200.

### **C. Final Observations and Conclusions of the AQRR**

- 4.15. NFRA has examined in detail the replies submitted by the Audit Firm, dated 23<sup>rd</sup> July 2021, on the above observations in the DAQRR and concludes as follows:

#### **4.15.1. Rollovers**

- 4.15.1.1. Audit Firm Response: The Audit Firm states as follows:

- a. The Audit Firm has reiterated that, when there are two regulations on the same subject, the regulation which is specifically for the subject will prevail over the regulation which generally applies to the subject. The Audit Firm states that *“Further, it is important to note that, if both regulations include requirements relating to the same matter, the requirements of specific direction will prevail. For identification of and provision against sub-standard assets, there is a separate requirement in CIC Direction and NBFC Direction. Restructuring of the loan is also linked to the provision requirement and which is provided only in NBFC Direction. In our view, therefore, restructuring related matter is to be applied only to NBFCs other than CICs.*

*SRBC would also like to highlight that CIC Direction does not mention anything on rollover of loans and therefore rollover of standard loans does not lead to loan being treated as a sub-standard asset.*

*Accordingly, NFRA’s interpretation that NBFC Direction were applicable for CIC is erroneous in nature and based on conjecture.”*

*Further, “NFRA’s logic that since rollover is not mentioned in CIC Direction, no rollover is permitted for CIC is again erroneous in nature*

*and based on conjecture. In our view, if rollover is not mentioned in the definition of sub-standard asset that does not infer that rollover is not permitted for CICs”.*

- b. *‘Without admitting but assuming that NBFC Direction with respect to sub-standard assets applies to CIC, SRBC would like to state the following:*

*The rollovers would not fall into the definition of restructured accounts as the same were granted by IL&FS on account of short-term liquidity issue and not long-term credit weakness or financial difficulty. Accordingly, these rollovers were not considered as restructured accounts. The Audit Firm further states that “Without prejudice to Point ‘a’ above, rollover was carried out for a short period of maximum six months and there was no sacrifice of any interest at the time of rollover. Further, fresh credit assessment was carried out by management at the time of rollover.” The Audit Firm also states that “Out of Rs. 960 Crore of loans, which were rollover, only Rs. 114 Crore (12%) were outstanding as on March 31, 2018. Further, the remaining amount was also received by IL&FS, before our audit report date. For documentation, refer Rollover repayment tab in IL&FS-Standalone Canvas Files Folder – 274.1 to 274.29 M18 Closing Loans outstanding. This itself demonstrates that there was no credit weakness at the time of rollover. Further, as per Company’s Credit Policy, rollover was permissible. Refer Credit Policy attached with our response to PFC.” The Audit Firm states that, “SRBC had verified the repayments, received during the year and noted that the amount was received in bank statements and that is evident from the referencing, date of receipt, break up of amount received and bank name documented in our workpaper. Refer ‘Repayment Sample Tracing’ tab in IL&FS-Standalone Canvas Files Folder – 274.1 to 274.29 M18 Closing Loans outstanding. The bank statements were not forming part of the audit file as all the documents verified during the audit were not required to retained in the audit file.”*

- c. *“With respect to communication to TCWG regarding rollover of loans, as given in our response above in our view rolled over loan is not required to be treated as sub-standard asset and hence the question of communicating to TCWG does not arise.”*

**4.15.1.2. NFRA Observations:** NFRA notes that the Audit Firm has not referred to any new WP nor given any new explanation other than what has already been examined by NFRA in the previous stages. NFRA has examined the replies of the Audit Firm in detail and observes as follows:

- a. The contention of the Audit Firm that the *“Restructuring of the loan is also linked to the provision requirement and which is provided only in NBFC Direction. In our view, therefore, restructuring related matter is to be applied only to NBFCs other than CICs.”* is absurd and incorrect. This kind

of reading of the regulations by an Audit Firm shows the ultimate lack of professionalism and absence of integrity and honesty. It is clear to any auditor of an NBFC that a CIC is only a subset of an NBFC and therefore the term NBFC includes a CIC as well. If the Audit Firm is unaware of this, a plain reading of Section 2 (applicability) of the two master directions referred here would have made it clear to them. As the Audit Firm says, the CIC Master directions are specific to the CICs. However, NBFC master directions apply to all NBFCs. The term restructuring is used in the CIC master directions but no explanation regarding restructuring is contained in these directions. The NBFC master directions on the other hand provide detailed “Norms on Restructuring of Advances by NBFC” which apply to “all restructurings” by the NBFCs. Therefore, the restructuring norms contained in the NBFC master directions apply to CICs also as CICs are NBFCs and the specific CIC norms do not provide any exceptions regarding norms on restructuring.

- b. NFRA, therefore, reiterates that as already established in the PFC, Master Directions – NBFC-ND-SI are applicable on the CIC-ND-SI, specifically since Master Direction – CIC-ND-SI, did not cover the treatment of rollovers of loans assets, which is contained in the norms of restructuring as detailed in the NBFC master directions. Master Direction – NBFC-ND-SI stated that rollovers of only short term loans, where *no concession has been provided due to credit weakness of the borrower* and only up to two times, *shall not be considered as restructured accounts*. Therefore, all other rollovers should have been treated as restructured accounts by the Company. Thus, the Audit Firm’s contention that since the restructuring of loan is only provided in NBFC Directions it will only apply to NBFCs other than CICs shows the dismal understanding of the Audit Firm. The Audit Firm is interpreting the law as per its convenience and is just trying in vain to mislead NFRA.
- c. Even though the Audit Firm also noted observations regarding the non-treatment of rolled over accounts as sub-standard and their non-provisioning, later it concurred with management’s views despite presence of multiple the red flags as pointed out by NFRA in point no. 4.13.9, 4.13.13 and 4.13.15 above. Now it is just trying to mislead NFRA by giving baseless explanations and unjustified interpretations. This shows the Audit Firm’s deliberate indulgence with the Management to whitewash the accounts of the Company.
- d. For the Audit Firm’s response that “*It is therefore necessary to bear in mind at the very foundation of an Audit Quality Review that the scope of such review must be restricted to whether the Audit Firm had adequate policies and if so whether auditing professionals conducting the audit conducted*

*themselves according to and consistent with the stated policies and practices. The exercise cannot be to explore whether the professional judgements of the auditor match the perceptual professional judgements of a reviewer”, it must be noted that even when the red flags were clear, the Audit Firm choose to ignore them and did not perform appropriate procedures. In such a scenario it cannot be said that the audit was conducted with due professional care and professional scepticism. The Audit Firm is advised to understand properly what ‘Audit Quality’ means (refer to the introduction to this AQR and SQC-1) and then apply these requirements in practice. Para 3 of SQC 1 is reproduced below for a better understanding.*

*“The firm should establish a system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements, and that reports issued by the firm or engagement partner(s) are appropriate in the circumstances.” Thus, while examining the audit quality the regulator examines compliance with professional standards, laws, regulations, the evidence obtained, evidence not obtained, and the professional judgements made or expected to be made by the Audit Firm.*

- e. The Company rolled over both short term and long term loan accounts without categorizing them as sub-standard assets. NFRA notes that the Company rolled over Rs 532.3 crores of long term loans during the FY 2017-18, of which Rs. 71.8 Crores were outstanding as of 31st March 2018. The outstanding rolled over accounts were of IECCL and IL&FS Renewable Energy Ltd. Clearly, the rollover of long term loans was to be classified as sub-standard assets. Even for rollover of short term loans, it was important to establish that no concession was given due to the credit weakness of the borrower and rollover was not more than two times. The Audit Firm has not mentioned anything regarding the rollover of long term loans anywhere in its responses. Further, even for the rollover of short term loans the Audit Firm has not given any valid explanation or has referred to any relevant WP other than what has already been examined by NFRA.
- f. Thus, based on the above, NFRA re-iterates its conclusions in the DAQR that the Audit Firm did not comply with para 18 of SA 250, para 6 of SA 500 and para 17 of SA 200.
- g. With regard to communication with TCWG NFRA reiterates that the Audit Firm did not communicate the above mentioned significant matters to TCWG as required by Para 12(d) of SA 260.

#### 4.15.2. Ever- Greening

- a. Audit Firm Response: The Audit Firm states as follows;

- a. *“In para 4.14.2.2 of DAQRR, NFRA has commented that “the Audit Firm has not replied to NFRA observations specifically”. As NFRA has not pointed out its observations which was not responded by SRBC, we are unable to respond specifically to the said para.”*
- b. *“With respect to NFRA comment regarding reporting under Section 143(1)(b), SRBC would like to state that, based on our sample checking, it is evident that loan has actually been disbursed and was supported by entry in bank statement. Hence, such loans cannot be considered as mere book entry prejudicial to the interest of the Company. Accordingly, Clause b of the sub-section (1) of Section 143 of the Companies Act, 2013, would not be applicable to these loans. Further, as verified by SRBC on sample basis it was evident that management performed credit assessment before sanction of any new facility including for rollover loans. Refer IL&FS-Standalone Canvas Files Folder - 236.1 to 236.12 M18 Loan disbursals workpaper and IL&FS-Standalone Canvas Files Folder - 235.1 to 235.22 M18 Loans TOC.”*

*“In the above paragraph, SRBC has concluded that they have not come across any transaction of loans which is undertaken by way of mere book entries or which was prejudicial to the interest of the Company. Further, credit assessment was carried out at the time of sanction of the loan. Accordingly, there was no risk of evergreening and window dressing perceived by us for concluding that there was the risk of material misstatements.”*

b. NFRA Observation:

- a. The Audit Firm did not respond specifically to NFRA’s observations made in points 4.13.13 to 4.13.15 above. There is no evidence in the audit file that the Audit Firm had carried out any substantive procedures to assess risks associated with the existing loans of the borrowers, which were seen to be repaid by the borrowing companies out of loans from IL&FS. The Audit Firm has not responded specifically to such cases pointed out by NFRA.
- b. The Audit Firm’s statement that *“based on our sample checking, it is evident that loan has actually been disbursed and was supported by entry in bank statement.”* is not supported by any WP and hence not accepted.
- c. As per Annexure-VII of the Master Directions – NBFC-ND-SI titled “RBI Norms on Restructuring of Advances by NBFC”, no account shall be taken up for restructuring by the NBFCs unless the financial viability is established and there is reasonable certainty of repayment from the borrower, as per the terms of restructuring package. Any restructuring done

without looking into cash flows of the borrower and assessing the viability of the projects/activity financed by NBFCs shall be treated as an attempt at evergreening a weak credit facility.

- d. The Audit Firm had failed to obtain sufficient appropriate evidence to verify the credit ratings of the borrowers, repayment capacity of the borrowers and understand the end use of loans. The Audit Firm did not consider the credit approval process and internal credit rating of the borrowers as part of its audit procedures. The Audit Firm also did not consider window dressing as a risk and did no test of controls to confirm the repayment source/accounts, even in the case of rolled over assets.
- e. NFRA thus reiterates its conclusion in the DAQRR that, the Audit Firm failed to meet the requirement of para 18 of SA 330, para 6 of SA 500 and para 17 of SA 200.

**Loans Given to ITNL by the Company and Subsequent Transfer of this Loan Liability by ITNL to its SPVs**

**A. Prima Facie Observations/Conclusions (PFC)**

4.16. In its Prima Facie Conclusions, NFRA conveyed the following:

4.16.1. NFRA observes that the Company had disbursed Rs.4,364 crore of loans to ITNL in FY 2017-18. However, during the course of FY 2017-18 itself, ITNL transferred its loan liability of Rs.2,704 crore to its nine SPVs. In specific query (Part II Section E-2) in letter dated 19th November, 2019, NFRA asked the Audit Firm regarding the reasons for assignment of loans and assessment of the repayment capacity of these SPVs. In reply dated 30th December, 2020, the Audit Firm has stated:

- a) *“The assignment of loan was decision of the management and as the auditors we had verified that the procedures for granting of loan was followed by the Company. The reasons for assignment was forming part of the approval memorandums / documents*
- b) *We had verified the following in respect of assignment of loan:*
  - i. *Approval memorandum refer SFS Canvas- Assignment Manual Approval Memos.zip (For relevant extract refer Attachment 119, Page no. A1118 to A1939)*
  - ii. *Assignment agreements refer SFS Canvas- ITNL Assignment Docs.zip and SFS Canvas ITNL Assignment Loan Docs 1 (For relevant extract refer Attachment 120, Page no. A1940 to A2144)*
  - iii. *Approved and accepted term sheets refer SFS Canvas- Assignment Manual Approval Memos (For relevant extract refer Attachment 121, Page no. A2145)*

to A2351)

- iv. *Obtained the independent valuation report / valuation model of the SPVs from the management and performed the procedures to obtain reasonable assurance about recoverability of loan: For sample cases, we had involved the auditor's expert as per SA 620 – Using the work of an Auditor's Expert to validate the fair value arrived by the management expert. Refer SFS Hard Copy File - File 3 - Flap A-G - G flap (Page no. 1 to 106)*
- v. *Assignment of these loans was also approved by audit committee on November 8, 2017, February 21, 2018 and 29 May 2018 as a part of approval of related party transactions. Refer- · SFS Canvas- Minutes - ACM 8Nov17 (For relevant extract refer Attachment 64, Page no. A1107) · SFS Canvas- Minutes - ACM 21Feb18 (For relevant extract refer Attachment 65, Page no. A1111) · CFS Canvas- Minutes - BM 29Aug18- ACM May 29, 2018 (For relevant extract refer Attachment 66, Page no. A1112)*
- c. *We had noted that for all SPVs there was equity value, after considering repayment of loan. We had therefore concurred with the management that the assigned loans were recoverable and no provision was required against the same. Refer SFS Hard Copy File - File 2 - Flap A-G – Flap G (page no. 1 to 106)” (emphasis added)*

4.16.2. Based on the response of the Audit Firm, NFRA has examined the WPs referred by the Audit Firm. NFRA notes that the reference to Hard Copy Box Files Attachment Pages is incorrect, for example assignment manual approval memos referred by the Audit Firm are not available on page no. A1118 to A1939, rather term sheets (originally referred on pages A2145 to A2351) are placed on page no. A1888 to A1939. NFRA, therefore, has referred to only the e-audit file references for all the WPs.

4.16.3. On perusal of the WPs (terms sheets, approval memorandums and assignment agreements loan amounting to Rs.2,704 crore), NFRA observes that the Audit Firm has merely, collected the term sheets, approval memorandum, and agreements pertaining to transfer of loans. The Audit Firm has not documented its understanding and the conclusion drawn from the examination of these documents. Merely collecting the term sheets, memorandums and agreements, does not constitute as sufficient appropriate audit evidence. The Audit Firm was required to understand and document its conclusion regarding the appropriateness of the audit evidence, for example the Audit Firm was required to confirm if the original term sheets and modified term sheets carry the same interest. However, there is no trace of any work done/conclusions drawn by the Audit Firm to confirm the appropriateness of the referred documents. Specific observations with respect to each assertion is provided in the table below:

WP	Observations
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Approval Memorandum (Refer SFS Canvas Assignment Manual Approval Memos)	<p>There are three board approved memorandums for transfer of loans worth Rs.1,243.9 crore, Rs.960 crore and Rs.500 crore dated 28th Sep 2017, 30th Dec 2017 and 27th March, 2018, respectively. These memorandum contains approval of proposal from ITNL for transfer of various Revolving Line of Credits (RLoCs) to its SPVs and rational for transfer.</p> <p>NFRA notes that these memoranda do not contain any reference to Audit Committee for approval. The memoranda with regard to RPT, simply states that since the Company reserves the right to assign or transfer all or any part of its rights and benefits and there is no change in commercial terms of assigned loans, except for nature of the facility, the transaction is RPT compliant. As observed in the PFC (Compliance with Related Parties), it seems that the Company had assumed these transactions as “Exempt RPTs” as per their RPT policy and did not take any prior approval of Audit Committee. The Audit Firm has also not performed any audit procedures to verify if the transactions were rather in ordinary course of business and on arm’s length. NFRA notes that this transaction includes both change in the borrower and modification of the type of loan.</p> <p>Section 177 (4) of the Companies Act, 2013 states that the Audit Committee shall also approve any subsequent modification of transactions of the company with related party. Thus, the Audit Firm was required to obtain sufficient appropriate audit evident that audit committee approval prior to the assignment, was received. However, there is no WP in the Audit File that suggest that the Audit Firm had actually verified if the transaction is in compliance with Section 177 of the act.</p> <p>[WPs Referred – WP ‘288.1.3.1 to 288.1.3.12 Assignment Manual Approval Memos_Assignment_ITNLAssignmnt Rs 12439 mn 28- Sept-2017.pdf’; WP ‘288.1.1.1 to 288.1.1.5 Assignment Manual Approval Memos_Assignment_ITNL assignment Rs 960 crs.pdf’; WP ‘288.1.2.1 to 288.1.2.8 Assignment Manual Approval Memos_Assignment_ITNLassignmnt Rs 5000 mn 27-Mar-2018.pdf’; WP ‘286.5.1 to 286.5.34 ITNL Assignment Docs_A5 ITNL Assgmnmt Sept 2017_MBEL_Rs 500 crs.pdf’]</p>
Assignment Agreements (Refer SFS)	<p>These documents contain loan agreements between the Company, ITNL and respective SPV. The agreements are dated from 16th October, 2017, to 26th February, 2018. Further, the</p>

<p>Canvas- ITNL Assignment Docs and SFS Canvas ITNL Assignment Loan Docs 1)</p>	<p>issue is discussed in 8.3 (a) above.</p> <p>NFRA notes that these loan agreements pertain only to the approvals received under memorandum dated 28th September, 2017, and 30th December, 2017. Loan agreements for loan transfer, approved on 27th March, 2018, (₹500 crore), are not available in the audit file. Even though the transfer memorandum was initiated only days before the financial year end, the Audit Firm did not bother to obtain the loan agreements and confirm the appropriateness of disclosure that the loans have been transferred to ITNL SPVs.</p> <p>The Audit Firm failed to obtain sufficient appropriate audit evidence regards transfer of loans worth ₹500 crore.</p> <p>[<b>WPs Referred</b> – WP ‘286.5.1 to 286.5.34 ITNL Assignment Docs_A5 ITNL Assgnmnt Sept 2017_MBEL_Rs 500 crs.pdf’; WP ‘286.3.1 to 286.3.34 ITNL Assignment Docs_A3 ITNL Assgnmnt Sept 2017_EHEL_Rs 62.10 crs.pdf’; WP ‘286.4.1 to 286.4.34 ITNL Assignment Docs_A4 ITNL Assgnmnt Sept 2017_IRIDCL_Rs 210 crs.pdf’; WP ‘286.6.1 to 286.6.35 ITNL Assignment Docs_A6 ITNL Assgnmnt Sept 2017_MBEL_Rs 90 crs.pdf’; WP ‘287.1.1 to 287.1.34 ITNL Assignment Loan Docs 1_A7 ITNL Assgnmnt Sept 2017_MPBCDCL_Rs 156.83 crs.pdf’; WP ‘287.2.1 to 287.2.34 ITNL Assignment Loan Docs 1_A8 ITNL Assgnmnt Dec 2017_MPBCDCL_Rs 85 crs.pdf’; WP ‘287.3.1 to 287.3.34 ITNL Assignment Loan Docs 1_ITNL Assgnmnt Dec 2017_PSRDCL_Rs 250 crs.pdf’; WP ‘287.4.1 to 287.4.36 ITNL Assignment Loan Docs 1_A10 ITNL Assgnmnt Sept 2017_RMGL_Rs 100 crs.pdf’]</p>
<p>WP ‘Hard Copy File - File 3 - Flap A-G - G flap’</p>	<p>As against the assertion of the Audit Firm that they had “performed the procedures to obtain reasonable assurance about recoverability of loan”, NFRA could not find any audit evidence to support the Audit Firm’s contentions that they performed procedures to obtain reasonable assurance about recoverability of loan. The Audit Firm had only collated the valuation reports but had not done any work to verify the veracity of the valuation report (refer to the section on</p>

	Investment of this PFC, for detailed comments on the reliability of valuation reports and audit quality therewith). The Audit Firm had thus failed to comply with the requirements of Para 8 of SA 500.  NFRA, also notes that the Audit Firm had given no consideration to the respective credit standing and the credit ratings of the SPVs. Therefore, the contention of the Audit Firm that they “obtain reasonable assurance about recoverability of loan” is a complete sham.
SFS Canvas Minutes – ACM 8Nov17	The contention of the Audit Firm that “Assignment of these loans was also approved by audit committee on November 8, 2017, February 21, 2018 and 29 May 2018 as a part of approval of related party transactions.” stands without any basis since none of the referred documents contains any reference to the RPTs that were approved by the audit committee. Even the internal auditor report available in the Audit File does not contain any reference to the list presented before the Audit Committee for approval.  Further, NFRA notes that the WP ‘SFS Canvas- Minutes - ACM 8Nov17’ and WP ‘SFS Canvas- Minutes - ACM 21Feb18’ are not signed by any of the members of the committee and are only draft copies of the minutes without any details of the transfer of loans to ITNL’s SPVs.
SFS Canvas Minutes - ACM 21Feb18	
CFS Canvas Minutes - BM 29Aug18- ACM May 29, 2018	

4.16.4. In light of the above, NFRA concludes that the Audit Firm had failed to obtain sufficient appropriate audit evidence to form an opinion that the transfer of loans is not prejudicial to the interest of the Company and in compliance with Section 177 of the Companies Act, 2013.

4.16.5. In reply to NFRA’s query on going concern status of the component entities (Part I Section E2) in letter dated 19th November, 2019, the Audit Firm has, inter-alia, stated the following: “*We observed that one of the material subsidiary Companies of IL&FS, i.e. ITNL along with some of its subsidiary companies had defaulted in payment of its borrowing obligations. Based on the audit procedures performed by us for the year ended March 31, 2018, we noted following triggers were observed by the ITNL auditor and reported to us, which raised significant doubt on ITNL’s ability to continue as going concern:*

- (a) *significant losses incurred during the year;*
- (b) *downgrade in credit ratings of subsidiary Companies of ITNL;*
- (c) *unable to financially support its subsidiaries resulting defaults in*

*servicing debts by subsidiary Companies of ITNL;*

- (d) *Planned asset monetisation not getting fructified; and*
- (e) *Delay in realisation of claims made to authorities” (emphasis added)*

4.16.6. Evidently, three of the ITNL’s SPVs, namely ITNL Road Infrastructure Company Ltd (IRICL), MP Border Checkpost Development Company Limited (MPBCDCL) and Rapid Metrorail Gurgaon Limited (RMGL), had defaulted on payment of loans before the signing of consolidated audit report. Thus the “CARE” credit ratings for the said SPVs had been revised to “D”.

<b>SPV (Rating)</b>	<b>Total Loan Assignment D</b>	<b>Default Month</b>	<b>Date of Rating</b>
IRICL (“D”)	Rs.210 crore	June 2018	1 <sup>st</sup> August, 2018
MPBCDCL (“D”)	Rs.242 crore	June 2018	1 <sup>st</sup> August, 2018
RMGL (“D”)	Rs.125 crore	June 2018	11 <sup>th</sup> July, 2018

4.16.7. Therefore, NFRA construes that because of the insufficient audit procedures performed by the Audit Firm regarding the recoverability of the transferred loans, the Audit Firm failed to note the implications of the triggers that were available (“based on the audit procedures performed for the year ended March 31, 2018”) indicating uncertainty on the collectability of the loans transferred to the SPVs. The Audit Firm simply turned a blind eye to the triggers available and had instead reached the conclusion that “*there’s no significant uncertainty on the collectability of the said loans*” and that the loans transferred are not prejudicial to the interest of the Company without any basis.

4.16.8. Para 16 (4) (i) of the CIC Master Directions states that “*‘standard asset’ shall mean the assets in respect of which, no default in repayment of principal or payment of interest is perceived and which does not disclose any problem or carry more than normal risk attached to the business*”. Para 16 (4) (iv) of the CIC Directions states that “*‘loss asset’ shall mean:*

- (a) *an asset which has been identified as loss asset by the CIC-ND-SI with asset size of ₹500 crore and above or its internal or external auditor or by the Bank during its inspection, to the extent it is not written off by it; and*
- (b) *an asset which is adversely affected by a potential threat of non-recoverability due to either erosion in the value of security or non-availability of security or due to any fraudulent act or omission on the part of the borrower.”*

In light of the above, the transfer of loans specifically with respect to IRICL, MPBCDCL, and RMGL (as indicated in table in para 8.7 above) was in the purview of the definition of loss asset, since they were affected by a potential threat of non-recoverability.

4.16.9. Para 10 of SA 560 states that *“The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor’s report. However, when, after the date of the auditor’s report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor’s report, may have caused the auditor to amend the auditor’s report, the auditor shall:*

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

4.16.10. Thus, even notwithstanding the implication of the triggers available to the Audit Firm, the fact that the three SPVs (along with ITNL) had defaulted on their borrowing obligations and their credit ratings were revised to “D”, the Audit Firm was required to perform procedures as provided in Para 10 of SA 560. However, NFRA is unable to trace any audit procedures performed by the Audit Firm in this regard.

## **B. Observations made in the DAQRR**

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

4.17.1. Audit Firm’s Response: The Audit Firm asserted that *“SRBC had verified the following on sample basis as part of our test of control procedures, with respect to assigned loans:*

- a. Party name as verified from Disbursement Memo (‘DM’) / Credit Approval Memo (‘CAM’) / Agreement*
- b. Disbursement Approval*
- c. Maturity Date as calculated / as per term sheet*
- d. Sanctioned amount as per DM and agreement*
- e. Disbursement amount as per DM*

- f. Interest type (floating / fixed)
- g. Interest rate as per DM and agreement (%)
- h. Agreement / term sheet verified

Refer IL&FS-Standalone Canvas Files Folder - 235.1 to 235.22 M18 Loans TOC.”  
 “Further, SRBC had verified the credit rating of three companies on sample basis, which was evident from the referencing in ‘Remarks’ column. Refer ‘Sample Testing’ tab in IL&FS-Standalone Canvas Files Folder – M18 Loans TOC. However, as per para A23 of SA 230, audit file cannot be treated as substitute of entity’s accounting records. Credit Rating Documents does not form part of audit documentation as audit file cannot be treated as substitution of company’s accounting records and Audit Firm cannot be expected to document every matter considered or professional judgement made. The ratings documented by us, during audit were as follows:

Party	Care rating	Date
Moradabad Bareilly Expressway Limited	CARE A; Outlook: Stable	11-Oct-2017
ITNL Road Infrastructurre Company Ltd	CARE BBB-; Outlook: Stable	31-Mar-2017
MP Border Checkpost Development Company Limited	CARE BBB; Outlook: Negative	23-Jan-2017

- 4.17.2. The Audit Firm also stated that “SRBC would like to state that we had performed audit procedures to obtain reasonable assurance about recoverability of assigned loan.” The Audit Firm, while referring to the Auditor’s Expert report/Management Expert report/Business Model of the SPVs, stated its conclusion that “Since there was equity value which was computed after taking into consideration timely repayment of loan, we concluded that there was no uncertainty on the collectability of the said loan.”
- 4.17.3. The Audit Firm further stated that “We had also read Internal Auditor’s reports wherein they had confirmed that all transactions entered with the related parties were at arm’s length price and in normal course of business”
- 4.17.4. The Audit Firm also stated that “At the outset, SRBC would like to clarify that we had issued two separate audit reports, one on the standalone financial statements for the year ended March 31, 2018 (‘SFS’) dated May 30, 2018 and other one on the consolidated financial statements for the year ended March 31, 2018 (‘CFS’) dated August 29, 2018. Further, these two were separate audit engagements and the evidences obtained / available during the time of CFS audit, cannot be applied retrospectively to the SFS audit.”
- 4.17.5. NFRA Observations (Para 4.17.1): NFRA notes that the Audit Firm, for its response quoted in [Para 4.17.1](#) above, has not referred to any new information or WP that was not examined by NFRA in its PFC while rebutting the conclusions made by NFRA in its PFC. The WPs referred to have already been

examined by NFRA in its PFC and hence the conclusions as made out in the PFC stand as it is.

- 4.17.6. Nevertheless, NFRA has re-examined the WP, with respect to the Audit Firm's assertions. On perusal of the WP, NFRA notes that the Audit Firm had indeed noted three samples, including Moradabad Bareilly Expressway Limited, ITNL Road Infrastructure Company Ltd, and MP Border Checkpost Development Company Limited, in its sample testing. However, NFRA notes that the Audit Firm has indicated "n/a" for a majority of the key areas, including CAM (Credit Approval Memorandum), its approval, conditions precedent, and conditions subsequent. Therefore, NFRA's prima conclusion that the Audit Firm has not documented its understanding and the conclusion drawn from the examination of these documents, stands valid.
- 4.17.7. Further, for a specific sample of Moradabad Bareilly Expressway Limited (Rs. 500 Crores), NFRA notes that the maturity date was "20-Oct-17", but the loan was repaid only on "18-Jan-18" (Repayments Dump – M18 Closing Loans Outstanding). Further, the Company assigned another loan of Rs. 500 Crores in March 2018 to Moradabad Bareilly Expressway Limited (MBEL) from ITNL. The Audit Firm did not note any such observation and failed to perform the audit with the professional scepticism expected out of an auditor. NFRA notes delay in repayment (approximately 90 days) of a newly assigned loan account, should have raised the red flag for the Audit Firm to understand if the subsequent loan assignment (March 2018) indicated more than normal risk. However, no further audit procedures were performed by the Audit Firm. The Audit Firm has even failed to provide a reference to the loan agreement for the transfer of this loan. Therefore, NFRA is justified in concluding that the Audit Firm failed to obtain sufficient appropriate audit evidence to conclude that the assignment was not prejudicial to the Company's interest.
- 4.17.8. NFRA Observations (Para 4.17.2): NFRA selected two SPVs, based on the value of assigned loans outstanding as on 31<sup>st</sup> March 2018, and notes the following:
- a. ChenaniNashri Tunnelway Limited ('CNTL') – Loan Outstanding of Rs. 425.2 Crores towards IL&FS: Even though the Audit Firm has asserted that "*We had involved the auditor's expert as per SA 620*", NFRA notes that the referred auditor's expert valuation report was prepared for the auditors of ITNL, for the purpose of impairment testing. The report stated that management of ITNL was testing the impairment of its SPVs and EY (ITNL's Auditor's expert) were asked to comment on the methodologies and/or assumption in the valuations.

NFRA notes that, as against the requirement of Para 12 of SA 620, the Audit Firm did not evaluate the adequacy of the auditor's expert's work

for the purpose of evaluating the repayment capability of the ITNL's SPVs.

Further, NFRA observes that the Auditor Expert, in its report has concluded the following "*Finally, based on the scope of work, it appears that our comparative calculations support the Management's conclusion of no impairment for the SPVs except for CNTL, HREL, JRIPCL*" (emphasis added by NFRA). The auditor expert in its report concluded that CNTL equity value was Rs. 327.7 Crores, as against ITNL's investment of Rs. 372.0 Crores, indicating an impairment of Rs. 44.3 Crores.

NFRA also notes that the valuation was based on a projection of financial upto March 2032. However, there is no audit evidence to substantiate how this was used to conclude that the borrowers have sufficient repayment capability to repay the loans that were due in 2019.

- b. Moradabad Bareilly Expressway Limited (MBEL) – Loan Outstanding of Rs. 500 Crores towards IL&FS: NFRA notes that the Audit Firm had used N.M. Raiji & Co.'s (management expert) equity valuation report, which was drafted for the management of ITNL, for sale of MBEL to a prospective investor.

As against the requirements of Para 8 of SA 500, the Audit Firm has not done any work to evaluate the management's expert and verify the veracity of the valuation report that was dated 31st August 2017.

Further, NFRA observes that the ITNL's management expert had computed equity of Rs. 599 Crores, based on estimates upto FY 2036. However, the loans granted to MBEL were to be due in November 2019. There is no audit evidence to substantiate how this was used to conclude that the borrowers have sufficient repayment capability.

- 4.17.9. NFRA Observations (Para 4.17.3): NFRA in [Para 4.2](#) of the DAQRR, has concluded that the Company was in contravention of the provision of Section 177 (4) (iv) of the Companies Act, 2013, the Audit Firm failed to obtain sufficient appropriate audit evidence and failed to appropriately report under clause 3 (xiii) of CARO, 2016. Even for the assignment of loans, the Audit Firm did not obtain sufficient appropriate audit evidence to confirm if the prior approval of the Audit Committee was received for this RPT and if they were on arms' length and in the ordinary course of business. The Audit Firm has only asserted that "*We had also read Internal Auditor's reports wherein they had confirmed that all transactions entered with the related parties were at arm's length price and in normal course of business.*" without providing reference to the internal audit reports. The Audit Committee meeting minutes referred by

the Audit Firm does not include any details of the transactions that were approved by the Audit Committee. In absence of any audit evidence, the assertion of the Audit Firm can only be construed as an afterthought and without any basis.

4.17.10. NFRA Observations (Para 4.17.4): NFRA notes that only the downgrade in credit ratings of subsidiary Companies of ITNL, was an event that happened after the SFS audit report date. All the other indications, that were identified by the Audit Firm, including

- a. significant losses incurred during the year;
- b. ITNL was unable to financially support its subsidiaries resulting in defaults in servicing debts of debts;
- c. Planned asset monetisation not getting fructified; and
- d. Delay in the realisation of claims made to authorities

should have raised enough red flags for the Audit Firm before the signing of the SFS, to exercise professional scepticism.

Therefore, the assertion of the Audit Firm can only be construed as an afterthought.

Also in line with NFRA's PFC [para 4.16.9](#) and [4.16.10](#), the Audit Firm was required to perform procedures as provided in Para 10 of SA 560. However, NFRA is unable to trace any audit procedures performed by the Audit Firm in this regard.

### **C. Final Observations and Conclusions of AQRR**

4.18. NFRA has examined in detail the replies to the DAQRR and the oral explanations submitted by the Audit Firm, on the above observations and concludes as follows:

4.18.1. Audit Firm Response: The Audit Firm states as follows:

- a. *“SRBC would like to state that ‘N/A’ was written in certain columns of Sample Testing tab in IL&FS-Standalone Canvas Files Folder - 235.1 to 235.22 M18 Loans TOC, as these transactions are different from other disbursements made by the Company.*

*It must be noted that the work done, and conclusion drawn from the term sheets, approval memorandums and assignment agreements was documented separately in IL&FS-Standalone Hardcopy Files Folder - 27\_Assignment of Loans.pdf (Page no. 1 to 106). SRBC reiterates that the supporting documents are to be read/reviewed with the main workpaper, as*

*these supporting documents together are used to conclude a specific assertion.”*

- b. *“It is also pertinent to note that, in the assignment agreement entered with MBEL and ITNL by the Company, there is a recourse clause which provides that if MBEL defaults in repayment of loan, the default has to be made good by ITNL. Accordingly, there was no additional exposure undertaken by IL&FS on account of these assignments as loan given to ITNL by IL&FS has been converted into loan to MBEL with the recourse to ITNL. Refer Appendix 9 attached with our response to PFC. As an auditor, we had evaluated whether the terms of assignment were prejudicial to the interests of the Company. Based on our evaluation, we did not find that these loans were prejudicial to the Company.”*
- c. *“SRBC submits that audit of IL&FS and ITNL for the year ended March 31, 2018 was conducted by same Audit Firm i.e. S R B C & Co. LLP. Hence, we had obtained the auditor’s expert valuation report from ITNL audit team. ITNL had utilized the service of the auditors expert to assess fair value of their investments and that the same valuation report was utilised by us to ascertain impairment of loan to CNTL. Since as per the valuation report, there was equity value which was arrived after taking into consideration outstanding borrowing, we concluded that no impairment was necessary for the said loan.” SRBC further quotes Para 12, A32, A35 & A39 of SA 620 and states that, “In the instant case we had obtained the valuation report from Valuation & Business Modelling Team of Ernst & Young LLP (‘EY LLP’), who has specialisation in performing such valuation task. Further, we had obtained evidence of Mr Sorabh Kataria and Mr Nilesh Jain had sufficient knowledge to deal with the valuation. Refer IL&FS-Standalone Canvas Files Folder – 443.1 Training completion evidence and IL&FS-Standalone Canvas Files Folder – 442.1 to 442.6 M18 131GL(R)-EY specialist-1. Basis this information we concluded that EY as an auditors’ expert was competent, capable, objective and had relevant expertise to perform this task.”*
- d. *“Regarding the use of N.M. Raiji& Co.’s (management expert) equity valuation report, that was prepared for the management of ITNL, for the purpose of sale of MBEL to a prospective investor, the Audit Firm states that they had verified the competence, capability and objectivity of management expert. Refer IL&FS - Standalone Canvas Files Folder - 441.1 M18 130GL(R)-Mgmt specialist.”*
- e. *The Audit Firm states that “we would like to reiterate that section 177(4)(iv) of the Companies Act, 2013 does not mandate prior approval for related party transactions. The issue regarding compliance with Section 177(4)(iv)*

*has been extensively dealt in para 4 above and has not been repeated here.”*

- f. Regarding the reference of the internal audit report, the Audit Firm states that *“As part of our audit procedures, we have read said reports during our audit and our files include internal auditor report for quarter 1 and quarter 2. Refer IL&FS-Standalone Canvas Files Folder - 436.1 M18\_Internal Audit Report - RPT - Q1 and Page 3 of IL&FS-Standalone Canvas Files Folder - 437.1 to 437.10 M18\_Internal Audit Report - Q2.”*

4.18.2. NFRA Observations:

- a. NFRA notes that the Audit Firm’s assertion that *“the work done, and conclusion drawn from the term sheets, approval memorandums and assignment agreements were documented separately in IL&FS-Standalone Hardcopy Files Folder -27\_Assignment of Loans.pdf (Page no. 1 to 106)”* is false. The WP consists of the valuation reports of the SPVs and a list of procedures purported to be done by the Audit Firm. It is also noted as conclusion that *“The value per share as per the cash flow models is higher than the cost per share as per books and hence there is no impairment in the value of investment other than already taken”*. It does not address any of the issues mentioned in para 4.17.8 (b) above.

Further, the assignment agreement with MBEL mentions that the borrower (i.e. the SPV) needs to execute the loan documents as stipulated by IL&FS. The Audit Firm was required to verify whether the required loan documents were executed by the SPV (for the samples selected) or not, but the Audit Firm has simply mentioned N/A in most of the columns and not verified the loan documentation.

The Appendix 9 referred by the Audit Firm is the loan agreement for assignment of the loan of Rs. 500 crore to MBEL and it does not form part of the Audit File and hence cannot be accepted as valid audit evidence.

Notwithstanding the above fact, NFRA has examined the document attached as Appendix 9. NFRA notes that the agreement does not contain any recourse clause which provides if MBEL defaults in repayment of the loan, the default will be made good by ITNL. Thus, this subsequent loan assignment should have been considered only after assessing the risk of non-payment. The Audit Firm’s reply is not acceptable. Therefore, NFRA reiterates its DAQRR conclusion that the Audit Firm failed to obtain sufficient appropriate audit evidence to conclude that the assignment was not prejudicial to the Company’s interest.

- b. Regarding recoverability of loan from CNTL, the Audit Firm responded that *“on page 10 of valuation report it is clearly visible that repayment of IL&FS*

*loan amounting to Rs. 4,252 million was considered as outflow in March 2019 and after considering that there is positive equity value of CNTL". Regarding recoverability of the loan from MBEL the Audit Firm's responded that, "on page 27 of valuation report of management expert, the net repayment of borrowing was considered as outflow of fund and after considering repayment of loan, valuer has arrived at positive value for equity shares of MBEL. Accordingly, no impairment of loan to MBEL was considered necessary". Both these responses are not an answer to the issues raised in the DAQRR. The Audit Firm has not evaluated the assumptions based on which it was considered that the loans would be recoverable. No analysis has been made by the Audit Firm of the valuation report as no WPs is evidencing it. The Audit Firm has simply collected the valuation reports. Further, as already noted, the valuation report is prepared for the audit of ITNL for impairment testing. It is not explained in any of the WPs how the Audit Firm concluded, based on the same reports, the recoverability of the loans in FY 2019.*

- c. For the evidence of evaluation of the competence, capability, expertise, and objectivity of the auditor's expert the Audit Firm referred to the following WPs:
  - i. IL&FS-Standalone Canvas Files Folder – 443.1 Training completion evidence – Is a training completion certificate for audit assistant's education requirements.
  - ii. IL&FS-Standalone Canvas Files Folder – 442.1 to 442.6 M18 131GL(R)-EY specialist-1- In the WP there is no evaluation of the expert who gave the valuation reports for CNTL and MBEL as mentioned in point no. 4.18.2 (c) above. The valuation reports referred to by the Audit Firm were the ones that were prepared for auditors of ITNL and not for IL&FS. Thus, the Audit Firm was required to assess the competence and capability of those experts for using these reports which are nowhere documented in the above-mentioned WPs.

The above-mentioned WPs do not document any communication between the Audit Firm and the expert as required by Para 11 (c) of SA 620. Further, as evident from the valuation report, the objective of the expert's work was the valuation of investment of ITNL in CNTL for impairment analysis. Thus, the Audit Firm failed to evaluate the adequacy of the work of the auditor's expert for the auditor's purposes as required by Para 12 of SA 620. There is no WP referred by the Audit Firm where it documented the analysis of the valuation report or any communication with the expert for this purpose.

- d. The WP '*IL&FS - Standalone Canvas Files Folder - 441.1 M18 130GL(R)-Mgmt specialist.*' cited by the Audit Firm is regarding the evaluation of the work of the expert for the valuation of investment of IL&FS in various entities. This has no connection with the valuation report of MBEL. The Audit Firm is thus only trying to mislead NFRA by referring to such irrelevant WPs. Thus, NFRA concludes that the Audit Firm failed to evaluate the adequacy of the work of the auditor's expert for the auditor's purposes as required by Para 12 of SA 620. There is no WP referred by the Audit Firm where it documented any analysis of the valuation report or any communication with the expert.
- e. The Audit Firm has repeated its response regarding Audit Committee approval for related party transactions "*that section 177(4)(iv) of the Companies Act, 2013 does not mandate prior approval for related party transactions.*" NFRA in Para 4.2 of this DAQRR, has concluded that the Company was in contravention of the provision of Section 177 (4) (iv) of the Companies Act, 2013, the Audit Firm failed to obtain sufficient appropriate audit evidence and failed to appropriately report under clause 3 (xiii) of CARO, 2016. Even for the assignment of loans, the Audit Firm did not obtain sufficient appropriate audit evidence to confirm if the prior approval of the Audit Committee was received for this RPT and if they were at arms' length and in the ordinary course of business. The internal auditor's reports referred by the Audit Firm do not contain any reference to the list presented before the Audit Committee for approval.
- f. The Audit Firm failed to take cognizance of the various indicators that were identified by the Audit Firm itself as mentioned in Para 4.17.10 above which should have alerted the Audit Firm before the signing of the audit report, to exercise professional scepticism. In the WP '*IL&FS-Standalone Hardcopy Files Folder - 16\_Subsequent event*' the Audit Firm has not identified any subsequent events and thus failed to perform any further procedures to address them. Thus, NFRA concludes that the assertions of the Audit Firm are an afterthought and it failed to exercise professional scepticism and due skill and care expected from an auditor.

4.19. Based on the above observations NFRA concludes that:

- 4.19.1. The Audit Firm falsely reported under clause 3 (xiii) of CARO, 2016, knowing it to be false.
- 4.19.2. The Audit Firm has failed to point out the violation of the Law in the RPT policy and failed to question the management and bring the same to the notice of TCWG.
- 4.19.3. The Audit Firm failed to obtain the duly approved credit policy as sufficient appropriate audit evidence. It failed to review the lending policies of the company, thus violating

the requirements of SA 500 and Para 6.23 of the ICAI's Technical Guide on Audit of NBFCs.

- 4.19.4. The Audit Firm has failed to design and perform sufficient and appropriate audit procedures to mitigate the risks, including risks of management override of internal controls, associated with the sanction of loans, and disbursement of loans during the FY 2017- 18 by the Company. The entire documentation was insufficient, inadequate and largely absent in reference to Para 29 of SA 250, Para 32 of SA 315 and Para 8 of SA 230. The entire process of identification and assessment of risks in loan appraisal and evaluation of controls over loan appraisal and disbursement is insufficient, inadequate and a sham.
- 4.19.5. The Audit Firm failed to report a serious lapse, relating to rollovers, in the credit policy that violates RBI's Directions and thus failed to meet the requirements of SA 260.
- 4.19.6. The Audit Firm failed to report that the assignment by ITNL of loans (provided by IL&FS to ITNL) of approximately Rs.2,700 crores to various SPVs violates the RBI's Master Directions for NBFCs and failed to obtain audit evidence to form an opinion that the transfer of loans is not prejudicial to the interest of the Company as required under Section 143 (1) of the Companies Act, 2013 and is in compliance with Section 177 of the Companies Act, 2013
- 4.19.7. Thus, the Audit Firm failed to conduct the statutory audit with professional scepticism in accordance with Para 15 of SA 200.

## **5. Revenue**

### **A. Prima Facie Observations and Conclusions (PFC)**

**5.1** NFRA in its Prima-facie Conclusions conveyed the following:

**5.1.1** Revenue of IL&FS Limited as per the financial statements is close to ₹1,899 crore consisting of ₹1,577 crore from fund-based income, ₹212 crore of fee-based income and other income of ₹110 crore. This being an important item, it is required that the Audit Firm should exercise the highest degree of due diligence with respect to recognition and measurement of revenue. In the case of NBFCs, where revenue is generated from the rendering of services, it is of utmost importance, to see that the Revenue is accounted for, as prescribed by Accounting Standards and that the accounts present a true and fair picture.

NFRA has examined the audit WPs in respect of revenue recognition and has identified significant deficiencies in audit procedures. The same is dealt with below.

#### ***Accounting Policy for Revenue Recognition***

**5.1.2** Vide its communication dated 19<sup>th</sup> November 2019, NFRA specifically asked the Audit Firm to explain the methodology adopted by them to verify that the Revenue Recognition Policy of the Company was duly compliant with AS 9. In its response dated 30<sup>th</sup> December 2019, the Audit Firm, inter alia, stated that they have compared the accounting policy of the company disclosed in notes to accounts of SFS with the requirements of AS 9 and have given the reference of a few WPs in this respect and which are given below. However, on perusal of the WPs referred by the Audit Firm, NFRA noted that there is no such comparison done by the Audit Firm. The details are as follows:

- WP SFS Hard Copy File – File 1 (Part 1 of 2) - AA1 - M18 IL&FS Standalone Signed FS (Page No. A1.18) for accounting policy on revenue recognition: It is the notes to the accounts on the accounting policy for revenue recognition as provided in the SFS and does not contain any comparisons of the policy and AS 9 requirements.
- WP IL&FS-Standalone Canvas Files Folder- M18\_UA Revenue - Tab- "Work Done": In this WP, it is mentioned that the Audit Firm has verified the Interest income on FCD investments, profit on the sale of units and investments, Dividend income, Consultancy fees and Brand fees.

**5.1.3** However, there is no evidence in the WPs of any analysis involving revenue and its comparison with the revenue recognition policy of the Company and meeting the requirements of AS 9. Similarly, there is no comparison between the policy and the requirements of the AS that has been done by the Audit Firm in all the entire WPs that have been cited in support of their claim.

#### ***Project and Consultancy Fees***

**5.1.4** NFRA vide its letter dated 19<sup>th</sup> November, 2019, addressed to the Audit Firm stated that the Company has generated an income of ₹159 crore from consultancy and project and infrastructure advisory fees from the group companies. The Audit Firm was to provide the agreements entered into with the group companies, invoices raised, and documents for completion of services provided to these group companies, with reference to work papers in the Audit File. In its response dated 30<sup>th</sup> November, 2019, the Audit Firm, inter alia, stated that “we are attaching herewith on a sample basis agreement, invoice, completion of service document and confirmations of two parties, considering the voluminous nature of information. For other parties the documents are available in Canvas. We are attaching four confirmation of RPT confirmations received and 2 samples of consultancy fees on sample basis, considering the voluminous nature of information. Refer –

- IL&FS-Standalone Canvas Files Folder- M18 RPT Confirmation.zip
- IL&FS-Standalone Canvas Files Folder - M18 Consultancy Fees.zip
- IL&FS-Standalone Canvas Files Folder - M18\_UA Revenue - Tab- "Work Done", "Consultancy Fees-Infra" and "Consultancy Fees"

**5.1.5** In this regard, NFRA has examined the WPs referred by the Audit Firm for checking the documents for **₹159 crore revenue**, and the details are as follows:

a. In WP- “IL&FS-Standalone Canvas Files Folder - M18\_UA Revenue - Tab- "Work Done", it is mentioned that the Audit Firm has verified the agreements entered into and invoices raised along with verification of documents for completion of services in case of Consultancy Fees. However, no agreements or invoices are found in the referred WP.

Also, on tab- “Consultancy fees- Infra” in the above said WP, though the ET had mentioned some reference for documents (signed agreements, Invoices and service completion documents), the same could not be traced in the audit file with the mentioned nomenclature (e.g. A1, A2, B1, C3, I9 etc.).

b. The Audit Firm has provided references of zip files in the audit file namely- “M18 RPT Confirmation.zip” and “IL&FS-Standalone Canvas Files Folder - M18 Consultancy Fees.zip”. NFRA could not trace such zip files in the audit file. Though there exist numerous WPs with the name- “M18 RPT Confirmation” and “M18 Consultancy Fees”, NFRA could not trace the WPs which specifically pertain to this amount or aggregate to **₹159 crore**.

**5.1.6** Though NFRA specifically asked for copies of agreements with group companies, invoices raised and documents for completion of services in respect of income of **₹159 crore** vide its communication dated 19<sup>th</sup> November 2019, the Audit Firm did not provide any reference of such WPs which are specifically related to the total revenue generated and amounting to ₹159 crore. Therefore, the Audit Firm failed to obtain sufficient appropriate audit evidence in respect of these transactions.

- 5.1.7** Moreover, as observed from the audit file, the Company had recognized non-routine revenue of ₹110 crore in the nature of project advisory and consultancy fees from various subsidiary companies during the year ended 31<sup>st</sup> March, 2018. Also, out of ₹110 crore, only ₹8 crore was received before 31<sup>st</sup> March, 2018. In this regard, NFRA asked the Audit Firm to provide engagement letters of said services, balance confirmation of ₹102 crore and evidence regarding receipt of fees of ₹8 crore during the FY18.
- 5.1.8** Despite being specifically asked by NFRA (vide its communication dated 19<sup>th</sup> November, 2019) to provide the Engagement Letters of the services entered into by the management in respect of non-routine revenue of ₹110 crore, the Audit Firm did not provide the same.
- 5.1.9** As the Audit Firm has not specified the names of the parties/debtors to whom service of ₹110 crore in the nature of project advisory and consultancy fee was given, NFRA is unable to verify the amount due as on 31<sup>st</sup> March, 2018, in WP- "IL&FS-Standalone Canvas Files Folder - M18 Sundry Debtors – Tab - "Party Wise Listing".
- 5.1.10** In their reply, the Audit Firm has mentioned that they had verified the amount of ₹8 crore having been received and credited to the bank account, but they did not provide any reference to the bank statement as audit evidence. Therefore, NFRA could not verify the authenticity of such credit to the bank as there is no evidence in support of the Audit Firm's assertion.
- 5.1.11** The Audit Firm stated that they verified the journal entry for bank payment of ₹8 crore and have referred to a specific journal entry - "IL&FS-Standalone Canvas Files Folder-M18 JE Testing-JE Dump tab- Journal Number: Jn303361" in support of their assertion. On perusal of the said journal entry, the following points were noted:
- Name of the bank in which the amount got credited is not mentioned.
  - Name of the party is not mentioned.
  - Amount of the said journal entry is ₹12.3 crore instead of ₹8 crore.
  - "Type" of transaction mentions that it is delayed payment interest.
- 5.1.12** Therefore, considering the above, it can be said that the Audit Firm has tried to mislead NFRA by providing wrong/incomplete information. In the attachment to the email referred to by the Audit Firm in their response, it can be observed that the transaction amount pertaining to consultancy fees is ₹12 crore instead of ₹8 crore as claimed by them.
- 5.1.13** Therefore, it is concluded that the Audit Firm failed to obtain sufficient appropriate audit evidence in respect of these transactions.

#### ***Business Centre Income***

- 5.1.14** The Company has leasehold properties which have been given on a rental basis to group companies. The Company has generated an income of ₹108 crore during FY18 in the form

of Business Centre Income. In this regard, the Audit Firm was asked by NFRA vide its communication dated 19<sup>th</sup> November 2019, to provide references of lease agreements, invoices raised, and WPs related to the evaluation of whether the rent received was based on arm's length price from the audit file.

**5.1.15** The Audit Firm has given the reference of a zip file in the audit file namely- "IL&FS Standalone Canvas Files Folder-M18 Agreement Rent Income.zip". NFRA could not trace such a zip file in the audit file. Though there exist numerous documents with the name - "M18 Agreement Rent Income", a perusal of a few agreements shows that they were entered into in FY17 and the exact validity date of such agreement is not mentioned. Rather, it contains one clause which says, "*This agreement shall remain valid and in force up to the date on which the Client vacates and makes over vacant possession of the said Portion to the Company in accordance with the said agreement upon termination of the said agreement either by efflux of time or sooner expiration/ determination thereof as provided therein*". Therefore, whether such agreements were in effect in FY18 or not is nowhere evident in the audit file. Moreover, NFRA is unable to trace the agreements that pertain to this particular amount of ₹108 crore. Also, the Audit Firm did not provide any reference for invoices raised in this respect even when specifically asked for by NFRA. Hence, the Audit Firm has clearly failed to obtain sufficient appropriate audit evidence in respect of these transactions.

**5.1.16** This shows that the occurrence assertion i.e. whether revenues that have been recorded actually occurred and are related to the client, was not supported by sufficient appropriate audit evidence.

**5.1.17** In respect of Business Centre Income of ₹108 crore, the Audit Firm mentioned that they have compared the agreements on sample basis to verify whether rent has been charged at a similar rate to group companies as well as third parties. But, only one sample (of ₹24 lakhs) is considered by the Audit Firm for verification. On the basis of only one sample which is only 0.22% of total population, the Audit Firm has concluded that rent income is at arm's length price. The Audit Firm has, therefore, failed to obtain sufficient appropriate audit evidence about the arm's length nature of the rental agreements.

### ***Fund Based Income***

**5.1.18** IL&FS Limited had earned a dividend income of ₹200.31 crore during FY18. In WP "M18 UA Revenue", on "work done" tab, it is mentioned that the ET verified the dividend certificate issued by the dividend paying company and have done bank tracing for the dividend amount credited in the bank account. However, the same is not evident in the said WP for the total amount of ₹200.31 crore.

**5.1.19** In WP "M18 Dividend Sheet", which is cross referred in WP "M18 UA Revenue", out of ₹200.31 crore of dividend received by IL&FS Limited in FY18, one document is embedded within the WP on tab "Dividend Income Sch" which is a statement of accounts for a single

day i.e. 29<sup>th</sup> June, 2017, of IL&FS Limited pertaining to Central Bank of India. The ET has claimed to verify the dividend of ₹66 crore from this one-day bank statement. Though, on reading the entry in the said statement, it is not clear that the same amount was a dividend or something else. Also, only one dividend certificate for ₹9 crore is available in the WP. For the rest of the amount, there is no evidence in the said WP as to whether the Audit Firm obtained sufficient appropriate audit evidence to verify the dividend income earned.

- 5.1.20** In respect of interest income (other than investments) amounting to **₹918.26 crore**, NFRA reviewed the WP “M18 Interest Income”. In the WP, there is no reference to any bank statement. The Audit Firm did not verify whether such interest was actually received or not.
- 5.1.21** In respect of interest income amounting to ₹386.95 crore, the ET had mentioned some references for documents but the same could not be traced in the audit file with the mentioned nomenclature (e.g. 2.1/2.2/2.3, 3.1/3.2 etc.).
- 5.1.22** NFRA could not trace any work done by the ET in respect of interest income from fixed deposits/certificate of deposits amounting to ₹59 crore. In WP “Fixed Deposits Working”, the Audit Firm has done workings up to 30<sup>th</sup> September, 2017, only. According to the said WP, there were FDs amounting to ₹997 crore as at 30<sup>th</sup> September, 2017. However, NFRA could not trace any WP in the audit file where the principal amount of FDs/CoDs outstanding as at 31<sup>st</sup> March, 2018, is available. Also, NFRA could not trace any external confirmations in the audit file obtained by the Audit Firm in respect of FDs/CoDs. As such, the Audit Firm did not comply with Para 5, the basic objective of SA 505.
- 5.1.23** There is a balance with banks in demand deposits amounting to ₹246.85 crore under the head “cash and cash equivalents”. The nature of these demand deposits is nowhere mentioned in the audit file. NFRA could not trace any workings pertaining to this amount if done by the **Audit Firm**. Also, NFRA could not trace any external confirmations in the audit file obtained by the Audit Firm in respect of the outstanding balance of these demand deposits as at 31<sup>st</sup> March, 2018. As such, the Audit Firm did not comply with Para 5, the basic objective of SA 505.
- 5.1.24** Moreover, in respect of interest income from FCDs, in WP “M18 UA Revenue”, on “Master Sheet” tab, the ET had mentioned some reference for documents but the same could not be traced in the audit file with the mentioned nomenclature (e.g. 8, 3.1/3.2, 1.1/1.2 etc.).
- 5.1.25** Therefore, the Audit Firm has failed to obtain sufficient appropriate audit evidence about the dividend and interest income as part of the reported fund-based income of the Company.

### ***Arm’s Length Pricing***

**5.1.26** IL&FS Limited had generated revenue from its related parties in the form of brand subscription fees, project advisory fees, interest income etc. Therefore, it was the professional duty of the ET to analyse whether the related party transactions were undertaken at arm's length and in the normal course of business.

**5.1.27** The RPT Policy and Framework of IL&FS Limited does not mention the date as to when such policy was framed. Also, the same does not possess the signature of any official management personnel. This somehow creates a doubt about whether the available policy is duly approved or not by the management.

**5.1.28** The parameter for Arm's Length as stated in RPT Policy states that *"The parameters for AL be gauged based on any one or more of the following criteria:*

*(a) Market Price if readily available and a market exists for the same*

*(b) Price charged by the respective Group Company to Unrelated Parties*

*(c) Independent Valuations by an empanelled set of Independent Valuers which have been approved by CoD*

*(d) Obtaining two or three quotes from Unrelated Parties for similar transactions, subject to availability*

*(e) Regulatory and other Obligations including Compliance and Transfer Pricing norms as required under the Provisions of Income Tax Act, 1961"*

**5.1.29** As per Para 24 of SA 550, the Audit Firm shall obtain sufficient appropriate audit evidence about the management assertion that related party transactions were conducted at arm's length price. NFRA analysed the WP "SFS File 3 (Part 3)-Flap W: Notes to Accounts-Memo on Arm's Length (Page no. W3.1 to W3.76)" related to work done by the ET in this respect and found various deficiencies which are explained as follows:

a) In respect of interest income, ET has simply compared the average lending rate with the average borrowing rate and did not check the transactions on at least a sample basis to verify that none of the transactions with related parties is prejudicial to the interest of the shareholders.

b) In respect of income from brand fees, the Audit Firm had obtained "Brand Royalty Report" issued by Deloitte and based on that report, the ET concluded that transactions with related parties were made on arm's length basis. The said report is dated 29th April, 2015, and it is nowhere evident that the audit team performed any procedures to analyse whether the parameters used to arrive at such a conclusion in the report were applicable for FY18 or not.

c) In respect of consultancy, project and infrastructure fees, the Audit Firm has stated that they obtained a certificate from the internal auditor, read minutes of the audit committee, management representation letter, approval documents, agreements between the parties, service completion documents and on the basis of these, concluded that transactions with

related parties were made on arm's length. As explained in detail above, the Audit Firm did not provide the reference of the said documents to NFRA; it can thus be presumed that the basis of this conclusion was non-existent.

d) In respect of Business Centre Income of ₹108 crore, the Audit Firm mentioned that they have compared the agreements on a sample basis to verify whether rent has been charged at a similar rate to group companies as well as third parties. But, only one sample (of ₹24 lakhs) is considered by the Audit Firm for verification. On the basis of only one sample which is only 0.22% of the total population, the Audit Firm has concluded that rent income is at arm's length price. The Audit Firm has, therefore, failed to obtain sufficient appropriate audit evidence about the arm's length nature of the rental agreements.

e) In the WP- "Memo on Arm's length", the ET has repeatedly mentioned that - "*As a process management obtained certificate from an independent internal auditor Patel & Deodhar on a quarterly basis for all the related party transaction are carried on arm's length transaction. We have obtained such report and noted the same*". Mere relying on internal auditor's report does not free the Audit Firm from its professional duties.

**5.1.30** The Audit Firm had also stated that, "*We had also read Internal Auditor's reports wherein they had confirmed that all transactions entered with the related parties were at arm's length price and in normal course of business.*" The Audit Firm referred to the following WPs in the support of their assertion:

a) WP "M18 Internal Audit Framework"- This is an internal audit framework for FY18. The same is not signed by any official personnel. In respect of RPTs, it states that "*(1) Review the compliance with approved framework, (2) Compliance with the provisions of Companies Act, 2013.*"

b) WP "Minutes- ACM 23Aug17, ACM 8Nov17, ACM21Feb18, ACM29May18"- These are the various audit committee meeting minutes that state that the quarterly report on RPTs by internal auditors of the company was placed before the committee for its review and the committee reviewed and noted that the report was satisfactory.

**5.1.31** On perusal of the report on a review of RPTs and confirmations issued by internal auditor Patel & Deodhar, for the quarter ended 31st March, 2018, NFRA noted that the report states that "*on the basis of examination and information and explanations furnished to us, in our opinion, the related party transactions undertaken and confirmed by COD of the Company are in the normal course of business on an arm's length basis and in accordance with the policy framework approved by the Audit committee.*" There is no evidence in support of the said statement. The report does not include any details of what information/explanation was provided to the internal auditor and how or what procedures were adopted by the internal auditor to assess whether the RPT were on arm's length price.

The Audit Firm did not bother to even identify or assess the basis of the internal auditor's report and merely relied on the same without performing any audit procedures to verify the authenticity of the report.

**5.1.32** As such, the Audit Firm failed to perform appropriate audit procedures to satisfy itself as regards compliance with Section 177 and 188 of the Companies Act, 2013, so as to report appropriately whether the related party transactions were duly approved by the Audit Committee and were at arm's length price. The Audit Firm did not comply with the requirements of Para 49 (m) of Guidance Note on CARO 2016.

**5.1.33** There is no communication in the Audit File where the Audit Firm inquired of management about the following as is required under Para 13 of SA 550:

- a) The identity of the entity's related parties, including changes from the prior period;
- b) The nature of the relationships between the entity and these related parties; and
- c) Whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions.

**5.1.34** There may be a risk that management's assertion that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction may be materially misstated. Even though the ET had themselves noted in various WPs that the related party transactions had significant risks, **the Audit Firm did not perform test of details to compare the transaction with related and unrelated parties to verify that the transaction with related party were made on arm's length.** Without actually performing any audit procedures, the Audit Firm simply concluded that the transactions with related parties were made on arm's length, thus failing to comply with the provisions of Para 24 of SA 550.

**5.1.35** The Audit Firm has, therefore, failed to obtain sufficient appropriate audit evidence about the arm's length nature of the related party transactions.

***Compliance regarding Related Party Transactions (RPTs)***

**5.1.36** During the year ended 31<sup>st</sup> March, 2018, IL&FS Limited generated ₹1,759 crore of revenue from related parties which constitutes almost 93% of total revenue. Therefore, it was important for the Audit Firm to take special care to exercise the required due diligence to satisfy itself that the related party transactions duly complied with relevant laws and regulations.

**5.1.37** Para 49 of the Guidance Note on the Companies (Auditor's Report) Order, 2016, requires the auditor to report whether all transactions with the related parties are in compliance with Sections 177 and 188 of the Companies Act, 2013. For this purpose, the auditor is prima-facie required to identify/assess whether Section 188 (1) of the Companies Act, 2013, is applicable or not on the related party transactions entered into by the Company.

- 5.1.38** As explained in Para on “Arm’s length Pricing” above, the Audit Firm failed to assess whether the RPTs were at arm’s length price. As such, the Audit Firm failed to determine whether Section 188 (1) was even applicable to the RPTs.
- 5.1.39** There is no WP available in the audit file which shows that the Audit Firm followed due procedure to check the applicability of Section 188 (1). Therefore, NFRA presumes that Section 188 (1) was applicable to all the RPTs entered into by IL&FS Limited and the compliance with the same is being examined which is discussed in detail in the following points.
- 5.1.40** As per Section 188 (1) of the Companies Act, 2013, no company shall enter into any arrangement with a related party without the consent of the Board of Directors given by a resolution at a meeting of the Board. Provided that no contract or arrangement, in the case of the Company having a paid-up share capital of not less than such amount, or transactions not exceeding such sums, as may be prescribed, shall be entered into except with the prior approval of the company by a resolution.
- 5.1.41** Rule 15 (3) of the Companies (Meetings of Board and its Powers) Rules, 2014, says: “*For the purposes of first proviso to sub-section (1) of section 188, except with the prior approval of the company by a resolution, a company shall not enter into a transaction or transactions, where the transaction or transactions to be entered into-*
- (a) as contracts or arrangements with respect to clauses (a) to (e) of sub-section (1) of section 188, with criteria as mentioned below-*
- (i) sale, purchase or supply of any goods or materials, directly or through appointment of agent, [amounting to ten percent or more] of the turnover of the company or rupees one hundred crore, whichever is lower, as mentioned in clause (a) and clause (e) respectively of sub-section (1) of section 188;*
- (ii) selling or otherwise disposing of, or buying, property of any kind, directly or through appointment of agent, [amounting to ten percent or more] of net worth of the company or rupees one hundred crore, whichever is lower, as mentioned in clause (b) and clause (e) respectively of sub-section (1) of section 188;*
- (iii) leasing of property of any kind [amounting to ten percent or more] of the net worth of the company or [ten percent or more of turnover] of the company or rupees one hundred crore, whichever is lower, as mentioned in clause (c) of sub-section (1) of section 188;*
- (iv) availing or rendering of any services directly or through appointment of agent, [amounting to ten percent or more] of the turnover of the company or rupees fifty crore, whichever is lower as mentioned in clause (d) and clause (e) of sub-section (1) of section 188;*

*Explanation- It is hereby clarified that the limits specified in sub-clauses (i) to (iv) shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year.*

*(b) is for appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding two and half lakh rupees as mentioned in clause (f) of sub-section (1) of section 188; or*

*(c) is for remuneration for underwriting the subscription of any securities or derivatives thereof, of the company exceeding one percent of the net worth as mentioned in clause (g) of sub-section (1) of section 188.*

*Explanation- (1) The turnover or net worth referred in the above sub-rules shall be computed on the basis of the Audited Financial Statement of the preceding Financial year.”*

**5.1.42** IL&FS Limited earned a total revenue of ₹1,787 crore in FY17. IL&FS Limited earned ₹108 crore as lease income in FY18 from its component entities. NFRA could not trace the value of the property given on lease as the Audit Firm failed to provide lease agreements to NFRA as mentioned in para 4 above. However, it is obvious that if lease income is ₹108 crore in a financial year, then the value of the property would be much higher. As such, as per the requirements of Rule 15 (3) mentioned above, the leasing of property definitely exceeds ten percent of the turnover of the preceding financial year. Therefore, prior approval of the Company by a resolution was also required along with the Board resolution.

In reference to Rule 15 (3) (a) (iv) of the Companies (Meetings of Board and its Powers) Rules, 2014, availing or rendering of any services amounting to ten percent or more of the turnover of the Company of the preceding financial year or ₹50 crore, whichever is lower, requires the Company to pass a resolution for approval prior to entering into such transactions. IL&FS Limited earned ₹212 crore of income from consultancy, project and infrastructure advisory fees in FY18 which is much higher than the prescribed limit. Therefore, prior approval of the Company by a resolution was also required along with the Board resolution.

**5.1.43** However, on perusal of the Board meeting minutes available in the audit file, it was noticed that no such resolutions were passed by the Board in relation to related party transactions. Rather, in the minutes of the Board meeting dated 24<sup>th</sup> August, 2017, under the head “Review of Various Reports”, for the item pertaining to related party transactions, it is mentioned that, “*The Company placed the Related Party Transactions for the period 1st April, 2017 to 30<sup>th</sup> June, 2017 before the Board. The Board was further informed that the Committee of Directors (COD) had reviewed all the transactions to ensure compliance with the approved RPT framework.*” In fact, the same practice has been followed by the Company at its quarterly board meetings wherein this report was placed with identical narration. NFRA observed that the details of the related party transactions that were placed before the Board and which related party transactions were approved are nowhere mentioned in any of the Board meeting minutes.

- 5.1.44** It is surprising to note further that in the Board meeting held on 30<sup>th</sup> May, 2018, the Board, by passing a resolution, delegated the authority to the Committee of Directors (COD) to review, approve and recommend or reject related party transactions under RPT policy and report to the Audit Committee and Board of Directors which is in violation of Section 188 of the Companies Act, 2013.
- 5.1.45** The related party transactions mentioned above required the prior approval of the Company by a resolution. As explained above, even the Board resolutions were not passed for such transactions. It is clear that the basic compliance with Section 188 (1) was not fulfilled by the Company. In this regard, neither did the Audit Firm ask any question to the management nor did it take any appropriate action for such non-compliance with the Act by the Company.
- 5.1.46** Therefore, NFRA concludes that the Audit Firm failed to verify whether the requirement of Section 188 (1) of Companies Act, 2013, in respect of related party transactions was duly complied with.
- 5.1.47** Section 188 (2) of the Companies Act, 2013, says - *“Every contract or arrangement entered into sub-section (1) shall be referred to in the Board’s report to the shareholders along with the justification for entering into such contract or arrangement.”*

While reading the Board’s report to the shareholders, NFRA observes that only details of material contracts or arrangements or transactions at arm’s length basis are disclosed in Form No. AOC-2. The Company did not disclose every contract or arrangement entered into as per Section 188 (1) of the Companies Act, 2013, thus failing to comply with Section 188 (2) of the Act.

- 5.1.48** Rule 15 (1) of the Companies (Meetings of Board and its Powers) Rules, 2014, states that, *“The agenda of the Board meeting at which the resolution is proposed to be moved shall disclose*
- a. the name of the related party and nature of relationship;*
  - b. the nature, duration of the contract and particulars of the contract or arrangement;*
  - c. the material terms of the contract or arrangement including the value, if any;*
  - d. any advance paid or received for the contract or arrangement, if any;*
  - e. the manner of determining the pricing and other commercial terms, both included as part of contract and not considered as part of the contract;*
  - f. whether all factors relevant to the contract have been considered, if not, the details of factors not considered with the rationale for not considering those factors; and*
  - g. any other information relevant or important for the Board to take a decision on the proposed transaction.”*

It is important to note that the agenda of the Board meetings are not available in the audit file. As per Para 6 of SA 500, the Audit Firm shall design and perform audit procedures

that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence. As such, the Audit Firm failed to obtain and record the agendas of the six Board meetings as audit evidence in the audit file, as is required under SA 500, to verify the compliance with the aforesaid Rule.

**5.1.49** Section 189 (1) of the Companies Act, 2013, states that - *“Every company shall keep one or more registers giving separately the particulars of all contracts or arrangements to which subsection (2) of section 184 or section 188 applies, in such manner and containing such particulars as may be prescribed and after entering the particulars, such register or registers shall be placed before the next meeting of the Board and signed by all the directors present at the meeting.”* NFRA could not trace any WP where the Audit Firm has noted its opinion regarding the verification of compliance with the said section.

**5.1.50** Section 177 (4) (iv) of the Companies Act, 2013 says *“every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall inter alia, include approval or any subsequent modification of transactions of the company with related party.*

*Provided that the Audit Committee may make **omnibus approval** for related party transactions **proposed to be entered into by the company** subject to such conditions as may be prescribed. Provided further that in case of transaction, other than transactions referred to in section 188, and where Audit Committee does not approve the transaction, it shall make its recommendations to the Board.”* (Emphasis Added)

**This clearly means that the approval of the Audit Committee for related party transactions is required prior to entering into such transactions. The above said Section does not talk about post-facto approvals.**

**5.1.51** On perusal of audit committee meeting minutes, it is noted that there is one standard clause in general which states that- *“Pursuant to the Companies Act, 2013, all the transactions of a Company with its related parties were required to be approved by the Audit Committee. The Company placed the RPT for the period October 1, 2017 to December 31, 2017 before the Audit Committee for approval. All the transactions placed for approval by the Audit Committee were in the ordinary course of business and at arm’s length basis as per the approved related party framework. As required by the RPT framework all the transactions had been reviewed by the Audit Committee of Directors (COD). The committee subsequently noted and approved the foregoing”.*

Details related to what all related party transactions were placed before the audit committee and approved are nowhere mentioned in the audit committee meeting minutes. Therefore, it can be concluded that Audit Firm failed to verify whether the requirement of Section 177 of Companies Act, 2013, in respect of related party transactions was duly complied with.

**5.1.52** Para 49 of the Guidance Note on the Companies (Auditor's Report) Order, 2016, requires the Audit Firm to report whether all transactions with the related parties are in compliance with Section 177 and 188 of the Companies Act, 2013. In this regard, the Guidance Note requires the Audit Firm to perform the following duties:

- Obtain written representations from the management and, where appropriate, TCWG to ensure that they have disclosed to the auditor the identity of the entity's related parties and all the related party relationships and transactions of which they are aware.
- Obtain written representations regarding specific assertions that management may have made, such as a representation that specific related party transactions do not involve undisclosed side agreements.
- Obtain a list of companies, firms or other parties, the particulars of which are required to be entered in the register maintained under Section 189 of the Act.
- Verify the entries made in the register maintained under Section 189 of the Act from the declarations made by the directors in Form MBP-1 i.e., general notice received from a director under Rule 9(1) of the Companies (Meetings of Board and Power) Rules, 2014.
- Check whether the Company had a documentary proof of the transactions entered into by it in its ordinary course of business with its related parties are on an arm's length basis.
- Perform appropriate procedures to satisfy himself as regards compliance with Section 177 and 188 of the Act so that auditor is able to appropriately report under this clause.

**5.1.53** On perusal of the audit file, NFRA observed that there exists no evidence that the Audit Firm had performed ANY of the above said duties to verify whether the Company duly complied with Section 177 and 188 of the Companies Act, 2013 while entering into transactions with related parties.

**5.1.54** As such, the Audit Firm's statement that "*According to the information and explanations given by the management, transactions with the related parties are in compliance with Section 177 and 188 of the Companies Act, 2013 where applicable and the details have been disclosed in the notes to the financial statements, as required by the applicable accounting standards*" as per the requirements of Companies (Auditor's Report) Order, 2016, in terms of Section 143 (11) of the Companies Act, 2013, has been made without obtaining any evidence for the same. It is, therefore, a false statement in material particulars, made with knowledge of it being false.

**5.1.55** Also, the ET failed to comply with the provisions of Para A21 of SA 550.

#### ***Internal Financial Controls over Financial Reporting***

**5.1.56** Accurate, complete reporting of the entity's transactions requires robust internal controls. As per the requirements of SA 315, the Audit Firm is required to perform an assessment of the risk of material misstatement in the planning stage of the audit. As such, the ET must design appropriate audit procedures to respond to the risk that they have identified and assessed. The Audit Firm must obtain an understanding of the internal controls that the client has in place to prevent or detect such risks because proper internal controls in place

can help to minimize the risk of material misstatement that can occur in the revenue account.

- 5.1.57** As per the requirements of Para IG 5.4 of Guidance Note on Audit of Internal Financial Controls Over Financial Reporting, the Audit Firm was required to test the entity-level controls pertaining to the revenue process to ensure whether the company has effective internal financial controls.
- 5.1.58** It is observed that though the Audit Firm itself identified revenue recognition as a fraud risk in various WPs at the very planning stage of the audit, NFRA could not trace any WP in the audit file which demonstrates the overall revenue process of the company, along with the associated risks, and the controls put in place by the management to avoid those risks. There is no WP where the Audit Firm has identified whether any, and what types of controls were set up by the management at various levels of revenue recognition, and whether such controls are effectively working or not. There is no specific WP that is referred by the Audit Firm in respect of revenue for their assertion in their response dated 30<sup>th</sup> December, 2019, to NFRA's letter dated 19<sup>th</sup> November, 2019, - *"We had performed Walkthroughs and Test of Controls (TOC) in order to obtain an understanding of entity level controls."*
- 5.1.59** In WP "M18 103gl(r) Entity Level Controls", the ET had noted that- *"We inquire of management about the sources of information they use in monitoring activities and how management becomes satisfied about the integrity of that information. We also inquire of management about what actions are taken when it identifies deficiencies from the entity's monitoring of controls."* Also, it is mentioned that- *"The Company has an adequate internal control which can prevent/detect any material misstatement. There are measures involved to oversee from time to time, the financial as well as any regulatory matters. We conclude that there are adequate measures in place."* There is no sufficient appropriate audit evidence in support of these assertions as per the requirement of Para 17 of SA 200 to reduce the audit risk to an acceptably low level.
- 5.1.60** In fact, on perusal of WPs pertaining to revenue, NFRA notes serious points which create a significant doubt on the aforementioned conclusion of the Audit Firm in respect of internal controls. In WP "M18 UA Revenue", on tab "Consultancy Fees- Infra", it is observed that voucher number (JVS/M/CORP17120963) is the same for two entries on the same date 28<sup>th</sup> December, 2017, with different amounts. In the same WP, on tab "Consultancy Fees", it is observed that many vouchers were generated on a single date i.e. 28<sup>th</sup> September, 2017. On noticing the voucher numbers on the said date, it is noted that the voucher numbers had a difference of almost 400 vouchers in between (JVS/M/CORP17090620 to JVS/M/CORP17090740 to JVS/M/CORP17091129). Moreover, in this respect, NFRA reviewed the Journal Entry Dump and found that there exist no such entries on 28<sup>th</sup> September, 2017. This should have triggered the Audit Firm to verify the vouchers in between on the same date to check whether these vouchers were genuine or bogus. Also, in reference to Para 13 of SA 315, the Audit Firm should have checked whether the company had implemented effective internal controls in this regard.

- 5.1.61** Further, in WP “M18 111GL-ELCs testing”, where the Audit Firm had listed various entity level controls to assess the operating effectiveness of those controls, we could not identify a single control related to revenue recognition process. It is a clear evidence that the ET did not check whether the whole revenue process was free from risk of material misstatements.
- 5.1.62** As per Para IG 19.20 of Guidance Note on Audit of Internal Financial Controls Over Financial Reporting, the Audit Firm was required to identify whether there exists any entity level control to prevent or detect the unauthorised journal entries passed by the entity personnel. The Audit Firm in this regard should have considered or analysed how journal entries were recorded in the general ledger. Also, the Audit Firm should have performed appropriate audit procedures to verify that the journal entries were free from any discrepancies.
- 5.1.63** In its own assertion, the Audit Firm mentioned that they had identified management override of controls in revenue from operations as a fraud risk. For procedures performed in respect of the same, the Audit Firm mentioned that they verified the completeness of the journal entry dump. The Audit Firm also said that they had performed journal entry testing to verify that maker checker control existed while passing journal entries in AXAPTA system and to verify that no entries were being passed by senior management personnel. On perusal of WP “M18 JE Testing”, it is noted that out of 2,79,874 journal entries in the JE Dump, the Audit Firm had performed testing for only 25 samples of journal entries. Also, in the same WP, under the heading “work done”, the Audit Firm had clearly mentioned that they had identified and performed procedures and obtained reasons for the entries which show blank checker/ same maker checker. While reviewing the actual work done in this respect, it is observed that reasons are nowhere documented as to why some journal entries had blank checker/ same maker checker. In fact, in this respect, there is no audit evidence if the Audit Firm performed any audit procedures at all. Also, it is nowhere documented in the audit file whether the Audit Firm inquired from the company’s staff related to internal controls processes, or observed the staff performing the controls. Therefore, it can be concluded that the Audit Firm failed to perform audit procedures to assess the risk of management override of controls, as required by Para 31 and 32 of SA 240.
- 5.1.64** The Audit Firm has, therefore, failed to identify the risk of material misstatement as per SA 315. Also, the Audit Firm failed to comply with the requirements of Para 12 to Para 24 of SA 315 and Para 32 of SA 240 and did not check whether the company had appropriate internal controls in place and if those controls were working effectively to mitigate the risk of material misstatement especially pertaining to revenue.
- 5.1.65** The audit Firm also failed to perform the audit of internal financial controls over financial reporting as per the requirements of Guidance Note on Audit of Internal Financial Controls Over Financial Reporting.

### ***Trade Receivables***

- 5.1.66** It is noticed that the Company had charged brand subscription fees to IL&FS Tamil Nadu Power Company Limited (ITPCL) amounting to ₹48 crore till March 2015. As at 31<sup>st</sup> March, 2018, the amount is presented under debtors and no provision has been created on the same. In this regard, NFRA asked a few queries to the **Audit Firm**.
- 5.1.67** In their response, the Audit Firm had said that as part of the audit procedures performed by them, they had discussed with the management and TCWG about non-provisioning of ₹48 crore but there is no evidence for the same. The Audit Firm has referred to the PPT presented to the audit committee on 29<sup>th</sup> May, 2018, as an evidence in this context which cannot be construed as audit evidence for the following reasons:
- The PPT was made on the day just before the signing of the Auditor's Report for SFS.
  - It was a one-side communication from the Audit Firm and hence, cannot be claimed as a DISCUSSION.
- 5.1.68** The Audit Firm claims that as part of the audit procedures, they have obtained representation from the management that no provision was required. The LOR in the said context was obtained on the very signing date of Auditor's Report which is clearly done for the sake of formality.
- 5.1.69** The WP- "SFS Hard copy File - File 3 H (part 1 of 2) - 3 IEDCL (Page no. IEDCL 5.1 to IEDCL 5.5)" referred to by the Audit Firm wherein cash flows of ITPCL were analysed also states under the heading "work done" that the Audit Firm obtained valuation model and representation from management to assess whether all assumptions and projections made by the management were correct. The same is not evident in the said reference given by the Audit Firm. Therefore, it can be concluded that the Audit Firm did not perform any audit procedure to evaluate the recoverability of ₹48 crore.
- 5.1.70** The audit evidence referred to by the Audit Firm in the context of balance confirmation of ₹48 crore from ITPCL is not reliable as the same was not obtained by the Audit Firm directly from ITPCL as was required to be obtained as per SA 505.
- 5.1.71** As per Para 16 (4) of Master Direction- Core Investment Companies (Reserve Bank) Directions, 2016, the said amount of ₹48 crore should have been considered as NPA and accordingly, as per Para 17 of the said Master Direction, appropriate provision should have been made by the Company. The Audit Firm relied on the Company's decision of not making any provision and accordingly, the Audit Firm failed to identify and assess the risk of material misstatement in the financial statement as per the requirements of Para 25 of SA 315. Further, in this regard, NFRA examined the WP- "SFS Hard copy File - File 3 H (part 1 of 2) - 3 IEDCL (Page no. IEDCL 5.1 to IEDCL 5.5)" referred by the Audit Firm with respect to subject provisioning and its relationship with the materiality defined by the Audit Firm for the purpose. However, there are no workings or evidence in the WP

regarding the application of materiality to the subject provisioning of 48 crore and further, there is no evidence of any examination having been done in this regard by the Audit Firm in the WP.

**5.1.72** Thus, in view of the above-mentioned reasons, it is reasonable to conclude that the Audit Firm relied on the decision of the management for non-provisioning of ₹48 crore without sufficient justification and did not perform appropriate audit procedures to analyse the need for provision of the said amount.

**5.1.73** Therefore, the Audit Firm failed in its professional duties.

### ***Substantive Analytical Procedures for Revenue***

**5.1.74** As per the provisions of Para 5 read with Para A1 of SA 520, the Audit Firm shall design and perform substantive analytical procedures, either alone or in combination with test of details, by considering the comparisons of the entity's financial information with a) information for prior periods, b) anticipated results such as budgets or forecasts, c) comparison of entity's ratios of sales to accounts receivables with industry averages or with other entities of comparable size in the same industry. On a perusal of the WP "IL&FS-Standalone Canvas Files Folder-M18 IL&FS OAR" placed in the audit file, it is noticed that no such analytical procedures were performed by the Audit Firm. Hence, in respect of revenue, the Audit Firm did not comply with the requirements of SA 520.

### **B. Observations made in the DAQRR**

5.2. After examining the replies of the Audit Firm to the above observations, NFRA in its DAQRR had conveyed the following:

**5.2.1** It must be noted that SA 230 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. Unsubstantiated claims and oral representations cannot be considered. Oral representations, if any, have also to be reduced to writing to form part of the record and to eliminate the scope for disputes. 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.

**5.2.2** The **ICAI Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards** says the following about the **Users of Financial Information**. "The users of financial statements include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public". **The management of the entity is specifically excluded from the set of users.**

- 5.2.3** The purpose of financial statements is said to be “The objective of financial statements is to provide information about the financial position, performance and cash flows of an entity that is useful to a wide range of users in making economic decisions”.
- 5.2.4** There is a clear set of positive duties that are cast upon the auditor by the SAs.
- 5.2.5** As a professional, the auditor must display the level of competence, skill, and application that is normally expected of such a professional. This is the irreducible minimum. Recognising the fact that the interests of the users as a group are at variance with the interests of the management, the SAs also require him to maintain independence from the management of the auditee company. Apart from the SAs, there are numerous restrictions and safeguards that are built into the Companies Act itself, that need to be complied with. The auditor is also required to maintain an attitude of professional skepticism which 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” (Para 13(l) of SA 200). It also includes “questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance” (Para A20 of SA 200).
- 5.2.6** In Para 3 of the response of the Audit Firm pertaining to revenue, the Audit Firm has listed in detail the audit procedures performed by them to verify that revenue was recognized as per AS 9. On analysis of the response, NFRA finds that the WPs referred by the Audit Firm in support of their assertions were already examined in detail by NFRA at the stage of forming its Prima Facie Conclusions (PFC). Nothing additional/new to what was considered earlier by NFRA has now been provided by the Audit Firm.
- 5.2.7** Hence, NFRA concludes that no further examination is required and NFRA reiterates its conclusions provided in Para 5.1.1 above.
- 5.2.8** In view of the above explanations, NFRA reiterates its conclusion that the Audit Firm did not conduct its professional duties as explained in the PFC.

**NOTE:** In its communication dated 30<sup>th</sup> December, 2019 and 14<sup>th</sup> April, 2021, the Audit Firm gave the references of few zip files which were not available in the audit file submitted by the Audit Firm to NFRA via FTP. In this regard, vide its letter dated 19<sup>th</sup> June, 2021, NFRA asked the Audit Firm to clearly provide the reference of individual/actual WPs instead of zip files from the audit file for examination by NFRA. Accordingly, vide its response dated 25<sup>th</sup> June, 2021, the Audit Firm provided the individual reference of the WPs which is now easily traceable in the audit file by NFRA. As the WPs are now traceable in the audit file, NFRA withdraws its observations provided in PFC that the WPs relevant to zip files were not available in the audit file submitted by the Audit Firm. It is clarified that this must not be taken as NFRA's conclusions about the content of such WPs. NFRA's conclusions on such content may be seen in subsequent sections of this chapter.

- 5.2.9** Vide its response dated 14<sup>th</sup> April, 2021, the Audit Firm has stated that *“We had read the accounting policy of the Company with respect to Revenue and AS 9, through this we analyzed that the accounting policy followed by the Company was in line with AS 9. Further, we had verified this during our substantive audit procedures performed on revenue and by filling checklist to verify overall compliance with AS 9.”* The Audit Firm has also given reference to the WPs “IL&FS-Standalone Hardcopy Files Folder - 2\_M18 Standalone Signed FS (Page No. A1.18) for accounting policy on revenue recognition, IL&FS-Standalone Canvas Files Folder - 358.1 to 358.23 M18\_UA Revenue and IL&FS-Standalone Canvas Files Folder - 498.1 M18 AS Checklist – Accounting Standard 09” in support of their assertion.
- 5.2.10** On perusal of the WP “IL&FS-Standalone Canvas Files Folder - 498.1 M18 AS Checklist – Accounting Standard 09”, NFRA finds that the said WP neither contains the date nor the FY it relates to. It is a mere a ‘Yes’ or ‘No’ checklist of the requirement of AS 9 without mention of any reason for stating ‘Yes’ or ‘No’. There is no documentation that forms the basis of the work performed or the conclusions reached in this checklist.
- 5.2.11** Further, the other two WPs referred by the Audit Firm in support of their assertion were already examined in detail by NFRA at the stage of forming its PFC. Nothing additional/new to what was considered earlier by NFRA has now been provided by the **Audit Firm**. Hence, NFRA concludes that no further examination is required.
- 5.2.12** In Para 18 of their response, the Audit Firm has stated that *“We verified that the amount had been received and credited to the Central Bank of India’s current account on September 28, 2017. However, as per SA 230, audit file cannot be treated as substitute for the entity’s accounting records and SRBC was not required to document all the matters considered during the audit”*. In [Para 5.2.1](#) above, NFRA has explained that audit file should be capable of speaking for itself without the need for any other aids to interpretation. As such, in view of the said explanation, the said assertion of the Audit Firm is unacceptable.

**5.2.13** The Audit Firm has also stated that “*The name of bank account, in which money was received, is Central Bank of India on September 28, 2017. Cross party name was mentioned in the journal entry as ‘East Delhi Waste Processing Company Limited’. ‘Type’ column had been added by SRBC, for performing some analysis, which is not relevant in this case*”. Though the journal entry “IL&FS-Standalone Canvas Files Folder-438.1 to 438.9 M18 JE Testing - JE Dump tab - Journal Number: Jn303361” ~~was~~ had been examined by NFRA at the stage of PFC, nevertheless, NFRA again examined the said journal entry. NFRA finds that neither the journal entry nor any of the WPs placed in the audit file evidence the receipt of ₹8 crore in “Central Bank of India”, as claimed by the Audit Firm.

**5.2.14** NFRA also notes that in WP “358.1 to 358.23 M18\_UA Revenue - Tab- "Consultancy Fees-Infra", where the Audit Firm had documented the details of consultancy income received from various parties, inter alia the following two entries are noted in the WP:

<b>Date</b>	<b>Voucher</b>	<b>Ledger account</b>	<b>Cross-party Name</b>	<b>Amount currency</b>
31 <sup>st</sup> March, 2018	<i>(Not mentioned in the WP)</i>	42100002	East Delhi Waste Processing Company Limited	4,00,00,000
15 <sup>th</sup> September, 2017	JVS/M/CORP1 7090185	42100002	East Delhi Waste Processing Company Limited	8,00,00,000

NFRA observes that the journal entry mentioned in Para 5.2.14 above was passed on **28<sup>th</sup> September, 2017**, mentioning voucher as “BR/M/Corp17090263”, amount as ₹12.3 crore. It is questionable as to how one can pass the journal entry of any transaction before such transaction has actually taken place. In the current case, as shown in the above table, IL&FS Limited earned the revenue of ₹4 crore on 31<sup>st</sup> March, 2018, (same is evident from the invoice “IL&FS-Standalone Canvas Files Folder - 357.1.19.1 M18 Consultancy Fees\_Consultancy Fee-Infra\_I12 East delhi” available in the audit file), which was recorded in the books of account of IL&FS Limited on 28<sup>th</sup> September, 2017, i.e., prior to the date when actual transaction of ₹4 crore took place.

**5.2.15** NFRA concludes that the Audit Firm failed to identify the significant deficiency mentioned above. It also creates a significant doubt about the internal controls of the Company pertaining to journal entries being passed. As the Audit Firm itself has stated that “*SRBC would like to state that the journal entry dump attached in workpaper was extracted from IL&FS accounting system ‘AXAPTA’*”, this clearly implies that the Audit Firm not only failed to test the entity level controls but also failed to perform IT Audit effectively.

- 5.2.16 Further, in respect of balance confirmation, the WP “IL&FS-Standalone Canvas Files Folder - 431.46.2.1 M18 RPT Confirmation\_R51\_Fw Balance confirmation-ILFS vs IEISL -- East Delli for confirmation” referred by the Audit Firm is an email communication from IL&FS limited to the **Audit Firm**. The said email has an embedded document which is the instructions given by the IL&FS Limited to East Delhi Waste Processing Company Limited for providing the information in respect of all the transactions/balances with IL&FS Limited to the **Audit Firm**. Clearly, it is evident that the Audit Firm failed to obtain balance confirmation **directly** from East Delhi Waste Processing Company Limited as per the requirements of SA 505.
- 5.2.17 Therefore, in view of above said explanation, NFRA reiterates its conclusion that the Audit Firm has tried to mislead NFRA by providing wrong/incomplete information and has failed to obtain sufficient appropriate audit evidence in respect of receipt of project & consultancy fees.
- 5.2.18 Para A9 of SA 500 says, “*Information from sources independent of the entity that the auditor may use as audit evidence may include confirmations from third parties, analysts’ reports, and comparable data about competitors.*” (Emphasis Added)
- 5.2.19 Para 2 of SA 505 says, “*SA 500 indicates that the reliability of audit evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained. That SA also includes the following generalisations applicable to audit evidence: • Audit evidence is **more reliable when it is obtained from independent sources outside the entity** • Audit evidence **obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.** • Audit evidence is more reliable when it exists in documentary form, whether paper, electronic or other medium. Accordingly, depending on the circumstances of the audit, audit evidence in the form of external confirmations **received directly by the auditor from confirming parties may be more reliable than evidence generated internally by the entity.** This SA is intended to assist the auditor in designing and performing external confirmations procedures to obtain relevant and reliable audit evidence.*” (Emphasis Added)
- 5.2.20 Considering the requirements of SAs stated above, it is clear that the Audit Firm is required to **obtain confirmations from third party directly without interference of the Auditee Company.**
- 5.2.21 Vide its response dated 14<sup>th</sup> April, 2021, in Para 30, the Audit Firm has given reference to various WPs which are related party confirmations for transactions undertaken during the year ended 31<sup>st</sup> March, 2018, in respect of dividend income received by IL&FS Limited. As per the documents, IL&FS Limited provided the instructions to respective third parties to provide the information directly to the Audit Firm. In fact, IL&FS Limited also attached the Annexure (which itself mentions all the details like account

group, account codes, account description, amount) with the instruction letter to provide the confirmation. On perusal of the referred WPs, NFRA observes that the confirmations were not directly received by the Audit Firm from the third party. There is nothing in the record as for example, a direct email receipt that proves that the confirmations were directly received by the Audit Firm from the third party. What the audit file contains is only documents purportedly signed by the third party which itself does not prove that the same was received by the Audit Firm from the third parties directly. Hence, NFRA concludes that the Audit Firm failed to comply with the requirements of SA 505 to obtain balance confirmations from the third party directly. Moreover, the Audit Firm did not even verify from the bank statements whether the dividend was actually credited to the bank account of IL&FS Limited or not.

- 5.2.22** In Para 38 to 40 of their response, the Audit Firm, inter alia, has stated that *“SRBC had performed the audit procedures in compliance with Guidance Note on Audit of Revenue to conclude that the interest income on fixed deposit recognized by the Company is in compliance with AS 9. We had recomputed entire interest income of fixed deposit for the year ended March 31, 2018. Refer ‘FD Income’ tab in IL&FS-Standalone Canvas Files Folder – 341.1 to 341.17 M18 Cash & Bank Lead.”* On perusal of the referred WP, NFRA finds that there is a difference of almost ₹35 lakh in interest computed by the Company and interest recomputed by the **Audit Firm**. The reason for such difference is nowhere recorded in the WP. Also, what audit procedures were performed by the Audit Firm in respect of the difference identified is not documented in the said WP.
- 5.2.23** In its PFC, NFRA specifically mentioned that the external confirmations pertaining to FDs amounting to ₹997 crore (as on 30<sup>th</sup> September, 2017) were not traceable in the audit file. Vide its response dated 14<sup>th</sup> April, 2021, the Audit Firm, in respect of confirmations of FDs, has given reference to the WPs *“‘CB 4’ tab in ‘IL&FS-Standalone Canvas Files Folder – 341.1 to 341.17 M18 Cash & Bank Lead’, ILFS Standalone canvas files – From 351.1.1.1.1 To 351.1.2.68 - M18 Direct Confirmations.zip and IL&FS-Standalone Hardcopy Files Folder - 25\_Direct Confirmations”*. On perusal of the audit file, NFRA finds that there is no statement prepared by the Audit Firm giving the total value of FDs for which confirmations have been received. Therefore, it is clear that the Audit Firm did not conduct any procedures to test that direct confirmation from the banks in respect of the entire amount of ₹997 crore have been received.
- 5.2.24** Further, NFRA mentioned in its PFC that external confirmations pertaining to balance with banks in demand deposits amounting to ₹246.85 crore were also not traceable in the audit file. There is no response provided by the Audit Firm to this point. Not providing reference to any WP placed in the audit file in this respect is conclusive proof that the Audit Firm failed to obtain external confirmations from the bank as per the requirement of SA 505.

**5.2.25** Vide its response dated 14<sup>th</sup> April, 2021, the Audit Firm has stated that *“At the outset, SRBC would like to state that it is not mandatory that all the evidences obtained during the audit needs to be signed by any official management personnel. RPT Policy and Framework was available on IL&FS website during the period of our audit, which in itself proves the authenticity and validity of the said policy. <https://www.ilfsindia.com/search?query=policy>. As RPT Policy and Framework is part of Company records, if required, the authenticity of the same can also be verified from the Company.”*

It is important to note that in order to establish authenticity and legal validity of any document, it is the prime duty of the Audit Firm to obtain the duly signed document by the Company. Even if it is a signed document, it has to be ensured that the person who has signed the document must possess the necessary authority to sign such a document and the same must be provided to the Audit Firm by one of the KMPs under his/her attestation. Also, Para A18 to A21 of SA 200 focuses on professional skepticism that is necessary for the critical assessment of audit evidence, reliability and the authenticity of the audit evidence obtained by the Audit Firm from Management or TCWG, Hence, NFRA refutes the statement *“SRBC would like to state that it is not mandatory that all the evidences obtained during the audit needs to be signed by any official management personnel”* of the **Audit Firm**.

Further, NFRA notes that the RPT Policy available on the website of the Company does not mention for which FY it is applicable. Hence, this creates a significant doubt that the policy available on the website was effective in FY18 or not or whether there were any changes in it.

**5.2.26** In Para 49 to 52 of their response, the WPs referred by the Audit Firm in support of their assertions were already examined in detail by NFRA at the stage of forming its PFC. Nothing additional/new to what was considered earlier by NFRA has now been provided by the Audit Firm. Hence, NFRA concludes that no further examination is required and NFRA reiterates its conclusion drawn in Para 6.4 (b) to 6.4 (e) of its PFC.

**5.2.27** Further, The Audit Firm has also stated that *“SRBC would like to state that we had obtained internal audit report as one of the audit evidences and not as a single conclusive evidence. The internal audit was conducted by a Chartered Accountant firm and SRBC had relied that the firm would had concluded its observations based on the evidence obtained by them.”* NFRA observations in this regard are as follows:

- a) Para 15 of SA 610 (Revised) says, *“The external auditor shall determine whether the work of the internal audit function can be used for purposes of the audit by evaluating the following: (a) The extent to which the internal audit function’s organizational status and relevant policies and procedures support the objectivity of the internal auditors; (Ref: Para. A5–A9) (b) The level of competence of the internal audit function; and (Ref: Para. A5– A9) (c) Whether the internal audit function*

*applies a systematic and disciplined approach, including quality control. (Ref: Para. A10–A11)”*

- b) Para 36 of SA 610 (Revised) says, *“If the external auditor uses the work of the internal audit function, the external auditor shall include in the audit documentation: (a) The evaluation of: (i) Whether the function’s organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors; (ii) The level of competence of the function; and (iii) Whether the function applies a systematic and disciplined approach, including quality control; (b) The nature and extent of the work used and the basis for that decision; and (c) The audit procedures performed by the external auditor to evaluate the adequacy of the work used.”*
  
- c) In WP “Memo on Arm’s Length”, the Audit Firm had formed the conclusion that the transactions with related parties are made on an arm’s length basis. One of the reasons in support of this conclusion states that *“As a process management obtained certificate from an independent internal auditor Patel & Deodhar on a quarterly basis for all the related party transaction are carried on arm’s length transaction. We have obtained such report and noted the same.”* Therefore, it is conclusive proof that the Audit Firm had used the work of the internal auditor Patel & Deodhar as also admitted by them in their above assertion that they had relied that the internal auditor would have concluded its observations based on the evidence obtained by them.
  
- d) As the Audit Firm had used the work of the internal auditor, in view of the above paras of SA 610 (Revised), the Audit Firm must have evaluated the competence, objectivity and work of the internal auditor instead of simply relying on it. Also, the Audit Firm must have done the documentation in the audit file as per the requirement of Para 36 of SA 610 (Revised) which it failed to do so. Therefore, NFRA concludes that the Audit Firm simply relied on the work of the internal auditor without complying with the requirements of SA 610 (Revised).

**5.2.28** The WPs referred by the Audit Firm in support of their assertion in Para 59 of their response was already examined in detail by NFRA at the stage of forming its PFC. Nevertheless, NFRA re-examined the referred WPs and finds that none of the documents is the communication from **Audit Firm to Management** inquiring about related party transactions as per the requirements of Para 13 of SA 550. In fact, the referred WPs do not mention changes from the prior period in related parties and the purpose of the RPTs as claimed by the Audit Firm in Para 59 of their response. Hence, NFRA reiterates its conclusion drawn in Para 5.1.33 above.

**5.2.29** Considering the reasons explained above, NFRA reiterates its conclusion that the Audit Firm failed to assess whether the RPTs were at arm’s length price and failed to determine whether Section 188 (1) was even applicable to the RPTs. The WP “IL&FS-Standalone Hardcopy Files Folder - 47\_Memo on Arm's Length (Page no. W3.1 to W3.76)” referred by the Audit Firm in support of their assertion that *“SRBC had*

*performed audit procedures to verify and concluded that the related party transactions were undertaken at arm's length*" was already examined in detail by NFRA at the stage of forming its PFC. Therefore, NFRA concludes that no further examination is required and rejects the Audit Firm's assertions provided in Para 65,66,67, 68, 74 and 75 of their response. NFRA reiterates its conclusion provided in Para 5.1.36 to 5.1.46 above.

**5.2.30** In Para 73 of its response, the Audit Firm has stated that "*Section 188(2) of Companies Act, 2013 prescribes disclosure in the board report of certain contracts or arrangements entered with related parties. The duty has been cast on the management to comply with this section. SRBC was not required to verify Board Report during the year ended March 31, 2018, as SA 720, which casts the responsibility on auditor to verify other information accompanying financial statements, was not applicable for the audit of financial statements for the year ended March 31, 2018. Further, Board Report containing AOC 2 was not available to SRBC, upto the issuance of audit report for the year ended March 31, 2018.*"

**5.2.31** First and foremost, SA 720 was very much effective for FY18. It is SA 720 (Revised) that came into effect on 1<sup>st</sup> April, 2018. Therefore, the Audit Firm's assertion that SA 720 was not applicable for the audit of financial statements for the year ended 31<sup>st</sup> March, 2018 is factually incorrect.

SA 720, The Auditor's Responsibility in Relation to Other Information in Documents containing Audited Financial Statements, defines the term 'other information' as "*Financial and non-financial information (other than the financial statements and the auditor's report thereon) which is included, either by law, regulation or custom, in a document containing audited financial statements and the auditor's report thereon.*" As per Para 6 of SA 720, the auditor shall read the other information to identify material inconsistencies, if any, with the audited financial statements. Also, Para 7 of SA 720 says, "*the auditor shall make appropriate arrangements with management or those charged with governance to obtain the other information prior to the date of the auditor's report. If it is not possible to obtain all the other information prior to the date of the auditor's report, the auditor shall read such other information as soon as practicable.*" Hence, the auditor was required to verify if other elements in the annual report has any material inconsistencies with the audited financial statements.

Moreover, the Audit Firm's assertion that the Board Report containing AOC 2 was not available to them up to the issuance of the audit report for the year ended 31<sup>st</sup> March, 2018, is again unacceptable in light of Para 11-14 of SA 720. According to the said SA, in case material inconsistencies identified in other information were obtained subsequent to the date of the Auditor's Report and when a revision of the other information is necessary but management refuses to make the revision, the Audit Firm shall carry out the procedures necessary under the circumstances or shall notify those charged with governance of the auditor's concern regarding the other information and take any further appropriate action.

Therefore, in light of the aforesaid paras of SA 720, the Audit Firm's assertion as reproduced above is unacceptable.

- 5.2.32** In Para 74 of its response, the Audit Firm, inter alia, has stated that *“considering the voluminous transactions, it was not practicable for management to reach out to Audit Committee for approval on a day to day basis i.e. whenever Company enters a transaction with related parties. Accordingly, management of IL&FS obtained Audit Committee approval for all the transactions undertaken in a quarter, in the Audit Committee meeting held subsequent to the quarter.”* The Audit Firm also states that *“It is also pertinent to note that the audit committee was comprised of eminent individuals who were independent to the Company and at no stage did the Audit Committee observe that the process of post facto approval was exposing the company to undue risks.”*

NFRA is surprised to read such an unprofessional statement from the Audit Firm that the Company could not obtain audit committee approval before entering into the related party transactions. Self-admission of the fact by the Audit Firm that the management of IL&FS Limited obtained Audit Committee approval for all the transactions undertaken in a quarter, in the Audit Committee meeting held subsequent to the quarter is a conclusive proof that IL&FS Limited failed to comply with the requirements of Section 177 of the Companies Act, 2013.

Further, the Audit Firm's assertion that the process of post-facto approval did not expose the Company to undue risks itself proves that the Audit Firm, despite full knowledge of the facts of the situation, did not do what they were professionally expected to do as per the requirement of the Companies Act, 2013 and SAs and made a false statement under Para 3 (xiii) of the Companies (Auditor's Report) Order, 2016.

- 5.2.33** As per the RPT Policy available on the website of the Company, the RPTs are divided into the following two categories:

- **Exempt RPTs:** RPTs of a Company in the OCB and on AL basis are referred to as “Exempt RPTs”.
- **Non-Exempt RPTs:** RPTs which are not in the OCB and/or not on AL basis are referred to as the “Non-Exempt RPTs”.

In the RPT Policy, the process of RPTs is stated as follows:

- a) **Exempt RPT:**
- i. *The Committee of Directors (CoD) would review all RPTs on an ongoing basis. The CoD shall confirm that all RPT transactions conform to the framework laid down by the Audit Committee. As a part of internal control and governance framework, all exempt RPTs will be approved by the CoD.*

ii. *The internal auditors of the Company shall review all RPTs approved by CoD on a periodic basis and report their observations to the Audit Committee.*

b) ***Non Exempt RPT:*** *All Non-Exempt RPTs falling outside the framework and not in the Ordinary Course of Business (OCB) and/or not on an Arm's Length (AL) basis shall be liable for the compliance requirement as prescribed under the Act. The procedure for approval of such Non-Exempt RPTs would be:*

i. *The CoD to put up the RPTs falling outside the RPT framework to Audit Committee of the Company (AC) for its review/approval and further action as may be deemed appropriate by the Committee. RPTs falling outside the framework could be reviewed periodically and be included in the RPT Framework, based on recurrence and significance to the Company, providing adequate justification and documentation for the same wherever necessary.*

ii. *AC shall review and evaluate the Non-Exempt RPTs and if the proposed RPT was found to qualify as an Exempt RPT, approve the same or otherwise recommend to the Board for its review and decision, as long as RPTs are within the threshold limits prescribed under the Act.*

iii. *In case on Non-Exempt RPTs which fall outside the threshold limit, such RPTs should be taken to the Board for approval. The Board shall recommend these RPTs to the Shareholders for their approvals.*

iv. *Pursuant to the Act, the RPTs which are not in OCB and/or which are not on AL basis would need prior approval of the Board and Shareholders of the Company."*

**5.2.34** As per the process laid down in the RPT Policy regarding approvals of the RPTs, **prior** approval of the **proposed RPTs** was required. The Company failed to comply with its own RPT Policy and the Audit Firm failed to identify this non-compliance. This clearly shows that the Audit Firm completely failed to read the RPT Policy of the Company.

**5.2.35** Also, the word "approval" as used in the Companies Act, 2013, and also in the Company's RPT Policy itself means that consent of the Audit Committee is required to be taken **before doing the act or before entering into transactions**. In common parlance, there is no point getting the approval of something after the action has already taken place.

**5.2.36** In first proviso to Section 177 (4) (iv) of the Companies Act, 2013, the words "*related party transactions proposed to be entered into by the Company*" (Emphasis Added) clearly implies that the transactions which are not already entered into by the Company, and which will be entered into the near future, need to be approved by the Audit Committee.

**5.2.37** Vide Circular No. CIR/CFD/CMD/5/2015 dated 24<sup>th</sup> September, 2015, SEBI issued the formats for Compliance Report on Corporate Governance which clearly asks the Company to answer whether prior approval of the audit committee was obtained or not.

- 5.2.38** In view of the reasons explained above, it is clear that the Company is required to take prior approval of the RPTs by the Audit Committee. As such, NFRA refutes the Audit Firm assertion that *“The interpretation of NFRA that prior approval is required under Section 177(4)(iv) for all related party transactions is, in our view, not correct”* as it is factually incorrect.
- 5.2.39** Also, NFRA reiterates its conclusion provided in Para 5.1.54 above that the Audit Firm made a false statement that *“According to the information and explanations given by the management, transactions with the related parties are in compliance with Section 177 and 188 of the Companies Act, 2013 where applicable and the details have been disclosed in the notes to the financial statements, as required by the applicable accounting standards”* as per the requirements of Companies (Auditor’s Report) Order, 2016, knowing to it to be false.
- 5.2.40** The document “Appendix 6 (Page No. A33 to A57)” as referred by the Audit Firm cannot be taken into consideration as the same does not form part of the audit file. Other than this document, the WPs referred by the Audit Firm in Para 82 and 85 of their response was already examined in detail by NFRA at the stage of forming its PFC. Nothing additional/new to what was considered earlier by NFRA has now been provided by the Audit Firm. Hence, NFRA concludes that no further examination is required and reiterates its conclusion provided in Para 5.1.51 to 5.1.54 above.
- 5.2.41** In Para 88 of their response, the Audit Firm has stated that *“SA 230 does not necessarily require SRBC to retain agenda as part of audit documentation because audit file cannot be treated as substitution of company’s accounting records and Audit Firm cannot be expected to document every matter considered or professional judgement made.”* In Para 5.2.1 above, NFRA has explained that audit file should be capable of speaking for itself without the need for any other aids to interpretation. As such, in view of the said explanation, the said assertion of the Audit Firm is unacceptable.
- 5.2.42** In Para 5.1.60 above, NFRA noted some discrepancy pertaining to voucher number “JVS/M/CORP17120963”. The Audit Firm has provided some explanation in Para 97 of their response in respect of the observation of NFRA which is not evident in the WP referred by the Audit Firm in support of their explanation. Hence, NFRA refutes the assertion of the Audit Firm that *“We would humbly like to clarify that there was no error in accounting and issues raised by NFRA are not tenable”*.
- 5.2.43** The sample size of 25 journal entries out of 2,79,874 journal entries in the JE Dump is only 0.009% of total population. As such there is no basis for the Audit Firm’s assertion that *“We had followed Random Sampling method (which is listed as a principal method of sampling under Appendix 4 of SA 530), so that the extent of coverage of the samples under audit were representative of the entire population in case of test of controls and test of details.”*

- 5.2.44** The WPs referred in Para 92, 94, 104, 105 and 106 of response of the Audit Firm were already examined in detail by NFRA at the stage of forming its PFC. Nothing additional/new to what was considered earlier by NFRA has now been provided by the Audit Firm. Hence, NFRA concludes that no further examination is required and reiterates its conclusions provided in Para 5.1.56 above.
- 5.2.45** The Audit Firm has stated that *“in this case management had followed provision policy approved by Committee of Directors, which were authorized by Board of Directors, and management had taken the approval of Audit Committee for not creating any provision on ITPCL brand fees dues, as required by said provision policy. Accordingly, the question of SRBC informing TCWG on the date of adoption of accounts, does not arise as management had already taken the approvals of TCWG for not creating provision, as required by the provision policy approved by TCWG.”* For NFRA’s observations on communication with TCWG, please refer ‘Communication with TCWG’ section of this AQRR.
- 5.2.46** As per the requirements of Para A16 of SA 580, the Audit Firm is required to obtain a written representation about a specific assertion in the financial statements from the management during the course of the audit. Whenever needed, it may be necessary to request an updated written representation. In Para 113 of its response, the Audit Firm has stated that *“management representation was obtained at the end of audit to confirm various representations made by management during the course of audit and does not provide new audit evidences.”* NFRA notes that the various representations made by the management during the course of audit (as stated by the Audit Firm itself) are not available in the audit file. As such, there is no proof of whether the Audit Firm even obtained the representation from the management during the course of the audit. Hence, NFRA considers this statement of the Audit Firm as an afterthought to mislead NFRA.
- 5.2.47** The WPs referred by the Audit Firm in Paras 114 and 115 of their response were already examined in detail by NFRA at the stage of forming its PFC. Nothing additional/new to what was considered earlier by NFRA has now been provided by the Audit Firm. Hence, NFRA concludes that no further examination is required and reiterates its conclusion drawn in Para 5.1.69 above.
- 5.2.48** The WPs referred by the Audit Firm in Paras 118 to 122 of their response were already examined in detail by NFRA at the stage of forming its PFC. Nothing additional/new to what was considered earlier by NFRA has now been provided by the Audit Firm. Hence, NFRA concludes that no further examination is required and reiterates its conclusion drawn in Para 5.1.71 to 5.1.73 above.
- 5.2.49** The WP referred by the Audit Firm in Para 124 of their response was already examined in detail by NFRA at the stage of forming its PFC. Nothing additional/new to what was considered earlier by NFRA has now been provided by the Audit Firm. Hence, NFRA

concludes that no further examination is required and NFRA reiterates its conclusion provided in Para 5.1.74 above.

**5.2.50** After examining in detail all the responses of the Audit Firm to the PFC, NFRA concluded in the DAQRR as follows:

- i.** In Para 5.2.1 above, NFRA has explained that the audit file should be capable of speaking for itself without the need for any other aids to interpretation. In view of the said explanation, the claim of the Audit Firm that it is not necessary to retain all the documents checked during the time of audit as part of audit documentation is inadmissible.
- ii.** The Audit Firm failed to verify whether the accounting policy for revenue recognition of the Company complied with AS 9 as there is no evidence in the WPs of any analysis involving revenue and its comparison with the revenue recognition policy of the Company and meeting the requirements of AS 9.
- iii.** In respect of discrepancies noted by NFRA in its PFC pertaining to journal entry 'Jn303361', the Audit Firm has given false assertions ending up in making a deliberate attempt to mislead NFRA.
- iv.** The Audit Firm failed to test the entity level controls and also failed to perform IT Audit effectively as explained above.
- v.** The Audit Firm failed to obtain balance confirmation directly from the third parties without the interference of the Auditee Company i.e., IL&FS Limited as per the requirements of SA 505.
- vi.** The Audit Firm has tried to mislead NFRA by providing wrong/incomplete information and has failed to obtain sufficient appropriate audit evidence in respect of receipt of project & consultancy fees, brand fees and fund-based income.
- vii.** The Audit Firm failed to comply with SA requirements relating to the evaluation of the management assertion that related party transactions were conducted on terms equivalent to those prevailing in an arm's length transaction.
- viii.** The Audit Firm failed to verify and obtain sufficient appropriate audit evidence about the arm's length nature of the related party transactions.
- ix.** The Audit Firm failed to comply with Para 26 of SA 240 to identify and assess the risks of material misstatement in revenue.
- x.** The Audit Firm failed to comply with the requirements of Para 12 to Para 24 of SA 315 and Para 32 of SA 240 and did not check whether the company had appropriate internal controls in place, and if those controls were working effectively to mitigate the risk of material misstatement especially pertaining to revenue.

- xi.** The Audit Firm failed to perform substantive analytical procedures for revenue as per Para 5 read with Para A1 of SA 520.
- xii.** The Audit Firm made a false statement that *“According to the information and explanations given by the management, transactions with the related parties are in compliance with Section 177 and 188 of the Companies Act, 2013 where applicable and the details have been disclosed in the notes to the financial statements, as required by the applicable accounting standards”*, with the full knowledge that such statement was a false statement. The Audit Firm knowingly ignored the fact that the Company was obtaining post-facto approvals instead of prior approvals for related party transactions by the audit committee.
- xiii.** The Audit Firm knowingly did not do what they were professionally expected to do as per the requirement of the Companies Act, 2013 and SAs and made a false statement under Para 3 (xiii) of the Companies (Auditor’s Report) Order, 2016.
- xiv.** The Audit Firm failed to conduct the statutory audit with professional scepticism in accordance with Para 15 of SA 200.

### **C. Final Observations and Conclusions of the AQRR**

5.3. NFRA has examined the replies to the DAQRR submitted and oral submissions made by the Audit Firm and observes as follows:

**5.3.1** On perusal of the response of the Audit Firm, NFRA notes that the Audit Firm has repeated its earlier responses submitted in reply to the PFC. NFRA formed its observations in the DAQRR after a detailed examination of the earlier responses of the Audit Firm. As nothing new/additional has now being produced by the Audit Firm, NFRA reiterates all its observations provided in its DAQRR subject to the specific modifications in the below paragraphs.

**5.3.2** The Audit Firm states that *“With regards to the WP – “IL&FS-Standalone Canvas Files Folder - 498.1 M18 AS Checklist – Accounting Standard 09” not containing details of FY it relates to or date, we would like to point out that the EY Canvas system in itself is capable of capturing date of preparation of the documents along with the details of the preparer in the system itself which NFRA by now must be aware of as the signing off feature in EY Canvas. The EY Canvas engagement was pertaining to FY 2018, therefore, it can be presumed that the checklist also has to be relating to FY 2018”*. It is baseless to assume that the EY Canvas of FY18 will only contain WPs relating to FY18. The EY Canvas copies/adopts data and documents from the previous audit files. It also has standard common templates used for all statutory audits. Unless updated with the current audit data, and the evidence of such updating is retained in the audit file, it cannot be presumed that the documents relate to the year of audit. (E.g., the audit file

contains a “Brand Royalty Report” issued by Deloitte which is dated 29<sup>th</sup> April 2015. The said WP has not been created in FY18).

- 5.3.3** SA 230 requires 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.
- 5.3.4** 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.
- 5.3.5** The Audit Firm has quoted Para A7 of SA 230 and has stated that *“It is evident from the above paras that the SA does not require auditor to document every matter considered or professional judgement made in an audit, nor is he required to document and file every single basis for every procedure performed”*. NFRA does not agree with the said statement of the Audit Firm in view of the explanation provided in Para 5.3.3 and 5.3.4 above.
- 5.3.6** The Audit Firm has stated that *“As already provided by us in PFC response, we reiterate that we had verified that the amount had been received and credited to the Central Bank of India’s current account on September 28, 2017, with the bank statements obtained from the Company”*. The Audit Firm failed to provide evidence in support of their assertion. Therefore, NFRA finds that the Audit Firm has continuously tried to mislead NFRA. The WP do not show that the said amount of ₹12.3 crore was received in the Central Bank of India, nor is there any bank statement available to evidence the same.
- 5.3.7** The Audit Firm has stated that *“With regards to receipt of Rs. 8 crores in the bank, NFRA needs to again refer to the journal entry Jn303361 with the filter in the “Journal Number column” where the debit and credit entries along with sufficient narration shall make it clear to NFRA that total amount received in bank account is Rs. 12.3 crore, which includes payment for project and consultancy fees (Rs. 8.64 crore) and other fees (Rs. 3.66 crore). Payment of project and consultancy fees (Rs. 8.64 crore) includes Rs. 1.44 crore on account of GST and reduction of Rs. 0.80 crore on account of TDS. After considering this adjustment, in fact the payment towards project & consultancy fee was Rs. 8 crores”*.
- 5.3.8** Further, the Audit Firm has also stated that *“SRBC would like to state that NFRA is referring to two different entries passed on two different dates for rendering different*

*services with the same journal entry. The journal entry passed on 28th September 2017 is only for consultancy fees for Rs. 8 cr on 15th September 2017, which is evident from the Journal entry no. Jn303361 as mentioned in paras above. Reiterating response to PFC in para 20, page 233, “There are two different services were provided to EDWPCL for which Rs. 8 Crore and Rs. 4 Crore was charged by IL&FS. Accordingly, total transaction amount is appearing as Rs. 12 Crore in EDWPCL confirmation and also in project and consultancy income dump. Refer IL&FS-Standalone Canvas Files Folder - 358.1 to 358.23 M18\_UA Revenue – Tab - ‘Consultancy Fees-Infra’”.*

- 5.3.9** The contentions of the Audit Firm are not backed fully by evidence available in the WPs. Rs 3.66 crore (other income) referred by the Audit Firm is not available in the balance confirmation certificate. Similarly, the Rs 4 crore of consultancy income received in March is not available in the JE Dump. However, the balance confirmation gives an amount of 12 crore as consultancy income. Therefore, going by the documents available in the Audit File, it can be seen that the journal entry of 12.3 crore passed in September 2017 is without basis. Going by the explanations now offered by the Audit Firm it can be seen that the revenue, balance confirmation, and journal entries passed are not matching.
- 5.3.10** In JE Dump, NFRA tried to find the journal entry for the said two transactions amounting to ₹4 crore and ₹8 crore. The journal entry for consultancy income earned for ₹8 crore is available in the JE Dump as explained by the Audit Firm. However, the journal entry pertaining to consultancy income of ₹4 crore is not available in the JE Dump. Even after applying the filter in the “cross party code” column as “C\_007351” which is for EDWPCL and in “Month-Year” column as “March 2018”, the said amount of ₹4 crore earned as consultancy income (as shown in the below screenshot of the WP) is not available in the JE dump.

Date	Month-Year	Value date	Voucher	Ledger ac	Account name	Crossparty type	Crossparty code	Crossparty Name	Amount currency	Transaction text	signed agreement	Invaic
31-Mar-18	Mar-2018	31-Mar-18		4210000	Consultancy Fees - Infrastructure			IL&FS Tamil Nadu Power Company Limited	35,00,00,000	Consultancy Income	A3	110
31-Mar-18	Mar-2018	31-Mar-18		4210000	Consultancy Fees - Infrastructure			IL&FS Solar Power Limited	15,00,00,000	Consultancy Income	A4	111
31-Mar-18	Mar-2018	31-Mar-18		4210000	Consultancy Fees - Infrastructure			East Delhi Waste Processing Company Limited	4,00,00,000	Consultancy Income	A1	112
31-Mar-18	Mar-2018	31-Mar-18		4210000	Consultancy Fees - Infrastructure			IL&FS Environmental Infrastructure & Services Limited	2,50,00,000	Consultancy Income	A8	113
31-Mar-18	Mar-2018	31-Mar-18		4210000	Consultancy Fees - Infrastructure			Karak Resources Management Limited	1,45,50,000	Consultancy Income	A6	114
15-Sep-17	Sep-2017	15-Sep-17	JV/Slu/COF/4210000	4210000	Consultancy Fees - Infrastructure	Customer	C_007351	East Delhi Waste Processing Company Limited	8,00,00,000	Fee charged for providing Project development & transaction advisory services for the capacity expansion at Ghatapuzh WZE project	A2	11
12-Dec-17	Dec-2017	12-Dec-17	JV/Slu/COF	4210000	Consultancy Fees - Infrastructure	Customer	C_007138	Delhi Jal Board	9,34,250	Fees towards Improvement & Renamping of Existing Water Supply & Transmission & Distribution Network Under Hangaio (WTP) awarded to consortium lead by IL&FS association with STUP consultant Phase-II-Vth Instalment 07CASPF/0030002		
31-Mar-18	Mar-2018	31-Mar-18	JV/Slu/COF	4210000	Consultancy Fees - Infrastructure	Customer	C_007138	Delhi Jal Board	4,23,100	Fees towards Improvement & Renamping of Existing Water Supply & Transmission & Distribution Network Under Hangaio (WTP) awarded to consortium lead by IL&FS association with STUP consultant Phase-II-Vth Instalment 07CASPF/0030002		
31-Mar-18	Mar-2018		JV/Slu/COF	4210000	Consultancy Fees - Infrastructure	Vendor	V0004151	IL&FS Township & Urban Assets Limited	(33,165)	Professional fee towards Improvement & Renamping of Existing Water Supply & Transmission & Distribution network under Hangaio (WTP) awarded to consortium lead by IL&FS association with STUP consultant Phase - II V Instalment 07CASPF/1120001		
28-Dec-17	Dec-2017		JV/Slu/COF	4210000	Consultancy Fees - Infrastructure	Vendor	V0004151	IL&FS Township & Urban Assets Limited	(73,283)	Professional fee towards Improvement & Renamping of Existing Water Supply & Transmission & Distribution network under Hangaio (WTP) awarded to consortium lead by IL&FS association with STUP consultant Phase - II V Instalment 07CASPF/1120001		

**5.3.11** In light of the above, NFRA reiterates its observations in the DAQR that there were discrepancies in passing and recording of the journal entries as well as in internal controls of the Company.

**5.3.12** The Audit Firm states that “We would like to state that the confirmation obtained from East Delhi Waste Processing Company Limited was direct confirmation only which is evident from the trail mail of the said attachment, ‘IL&FS Standalone Canvas Files Folder - 431.46.2.1 M18 RPT Confirmation\_R51\_Fw Balance confirmation- ILFS vs IEISL -- East Delli’ The trail mail clearly provides that it was received from - R Adhikari/IEISL i.e. the third party to audit team members - Naushad Ali Rangoonwala and Amit Kanthed. Therefore, it is evident that the SRBC had obtained direct confirmation from East Delhi Waste Processing Company Limited as per the requirements of SA 505”. However, the mail included in the audit documentation is NOT the one shown as received by the audit team members. It is a mail forwarded by an ILFS staff to Ayush Jain of SRBC/EY ([Ayush13.Jain@in.ey.com](mailto:Ayush13.Jain@in.ey.com)). The subject line of the forwarded mail is edited while forwarding and it is unclear whether the attachment (in which the balances and transactions are detailed) is the original one or edited, as it comes from the auditee company. The attachment also makes it clear that the original request letter for confirmation is sent directly by ILFS to the confirming parties, with no copy marked to the Audit Firm. The Audit Firm **did not send the confirmation request directly to EDWPCL** failing to comply with the requirements of Para 7 of SA 505. The Audit Firm failed to obtain balance confirmation **independently outside the entity** from East Delhi Waste Processing Company Limited as per the requirements of Para 2 of SA 505.

**5.3.13** Para 2 of SA 505 states that “SA 500 indicates that the reliability of audit evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained. That SA also includes the following generalisations applicable to audit evidence: • Audit evidence is more reliable when it is obtained from **independent sources outside the entity**. • Audit evidence obtained **directly by the auditor** is more reliable than audit evidence obtained indirectly or by inference. • Audit evidence is more reliable when it exists in documentary form, whether paper, electronic or other medium. Accordingly, depending on the circumstances of the audit, audit evidence in the form of external confirmations received directly by the auditor from confirming parties may be more reliable than evidence generated internally by the entity. This SA is intended to assist the auditor in designing and performing external confirmations procedures to obtain relevant and reliable audit evidence”. (Emphasis Added)

Para 7 of SA 505 states that “When using external confirmation procedures, **the auditor shall maintain control over external confirmation requests**, including: (a) Determining the **information to be confirmed or requested**; (Ref: Para. A1) (b) Selecting the appropriate confirming party; (Ref: Para. A2) (c) **Designing the confirmation requests**, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and (Ref: Para. A3-A6) (d) **Sending the requests, including follow-up requests** when applicable, to the confirming party. (Ref: Para. A7)”

Para A5 of SA 505 states that “A positive external **confirmation request asks the confirming party** to reply to the auditor in all cases, either by indicating the confirming party’s agreement with the given information, or by asking the confirming party to provide information”.

Para A6 of SA 505 states that “Determining that **requests are properly addressed** includes testing the validity of some or all of the addresses on confirmation requests before they are sent out”.

Para A7 of SA 505 states that “The **auditor may send an additional confirmation request** when a reply to a previous request has not been received within a reasonable time. For example, the auditor may, having re-verified the accuracy of the original address, send an additional or follow-up request”.

**5.3.14** It is clear from the above paras of SA 505 that it is the duty of the auditor to send the confirmation request directly to and obtain the confirmation request directly from **the confirming party after following the process enumerated in the SAs**. In case the request letters are sent by the auditee, the auditor shall take sufficient control mechanism to ensure the integrity of the process. Re-emphasizing this aspect, para 30

of the Guidance Note on Audit of Debtors, Loans and Advances states as follows. “*The method of selection of the debtors to be circularised should not be revealed to the entity until the trial balance of the debtors' ledger is handed over to the auditor. A list of debtors selected for confirmation should be given to the entity for preparing requests for confirmation which should be properly addressed and duly stamped. The auditor should maintain strict control to ensure the correctness and proper dispatch of request letters. In the alternative, the auditor may request the client to furnish duly authorised confirmation letters and the auditor may fill in the names, addresses and the amounts relating to debtors selected by him and mail the letters directly. It should be ensured that confirmations as well as any undelivered letters are returned to the auditor and not to the client.*” The Audit Firm failed to adhere to such practices as laid down in the SA 505.

- 5.3.15** The Audit Firm submits that “*We would also like to point out that we had obtained direct confirmations from the related parties covering 99% of the balances outstanding as on the balance sheet date. This was communicated via ACM PPT to TCWG. NFRA may refer ‘IL&FS-Standalone Canvas Files Folder - 429.1 to 429.3 M18 RPT Tracker’ for details and references for related party confirmations received*”. While agreeing to the quoted claim, NFRA observes that the entire process of balance confirmation was flawed as explained in the above paragraphs as the process does not fully conform to SA505.
- 5.3.16** Regarding the dividend income, the Audit Firm has reiterated their earlier response stating that “*With regards to verification of bank statements for dividend, we reiterate our response from PFC, “Extract of Bank Account Statement in which dividend income was received. Refer DIV RECD BANK STATEMENTS.pdf attached in ‘Dividend Income Sch’ tab of IL&FS-Standalone Canvas Files Folder – 208.1 to 208.4 M18 Dividend Sheet.*” The referred WP is the extracts of the bank statements of various banks. In the bank statements, it is not clear whether the amount credited is on account of dividend or otherwise. Assuming that the credits in the bank statements pertain to dividends, these total only Rs 89 crore, while dividend income is Rs 200 crore. The balance amount of ₹111 crore is not seen to be verified by the Audit Firm. So NFRA concludes that the Audit Firm did not verify from the bank statements whether the dividend was credited to the bank account of IL&FS Limited or not.
- 5.3.17** Regarding the fixed deposits the WPs referred by the Audit Firm was already examined in detail by NFRA at the time of forming its conclusions in DAQRR. So, NFRA reiterates its conclusions in the DAQRR that the Audit Firm did not conduct any procedures to test that direct confirmation from the banks in respect of the entire amount of ₹997 crore has been received.
- 5.3.18** The Audit Firm states that “*It seems from NFRA’s comments that even if a policy is adopted by the Board of Directors in their meeting and published on the website of a company, which is available for all stakeholders to refer to, it has no validity nor is*

*applicable on the Company at all unless it is signed. NFRA is making allegations without any evidence, only based on conjectures and surmises, which is not acceptable at all. The whole premise of the allegations made in par 5.10.10 are based on the fact that the RPT policy is not signed. 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".* 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 obligations to perform the required audit procedures. It is a basic step to ensure the authenticity and relevance of the documents/information used as audit evidence. The omissions observed by NFRA in the DAQRR are as plain as daylight and do 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 scepticism. Thus, NFRA reiterates all its observations in para 5.2.26 above.

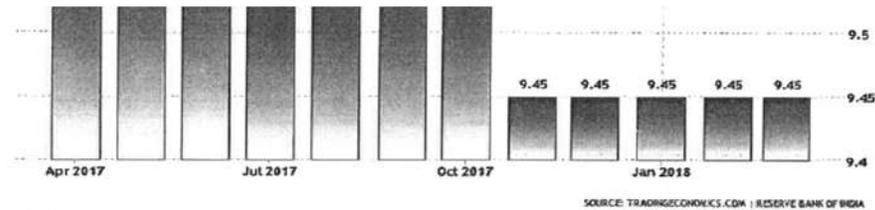
**5.3.19** The Audit Firm states that *"To evaluate management's substantiation of assertion that related party transactions were undertaken at arm's length:*

- a) We had noted that it was part of the scope of Internal Auditor to verify the compliance with Approved Framework and compliance with the provisions of Companies Act 2013, in respect of related party transactions. We had also read Internal Auditor's reports wherein they had confirmed that all transactions entered with the related parties were at arm's length price and in normal course of business.*
- b) We had verified that all the transaction entered with related parties were authorised as per delegation of authority and verified that the same were approved by the Audit Committee.*
- c) We had independently benchmarked related party transactions to satisfy that the transactions were undertaken at Arm's length and in normal course of business."*

**5.3.20** It is clear from the above assertion of the Audit Firm that it relied on the internal auditor's report and audit committee approval to verify whether the related party transactions were at arm's length price. It is important to note that all the approvals of the audit committee were post-facto approvals and were in non-compliance with the Companies Act, 2013. (Refer to Paras 5.1.50, 5.2.36 and 5.2.37 above for details)

**5.3.21** Moreover, as stated by the Audit Firm that they independently benchmarked RPTs to satisfy that the transactions were undertaken at arm's length and in the normal course and has given reference of WP "IL&FS-Standalone Hardcopy Files Folder - 47\_Memo on Arm's Length (Page no. W3.1 to W3.76)". On perusal of the said WP, NFRA notes that under the head "Analysis", the Audit Firm had everywhere mentioned that *"As a process management obtained certificate from an independent internal auditor Patel &*

Deodhar on a quarterly basis for all the related party transaction are carried on arm's length transaction. **We have obtained such report and noted the same**". (Emphasis Added). Considering internal audit report as one of the basis, the Audit Firm has concluded that "Based on the above points, we conclude that the transactions with related parties are made on arm's length". The same is evident from the below screenshot of an extract of the above referred WP.



**Conclusion**

- a) We have compared the lending rate with the borrowing rate, and the borrowing rate is more than lending rate and company is lending at a rate more than prime lending rate of India, which shows that company is not lending prejudicial to interest of shareholder.
- b) As a process management obtained certificate from an independent internal auditor Patel & Deodhar on a quarterly basis for all the related party transaction are carried on arm's length transaction. We have obtained such report and noted the same.

Based on the above points, we conclude that the transactions with related parties are made on arm's length.

**5.3.22** Therefore, the Audit Firm's statement that "At the outset, we would like to state that we had not relied on the work of the internal auditor. We had simply obtained and read Internal Auditor's reports wherein they had confirmed that all transactions entered with the related parties were at arm's length price and in normal course of business" and "Since SRBC has not relied on the work of the internal auditor, there was no requirement to evaluate the competence, objectivity, and work of the internal auditor" are false. The Audit Firm relied on the internal auditor's report and used the same as the key basis for forming the opinion that whether the RPTs were arm's length price. As such, NFRA observes that the Audit Firm simply obtained and read the internal auditor's report and did not verify the authenticity of the said report. The Audit Firm failed to evaluate the competence, objectivity and work of the internal auditor as also mentioned by NFRA in its DAQRR.

**5.3.23** The Audit Firm states that "Given the fact that the transactions with related parties of the Company are under the ordinary course of business based on the nature of the Company and the same are at arm's length as substantiated by management and verified by us, Section 188(1) of Companies Act, 2013 was not applicable to IL&FS and accordingly all the observations raised by NFRA are devoid of any fact and substance". However, the Audit Firm failed to provide any evidence or working from Audit File to prove that the RPTs were under the ordinary course of business. Thus for the reasons explained above in the DAQRR, it is found that the Audit Firm failed to verify that the RPTs entered into by the Company were under the ordinary course of business and at arm's length price. NFRA, therefore, reiterates its findings provided in the DAQRR.

**5.3.24** The Audit Firm state that *“NFRA has refused to take into consideration our PFC response in this regard stating that it has already examined the workpapers at the time of framing PFC. This shows that NFRA has not even considered our explanations, which is supported by our audit workpapers, provided in our PFC response. It may be possible that on preliminary assessment NFRA may not have understood the approach of the audit workpaper but in our PFC response we have made it quite clear as to how our workpaper covers each aspect of our arm’s length verification and how it supports our conclusion”*. All the conclusions formed by NFRA in PFC and DAQRR are after a thorough examination of the submissions of the Audit Firm. The WPs referred by the Audit Firm is examined in detail by NFRA before forming any opinion. Nevertheless, the same is examined by NFRA again and it is observed that the WP does not address any of the issues mentioned in [para 5.1.29](#) above. Read with the observations regarding the use of internal audit report, NFRA reiterates its finding that the Audit Firm did not perform the test of details to compare the transaction with related and unrelated parties to verify that the transactions with the related parties were made on arm’s length. (For detailed analysis in this regard, refer to paras 5.1.26 to 5.1.35 above).

**5.3.25** Regarding the applicability of SA 720 (Revised), the Audit Firm in its response states that *“SRBC would like to clarify that our response in PFC stating SA 720 was not applicable for SFS of IL&FS, was in the context of auditor’s responsibilities for reporting in its statutory audit report relating to Other Information, i.e. to say that mandatory reporting in audit report regarding Other Information was not applicable till March 2018. The mandatory reporting was introduced in the SA 720 (Revised) (‘SA 720 (R)’). In the pre-revised SA 720 (‘SA 720’) reporting in audit report was on exception basis only”*. The said argument of the Audit Firm cannot be accepted as a valid explanation of what the Audit Firm had stated in its response to PFC. Earlier, the Audit Firm clearly and outrightly stated that SA 720 was not applicable for audit for FY18. The extract of what was stated by the Audit Firm is as follows:

8. NFRA has inadvertently assumed that SA 720 - The Auditor’s Responsibilities Relating to Other Information is applicable to the audit of IL&FS for the year ended March 31, 2018. However, the said standard on auditing is applicable for the audits of financial statements for the period beginning on or after April 1, 2018. The extract of the paragraph 10 of SA 720 is reproduced below for your convenience:

*“This SA is effective for audits of financial statements for periods beginning on or after April 1, 2018.”*

We are surprised that NFRA has framed their prima-facie comments/observations/conclusions based on a standard on auditing which was not applicable for the audit of the financial statements of IL&FS for the year ended March 31, 2018. Thus, in the absence of SA 720 being applicable on the audit period under consideration, there was no requirement for the Audit Firm to verify Form MGT 9 (Extract of Annual Return) provided by the management in the Annual Report of IL&FS for the year ended March 31, 2018.

9. In view of the non-applicability of SA 720, para 2.4 and para 2.5 of PFC are incorrect and any conclusion drawn by NFRA in this regard shall be deemed to be invalid. SRBC strongly refutes and denies NFRA’s prima facie comments/observations/conclusions in Para 2. We therefore most humbly request NFRA to delete/withdraw the baseless observations/comments made and incorrect conclusions drawn in para 2 of PFC.

**5.3.26** Therefore, it is clear that the present explanation given by the Audit Firm regarding the applicability of SA 720 is just an attempt to distort the facts. NFRA observes that this

is not the first time the Audit Firm has resorted to such unprofessional practices in its futile attempts to mislead the regulator. In any case, the fact remains that the Audit Firm has failed to perform the required procedures as per SA 720 as NFRA observed in the PFC and DAQRR. (Refer to Paras 5.2.31 and 5.2.32 above).

- 5.3.27** The Audit Firm has stated that *“NFRA has not appreciated the basic facts of the situation and practicability of obtaining the approval before each transaction has occurred. We are immensely surprised seeing the unrealistic and impractical expectations of NFRA as IL&FS being a CIC Company and being the Holding Company of the group, had most of the transactions with the group companies and one cannot expect the Company of such nature and size to call for the Audit Committee meeting twice or thrice in a week, it is neither practicable nor sensible to have done so. And one should take into account whether calling a meeting for initiating each and every transaction is feasible. Management had adopted practical approach of listing down the transactions conducted during each quarter and obtaining the approval of the audit committee in the first meeting held after the end of each quarter”*. It is important to understand here that every Company irrespective of its size, complexities, and nature, (other than specifically exempted by Law), is bound to comply with the requirements of the Companies Act, 2013 and other relevant Laws. Therefore, the Audit Firm’s contention is unacceptable. The professional duty must be **strictly** conducted as per the requirements of the relevant Laws, SAs, ASs, etc. and not based on alleged “Practices” which have no legal backing. The Company was required to take prior approvals of the RPTs and it failed to do so. Post facto approvals cannot be routine. When found so The Audit Firm failed to raise this concern in spite of having the full knowledge of the non-compliance of the Companies Act, 2013.
- 5.3.28** The Audit Firm has stated that *“NFRA has refused to take into cognizance the document submitted by us in Appendix 6 (Page No. A33 to A57) in our PFC response, which consisted of Extracts of AGM agenda. The aforementioned document is the AGM Agenda, which is a factual and pre-existing document and are not actually the working papers of the Audit Firm. NFRA’s view on not taking the same into account is without any basis and support. This shows NFRA’s premediated and biased approach towards the audit quality review”*. In view of [para 5.2.42](#) above, the said statement of the Audit Firm is not acceptable. In the absence of evidence in the Audit File, the conclusion is that the Audit Firm did not verify the transactions.
- 5.3.29** The response of the Audit Firm about Internal Financial Controls over Financial Reporting is a repetition of what the Audit Firm submitted in their response to PFC. As nothing new/additional is now being submitted by the Audit Firm, NFRA reiterates its conclusions in the DAQRR. Similar cases where there are no new explanations are offered by the Audit Firm are re-examined in light of the repeated submissions and after examining in detail all the responses of the Audit Firm to the DAQRR, NFRA concludes as follows:

- i. In Para 5.2.1 above, NFRA has explained that the audit file should be capable of speaking for itself without the need for any other aids to interpretation. Therefore, the claim of the Audit Firm that it is not necessary to retain all the documents checked during the time of audit as part of audit documentation is inadmissible in the present context.
- ii. The Audit Firm failed to verify whether the accounting policy for revenue recognition of the Company complied with AS 9 as there is no evidence in the audit file of analysis involving revenue and its comparison with the revenue recognition policy of the Company and meeting the requirements of AS 9.
- iii. In respect of discrepancies noted by NFRA in its PFC and DAQRR regarding the journal entry 'Jn303361', the Audit Firm has given false assertions in a deliberate attempt to mislead NFRA.
- iv. The Audit Firm failed to test the entity level controls and also failed to perform IT Audit effectively as explained above.
- v. The Audit Firm failed to obtain balance confirmation directly from the third parties as per the requirements of SA 505.
- vi. The Audit Firm failed to comply with the requirements of the SAs relating to the evaluation of the management assertion that related party transactions were conducted on terms equivalent to those prevailing in an arm's length transaction. The Audit Firm hence failed to verify and obtain sufficient appropriate audit evidence about the arm's length nature of the related party transactions.
- vii. The Audit Firm failed to comply with Para 26 of SA 240 to properly identify and assess the risks of material misstatement in revenue.
- viii. The Audit Firm failed to comply with the requirements of Para 12 to Para 24 of SA 315 and Para 32 of SA 240 and did not check whether the company had appropriate internal controls in place, and if those controls were working effectively to mitigate the risk of material misstatement especially pertaining to revenue.
- ix. The Audit Firm failed to perform substantive analytical procedures for revenue as per Para 5 read with Para A1 of SA 520.
- x. The Audit Firm made a false statement in the audit report under CARO 2016 that "*According to the information and explanations given by the management, transactions with the related parties are in compliance with Section 177 and 188 of the Companies Act, 2013 where applicable and the details have been disclosed in the notes to the financial statements, as required by the applicable accounting standards*", with the full knowledge that such statement was an incorrect one—The Audit Firm knowingly ignored the fact that the Company was obtaining post-facto approvals instead of prior approvals for related party transactions by the audit committee. The Audit Firm knowingly did not do what they were professionally expected to do as per the requirement of the Companies Act, 2013 and SAs and made the false report under Para 3 (xiii) of the Companies (Auditor's Report) Order, 2016.

- xi.** The Audit Firm failed to conduct the statutory audit with professional skepticism in accordance with Para 15 of SA 200.

## 6 Principal and Component Auditor

### A. Prima Facie Observations and Conclusions (PFC)

6.1 NFRA in its Prima-facie observations conveyed the following:

6.1.1 The claims/assertions made by the Audit Firm without support from the audit file (in the form of supporting documentation) are unacceptable and NFRA discards the same as afterthoughts and false claims. If any of these claims are considered as to their merits, it is without prejudice to this conclusion of NFRA. When the Audit Firm uses the work performed by other auditors, it will continue to be responsible for forming and expressing its opinion on the financial information. NFRA has examined the audit WPs in respect of work done by the Audit Firm in the capacity of the principal auditor and has discovered serious deficiencies. The Audit Firm has failed in its professional duties to perform audit procedures required to obtain sufficient appropriate audit evidence to rely on the work of the other auditor. This is further explained as follows.

#### *Ambiguity in the total number of component entities of IL&FS Limited*

6.1.2 It was observed that the total number of component entities of IL&FS Limited differs from each other in number in different documents which are shown as follows:

Particulars	Subsidiaries	Associates	JV/JCE	Total No. of Components
As per Extract of Annual Return (Form MGT 9)	159	4	6	169
As per Note 37 of CFS	186	20	44	250
As per Note 55 (a) of CFS	176	20	44	240
As per LOR	177	20	43	240

6.1.3 As per Section 92 (1) and 92 (2) of the Companies Act, 2013, every company shall prepare the annual return (specifying particulars of its holding, subsidiary and associate companies as per section 92 (1) (a) of the said Act) and the same shall be certified by a Company Secretary stating that the annual return discloses the facts correctly and adequately. As per Sec 92(3) of the Act, an extract of the annual return in such form as may be prescribed shall form part of the board's report. In this regard, the Audit Firm was asked to vide NFRA's communication dated 26<sup>th</sup> August, 2020, to explain under which provisions of law and or accounting or auditing standards such differing number of components have been disclosed as part of the certified financials of the Company.

- 6.1.4** In its response dated 6<sup>th</sup> September, 2020, the Audit Firm, inter alia, has stated that *“Annual Return which forms part of the Annual Report of the Company for the year ended March 31, 2018 was not available to us up to the conclusion of our audit of the consolidated financial statements of the Company. Further in case of all listed and certain specified companies, its Annual Return is required to be certified by the Company Secretary in practice. IL&FS being a debt-listed company, is required to file an annual return duly certified by a company secretary. Statutory auditors are neither required to certify the Annual Return nor required to verify its correctness.”*
- 6.1.5** SA 720, details The Auditor’s Responsibility in Relation to Other Information in Documents containing Audited Financial Statements, defines the term ‘other information’ as “Financial and non-financial information (other than the financial statements and the auditor’s report thereon) which is included, either by law, regulation or custom, in a document containing audited financial statements and the auditor’s report thereon.” As per Para 6 of SA 720, the auditor shall read the other information to identify material inconsistencies, if any, with the audited financial statements. Also, Para 7 of SA 720 says, “the auditor shall make appropriate arrangements with management or those charged with governance to obtain the other information prior to the date of the auditor’s report. If it is not possible to obtain all the other information prior to the date of the auditor’s report, the auditor shall read such other information as soon as practicable.” Hence, the auditor was required to verify if other elements in the annual report, and specifically the extract of the annual return showing the number of subsidiaries etc, has any material inconsistencies with the audited financial statements. As admitted by the Audit Firm, the number of subsidiaries shown in the annual return extract was materially inconsistent with the audited financial statements. In the light of these facts, it is an admission of failure of due diligence on the part of the Audit Firm to claim, as they have done, that they did not have any requirement to discharge in the light of such discrepancy.
- 6.1.6** Moreover, the Audit Firm’s assertion that the Annual Report was not available to them up to the conclusion of their audit of the consolidated financial statements of the Company is again unacceptable in light of Para 11-14 of SA 720. According to the said SA, in case material inconsistencies identified in other information were obtained subsequent to the date of the Auditor’s Report and when a revision of the other information is necessary but management refuses to make the revision, the Audit Firm shall carry out the procedures necessary under the circumstances or shall notify those charged with governance of the auditor’s concern regarding the other information and take any further appropriate action.
- 6.1.7** Therefore, in light of the aforesaid paras of SA 720, the Audit Firm ’s assertions are unacceptable and clearly shows that the Audit Firm did not exercise due diligence in the conduct of its professional duties.

**6.1.8** Further, the Audit Firm was asked to provide the details for the difference in the number of entities in different WPs. The response of the Audit Firm pertaining to the said query and NFRA's observations are as follows:

- i. In respect of the difference in number of entities as per Note 37 of CFS and Annual Return, the Audit Firm has said that the difference arises as the management did not consider noncorporate entities, indirect associates and JVs, entities which ceased to exist as on 31<sup>st</sup> March, 2018, in the Annual Report. The contentions of the Audit Firm that management did not consider the non-corporate entities for consolidation purpose is not acceptable because the non-corporate entities are not required to be consolidated under Section 129(3) of the Companies Act, 2013, and the contention that the management has not considered indirect associates and JVs is also not acceptable because of the reasons stated in Paras below. The Audit Firm has also failed to read the Annual Return and to take appropriate actions as per SA 720 as mentioned above.
- ii. In respect of difference as per Note 55 (a) of CFS and LOR, the Audit Firm has stated "*Total number of entities as per Note 55 (a) of CFS and total number of entities mentioned in LOR are 240 and do not require any reconciliation*". It is important to note here that the number of subsidiaries and JVs are different as per the said two documents but the Audit Firm tried to mislead NFRA by just quoting the total number of entities in their answer and failed to provide the reason for such difference. Further, the Audit Firm failed to provide any reference to the WP where the details for the difference in number of entities shown in CFS and LOR, placed in the Audit File despite being specifically asked to do so.

**6.1.9** Therefore, it can be concluded that the Audit Firm failed to provide a justified answer backed by any evidence to support their contention in the audit file documentation in this respect.

#### ***Unaudited Components***

**6.1.10** Independent Auditor's Report of Consolidated Financial Statements stated that unaudited financial statements of 18 subsidiaries, 6 associates and 17 joint ventures have been taken into consideration while preparing consolidated financial statements. The total of assets of these entities include an amount of ₹929 crore as of 31<sup>st</sup> March, 2018. The Audit Firm has in its opinion stated that the financial statements of these entities were not material to the group.

**6.1.11** In this regard, the Audit Firm was asked vide communication dated 26<sup>th</sup> August, 2020, to specify a) what audit procedures were adopted by them to verify the transactions covered by the unaudited Financial Statements; b) what qualitative and quantitative evaluations were done by the Audit Firm to ensure that financials of unaudited components give a true and fair view in reference to Para 57 of Guidance Note on Audit

of Consolidated Financial Statements. The Audit Firm has failed to provide any specific response in respect of these queries. Therefore, NFRA concludes that no such procedures or evaluations were carried out by the Audit Firm, though required to do so.

- 6.1.12** NFRA also asked the Audit Firm to explain the meaning of the term “unaudited” with reference to the Companies Act, 2013, and whether the Audit Firm asked the management the reason as to why the components were unaudited when the Companies Act, 2013, makes statutory audit mandatory for all registered companies. In response to the said query, the Audit Firm failed to provide the meaning of the term “unaudited” with reference to the Companies Act, 2013. Instead, they merely provided the dictionary meaning of the said term. Moreover, the Audit Firm did not give any response whether they have asked the management as to why the components were unaudited. Hence, it can be concluded that the Audit Firm failed to conduct the statutory audit with professional scepticism in accordance with Para 15 of SA 200 and did not inquire with the management about the reason for the entities being unaudited in spite of the fact that as per the Companies Act, 2013, it is mandatory for all registered companies to get themselves audited.
- 6.1.13** NFRA has asked the Audit Firm vide its communication dated 26<sup>th</sup> August, 2020, to provide the reference of the WPs in which the reasons, workings and justification for arriving at such a decision that “These unaudited Components are not considered to be material to the CFS” were recorded. The Audit Firm in its response dated 6th September, 2020, has failed to provide any reference to a WP where they had the workings and justification for arriving at such a decision.
- 6.1.14** In the case of Dighi Port Limited (DPL) and Dighi Project Development Company Limited (DPDCL), unaudited associate entities of IL&FS Limited, the Audit Firm had itself noted in the WP “Other matter- audit report backup” that the financial statements for FY18 for these entities were not available. In fact, as per Note 55 (b) of CFS, the last audited financial statements available were for FY16 for DPL and FY15 for DPDCL. This shows that financial statements, not only for FY18 were not available, even the same was not available for earlier years as well. Hence, the Audit Firm’s contention that “*Up to the time of approval of CFS of IL&FS, there were 41 entities whose audit process of financial statements for the year ended March 31, 2018 was not complete and hence these entities were consolidated in CFS of IL&FS, on the basis of management certified financial statements*” is not acceptable.
- 6.1.15** Further, the Audit Firm also mentioned in their response that “*we noted that none of the unaudited entities were direct subsidiary, joint venture or associates (components) of IL&FS*”. It is important to note that there is no concept of direct and indirect associate companies that is recognised in Companies Act, 2013. Even section 129 (3) of the Companies Act, 2013, does not provide any distinction between direct or indirect subsidiaries or associate companies. As such, the argument made by the Audit Firm is neither borne out by law nor relevant. Hence, the consolidation of the financials of these

entities shall have been done in the consolidated financial statements by the **Audit Firm**. Thus, the assertion of the Audit Firm is a deliberate attempt to mislead NFRA.

### ***Component Entities not considered in consolidation***

- 6.1.16** It has been noticed in Note 14 (c) of the Consolidated Financial Statements that the two associate companies - IECCL and HCPL are not considered in consolidation stating the reason as - *“The Group has acquired management control of IECCL and HCPL vide Orders of the Company Law Board (CLB) dated August 31, 2009 and January 13, 2011 respectively, in order to protect the credit exposure of the Group to IECCL and IECCL’s exposure to HCPL. Towards this objective, the Group subscribed to the preferential allotments of shares in IECCL. These exposures are exclusively to protect and optimise return on asset and these continue to be held exclusively for subsequent disposal in the near future.”*
- 6.1.17** In this regard, NFRA asked the Audit Firm vide its communication dated 26th August, 2020, to explain the reason for such non-inclusion with reference to WPs placed in the audit file in support of such non-compliance with section 129 (3) of the Companies Act, 2013. Also, the Audit Firm was asked to provide reference of the WPs placed in the audit file in support of specific tests/examination performed by them on the likely fallout of such non-inclusion of financials of these entities in the consolidated financial statements of the holding company. The Audit Firm in its response dated 6th September, 2020, failed to give any reference to the WPs where the reasons for such non-inclusion of the entities is recorded and similarly the specific tests/examination performed by them on the impact arising out of such non-inclusion of these entities.
- 6.1.18** As per Section 129 (3) of the Companies Act, 2013, where a company has one or more subsidiaries or associate companies, it shall prepare a consolidated financial statement of the company and of **ALL** the subsidiaries and associate companies in the same form and manner as that of its own and in accordance with applicable accounting standards.
- 6.1.19** The aforesaid Section does not mention about the exclusion of any subsidiary or associate company from consolidation. Even though the Audit Firm was specifically asked to justify the non-consolidation of two associate companies in consolidated financial statements of IL&FS Limited strictly as per said section of the Companies Act, 2013, the Audit Firm failed to justify the non-inclusion of these entities and has given explanations in their support citing Accounting Standards only. This appears to be a mere afterthought as such examination is not evidenced by any WPs forming part of the audit file.

Moreover, Rule (4) (2) of Companies (Accounting Standards) Rules, 2006, states that *“the accounting standards shall be applied in the preparation of General Purpose Financial Statements”*. Para 2 of general instructions mentioned in Annexure to the Companies (Accounting Standards) Rules, 2006, states that *“Accounting Standards,*

*which are prescribed, are intended to be in conformity with the provisions of applicable laws. However, if due to subsequent amendments in the law, a particular accounting standard is found to be not in conformity with such law, **the provisions of the said law will prevail and the financial statements shall be prepared in conformity with such law***". (Emphasis Added)

Therefore, in view of the aforesaid rule, if a particular Accounting Standard is not in conformity with the prevailing law due to an amendment to the Act, the specific provision of the Companies Act, 2013, will override the said accounting standard.

**6.1.20** Without prejudice to what has been stated above, even if the contentions of the Audit Firm in the light of Accounting Standards are accepted, Para 11 of AS 21, Consolidated Financial Statements, talks about the conditions when a subsidiary should be excluded from consolidation. There are no such conditions prescribed anywhere in AS where associate companies can be excluded from consolidation. Also, it is important to note that subsidiary and associate company are two different terms defined by AS.

a) AS 21, Consolidated Financial Statements, defines the term 'subsidiary' as- "A subsidiary is an enterprise that is controlled by another enterprise (known as the parent)."

b) AS 23, Accounting for Investments in Associates in Consolidated Financial Statements, defines the term 'associate' as - "An associate is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor."

c) Also, in its response dated 6th September, 2020, the Audit Firm itself mentioned that "IECCL and HCPL are not subsidiary companies within the meaning of AS 21".

d) Further, the Audit Firm also stated that "IECCL and HPCL would be treated as an associate, however management chose not to consolidate the same taking into consideration exemption given in AS 23 read with AS 8". In this regard, NFRA notes Para 7 of AS 23 which talks about the conditions when investment in associate should not be accounted for in consolidated financial statements under equity method. It does not say anything relating to exclusion of associate company from consolidation. Para 7 of AS 23 is reproduced below:

*"An investment in an associate should be accounted for in consolidated financial statements under the equity method except when: (a) the investment is acquired and held exclusively with a view to its subsequent disposal in the near future; or (b) the associate operates under severe long-term restrictions that significantly impairs its ability to transfer funds to the investor. Investments in such associates should be accounted for in accordance with Accounting Standard (AS) 13, Accounting for Investments. The reasons for not applying the equity method in accounting for*

*investments in an associate should be disclosed in the consolidated financial statements.”*

- 6.1.21** Therefore, based on reasons mentioned above, it is concluded that the Audit Firm’s assertion that non consolidation of IECCL and HCPL by management was permitted by the accounting standards is factually incorrect. Moreover, the Audit Firm simply relied on the decision of the management to not to consolidate the said entities and failed to interpret the requirements of AS correctly.
- 6.1.22** Further, the Audit Firm was also asked to provide reference of the WPs placed in the audit file in support of specific tests/examination performed by them on the likely fallout of such non-inclusion of financials of these entities in the consolidated financial statements of the holding company and the Audit Firm failed to provide any WP in this regard. All the WPs referred to by the Audit Firm in response to the query were pertaining to impairment analysis of IECCL and HCPL which are not relevant for this query.

#### ***Role as Principal Auditor***

- 6.1.23** NFRA asked the Audit Firm vide its communication dated 26<sup>th</sup> August, 2020, as to whether the Audit Firm obtained the management representation at **the initial stage** of audit to list out all the entities whose accounts needed to be consolidated as per Section 129 (3) of the Companies Act, 2013. In this regard, the Audit Firm vide its response dated 6<sup>th</sup> September, 2020, stated that the management has provided them with the details of components as on 31<sup>st</sup> December, 2017, as a part of closing instructions to be sent to components and has given reference of WPs- ‘IL&FS - Consolidation Canvas Files Folder – Attachment to mail - C 648.1 IL&FS - Group Reporting Instructions for the year ended March 31 2018 – IL&FS Management Instructions – Appendix 15, 17 & 18 - Accounting Policies, List of Consolidating Entities and Contact List’. It is important to note that the WPs referred to is an attachment to the mail sent by the Audit Firm to the component auditors and is not a communication from the Company to the **Audit Firm**. Moreover, the said WPs list out the component entities as on 31<sup>st</sup> December, 2017, and not as on 31<sup>st</sup> March, 2018. Also, the WP so referred is merely a Word document and does not seem to be an official document of the Company as it is not signed by any company officials. Therefore, it can be concluded that the response given by the Audit Firm in reference to the query asked by NFRA is not relevant and is an attempt to mislead NFRA, and the Audit Firm did not obtain the complete list of component entities at **the initial stage** of audit.
- 6.1.24** The Audit Firm has also stated that “*as per Paragraph 13 of SA 580 – Management Representations, auditor requires to obtain the written representation from management as near as practicable to the auditor’s report date.*” As per Para 18 of Guidance Note on Audit of CFS, before commencing an audit of consolidated financial statements, the auditor should plan his work to enable him to conduct an effective audit

in an efficient and timely manner. The auditor should make plans, among other things, for understanding the group structure. Also, Para A16 of SA 580 says, *“In some circumstances it may be appropriate for the auditor to obtain a written representation about a specific assertion in the financial statements during the course of the audit.”* Therefore, the Audit Firm’s assertion about obtaining written representation near to auditor’s report is unacceptable for obtaining the complete list of component entities from the management.

- 6.1.25** Therefore, it can be concluded that the Audit Firm has failed to properly plan the audit as required by Para 18 of Guidance Note on Audit of CFS and obtain written representations as required by Paras 13 and A16 of SA 580.
- 6.1.26** As per Para 13 of AS 21, the financial statements of the parent and its subsidiaries should be consolidated on a line by line basis by adding together like items of assets, liabilities, income and expenses. Accordingly, NFRA has asked the Audit Firm to provide reference to the WP where arithmetic calculations for the same were done. Though the Audit Firm had mentioned that *“the consolidation was carried out on a line by line basis for direct subsidiaries, as per the requirement of AS 21, for joint ventures, proportionate line by line consolidation was carried out as per the requirement of AS 27 and for associates consolidation was carried out as per the principle of equity method in accordance with requirement of AS 23”*, they have not referred to any WP specifically in support of these assertions even though NFRA demanded every reply with reference to specific WPs forming part of the audit file. NFRA, prima-facie cannot accept any contentions of the **Audit Firm** without reference to the actual work done, documented (refer SA 230), and forming part of the audit file.
- 6.1.27** On perusal of the WP “M18 Railroad Completeness and tracing- tab- “Balance Sheet” and tab- “Profit & Loss Ac”, it is observed that the Audit Firm had taken into consideration the Standalone Financial Statements for some entities, and the Consolidated Financial Statements for some other entities for the purpose of consolidation.
- 6.1.28** Para 13 of AS 21 states, *“In preparing consolidated financial statements, the financial statements of the parent and its subsidiaries should be combined on a line by line basis by adding together like items of assets, liabilities, income and expenses.”*
- 6.1.29** Section 2 (40) of the Companies Act, 2013, defines the term “financial statements” as -  
*“financial statement” in relation to a company, includes-*  
*a balance sheet as at the end of the financial year;*  
*b. a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;*  
*c. cash flow statement for the financial year;*  
*d. a statement of changes in equity, if applicable; and*

*e. any explanatory note annexed to, or forming part of, any document referred to in sub-clause*

*(i) to sub-clause (iv).”*

**6.1.30** Section 2 (87) of the Companies Act, 2013, defines the term “subsidiary” as—  
“*subsidiary company” or “subsidiary”, in relation to any other company (that is to say the holding company), means a company in which the holding company controls the composition of the Board of Directors; or b. exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies:*

*Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.*

*Explanation- For the purposes of this clause-*

***(a) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;***

***(b) the composition of a company’s Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;***

***(c) the expression- “company” includes anybody corporate.***

***(d) “layer” in relation to a holding company means its subsidiary or subsidiaries”***

**(Emphasis Supplied)**

**6.1.31** Para 12 of Guidance Note on audit of CFS states that, “*the consolidated financial statements (including the intermediate consolidated financial statements prepared internally) are prepared using the separate financial statements of the parent and its components and also other financial information, which might not be covered by the separate financial statements of these entities.*”

In view of the Paras and requirements of the Companies Act, 2013, mentioned above, it is clear that consolidated financial statements of components shall not be considered while preparing consolidated financial statements of the holding company. Instead, the financial statements (standalone in commonly used terminology) of the component entities shall be considered for preparing consolidated financial statements. Also, as per clause (a) of explanation to Section 2 (87) of the Companies Act, 2013, indirect subsidiaries of the holding company shall also be taken into consideration while consolidating. Therefore, NFRA concludes that the Audit Firm did not comply with the requirements of the Companies Act, 2013 and misinterpreted the requirements of the Guidance Note on Audit of CFS.

**6.1.32** In response to the query of NFRA whether the Audit Firm as principal auditor determined how the work of other auditor will affect the audit, the Audit Firm had mentioned that at the time of planning they confirmed that the assets of identified material direct components and IL&FS together constitute major part (i.e. 99%) of total

consolidated assets of IL&FS based on the last audited consolidated financial statements and have referred to WPs “M18 GRI Backup- planning” and “C 12\_Audit summary memorandum.pdf” in support of their assertion. On perusal of the said WPs, it is observed that the Audit Firm had analysed the scope of only 24 component entities (not even covering all the direct components of the Company) for group audit reporting and the same are classified under ‘Full Scope’ and ‘Specific Scope’. In the said WPs, the terms ‘Full Scope’ and ‘Specific Scope’ are nowhere defined. Even the basis as to how the Audit Firm selected 10 entities under specific scope is not mentioned.

- 6.1.33** Further, the principal auditor has issued instructions only to the auditors of the abovementioned 24 components regarding areas requiring special considerations, significant accounting, auditing and reporting requirements. It is to be noted that Para 12 of SA 600 does not mention that the instructions need to be issued only to the auditors of material component entities. Moreover, the Audit Firm had referred to the WP “Group audit Instructions Meeting” where minutes of the meeting in which group audit instructions were given to the component auditors. On perusal of the said WP, it is observed that the names of the component auditors who attended the meeting were not documented. Hence, it can be concluded that the Audit Firm did not perform its professional duties with due diligence and failed to comply with provisions of Para 12 of SA 600.
- 6.1.34** With reference to Para 13 of SA 600, the Audit Firm was asked to provide evidence for nature, timing and extent of audit procedures applied by principal auditor in using the work of another auditor. In their response, the Audit Firm has detailed the procedures they had performed at the planning stage only. However, what discussions took place among the ET and other auditors, what procedures were applied by the other auditor, what procedures were applied by the principal auditor during the audit is nowhere mentioned. The Audit Firm had stated that “*We had also performed adequate work on coordination / communication with component auditors. Apart from the written communication mentioned below, we had calls with the material direct component auditors, to ensure proper coordination and understanding where required*”. However, there is no evidence in support of this assertion in the audit file, even though NFRA asked to submit every reply with reference to specific WPs forming part of the audit file. NFRA, prima-facie cannot accept any contentions of the Audit Firm without reference to the actual work done, documented (refer SA 230), and forming part of the audit file.
- 6.1.35** With reference to Para 16 of SA 600, the Audit Firm was asked to provide evidence as to what significant findings were discussed with the other auditors and the management of the components and details of supplemental tests performed by the principal auditor. The Audit Firm’s response in this regard did not mention any discussions with the other auditors. The WPs referred to by the Audit Firm in this regard are either the financials of the component entity or the response of the component auditors to group reporting instructions issued by the principal auditor. In fact, in the WP ‘C 47\_CHDCL GRI’,

referred by the Audit Firm, no audit findings or other matters affecting the financial information of the component entity are documented. Further, in case of component auditor of IFIN, the Audit Firm stated that they had a meeting with the management of IFIN and had made reference to the WP 'IL&FS-Consolidation Hardcopy Files Folder C 39\_IFIN related work done, subsequent event, ACM PPT, GRI.pdf'. NFRA examined the said WP and noted that these WPs contain response to group audit instructions from component auditor (IFIN). However, discussions of the principal auditor with IFIN's Management is not documented in the WP. Hence, it can be reasonably concluded that the Audit Firm did not discuss the audit findings or other matters affecting the financial information of the components with other auditors and the Management, thus failing to comply with the provisions of Para 16 of SA 600.

- 6.1.36** Further, it was observed that nationality of the Joint Venture 'Kukuza Project Development Company' has been mentioned as 'Foreign' in the Audit File whereas it has been mentioned as 'Indian' as per Note 37 (b) of Consolidated Financial Statements. The Audit Firm was asked to clarify the reason for the difference. In their response, the Audit Firm had stated that nationality is correctly stated as 'Foreign' in the audit file and KPDC was inadvertently shown as Indian entity by the management. The Audit Firm had also stated that "mentioning incorrect domicile of one company in no way affects true and fair view of CFS". It is important to note that the information provided in signed CFS is what stakeholders believe to be true and quoting the wrong nationality of any component entity is unacceptable. Even the contention of the Audit Firm that management had inadvertently shown the nationality as 'Indian' instead of 'Foreign', proves the casual attitude of the Audit Firm while auditing the financial statements.

#### ***General Contingency Provision***

- 6.1.37** NFRA observes that the Company had General Contingency Provision (GCP) of ₹854.0 crore in Standalone Financial Statement (SFS) and ₹380.2 crore in Consolidated Financial Statements (CFS) as at March 31st, 2018. Further, the Company had two different sets of GCP policies at the SFS and CFS. The SFS GCP policy stated that "*The Company carries a significant quantum of long tenor project finance and infrastructure assets on its books. Given the risk profile attendant to such assets, the Company has created a Provision for General Contingency to cover adverse events that may affect the quality of the Company's Assets. The Provision for General Contingency is utilized against specific provisions on a case-to-case basis if there are indicators of impairment other than temporary.*" Whereas the CFS GCP policy stated that "*The Group carries a significant quantum of long tenor project finance and infrastructure assets on its books. Given the risk profile attendant to such assets, the Group has created a Provision for General Contingency to cover adverse events that may affect the quality of the Group's Assets. Provision for General Contingency at Group level is assessed at the end of each year with respect to the net assets consolidated.*"

- 6.1.38 Para 11 of AS 1 says, “*The accounting policies refer to the specific accounting principles and the methods of applying those principles **adopted by the enterprise** in the preparation and presentation of financial statements*”.
- 6.1.39 Para 20 of AS 21 states that “*Consolidated financial statements should be prepared using **uniform accounting policies** for like transactions and other events in similar circumstances. If it is not practicable to use uniform accounting policies in preparing the consolidated financial statements, that fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.*”
- 6.1.40 On a plain reading of the above, it is clear that the accounting policies are enterprise-specific and consistency of the accounting policy for consolidation is a must. CFS should be prepared using **uniform accounting policies**. However, the Company had a different accounting policy for its CFS.
- 6.1.41 Para 18 of Guidance Note on Consolidated Financial Statements by ICAI (GN-CFS) states that before commencing an audit of consolidated financial statements, the auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. The auditor should make plans, among other things, for the understanding of **accounting policies of the parent and its components** as well as of the consolidation process including the process of translation of financial statements of foreign components.
- 6.1.42 Given the fact that the Company had a separate accounting policy for GCP in CFS, the Audit Firm was required to question the basis and the need for the change in accounting policy. Para 20 of AS 21 states that the Company should have **uniform accounting policies** unless it is not practicable to use uniform accounting policies. Further, it is to be noted that this fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied. However, NFRA notes that the Audit Firm did not identify this issue and did not communicate the same to the TCWG.
- 6.1.43 NFRA further notes that the GCP accounting policy in the SFS does not even provide any clarity with respect to the circumstances and conditions under which the GCP can be utilized. The policy in vague statement simply states that “*The Provision for General Contingency is utilized against specific provisions **on a case to case basis** if there are indicators of impairment other than temporary.*” (Emphasis added). As detailed in Para 13.6, there are no WPs referred by the Audit Firm, whereby it had documented any conclusion/understanding of the specific cases under which utilization of the GCP was permitted.
- 6.1.44 Instead, NFRA notes that this policy violates the requirements of AS 28. Para 58 of AS 28 states that “*An impairment loss **should be recognised as an expense in the statement***

*of profit and loss immediately, unless the asset is carried at revalued amount in accordance with another Accounting Standard (see Accounting Standard (AS) 10, Accounting for Fixed Assets), in which case any impairment loss of a revalued asset should be treated as a revaluation decrease under that Accounting Standard”* (emphasis added). Clearly, the Company’s GCP (SFS) policy negates the requirements of AS 28, since the GCP policy implies that **impairment loss will be adjusted with the GCP** instead of the P&L account (as required by AS 28).

**6.1.45** Therefore, it is construed that the Audit Firm, prima-facie, failed to satisfy itself that the CFS has been prepared in accordance with the requirements of the financial reporting framework (Para 9 of GN-CFS).

**6.1.46** Vide its email dated 2<sup>nd</sup> December, 2020, NFRA asked the Audit Firm the audit procedures done with respect to verification of GCP in CFS. In their email reply dated 12th December, 2020, the Audit Firm has, inter-alia, stated that the decrease in GCP from ₹854.0 crore in SFS to ₹380.2 crore in CFS was due to elimination/reversal entries of:

- a. ₹544.0 crore pertaining to FY 2015, FY 2016 and FY 2017, and
- b. ₹204.8 crore pertaining to FY 2018.

**6.1.47** Elimination/reversal of ₹204.8 crore for FY 2017-18, was due to the elimination of ₹54.0 crore GCP (that was created in FY 2017-18), along with the reversal of ₹150.8 crore, which was majorly on account of two SPVs of ITNL, namely MP Border Checkpost Development Company Limited (MPBCDCL) and Thiruvananthapuram Road Development Company Limited (TRDCL). This GCP (₹149.20 crore) was created against ITNL’s investment in these SPVs in FY 2016-17 itself. Therefore, after considering eliminations/reversal of ₹748.8 crore, the Company’s GCP in CFS was ₹105.2 crore. This GCP, along with the GCP of ₹275.0 crore considered from the CFS of IFIN (after a reversal of ₹175.0 crore) constituted the Company’s GCP of ₹380.2 crore in CFS.

**6.1.48** The Audit Firm in this regard stated the background of the GCP and mentioned that *“It may be noted that the GCP was created in addition to provisions created towards Non-Performing Assets (NPA), standard asset provisioning and diminution in the value of investments as per the requirement of the Reserve Bank of India directions. The GCP in the SFS was created on an overall exposure of the Company (i.e. Loans and investments) and **not against any specific asset**. This provision was created by way of a charge to the standalone Profit and Loss Account.”* (emphasis added)

**6.1.49** The Audit Firm in its reply also asserted that *“GCP created in Standalone Financial Statements of the Company was based on the policy recommended/approved by the audit committee of the Company from time to time on the exposures of Loans given and Investments made by IL&FS. In the Consolidated Financial Statements of the Company, Loans and Investments of intra group gets eliminated and therefore the **GCP was***

*retained to the extent of Loans and Investments exposures, remaining in CFS after elimination. We would like to point out that any losses incurred by Subsidiaries and Joint Ventures have been recognised in the CFS at the time of consolidation and to this extent net-worth of the Group has already been reduced in CFS. These losses are not required to be recognised in the SFS of IL&FS, unless it reflects diminution, other than temporary, in value of investments. The management had created GCP in SFS on an overall basis to take care of any future diminution in value of investments and therefore GCP created in SFS relating to investments in subsidiaries and joint ventures was eliminated by the management at the time of consolidation.”* (emphasis added)

**6.1.50** NFRA notes that the assertion of the Audit Firm in itself contradicts the background with which the GCP has been created. As stated by the Audit Firm the GCP is created on the overall exposure of the Company and is not specific to any asset. Para 13 of AS 21 states that in preparing CFS, the financial statements of the parent and its subsidiaries should be combined on a line by line basis by adding together like items and by eliminating, inter-alia, the cost of the parent of its investment in each subsidiary and the parent’s portion of equity of each subsidiary. Para 17 of AS 21 states that “*Intragroup balances and intragroup transactions, including sales, expenses and dividends, are eliminated in full. Unrealised profits resulting from intragroup transactions that are included in the carrying amount of assets, such as inventory and fixed assets, are eliminated in full. Unrealised losses **resulting from intragroup transactions that are deducted in arriving at the carrying amount of assets** are also eliminated unless cost cannot be recovered”* (emphasis added). Therefore, all the items should be added on line to line basis except for the intragroup balances and transaction which are eliminated in full. Unrealized losses, only to the extent, that they have resulted from a specific **intragroup transaction and are deducted** in arriving at the carrying amount of assets, should be eliminated.

**6.1.51** However, NFRA notes the GCP is not meant to be created on any specific asset. It neither resulted from any specific transaction nor was being deducted in arriving at the carrying amount of any specific asset. But, NFRA notes that the Audit Firm, without any due diligence accepted this treatment of GCP in CFS. As evident from the Audit Firm’s reply, it did not exercise professional scepticism and did not obtain sufficient appropriate audit evidence to understand the basis for the creation of GCP and the substance of creating the GCP.

**6.1.52** On perusal of the WP ‘C 536.1 to C 536.4 M18 GCP working consol’, which is the only WP whereby the Audit Firm has documented any work procedures performed regarding the elimination of GCP at CFS level, NFRA notes that the Audit Firm has not noted any details regarding the basis for creation or eliminations with regard to the opening balance of GCP. In the ‘Movement’ tab of the WP, the Audit Firm has simply noted that there was ₹544.0 crore of opening elimination and ₹204.8 crore of elimination pertaining to FY 2017-18. The ‘Summary’ tab contains the arithmetic movement (including a contribution on part of IFIN) of GCP from FY 2015 - FY 2018. Although,

as against the ‘Movement’ tab (which indicates reversal of ₹204.8 crore for FY 2018), the ‘Summary’ tab indicates reversal of ₹201.8 crore for FY 2017-18. The reason for the difference in the amount of reversal is also not documented.

**6.1.53** Para 6 of SA 510 states that the auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period’s financial statements by determining whether the opening balances reflect the application of appropriate accounting policies. However, based on the above observation and the Audit Firm’s reply that SFS and CFS of IL&FS for the year ended March 31, 2017 was audited by another firm of Chartered Accountants and accordingly elimination for the year ended 2017 was audited by them, it is evident that the Audit Firm did not consider risk of material misstatement from the opening balance of GCP and did not obtain sufficient appropriate audit evidence to satisfy itself that the opening balances reflect the application of appropriate accounting policy. In spite of having clear evidence that the Company had created GCP amounting to ₹149.20 crore at CFS for FY 2017-18, specifically for SPVs of ITNL (as against the background with which GCP is created), the Audit Firm did not question the management or raise the issue with TCWG.

**6.1.54** Notwithstanding the above conclusion and assuming, but not admitting, that the elimination of GCP was in line with the financial reporting framework, NFRA has examined all the WPs referred by the **Audit Firm**. NFRA’s observations are noted below:

WPs	NFRA’s Observations
WP ‘C 536.1 to C 536.4 M18 GCP working consol’  &  WP ‘C 538.1 to C 538.8 GCP Note on MP Border and TRDCL’	The Audit Firm has noted the movement of GCP from SFS to CFS (as discussed in para 13.4 above), along with the Audit Firm’s conclusions on reversal of ₹149.20 crore pertaining to two SPVs of ITNL.  NFRA notes that the conclusion drawn by the Audit Firm were without any basis, due to the following reasons <ul style="list-style-type: none"> <li>- The Audit Firm has claimed that there was no exposure of IL&amp;FS in ITNL’s SPVs, however NFRA notes that after the transfer of loans from ITNL to its nine SPVs (discussed in PFC on Loans and Advances), the Company had existing loan exposures in both the SPVs.</li> <li>- The Audit Firm has stated that GCP was not required since both MPBCPL and TRDCL have filed claims on the authority and expects recovery more than the</li> </ul>

	<p>cost of investment (WP ‘C 538.1 to C 538.8 GCP Note on MP Border and TRDCL’). However, NFRA notes that there is no evidence of evaluation of the merits of this argument of the management. The Audit Firm has only taken a note from ITNL’s management stating that a claim is filed. In fact, the MPBCPL had already defaulted on its loans in June 2018 and its credit rating was revised to “D” on 1<sup>st</sup> August, 2018. Further, the Audit Firm in its reply dated 30<sup>th</sup> December, 2019, to NFRA query on going concern had itself quoted that there were triggers raising significant doubt on ITNL’s ability to continue as going concern since there was “<i>delay in realisation of claims made to authorities</i>”.</p>
<p>WP ‘C 537.1 to C 537.5 M18 Signed GCP Memo’</p>	<p>The WP only contains a copy of the memorandum by the Company on review of GCP for FY 2017-18 for CFS. The memorandum states the Company wise movement of GCP for the Company and IFIN along with the opening eliminations and reversals for the year. The memorandum also provides the allocation of GCP on Equity-Listed, Equity-Unlisted and Loans and Debts, separately for Subsidiaries/JV and Other Entities for year ending March 2018. However, there are no observations/notes/conclusion drawn by the <b>Audit Firm</b>.</p>
<p>WP ‘C 4_M18 Consol LOR - IL&amp;FS-Consolidation Hardcopy Files Folder – Page 14’</p>	<p>NFRA noted that the management’s representation is dated 29<sup>th</sup> August, 2018, i.e. on the date of the Audit Report. Therefore, it is evident that this was obtained merely for the sake of formality. There are no further audit procedures being performed.</p>
<p>WP ‘C 23_ACM PPT - IL&amp;FS-Consolidation Hardcopy Files Folder – Page 15’</p>	<p>Presentation to Audit Committee on 28<sup>th</sup> August, 2018, whereby the Audit Firm has listed the details of reversal of ₹149.2 crore pertaining to the two SPVs of ITNL. As detailed in the PFC on TCWG, of this report, communicating with TCWG, one day prior to signing to the audit report cannot be construed as meeting the requirements of SA 260 (Revised).</p>
<p>WP ‘C 59_M18 IFIN Financials – CFS – IL&amp;FS-Consolidation</p>	<p>Contains note on break up of provisions of GCP from IFIN CFS for FY 2017-18. Para 1 of SA 600 states that when the auditor uses work performed by other auditors and experts, he will continue to be responsible for</p>

Hardcopy Files Folder – Page 39’	forming and expressing his opinion on the financial information. However, he will be entitled to rely on work performed by others, provided he <b>exercises adequate skill and care</b> and is not aware of any reason to believe that he should not have so relied. Therefore, the Audit Firm was required to even examine and document the basis and appropriateness of reversal of GCP of ₹175.0 crore by IFIN. However, based on the above examination, NFRA notes that there is no documentation, whereby the Audit Firm had noted its observations on the appropriateness of the reversal by the Company. The Audit Firm had relied on the component auditor without exercising any due skill or care.
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**6.1.55** In light of the above, it is evident that the Audit Firm has merely relied on the management and has not performed any audit procedures to evaluate either the opening balance of GCP reversal or the basis of reversal during the year FY 2017-18. Therefore, NFRA concludes that the Audit Firm did not exercise any professional scepticism.

**6.1.56** In view of the above-mentioned observations noted by NFRA, it can be concluded that the Audit Firm did not exercise professional scepticism in the conduct of its professional duties as a principal auditor and failed to comply with the provisions of SA 600.

**B. Observations made in the DAQRR**

6.2. After examining the replies of the Audit Firm regarding the above observations, NFRA in its DAQRR conveyed the following:

**6.2.1** In Para 7 and 8 of their response dated 14<sup>th</sup> April, 2021, the Audit Firm has stated that *“We would like to re-iterate that the details of number of subsidiaries provided in the annual report was prepared and disclosed by the management itself and as the statutory auditor, we do not have any role to play. NFRA has inadvertently assumed that SA 720 - The Auditor’s Responsibilities Relating to Other Information is applicable to the audit of IL&FS for the year ended March 31, 2018. However, the said standard on auditing is applicable for the audits of financial statements for the period beginning on or after April 1, 2018. We are surprised that NFRA has framed their prima-facie comments/observations/conclusions based on a standard on auditing which was not applicable for the audit of the financial statements of IL&FS for the year ended March 31, 2018. Thus, in the absence of SA 720 being applicable on the audit period under consideration, there was no requirement for the Audit Firm to verify Form MGT 9 (Extract of Annual Return) provided by the management in the Annual Report of IL&FS for the year ended March 31, 2018.”*

- 6.2.2** Para 3 of SA 720 says, “*This SA is effective for audits of financial statements for periods beginning on or after April 1, 2010*”. Accordingly, SA 720 was very much effective for FY18. NFRA would like to bring to the notice of the Audit Firm that it is SA 720 **(Revised)** that came into effect on 1<sup>st</sup> April, 2018. Paras 6 and 7 of SA 720 that has been quoted at Para 2.4 of PFC are as they stood prior to the revision of SA 720. As such, the Audit Firm’s claim that SA 720 was not applicable for the audit of financial statements for the year ended 31<sup>st</sup> March 2018 is factually incorrect.
- 6.2.3** Therefore, NFRA refutes the Audit Firm’s assertion that “*In view of the non-applicability of SA 720, para 2.4 and para 2.5 of PFC are incorrect and any conclusion drawn by NFRA in this regard shall be deemed to be invalid*”. Also, as explained by NFRA in its PFC the Audit Firm was required to verify Form MGT 9 (Extract of Annual Return) provided by the management in the Annual Report of IL&FS Limited for the year ended 31<sup>st</sup> March, 2018. As such, NFRA reiterates its conclusion provided in its PFC that the Audit Firm failed to identify the ambiguity in total number of component entities of IL&FS Limited.
- 6.2.4** The Audit Firm has stated that “*the conclusion drawn by NFRA that ‘the Audit Firm failed to read the Annual Return and to take appropriate actions as per SA 720’, is invalid as SA 720 was not applicable to audit under review, as explained in para 8 above.*” As explained in Para 6.2.2 above, SA 720 was effective for FY18. Hence, NFRA refutes the said statement of the Audit Firm.
- 6.2.5** The Audit Firm, in Para 16 of their response, has provided a table showing reconciliation between 240 number in Note 55 (a) of CFS and 240 number derived from LOR in response to Para 3.2 of PFC. The Audit Firm has also referred to WPs “IL&FS-Consolidation Hardcopy Files Folder - C 5\_Other matter - audit report backup (Page no. A3.12) and IL&FS-Consolidation Hardcopy Files Folder - C 30\_Note 37 & 55” in support of their response. On analysis of the response of the Audit Firm, NFRA finds that the reconciliation given by the Audit Firm is not evident in any of the WPs referred by the Audit Firm in support of their explanation.

Further, the Audit Firm has stated that “*It must be noted that LOR dated August 29, 2018, covers specific representation from the Company in respect of details provided in Note 55(a) of the consolidated financial statements, which states “We confirm that all disclosures of Section 129 and Schedule III of Companies Act, 2013 as disclosed in Note No 55 is complete and accurate”. Refer Para XXII(9) of LOR. Refer IL&FS-Consolidation Hardcopy Files Folder – C4\_M18 Consol LOR*”. As pointed out by NFRA in its PFC, the number of components as per Note 55 (a) of CFS and LOR were different, the Audit Firm themselves should have checked the veracity of the statement of the management as given in Para XXII (9) of LOR and should have identified the difference. This itself clearly shows the casual attitude of the Audit Firm while performing the statutory audit.

- 6.2.6** In Para 22 and 23 of their response dated 14<sup>th</sup> April, 2021, the Audit Firm has reiterated what they responded vide their communication dated 30<sup>th</sup> December, 2019 to the preliminary queries being asked by NFRA in respect of unaudited components taken into consideration by the Company while preparing CFS. NFRA formed its PFC after examining the response given by the Audit Firm vide its communication dated 30<sup>th</sup> December, 2019. As such, NFRA concludes that there is no need for re-examination as no new/additional response or WPs to what was provided earlier is now submitted by the Audit Firm. Hence, NFRA reiterates its conclusion provided in Para 4.1, 4.2 and 4.4 of its PFC.
- 6.2.7** In respect of PFC as stated in Para 6.5.5 above, the Audit Firm has stated that *“We would like to clarify that Dighi Port Limited (DPL) and Dighi Project Development Company Limited (DPDCL) were not included in the count of 41 entities referred to in our response dated September 6, 2020 as well as in our audit report on CFS of IL&FS, as separate reporting was done for these entities in our audit report. Refer IL&FS-Consolidation Hardcopy Files Folder - C 5\_Other matter - audit report backup (Page no. A3.1 to A3.22)”*. NFRA notes that there is no such list available in the referred WP which specifically clarifies which 41 entities the Audit Firm is talking about and whether these 41 entities include DPL and DPDCL or not. Moreover, even assuming the contention of the Audit Firm to be true, but not accepting, the reason as to why these 41 entities do not include DPL and DPDCL is nowhere mentioned in the WP.
- 6.2.8** In Para 29 of their response, the Audit Firm has stated that *“SRBC acknowledges that audit of financial statements under the Companies Act, 2013 is mandatory for all the registered companies, however, we would categorically like to mention that timing of these audits can differ for each company. To take care of such situation that some companies audit will get finalized after CFS of holding company, there is a provision in the Companies Act, 2013 to provide unaudited financial statements to the member of the Company.”*
- 6.2.9** Further, in Para 32 of their response, the Audit Firm has stated that *“Note 55(b) of CFS provides the details with respect to audited financial statements. In case of DPL and DPDCL, last audited financial statements which were available is of March 31, 2016 and March 31, 2015 respectively. However, the consolidation of these entities **had been done on the basis of unaudited financial statements for the year ended March 31, 2017**. Since, the financial statements for the year ended March 31, 2018 were not available, management had disclosed this fact in CFS and we had reported this fact in our audit report as an Emphasis of Matter Paragraph.”* (Emphasis Added)
- 6.2.10** NFRA would like to bring to the notice of the Audit Firm that there is no such specific Section in the Companies Act, 2013, which says unaudited financials can be considered while consolidation. As such, the Audit Firm’s contention that *“To take care of such situation that some companies audit will get finalized after CFS of holding company,*

*there is a provision in the Companies Act, 2013 to provide unaudited financial statements to the member of the Company” is factually incorrect. (Emphasis Added)*

- 6.2.11** First proviso to Section 96 (1) of the Companies Act, 2013, requires the Company to hold its Annual General Meeting within six months from the date of closing of the financial year. As per Section 101 (1) of the Companies Act, 2013, AGM of the Company may be called by giving not less than clear twenty-one days notice. Also, as per Section 136 (1) of the Companies Act, 2013, copy of financial statements, including CFS, if any, **auditor’s report**, and any other document required by law shall be sent to every member of the Company not less than twenty-one days before the date of AGM. Therefore, combined reading of all these Sections clearly implies that the **auditor’s report must be made available before sending the notice of the AGM** to members of the Company.
- 6.2.12** Simply put, the above assertions of the Audit Firm itself shows the failure to conduct audit according to the SAs. Even the **audited** financial statements of DPL and DPDCL for FY17 were not available at the time of conducting audit for FY18. In spite this the Audit Firm did not raise this concern to the management or audit committee or TCWG and did not take any action for this serious violation of the provisions of the Companies Act, 2013, which mandates all the companies to get their accounts audited before holding its AGM.
- 6.2.13** Vide its response dated 14<sup>th</sup> April, 2021, the Audit Firm has stated that *“A bare perusal of Section 129(1), 129(3) and 129(4) of the Companies Act, 2013 reveals that Section 129(3) merely states the requirement that the Company need to prepare consolidated financial statements, whereas Section 129(4) states the method of preparation of consolidated financial statements. The financial statements of holding company has to be prepared as per Section 129(1) and hence by application of Section 129(4), Section 129(1) will also apply in preparation of consolidated financial statements. Accordingly, the consolidated financial statements are also to be prepared in accordance with the accounting standards notified under Section 133.”*
- 6.2.14** NFRA in its PFC cited Rule (4) (2) of Companies (Accounting Standards) Rules, 2006, along with Para 2 of general instructions mentioned in Annexure to the Companies (Accounting Standards) Rules, 2006, and clearly stated that if a particular Accounting Standard is not in conformity with the prevailing law due to an amendment to the Act, the specific **provision of the Companies Act, 2013, will override the said accounting standard**. As such, as per Section 129 (3), the holding company is required to consolidate **ALL** the subsidiaries and associate companies in the same form and manner as that of its own.
- 6.2.15** The Audit Firm has also stated that *“We would like to clarify NFRA that, there are three methods of consolidation as per accounting standards prescribed by Section 133 of Companies Act, 2013. The methods for consolidation are:*

- *Line by Line consolidation for subsidiaries as per AS 21,*
- *Equity method for associate as per AS 23, and*
- *Proportionate consolidation for joint ventures as per AS 27.*

*Exemption provided by Para 7 of AS 23, to not account for investment in associate under the equity method in certain cases is to be construed as exemption from consolidation only, as there is no other method to consolidate the associate entity as mentioned above”.*

- 6.2.16** Notwithstanding what is stated in Para 6.2.14 above, even assuming for the sake of argument, but not accepting, that interpretation of Para 7 of AS 23 can be construed as exemption of an associate company from consolidation only, it is also important to note that such an exemption is available only when the investment is acquired and held exclusively with a view to its subsequent disposal in the **near future**. The interpretation of the term “near future” as stated by Accounting Standards Interpretation (ASI) 8 is that *“A period of more than twelve months would not normally signify ‘near future’.* Accordingly, it is considered appropriate that the near future should normally be considered as **a period not exceeding twelve months**”. (Emphasis Added)
- 6.2.17** In Note 14 (c) of CFS, the management of IL&FS Limited had mentioned that *“the Group has acquired management control of IECCL and HCPL vide Orders of the Company Law Board (CLB) dated August 31, 2009 and January 13, 2011 respectively, in order to protect the credit exposure of the Group to IECCL and ECCL’s exposure to HCPL”.* As such, it is clear that investment was held for more than twelve months in both IECCL and HCPL. Therefore, it was required by the Audit Firm to raise question to the management for holding these investments for so long and then not consolidating them while preparing CFS.
- 6.2.18** Moreover, the Audit Firm has also given reference to various WPs in support of their response to NFRA’s PFC in respect of component entities not considered for consolidation. On perusal of the response, NFRA finds that the WPs referred by the Audit Firm in support of their assertions were already examined in detail by NFRA at the stage of forming its Prima Facie Conclusions (PFC). Hence, NFRA concludes that there is no need for re-examination as no new/additional response to what was provided earlier is now submitted by the Audit Firm. Also, considering the reasons explained in Para 6.2.14 to 6.2.17 above, NFRA reiterates its conclusions provided in Para 5 of its PFC that the Audit Firm simply relied on the decision of the management to not to consolidate IECCL and HCPL while preparing CFS.
- 6.2.19** Vide its response dated 14<sup>th</sup> April, 2021, the Audit Firm has stated that *“We had obtained final list of components as on March 31, 2018 which is available in our workpaper. Refer IL&FS - Consolidation Hardcopy Files Folder - C 30\_Note 37 & 55 – (Page no. W1 to W22). The list of components was also disclosed in Note 37 of CFS, which includes entities in the group at any time during the year and previous year for*

*comparative purpose. Refer ILFS- Consolidation Hardcopy Files Folder- C 3\_M18 ILFS CFS signed FS. We had also obtained management representation on completeness and accuracy of the details disclosed in Note 37 of CFS. Refer IL&FS- Consolidation Hardcopy Files Folder – C4\_M18 Consol LOR.”*

- 6.2.20** The WP “IL&FS - Consolidation Hardcopy Files Folder - C 30\_Note 37 & 55 – (Page no. W1 to W22)” referred by the Audit Firm is just the replica of what is mentioned in Note 37 and 55 of CFS. The WP “ILFS- Consolidation Hardcopy Files Folder- C 3\_M18 ILFS CFS signed FS” is the signed CFS of IL&FS Limited. The WP “Refer IL&FS- Consolidation Hardcopy Files Folder – C4\_M18 Consol LOR” is the letter of representation obtained by the Audit Firm from the management on 29<sup>th</sup> August, 2018, i.e., on the day of signing of the auditor’s report on CFS. In its PFC, NFRA stated that the Audit Firm did not obtain the complete list of component entities at **the initial stage** of audit. In response to the said conclusion of NFRA, all said WPs referred by the Audit Firm are irrelevant as none of the WP obtained by the Audit Firm as management representation at the beginning of the audit.
- 6.2.21** Further, the Audit Firm in Para 50 of their response has reiterated what they responded vide their communication dated 6<sup>th</sup> September, 2020. NFRA formed its PFC after detailed examination of the said response. As such, NFRA concludes that there is no need for re-examination as no new/additional response to what was provided earlier is now submitted by the **Audit Firm**. NFRA reiterates its conclusions provided in Para 6 of its PFC.
- 6.2.22** In Para 51 of their response, the Audit Firm has cited Para 3, A15 and A16 of SA 580 and stated that *“Based on above, audit team has performed audit procedures mentioned in Para 1 above and has obtained the written representation on August 28, 2018, to comply with the requirements of SA 580. Further, per the generally followed audit practice, it is acceptable to obtain management representation at the end of audit, in accordance with Para A15 of SA 580. As per Para A16 of SA 580, even if auditor had obtained management representation during the audit, auditor was required to obtain the updated representation at the end of audit. Also, management representation was obtained at the end of audit to confirm various representations made by management during the course of audit and does not include any additional audit evidence.”*
- 6.2.23** NFRA in Para 6.2 of its PFC already communicated that as per Para 18 of Guidance Note on Audit of CFS, before commencing an audit of consolidated financial statements, the auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. The auditor should make plans, among other things, for understanding the group structure. As such, obtaining the complete list of the components entities is the basic step in the conduct of audit of CFS. NFRA understands that it is really impractical to perform the audit of CFS without the knowledge and complete understanding of the total components of the Company.

Also, as stated by the Audit Firm itself that even if the auditor had obtained management representation during the audit, the auditor was required to obtain the updated representation at the end of the audit **to confirm various representations made by management during the course of the audit** and does not include any additional audit evidence. NFRA notes that there is no document in the audit file that pertains to management representations obtained by the Audit Firm at the initial stage/during the course of the audit.

**6.2.24** Moreover, the Audit Firm has also repeatedly stated that *“SRBC is surprised that NFRA has conveniently chosen to use only selected extracts of standard on auditing. SRBC respectfully submits that the interpreting a standard on auditing requires a holistic approach and a harmonious interpretation and not a piecemeal approach. It seems that NFRA has overlooked the inter-dependence and interconnected principles and paragraphs of various standards on auditing which must be reviewed as a whole to consider for the purposes of present audit review.”*

**6.2.25** NFRA would like to bring the attention of the Audit Firm to the following Paras of SA 200 which clearly states that SAs are mandatory in nature and **each requirement/para of an SA is important in its own self**. Each Para of an SA has its individual importance and mandatory applicability except in the circumstances where such SA or a particular requirement/Para of an SA is not applicable.

Para 2 of SA 200 says, *“SAs are written in the context of an audit of financial statements by an auditor. They are **to be adapted as necessary** in the circumstances when applied to audits of other historical financial information”*. (Emphasis Added)

Para 19 of SA 200 says, *“The auditor shall have an **understanding of the entire text of an SA**, including its application and other explanatory material, to understand its objectives and to apply its requirements properly”*. (Emphasis Added)

Para 22 of SA 200 says, *“Subject to paragraph 23, the auditor shall comply with **each requirement of an SA** unless, in the circumstances of the audit: (a) The entire SA is not relevant; or (b) The requirement is not relevant because it is conditional and the condition does not exist. (Ref: Para. A72-A73)”*. (Emphasis Added)

Para A58 of SA 200 says, *“In addition to objectives and requirements (requirements are expressed in the SAs using “shall”), an SA contains related guidance in the form of application and other explanatory material. It may also contain introductory material that provides context relevant to a proper understanding of the SA, and definitions. **The entire text of an SA, therefore, is relevant to an understanding of the objectives stated in an SA and the proper application of the requirements of an SA**”*. (Emphasis Added)

Para A67 of SA 200 says, *“Each SA contains one or more objectives which provide a link between the requirements and the overall objectives of the auditor. The objectives*

*in individual SAs serve to focus the auditor on the desired outcome of the SA, while being specific enough to assist the auditor in: • Understanding what needs to be accomplished and, where necessary, the appropriate means of doing so; and • Deciding whether more needs to be done to achieve them in the particular circumstances of the audit”.*

- 6.2.26** Considering the above Paras of SA 200, NFRA refutes the Audit Firm’s assertion mentioned in Para 6.2.24 above.
- 6.2.27** The Audit Firm in their response has stated that *“For the large entities such as IL&FS, it is a common practice to consider the consolidated financial statements of direct components, if the audited consolidated financial statements are available. In our view, whether indirect components are consolidated directly into the parent company or through direct components of the parent company, end result of CFS will be same.”*
- 6.2.28** NFRA rejects the said assertion of the Audit Firm and reiterates that the Audit Firm has the professional duty to conduct the audit as per the requirements of the relevant Acts, Standards of Auditing, Accounting Standards, Law etc. and not based on alleged “Practices” which have no legal or statutory backing.
- 6.2.29** Vide its response dated 14<sup>th</sup> April, 2021, the Audit Firm has given reference to various WPs in support of their assertions. On perusal of the response, NFRA finds that the WPs referred by the Audit Firm was already examined in detail by NFRA at the stage of forming its PFC. Hence, NFRA concludes that there is no need for re-examination as no new/additional WP to what was provided earlier is now submitted by the **Audit Firm**. As such, NFRA reiterates its conclusions provided in Para 9 to 11 of its PFC.
- 6.2.30** Vide its response dated 14<sup>th</sup> April, 2021, the Audit Firm, inter alia, has stated that *“oversight of incorrect domicile of one company inadvertently, considering the volume of entities involved in consolidation, in no way will affect the users and their needs. Accordingly, mentioning incorrect domicile of one company in no way affects true and fair view of whole consolidated financial statements of IL&FS for the year ended March 31, 2018.”*
- 6.2.31** The basic objective of AS 11 says, *“An enterprise may carry on activities involving foreign exchange in two ways. It may have transactions in foreign currencies or it may have foreign operations. **In order to include foreign currency transactions and foreign operations in the financial statements of an enterprise, transactions must be expressed in the enterprise’s reporting currency and the financial statements of foreign operations must be translated into the enterprise’s reporting currency.”***  
(Emphasis Added)

As per AS 11 Foreign operation is defined as “a subsidiary, associate, joint venture or branch of the reporting enterprise, the activities of which are based or conducted in a country other than the country of the reporting enterprise.”

- 6.2.32** In view of the above Paras of AS 11, it is important for the holding company to identify the correct domicile of its foreign operations correctly to convert its foreign operation’s reporting currency into its own reporting currency. In the current case, as ‘Kukuza Project Development Company’ is a Company domiciled in Mauritius (as admitted and stated by the Audit Firm itself), it was important for IL&FS Limited, the holding company, to correctly disclose the nationality of its foreign operation in the Financial Statements. Also, NFRA is of the view that when management has wrongly disclosed the nationality of its foreign operation as ‘Indian’ instead of ‘Foreign’, this in fact creates a significant doubt that whether the management even converted Mauritius Rupee into Indian Rupee for consolidation purposes. (The reporting currency of ‘Kukuza Project Development Company’ is nowhere mentioned either in the Financial Statements or in the audit file. As Kukuza is domiciled in Mauritius, NFRA has presumed that its reporting currency to be Mauritius Rupee).
- 6.2.33** Further, Para 3 of SA 200 says, “*The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework. An audit conducted in accordance with SAs and relevant ethical requirements enables the auditor to form that opinion.* (Emphasis Added)
- 6.2.34** Therefore, the Audit Firm was responsible to identify the discrepancy that the management had wrongly disclosed the nationality of its foreign operation. As per Para 3 of SA 200 as stated above, the Audit Firm was also required to verify whether the Company complied with AS 11 while preparing its CFS which the Audit Firm failed to do so. Instead, the Audit Firm has said that mentioning the incorrect domicile of one company in no way affects the true and fair view of the whole consolidated financial statements of IL&FS Limited. As such, NFRA disagrees with the Audit Firm’s statement. Also, NFRA concludes that the Audit Firm did not perform its professional duties with due diligence and failed to comply with Para 15 of SA 200.
- 6.2.35** In respect of the accounting policy of GCP for CFS, vide its response dated 14<sup>th</sup> April, 2021, the Audit Firm has stated that “*We would like to draw your attention to the fact that the accounting policies followed by management with respect to GCP were the same for SFS and CFS of IL&FS. The wording of the accounting policy for CFS, with respect to GCP, was modified to reflect GCP accounting after elimination of intra group loans and investments. In the Consolidated Financial Statements of the Company, Loans*

*and Investments of intra group gets eliminated and therefore the GCP was retained to the extent of Loans and Investments exposures, remaining in CFS after elimination.”*

- 6.2.36** As also stated by NFRA in Para 13.1 of its PFC, GCP Policy of CFS mentions that *“The Group carries a significant quantum of long tenor project finance and infrastructure assets on its books. Given the risk profile attendant to such assets, the Group has created a Provision for General Contingency to cover adverse events that may affect the quality of the Group's Assets. Provision for General Contingency at Group level is **assessed** at the end of each year with respect to the net assets consolidated.”* (Emphasis Added)
- 6.2.37** The dictionary meaning of the word “assessed” is *“to decide the amount or value of something”*. As such, it clearly means that as per the GCP policy for CFS, provision for GCP was calculated at the end of each year which is contradictory to the assertion of the Audit Firm that the GCP was retained to the extent of Loans and Investments exposures, remaining in CFS after elimination. Also, in the WP “IL&FS-Consolidation Canvas Files Folder – C 536.1 to C 536.4 M18 GCP working consol”, the workings pertaining to GCP for CFS clearly shows that the reversals have been taken into consideration which is obviously something different from ‘elimination’.
- 6.2.38** Further, as per the GCP policy for SFS, the Provision for General Contingency is utilized against specific provisions on a **case-to-case basis** if there are indicators of impairment other than temporary. On the other hand, basis and rationale for creation of GCP as stated by the Audit Firm and also approved by the Audit Committee states that the **GCP in the SFS was created on an overall exposure** of the Company (i.e. Loans and investments) **and not against any specific asset**. As such, basis for creation of GCP as per policy and what is stated by the Audit Firm is contradictory. This clearly implies that the Audit Firm failed to understand the basis for creation of GCP and did not conduct the audit with professional scepticism as per the requirements of Para 15 of SA 200.
- 6.2.39** In Para 104 of their response, the Audit Firm has stated that IL&FS does not have a direct investment in MPCDC and that MPCDC was a direct subsidiary of ITNL. The Audit Firm has also explained the audit procedures performed by them to verify reversal of GCP with respect to MPCDC as principal auditor. After a detailed examination of the WPs placed in the audit file pertaining to the work done by the Audit Firm in the capacity of principal auditor, NFRA finds that the Audit Firm failed to conduct the audit as per the requirements of SA 600 which are well explained in paras above. For the sake of brevity, the same is not reproduced here.
- 6.2.40** As per the requirements of Para A16 of SA 580, the Audit Firm is required to obtain a written representation about a specific assertion in the financial statements from the management during the course of audit. Whenever needed, it may be necessary to request an updated written representation. As such, the Audit Firm’s assertion that *“audit team had obtained the written representation on August 28, 2018, to comply with*

*the requirements of SA 580*” is unacceptable for obtaining the management representation regarding GCP.

- 6.2.41** For NFRA’s observations regarding PPT made to Audit Committee just one day prior to signing of the auditor’s report cannot be considered as a communication to TCWG, please refer Communication with TCWG Chapter of this DAQRR.
- 6.2.42** Moreover, all the WPs provided by the Audit Firm in support of their assertions pertaining to GCP were already examined in detail by NFRA at the stage of forming its PFC. Nothing additional/new to what was considered earlier by NFRA has now been provided by the **Audit Firm**. Hence, NFRA concludes that no further examination is required and NFRA reiterates its conclusions provided in Para 13 of its PFC.
- 6.2.43** It must be noted that 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. Given this position in the SAs, there is virtually no scope for purely oral submissions or discussions. All oral representations have also to be reduced to writing to form part of the record, and to eliminate the scope for disputes. 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.
- 6.2.44** Therefore, in view of the above explanations and observations of NFRA as stated from Para 6.2, 6.4, 6.6... to 6.30 NFRA reiterates its conclusion that the Audit Firm failed to comply with the provisions of SA 600.
- 6.2.45** After examining in detail all the responses of the Audit Firm to the PFC, NFRA concludes as follows:
- a) The Audit Firm failed to understand the applicability of SA 720 and hence did not comply with the requirements of Paras 6, 7, 11, 12 and 13 of SA 720.
  - b) The Audit Firm did not identify the ambiguity in the total number of component entities of IL&FS Limited in different documents.
  - c) The Audit Firm failed to comply with Section 129 (3) of the Companies Act, 2013 and also failed to understand the provisions of AS 23 and completely ignored the importance of interpretation of the term “near future”.
  - d) The Audit Firm failed to perform its professional duties in the capacity of the principal auditor as per the requirements of SA 600.

- e) The Audit Firm failed to understand the mandatory nature of each requirement/para of an SA, the entire text of an SA, and all SAs as a whole.
- f) The Audit Firm failed to conduct the statutory audit with professional scepticism in accordance with Para 15 of SA 200.
- g) The Audit Firm failed to verify whether the consolidation of subsidiaries was done on line by line basis strictly as per the requirements of Para 13 of AS 21. In fact, in order to cover up its casual behaviour, the Audit Firm tried to mislead NFRA by saying that whatever they had done was done by them as part of the common practice. The Audit Firm's contention is unacceptable as the professional duty must be strictly conducted as per the requirements of the relevant Acts, SAs, ASs, Law etc. and not based on alleged "Practices" which have no legal or statutory backing.
- h) The Audit Firm failed to understand the importance of correctly disclosing each and every piece of information (whether material or not) in the Financial Statements. The Audit Firm failed to understand that disclosure of the wrong nationality of a joint venture in the financial statements by the management was a matter of concern and due importance as the same will affect the accounting procedures accordingly.

### **C. Final Observations and Conclusions of AQRR**

6.3. NFRA has examined the replies to the DAQRR submitted and oral submissions made by the Audit Firm and concludes as follows:

- 6.3.1** On perusal of the response of the Audit Firm, NFRA notes that the Audit Firm has repeated its earlier responses. NFRA's findings in the DAQRR were after a detailed examination of the responses of the Audit Firm. As nothing new/additional to what was submitted earlier is given by the Audit Firm, NFRA reiterates its observations in the DAQRR, subject to the specific modifications in the below paras.
- 6.3.2** The Audit Firm in its response dated 27<sup>th</sup> September 2021, states that *"SRBC would like to clarify that our response in PFC stating SA 720 was not applicable for SFS of IL&FS, was in the context of auditor's responsibilities for reporting in its statutory audit report relating to Other Information, i.e. to say that mandatory reporting in audit report regarding Other Information was not applicable till March 2018. The mandatory reporting was introduced in the SA 720 (Revised) ('SA 720 (R)'). In the pre-revised SA 720 ('SA 720') reporting in audit report was on exception basis only"*. The said argument of the Audit Firm cannot be accepted as a valid explanation of what the Audit Firm had stated in its response to PFC. Earlier, the Audit Firm clearly and outrightly stated that SA 720 was not applicable for audit for FY18. The extract of what was said by the Audit Firm is as follows:

8. NFRA has inadvertently assumed that SA 720 - The Auditor's Responsibilities Relating to Other Information is applicable to the audit of IL&FS for the year ended March 31, 2018. However, the said standard on auditing is applicable for the audits of financial statements for the period beginning on or after April 1, 2018. The extract of the paragraph 10 of SA 720 is reproduced below for your convenience:

*"This SA is effective for audits of financial statements for periods beginning on or after April 1, 2018."*

We are surprised that NFRA has framed their prima-facie comments/observations/conclusions based on a standard on auditing which was not applicable for the audit of the financial statements of IL&FS for the year ended March 31, 2018. Thus, in the absence of SA 720 being applicable on the audit period under consideration, there was no requirement for the Audit Firm to verify Form MGT 9 (Extract of Annual Return) provided by the management in the Annual Report of IL&FS for the year ended March 31, 2018.

9. In view of the non-applicability of SA 720, para 2.4 and para 2.5 of PFC are incorrect and any conclusion drawn by NFRA in this regard shall be deemed to be invalid. SRBC strongly refutes and denies NFRA's prima facie comments/observations/conclusions in Para 2. We therefore most humbly request NFRA to delete/withdraw the baseless observations/comments made and incorrect conclusions drawn in para 2 of PFC.

- 6.3.3** Therefore, it is clear that the present explanation given by the Audit Firm regarding the applicability of SA 720 is an attempt to distort facts. NFRA observes that this is not the first time the Audit Firm has resorted to such unprofessional practices in its futile attempts to mislead the regulator. In any case, the fact remains that the Audit Firm has failed to perform the required procedures as per SA 720 as NFRA observed in the PFC and DAQRR (see paras 6.1.5, 6.1.6 and 6.2.3 to 6.2.4 above).
- 6.3.4** SA 230 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.
- 6.3.5** 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 conclusions in the audit file is not sufficient as the auditor is required to document the basis of forming his opinion/conclusions as well.
- 6.3.6** Therefore, the Audit Firm's statement that *"With respect to para 6.4.2 of DAQRR regarding NFRA's comment that the reconciliation between entities derived from LOR and Note 55(a) is not present in the workpaper, we would like to clarify that as part of our audit, we are not required to prepare reconciliation between different listing of components. We have verified each listing of component individually"* is not acceptable since there is no proof whether the work as claimed to have been done by the Audit Firm has been done or not. In the absence of any proof, the conclusion is that the work has not been done.

- 6.3.7** Regarding the use of unaudited financial statements, the Audit Firm states that *“In this regard we would like to state that preparation of CFS is the responsibility of management and accordingly, use of component’s unaudited financial statements, considering the non-availability of audited financial statements, was also decision of management. As an auditor, we had no role to play in this regard. Further with respect to components, getting the financials audited as well as holding AGM in compliance with the Companies Act, 2013, is the responsibility of component’s management. As a holding company auditor, it is not in our realm to insist on the management that all components financial statements should be audited”*. The said statement of the Audit Firm cannot be accepted in view of Para 16 of SA 600. According to the said para, the principal auditor is responsible to **discuss with the other auditor and the management of the component about** any matter affecting the financial information of the components. Accordingly, in the given case, it was the duty of the Audit Firm to discuss the non-compliance of the Companies Act, 2013 with the management of the component and with TCWG.
- 6.3.8** The Audit Firm states that *“we would like to clarify that the intention to sell the investment in ‘future’ is to be noted and hence past holding period of investment is not relevant for the purpose of this assessment. For verification of intention of management, we had obtained resolution passed in Board of Directors meeting and as per said resolution management continues to hold these investments exclusively for subsequent disposal in near future Refer IL&FS-Consolidation Hardcopy Files Folder - C 15\_IECCL and HCPL evaluation (Page no. IH6)”*. It is important to note that as per Para 7 of AS 23 the exemption for an associate company from consolidation is available only when the investment is **acquired and held exclusively** with a view to its subsequent disposal in the near future. The explanation to para 7 of AS 23 states that *“The intention with regard to disposal of the relevant investment is considered at the time of acquisition of the investment. Accordingly, if the relevant investment is acquired without an intention to its subsequent disposal in near future, and subsequently, it is decided to dispose off the investment, such an investment is not excluded from application of the equity method, until the investment is actually disposed off”*. There is no evidence in the Audit File to confirm the said condition. None of the WPs referred by the Audit Firm had evidence of such testing. The audit evidence referred by the Audit Firm in this regard is a Board Resolution dated August 29 2018. This resolution does not provide any evidence of the intention about the disposal of the relevant investment at the time of acquisition of the investment. Therefore, the above said contention of the Audit Firm is rejected as baseless.
- 6.3.9** The Audit Firm states that *“we had obtained the list of components as on December 31, 2017 from management in the month of February 2018 vide-email. Further, we would like to state that, SA 230 does not require auditor to retain, as part of audit file, the emails through which audit data is received. Also, it is not practically possible to obtain, all the audit data on the letterhead of the Company and signed by the officials of the Company, as voluminous information is received from the Company to assist us in*

obtaining sufficient and appropriate audit evidence. We had obtained the said information through Email, which is sufficient proof that this information had been obtained directly from the Company officials. We are attaching a copy of the said e-mail for NFRA's reference. Refer Appendix 11 (Page A169 to A170)". The said email states "Dear Vyapak / Amit, Kindly find attached the draft CFS instructions for March 2018 for your review and comments" along with some attachments. There is no proof that the attachments are the list of components. As already made clear in the above paras, claims that are not supported by clear evidence in the Audit File cannot be taken into consideration.

**6.3.10** Regarding the interpretation of the SAs, the Audit Firm states that "*In this regard, we would like to state that none of the paragraphs of SA 200 quoted by NFRA in above referred paragraphs, supports their view that interpreting a standard on auditing does not require a holistic approach and a harmonious interpretation*". It is emphasised that NFRA has not said anywhere that 'interpreting a standard on auditing does not require a holistic approach and a harmonious interpretation'. Instead, NFRA observed in the PFC that "*SAs are mandatory in nature and **each requirement/para of an SA is important in its own self**. Each Para of an SA has its individual importance and mandatory applicability except in the circumstances where such SA or a particular requirement/Para of an SA is not applicable*". NFRA observes that the Audit Firm employs the unprofessional practice of distorting facts in its futile attempts to defend a meritless case. The Audit Firm has further stated that "*We would like to further submit that there are cross referencing given in the Standards on Auditing. Also, SAs have to be read, understood and applied comprehensively. For example, each SA indicate the documentation specific to that particular SA. At the same time, the basic requirements of documentation are contained in SA 230 also. **Thus, what is required to be documented in accordance with a particular SA will have to be done in accordance with the principles and requirements of documentation as contained in that specific SA***"(emphasis added). The above-emphasised part of the opinion of the Audit Firm underlines the observation of NFRA that each requirement/para of an SA is important on its own self. The mandatory nature of SAs is explained in Section 143, paras 18, 20 and 22 of SA 200, Handbook of Auditing Pronouncements issued by ICAI, and the Code of Ethics. All the observations of NFRA in this regard in the DAQRR are therefore reiterated.

**6.3.11** Regarding the method of consolidation, the Audit Firm states that "*we agree that Audit Firm has professional duty to conduct the audit as per the requirements of the relevant Acts, Standards of Auditing, Accounting Standards, Law etc. However, **in absence of any specific guidelines, auditor has to ensure compliance with generally accepted auditing procedures**. Further, we would like to re-emphasize that in our view, whether indirect components are consolidated directly into the parent company or through direct components of the parent company, end result of CFS will be the same. NFRA has not provided any evidence to support that consolidation carried out using*

*consolidated financial statements of direct components had in any way affected true and fair view of the CFS of IL&FS". (Emphasis Added)*

- 6.3.12** The contention of the Audit Firm is not tenable as Para 13 of AS 21 states that the **financial statements of the parent and its subsidiaries should be consolidated** on a line by line basis by adding together like-items of assets, liabilities, income and expenses. Also, the term “subsidiary” is defined by the AS as well as the Companies Act, 2013. Therefore, despite the law available as to how to perform consolidation of the financial information of the parent and subsidiaries, the Audit Firm is bound to follow that law. NFRA points out the need for adherence to this standard pertaining to consolidation of financial statement. It is not NFRA’s case whether the wrong method adopted by the Audit Firm could result in the same “end result” or not.
- 6.3.13** The response provided by the Audit Firm in respect of General Contingency Provision is not supported by any relevant new/additional WP. Hence, NFRA reiterates all its observations on GCP as stated in its DAQRR. Similarly, the explanation regarding Audit Documentation is also baseless to the core. The Audit Firm, for, e.g, quotes para A5 of SA 230 and contents that *“SRBC submits that our entire audit file is fully supported by audit evidence for the work performed and the conclusions reached during the audit. The explanation provided by SRBC in response to NFRA’s PFC were only to clarify certain information required by / matters specifically raised or requested by NFRA. Further, SRBC would like to submit that the explanations and audit file documentation reference provided by SRBC are at the request of NFRA since NFRA reviewer is not able to review the audit file documentation (CANVAS) as prepared in accordance with the SA 230 (Revised) and submitted to NFRA. An audit file is maintained in time bound manner and our canvas has linkages to comply with audit methodology used by us and it should be reviewed considering the fact that no workpapers were added after the archival date. This is a global practice by any regulatory body who conducts an audit file review unlike NFRA which has asked for multiple information, document references and documentations from the audit files to be provided / uploading to them in different formats and systems due to its own inability to review the audit files as prepared and maintained by SRBC”*. The Audit Firm itself states that oral explanations by the auditors may be used to explain or clarify information contained in the audit documentation. NFRA may seek explanations from the Audit Firm in all cases where there is no information contained in the Audit File regarding various requirements of the SAs. It is also in the best interest of the Audit Firm that NFRA is offering multiple chances of representation for the Audit Firm to submit its case. In all cases where NFRA has rejected the explanations offered by the Audit Firm, it is explained in detail in the respective places that either the explanation is not in conformity with the law/SAs or there is no supporting information/documents contained in the Audit File.
- 6.3.14** The observation regarding 41 unaudited entities in para 6.2.7 above stands deleted based on the evidence submitted. However, NFRA observes that the reporting of 41 unaudited entities under ‘Other Matters’ of the audit report of CFS is ambiguous and misleading

for the users of the financial statement, since there is no clarity in reporting regarding inclusion or non-inclusion of the two other unaudited entities, DPL and DPDCL.

**6.3.15** Thus, NFRA concludes as follows.

- i) The Audit Firm failed to understand the applicability of SA 720 and hence did not comply with the requirements of Paras 6, 7, 11, 12 and 13 of SA 720.
- j) The Audit Firm did not identify the ambiguity in the total number of component entities of IL&FS Limited in different documents.
- k) The Audit Firm failed to identify and report non-compliance with Section 129 (3) of the Companies Act, 2013 and also failed to understand the provisions of AS 23 and ignored the importance of interpretation of the term “near future”.
- l) The Audit Firm failed to perform its professional duties in the capacity of the principal auditor as per the requirements of SA 600.
- m) The Audit Firm failed to understand the mandatory nature of each requirement/para of an SA, the entire text of an SA, and all SAs as a whole.
- n) The Audit Firm failed to conduct the statutory audit with professional scepticism in accordance with Para 15 of SA 200.
- o) The Audit Firm failed to verify whether the consolidation of subsidiaries was done on a line by line basis strictly as per the requirements of Para 13 of AS 21. To cover up its lapses, the Audit Firm tried to mislead NFRA by saying that whatever they had done was done by them as part of the common practice. The Audit Firm’s contention is unacceptable as the professional duty must be **strictly** conducted as per the requirements of the relevant Laws, SAs, ASs, etc. and not based on alleged “Practices” which have no legal or statutory backing.
- p) The Audit Firm failed to understand the importance of **correctly** disclosing each information (whether material or not) in the Financial Statements. The Audit Firm failed to understand that disclosure of the wrong nationality of a joint venture in the financial statements by the management was a matter of concern and due importance as the same will affect the accounting procedures accordingly.

## 7. RBI Compliance

### Reporting of Breach of CoR, that the Company holds under Section 45-IA of the RBI Act, 1934

#### A. Prima Facie Observations and Conclusions (PFC)

7.1 In Prima Facie Conclusions, NFRA conveyed the following:

- 7.1.1 The Audit Firm has, in compliance to Clause 3(xvi) of the Companies (Auditor's Report) Order, 2016, in Annexure to the Independent Auditors' Report on the Company's standalone financial statements for FY 2017-18, stated that "*According to the information and explanations given to us, we report that the Company is registered under section 45- IA of the Reserve Bank of India Act, 1934.*"
- 7.1.2 The Company had received Certificate of Registration (CoR) to operate as a CIC-ND-SI on September 11, 2012 (WP 'C 914.1.1.2.1 to C 914.1.1.2.4 M18 CIC and Board report2\_CIC Certificate\_002 Regulations\_COR Letter.pdf') based on which the Audit Firm has provided its report under clause 3 (xvi) of CARO, 2016. Further the CoR issued in itself is subject to the Company complying with various terms and conditions including the requirements of Para 8 and Para 9 of Master Directions – CIC-ND-SI.
- 7.1.3 Para 52 (k) of the Guidance note on the Companies (Auditor's Report) Order (CARO), 2016 states that under clause 3 (xvi) of CARO, 2016 the auditor has to verify "*Whether the company has net owned funds as required for the registration as NBFC.*"
- 7.1.4 The Guidance Note on CARO, 2016 has provided an illustrative checklist in Appendix IV stating that "*This checklist does not form part of the Guidance Note and is only illustrative in nature. Members are expected to exercise their professional judgment while making its use depending upon facts and circumstances of each case and read this check list in conjunction with the Guidance Note on Companies (Auditor's Report) Order 2016.*" (Emphasis added). The checks indicated for clause 3 (xvi) are listed as follows:
- (a) "*Examine the financial statements of the Company and assess whether the company has financial assets and financial income.*"
  - (b) "*Check whether the company has financing activity as a principal business of the Company.*"
  - (c) Obtain understanding of the requirements of section 45- IA of RBI Act, 1934 with regard to registration of the company with RBI.
  - (d) "*Examine whether the Company is carrying out NBFC activity / Core investment company.*"
  - (e) "*Examine the steps taken by the company to comply with requirements of the RBI Act, 1934 with respect to registration as a NBFC. Also examine the correspondence and documents filed with the RBI, minutes of the Board*"

meeting.

- (f) *Examine whether the Company has obtained Certificate of Registration from RBI in terms of section 45-IA of the RBI Act, 1934.*
- (g) *Consider the implications of non-compliances above also in the auditors' opinion on the financial statements.” (emphasis added)*

**7.1.5** The illustrative checklist, given above, clearly indicates that the Auditor is required to obtain sufficient appropriate audit evidence to examine the facts about whether the Company holds a CoR from RBI and if the Company is in compliance with the regulatory requirements. The Auditor is required to obtain sufficient appropriate audit evidence and ensure, at the minimum, that the checks listed in the checklist are examined before reporting under clause 3 (xvi) of CARO, 2016.

**7.1.6** In light of the Guidance Note issued by ICAI on CARO, 2016 and the fact that the CoR, that the Company holds under Section 45-IA of the RBI Act, 1934 to operate as an CIC-ND-SI, **is subject to various terms and conditions**, it is evident that the Audit Firm should have examined and reported on any non-compliance with regard to the CoR. However, NFRA notes that the reporting under clause 3 (xvi) does not indicate the non-Compliance that was concluded by the Auditor. The reporting omits the conclusion drawn by the Audit Firm that the Company has breached the terms and conditions (capital requirements, as explained subsequently in this chapter) and to continue to hold the CoR.

## **B. Observations made in the DAQRR**

**7.2** NFRA has examined in detail the replies submitted by the Audit Firm on above observations and observed in the DAQRR as follows:

**7.2.1 Summary of Audit Firm's Response:** In its response dated 14<sup>th</sup> April 2021, the Audit Firm quoted Clause 3 (xvi) of CARO, 2016 and asserted that the requirement of this clause is to report whether the Company is required to be registered as NBFC with RBI and if that is so, whether the registration is obtained or not. The Audit Firm asserted that it is important to note that the Clause 3 (xvi) does not require to report on compliance with the requirements specified in Certificate of Registration (CoR) or the Master Direction.

In its reply, the Audit Firm stated that:

- (a) *“For the purpose of our reporting, we had verified the Certificate of Registration (CoR) obtained by the Company under section 45-IA of the Reserve Bank of India Act, 1934. Based on the Certificate of Registration obtained on September 11, 2012, the Company was permitted to commence and carry on the business of a Core Investment Company CIC- ND-SI and the same was valid as of March 31, 2018. Refer IL&FS - Standalone Canvas Files Folder ‘C 914.1.1.2.1 to C 914.1.1.2.4 M18 CIC and Board report2\_CIC Certificate\_002 Regulations\_COR*

*Letter.pdf”*

- (b) *“Further as noted by NFRA, the Company needs to comply with various terms and conditions of Master Directions and accordingly we had verified whether the Company was compliant with same, Refer IL&FS- Standalone Hardcopy Files Folder - 5\_CIC compliance checklist. We are not, however, mandated to report the same under Clause 3 (xvi) of CARO, 2016 and hence question of our reporting on compliance does not arise.”*
- (c) *“Based on Illustrative Checklist in Appendix IV of Guidance Note on CARO 2016 reproduced by NFRA in Para 2.6 of PFC, NFRA concluded that any non-compliance in respect of the Master Directions or the terms and conditions of CoR is required to be reported under this Clause (xvi) of CARO. However, we are of the view that the conclusion drawn by NFRA is not correct as the clause of CARO clearly requires reporting of whether or not the company is required to be registered under Section 45 IA of Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained. There is no requirement to report under this clause non-compliance under Master Direction - Core Investment Companies (Reserve Bank) Directions, 2016 (Master Direction - CIC-ND-SI).”*

7.2.2 **NFRA Observations:** NFRA notes that the assertion of the Audit Firm, that it was not required to report non-compliance with the CoR, is incorrect. In its PFC (Para 7.1), NFRA had already established that the Auditor was required to report the non-compliance with CoR, obtained under section 45-IA of the Reserve Bank of India Act, 1934. Merely reporting that the Company is registered under section 45-IA of the Reserve Bank of India Act, 1934, while omitting to state that the Company has breached the terms & conditions to hold the said registration, is a false statement.

In fact, NFRA notes that the Audit Firm, in its audit report for the FY 2018-19, itself reported the non-compliance with the CoR for the Company. Therefore, these arguments are clearly an attempt to mislead NFRA.

Further, the assertion of the Audit Firm that the (Para 7.2.1 (a)) certificate “**was valid**”, is also not supported by the facts and is misleading. As observed in the PFC, with the non-compliance of the capital requirements, the Company had breached the basic terms & conditions that the CoR was subject to.

7.2.3 NFRA notes that the assertion of the Audit Firm that it was required to verify (under clause 3 (xvi) of CARO, 2016) whether the Company was not in compliance with the CoR, **but was not required to report** the same and therefore it omitted to report the non-compliance under clause 3 (xvi) of CARO, 2016, can only be construed as negligence.

### **C. Final Observations and Conclusions of AQRR**

7.3 NFRA examined in detail the replies to the DAQRR submitted and oral submissions by the Audit Firm and concludes as follows:

7.3.1. **Summary of Audit Firm's Response:** The Audit Firm has not given any new explanation other than what has already been examined by NFRA at the PFC stage. The Audit Firm states as follows:

- a. *"It should be noted that in CARO, Auditors are required to report only on specific matter which has been asked in CARO and it cannot be generalized to providing opinion on Financial Statements. Clause 3 (xvi) requires auditors to report whether the Company is required to be registered as NBFC under section 45IA with RBI and if that is so, whether the registration is obtained or not. It is important to note that the said clause does not warrant reporting on compliance with the requirements of Certificate of Registration (CoR) or the Master Direction."*
- b. *"NFRA has observed that the Company needs to comply with various terms and conditions of Master Directions. Accordingly, during our audit, we had verified whether the Company was meeting the requirements, this was document in our workpapers submitted to NFRA, refer IL&FS-Standalone Hardcopy Files Folder - 5\_CIC compliance checklist. NFRA has incorrectly linked the compliance of terms and conditions of Master Direction with the reporting requirement of CARO. There is no basis to establish that auditors are required to report the same under Clause 3 (xvi) of CARO, 2016 and hence question of our incorrect reporting in CARO does not even arise."*
- c. *"In the premises above, the DAQRR in this regard is based on misconstruction or selective application or interpretation of requirement in respect of Clause 3 (xvi) of CARO, 2016."*

7.3.2. **NFRA Observations:** NFRA has examined the replies of the Audit Firm and observes as follows:

- a. Para 60 of Guidance note on CARO 2016 states that:  
*"It is important to note that replies to many of the requirements of the Order will involve expression of opinion and not necessarily statement of facts. It is necessary, therefore, that this is indicated when making the report under the Order."* (Emphasis added)
- b. Para 64 of Guidance note on CARO 2016 states as follows:  
*"The auditor's report under sub-section (3) of section 143 is required to state whether the auditor has sought and obtained all the information and explanations which to the best of his knowledge and belief, were necessary for the purposes of his audit and if not, the details thereof and the effect of such information on the financial*

statements. **The term “audit” would include the reporting requirements under the Order. Therefore, when making his report, the auditor has to consider whether he has sought and obtained the information and explanations needed not merely for the purposes of normal audit, but also for the purpose of reporting in terms of the Order.** If he has sought but not received the information and explanations necessary for reporting in terms of the Order, he should mention that fact both when reporting on the specific question in the Order and also consider the impact of such non receipt of the information on the auditor’s report under section 143(3)(a) of the Act.” (Emphasis added)

- c. Para 60 and 64 of Guidance Note on CARO 2016 as quoted above very clearly states that auditor’s replies under the Order are also in the form of expressing an opinion and not merely a statement of facts (in the instant case it is a statement of half-fact, as done by the Audit Firm). The certificate of registration (CoR) is subject to the Company complying with various terms and conditions including the requirements of Para 8 and Para 9 of Master Directions – CIC-ND-SI. As there was an established violation of these conditions the validity of the CoR is questionable. Under such circumstances, it is the responsibility of the Auditor to report the full facts and his opinion on those facts. Thus, the Audit Firm’s contentions that, *“It should be noted that in CARO, Auditors are required to report only on specific matter which has been asked in CARO and it cannot be generalized to providing opinion on Financial Statements”* is unacceptable.
- d. Therefore, NFRA concludes that the Audit Firm has issued a misleading and false report under Clause 3(xvi) of the Companies (Auditor’s Report) Order, 2016, knowing it to be incorrect.

### **Non-Compliance with the CoR**

#### **A. Prima Facie Observations and Conclusions (PFC)**

7.4. In its **Prima Facie Conclusions**, NFRA conveyed the following:

7.4.1. NFRA asked the Audit Firm to provide information on the work done by the Audit Firm on verification of ratios as per CIC-ND-SI guidelines of RBI vide its letter dated 19th November 2019, as Part II Section D-1. The Audit Firm in its response dated 30th December 2020, has referred to WP ‘SFS Canvas - M18 Compliance Workpaper (Attachment 113, Page no. A1852 to A1862)’, which includes work done by the Audit Firm to verify the CIC-ND-SI ratios. The Audit Firm has also referred to WP ‘C 914.4.7.1 to C 914.4.7.11 M18 CIC and Board report2\_Working Papers\_007 CIC Certificate’, which includes the Independent Auditor’s Report for FY 2017-18 on certain conditions prescribed by RBI for CIC-ND-SI and contains annexures with management computation of the CIC-ND-SI ratios.

7.4.2. On examination of these WPs, NFRA observes the following:

- a. The management had calculated capital ratio of 32.66% and leverage ratio of 2.3 times after including General Contingency Provision (GCP) amounting to ₹854 crore in the computation of Adjusted Net Worth (ANW). However, the Audit Firm noted that GCP should be excluded from the calculation of ANW since
  - i. the definition ANW in para 3 (i) of Master Directions – CIC-ND- SI, read with definition of “owned funds” in para 3 (xx) of Master Direction – CIC-ND-SI, is exhaustive and does not consider provision (GCP) and
  - ii. inclusion of GCP is inconsistent with the Company’s own approach.

Accordingly, the Audit Firm concluded that the Company had breached the capital ratio and leverage ratio requirements of 30% and 2.5 times, respectively as required by Para 8 and Para 9 of the Master Direction – CIC-ND-SI

- b. The management had also included Preference Share Premium Redemption Reserve (PSPRR) amounting to Rs.236 crore while calculating ANW. RBI in its inspection report dated 15th November 2016 had raised specific observations on PSPRR. RBI had stated that PSPRR should be reduced from owned funds. However, the Audit Firm concluded that PSPRR should be considered while Calculating ANW, considering:
  - i. The Company’s had sent a reply to the RBI (dated 9th January 2017) stating the reasons for inclusion of PSPRR as free reserve and the RBI had not communicated anything to the Company in this regard.
  - ii. Definition of free reserves (section 2 (43)) and net worth (section 2 (57)) from the Companies Act, 2013, as an additional ground to justify that PSPRR should be included in ANW.
- c. The management has not considered financial guarantees in computation of Risk Weighted Assets (RWA). The Group Companies of the Company had availed third party limits carved out of the Company's limits from Banks for Letters of Credit, Performance Guarantees and other Financial Guarantees facilities (collectively referred to as 'third party guarantees') amounting to Rs 1,383.3 crore. However, based on the Company’s assessment of the current status of each underlying transactions as well as of the cash flow of the Projects undertaken by the Group Companies as at 31st March, 2018, the Company was of the view that there was only a remote possibility of devolvement of any liability on the Company. Therefore, the Company had **not considered Financial Guarantees of ₹1,383.3 crore** as off Balance Sheet Outside Liabilities.

7.4.3. Given the above facts, the Audit Firm was required to

- a. Examine the nature and the consequences of non-compliance with the conditions attaching to the CoR, and the Master Directions – CIC-ND-SI.
- b. Exercise highest degree of professional skepticism and obtain sufficient

appropriate audit evidence to confirm management’s view on PSPRR and Financial Guarantees.

- c. In view of the issues raised above (a, b and c), the Audit Firm failed to obtain sufficient appropriate audit evidence regarding, and to 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 existed about the entity’s ability to continue as a going concern. (Para 6 read with Para A3 of SA 570).
- d. Communicate the non-compliance with TCWG on the issues of capital ratio and leverage ratio requirements, consideration of PSPRR while calculating ANW and non-consideration of financial guarantees in computation of Risk weighted Assets (RWA) in a timely manner. (Para 22 of SA 250 read with Para 21 of SA 260 (Revised))
- e. Failed to appropriately report its observations on the examination done under clause 3 (xvi) of CARO, 2016.

7.4.4. In response to NFRA’s query Part II Section D-1 vide its communication dated 19th November 2019, vide its response dated 30th December 2019, the Audit Firm referred to the following WPs, and which were examined by NFRA as follows:

<b>Audit Firm’s Contention</b>	<b>WP Referred</b>	<b>NFRA’s Observations</b>
<p>The RBI vide its Inspection Report dated 15 November 2016 had raised certain observations on items to be deducted from the owned funds of the Company. This included, amongst others, the reduction of preference share redemption reserve from owned funds. The management had responded to the inspection report with their response letter dated 9 January 2017. The Company represented that it has consistently computed owned funds and related ratios based on its interpretation of the CIC Directions. In the view of the</p>	<p>C 914.4.7.1 to C 914.4.7.11 M18 CIC and Board report2_Working Papers_007 CIC Certificate’</p>	<p>NFRA notes that merely the fact that there was no further reply from RBI to the Company’s response dated 09th January 2017 does not absolve the Audit Firm of its responsibility to obtain sufficient appropriate audit evidence. The fact that the Company was unable to meet the regulatory requirements pertaining to capital ratio and leverage ratio and had used GCP (inconsistent with its own approach) to meet RBI’s CIC-ND-SI requirement, should have been a red flag for the Audit Firm. The Audit Firm</p>

<p>Company the computation of owned funds and related ratios was appropriate. The Company had provided responses to the RBI on their observations after having discussed with the audit committee and the board of directors on 9 January 2017.</p> <p>As informed by the management, submission of response RBI had not communicated to the Company in this regard.</p> <p>We had read the RBI Inspection Report dated 15 November 2016 and the response letter of IL&amp;FS dated 9 January 2017. We noted that there was no further reply from RBI till the date of the SFS and CFS and / or till the date of the audit report of SFS and CFS. Further, we had mentioned the fact that RBI has made observations with respect to owned funds and related ratios in our report to the Board of Directors of the Company dated June 28, 2018.</p>		<p>was required to obtain sufficient appropriate audit evidence and understand, the consequences and the reasons of the objections raised by the RBI in its inspection report dated 15th Nov 2016.</p> <p>Note 3 (c) of the Standalone Financial Statements, inter-alia, give details of the terms of issue of Non- Convertible Redeemable Cumulative Preference Shares (NCRCPs), of a face value of Rs.7,500, in FY 2015 and FY 2016. NFRA observes that 8,00,000 NCRCPs were issued at a premium of Rs.5,000 in FY 2015 and 3,33,000 NCRCPs were issued at a premium of Rs.7,500 in FY 2016. Further, the entire amount received at the issue (face value and the premium) in FY 2015 and FY 2016, was redeemable in FY 2021 and FY 2022, respectively.</p> <p>On perusal of the correspondence between the RBI and the Company, NFRA observes the following:</p> <p>i. The RBI in its inspection report dated 15th Nov 2016 (for FY 2015), had stated that since the premium received (included in the Securities Premium Account) on issue of NCRCPs is redeemable in 2021, the same was not considered as part of free</p>
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	<p>reserve for the calculation of “Owned Funds”.</p> <p>ii. The Company in its reply, dated 09th Feb 2017, to RBI had stated that the Board of Directors, at its Meeting held on December 12, 2016, had approved creation of Preference Share Premium Redemption Reserve (PSPRR) with an amount being appropriated to this account each year to build adequate reserves for redemption. The Board further resolved that this reserve will not be available for distribution of dividend.</p> <p>The Company had transferred the premium received of ₹649.8 crore on the issue of NCRCPs, to the securities premium account. However, based on RBI’s objection on the inclusion of the share premium received on the issue of NCRCPs, the board resolved that a separate PSPRR will be created with an amount appropriated each year to this account for the redemption of premium on issue of NCRCPs. Sec 55(2) of the Companies Act, 2013, inter-alia, states that no preference shares shall be redeemed except out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption. Therefore, the PSPRR created out of the</p>
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	<p>profits of the Company alone, could have been considered for deduction from the share premium received on the issue of NCRCPs to arrive at the net share premium that should be excluded from the calculation of “owned funds”.</p> <p>However, on perusal of WP ‘SFS Canvas - M18 Compliance Workpaper’, NFRA notes that the Company had considered both, the share premium account (which includes the share premium received on issue of NCRCPs) and the PSPRR (which includes ₹123.7 crore appropriated from Securities Premium Account and ₹112.7 crore appropriated from the Profit and Loss Account as of 31st March 2018) for calculation of owned funds. The Audit Firm had concurred with the Company’s calculation in this respect and had considered the entire share premium account along with the PSPRR for inclusion in the owned funds.</p> <p>WP ‘C 914.1.7.1 M18 CIC and Board report2_CIC Certificate_005 RBI Letter &amp; Response’, whereby the Audit Firm has documented its observations on the RBI inspection report, states just the following with regard to preference shares premium, <i>“As per the definition of free reserve and net worth given in</i></p>
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		<p><i>The Companies Act, 2013, it can be said that preference share premium redemption reserve is a free reserve. (Refer 004 Ratio Calculation).”</i></p> <p>Thus, NFRA concludes that the Audit Firm has not considered the management’s response to the RBI inspection report with the skepticism expected of a professional auditor. The Audit Firm has failed to obtain sufficient appropriate audit evidence with regard to the inclusion of share premium received worth ₹649.8 crore, redeemable by FY 2022, in the “owned funds” by the Company, ignoring the major supervisory concern noted by the RBI. Therefore, the Audit Firm failed to obtain sufficient appropriate audit evidence.</p>
<p>In accordance with the requirement of paragraph 22 of SA 250, the matter was discussed by the management in the audit committee meeting of IL&amp;FS held on May 29, 2018 and August 28, 2018, and the audit committee was made aware of the matter.</p>	<p>CFS Hard Copy File - File 1 (Part 3 of 3) - Flap A9 - File review documentation ACM PPT (Page no. A9.268) · CFS Canvas- Minutes - BM 29Aug18-May 29, 2018 (For relevant extract refer Attachment 144, Page no. A2595)</p>	<p>On a plain reading of the Audit Firm’s contentions, it is evident that the Audit Firm has assumed that the audit committee of the Company itself was the TCWG.</p> <p>According to Para 10 (a) of SA 260 (Revised), TCWG has the following functions:</p> <ul style="list-style-type: none"> <li>• Over seeing the obligations related to the accountability of the entity.</li> <li>• Over seeing the strategic direction of the entity.</li> </ul>

	<ul style="list-style-type: none"> <li>• Over seeing the financial reporting process.</li> </ul> <p>On the other hand, as per Section 177 (4) of the Companies Act, 2013, for the Audit Committee, it is mandatory to perform the following functions:</p> <ul style="list-style-type: none"> <li>• Recommend the appointment of auditors of the Company.</li> <li>• Review and monitor the auditor's independence and performance.</li> <li>• Examination of financial statements and auditor's report.</li> <li>• Approval of related party transactions.</li> </ul> <p>In view of the above, the audit committee does not have the mandate for overseeing the accountability of the functions of the management and overseeing the financial reporting process. TCWG should be the one who can oversee the work of the management and can take appropriate action against the management in case management does not comply with applicable laws and regulations, indulge in fraudulent activities or violates corporate governance. As the audit committee cannot perform such functions similar</p>
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		<p>to TCWG, the Audit Committee cannot be considered TCWG. Para 21 of SA 260 (Revised) states that the auditor shall communicate with those charged with governance on a timely basis. Assuming but not admitting, for the sake of argument, that the audit committee was a part or sub group of the relevant TCWG in this case, the Audit Firm communicated with the audit committee only a day before the signing date of the audit report. Given the nature of the violation, the Audit Firm should have communicated with the TCWG on a timely basis as is required under Para 21 of SA 260 (Revised).</p>
<p>Accordingly, we had informed RBI of the non-compliance vide our letter dated July 18, 2018.</p>	<p>RBI Letter (For relevant extract refer Attachment 143, page A2580 to A2594)</p>	<p>Merely reporting to the RBI does not absolve the Audit Firm of the responsibilities cast under the Companies Act, 2013. As enumerated in Para 2 and 3.2 above, the Audit Firm was also required to report under clause 3 (xvi) of CARO, 2016. The contentions of the Audit Firm that “<i>there was no requirement to disclose any such minor breaches under the extant Indian GAAP, Indian GAAS or any other regulation</i>” is inappropriate.</p>
<p>We concluded that there was no requirement to disclose any such minor breaches under the extant Indian GAAP, Indian GAAS or any other regulation and accordingly our audit report to the financial statements was not modified</p>	<p>SFS Hard Copy File File 1 (Part 1 of 2) - AA12.Going concern form (Page no. A12.69) SFS Hard copy File File 1 (part 1 of 2) - FlapAA12 - Closing Meeting Minutes (Page no. 12.65.5)</p>	<p>Based on the above, NFRA concludes that this is only an afterthought of the Audit Firm, since no such conclusion drawn by the Audit Firm was documented in the Audit File.</p>

	<p>Nevertheless, the Audit Firm was even required to consider the implication of the non-compliance with the CIC- ND-SI ratios on the going concern of the Company to form an opinion in the independent Auditor’s report and which is not evident from the audit file.</p> <p>Referred WP ‘SFS Hard Copy File- File 1 (Part 1 of 2) - AA12. Going concern form (Page no. A12.69)’ indicates that the Audit Firm had considered non-compliance with capital requirements as an indicator of impact on going concern. However, the Audit Firm noted that since this is not a material breach, no further procedures are required.</p> <p>As observed above, Master Directions – CIC-ND-SI used the words “shall at no point of time” for compliance with the capital requirements. Even the CoR is subject to the Company meeting these requirements. Further, did not obtain sufficient appropriate audit evidence to conclude that PSPRR should be included in the Adjusted Net Worth and financial guarantee (refer para 3.4 below) should be excluded from Off Balance Sheet Outside Liabilities.</p> <p>Therefore, the contentions that it is a minor breach and there is no impact on going concern, without performing any audit procedures, is not acceptable as</p>
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		there is no record of any basis available in the audit file.
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7.4.5. The Audit Firm failed to examine the non-inclusion of Financial Guarantees ₹1,383.3 crore in the computation of Risk-weighted Assets (RWA). Para 8 (3) of the Mast Direction – CIC- ND-SI defines degrees of credit risk exposure attached to off-balance sheet items that include financial & other guarantees with a 100% credit conversion factor. However, the Audit Firm failed to obtain sufficient appropriate audit evidence to justify the non-inclusion of financial guarantees in the computation of RWA. No WP where such examination was done by the Audit Firm is available in the audit file. Therefore, the Audit Firm failed to comply with the requirements of Para 17 of SA 200.

7.4.6. In light of the above observation, NFRA concludes that the Audit Firm failed to calculate the actual quantum of non-compliance with the capital requirements for a CIC-ND-SI and also to obtain sufficient appropriate audit evidence. The below table shows the impact of non-compliance with the RBI guidelines and RBI inspection report.

(₹ in crores)

<b>Particulars</b>	<b>Audit Firm Computation</b>	<b>Impact of inclusion/exclusion of the items noted in NFRA's observations</b>	<b>Comments</b>
Adjusted Net Worth	₹5,821.8	₹5,172.02	The difference is due to the reduction of the entire Share Premium  Received (₹649.80 crore), in line with RBI's observations, on which Audit Firm failed to perform its duties.

Risk Weighted Assets	₹19,589.5	₹20,972.8	The difference is due to the addition of the financial guarantees (₹1,383.3 crore) as concluded in Para 3.4 above, on which the Audit Firm has failed to perform its duties.
Outside Liabilities	₹15,381.21	₹15,381.21	NA
Capital Ratio (ANW/RWA)	29.72%	24.7%	NA
Leverage Ratio (Outside Liabilities /ANW)	2.64 times	2.97 times	NA

7.4.7. Therefore, NFRA concludes that the Audit Firm failed to

- a. Bring out the non-compliance with the RBI's CIC-ND-SI capital requirements, even though it was known to it and RBI's Master Directions – CIC-ND-SI state that the Company (being a CIC-ND-SI) shall at no point of time be in non-compliance with the capital requirements (capital ratio and leverage ratio).
- b. Understand, examine and document the consequences of non-compliance with the CoR and Master Directions – CIC-ND-SI.
- c. Exercise the highest degree of professional scepticism and obtain sufficient appropriate audit evidence while confirming management's view on PSPRR and Financial Guarantees in their audit report.
- d. Obtain sufficient appropriate audit evidence regarding 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. (Para 6 read with Para A3 of SA 570)
- e. Communicate the non-compliance with RBI's Master Directions – CIC-ND-SI to TCWG in a timely manner. (Para 22 of SA 250 read with Para 21 of SA 260 (Revised))
- f. Appropriately report under clause 3 (xvi) of CARO, 2016.

## **B. Observations made in the DAQRR**

7.5. NFRA has examined in detail the replies submitted by the Audit Firm on the above observations and observed in the DAQRR as follows:

7.5.1. Summary of Audit Firm's Response (Reporting that the Company was not in compliance with the Capital Requirements after exclusion of GCP [as concluded by the Audit Firm]): Vide its response dated 14<sup>th</sup> April 2021, the Audit Firm (similar to its reply, dated 30<sup>th</sup> December 2019, to NFRA's questionnaire) quoted Para 25 of SA 250 and stated that since there was only a minor breach of the *capital ratio and leverage ratio requirement* (required for the CoR, obtained from the RBI, for a CIC-ND-SI), they concluded that it did not *affect the overall true and fair view of the Financial Statement of the Company and reporting on the Financial Statement*.

The Audit Firm further stated that “*We had discussed the said minor breach with the management and made them aware of the same. The management was of the firm view that GCP should be considered as part of adjusted net-worth for the purpose of calculation of Capital and Leverage ratios. The management had conveyed to Audit Committee Meeting of IL&FS held on May 29, 2018, that the Company is in compliance with the said ratios after considering the GCP as part of Adjusted Net-worth. After a detailed deliberation within the audit team, we had concluded that GCP cannot be considered as part of adjusted net-worth for the purpose of calculation of capital and leverage ratios. Accordingly, we had communicated to the Board of Directors vide our certificate dated June 28, 2018 of non-compliance by the Company, of the requirement under Para 8 and Para 9 of Master Directions and Certificate of Registration. It should be noted that all the members of Audit Committee were part of the Board of Directors. The matter relating to considering audit committee as TCWG, has already been dealt with by us in our response in Para 1 to 8 of J. Communication with those charged with governance (Page No. 402 to 407) to Para 1 of PFC and therefore has not been again dealt with here. NFRA comment that Audit Committee cannot be considered as TCWG is inappropriate and devoid of the facts of IL&FS. Further, NFRA has pointed out that the communication was made one day before the date of signing of Audit Report. We submit that the aforesaid breach was identified during the finalization of the audit, since the requirement under Para 8 states that aggregate risk weighted assets on balance sheet and risk adjusted value of off - balance sheet items as on the date of the last audited balance sheet should be considered and for computing the ratios as on March 31, 2018, the audited figures of the balance sheet was available only on finalization of the audit. Accordingly, management and TCWG was made aware of the non-compliance when the same was identified. In our view, the communication was made on a timely basis. Further, it should be noted that for the first time, the Company had a breach in maintaining the required ratios*”

Quoting Para A44 of SA 260, the Audit Firm further stated that “*on observing the instance of non-compliance with the Master Direction with regards to Capital ratio and Leverage ratio, we had reported our observation by way of report to the Board of Directors on June 28, 2018 as per the requirement of paragraph 3 of Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016.*

*We had also informed RBI of the same vide letter dated July 18, 2018 as per the requirement of paragraph 5 of Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016. For Board Report and Letter sent to RBI – Refer IL&FS Consolidation Hardcopy Files Folder - C 16\_SRM (Page 38 to 53)."*

- 7.5.2. **NFRA Observations:** NFRA notes that, in PFC dated 21<sup>st</sup> December 2020, it had replied to all these contentions of the Audit Firm. Further, NFRA had already examined the WPs that have been referred by the Audit Firm.

Even with regard to timely communication of the stated non-compliance with the TCWG, the Audit Firm has failed to provide any audit evidence to support its assertions. Therefore, these assertions of the Audit Firm can only be construed as an afterthought.

RBI's Master Direction – CIC-ND-SI, for the capital requirements (Adjusted Net Worth to aggregate risk-weighted assets) and leverage ratio requirements, uses the words "*shall at no point of time*" and does not provide any relaxation for a minor breach in the said ratios.

Even, Para 2 of SA 320 (Revised) explains materiality as misstatements, including omissions, individually or in the aggregate, that could **reasonably be expected to influence the economic decisions of users** taken on the basis of the financial statements. It further states that judgments about materiality are made in the light of surrounding circumstances, and are affected by the size or **nature** of a misstatement, or a combination of both.

Therefore, as against the Audit Firm's assertions, the size of the misstatement alone cannot be considered to define the materiality. The nature and the influence that an item may have on the economic decisions of users are also to be considered while deciding the materiality.

Further, the nature of the breach was such that the entire structure and the business model of the Company, could have been affected by it. As observed in its PFC, NFRA notes that even the Audit Firm had considered non-compliance with capital requirements as an indicator of impact on the going concern.

Nevertheless, NFRA also notes that the non-compliance concluded by the Audit Firm was due to the GCP of Rs. 854 Crores, which was above the planned materiality of Rs. 100 Crores. Therefore, even the size of the item which led to the non-compliance was material. As concluded in the PFC (and re-iterated in the DAQRR – subsequent paras), the non-compliance was not limited to the exclusion of GCP.

Further, considering the impact of PSPRR and financial & other guarantees, the Company's Capital Ratio (ANW / RWA) was only 24.7% (as against the Audit Firm's computation of 29.7%), and Leverage Ratio (Outside Liabilities / ANW) was 2.97 times (as against the Audit Firm's computation of 2.64 times)

Therefore, the assertion of the Audit Firm that the breach was only minor/not material is not acceptable.

7.5.3. NFRA has already explained, in Para 8.2 above, that merely reporting to the RBI does not absolve the Audit Firm of the responsibilities cast under the Companies Act, 2013. The Audit Firm was required to report the non-compliance under clause 3 (xvi) of CARO, 2016. The assertion that they were only required to report the stated non-compliance by way of board report to the RBI is therefore invalid.

7.5.4. Summary of Audit Firm's Response (Inclusion of Preference Share Premium Redemption Reserve (PSPRR) as a part of Owned Fund of the Company for the purpose of calculating Adjusted Net Worth (ANW)):

NFRA notes that the Audit Firm has failed to provide any new assertion/argument to rebut to NFRA's PFC that PSPRR cannot be included in the computation of ANW. In its reply dated 14<sup>th</sup> April 2021 (similar to its reply, dated 30<sup>th</sup> December 2019, to NFRA's questionnaire), the Audit Firm asserted that

- a. RBI vide its letter dated 15th November 2016, had observed that security premium received on issue of Preference Share should not be considered as part of net owned funds. However, since there was no objection from RBI with regards to PSPRR to be considered as net owned funds after communication dated January 09 2017, by the management of the Company to RBI, the Audit Firm had agreed with the management's contention in respect of the inclusion of PSPRR as part of the net owned fund.
- b. *"Based on the decisions taken by the Board of Directors of the Company, the Company, from FY 2016- 17, had started creating PSPRR by appropriating amount from Securities Premium account and balance in Profit and Loss account. The intention was to create adequate reserves which may be utilized at the time of redemption of preference shares. Till the time preference shares are not redeemed, this reserve was available to the Company and was akin to Securities Premium. We would like to point out that NFRA had conveniently ignored the intention behind creating PSPRR, which was to ensure availability of adequate reserves amount for redemption. It is also important to note that Securities Premium is not available for distribution of dividend as per the Companies Act, 2013, however the same is considered as a part of the Net-worth. RBI also specifically allows Securities Premium as a part of net owned funds.*

*NFRA has referred to Section 55(2) of the Companies Act, 2013, which provides that no Preference share should be redeemed except out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption. In our view this section will have applicability only when preference shares are redeemed and not before that and hence the said section was not relevant at that point of time.*

*Based on the above explanations it is very clear that the PSPRR created by the Company was out of the apportionment of the Undistributed profit of the Company and balance in securities premium account, which are both eligible to be included in the definition of Net Owned Funds as per Paragraph 3(xx) of Master Direction - Core Investment Companies (Reserve Bank) Directions, 2016 (CIC Directions)."*

- 7.5.5. NFRA Observations: The Auditor has repeated the same line of argument as earlier without any additional evidence. Nothing new has been referred or asserted by the Audit Firm. Therefore, NFRA re-iterates its prima facie conclusions.
- 7.5.6. The assertion of the Audit Firm (Para 7.5.4 (a)) that *"there was no objection from RBI with regards to PSPRR"* is incorrect and misleading. The RBI vide its letter dated 15th November 2016, had unambiguously concluded that the security premium received on the issue of Preference Share (**since it was entirely redeemable**) should not be considered as part of net owned funds. NFRA notes that just because the RBI did not reply to the Company's communication dated January 09, 2017, it cannot be construed as no objection/permission from the RBI for the inclusion of a part of the security premium (Rs. 649.8 Crores), in form of the newly created *PSPR reserve*, for the calculation of "Net Owned Funds". In fact, the absence of a reply from the RBI agreeing to the Company's stand had to be treated as a rejection of the request.

Further, the assertion of the Audit Firm (Para 7.5.4 (b)) that the *"intention was to create adequate reserves which may be utilized at the time of redemption of preference shares. Till the time preference shares are not redeemed, this reserve was available to the Company and was akin to Securities Premium.... RBI also specifically allows Securities Premium as a part of net owned funds"* is misleading. RBI, in its inspection had issued major supervisory concern over inclusion of securities premium since it was entirely redeemable in FY 2021 and FY 2022. Therefore, the securities premium received should not have been considered for the computation of the "Net Owned Funds". Simply because the Company decided to create PSPRR, by appropriating amount from the same securities premium account, against which the RBI had issued supervisory concern, and balance from the Profit and Loss account, does not mean that the entire PSPRR was eligible for computation of "Net Owned Funds".

In its PFC, NFRA had already concluded that the PSPRR created out of the profits of the Company alone (while referring to Section 55 (2) of the Act), could have been considered for the calculation of "Net Owned Funds".

Therefore, as enumerated in the PFC, NFRA concludes that the Audit Firm has not considered the management's response to the RBI inspection report with the scepticism expected of a professional auditor. The Audit Firm had failed to obtain sufficient appropriate audit evidence with regard to the inclusion of share premium received worth ₹649.8 crore, redeemable by FY 2022, in the "owned

funds” by the Company, ignoring the major supervisory concern noted by the RBI.

7.5.7. The assertion of the Audit Firm, that “*this section (Section 55 (2)) will have applicability only when preference shares are redeemed and not before that and hence the said section was not relevant at that point of time*”, is an erroneous interpretation of the Act and can only be construed as an attempt to mislead NFRA. As asserted by the Audit Firm itself, the Company had started creating PSPRR (from Securities Premium account and Profit and Loss account) with an intention to create adequate reserves *which may be utilized at the time of redemption of preference shares*. Therefore, in substance, the reserve falls under the purview of Section 55 (2) of the Act.

7.5.8. **Summary of Audit Firm’s Response (Non-Inclusion of Financial Guarantees of Rs. 1,383.3 crores in computation of Risk Weighted Assets (RWA)):**

In its reply dated 14th April 2021, the Audit Firm quoted Para 8.8.7.2 of the Guidance note on Schedule III of Companies Act, 2013 and asserted that

a. “*The guarantees given by IL&FS to group companies were in the nature of performance guarantees to Bankers and therefore were not considered as a contingent liability. Guidance note (Schedule III) itself clarifies that counter guarantees were not in the nature of guarantees and accordingly performance guarantees given by IL&FS were not considered in the computation of Risk weighted asset (RWA)*”.

b. “*Further, we would like to bring to your kind attention that the Company had obtained counter guarantees from the group companies with respect to the so-called guarantees given to the Third Parties on behalf of them. Accordingly, it should be noted that the Company does not have any off-balance sheet exposures with regards to any guarantees. For the sample cases, we had also verified the counter corporate guarantees issued by the group companies and verified the respective counter guarantee agreements Refer IL&FS - Standalone Canvas Files Folder - 419.1 to 419.4 M18\_ILFS\_LC checking*”

c. The Audit Firm also asserted that “*We had also checked no devolvement certificate (NDC) obtained by the management from the group companies for samples selected by us to ensure that the exposure on the so-called guarantees as on March 31, 2018 was remote.*

*Refer IL&FS - Standalone Canvas Files Folder – 415.1 to 415.8 Note 30 – Refer worksheet “NDC Testing”; 405.1 to 405.5 M18 NDC1 to NDC 5 NDC supporting documents”*

7.5.9. NFRA Observations: NFRA notes that the Guidance Note on Schedule III of the Companies Act, 2013, only provides the manner in which every company registered under the Act shall prepare its Balance Sheet, Statement of Profit and Loss and notes thereto. The guidance note does not cover the calculation of the ratios for verification of compliance with the requirement under the RBI Act, 1934. The ratios are to be calculated according to the Master Direction – CIC-ND-SI.

Para 8 (3) of the Master Direction – CIC-ND-SI specifically uses the term “**Financial & other guarantees**” with a credit conversion factor of 100%. Therefore, irrespective of the nature of such guarantees (as asserted by the Audit Firm), Master Direction – CIC-ND-SI requires them to be considered for the calculation of the capital requirements. Thus, the Audit Firm’s assertion that “*performance guarantees given by IL&FS were not considered in the computation of Risk weighted asset (RWA)*” is false and unacceptable.

7.5.10. Further, with regard to the assertion of the Audit Firm that “*the Company had obtained counter guarantees from the group companies with respect to the so-called guarantees given to the Third Parties on behalf of them. Accordingly, it should be noted that the Company does not have any off-balance sheet exposures with regards to any guarantees.*”, NFRA notes that the counter guarantees stated were provided by the same group companies, for whom the Company provided guarantees to third parties. Therefore, the stated “counter guarantees” have no meaning at all, since these Counter Guarantees (from the same entity for whom the Company had provided a guarantee) do not, in any way, reduce the credit risk of the Company.

Nevertheless, NFRA perused a sample case, from the referred WP ‘419.1 to 419.4 M18\_ILFS\_LC checking’, and observed that the Company had provided a Bank Guarantee of Rs. 630 Crores (issued on 11<sup>th</sup> Feb 2016 with a maturity date of 21<sup>st</sup> Feb 2021) for its Group Company “ITPCL”. The issuing bank was “IDBI Bank” with the beneficiary being “The President of India, through the Deputy Commissioner of Customs”. The WP further notes that on 24<sup>th</sup> Feb 2016, the Company received a counter-guarantee from “ITPCL” for Rs. 630 Crores.

However, on perusal of the referred documents (within the WP ‘419.1 to 419.4 M18\_ILFS\_LC checking’), NFRA noted that the stated “counter-guarantee”, was a backstop indemnity agreement between the Company and “ITPCL”.

Further, NFRA could not trace any audit procedures that were performed by the Audit Firm to conclude, if the stated ‘counter-guarantees’ reduced the credit risk of the Company in any form. The Audit Firm had only verified if a backstop indemnity agreement is available for the guarantees provided by the Company.

Therefore, the assertion that *the Company does not have any off-balance sheet exposures*, is without sufficient appropriate audit evidence and incorrect.

- 7.5.11. The assertion of the Audit Firm that “*the exposure on the so-called guarantees as on March 31, 2018 was remote*” is also without sufficient appropriate audit evidence. On plain review of the referred WPs, no one can understand how the Audit Firm concluded that there is only a “remote” possibility of an outflow of resources embodying economic benefits. NFRA notes that the Audit Firm had merely obtained the “**no devolvement certificate**” that was received by the management from the respective group companies.
- 7.5.12. Further, even the referred certificate simply holds an undertaking by the respective group company stating that they have taken a detailed assessment and that there is no risk of default with only a remote possibility of devolvement of any liability. The undertaking is followed by annexures stating the list of non-fund based facilities availed by the respective group company, along with details including the amount to be repaid, repayment date, agreement date, and a column where they are classified as “Remote”. However, NFRA notes that no basis for such classification is provided by the group companies. Even the column that requires the reasons for such classification, has been left blank (“-”) for all the non-fund based facilities.
- 7.5.13. Therefore, NFRA concludes that the Audit Firm did not exercise professional skepticism in concluding that there is only a remote possibility of devolvement for the stated *guarantees* provided by the Company.
- 7.5.14. In light of the above fact, NFRA concludes that the Audit Firm failed to calculate the actual quantum of non-compliance with the capital requirements for a CIC-ND-SI and also to obtain sufficient appropriate audit evidence. Even in light of the understanding that the Audit Firm has of “Materiality”, the non-compliance was “material”. The Audit Firm failed to
- a. Bring out the non-compliance with the RBI’s CIC-ND-SI capital requirements, even though it was known to it and RBI’s Master Directions – CIC-ND-SI state that the Company (being a CIC-ND-SI) shall at no point of time be in non-compliance with the capital requirements (capital ratio and leverage ratio).
  - b. Understand, examine and document the consequences of non-compliance with the CoR and Master Directions – CIC-ND-SI.
  - c. Exercise highest degree of professional skepticism and obtain sufficient appropriate audit evidence while confirming management’s view on PSPRR and Financial Guarantees in their audit report.
  - d. Obtain sufficient appropriate audit evidence regarding 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. (Para 6 read with Para A3 of SA 570)
  - e. Communicate the non-compliance with RBI’s Master Directions – CIC- ND-SI to TCWG in a timely manner. (Para 22 of SA 250 read with Para 21 of SA 260 (Revised))
  - f. Appropriately report under clause 3 (xvi) of CARO, 2016

### C. Final Observations and Conclusions of the AQRR

7.6. NFRA has examined in detail the replies to the DAQRR and oral explanations submitted by the Audit Firm on the above observations and concludes as follows:

7.6.1. Summary of Audit Firm's Response (Reporting that the Company was not in compliance with the Capital Requirements after exclusion of GCP [as concluded by the Audit Firm]): The Audit Firm has merely repeated its responses that it gave at the PFC stage which has already been addressed by NFRA. The Audit Firm states that:

- a. *"It is apparent that NFRA has confused the reporting requirement under Standards of Auditing and CIC Master Direction. It is pertinent to note that Standards of Auditing clearly emphasizes on materiality of the misstatement noted and its impact on the overall true and fair view of the Financial Statement. Whereas, Master Direction doesn't differentiate between non-compliance being minor or major and irrespective of the nature of the misstatement / non-compliance, requires reporting of the same vide Board Report addressed to the Board of Directors and communication of exception, if any to the RBI."*
- b. *"Further, as far as reporting under CARO 2016 is concerned, we have appropriately substantiated in paragraph 3 to 18 above that the requirement under Para 3(xvi) is only limited and specific to reporting as to whether the Company is required to obtain registration under section 45IA of RBI Act or not and if so, whether it has obtained the same. Accordingly, our reporting fully complies with the requirements under CARO, 2016."*
- c. The Audit Firm further quotes Para 2 and 3 of SA 320 and states that *"Aforesaid paragraphs clearly explain that the concept of materiality is always used to evaluate the extent of misstatement, NFRA is extremely selective and arbitrary in arriving at its interpretation to apply materiality concept in every component of a computation. If NFRA's conclusions are assumed and not admitted, the concept of materiality would have no meaning at all. The breach in the capital and leverage ratios is ultimately the driving factor of non-compliance and accordingly materiality of breach in the ratios needs to be considered rather than taking GCP amount for assessing materiality."*
- d. *"In respect of communication with TCWG of the breach identified, we would like to state that the said observation was adequately responded in our response to PFC. The Audit Firm further states that "Accordingly, we had communicated the said non-compliance to Board of Directors vide our certificate dated June 28, 2018 and the same was also forming part of the presentation to the Audit Committee at the time of finalization of Consolidated Financial Statement for the year ended March 31, 2018."*

7.6.2. NFRA Observations: NFRA has already examined all the contentions of the Audit Firm. There is no new WP or explanation provided by the Audit Firm therefore NFRA reiterates its earlier observations.

- a. RBI's Master Direction – CIC-ND-SI, for the capital requirements (Adjusted Net Worth to aggregate risk weighted assets) and leverage ratio requirements, uses the words “*shall at no point of time*” and does not provide any relaxation for any breach in the said ratios. NFRA has already explained above why the breach of Capital Ratio and Leverage Ratio cannot be considered to be a minor breach. Capital Ratio and Leverage ratio are the most critical regulatory tools of the Financial Sector Regulator to monitor the soundness and solvency of the financial sector entities and any breach of these ratios is being viewed seriously. NFRA has already explained above, that merely reporting to the RBI does not absolve the Audit Firm of the responsibilities cast under the Companies Act, 2013. The Audit Firm was required to report the non-compliance under clause 3 (xvi) of CARO, 2016. The contention that they were only required to report the stated non-compliance by way of board report is therefore a narrow and distorted interpretation of the law.
- b. The Audit Firm's response that, “*Further, we had also considered the management's plan to address the matter by way of increase in Share capital in near future and therefore it was considered as a temporary situation, capable of being remedied. Refer IL&FS-Consolidation Hardcopy Files Folder – C 23\_ACM PPT. Accordingly, we had enough reasons to believe that such ratios would be met in the immediate future and it does not have any impact on the overall true and fair view of the Financial statements*” is not supported by any evidence. The only statement mentioned in the WP referred is “*The management is in the process of infusing equity capital to improve the aforesaid ratios.*” The said WP is dated 28<sup>th</sup> August 2018, yet there is no evidence of any action plan to infuse equity capital, e.g., what is the amount of infusion the management is planning and when it will be infused etc. There is no evidence of the planned start of the process. The Audit Firm has just relied on the statement of the management without sufficient appropriate evidence.
- c. The Audit Firm asserted that “*The breach in the capital and leverage ratios is ultimately the driving factor of non-compliance and accordingly materiality of breach in the ratios needs to be considered rather than taking GCP amount for assessing materiality.*” As already explained by NFRA that the size of the misstatement alone cannot be considered to define the materiality. The nature and the influence that an item may have on the economic decisions of users are also to be considered while deciding the materiality. The nature of the breach was such that the entire structure and the business model of the Company could have been affected by it. As observed in its PFC, NFRA notes that even the Audit Firm had considered non-compliance with capital requirements as an indicator of impact on

the going concern. Therefore, the assertion of the Audit Firm that the breach was only minor/not material proves that the Audit Firm was not diligent in the conduct of its professional duties. By adhering to such narrow interpretations and erroneous application of the law, the Audit Firm brings to daylight a very serious unprofessional approach it has repeatedly adopted throughout this AQR process.

- d. As already explained by NFRA about timely communication of the stated non-compliance with the TCWG, the Audit Firm has failed to provide any audit evidence to support its assertions. Therefore, these assertions of the Audit Firm can only be construed as an afterthought.

7.6.3. Summary of Audit Firm's Response (Inclusion of Preference Share Premium Redemption Reserve (PSPRR) as a part of Owned Fund of the Company to calculate Adjusted Net Worth (ANW)): NFRA notes that the Audit Firm has failed to provide any new evidence to rebut DAQRR observation that PSPRR cannot be included for the computation of ANW. The Audit Firm asserted as follows:

- a. The Audit Firm has reiterated its PFC response as to why Preference Share Premium Redemption Reserve (PSPRR) was considered as a part of Owned Fund. The Audit Firm quotes Para 3(xx) of Master Direction - Core Investment Companies (Reserve Bank) Directions, 2016 (CIC Directions) and Section 52(1) and 52(2) of the Companies Act, 2013 and states that:  
*"Based on the above paragraphs from Master Direction and Companies Act, 2013, SRBC submits that,*
  - a. *Definition of "Owned Funds" itself includes share premium account, accordingly inclusion of Preference share premium redemption reserve (PSPRR), which is an appropriation from Securities Premium account, is allowed to be included in computation of adjusted net-worth;*
  - b. *One of the application of Securities Premium Account is towards the premium payable on the redemption of any redeemable preference shares or of any debentures of the company, accordingly, even if the amount has been apportioned out of securities premium account to PSPRR, the nature of the reserve is same as Securities Premium Account that has been specifically created towards redemption of Non- Convertible Redeemable Cumulative Preference Shares (NCRCPs)."*
- b. The Audit Firm further quotes the Company's response to RBI dated January 09, 2017, and states that *"We had not merely relied on the facts that there was no communication from the RBI. We had specifically mentioned that, considering this fact and the analysis given in Para 41 above, we had agreed with the management's contention in respect of inclusion of PSPRR as part of Net owned fund."*

7.6.4. NFRA Observations: The Auditor has repeated the earlier line of argument without any additional evidence. Therefore, NFRA re-iterates its DAQRR conclusions.

- a. RBI, in its inspection, had issued major supervisory concern over the inclusion of securities premium since it was **entirely redeemable in FY 2021** and FY 2022. Therefore, the securities premium received should not have been considered for the computation of the “Net Owned Funds”. Simply because the Company decided to create PSPRR, by appropriating amount from the same securities premium account, against which the RBI had issued supervisory concern, and balance from the Profit and Loss account, does not mean that the entire PSPRR was eligible for computation of “Net Owned Funds”. In its PFC, NFRA had already concluded that the PSPRR created out of the profits of the Company alone (while referring to Section 55 (2) of the Act), could have been considered for the calculation of “Net Owned Funds”.
- b. Therefore, NFRA concludes that the Audit Firm has not considered the management’s response to the RBI inspection report with the skepticism expected of a professional auditor. The Audit Firm had failed to obtain sufficient appropriate audit evidence concerning the inclusion of share premium received worth ₹649.8 crore, redeemable by FY 2022, in the “owned funds” by the Company, ignoring the major supervisory concern noted by the RBI.

7.6.5. Summary of Audit Firm’s Response (Non-Inclusion of Financial Guarantees of Rs. 1,383.3 crores in the computation of Risk Weighted Assets (RWA)): The Audit Firm has not referred to any new WPs or given any new explanations apart from what has already been examined by NFRA. The assertions of the Audit Firm are as follows:

- a. *“It is important to note that the said guarantees were either Letter of Credit or support letters or Performance Guarantees backed by counter guarantees of the Parties for whom the guarantees were given. We had examined the documents in this regard at the time of our audit and had documented the purpose in our workpaper that the guarantees were of the nature discussed above.” The Audit Firm further states that, “SRBC submits that, during our audit, we had observed that so called guarantees were in substance not creating any guarantee exposure on the Company and hence the same was not considered for the purpose of computation of RWA. Such obligations were mainly in the nature of performance obligations of group companies and not financial guarantees as has been inadvertently perceived by NFRA.”*
- b. The Audit Firm further quotes Para 8.8.7.2 of Guidance note on Schedule III of Companies Act, 2013, and states that NFRA has “*ignored the fact which auditors have implied by referring the aforesaid paragraph, i.e., to bring out the attention of NFRA that Performance guarantee or counter guarantees are not the real guarantees in the eyes of law. Further, it is an industry practice to not consider*

*the performance guarantees in Risk Weighted asset, since the same is not a guarantee at all.”*

- c. *“It is important to note that that all the guarantees given were of the nature of performance guarantee, accordingly guarantees if invoked would be on account of non-performance of activities. Hence, counter guarantee given by the respective group company on behalf of which Company had given guarantee to the third party, were in fact the most appropriate collateral available with the Company as in case of any such liability the respective Group Company has undertaken to repay the exposure amount.”*
- d. *“Management had relied on the aforesaid NDC in preparation and presentation of the Contingent Liabilities in the Financial Statement and based on our professional judgement since all the guarantees were non fund facilities and the group companies had given counter guarantees with respect to each such guarantees and had also certified on the non-devolvement of the guarantees, it was considered appropriate to classify the same as “remote”.”*

7.6.6. NFRA Observations: The Auditor has repeated the same line of argument as earlier without any additional evidence. Therefore, NFRA re-iterates its prima facie conclusions.

- a. The Audit Firm’s assertion that *“during our audit, we had observed that so called guarantees were in substance not creating any guarantee exposure on the Company and hence the same was not considered for the purpose of computation of RWA. Such obligations were mainly in the nature of performance obligations of group companies and not financial guarantees as has been inadvertently perceived by NFRA”* is not supported by sufficient appropriate audit procedures and hence considered only an afterthought. Further, Master Direction – CIC-ND-SI specifically uses the term “Financial & other guarantees” with a credit conversion factor of 100%. Therefore, irrespective of the nature of such guarantees (as asserted by the Audit Firm), Master Direction – CIC-ND-SI requires them to be considered for the calculation of the capital requirements. Thus, not including performance or other guarantees given by IL&FS in the computation of Risk-weighted asset (RWA) is incorrect.
- b. As pointed out in the above Para that Master Direction – CIC-ND-SI specifically uses the term **“Financial & other guarantees”** with a credit conversion factor of 100%. Thus, the Audit Firm’s contention that *“it is an industry practice to not consider the performance guarantees in Risk Weighted asset, since the same is not a guarantee at all”* is without any basis and hence not acceptable.
- c. Since the counter guarantees were provided by the same third party to whom IL&FS gave the guarantee, the said counter guarantees do not in any way reduce

the credit risk of the company. The Audit Firm did not perform any audit procedures to conclude if the stated ‘counter guarantees’ reduced the credit risk of the Company in any form.

- d. As already stated by NFRA the Audit Firm’s assertion that *‘the classification of guarantees as remote is justified’* is also without sufficient appropriate audit evidence. The Audit Firm has nowhere documented the reason for classifying the so-called guarantees as ‘remote’. Even the column (in the referred WP by the Audit Firm) that requires the reasons for such classification has been left blank (“-”) for all the non-fund based facilities. Therefore, NFRA concludes that the Audit Firm did not exercise professional skepticism in concluding that there is only a remote possibility of devolvement for the stated guarantees provided by the Company.

7.6.7. In light of the above fact, concludes that the Audit Firm did not calculate the actual quantum of non-compliance with the capital requirements for a CIC-ND-SI and also did not obtain sufficient appropriate audit evidence. The Audit Firm did not:

- i. Bring out the non-compliance with the RBI’s CIC-ND-SI capital requirements, even though it was known to it and RBI’s Master Directions – CIC-ND-SI state that the Company (being a CIC-ND-SI) shall at no point of time be in non-compliance with the capital requirements (capital ratio and leverage ratio).
- ii. Understand, examine and document the consequences of non-compliance with the CoR and Master Directions – CIC-ND-SI.
- iii. Exercise the highest degree of professional skepticism and obtain sufficient appropriate audit evidence while confirming management’s view on PSPRR and Financial Guarantees in their audit report.
- iv. Obtain sufficient appropriate audit evidence regarding 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. (Para 6 read with Para A3 of SA 570).
- v. Communicate the non-compliance with RBI’s Master Directions – CIC-ND-SI to TCWG on time. (Para 22 of SA 250 read with Para 21 of SA 260 (Revised))
- vi. Appropriately report under clause 3 (xvi) of CARO, 2016.

## **8. Materiality**

### **A. Prima Facie Observations and Conclusions (PFC)**

8.1. NFRA in its Prima-facie Conclusions conveyed the following:

**8.1.1** Materiality is the most important concept in financial reporting as the fundamental concept of “true and fair” revolves around financial information being materially correct. Where information that is required by a financial reporting standard is omitted or misstated and such information is deemed material, those financial statements cannot then be said to achieve a fair presentation or give a true and fair view. NFRA has examined the audit WPs in respect of Materiality as determined by the Audit Firm and has identified significant deficiencies to obtain sufficient appropriate audit evidence on the part of the Audit Firm.

**8.1.2** As per Para 5 of SA 320, the concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor’s report. In WP “M18\_IL&FS\_PM TE SAD”, the Audit Firm had determined materiality at ₹100 crore considering 0.5% of the total asset as at 31<sup>st</sup> March 2018. Under “Basis for taking asset size as a base for materiality threshold determination”, the Audit Firm had stated that “*The Company is registered with RBI as a non-deposit accepting Core Investment Company (CIC). Major revenue from Operations is from the investments made in the group companies which is dependent on its asset size and net worth. The Asset size of the company is accordingly a critical factor for the various users of the financial statements in comparison to pre-tax earnings and hence the same has been taken as basis for determining the materiality*”. NFRA has examined the audit WPs in respect of materiality determined by the Audit Firm and has identified significant lapses. This is further explained as follows:

i. The following table denotes who prepared/reviewed the mentioned WPs and when:

<b>WP Name</b>	<b>Sign off as Preparer</b>	<b>Sign off date of Preparer</b>	<b>Sign off as Reviewer</b>	<b>Sign off date of Reviewer</b>
M18_IL&FS_PM TE SAD	N. Ramakrishna	15/01/2018	N. Ramakrishna	15/01/2018
	V. Shrivastava	09/01/2018	V. Shrivastava	09/01/2018
	A. Kanthed	09/01/2018	A. Kanthed	09/01/2018
	N. Rangoonwala	24/11/2017	N. Rangoonwala	24/11/2017
	A. Nandawat	23/11/2017	A. Nandawat	23/11/2017
ILFS_Identification of Significant Accounts	N. Rangoonwala	05/01/2018	N. Rangoonwala	05/01/2018
	D.Soni	05/01/2018	D.Soni	05/01/2018

- a) Para 17 of SA 220 says, “*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.***” (Emphasis Added)
- b) Para 9 of SA 230 says, “*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;* (Ref: Para A12) (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.** (Ref: Para A13)” (Emphasis Added)*

From the above table, it is clear that there is no sign off of the EP, CA Jayesh Gandhi, on any of the materiality WPs. Therefore, the EP has failed to document his review of the materiality WPs- “M18\_IL&FS\_PMTE SAD” and “ILFS- Identification of Significant Accounts” in the conduct of statutory audit for FY18 as is required under the standards of auditing. Though the EP need not review all audit documentation, materiality is the basic metric used in planning and conducting the audit and hence the rationale for fixing this metric should have been reviewed by the EP. Therefore, the EP violated the requirements of Para 17 of SA 220.

- ii. Para 66 of SQC 1 says, “*The engagement quality control reviewer conducts the **review** in a timely manner at appropriate stages during the engagement so that significant matters may be promptly resolved to the reviewer’s satisfaction before the report is issued.*” (Emphasis Added)
- iii. Para 20 of SA 220 says, “*The engagement quality control reviewer shall perform an objective **evaluation** of the significant judgments made by the engagement team, and the conclusions reached in formulating the auditor’s report. This **evaluation shall involve:** (a) *Discussion of significant matters with the engagement partner;* (b) *Review of the financial statements and the proposed auditor’s report;* (c) **Review of selected audit documentation relating to the significant judgments the engagement team made and the conclusions it reached;** and (d) *Evaluation of the conclusions reached in formulating the auditor’s report and consideration of whether the proposed auditor’s report is appropriate.*” (Emphasis Added)*
- iv. It is noticed that the preparer and reviewer of the WPs in the above-mentioned table are the same. The segregation of duties plays an important role as there must be at least two different individuals necessary for the preparation and reviewing of the WPs to ensure correctness and avoid bias. Therefore, the Audit Firm violated the maker-checker principle.

v. In the WP mentioned in the above table- “M18\_IL&FS\_PM TE SAD”, materiality has been calculated using the financial results of 30<sup>th</sup> September 2017, and the final financial results of 31<sup>st</sup> March 2018. Any calculations done by the ET using the final financial figures as of 31<sup>st</sup> March 2018, must have been done after the said date and before the signing of the audit report in the WP. In case the work documented in the WP was done after March 2018, there should have been a sign off after 31<sup>st</sup> March 2018, and before the date of signing of the audit report.

**8.1.3** Therefore, the Audit Firm failed to meet the requirements of Para 9 of SA 230 and has performed the exercise of signing off on the WPs as a mere formality that defeats the very purpose of sign off, which is to record who and when prepared/reviewed the WPs.

**8.1.4** NFRA did not find any WP in which the Audit Firm has used the materiality so determined i.e. ₹100 crore. Even while identifying the significant accounts in WP- “ILFS\_ Identification of Significant Accounts”, the Audit Firm had taken performance materiality as the base for all the financial balances. There is no evidence in the audit file where the Audit Firm actually performed the audit procedures using the materiality so calculated.

**8.1.5** Para 11 of SA 320 says, “*The auditor shall determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures. (Ref: Para A12)*” The Audit Firm has failed to show how the performance materiality as determined in WP “M18\_IL&FS\_PM TE SAD”, was used for assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures as required by Para 11 of SA 320.

**8.1.6** Para 14 of SA 320 says, “*The audit documentation shall include the following amounts and the factors considered in their determination: (a) Materiality for the financial statements as a whole (see paragraph 10); (b) If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures (see paragraph 10); (c) Performance materiality (see paragraph 11); and (d) Any revision of (a)-(c) as the audit progressed (see paragraphs 12- 13).*” (Emphasis Added)

**8.1.7** In view of the above, the Audit Firm is required to document performance materiality and the **factors** considered while determining it. In WP “M18\_IL&FS\_PM TE SAD”, the Audit Firm had determined performance materiality at ₹50 crore (50% of the materiality determined). However, the **FACTORS** considered for determining the performance materiality at ₹50 crore are nowhere documented in the said WP. As such, the Audit Firm failed to comply with the requirements of Para 14 of SA 320.

**8.1.8** Para 10 of SA 320 says, “*if there is one or more particular classes of transactions, account balances, or disclosures for which misstatements of lesser amounts than the*

*materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.”*

- 8.1.9** The various working papers quoted by the Audit Firm pertaining to materiality do not show any attempt made by the Audit Firm for identifying if there were any such particular classes of transactions, account balances or disclosures where the lower materiality level would be applicable. As such, it can be concluded that the Audit Firm did not comply with the provisions of Para 10 of SA 320.

## **B. Observations made in the DAQRR**

8.2. After examining the replies submitted by the Audit Firm to the above observations, NFRA conveyed the following in its DAQRR:

- 8.2.1** In respect of observation in PFC on non-signing by EP CA Jayesh Gandhi of any materiality WPs, the Audit Firm has stated that *“we would like to submit that there are various workpapers relating to determination of materiality available in the audit files which were in fact reviewed and signed off by the EP, Jayesh Gandhi. The following are the list of such workpapers available in our audit working paper file on standalone financial statements:*

- i. IL&FS-Standalone Hardcopy Files Folder - 11\_ASM – Sign off by EP, Jayesh Gandhi on 29/09/2017 as a reviewer.*
- ii. IL&FS-Standalone Hardcopy Files Folder - 9\_Team planning event - Sign off by EP, Jayesh Gandhi on 29/09/2017 as a reviewer.*
- iii. IL&FS-Standalone Canvas Files Folder - 26.1 Determine PM, TE, SAD.smt – Sign off by EP, Jayesh Gandhi on 15/01/2018 as a reviewer.*
- iv. IL&FS-Standalone Hardcopy Files Folder - 17\_Summary Review Memorandum – Sign off by EP, Jayesh Gandhi on 30/05/2018 as a reviewer”.*

- 8.2.2** It is important to note that in the WPs mentioned in point (i) to (iii) above materiality was determined using the total asset size as on 30<sup>th</sup> September, 2017. Though in WP “Summary Review Memorandum”, the materiality was determined using total asset size as on 31<sup>st</sup> March, 2018, the same was signed by EP on 30<sup>th</sup> May, 2018, i.e., the date of signing of audit report. As such, it conclusively proves that the EP did not review final materiality during the course of audit i.e., after 31<sup>st</sup> March, 2018 and before signing of the audit report.

- 8.2.3** Further, the Audit Firm has also stated that *“The document mentioned by NFRA i.e. “M18\_IL&FS\_PM TE SAD” was one of the additional documents in the canvas with relation to materiality. As there are various other documents signed off by EP for materiality evidencing his review, the additional workpaper referred by NFRA will not add to any substance in the matter of materiality”.* (Emphasis Added)

- 8.2.4** NFRA would like to bring to the notice of the Audit Firm that vide its response dated 30<sup>th</sup> December, 2019, to the preliminary queries of NFRA, the Audit Firm had itself referred to the WP “SFS Canvas-M18\_IL&FS\_PM TE SAD” in support of their assertions pertaining to materiality.
- 8.2.5** As such, the Audit Firm’s contention that the said WP is just one of the additional WPs in Canvas is unacceptable.
- 8.2.6** The Audit Firm has stated that “*Initial materiality for March 2018 was prepared and reviewed at the time of planning of audit based on September 30, 2017 financial numbers of the Company and the same has been mentioned in the workpaper 'M18\_IL&FS\_PM TE SAD'. Thereafter, this document was updated with the March 2018 numbers closer to the conclusion of our audit. Our revisiting of materiality with March 2018 numbers has been documented in summary review memorandum workpaper and the said workpaper was signed off and concluded after March 31, 2018 i.e. 30/05/2018, refer IL&FS-Standalone Hardcopy Files Folder - 17\_Summary Review Memorandum (Page AA12.17 to AA12.18). Accordingly, the workpaper 'M18\_IL&FS\_PM TE SAD' was not signed off again*”.
- 8.2.7** It is important to note that the whole statutory audit is being conducted using materiality as the base document. As such, it is important that the EP reviews the calculated materiality at the initial stage after the close of the financial year. Therefore, reviewing the materiality WP by EP on the date of signing of audit report is unacceptable.
- 8.2.8** Vide its response dated 14<sup>th</sup> April 2021, the Audit Firm has stated that “*differences identified below the SAD nominal amounts were considered as immaterial and were ignored. Wherever the identified difference was below SAD, they are generally marked as “#” or “immaterial” For instances of the same, refer the workpapers listed below.*
- *IL&FS-Standalone Canvas Files Folder – 341.1 to 341.17 M18 Cash &Bank Lead - Tab “Sublead”*
  - *IL&FS-Standalone Canvas Files Folder – 155.1 to 155.16 M18 Fixed Asset leadsheet -Tab “Lead”*
  - *IL&FS-Standalone Canvas Files Folder – 397.1 to 397.12 M18 ILFS VD expense - Tab “Lead”*
- 8.2.9** There is no evidence in the WPs that the Audit Firm had considered the calculated materiality to perform audit procedures or to make any judgement. As such, NFRA reiterates its conclusions provided in Para 3 of its PFC (same is reproduced in Para 8.1.4 above).
- 8.2.10** The Audit Firm had referred to a few WPs claiming that the materiality levels were used in identification of various risks and the procedures to be performed to address those

risks. In the WPs referred by the Audit Firm neither the materiality is mentioned nor it is stated in 'work done' that how the materiality was considered for performing audit procedures. Simply put, there is no mention of how materiality was used specifically while performing audit procedures in any of the WP in the audit file. Therefore, NFRA rejects all the assertions of the Audit Firm from Para 20 to 27 and NFRA reiterates its conclusion that the Audit Firm failed to comply with Para 11 of SA 320.

- 8.2.11** The Audit Firm has failed to provide the reference of any WP where factors for determining performance materiality were documented. Instead, the Audit Firm has stated that *“the Auditing Standards are not prescriptive but are principle based and are to be implemented in practice. It is not possible to make extensive detailing in work papers on compliance with each para of the standards of auditing. What is expected from the auditor is adherence to the auditing standard on an overall basis and the documentation of the same in the workpapers”*.
- 8.2.12** In Para 6.10.7 of Chapter Principal and Component Auditor of this AQRR, NFRA has explained in detail that SAs are mandatory in nature and **each requirement/para of an SA is important in its own self**. Each Para of an SA has its individual importance and mandatory applicability except in the circumstances where such SA or a particular requirement/Para of an SA is not applicable. In view of such explanation, NFRA reiterates its conclusion that the Audit Firm failed to comply with the requirements of Para 14 of SA 320.
- 8.2.13** The Audit Firm has given reference to a few WPs in respect of observations of NFRA. The WPs referred by the Audit Firm had already been examined in detail by NFRA while forming its PFC. As nothing new/additional to what was provided earlier is now submitted by the Audit Firm, NFRA concludes that there is no need for further examination. Hence, NFRA reiterates its conclusions in Para 6 of its PFC, reproduced in para 8.1.8 above.
- 8.2.14** After examining in detail all the responses of the Audit Firm to the PFC, NFRA concluded as follows:
- a. The Audit Firm failed to document the factors considered while determining the performance materiality as per the requirements of Para 14 of SA 320.
  - b. The Audit Firm did not identify classes of transactions, account balances or disclosures where the lower materiality level would be applicable, thus failing to comply with requirements of Para 10 of SA 320.
  - c. The EP, CA Jayesh Gandhi, failed to review the materiality WPs as per the requirements of Para 17 of SA 220.
  - d. The Audit Firm failed to understand the mandatory nature of **each requirement/para** of an SA, the entire text of an SA, and all SAs as a whole.

### C. Final Observations and Conclusions of the AQRR

8.3. NFRA has examined the replies to the DAQRR submitted and oral submissions by the Audit Firm to the above observations and concludes as follows:

**8.3.1** NFRA observes that the replies of the Audit Firm are mostly a reproduction and reiteration of the earlier replies to the PFC. Also, for a few observations or conclusions of NFRA in the DAQRR, the Audit Firm has not even given any response and simply stated that their response to PFC should be read for the same. However, NFRA has again examined the above observations in light of the repeated replies by the Audit Firm and reiterates all its conclusions drawn in DAQRR except as modified below.

**8.3.2** 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 to comply with the requirements of SA 320.

**8.3.3** Vide its response dated 27<sup>th</sup> September 2021, the Audit Firm has stated that *“SRBC would like to reiterate the fact that there was no change in the materiality level determined at the time of planning, as the materiality determined on the basis of March 2018 numbers was higher than materiality level determined at the time of planning. It is conservative and common audit practice to continue using the lower materiality, if subsequent evaluation of the materiality level at the time of finalization results in higher materiality as compared to the materiality levels determined at the time of planning. This does not result in missing any sample to be checked or determination of insignificant account to be significant account. Just because the document is signed off as on last day does not mean it was never reviewed by partner before it as the EP has reviewed materiality in various WP as mentioned in para 4 of response to PFC (Page no. 388 of PFC response). This was already forming part of our PFC response however NFRA has chosen to ignore the same. We would like to further state that signing off is just confirmation that document was reviewed earlier by EP and it captures the day the document was last revisited/opened. NFRA has drawn incorrect conclusion merely on basis of signing off document as document had been reviewed by EP earlier on May 7, 2018 but had been just signed off on 30th May 2018”*. As there is no evidence in the Audit File to support any of the above contentions, NFRA rejects the same. The Audit Firm’s failure to keep the Audit Documentation in accordance with the SAs is evident in this case. This also highlights the casual documentation practices followed by the Audit Firm, in contravention of Para 8 read with Para A10 of SA 230 , which require the auditor to prepare audit documentation that is sufficient to enable an experienced auditor to understand inter alia the nature, timing and extent of the audit procedures, their results, and significant matters arising during the audit.

**8.3.4** The Audit Firm has stated that *“....signing off is just confirmation that document was reviewed earlier by EP and it captures the day the document was last revisited/opened. NFRA has drawn incorrect conclusion merely on basis of signing off document as*

*document had been reviewed by EP earlier on May 7, 2018 but had been just signed off on 30th May 2018*". The Audit Firm's assertion that EP reviewed the materiality WP on 7<sup>th</sup> May 2018, is not supported with any evidence and hence, cannot be accepted.

- 8.3.5** Moreover, signing off of the document is not just a mechanical exercise. As per Para 9 of SA 230, in documenting the nature, timing and extent of audit procedures performed, the auditor shall record who reviewed the audit work performed and the date and extent of such review. As such, if a WP does not document the name of the person who reviewed it along with the date, it conclusively proves that the same WP is not reviewed. The Audit Firm's assertion that "*Non signing of EP on WP does not conclude that EP has not reviewed the determination of materiality*" is not tenable.
- 8.3.6** NFRA in its DAQRR observed that the Audit Firm failed to document how materiality was used while performing the audit procedures in any of the WPs so mentioned by the Audit Firm. Vide its response dated 27<sup>th</sup> September 2021, the Audit Firm has attached various screenshots of WPs where it is mentioned what was the determined materiality. There is no WP available wherein the materiality was used to test various account balances or to perform the audit procedures as a whole. As per Para 10 of SA 320, the auditor shall determine the materiality level or levels to be applied to the particular classes of transactions, account balances or disclosures. But there is no such WP available in the audit file where materiality was used while testing various account balances. As such, the response of the Audit Firm is found to be baseless.
- 8.3.7** In response to the observation of NFRA that the Audit Firm has failed to provide reference of any WP where factors for determining performance materiality were documented, the Audit Firm has repeated what it submitted in response to the PFC. The Audit Firm has referred to WP "IL&FS-Standalone Hardcopy Files Folder - 11\_ASM (Page no. A9.24)" and "IL&FS-Standalone Canvas Files Folder - 27.1 to 27.2 M18\_IL&FS\_PM TE SAD" claiming that the factors for determining performance materiality are mentioned in these WPs. NFRA found that no such factors that were considered for determining the performance materiality have been mentioned in the WPs. Thus, the Audit Firm failed to comply with the requirements of Para 14 of SA 320.
- 8.3.8** Regarding the factors considered for deciding performance materiality the Audit Firm refers to WP 'IL&FS-Standalone Hardcopy Files Folder - 11\_ASM (Page no. A9.24)' where it is stated that "*We document: • The **factors we considered** in making our determination of PM and TE*". But there is no documentation of the actual factors so considered.
- 8.3.9** Based on the above observations NFRA concludes that:
- i. The Audit Firm did not document the factors considered while determining the performance materiality as per the requirements of Para 14 of SA 320.

- ii. The Audit Firm did not identify classes of transactions, account balances or disclosures where the lower materiality level would be applicable, thus failing to comply with the requirements of Para 10 of SA 320.
- iii. The Engagement Partner did not review the materiality WPs as per the requirements of Para 17 of SA 220. The Audit Firm failed to understand the mandatory nature of **each requirement/para** of an SA, the entire text of an SA, and all SAs as a whole.

## **9. Communication with Those Charged With Governance (TCWG)**

### **A. Prima Facie Observations and Concussions (PFC)**

9.1. NFRA in its Prima-facie Conclusions conveyed the following:

**9.1.1** Vide its communication dated 19<sup>th</sup> November, 2019, NFRA specifically asked the Audit Firm to provide the details of persons who were part of TCWG and whether they were part of Board of Directors (BOD) and/or Audit Committee and/or Management. The Audit Firm, in its response dated 30<sup>th</sup> December 2019, has inter alia, stated and provided the details of the same in tabular format as was desired by NFRA. However, the same details are not captured or recorded in any WP forming part of the audit file. NFRA, therefore, concludes that the Audit Firm has completely failed in the fundamental duty of identifying clearly TCWG. From the tabulation (provided in the above response of the Audit Firm), it is noticeably clear that the same persons were part of TCWG, BOD, Audit Committee and Management.

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

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

On the other hand, as per Section 177 (4) of the Companies Act, 2013, for the Audit Committee, it is mandatory to perform the following functions:

- Recommend the appointment of auditors of the Company.
- Review and monitor the auditor's independence and performance.
- Examination of financial statements and auditor's report.
- Approval of related party transactions.

**9.1.3** In view of the above, the audit committee does not have the mandate for overseeing the accountability of the functions of the management and overseeing the financial reporting process. TCWG should be the one who can oversee the work of the management and can take appropriate action against the management in case management does not comply with applicable laws and regulations, indulges in fraudulent activities or violates corporate governance. As the audit committee cannot perform such functions similar to TCWG, the Audit Committee cannot be considered as synonymous with TCWG.

**9.1.4** Therefore, the identification and dealing with the TCWG by the Audit Firm appears to have been dealt in a mechanical manner rather than recognizing it as an important body

charged with responsibility to oversee the strategic direction of the entity, obligations related to the accountability of the entity and overseeing the financial reporting process. In this regard, the following stipulations of the Standards of Auditing and Code of Ethics of ICAI appears to have not been taken into consideration by the Audit Firm while identifying and dealing with TCWG.

- i) Para 11 of SA 260 (Revised) says, *“The auditor shall determine the appropriate person(s) within the entity’s governance structure with whom to communicate.” Further, Para A1 of SA 260 (Revised), inter alia, says, “Governance structures vary by entities, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics.”*
- ii) Para 12 of SA 260 (Revised) says, *“If the auditor communicates with a subgroup of those charged with governance, for example, an audit committee, or an individual, the auditor shall determine whether the auditor also needs to communicate with the governing body.”*
- iii) Para A5 of SA 260 (Revised) says, *“When considering communicating with a subgroup of those charged with governance, the auditor may take into account such matters as:*
  - *The respective responsibilities of the subgroup and the governing body.*
  - *The nature of the matter to be communicated.*
  - *Relevant legal or regulatory requirements.*
  - ***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.” (Emphasis Added)***

**9.1.5** This indicates that TCWG as a body should have the power to take action against the management, if required, based on the seriousness of non-compliance of laws and regulations that are detected by the auditor and which are brought to their notice by such auditor.

**9.1.6** The following paras of Code of Ethics, 2009, of ICAI shows the importance of TCWG for the purposes the statutory audit of financial statements and the same appears to have not been complied with by the Audit Firm as there is no specific communication exchanged on these matters with TCWG in the audit file.

200.13 Engagement-specific safeguards in the work environment may include:

- Involving an additional professional accountant to review the work done or otherwise advise as necessary.

- Consulting an independent third party, such as a committee of independent directors, a professional regulatory body or another professional accountant.
- Discussing ethical issues with those charged with governance of the client.
- **Disclosing to those charged with governance of the client the nature of services provided and extent of fees charged.** (Emphasis added)
- Rotating senior assurance team personnel.

290.33 If a non-assurance service was provided to the financial statement audit client during or after the period covered by the financial statements but before the commencement of professional services in connection with the financial statement audit and the service would be prohibited during the period of the audit engagement, consideration should be given to the threats to independence, if any, arising from the service. If the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards may include:

- Discussing independence issues related to the provision of the non-assurance service with those charged with governance of the client, such as the audit committee.

**9.1.7** The Audit Firm, in its response to the queries asked by NFRA pertaining to TCWG, had mentioned that they had communicated with TCWG and Management and had given reference to the WPs “SFS Hard Copy File- File 1 (Part 1 of 2) – Flap AA12 - ACM PPT (A12.94 to A12.150)” and “CFS Hard Copy File-File 1 (Part 3 of 3)-Flap A9 - ACM PPT (Page no. A9.256 to A9.275)”. The said WPs are the presentations made to the audit committee by the Audit Firm in reference to standalone and consolidated financial statements dated 29th May, 2018, and 28th August, 2018, respectively i.e. the day before the signing of the respective audit reports. This does not amount to compliance with the requirement of communication with TCWG as laid down in SA 260 (Revised). Moreover, the Audit Firm had also stated that “*We discussed our presentation to the audit committee in the audit committee meeting, where in all the matters stated above, were discussed and addressed.*” On perusal of the said presentation made to audit committee by the Audit Firm, NFRA observed that the PPT lists out several issues but does not include any opinion of the Audit Firm on the same.

**9.1.8** Also, apart from the presentations made to the audit committee, there is no other communication by the Audit Firm to TCWG during the course of conducting the statutory audit for FY18. There is no evidence in the audit file to *show “what matters/audit observations were discussed and when”* with TCWG, prior to the date of signing of the Audit Report or during the audit process. Para 23 of SA 260 (Revised) says, “*Where matters required by this SA to be communicated are communicated orally, the auditor shall include them in the audit documentation, and when and to whom they were communicated. Where matters have been communicated in writing, the auditor*

*shall retain a copy of the communication as part of the audit documentation*". Hence, it can be concluded that the Audit Firm failed to provide TCWG timely observations arising from the audit that were significant and relevant to their responsibility to oversee the financial reporting process, which is a total violation of requirements as per Para 9(c) and Para 21 of SA 260 (Revised). Also, there is no evidence in the audit file submitted by the Audit Firm to NFRA regarding clear and timely communication of specific matters during the course of the audit process. As such, NFRA concludes that the Audit Firm failed to achieve the basic objective of an auditor to have effective two way timely communication with TCWG as stipulated in Para 9 of SA 260 (Revised).

**9.1.9** It is important to note that Para 12 of SA 260 (Revised) requires that if the Audit Firm communicates with a subgroup of TCWG e.g., an audit committee, the auditor shall determine whether the auditor also needs to communicate with the governing body. However, there is no evidence of this in the audit file, nor is there any evidence that the Audit Firm communicated with the governing body. The other violations noted were:

- i) under good governance principles mentioned in Para A7 of SA 260 (Revised), the Audit Committee should meet the auditor **WITHOUT** management present at least annually. However, on perusal of Audit Committee Meeting Minutes for FY18, it is seen that in every such meeting the Audit Firm had with the Audit Committee, one of the individuals forming part of Management was present, namely Mr. Hari Sankaran, Managing Director. There was no meeting of the Audit Committee with the Audit Firm without the presence of the Management. Also, the Audit Firm failed to raise the question of the presence of a management representative for at least one meeting with the audit committee. As such, it does not satisfy the requirements of Para 12 and A7 of SA 260 (Revised).
- ii) the Audit Firm mentioned that they had made certain recommendations to TCWG regarding areas of improvement noted during the course of testing controls. The Audit Firm also mentioned that "*Our recommendations were discussed with TCWG i.e. audit committee and they had noted plan for improvement.*" There is no evidence in support of this assertion in the audit file except for the Power Point presentation (PPT). The PPT cannot be considered as sufficient appropriate audit evidence in view of the following reasons:
  - Audit Committee cannot be considered as TCWG for the reasons explained in para 9.1.3 above.
  - In the absence of any discussion note or any other evidence, a power point presentation was a one-sided communication from the Audit Firm and cannot be claimed to have been a DISCUSSION.

**9.1.10** In its own assertion, the Audit Firm mentioned that TCWG and audit committee are one and the same thing. The same is unacceptable for the reasons explained in point 2 above and hence, audit committee cannot be considered as synonymous with TCWG.

**9.1.11** Para 14 to Para 17 of SA 260 (Revised) discuss various matters on which the **Audit Firm** should communicate with TCWG. On a detailed examination of the audit file, NFRA identified several such matters on which the Audit Firm completely failed to communicate with TCWG. A few instances are mentioned below:

i) In reference to Para 15 of SA 260 (Revised), the Audit Firm shall communicate with TCWG an overview of the planned scope and timing of the audit, which includes communicating about the significant risks identified by the auditor. In this respect, the Audit Firm had made reference to the PPT made to the audit committee just a day before the signing of the audit report. The planned scope and timings of the audit should have been communicated by the Audit Firm to TCWG at **the initial stage of the audit** and not at the end of the audit.

Also, in spite of the fact that IL&FS Limited reported varying numbers for component entities, the Audit Firm did not communicate about the same with TCWG. The Audit Firm did not even obtain the complete list of component entities at **the initial stage** of the audit to be able to identify and reconcile the deficiencies in time.

Hence, NFRA concludes that the Audit Firm failed to comply with the provisions of Para 15 of SA 260 (Revised).

ii) As per the requirements of Para 16 of SA 260 (Revised), the Audit Firm shall communicate with TCWG the auditor's view about significant qualitative aspects of the entity's accounting practice, **including accounting policies**, accounting estimates and financial statement disclosures. NFRA noted that the Audit Firm failed to obtain the board approved investment policy as an important audit evidence in order to understand and verify whether the investments made by the company were as per the company's own policy or not.

**9.1.12** In reference to Para 17 of SA 260 (Revised), IL&FS being a debt listed entity, the Audit Firm should have communicated with TCWG the following:

- Independence of the Audit Firm and the Engagement Team as envisaged under Standards of Auditing and Code of Ethics of ICAI.
- All the business relationships of the Audit Firm as well as its network entities with the IL&FS Group.
- Total fees charged during the period covered by the financial statements for audit and non-audit services provided by the Audit Firm and its network entities to IL&FS Limited and its components entities.

**9.1.13** However, the Audit Firm failed to share the above said information with TCWG as there is no evidence of any such communication in the Audit File.

**9.1.14** Para A17 of SA 260 (Revised) requires the Audit Firm to communicate the findings from the audit that may include requesting further information from TCWG in order to complete the audit evidence obtained. In respect of communicating the significant findings from the audit, the Audit Firm had claimed the same being communicated to the audit committee through the aforementioned PPT. As per Para 21 read with Para A49 of SA 260 (Revised), the auditor shall communicate with TCWG on a timely basis. Timely communication of the significant findings from the audit to the TCWG may enable remedial actions to be taken. There is no other support or evidence from audit file on the matter of timely communication to TCWG except the referred PPT. Further, the Audit Firm has not referred or quoted any specific reference or WP wherein there is evidence of any exchange of communications between the Audit Committee and the Audit Firm is available, wherein the significant issues have been discussed or addressed by the Audit Committee. Hence, communication by way of a presentation (PPT) by the Audit Firm to the Audit Committee cannot be considered as communication of significant findings in timely manner by the Audit Firm in the absence of any other support from Audit file.

**9.1.15** Applying the guiding principles as contained in SA 260 (Revised) on matters to be communicated to TCWG, specific communication should have been done with TCWG on the important findings of the audit, which was not done. A few instances which should have been communicated are as per the following list:

- i) IL&FS Limited had an investment of ₹297 crore in Dighi Port Limited, which is facing bankruptcy proceedings filed under the Insolvency and Bankruptcy Code, 2016 (IBC). The Company did not provide for diminution in the value of the investment made in DPL. In this regard, the Audit Firm did not ask the management as to the likely amount to be recovered by the equity holders upon settlement and failed to identify and assess the risk of material misstatement in the financial statements. Also, the Audit Firm failed to discuss this significant matter with TCWG. Merely informing the Audit Committee about the status of impairment through a presentation made just a day before the date of signing of the Audit Report cannot be considered as a discussion of the matter with TCWG and is a violation of provisions of SA 260 (Revised).
- ii) IL&FS Limited had charged brand subscription fees to IL&FS Tamil Nadu Power Company Limited (ITPCL) amounting to ₹48 crore till March 2015. As at 31st March 2018, the amount is presented under debtors and no provision has been created on the same. In this regard, the Audit Firm had said that as part of the audit procedures performed by them, they had discussed with the management and TCWG about non-provisioning of ₹48 crore. The Audit Firm has referred to the PPT presented to the audit committee on 29th May 2018, as evidence in this context which cannot be construed as audit evidence for the following reasons:

- The PPT was made on the day just before the signing of the Auditor’s Report for SFS.
  - Audit Committee cannot be considered as TCWG.
  - It was a one-sided communication from the Audit Firm and hence, cannot be claimed to have been a DISCUSSION.
- iii) It is observed that the number of total component entities as per the extract of the Annual Return of the Company differs from what was mentioned in the signed financials for FY18. As per Para 7 of SA 720, the auditor shall make appropriate arrangements with management or TCWG to obtain the other information prior to the date of the auditor’s report. Therefore, the Audit Firm should have communicated with TCWG pointing out the discrepancy in case the management had not rectified the same, to ensure that the details mentioned in the Annual Report of the Company were in sync with what was mentioned in the signed financials. However, there is no evidence in the audit file for any such communication from the Audit Firm to TCWG in this regard.
- iv) IL&FS Limited did not comply with the requirements prescribed by RBI CIC Directions to maintain the adequate Capital Ratio and Leverage Ratio in FY18. On perusal of this matter, NFRA noted that the Company wrongly calculated the said ratios. Despite knowing lacuna in the calculations of capital and leverage ratio, the Audit Firm did not to communicate and discuss this matter with TCWG.

**9.1.16** Vide its communication dated 19th November 2019, NFRA asked the Audit Firm whether it communicated in writing significant deficiencies in internal controls identified during the audit to TCWG on a timely basis. In their response, the Audit Firm had stated that based on the results of test of controls performed including entity level controls, they had concluded that the internal controls over financial reporting were adequately designed and were operating effectively to address the risk of material misstatement in the financial statements. On perusal of the WP “M18 111GL-ELCs testing”, where the Audit Firm had listed various entity level controls to assess the operating effectiveness of those controls, NFRA could not identify a single control related to revenue recognition process. The various processes with respective control activities as mentioned in the aforesaid WP are “*Code of Conduct and Whistle blower policy, Subsidiary Management, Organisation structures, performance appraisal, delegation of authority, budget and planning etc*”. It is clear evidence that the Audit Firm did not check whether the whole revenue process was free from risk of material misstatements.

**9.1.17** Moreover, in its own assertion, the Audit Firm mentioned that they had identified management override of controls in revenue from operations as a fraud risk. On detailed examination, NFRA noted significant deficiencies on the part of the Audit Firm to assess

the risk of management override of controls in the revenue recognition process. Some of the deficiencies identified by NFRA are:

- a) There is no WP where the Audit Firm has identified whether any, and what types of controls were set up by the management at various levels of revenue recognition, and whether such controls were effectively working or not.
- b) On perusal of WP “M18 JE Testing”, it is noted that out of 2,79,874 journal entries in the JE Dump, the Audit Firm had performed testing for only a sample size of 25 journal entries.
- c) In WP “M18 JE Testing”, under the heading “work done”, the Audit Firm had clearly mentioned that they had identified and performed procedures and obtained reasons for the entries which show blank checker/ same maker checker. While reviewing the actual work done in this respect, NFRA observed that reasons are nowhere documented as to why some journal entries had blank checker/ same maker checker.

**9.1.18** As such, the Audit Firm failed to perform audit procedures to assess the risk of management override of controls, as required by Para 31 and 32 of SA 240. Further, it was the responsibility of the Audit Firm to identify the deficiencies in internal control and to timely and effectively communicate the same to TCWG.

**9.1.19** NFRA observed that Risk Management Committee did not meet even once in past three years. In this context, vide its communication dated 19th November 2019, NFRA asked the Audit Firm, *“how did the company evaluate the overall risks including liquidity risk”*. In its response dated 30th December, 2019, the Audit Firm stated that, *“We had read minutes of the audit committee and Board of directors and concluded that audit committee/Board was also functioning as a risk management committee considering the charter of the audit committee as set out in the annual report and matters discussed at Board Meetings.”*

**9.1.20** On perusal of the annual report 2018 of IL&FS Limited, NFRA noted that the annual report clearly mentions the duties and responsibilities of both the Audit Committee and Risk Management Committee. The annual report states that *“The duties and responsibilities of the Audit Committee are as defined under provisions of the Companies Act, 2013”*. The responsibilities of the Risk Management Committee as mentioned in the annual report are reproduced below:

- *“review of the adequacy of the risk management framework and operational procedures developed for new businesses and products from time to time;*
- *provision of guidance on strengthening of risk management practices to respond to emerging global and national market and regulatory developments;*
- *approval of overall limits for management of credit risk, liquidity risk and market risks;*
- *review of asset liability management reports and provision of directions on improved management of liquidity and interest rate risk;*

- *review of the capital adequacy requirements of the Company and provision of recommendations for the consideration of the Board in relation to the parameters to be considered in this regard;*
- *review of the Company's compliance programme; and*
- *review of the status of any enquiry, investigation and other disciplinary action initiated by RBI, SEBI or other regulatory agencies;"*

**9.1.21** Clearly, the duties and functions of both committees are different. As such, the Audit Firm's assertion that the "*audit committee/Board was also functioning as a risk management committee*" is unacceptable. The Audit Firm failed to assess the difference between the audit committee and risk management committee, their functions, duties and responsibilities. The Audit Firm did not evaluate the consequences of non-functioning of Risk Management Committee in the Company.

**9.1.22** Therefore, the Audit Firm failed to exercise professional scepticism while conducting the statutory audit and failed to ask TCWG why the risk management committee had not met for the past three years.

**9.1.23** In consideration of above-mentioned observations and in the absence of any documentation that conforms to the requirements of the SA 260 (Revised), NFRA concludes that there has been virtually no effective communication with TCWG on matters of importance as envisaged by the SA. Therefore, the Audit Firm has failed to comply with the requirement of SA 260 (Revised).

## **B. Observations made in the DAQRR**

9.2. After examining the replies to the above observations NFRA had conveyed the following in its DAQRR.

**9.2.1** In its response dated 14<sup>th</sup> April, 2021, the Audit Firm has cited Section 177 of the Companies Act, 2013, and names of the person who were part of the audit committee for FY18. The Audit Firm has also stated that "*the audit committee was comprised of majority of its members as independent directors and one of the key management personnel involved in overseeing the strategic direction including the financial reporting process of the entity and obligations related to the accountability of the entity*". The said assertion of the Audit Firm is neither documented and supported by any WP placed in the audit file nor it is mentioned anywhere in the Annual Return of the Company for FY18. As per the Annual Return of the Company, the duties and responsibilities of the Audit Committee were as defined under the provisions of the Companies Act, 2013. As also stated by NFRA in Para 2 of its PFC (same is reproduced

in Para 9.1.2 to 9.1.4 above), the provision of the Companies Act, 2013, does not mandate the audit committee for overseeing the accountability of the functions of the management and overseeing the financial reporting process. As such, the claim of the Audit Firm that members of the audit committee were involved in overseeing the strategic direction including the financial reporting process of the entity and obligations related to the accountability of the entity is merely an afterthought and is unacceptable.

- 9.2.2** The Audit Firm has reproduced Para 12, A5, A6 and A7 of SA 260 (Revised) and has stated that *“With reference to above paras and read along with the provisions of the Companies act, 2013 as above in para 2, we concluded that the audit committee, constituted by the Board of directors with the necessary power to deal with the statutory audit matters, was responsible for handling statutory audit matters and therefore to be considered as TCWG in case of IL&FS”*.
- 9.2.3** NFRA in Para 2 of its PFC (same is reproduced in Para 9.1.2 above) clearly identified and stated the functions of TCWG as per Para 10 (a) of SA 260 (Revised) as well as of the audit committee. In view of the same, the above claim of the Audit Firm that the audit committee, constituted by the Board of directors with the necessary power to deal with the statutory audit matters, was responsible for handling statutory audit matters and therefore to be considered as TCWG in case of IL&FS, is baseless and unacceptable.
- 9.2.4** The Audit Firm has also cited Clause 49 of SEBI Listing Agreements and in reference to it has stated that *“the Audit Committee has the powers, which includes, investigation in any activity within its terms of reference.”* Also, the Audit Firm has stated that *“Therefore, from the above, it is clear that SRBC has duly determined and identified that communication with the Audit Committee is sufficient communication with TCWG in accordance with the Standards of Audit as well as the uniform Listing Agreement”*. It is important to note that it is nowhere documented that the Audit Committee will perform its functions according to SEBI Listing Agreements. The Annual Report of the Company also clearly states that the Audit Committee will function as per the requirement of the Companies Act, 2013. As such, the above assertions of the Audit Firm are merely afterthought and cannot be justified.
- 9.2.5** In Para 14 of its response, the Audit Firm has stated that *“We would like to inform that in case of IL&FS, we had identified an individual, Mr. Arun Saha, as a subset of the governing body. The important audit observations were discussed with Mr. Arun Saha and if considered necessary were also communicated to the audit committee. In our view, the audit committee had the power to take action against the management, if required”*. The said argument of the Audit Firm is not supported by any audit evidence and hence, it is just an afterthought to mislead NFRA.
- 9.2.6** Hence, after perusal of the response of the Audit Firm, NFRA concludes that none of the assertions of the Audit Firm is supported by any audit evidence placed in the audit

file. All the arguments of the Audit Firm are baseless and mere an afterthought. Hence, **the audit committee cannot be considered as TCWG.**

- 9.2.7** In respect of the observation of NFRA in Para 3 of its PFC (same is reproduced in Para 9.1.7 above), the Audit Firm has given reference to a few WPs in support of their assertions. On perusal of the response, NFRA finds that the WPs referred by the Audit Firm had been already examined in detail by NFRA at the stage of forming its Prima Facie Conclusions (PFC). Hence, NFRA concludes that there is no need for re-examination as no new/additional response to what was provided earlier is now submitted by the Audit Firm. Also, considering the reasons explained in Para 9.2.1 to 9.2.7 above, NFRA reiterates its conclusions provided in Para 3 of its PFC.
- 9.2.8** In Para 4 of its PFC, NFRA stated that there is no other communication apart from the presentation (PPT) to the audit committee by the Audit Firm during the course of conducting the statutory audit for FY18. There is no evidence in the audit file to show “*what matters/audit observations were discussed and when*” with TCWG, prior to the date of signing of the Audit Report or during the audit process. In response to this, the Audit Firm has stated that “*routine matters of discussion and critical information required for audit such as legal matters, fraud consideration, understanding of entity and industry specific risks, accounting policies followed by the entity, etc., were obtained in a timely manner from the management including Mr. Arun Saha (Joint MD and CEO, member of audit committee), Mr. Sushil Khandelwal (Head – Accounts and Finance) and Mr. Wagle (CFO of the IL&FS group)*”. The said argument is completely irrelevant to the respective observations of NFRA as it does not talk about anything being communicated by the Audit Firm to TCWG. Also, the WPs referred by the Audit Firm in Para 26 of their response are irrelevant as none of the WPs is a communication by the Audit Firm to TCWG. As such, NFRA reiterates its conclusion provided in Para 4 of its PFC (same is reproduced in Para 9.1.8 above).
- 9.2.9** The Audit Firm has stated that “*we understand that as a part of good governance principles, certain procedures to be followed by the audit committee have been **suggested in the standards on auditing**. We submit that, it is prerogative of the audit committee to invite the auditors for discussion without management, if they deem necessary. The procedures listed in the above para are **indicative procedures and not mandatory procedures**”.* (Emphasis Added)
- 9.2.10** Para (B) of ‘Announcements of the Council regarding status of various documents issued by the Institute of Chartered Accountants of India (ICAI)’, which forms part of Handbook of Auditing Pronouncements issued by ICAI, inter alia, says, “*According to the new format the Standards on Auditing (SAs) would now contain two distinct sections, one, the Requirements section and, two, the Application Guidance section. The fundamental principles of the Standards are contained in the Requirements section and represented by use of “shall”. The application and other explanatory material contained in a SA is an integral part of the SA as it provides further explanation of,*

guidance for carrying out, the requirements of an SA, along with the background information on the matters addressed in the SA”. Thus, Para A7 of SA 260 (Revised) is just a further explanation of Para 12 of SA 260 (Revised) and is an integral part of the SA which the Audit Firm is required to comply with. As such, NFRA refutes the assertion of the Audit Firm reproduced in Para 9.2.9 above.

**9.2.11** In reference to the observation of NFRA in Para 5 (ii) of its PFC (same is reproduced in Para 9.1.9.(ii) above), the Audit Firm has stated that *“NFRA may refer to ACM minutes of the Company wherein the presentation made by SRBC had been discussed including the recommendations made and the consequent discussion and noting of the same by the directors. The ACM PPT has not been presented to the audit committee simply as a monologue and there were discussions and deliberations on the content of the auditor presentation as well as on the overall audited financial statements and was minuted in the minutes of the audit committee. The presentation had been acknowledged by the committee and signed by the company secretary as well. Hence, it cannot be said to be a one-sided communication. Refer IL&FS-Standalone Hardcopy Files Folder - 20\_ACM PPT (A12.94 to A12.150), IL&FS-Consolidated Hardcopy Files Folder - C 23\_ACM PPT (Page no. A9.256 to A9.275)”*.

**9.2.12** NFRA notes the following observations on perusal of the PPTs referred by the Audit Firm in their response and Audit Committee Meeting (ACM) minutes dated 29<sup>th</sup> May, 2018, and 28<sup>th</sup> August, 2018:

- The PPT made to the Audit Committee mentions that *“This document is furnished solely **for your information** and should not be used as distributed for any other purpose, disclosed or made available to any party or referred to in any document without prior written consent”*. (Emphasis Added)
- The minutes of the ACM held on 29<sup>th</sup> May, 2018, in respect of PPT merely says, *“The **Committee notes the contents of the Presentation** and reviewed the Standalone Audited Financials for the financial year ended March 31, 2018. After discussion, the Committee expressed its satisfaction over the performance of the Company and recommended it for the approval of the Board”*. (Emphasis Added)
- Neither on the PPT is the signature of the Company Secretary (CS) nor is it evident from the ACM minutes that CS signed the PPT.

Hence, in view of above observations, NFRA rejects the assertion of the Audit Firm (reproduced in Para 9.2.11 above) and concludes that the same is a mere afterthought, and baseless.

**9.2.13** As such, NFRA reiterates its conclusions provided in Para 5 of its PFC (same is reproduced in Para 9.1.9 and 9.1.10 above).

- 9.2.14** In response to observation of NFRA drawn in Para 6 (i) of its PFC (same is reproduced in Para 9.1.11 (i) above), the Audit Firm has given reference to the WPs “IL&FS-Standalone Hardcopy Files Folder - 8\_Engagement agreement (Page no. 7.17), IL&FS-Standalone Canvas Files Folder - 461.1 to 461.30 Minutes - ACM 8Nov17 and IL&FS-Consolidation Canvas Files Folder - C 517.1 to C 517.92 Minutes – BM 29Aug18 (which includes minutes of ACM dated 29 May 18)” claiming that they had discussed the scope of audit during the initial stage and had also communicated the scope and timing of their review/audit procedures along with significant areas and matters identified during the course of review/audit to the audit committee.
- 9.2.15** NFRA observes that WP “Engagement agreement (Page no. 7.17)” only contains the list of services provided by the Audit Firm to the IL&FS Limited along with fees charged for the respective services. Further, the Audit Committee cannot be construed as TCWG, therefore, reference to ACM minutes as evidence of communication with TCWG is irrelevant. Further, the ACM minutes neither contains any information regarding the planned scope and timing of the audit nor about the significant risks identified by the auditor. Hence, NFRA concludes that the the WPs referred are irrelevant to the NFRA’s PFC. NFRA reiterates its conclusion in Para 6 (i) of its PFC (reproduced in Para 9.1.11 (i) above) that the Audit Firm failed to comply with the provisions of Para 15 of SA 260 (Revised).
- 9.2.16** In Para 6.10 of Chapter Principal and Component Auditor of this AQRR, NFRA has explained in detail the reasons for its conclusion that the Audit Firm did not obtain the complete list of component entities at **the initial stage** of the audit. As such, NFRA reiterates its conclusion that the Audit Firm did not communicate the varying numbers of component entities to TCWG.
- 9.2.17** In Para 3.4 of Chapter Investments of this DAQRR, NFRA has explained in detail the reasons for its conclusion that the Audit Firm failed to obtain the board approved policy as important audit evidence. As such, NFRA reiterates its conclusion that the Audit Firm failed to communicate with TCWG the auditor’s view about significant qualitative aspects of the entity’s accounting practice, **including accounting policies**, accounting estimates and financial statement disclosures as also stated in Para 6 (ii) of its PFC (same is reproduced in Para 9.1.11 (ii) above).
- 9.2.18** The documents/WPs referred by the Audit Firm in Para 50 to 52 of their response dated 14<sup>th</sup> April, 2021, are not the communication to TCWG by the Audit Firm. Moreover, none of the referred WP contains any information as per the requirement of Para 17 of SA 260 (Revised). Hence, NFRA reiterates its conclusion in Para 7 of its PFC (reproduced in Para 9.1.12 above).
- 9.2.19** In respect of observation of NFRA in Para 8 of its PFC (reproduced in Para 9.1.14 above), the Audit Firm has given reference to a few WPs in support of their assertions.

NFRA finds that the WPs referred by the Audit Firm were already examined in detail by NFRA at the stage of forming its PFC. Hence, NFRA concludes that there is no need for re-examination as no new/additional response to what was provided earlier is now submitted by the Audit Firm and NFRA reiterates its conclusions in the PFC.

- 9.2.20** In Para 3.18 of Chapter Investment of this DAQRR, NFRA has explained in detail the reasons for its conclusion that the Audit Firm failed to identify and assess the risk of material misstatement in the financial statements in respect of investment of IL&FS Limited in DPL amounting to ₹297 crore. As such, NFRA refutes the response of the Audit Firm from Para 59 to 61 and reiterates its conclusion in Para 9 (i) of its PFC (reproduced in [Para 9.1.15 \(i\)](#) above).
- 9.2.21** For the reasons explained in [Para 9.2.1](#) above, audit committee cannot be considered as TCWG. As such, NFRA refutes the response of the Audit Firm in Para 62 and 63 and reiterates its conclusion in Para 9 (ii) of its PFC (reproduced in [Para 9.1.15 \(ii\)](#) above).
- 9.2.22** In Para 6.2.2 of Chapter Principal and Component Auditor of this AQRR, NFRA has explained in detail the reasons for its conclusion that SA 720 was in effect for FY18. As such, NFRA refutes the response of the Audit Firm from Para 64 to 66 and reiterates its conclusion in Para 9 (iii) of its PFC (reproduced in [Para 9.1.15 \(iii\)](#) above).
- 9.2.23** In Chapter RBI Compliance of this DAQRR, NFRA has explained in detail the reasons for its conclusion that the Audit Firm failed to communicate the discrepancies in calculation of Capital Ratio and Leverage Ratio by IL&FS Limited. As such, NFRA refutes the response of the Audit Firm from Para 67 to 69 and reiterates its conclusion in Para 9 (iv) of its PFC (reproduced in [Para 9.1.15 \(iv\)](#) above).
- 9.2.24** In Para 5.14 of Chapter ‘Revenue’ of this DAQRR, NFRA has explained in detail the reasons for its conclusion that the Audit Firm did not check whether the company had appropriate internal controls in place, and if those controls were working effectively to mitigate the risk of material misstatement. Also, the Audit Firm failed to perform audit procedures to assess the risk of management override of controls as per the requirement of Para 31 and 32 of SA 240. As such, NFRA refutes the Audit Firm response from Para 70 to 78 and reiterates its conclusion in Para 10 of its PFC that the Audit Firm failed to identify and communicate significant deficiencies in internal control to TCWG.
- 9.2.25** In WP “IL&FS-Standalone Hardcopy Files Folder - 9\_Team planning event (Page no. 9.16.1)”, the Audit Firm noted that the responsibilities assigned to RMC were undertaken by the Board of Directors (BOD) and Audit Committee. The Audit Firm in its response has stated that *“the minutes of the board meetings and audit committee meetings demonstrates that the functions of risk management committee were carried out by them. Refer SFS Canvas – Task – Read minutes of meetings of shareholders, those charged with governance and important committee”*. However, the Audit Firm

failed to provide specific references to the minutes of TCWG and important committees as stated by them in their response.

**9.2.26** Also, in the Annual Report of the Company for FY18, it is nowhere mentioned that the responsibilities of RMC were taken by the Audit Committee and Board of Directors. In fact, the responsibilities of both the Committees are mentioned separately in the Annual Report. It is also important to note that if the responsibilities of RMC were taken by BOD and Audit Committee, then there was no need for the Company to form RMC separately and include its details separately in its Annual Report. An annual Report is a document that is available to its stakeholders and the public in general and the information included in it is what people believe to be true. So, even if the responsibilities of the RMC were taken by the Audit Committee and BOD, the Company should have mentioned this clearly in its Annual Report. As such, the Audit Firm also failed to point out that Annual Report does not disclose this information. Hence, NFRA reiterates its conclusion that the Audit Firm failed to raise the concern to TCWG that RMC did not meet for the past three years.

**9.2.27** Hence, in view of the reasons mentioned in paras from 9.2, 9.4, 9.6 to 9.16 above, NFRA concludes that the Audit Firm completely failed to comply with the requirements of SA 260 (Revised).

**9.2.28** After examining in detail all the responses of the Audit Firm to the PFC, NFRA concludes as follows:

- i.** The Audit Firm failed to achieve the basic objective of communication with TCWG as per the requirements of Para 9 of SA 260 (Revised).
- ii.** In reference to Para 12 and A7 of SA 260 (Revised), Audit Committee cannot be considered as TCWG.
- iii.** The Audit Firm failed to communicate with TCWG an overview of the planned scope and timing of the audit as per the requirements of Para 15 of SA 260 (Revised).
- iv.** The Audit Firm failed to communicate the Firm's and Engagement Team's independence, business relationships with IL&FS Limited and details regarding total fees charged for audit and non-audit services with TCWG as per the requirements of Para 17 of SA 260 (Revised).
- v.** The Audit Firm failed to communicate the significant deficiencies identified during the course of the audit to TCWG.
- vi.** In spite of the lapses in the internal control pertaining to the revenue recognition process, the Audit Firm failed to communicate and discuss the matter with TCWG.

- vii. The Audit Firm itself has noted in the WPs that the Company did not comply with the capital and leverage ratios as prescribed by the RBI CIC Directions. Despite knowing this, the Audit Firm did not discuss the matter with TCWG.
- viii. No meeting of the Risk Management Committee was held in the past three years and the Audit Firm failed to ask any questions in this regard to TCWG.
- ix. The Audit Firm failed to conduct the audit in compliance with the standards of auditing and hence, failed to comply with Section 143 (9) of the Companies Act, 2013.

### C. Final Observations and Conclusions of AQRR

9.3. NFRA has examined in detail the replies to the DAQRR and oral submissions by the Audit Firm and concludes as follows:

- 9.3.1 The replies of the Audit Firm are mostly a reproduction and reiteration of the earlier replies to the PFC. Moreover, the WPs referred by the Audit Firm in its response dated 27<sup>th</sup> September 2021, are the same as in their response to the PFC.
- 9.3.2 As the Audit Firm failed to provide any new/additional evidence or information in support of their contentions, NFRA reiterates the earlier conclusion that the Audit Firm has not provided any evidence that they have performed adequate audit procedures to comply with the requirements of SA 260 (Revised) regarding communication with TCWG.
- 9.3.1 Vide its communication dated 27<sup>th</sup> September 2021, the Audit Firm states that *“It is pertinent to note that the Act also mandates Audit Committee to **review and monitor the auditor’s independence and performance, and effectiveness of audit process, i.e., audit committee is the authority which is mandated to perform the communication with the Auditors with respect to progress of the audit, any significant issues and observations identified by the auditor and monitoring the effectiveness of the audit process. Further, the above-mentioned scope of audit committee covers the function of examination of financials statements, appointment and monitoring the performance, interacting with the statutory auditors, and reviewing the effectiveness of the audit process. It should also be noted that the audit committee may seek comments from the auditor regarding the internal controls, scope and overall audit carried out and they shall submit to the Board the audit observations or any significant matter arising during the audit. As per our understanding, the audit committee have all the powers to deal with the auditors and finally decide on the matters relating to the financial statements. Hence, in our view, it carries out the function of overseeing the financial reporting process of the entity, the strategic direction of the entity and the obligations with relation to accountability of the entity”***. (Emphasis Added)

- 9.3.2** It is important to note that mere reviewing and evaluating the auditor’s independence and performance does not imply that the Audit Committee carries out the function of overseeing the financial reporting process of the entity, the strategic direction of the entity and the obligations with relation to accountability of the entity. As already explained in DAQRR as well, TCWG and Audit Committee share different sets of functions as per the Companies Act, 2013 and SAs. Therefore, the above-quoted opinion of the Audit Firm is without any support from the law or facts.
- 9.3.3** Further, the Audit Firm also states that *“It should be emphasized that it is the general practice and approach followed by the statutory auditors of listed companies to consider audit committee as TCWG. Any experienced auditor would be aware of this practice. Further by SRBC conduct, it was quite obvious that audit committee was considered as TCWG in the case of IL&FS”*. The statutory audit must be conducted based on relevant Law, SAs and other applicable rules and regulations. As such, this statement from the Audit Firm is unacceptable.
- 9.3.4** The Audit Firm states that *“SRBC had filed documents and papers and issued clarifications through several written communications in support of its claims and assertions. However, NFRA has refused to take cognizance of these claims and assertions stating that these are afterthoughts without justification. SRBC categorically denies this allegation and states that all claims and assertions made by SRBC, have a basis and support and are governed by the applicable statute and accounting and auditing principles and practices”*. NFRA clarifies that none of the WPs referred by the Audit Firm in its responses was a ‘communication’ to TCWG. The basis for all the observations of NFRA is explained in detail and is self-sufficient. The Audit Firm’s stand shows the absence of professionalism in applying the statutory provisions in letter and spirit. It is emphasised that none of the arguments made by the Audit Firm in this regard has any basis in the Companies Act, SAs or the Code of Ethics. As such, NFRA does not accept the said assertions of the Audit Firm.
- 9.3.5** SA 230 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. Only the records backed by pre-existing evidence from the Audit File can be accepted for the Audit Quality Review (AQR) by NFRA.
- 9.3.6** Para 2 of SA 230 clearly states that the nature and purpose of the audit documentation are 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 conclusions in the audit file is not sufficient as the auditor is required to document the basis of forming his opinion/conclusions as well.

- 9.3.7** The Audit Firm has stated that *“As per our understanding, NFRA has commented in para 9.2.5 of DAQRR that there is no audit evidence of communication with Mr. Arun Saha in our audit files. As communicated in our response to PFC, we had several meetings with Mr. Arun Saha and Mr. Hari Sankaran for discussing the audit related matters, however it is neither required nor practicable to retain such communications as a part of audit evidences. Our important conclusion and communication with Mr. Arun Saha were also communicated to the audit committee which can be evidenced from the audit committee presentation and minutes”*. The statement of the Audit Firm reinforces the observation **that there is no audit evidence of communication** with the said individual. Therefore, because of what is stated in [Para 9.3.7](#) and [9.3.8](#) above and as per the requirements of Para 23 of SA 260 (Revised), NFRA does not accept the said claim of the Audit Firm.
- 9.3.8** All the conclusions of NFRA are being made after a detailed examination of the responses and WPs submitted by the Audit Firm. Mere repetition of the contentions by the Audit Firm at each stage of the review has no merits as these are not backed by evidence or basis in law. NFRA therefore gives no merits to the statements of the Audit Firm such as *“NFRA’s view of not re-examining the workpapers and not taking the cognizance of explanations/references provided in our response to PFC in the light of that same has already been taken into account in forming PFC is untenable and bad in law. NFRA while exercising its inherent power to review, has the responsibility to conduct the said review in an unbiased manner. It is submitted that NFRA has failed to appreciate the facts and documents submitted by SRBC”*.
- 9.3.9** The Audit Firm has cited the extract from ‘Para (B) of ‘Announcements of the Council regarding the status of various documents issued by the Institute of Chartered Accountants of India (ICAI)’, which forms part of Handbook of Auditing Pronouncements issued by ICAI and has stated that *“From the reading of the above extract of the Audit handbook, it is clear that while the application and other explanatory material contained in a Standard on Auditing (SA) is an integral part of the SA, **such guidance is not intended to impose a requirement**. However, NFRA reviewer has deliberately not quoted the complete para from the Audit handbook with the intention to conclude the matter against the Audit firm”*. In this regard para 9.1.9 above may be referred to, where NFRA has given reasons why the Audit Firm violated para 12 of SA 260. Also, NFRA has made it clear in para 9.2.10 that Para A7 of SA 260 (Revised) is a further explanation to Para 12 of SA 260 (Revised) and is an integral part of the SA which the Audit Firm is required to comply with. Thus, NFRA has not observed anything more than what is provided in the ICAI pronouncement. The Audit Firm is under obligation to comply with the SAs. In this case, the Audit Firm failed in this obligation by violating para 12 of SA 260. The violation continued even after observing the absence of good governance practices as provided in the explanatory part, i.e, para A7 of SA 260 (Revised). Thus, the Audit Firm also failed to take cognizance of the guidance given by para A7 as well.

- 9.3.10** All the claims made by the Audit Firm regarding the presentation made in the Audit Committee meeting at the conclusion of the Audit are not accepted for the reasons explained earlier. It is emphasized that this presentation is not a timely communication made during the Audit, is not a two-way communication since there is no evidence in the minutes of any two-way discussions and is not a communication to the TCWG as envisaged by SA 260.
- 9.3.11** Further, the Audit Firm has also stated that *“Without any basis, NFRA has commented that the ACM presentations were not signed and stamped by the company secretary of IL&FS. We would like to point out that, the ACM presentation was presented to the audit committee and also stamped and signed by the then Company Secretary, Varsha Sawant”*. The Audit Firm has also attached the screenshot of the same. The stamp only mentions the name of the Company i.e. IL&FS Limited and does not show any indication to attribute it to the Company Secretary. Moreover, the signatures are the initials only without a name and there is no mention anywhere who has signed it and in what capacity. As such, there is no conclusive proof that the stamp and signature on the PPT, presented as evidence to NFRA, are of the Company Secretary.
- 9.3.12** The Audit Firm has stated that *“NFRA has mentioned in Para 9.8.2 of DAQRR that ‘WP “Engagement agreement (Page no. 7.17)” only contains the list of services provided by the Audit Firm to the IL&FS Limited along with fees charged for the respective services.’ We believe that NFRA has referred only to page A7.17 of the aforesaid workpaper, which is in essence a service scope letter listing the fees charged for the services and is an addendum to the original master agreement. The detailed scope of the services along with the responsibilities of the auditor and management have been provided in pages A7 to A7.16. We request NFRA to read the same again thoroughly”*.
- 9.3.13** Vide its response dated 14<sup>th</sup> April 2021, to the PFC of NFRA, the Audit Firm specifically referred to Page 7.17 only of the Engagement Agreement stating that *“SRBC submits that we had discussed the scope of audit during the initial stage and the said scope was documented in the engagement and service scope letter – Refer IL&FS-Standalone Hardcopy Files Folder - 8\_Engagement agreement (Page no. 7.17)”*. As such, NFRA examined the same page and formed its opinion. Nevertheless, NFRA re-examined the Engagement Agreement from Page A7 to A7.16 as now specified by the Audit Firm. On perusal of the said WP, NFRA notes that the said engagement agreement mentions the responsibilities of both the auditor and the management. It does not cover the planned **scope** and **timings** of the audit including the significant risks being identified by the auditor during the audit. Hence, NFRA reiterates its conclusion that the Audit Firm failed to comply with the provisions of Para 15 of SA 260 (Revised).
- 9.3.14** In view of reasons provided in [Para 9.3.7](#) and [9.3.8](#) above, NFRA does not accept the statement of the Audit Firm that *“In respect of communication with TCWG regarding the Board approved policy as mentioned in para 9.8.4 of DAQRR above, kindly refer*

our detailed explanation in our response to Para 3.4 of Chapter Investments of the DAQRR. From the said response it is clear that the policy was available and was reviewed by the auditors. The policy was not part of the audit file as it is neither necessary nor practicable to keep all the documents verified by the auditors in the audit file, as indicated in para A7 of SA 230 (Revised)”.

**9.3.15** Refer following Chapters of this AQRR for conclusions of NFRA pertaining to non-communication of the respective matter with TCWG:

S. No.	Chapter	Related Matter
1.	Independence	Business relations and audit and non-audit fees charged
2.	Investment	Correct valuation of investments
3.	Principal and Component Auditor	The discrepancy in the total number of components
4.	RBI Compliances	Discrepancies in the calculation of Capital and Leverage Ratios
5.	Revenue	Deficiency in internal control

**9.3.16** The Audit Firm has repeated its earlier response stating that *“The Audit committee, Board of directors and all the stakeholders of the company were aware of the fact that the risk management committee meetings were not being held as it was also published in the annual report for FY 2016-17. It is not the duty of the auditors to bring to the notice of Audit Committee or Board of Directors the matters they already know. **In the instant case, the board of directors and the audit committee were discharging all functions of the RMC.** Accordingly, they were aware fully that RMC was not functioning. An auditor cannot be charged for professional misconduct for not specifically informing the board of directors and the audit committee of its own decision. Since TCWG was aware of the same, SRBC concluded that the communication of the same to TCWG again was not required”*. (Emphasis Added) The extract emphasised above is not supported by any evidence and hence not accepted. When Annual Report specifically mentions separate responsibilities of the audit committee and the RMC, it was the duty of the Management to disclose specifically in the financial statements that the functions of the RMC were carried out by Audit Committee and BOD. As per SA 720, the Audit Firm was responsible to bring out the said non-disclosure to the notice of the TCWG which the Audit Firm failed to do. Moreover, without even ascertaining who all are identified as TCWG, there are no merits in the arguments of the Audit Firm that TCWG is aware of something. It may be noted that the general purpose financial statements are prepared in accordance with a financial reporting framework, which is designed to meet the common financial information needs of a wide range of users, including lenders, investors and public interest stakeholders. 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. By not following the communication requirements with TCWG, the Audit Firm has ignored this basic objectives of SA 260 (Revised) as laid down in para 9(c) of this SA. Also, though the audit firm contends that the function of risk committee was undertaken by the audit committee/Board of Directors, there is no such evidence in the minutes of the Audit Committee. All the observations in the DAQRR in this regard stand reiterated.

- 9.3.1** Also, in the Annual Report of the Company for FY18, it is nowhere mentioned that the responsibilities of RMC were taken by the Audit Committee and Board of Directors. In fact, the responsibilities of both the Committees are mentioned separately in the Annual Report. It is also important to note that if the responsibilities of RMC were taken by BOD and Audit Committee, then there was no need for the Company to form RMC and include its details separately in its Annual Report. An annual Report is a document that is available to its stakeholders and the public in general and the information included in it is what people believe to be true. So, even if the responsibilities of the RMC were taken by the Audit Committee and BOD, the Company should have mentioned this clearly in its Annual Report. However, the Audit Firm did not notice this and failed to discharge its functions and responsibilities related to “other information” as mandated by SA 720.
- 9.4. Thus, it is clear that the Audit Firm failed to identify and communicate with the TCWG properly. The purported communications with the audit committee do not meet the requirements of SA 260 (Revised), because the Audit Committee is not synonymous with TCWG and is at best a sub-group of TCWG. and. The claimed communications (such as the presentation made to the Audit Committee on the previous day of signing the audit report) does not meet the requirements of ‘timely’ and ‘two way’ communication mandated by SA 260 (Revised). According to paragraph 12 of SDA 260 (revised) if the auditor of communicates with a sub group of TCWG, the auditor shall determine whether the auditor also needs to communicate with the governing body (Para 12 of SA 260 (Revised)). The auditor clearly failed in this requirement as there is no evidence in the Audit File of this having been done.
- 9.5. Lapses in communication with TCWG is viewed seriously internationally as well. The UK audit regulator FRC, for example, in its disciplinary order in the case of (1) KPMG Audit PLC (2) Michael Francis Barradell has noted that “During their audit of Ted Baker’s accounts for FY13 they failed to ensure that those charged with governance of Ted Baker were informed of all significant facts and matters that impacted upon KPMG’s objectivity and independence as auditor, whether on a timely basis or at all.”
- 9.6. Given all the reasons and explanations in the above paras, NFRA concludes that the Audit Firm failed to comply with the provisions of SA 260 (Revised). The Audit Firm failed to achieve the objective of SA 260 (Revised) and hence failed to achieve the overall objectives of the audit. After examining in detail all the responses of the Audit Firm to the DAQRR, NFRA concludes as follows:

- i.** The Audit Firm failed to achieve the basic objective of communication with TCWG as per the requirements of Para 9 of SA 260 (Revised).
- ii.** The Audit Firm failed to identify TCWG properly. In reference to Para 12 and A7 of SA 260 (Revised), Audit Committee cannot be considered synonymous with TCWG.
- iii.** The Audit Firm did not communicate with TCWG an overview of the planned scope and timing of the audit as per the requirements of Para 15 of SA 260 (Revised).
- iv.** The Audit Firm did not communicate the Firm's and Engagement Team's independence, business relationships with IL&FS Limited and details regarding total fees charged for audit and non-audit services with TCWG as per the requirements of Para 17 of SA 260 (Revised).
- v.** The Audit Firm did not communicate to TCWG the significant deficiencies identified during the audit.
- vi.** Despite the lapses in the internal control of the revenue recognition process, the Audit Firm did not communicate and discuss the matter with TCWG.
- vii.** The Audit Firm noted in the WPs that the Company did not comply with the capital and leverage ratios prescribed by the RBI CIC Directions. The Audit Firm did not discuss the matter with TCWG.
- viii.** No meeting of the Risk Management Committee was held in the past three years and the Audit Firm did not ask any questions in this regard to TCWG.

## 10. Risk of Material Misstatement (ROMM)

### A. Prima Facie Observations and Conclusions

10.1 In its Prima Facie Conclusions, NFRA conveyed the following:

10.1.1 As per the requirements of Para 10 of SA 315, EP and ET 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. On perusal of WP, '*SFS Hard Copy File-File 1 (Part 1 of 2) – Flap AA9 - Team planning event (TPE) (Page no. 9.4)*' NFRA observes that, Audit Firm has noted in 'Background' section of the WP as "*We conducted team planning event on 28 Sep 2017. The team held another meeting 16 Jan 2018 for an update on team planning and post interim event.*" However, in the 'Team planning event form' the team event date is mentioned as 16<sup>th</sup> January, 2018 and the participants of the meeting have signed the document on 29<sup>th</sup> September, 2017. This clearly demonstrates the contradiction within the WP and this casts a serious doubt on the reliability of the WP.

10.1.2 The Audit Firm has in WP, '*SFS Hard Copy File-File 1 (Part 1 of 2) – Flap AA9 - Team planning event (TPE) (Page no. 9.4)*' stated that they had done the following work to find any significant changes in the nature of the entity or its environment, the entity's business, markets, other key environmental factors, and key stakeholders which have an effect on their review:

- (a) Read the annual report of FY 17 including standalone and consolidated financial statements.
- (b) Read minutes of the meetings of the board to identify any of the significant changes made and
- (c) Discussed and inquired with Group CFO – Maharudra Wagle – for any significant changes and he has responded none.

The Audit Firm has simply noted above without documenting any observations or conclusions after performing the above-mentioned audit procedures. Hence, one cannot conclude from the referred WP, what understanding of the entity was obtained by the ET, for identifying and assessing the 'Risk of material misstatements'.

10.1.3 Para 13(n) of SA 200 defines Risk of material misstatement (ROMM) as the risk that financial statements are materially misstated prior to audit. Para A14 of SA 315 states that analytical procedures may help auditor identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatements due to fraud. Further, Para 6 of SA 315 states that risk assessment procedures (RAP) **shall** include '*analytical procedures*'. On combined reading of the above requirements, one can clearly

conclude that Risk Assessment Procedures have to be done prior to the audit to identify and assess ROMM. Hence, the Audit Firm should have done and documented the analytical procedures done by it on the financials of 2016-17. The Audit Firm has in WP, 'SFS Hard Copy File-File 1 (Part 1 of 2) – Flap AA9 - Team planning event (TPE) (Page no. 9.4)' stated that "We have performed an overall analytical review in our limited review of Sep2017 accounts and not noted any adverse observations (S17 IL&FS OAR)". However, on perusal of the Audit File, NFRA could not trace the referred WP and hence, it can be concluded that Audit Firm has failed to meet the requirements of Para 6 of SA 315.

**10.1.4** The Audit Firm in WP, 'SFS Hard Copy File-File 1 (Part 1 of 2) – Flap AA9 - Team planning event (TPE) (Page no. 9.4)' has noted as "*while performing control testing procedures, it has been observed that no Risk Management Committee (RMC) meeting is conducted during the year ended March, 2018. These responsibilities of RMC have been undertaken by Board of Directors and some of the responsibilities are also undertaken by audit committee, as the agenda of the meetings includes them.... Based on the above- mentioned factors, the entity level controls related to risk management committee is considered as operating effectively.*" It is to be noted that Regulation 21(4) of the SEBI (LODR) Regulations, 2015 states that the board of directors shall define the role and responsibility of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit. IL&FS is a debt listed entity and SEBI (LODR) Regulations, 2015 are very much applicable to the company. Hence, by these norms IL&FS must constitute a Risk Management Committee and it should monitor and review the risk management plan. These powers cannot be delegated to board of directors or management of the company. By failing to conduct the meetings of the Risk Management Committee, the company has violated Regulation 21 of SEBI (LODR) Regulations, 2015. The Audit Firm should have questioned the Management and obtained written communications from them regarding the same. This fact noted in the WP is contrary to the Audit Firm's response to NFRA query 4.1 wherein the Audit Firm has stated that RMC oversees the annual review and update the Risk Assessment and related Risk registers, Management had reviewed at frequent intervals the Performance Analysis Plan and also that the entity had a process in place for periodic review and update on entity wide strategic plans and objectives. The assertions made by the Audit Firm are hence without any basis.

**10.1.5** The Audit Firm has noted the responsibilities of the Risk Management Committee as follows. However, the source of such information is not documented:

- (a) *Approval of overall limits for management of credit risk, liquidity risk and market risks*
- (b) *Review of asset liability management reports and provision of directions on improved management of liquidity and interest rate risks.*
- (c) *Review of capital adequacy requirements of the company and provision of recommendations for the consideration of the Board in relation to the parameters to be considered in this regard*

- (d) *Review of company's compliance programme; and*
- (e) *Review of status of any enquiry, investigation and other disciplinary action initiated by RBI, SEBI or other regulatory agencies*

**10.1.6** Having noted the responsibilities of the RMC and also noting the fact that no RMC meeting had taken place during the year ended March, 2018, the Audit Firm should have actually evaluated the design of controls. Para A72 of SA 315 states that evaluating the design of control involves considering whether the control individually or in combination with other controls, is capable of effectively preventing, or detecting and correcting, material misstatements. Implementation of control means that the control exists and that the entity is using it. There is little point in assessing the implementation of control that is not effective, and so the design of a control is considered first. An improperly designed control may represent a significant deficiency in internal control. The Audit Firm has not documented how the responsibilities of RMC are being fulfilled by the other committees and what were their conclusions after performing RAPs, if any. Further it is to be noted that Para 12 of SA 315 requires the auditor to obtain understanding of the internal controls relevant to the audit.

In WP '*SFS Canvas- M18\_103gl(r)\_Entity Level Controls (For relevant extract, refer Attachment 17, Page no. A312 to A325)*' one of the controls tested for evaluating design and implementation of Entity Level controls (ELCs) is whether *self-assessment* is done within all departments with regard to controls mentioned in the policies and procedures on regular frequency. To this inquiry the Audit Firm has noted "*as understood from client, every department of the organisation sends an exception report to CRMG which is then consolidated and presented to audit committee and board of directors.*" This clearly explains that there is no monitoring of controls. Hence, the Audit Firm's conclusions, "*Based on the above-mentioned factors, the entity level controls related to risk management committee is considered as operating effectively*" is without any basis and hence it has failed to meet the requirements of Para 12 of SA 315.

**10.1.7** It is to be noted that Section 45 IA of RBI Act, 1934 stipulates certain terms and conditions which CIC-ND-SI has to comply for Certificate of Registration. One of such Terms and Conditions is that at no point of time shall leverage ratio be more than 2.5 and Capital ratio be less than 30%. In the case of IL&FS, the company has violated this requirement and the Audit Firm has concluded that "*this is a matter of interpretation and there was only a minor breach (not material) and hence there is no risk to going concern.*" However, the Audit Firm has failed to understand the prescriptive nature of RBI Act and that the violation of the Act could have serious impact on the continuation of the Company as a going concern and hence the conclusion drawn by the Audit Firm is without any basis. For the detailed observations on GCP, please refer to Principal and component auditors Para of this PFC (now AQRR).

**10.1.8** On perusal of WP, '*M18 ALM loans.xlsx*', the Audit Firm noted as follows: "*As per*

*the terms of the loan Agreements, IL&FS has a right to exercise the call option by giving 30 days notice to IECCL. These facilities that have been availed by IECCL, are in the nature of long term finance and hence the Company intends to classify these facilities as long term loans in their financial statements for the period ending March 2018. In context of the same, the auditors of IECCL have requested IECCL to obtain a letter from IL&FS (in their capacity as Lenders), stating that they would not exercise their right of the call option in the next 12 months commencing from April 1, 2018.”* Further, in WP, ‘*IECCL Loans ALM COD.Pdf*’, which is embedded in WP, ‘*M18 ALM loans.xlsx*’ the company has granted the approval sought by IECCL. This clearly indicates that though the company had a call option on loans and advances of ₹3,485 crore, it has subsequently agreed not to exercise its call. Hence, the Audit Firm’s conclusion that there is no net liability position or net current liability position is contrary to its own referred WPs. While the low level of RBI stipulated ratios and other indicators clearly demonstrated the existence of risk on company’s ability to continue as a going concern, the Audit Firm has merely gone ahead with the management’s explanations without critically examining the same and without obtaining sufficient appropriate audit evidence to this effect and mitigate the existing risks. The Company’s decision to not exercise the call option was one such decision that was never questioned by the auditor despite the precarious financial position of the Company.

**10.1.9** The company has in Annexure 1 to the Annual Report for the FY 2017-18, disclosed the ‘Maturity pattern of certain items of assets and liabilities’ as of 31st March, 2018. The company has under 1 day to 30/31 days bucket, disclosed borrowings from banks as ₹40 crore, Market borrowings as ₹822.25 crore (Total cash outflows were ₹862.25 crore), loans and advances as ₹2,625.86 crore and investments as ₹1,574 cr. (Total cash inflows were ₹4,199.86 crore). This indicates there is expected net cash inflow of ₹3,337.61 cr. The Independent Auditor’s Report for Standalone Financial Statements of the company was dated 30th May, 2018, and hence, 1-30/31 days information presented in the ‘Maturity Pattern of certain items of assets and liabilities’ as of 31st March, 2018, is no longer a projection. It was a matter of actuals. Least that the Audit Firm should have done is to verify that the information provided by the entity is appropriate. There is no WP in the Audit File which explains the Audit Firm’s verification of these details disclosed in the Annual Report. Further, the company in note 1 to ‘Maturity Pattern of certain assets and liabilities’ has stated that certain long-term loans extended by the company have an option wherein the company has right to call the loans on specific dates. The company has disclosed factually incorrect information and the Audit Firm has failed to exercise due care and professional scepticism in the conduct of their duties and failed to question the Management about presenting the factually incorrect information.

**10.1.10** The Audit Firm has in WP, ‘*SFS Hard Copy File-File 1 (Part 1 of 2) – Flap AA9 - Team planning event (TPE) (Page no. 9.4)*’ stated that their audit procedures for related party transactions verification include:

- (a) Obtain the list of the related party along with the nature of the transaction
- (b) Obtain and test arm's length justification for related party
- (c) Obtain direct/indirect confirmation for related party balance/transaction

On perusal of WP, '428.1 M18 Related party transaction – arm's length, the Audit Firm has noted that for interest cost and interest income, *“total borrowings of the company includes both to related parties and other parties. The company's average borrowing rate ranges from 9% to 11% for all the parties. Being a CIC, the company is also engaged in lending to group companies and average lending rate is 13% to 16%. Other CIC companies also have an average borrowing rate of 9.75% to 10.5%. The same is in line with the market practice also and hence arms length is justified.”* Except this note there is nothing in the WP which provides the Audit Firm's basis for arriving at the above stated conclusion. Hence, the Audit Firm's contention that arm's length is justified, is without any basis. It is also important to note that the Related Party Transactions Policy of the company documented in WP, 'RPT Policy & Framework BM 10032015' categorizes RPTs into 'Exempt RPT' and 'Non-Exempt RPT'. The policy defines exempt RPTs as RPTs of a company in the OCB and on AL basis. There could be deviations in exempt RPT with Group companies under certain circumstances, as provided in the policy. The policy also defines non-exempt RPTs as RPTs which are not in the OCB and/or not on AL basis. Under 'RPTs Framework Process', it is mentioned that for exempt RPTs, *“As a part of internal control and governance framework, all exempt RPTs will be approved by CoD”* and all non-exempt RPTs falling outside the framework and not in OCB and/or not on an AL basis shall be liable for compliance requirements as prescribed under the Act. Section 177 (4) (iv) of the Companies Act, 2013, states that audit committee shall provide approval or any subsequent modification of transactions of the company with related parties. The Act does not differentiate between exempt and non-exempt RPTs. Hence, the RPT policy of the company is in violation of the Act and the Audit Firm has failed to bring this violation to the notice of TCWG and Audit Committee and has merely relied on the company's RPT policy.

## **B. Observations made in the DAQRR**

**10.2** NFRA has examined in detail the replies submitted by the Audit Firm on above observations and concluded in the DAQRR as follows:

**10.2.1** The Audit Firm has stated that *“there was no contradiction relating to dates of the meeting in the workpaper as the workpaper mentions the fact that both the meetings were held. We understand that NFRA has reached the observation mentioned in para 2.1 merely on the ground that the hardcopy document available in the audit working file shows that physical sign off has been done on only for the meeting held on September 28, 2017. The signoff of audit team for the updated meeting held on January 16, 2018 is not available in the hard copy of the minutes, do not in any way*

*shows that said second meeting was not held. We would like to draw attention of NFRA that the said minutes is also available in Canvas and have been signed off subsequent to the meeting by both the preparer and reviewer including engagement partner and EQR.”* NFRA notes that the Audit Firm has not provided reference to any workpapers in the Audit File to substantiate their response and hence these arguments are without any basis and shall be treated as an afterthought. Therefore, NFRA’s conclusion in Para 2.1 (same is reproduced in [para 10.1.1 above](#)) of the PFC is reiterated. The Audit Firm has clearly accepted that physical sign off for the second meeting is not available and which supports the conclusion of the PFC in this regard. A mere statement that it is available in Canvas is not acceptable without any corroborative evidence of the meeting having taken place, discussions undertaken, and conclusions or decisions made is made available. Therefore, in the absence of any substantiating evidence from the Audit Firm, the conclusion reached in the PFC is reiterated.

- 10.2.2** The Audit Firm has stated that *“NFRA’s observations is in context of our documentation with regards to conclusion on procedures performed for identifying significant changes in the nature of the entity or its environment and its effect on our audit. In addition to the procedures performed and referred by NFRA, we had documented our conclusion in respect of the changes in the same workpaper, i.e., in the workpaper IL&FS-Standalone Hardcopy Files Folder - 12\_ASM. The extract of our conclusion is “Based on the procedures set out below, we did not find any significant changes in the nature of the entity or its environment, the entity’s business, markets, other key environmental factors, and key stakeholders which have an effect on our review....” NFRA’s comment that, the Audit Firm has simply noted above without documenting any observations or conclusions after performing the above-mentioned audit procedures, is completely unfounded and baseless as the workpaper clearly demonstrates our conclusion with regards to significant changes in the nature of the entity or its environment, the entity’s business, markets, other key environmental factors, and key stakeholders which have an effect on our audit.”*

NFRA notes that the Audit Firm has quoted the very same WP, which NFRA has gone through while providing its detailed PFC. Nevertheless, NFRA has re-examined the referred WP and concludes that the Audit Firm has in their response reproduced the conclusions that they had documented in the WP, without actually addressing the NFRA’s PFC observations. NFRA has in its PFC, very clearly stated that the Audit Firm has simply noted their conclusions without documenting audit procedures performed, if any. From the referred WP, one cannot draw any conclusions as to what understanding of the entity and its environment was obtained by ET, for identifying and assessing the ‘Risk of Material Misstatements’. This clearly indicates that the WP is not self-explanatory as to the Audit Firm’s identification and assessment of Risk of Material Misstatement. Therefore, NFRA’s conclusions in Para 2.2 (same is reproduced in [para 10.1.2 above](#)) of its PFC stands proved.

**10.2.3** The Audit Firm has quoted Para 6 and Para A13 to Para A15 of SA 315 and has further stated that “*we understand that analytical procedures will be useful for the purpose of performing risk assessment procedures for identifying the risk of material misstatements. analytical procedures can be carried out in a different way and choice of procedures involves professional judgement. NFRA has commented that Audit Firm should have done and documented the analytical procedures carried out on the Financial Statements of 2016-17. We would like to point out here that SA 315 does not prescribe manner in which analytical procedures are required to be carried out and the use of previous year’s financial statements in the analysis. SRBC had carried out analytical procedures based on September 30, 2017 financials as the same was latest financial information available at the time of planning of audit and which was relevant for the purpose of audit for FY 17-18. In our professional judgement it was proper to use latest financial information available at the time of planning of audit for the purpose of performing analytical procedures. We had performed an overall analytical review on the September 2017 Financials and had not noted any unusual trend or any additional risk to be considered while performing audit procedures. Our overall analytical procedures have been documented in our workpapers IL&FS-Standalone Canvas Files Folder - 58.1 to 58.23 S17 IL&FS OAR.*”

NFRA perused the referred WP and noted that the Audit Firm has documented the variances and the reasons for such variances. Para 5 of SA 315 states that the auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of the risk of material misstatement at the financial statement level and assertion levels. However, the analytical procedures documented by the Audit Firm do not lead one to any conclusions as to what risks are being identified by the Audit Firm and hence the referred WP does not meet the requirements of Para 5 of SA 315.

**10.2.4** The Audit Firm has stated that “*Para 15 of Chapter IV of SEBI (LODR) Regulations, 2015 (“LODR”) specifies that Para 21 of LODR shall apply to a listed entity which has listed its specified securities on any recognised stock exchange(s) either on the main board or on SME Exchange or on institutional trading platform. Specified Securities is defined under Para 2(zl) of LODR and includes only ‘equity shares’ and ‘convertible securities’. The definition of specified securities given in Para 2(zl) is reproduced below, ‘specified securities’ means ‘equity shares’ and ‘convertible securities’ as defined under clause (zj) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009; As IL&FS was a debt listed entity on the stock exchange and does not have any specified equity securities listed on stock exchanges, the provisions of Para 21 of the LODR was not applicable to IL&FS. Though the requirements of Risk Management Committee, as specified in Para 21 of LODR is not applicable to the Company, it was voluntarily decided by the management of the Company to form Risk Management Committee. As Para 21 of SEBI (LODR) Regulations, 2015 is not applicable to IL&FS, the question NFRA’s prima facie observation on violation of Regulation 21 of SEBI (LODR) Regulations,*

*2015 doesn't arise. Notwithstanding above, the provisions of Para 21 of the regulation is applicable to top 100 listed entities, determined on the basis of market capitalization, as at the end of the immediate previous financial year, and hence the same was not applicable to IL&FS."*

NFRA has perused Para 15 and Para 21 of SEBI (LODR) Regulations, 2015 and in view of the submissions made, the observations of NFRA made in its PFC in Para 2.5 (same is reproduced in [Para 10.1.4 above](#)) stand withdrawn to the extent of applicability of these Regulations. However, since in the case of IL&FS, the company had voluntarily constituted Risk Management Committee (RMC), all the functions of Risk Management, as disclosed on Page 41 of the Annual Report for FY 2016-17, should have been exercised by the RMC instead of various other committees of the Board. The fact that no RMC meeting was held during the FY 2017-18 clearly indicates a lack of supervisory and monitoring controls as established by the company and should be a red flag for any auditor. Hence, NFRA observations on these matters in the PFC, i.e. *"The Audit Firm should have questioned the Management and obtained written communications from them regarding the same. The fact that the Audit Firm has noted in the WP that no RMC meeting was held in the FY 2017-18 is contrary to the Audit Firm's response to NFRA query 4.1 wherein the Audit Firm has stated that RMC oversees the annual review and update the Risk Assessment and related Risk registers. Management had reviewed at frequent intervals the Performance Analysis Plan and also that the entity had a process in place for periodic review and update on entity wide strategic plans and objectives. The assertions made by the Audit Firm are hence without any basis"* stands proved.

**10.2.5** The Audit Firm has stated that *"NFRA's prima facie observations in the Para 2.6 of PFC is factually incorrect and unfounded as the workpaper (IL&FS-Standalone Hardcopy Files Folder - 10\_Team planning event – Page 9.16.1), clearly states the source of the information given in the workpaper. The responsibilities of the Risk Management Committee are given in the Annual Report of the Company. We had referred Annual Report of IL&FS for the 2016 – 17, (Refer IL&FS-Standalone Canvas Files Folder - 54.1 to 54.279 ILFS Annual Report 2016-17 – Page 41) for the purpose of documenting the responsibilities of the Risk Management Committee"*. In view of the submissions made, NFRA drops its observations in Para 2.6 (reproduced in [Para 10.1.5 above](#)) of the PFC.

**10.2.6** The Audit Firm has stated that *"While performing control testing procedures, we had noted that though no Risk Management Committee (RMC) meeting was held during the year ended March 31, 2018, the said control was exercised by other Board level committees. Accordingly, the function of risk committee was undertaken by the audit committee / Board of Directors. Further, we had performed adequate audit procedures to verify that the risk controls were adequately dealt by the Company and had also documented the same in our workpaper IL&FS-Standalone Hardcopy Files Folder - 10\_Team planning event - Page no. 9.16.1 In our view, what is important is*

*to verify that the risk is adequately addressed by the Management. Based on the risk assessment procedures performed by us, we had concluded that the risk management was operating effectively and had documented the same in the above referred workpaper stating, “the entity level control related to risk management committee is considered as operating effectively”*”.

NFRA notes that the referred WPs were the same as referred by NFRA in PFC. The WP contains only the conclusions of the Audit Firm and does not contain any details of the risk assessment procedures, based on which those conclusions were drawn. Hence, NFRA’s observations in Para 2.7 (reproduced in [Para 10.1.6 above](#)) of the PFC stands.

- 10.2.7** The Audit Firm has stated that it is important to understand that RBI does not cancel the registration merely on the ground that there was breach on the compliance of the ratios specified under the Directions. “The intensity and volume of the breach is also considered. Further, it is a general practice of RBI to provide opportunity to the concerned Company to rectify such breach within a reasonable time. We had also considered that management had a plan to address the matter by way of increase in Share capital in near future and therefore it was considered as a temporary situation. In our view, therefore, uncertainty relating to Going concern assumptions is not triggered at that point of time. Refer IL&FS- Consolidation Hardcopy Files Folder - C 23\_ACM PPT.”

NFRA notes that RBI’s Master Direction – CIC-ND-SI, for the capital requirements (Adjusted Net Worth to aggregate risk weighted assets) and leverage ratio requirements, uses the words “*shall at no point of time*” and do not provide any relaxation in the said ratios. Further, the Audit Firm has no authority to decide on the breach being a minor or major without such provision of categorising the breaches being available in the said directions of RBI. Hence, the assertions of the Audit Firm are not acceptable and are mere afterthoughts. Further for our detailed observations on this matter please refer to [Para 7.4.3](#) and [Para 7.4.14](#) of the ‘RBI Compliances’ Para of this DAQRR.

- 10.2.8** The Audit Firm has quoted Para 6 and 7 of SA 570 and stated that “*based on the analysis of Balance sheet, there was a net current liability position as at March 31, 2018 of Rs. 2,296 crores, i.e., Current Liability Rs. 6,416 crores Less Current Asset Rs. 4,120 crores. However, the Company had a Call option on the Loans and advances given of Rs. 3,486 crores. It is important to note that the above call options of Rs. 3486 crores does not include call options on Loans and advances given to IL&FS Engineering and Construction Company Limited (IECCL) to the extent of Rs. 420.40 crores. We would like to highlight here certain facts relating to the said call options on Loans and advances given to IECCL:*

- (a) *as per the terms of the loan Agreements, IL&FS had right to exercise the*

*call option by giving 30 days' notice to IECCL.*

- (b) IECCL had obtained a letter from IL&FS (in their capacity as Lenders), stating that they would not exercise their right of the call option in the next 12 months commencing from April 1, 2018.*
- (c) These facilities that had been availed by IECCL, were in the nature of long term finance and hence the Company classified these facilities as non-current assets in their financial statements for the period ended March 31, 2018.*

*Accordingly, on the Loans and Advances given to IECCL of Rs. 420.40 crores, no call options were available till 12 months and hence the same was not included as a part of Rs. 3,486 crores of Call option mentioned above. The comment of NFRA that the company had considered a call option on loans and advances of IECCL, to which Company had agreed not to exercise its call, is incorrect. For only Loans and advances to the extent of Rs. 420.40 crores given to IECCL, the Company had agreed not to exercise the call option and the same was accordingly not considered in working of the Loans and advances for which the Company had call options. The amount of Rs. 3486 crores were the balance Loans and Advances on which the call options were available on the balance sheet date and which could have been exercised if the Company would have been in need of fund in next one year. An amount of Rs. 3486 crores were grouped under current asset (Rs. 472.30 crores) and non-current asset (Rs. 3013.50 crores) in the Balance Sheet as of March 31, 2018 considering scheduled maturity. The amount of Rs. 3013.50 crores grouped under non-current assets was considered as fund available for working out net asset / liability position and therefore there was an estimated surplus fund position of next 1 year from the Balance Sheet date i.e., March 31, 2018. This was considered in our assessment of Going Concern.”*

NFRA notes that the Audit Firm has not referred to any WPs to support their contentions and therefore these assertions of the Audit Firm are without any basis and would be construed as an afterthought. Nevertheless, NFRA has perused ‘M18 ALM Loans.xlsx’ and notes that IL&FS has extended long term loan facilities of Rs. 1,348.50 crores to IECCL. The auditors of IECCL had requested IECCL to obtain a letter from IL&FS (lenders), stating that they would not exercise the call option in next 12 months commencing from April 2018 and IL&FS had granted its approval to not exercise its right of call. However, the approval copy which is embedded in the above referred WP does not in any way specify the quantum of the loan against which the company would not exercise its right of call. Hence the Audit Firm’s contentions that “*For only Loans and advances to the extent of Rs. 420.40 crores given to IECCL, the Company had agreed not to exercise the call option and the same was accordingly not considered in working of the Loans and advances for which the Company had call options*” is factually incorrect. Further as explained in [Para 4.6.4 of ‘Loans and Advances’](#) forming part of this DAQRR, the Audit Firm gave no consideration to the

financial standing of the borrower as well as the lender. Rather, even when audit evidence indicated that the loans granted were prejudicial to the company's interest, the Audit Firm did not exercise professional skepticism. The Audit Firm mechanically collected the details of Right to Call and verified whether it is sufficient to meet the negative net current liability position, without critically examining the risk posed by the negative current liability position to the Going Concern status of ILFS and obtaining sufficient appropriate audit evidence to mitigate the risk. Hence, the observations made by NFRA in Para 2.11 (reproduced in [Para 10.1.8](#) above) of its PFC stand.

**10.2.9** The Audit Firm has stated that *“it is pertinent to note that the disclosures made under maturity pattern is based on the contractual maturity. The disclosure as required by the regulation is to be made as on the reporting date and accordingly the assessment is to be made as on that date. The Company had disclosed information in the note based on the contractual maturity of the asset / liability and availability of call options, if any and accordingly classified the same in the respective buckets. We understand that this is a practice generally followed for such disclosure. We would also like to point out that the management had given explanatory note wherever required, for the amount considered in various periods bucket. Further, auditors are not expected to verify subsequent movement of the funds as the disclosure is based on contractual terms of assets and liabilities. Our said response clearly demonstrates that the information given by the Company in Annexure 1 of the Financial Statements regarding maturity pattern of certain items of assets and liabilities as at March 31, 2018 was not factually incorrect.”* and *“Based on the above explanations, it is clear that Company had made the disclosures under Maturity pattern of assets and liabilities as per the contractual maturity of the balances. This was only a disclosure requirement and was based on the requirements under CIC Master Directions, hence verification of actual receipts was not required for this purpose.”*

NFRA notes that Para 19(5) of Master Directions CIC-NDSI states that CIC NDSI with total assets of Rs. 500 crores and above shall disclose: (i) Exposure to Real Estate Sector both direct and indirect and (ii) Maturity Pattern of Assets and Liabilities. In these Directions, RBI has nowhere mentioned that the contractual maturity of assets and liabilities has to be disclosed. On a plain reading of the Directions, it can be clearly stated that disclosures cannot be purely on contractual maturity. It has to be an estimate of likely cash flows. The purpose of such disclosure is to ascertain whether the company is likely to face a liquidity crunch and hence the disclosure has to be based on the best estimated of likely cash flows. Even if the disclosure is based on the contractual maturity of assets and liabilities, the Audit Firm has not referred to any WPs to support their contentions. Hence, the assertions of the Audit Firm shall be considered an afterthought. Hence, all the observations made by NFRA in Para 2.12 (same is reproduced in [Para 10.1.9](#) above) of its PFC stands proved.

**10.2.10** The Audit Firm has stated that they had performed the following procedures to verify whether the RPT were at arm's length:

- (a) We verified that all the transaction entered with related parties were authorised as per delegation of authority and verified that the same were approved by the Audit Committee. Refer IL&FS-Standalone Canvas Files Folder - 460.1 to 460.46 Minutes - ACM 23Aug17, IL&FS-Standalone Canvas Files Folder - 461.1 to 461.30 Minutes - ACM 8Nov17, IL&FS- Standalone Canvas Files Folder - 462.1 to 462.24 Minutes - ACM 21Feb18 and IL&FS Consolidation Canvas Files Folder - C 517.1 to C 517.92 Minutes - BM 29Aug18 (which includes minutes of ACM dated 29 May 18).
- (b) We understood that it was part of the scope of Internal Auditor to verify the compliance with approved framework and compliance with the provisions of Companies Act 2013, in respect of related party transactions. We had also read Internal Auditor's reports wherein they had reported that all transactions entered with the related parties were at arm's length price and in normal course of business. Refer IL&FS Standalone Canvas Files Folder - 36.1 to 36.27 M18 Internal Audit Framework, IL&FS-Standalone Canvas Files Folder - 460.1 to 460.46 Minutes - ACM 23Aug17, IL&FS-Standalone Canvas Files Folder. 461.1 to 461.30 Minutes - ACM 8Nov17, IL&FS-Standalone Canvas Files Folder - 462.1 to 462.24 Minutes - ACM 21Feb18 and IL&FS Consolidation Canvas Files Folder - C 517.1 to C 517.92 Minutes - BM 29Aug18 (which includes minutes of ACM dated 29 May 18)
- (c) We had planned and verified the arm's length justification for the material related party transactions entered during the year, to ascertain that the transactions entered with the related parties were at arm's length price. Refer IL&FS-Standalone Hardcopy Files Folder - 47\_Memo on Arm's Length.
- (d) We had verified the disclosure in the Financial Statements of related party transactions in terms of AS 18 – Related Party Disclosures. Refer IL&FS-Standalone Canvas Files Folder - - 425.1 to 425.11 M18 Related Party Disclosure.

*“The differentiation between exempt and non-exempt transaction had been done by the Company for the purpose of simplification and as a measure of policy document which will act as a guidance to be followed for complying with the provisions of the Act. The bifurcation done by the Company was for defining the procedures that needs to be followed in each of the situations. It was just a way to structure the policy and we request NFRA to look at the substance of the Policy and whether it is in line with the requirement of the Act.”*

The assertions made by the Audit Firm are invalid because of the below-mentioned reasons:

- 1) As explained in the section on ‘Loans and Advances’ the company was not just in violation of Section 177 of the Companies Act, 2013 but also was in violation of its own RPT Policy, since Audit Committee was merely ratifying the RPTs that were up to 8 months old. Hence, the assertions of the Audit Firm that *“We verified that all the transaction entered with related parties were authorised as per delegation of authority and verified that the same were approved by the Audit Committee”* are not tenable.
- 2) The Audit Firm has referred to certain WPs in Para 10.2.10 (b) which were the same WPs examined by NFRA while forming its observations in the PFC. Nevertheless, NFRA has re-examined the referred WPs and concludes that the Audit Firm has merely obtained the Internal Audit Reports from the Management without documenting the audit procedures performed and their observations, if any, after reading the Internal Audit Reports. Hence the contentions of the Audit Firm made in Para 10.2.1 are not tenable.
- 3) As explained in the section on ‘Loans and Advances’ the RPT Policy of the company was not in compliance with the requirements of the Companies Act, 2013. Further, the company was found to be in violation of Section 177(4)(iv) of the Act. Hence, the contentions of the Audit Firm in Para 10.2.10 are not tenable.

**10.2.11** Therefore, NFRA concludes that the Audit Firm has failed to:

- (a) Identify and assess the risks of material misstatement through understanding the entity and its environment, including the entity’s internal control.
- (b) Exercise professional skepticism, professional competence and due care.
- (c) Document significant matters arising during the audit, the conclusions reached thereon, and significant professional judgements made in reaching those conclusions.

### **C. Final Observations and Conclusions of the AQRR**

10.3 NFRA has examined in detail the replies to the DAQRR and the oral submissions by the Audit Firm, and concludes as follows:

**10.3.1** Regarding the observations in para 10.2.1 above the Audit Firm states that *“SRBC resubmits that in compliance with Para 10 of SA 315, we had conducted our initial planning on September 28, 2017, wherein audit team discussed composition of team, involvement of other professionals, susceptibility of fraud, significant accounts and risk associated with them, planned procedures, materiality etc. and the same was accordingly minuted and signed off. Another*

*meeting was held on January 16, 2018 after our work on interim audit. We would like to reiterate that, for the said meeting we had prepared our presentation and the minutes of the same are available in our Canvas. Refer, "IL&FS-Standalone Canvas Files Folder - 15.1 to 15.30 M18 ILFS - TPE Update and PIE January 16" and "IL&FS-Standalone Canvas Files Folder - 15.1 to 15.30 M18 ILFS - TPE Update and PIE January 16". This clearly demonstrates that both the meetings were held. It seems that NFRA has chosen to ignore the facts submitted by SRBC and overlooked documents referred in our PFC response."*

**10.3.2** The Audit Firm has not provided reference to any new WP other than what has already been examined by NFRA. The WP '*IL&FS-Standalone Canvas Files Folder - 15.1 to 15.30 M18 ILFS - TPE Update and PIE January 16*' (cited twice in the above reply) is a .pptx file (dated 16<sup>th</sup> of January, 2018) and is not a minutes of the meeting. There is one more .pptx file named '*14.1 to 14.24 M18 ILFS - TPE PPT - Sep 29, 2017*' in the Audit File (dated September 27, 2017). Both these documents do not have the signoffs of any person who attended the purported meetings claimed to be held on the respective dates. Both these files were created on 11-03-2000 and last modified on 24-05-2020. These file properties show that the presentation slides were made much before the date of audit and were modified even after the date of closing of the audit file. There is also no evidence that the presentation was made, and effective discussions took place among the ET members. Such a presentation files, not supported by the evidence of effective discussions as mandated by the SAs, can in no way prove the contentions of the audit firm. Therefore, in the absence of any substantiating evidence from the Audit Firm, the conclusion reached in [para 10.2.1](#) above is reiterated.

**10.3.3** Regarding [the observations in para 10.2.2](#) above, the Audit Firm states that "*In the DAQRR, NFRA has simply contradicted its own observation raised in the PFC and have stated "NFRA has in its PFC, very clearly stated that the Audit Firm has simply noted their conclusions without documenting audit procedures performed, if any". However, in both the cases, SRBC has documented in its workpaper (refer extract reproduced in Para 13 above) as to what procedures have been performed by the Audit Team and what conclusion/observation has been drawn after performing those procedures."* The Audit Firm further quotes *Para A7 of SA 230 and states that, "Based on above Para and the example given under the SA, the extent of detailing has not been prescribed, and the precise-writing form of recording of activities and evidence cannot be presumed to negate the professional exercise of duties and responsibilities. The workpaper stated above adequately captures the objective to be met, procedures performed by us and the observation / conclusions drawn after performing the said procedures."*

**10.3.4** NFRA notes that the WP referred by the Audit Firm i.e. '*IL&FS-Standalone*

*Hardcopy Files Folder - 12\_ASM'* has documented only the following, regarding significant changes in the nature of the entity or its environment, the entity's business, markets, other key environmental factors, and key stakeholders which affect their review:

*“Based on the procedures set out below, we did not find any significant changes in the nature of the entity or its environment, the entity's business, markets, other key environmental factors, and key stakeholders which have an effect on our review*

- a. Read the annual report of FY 17 including standalone and consolidated financial statements.*
- b. Read minutes of the meetings of the board to identify any of the significant changes made and*
- c. Discussed and inquired with Group CFO – Maharudra Wagle – for any significant changes and he has responded none.”*

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.”*

The Audit Firm has nowhere documented what discussions were held with the Group CFO. Just mentioning that discussions were held is not considered valid evidence. The Audit Firm was required to document what discussions/inquiries happened, and the responses of the person inquired. Further, the Audit Firm should perform procedures to verify whether the response of the management corroborates the evidence available. For instance, the Audit Firm is aware that the Company is in breach of the RBI liquidity requirements. Despite this weakness in the liquidity position, the Company waived its call option rights on term loans (discussed earlier) which in turn had further adverse effect on the liquidity and hence on the Going Concern position of the Company. The audit firm ignored such clearly visible significant matters altogether. The Audit Firm, thus, failed to demonstrate compliance with the requirements of Para 10 of SA 230 and also failed to demonstrate the performance of sufficient appropriate audit procedures as required by Para 6 of SA 500.

- 10.3.5** Regarding the observations in para 10.2.3 above, the Audit Firm quotes Para 4, 5 and 6 of SA 315 and states that *“In our PFC response, we had clearly stated that during the planning stage of our audit, we had performed analytical review procedures on 2 sets of Financial Statement, one in the Financial statement available for September 30, 2017, which was the latest available financials of the Company and other on the 1st Cut Draft financial statement of March 31,*

2018. We understand that NFRA had only considered IL&FS Standalone Canvas Files Folder - 58.1 to 58.23 S17 IL&FS OAR in forming its conclusion and has omitted the workpaper (referred in Para 22 of Section K of our response to PFC) wherein we had determined our expectations and planned our substantive procedures in accordance with SA 330, The Auditor's responses to assessed risk. The said document includes our detailed analysis on movement of Income statement and balance sheet and our planned procedures against each account caption (Refer IL&FS-Standalone Hardcopy Files Folder - 13\_Planning OAR)." The Audit Firm further quotes para A14 of SA 315 and states that, "Based on the reading of the paragraph, it is clear that analytical procedures are useful for the purpose of performing risk assessment procedures for identifying the risk of material misstatements and such procedures can be carried out in different ways and selection of procedures to be adopted involves professional judgement."

**10.3.6** NFRA notes that in the WP 'IL&FS Standalone Canvas Files Folder - 58.1 to 58.23 S17 IL&FS OAR' the analytical procedure referred by the Audit Firm is confined to variance analysis of half-year ended balances alone. Not many meaningful insights into understanding an organisation flow 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 the audit. The WP 'IL&FS-Standalone Hardcopy Files Folder - 13\_Planning OAR' is for substantive procedures as per SA 330. It is not regarding the identification of material misstatements. Further, even in this WP, the analytical procedures are limited to year on year variance analysis. Thus, the Audit Firm has not performed any analytical procedures for risk assessment except for variance analysis of the balance sheet and statement of profit/loss. There is not even a single ratio analysis, trend analysis, relationships among both financial and non-financial data, anticipated results of the entity, such as budgets or forecasts or other data analytics performed in the Working Papers. No indicators of risk of material misstatements have been documented by the Audit Firm based on its stated analytical procedures.

**10.3.7** Regarding the observations in para 10.2.4 to 10.2.6 above, the Audit Firm states that "SRBC re-submits that, though no Risk Management Committee (RMC) meeting was held during the year ended March 31, 2018, adequate compensating controls were identified during the audit and the same was operating effectively. It was identified that the said controls were exercised either by the Audit Committee or the Board. In our view, what is important is to verify that the risk is adequately addressed by the Management". The Audit Firm further states that "the referred workpaper i.e., IL&FS-Standalone Hardcopy Files Folder -10\_Team planning event clearly indicates the mitigating controls available with the Company and how these responsibilities have been

*undertaken by the board of directors and Audit Committee”.*

- 10.3.8** NFRA notes that the Audit Firm has neither referred to any new WP nor provided any new explanation to support its submissions. The Audit Firm has simply repeated its PFC response. Thus, NFRA reiterates its conclusions that the referred WP does not contain any details of the risk assessment procedures, based on which the Audit Firm has concluded. The Audit Firm has not documented how the responsibilities of RMC are being fulfilled by the other committees and what were their conclusions after performing RAPs, if any. The Audit Firm has not obtained any understanding of the internal controls in this regard as required by Para 12 of SA 315.
- 10.3.9** Regarding the observations in para 10.2.7 above, the Audit Firm states that *“The response to the breach in compliance of Master Direction and the implication of the violations in our reporting have been dealt in length in our response in Para 20 to 35 of Section G - RBI Compliances. In the said response we had concluded that minor breach in compliance of Master Direction / CoR does not affect the true and fair view of the Financial Statements and therefore it was not covered in our Audit report. We had drawn attention of such breach to the management and the audit committee.”* The Audit Firm further states that, *“Further, we would like to reiterate that RBI doesn't cancel the registration merely on the ground that there was breach on the compliance of the ratios specified under the Directions. The intensity and volume of the breach is also considered. Further, it is a general practice of RBI to provide opportunity to the concerned Company to rectify such breach within a reasonable time. In the case of IL&FS, even after filing the exception report, RBI has not cancelled the registration of the Company till date and as a matter of fact it does not operate in that manner across the industry.”*
- 10.3.10** NFRA notes that the Audit Firm has neither referred to any new WP nor provided any new explanation to support its submissions made. The Audit Firm has simply repeated its PFC response. Thus, NFRA reiterates its DAQRR conclusions. The Audit Firm has not given any reasonable grounds to decide whether the breach was a minor or major one. There is no basis for such categorisation available in the said directions of the RBI. Hence, the assertions of the Audit Firm are not acceptable. NFRA's detailed observations on this matter are in the section on 'RBI Compliances' of this AQRR.
- 10.3.11** Regarding the observations in para 10.2.8 above, the Audit Firm has repeated its earlier responses to the PFC, stating that *“Accordingly, it is explicit that out of Rs. 1348.50 crores of total Loans outstanding to IECCL, except for Rs. 373 crores (i.e., Rs. 337 crores, which is already within 1-year bucket and hence not included in Rs. 3,486 crores of call option amount and Rs. 36 crores, which is included in Rs. 3,486 crores), no other amount due from IECCL was considered in 1-year bucket. Further, for Rs. 36 crores, Company continued to have the call*

*option and was not covered under the request letter of IECCL. Refer “Partywise Sheet” in IL&FS-Standalone Canvas Files Folder - 306.1 to 306.4 M18 ALM Loans.” The Audit Firm further states that, “The response to the NFRA’s conclusion with respect to its observation in Para 4.6.4 of ‘Loans and Advances’ section of DAQRR have been dealt in length in our response under Para 68 to 72 of Section D – Loans and Advances. In the said response we had concluded on how the Audit Firm had adequately tested all the loans outstanding as on March 31, 2018 for impairment, based on the audit evidences in place and facts of the situation.”*

- 10.3.12** NFRA notes that as per the WP ‘M18 ALM Loans, tab Partywise sheet’ an amount of Rs 787.48 crore is shown as due from IECCL within the 1-year bucket. In the document ‘IECCL Loans ALM COD’, in the background section, a loan of Rs 814 crore is mentioned for which call option frequency is 12 months. Further, the section ‘Approval Sought’ states that:

*“We hereby seek approval for issuing a letter from IL&FS stating that **they would not exercise their right to call any of the above loans during the period 1<sup>st</sup> April 2018 to March 31, 2019.**” (Emphasis added)*

Thus, approval was sought and given for the whole amount of 814 crores as evident from the document. The Audit Firm’s response that except for Rs. 373 crores no other amount due from IECCL was considered in the 1-year bucket is not substantiated from any WP. The response is contradictory to the information mentioned in the above WP and misleading.

Regarding the verification of the financial standing of the borrower, NFRA has commented in detail in the section on ‘Loans and Advances’ of this AQRR. The Audit Firm has not given any consideration to the financial standing of the borrower. Rather, while the audit evidence indicated that the loans granted were prejudicial to the company’s interest and presented a serious risk to its Going Concern status, the Audit Firm did not exercise any professional scepticism to arrive at audit conclusions. Hence, the observations of NFRA in Para 10.2.8 above are reiterated.

- 10.3.13** Regarding the observations in para 10.2.9 above, the Audit Firm states that “NFRA has made the assertion that “In these Directions RBI, has nowhere mentioned that the contractual maturity of assets and liabilities has to be disclosed. On plain reading of the Directions, it can be clearly stated that disclosures cannot be purely on contractual maturity. It has to be an estimate of likely cash flows”, which also supports the auditor’s point that there is no requirement in the direction of giving the disclosure on the basis of actual receipts and disclosures can only be on the basis of an estimate of likely cashflows and based on the available information as on the date of reporting.

*The only available information and estimate of likely cashflows can be the contractual maturity and this is followed across the industry. Had it not been the case, Auditor's responsibility would have been extended to cover all the events that have occurred till the date of reporting, which is not the case. Further, we have also done the subsequent event testing, but checking the actual receipts of contractual maturities after the balance sheet date is neither required nor practicable to do so. Accordingly, NFRA's conclusion in Para 10.2.9 is based on their conjectures, surmises and imaginative requirements."*

As already explained by NFRA earlier that the purpose of this disclosure is to ascertain whether the company is likely to face a liquidity crunch or not. Hence, when the Audit Firm could verify whether the disclosure made by the management matches with the actual results (for 1/30 days bucket), then it was the duty of the Audit Firm to verify the same. The Audit Firm's contention that it is not required to verify the actual receipts after the balance sheet date is not supported by any SAs. Further, if the disclosure is based on the contractual maturity of assets and liabilities, the Audit Firm has not referred to any WPs to support their contentions. Para A66 of SA 540 states in this regard that "*Even though the auditor may decide not to undertake this approach in respect of specific accounting estimates, the auditor is required to comply with SA 560. The auditor is required to perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified and appropriately reflected in the financial statements. Because the measurement of many accounting estimates, other than fair value accounting estimates, usually depends on the outcome of future conditions, transactions or events, the auditor's work under SA 560 is particularly relevant*". There is no evidence to prove that the Audit Firm has used the outcome approach or verified the reasonableness and prudence of this estimate, reviewed the outcome of the estimates, and reviewed events occurring up to the date of the auditor's report to provide sufficient appropriate audit evidence about the estimate. Para A66 of SA 540 states that even if the auditor decides not to undertake the outcome approach in respect of specific accounting estimates, the auditor is required to comply with SA 560. This was all the more important in light of clear indications of the threat to Going Concern status of IL&FS. There is no documentation evidencing verification of such matters in the Audit File nor of any efforts made to ascertain the likelihood of receipts when the liquidity position of IL&FS was under serious stress. Thus, the Audit Firm has failed to exercise due care and professional scepticism in the conduct of their duties and failed to question the Management about presenting misleading information.

**10.3.14** Regarding the observations in para 10.2.10 above, the Audit Firm states that "*The response to the NFRA's conclusion with respect to violation of Section 177*

*of the Companies Act, 2013 and the RPT Policy have been dealt in length in our response in Para 68 to 72 of Section D – Loans and Advances. In the said response we had concluded that the related party transactions were in the normal course of business and all the transactions during the quarter was adequately taken into consideration and approved by the Audit Committee in its ensuing meeting at the end of the quarter.” Regarding internal audit reports the Audit Firm states that, “As previously submitted in our response to PFC, SRBC had interacted with the internal auditor on a quarterly basis during the audit committee meetings and had discussions on the observations made by them and their impact on the overall control design and its operating effectiveness. Further, on perusal of the Internal audit reports, considering the nature and materiality of the findings and its remediation, it was determined that there was no need to change SRBC’s audit strategy including identification of risk of material misstatements due to fraud.”*

**10.3.15** NFRA notes that the Audit Firm has not referred to any new WP or given any new explanations other than what has already been examined by NFRA at the previous stages. Thus, NFRA reiterates its DAQRR conclusions. As already explained in the section on ‘Loans and Advances’ of this AQRR the company violated Section 177(4)(iv) of the Companies Act, 2013 since the Audit Committee was merely ratifying the RPTs instead of providing a prior approval as required by the Act. Further, as already observed by NFRA the Audit Firm had merely obtained the Internal Audit Reports from the management without documenting any audit procedures performed. There is no documentation of observations, if any, after reading the Internal Audit Reports or of having fulfilled the requirements under SA 610. The Audit Firm’s response that “*SRBC had interacted with the internal auditor on a quarterly basis during the audit committee meetings and had discussions on the observations made by them and their impact on the overall control design and its operating effectiveness*” is not supported by any evidence and hence considered only an afterthought.

**10.3.16** Considering all the above, NFRA concludes that the Audit Firm has violated SA 315, 230 and 500 and 610 and failed to:

- a. Identify and assess the risks of material misstatement through understanding the entity and its environment, including the entity’s internal control.
- b. Exercise professional scepticism, professional competence and due care.
- c. Document significant matters arising during the audit, the conclusions reached thereon, and significant professional judgements made in reaching those conclusions.

## 11. SQC 1 Compliance

### A. Prima Facie Observations and Conclusions

11.1. NFRA in its Prima-facie Conclusions conveyed the following:

**11.1.1** The majority of the documents in SQC Policy submitted by the Audit Firm seem to be from the Global Network Entity (EYG) and had not been developed with reference to Indian laws, rules and regulations. This can be seen from the policy related to communication with TCWG which is based on the IESBA Code of Ethics and PCAOB Rules and not according to the Standards of Auditing or Code of Ethics issued by ICAI.

**11.1.2** NFRA is a body constituted under the Companies Act, 2013 to, inter alia, monitor and enforce compliance with auditing and accounting standards prescribed under the said Act. All auditors of companies that are registered under the Act will be monitored only with reference to standards that are in force in India. The supposed equivalence of International Standards to, or their even greater rigour in comparison with Indian Standards is not relevant for the examination of certified financial statements by NFRA. The SQC Policy submitted by the Audit Firm contains EYG Independence Policy which is based on International Standards and does not address the specific Indian standards or laws directly. By following such a policy, the compliance of the Audit Firm with respect to Indian laws or standards becomes doubtful as there is no specific examination done by the Audit Firm in this regard.

**11.1.3** Para 2.4.1 of India guidance document on the Global Code of Conduct in SQC Policy is related to maintaining objectivity and Independence of the Audit Firm and its personnel. The same is not as per the requirements of Para 18 and 19 of SQC 1 as issued by ICAI. Instead, it cross-refers to 'EYG Independence Policy' which is irrelevant for the Indian workforce of the Audit Firm as explained in [para 11.1.2](#) above.

**11.1.4** Even the document with the heading- "*This document is a summary of those specific independence requirements applicable to EY member practices, professionals, and engagements in India. The requirements shown below must be followed in addition to the requirements in the EYG Independence Policy*" does not include any guidance on threats to independence and safeguards, including application to specific situations as contained in the Code (full). As such, the Audit Firm failed to comply with the requirements of Para 21 of SQC 1.

**11.1.5** In SQC Policy, no details are provided about the actions to be taken by the Audit Firm to mitigate and eliminate the familiarity and self-interest threats. As explained in Chapter 2 of this AQRR, the declaration of eligibility submitted by the Audit Firm in terms of Section 139 (1) of the Companies Act, 2013, read with Rule 4 of the Companies

(Audit and Auditors) Rules, 2014, was false and invalid, with full knowledge of such illegality, as discussed in Chapter 2.

- 11.1.6 The other violations discussed had undoubtedly fatally compromised the independence in mind and independence in appearance required of the Audit Firm.
- 11.1.7 Even the Audit Firm's compliance with the fundamental principles of the Code of Ethics was threatened by familiarity and self-interest threat.
- 11.1.8 SQC Policy does not provide any details as required by Para 36-38 of SQC 1 relating to policies and procedures on human resources addressing the personnel issues such as recruitment, competence, promotion etc.
- 11.1.9 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 and at several places in SQC Policy it is mentioned that SRBC & Co LLP is bound by EYG Policies. For instance, policy mentions that *"As employees of a member firm of EY Global, you are bound by EY Globe's Guidelines on the use of social media."*
- 11.1.10 As such, the Audit Firm's SQC Policy is in contradiction to the Audit Firm's own assertion that EYG is not related to SRBC & Co LLP in the manner provided under Section 144 of the Companies Act, 2013, and more particularly the explanation given therein.
- 11.1.11 In reference to Para 23 of SQC 1, the Audit Firm is required to obtain the written confirmation of compliance with its policies and procedures from all the firm personnel. The same is not available in the audit file and hence, NFRA presumes that no such confirmations were in fact obtained by the **Audit Firm**.
- 11.1.12 On perusal of the SQC policy of the Audit Firm regarding criteria to choose benchmark for determining materiality, NFRA noted that, in the SQC Policy, the Audit Firm had cross-referred to a document- "Supplementary Guidance G600.2" for discussion on materiality threshold and the same is not available/attached in the SQC Policy.

***Communicating identity and role of Engagement Partner to Management and TCWG***

- 11.1.13 Para 42 of SQC 1 requires the Audit Firm to communicate the identity and role of the **engagement partner** to key members of the client's management and TCWG. In this respect, vide its letter dated 19th November 2019, NFRA asked the Audit Firm to provide the audit evidence for such communication available in its audit file submitted to NFRA. Vide its response dated 30th December 2019, the Audit Firm stated that *"The engagement letter and acceptance letter were signed by the Engagement Partner,*

*through which it was informed to the management that he is in-charge of the audit. Further, at the time of starting of audit, opening client meeting was held and the all the engagement team members were officially introduced.”*

**11.1.14** On perusal of the WP “SFS Hard Copy File- File 1 (Part 1 of 2) - AA7 Engagement Agreement (Page no. A7 to A7.2)”, NFRA noted that the engagement agreement was signed by CA Jayesh Gandhi in the capacity of ‘**Partner**’ of the **Audit Firm- SRBC & Co LLP**. In the engagement agreement, it is nowhere mentioned that CA Jayesh Gandhi would be the ‘**Engagement Partner**’ for conducting the statutory audit of IL&FS Limited for FY18. Here, it is important to note that the terms ‘Partner’ and ‘Engagement Partner’ are differently defined as per Standards of Auditing. The same are reproduced below for quick reference:

Para 6 (b) of SQC 1 defines the term “Engagement Partner” as *“the partner or other person in the firm who is a member of the Institute of Chartered Accountants of India and is in full time practice and is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.”* (Emphasis Added)

Para 6 (l) of SQC 1 defines the term “Partner” as *“any individual with authority to bind the firm with respect to the performance of a professional services engagement.”* As such, mere signing of the engagement letter as Partner of the Audit Firm does not imply that the same person would be the Engagement Partner on the audit assignment.

**11.1.15** Also, the Audit Firm has asserted that in the client opening meeting, all the engagement team members were officially introduced. On perusal of the WP “SFS Canvas – M18 Client Opening Meeting”, NFRA observed that the WP is merely a Word document and is not signed by any official personnel of the **Audit Firm**. This creates doubt on the authenticity of the WP. Also, nowhere in the document it is mentioned that CA Jayesh Gandhi is the engagement partner for the conduct of the statutory audit of IL&FS Limited for FY18. In fact, in the said WP, Naushad Ali Rangoonwala was introduced as the team leader.

**11.1.16** Therefore, the Audit Firm failed to communicate to management and TCWG that CA Jayesh Gandhi would be the engagement partner and hence, failed to comply with the requirements of Para 42 (a) of SQC 1.

## **B. Observations made in the DAQRR**

11.2. NFRA in its DAQRR has conveyed the following:

**11.2.1** Vide its response dated 14<sup>th</sup> April, 2021, in respect of observations of NFRA in Para 1 of PFC (same is reproduced in Para 11.1 above), the Audit Firm has stated that “we

*understand that the same is in context of Section 302 of the EYG Independence Policy given in Annexure VIII of Appendix 12 (Page No. A307). We submit that the above statement is not true, as the policy provided by us clearly indicates “IESBA Code of Ethics and local independence regulations and professional standards,” which includes the Standards of Auditing or Code of Ethics issued by ICAI”. On perusal of the Annexure VIII and SQC Policy of the Audit Firm as a whole, NFRA notes that **there are no references to ICAI Standards of Auditing (SAs) and ICAI Code of Ethics.** Instead, there are references to the Rules of PCAOB in the SQC Policy. Also, the Audit Firm’s claim that the phrase “local independence regulations and professional standards” includes the SAs and Code of Ethics issued by ICAI is not evident from the SQC policy of the Audit Firm and this phrase itself does not prove that it includes ICAI SAs.*

- 11.2.2** As there are no references of SAs and Code of Ethics issued by ICAI in the SQC Policy of the Audit Firm, NFRA rejects the assertion of the Audit Firm as stated in Para 35 of Preliminary Submissions/Objections of the response of the Audit Firm (Page 10 of 522) that *“The Firm has designed and implemented a comprehensive set of audit quality control policies and practices. These meet the requirements of Standard on Quality Control (SQC 1), Code of Ethics and Standards on Auditing (SA’s) issued by ICAI.”*
- 11.2.3** The Audit Firm has also stated that *“We would like to bring to your attention that our firm i.e., S R Batliboi and its affiliates have adopted the EY Global Policy (hereinafter referred to as EYG Policy) in practice, which are based on Code of Ethics of International Ethics Standards Board of Accountants (“IESBA Code of Ethics”). It is specifically stated that in case of a conflict between anything included in EYG requirements and the laws applicable in India, the latter shall prevail, which further implies that the policy is compliant with Code of Ethics as given under IESBA Code of Ethics and also with Code of Ethics issued by ICAI; further, EYG requirements raise the bar in respect of protocols to be complied with. This results in stricter monitoring of legal and ethical independence requirements which SRBC is committed to”*. The said assertion of the Audit Firm is not supported by any evidence. In the SQC Policy submitted by the Audit Firm to NFRA, it is nowhere mentioned that in case of conflict between EYG policy and laws applicable in India, the latter shall prevail.
- 11.2.4** Further, in Para A.2 on Page 20 of 522 of the response, the Audit Firm has stated that *“We wish to place on record that SRBC conducts and signs its audits under its own name and style. SRBC or any of SRB Network entities does not use EY brand and trademark for obtaining or providing audit services. To the best of SRBC’s knowledge, the brand name “EY” (or formerly, “Ernst & Young”) is owned by EYG and it is clarified that, **to use “EY” name and logo, a member firm has to sign EY Name License agreement with EYG and it should be noted that SRBC has not signed such agreement with EYG**”*.

**11.2.5** Self-admission of the fact that S R Batliboi and its affiliates have adopted EYG policy in practice is conclusive proof that S R Batliboi and its affiliates are related to EYG. It is incomprehensible that S R Batliboi and its affiliates are using EYG Policy and not using EY brand name. As such, the Audit Firm's assertions as reproduced in Para 11.2.3 and 11.2.4 above are contradictory to each other. Hence, NFRA concludes that S R Batliboi and its affiliates and EYG are related to each other and this creates significant doubt on the independence of the Audit Firm to conduct the audit of IL&FS Limited for FY18 as explained in detail in Chapter Independence of this DAQRR.

**11.2.6** Further, the Audit Firm has repeatedly stated that *"In our view, we believe that our Firm's policies and procedures, are more stringent and are in compliance with all the aspects of Standard on Quality Control (SQC) and Code of Ethics issued by ICAI"*.

**11.2.7** Section 143 (2) of the Companies Act, 2013 says, *"The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall **after taking into account the provisions of this Act, the accounting and auditing standards** and matters which are required to be included in the audit report under the provisions of this Act or any rules made thereunder or under any order made under sub-section (11) and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed"*. (Emphasis Added)

Section 143 (9) of the Companies Act, 2013, says, *"Every auditor **shall comply with the auditing standards**"*. (Emphasis Added)

Section 143 (10) of the Companies Act, 2013 says, *"The Central Government may prescribe the standards of auditing or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949 (38 of 1949), in consultation with and after examination of the recommendations made by the National Financial Reporting Authority: **Provided that until any auditing standards are notified, any standard or standards of auditing specified by the Institute of Chartered Accountants of India shall be deemed to be the auditing standards**"*. (Emphasis Added)

**11.2.8** In view of the aforementioned Sections of the Companies Act, 2013, it is clear that every auditor shall comply with the SAs as specified by the ICAI ONLY. Nowhere in the Companies Act, 2013, does it mention that an auditor can comply with any standards other than those issued by ICAI. Also, as clearly stated by NFRA in Para 2 of its PFC (same is reproduced in Para 11.1.2 above), all auditors of companies that are registered under the Companies Act, 2013, will be monitored by NFRA only with reference to standards that are in force in India, the supposed equivalence of International Standards

to, or their even greater rigor in comparison with Indian Standards is not relevant for the purposes of examination of certified financial statements by NFRA. As such NFRA rejects the assertion of the Audit Firm as reproduced in [Para 11.2.6](#) above.

**11.2.9** The Audit Firm has referred to EYG Policy in response to Para 3 to 6 of PFC of NFRA (reproduced in [Para 11.1.3 to 11.1.6](#) above). In view of the explanation provided in [Para 11.2.8](#) above, EYG Policy cannot be considered as a relevant document to be examined by NFRA. As such, NFRA rejects all the assertions of the Audit Firm provided in their response dated 14<sup>th</sup> April, 2021, in respect of any references to EYG Policy.

**11.2.10** In Chapter on 'Independence' of this DAQRR, NFRA with a detailed explanation has conclusively proved that EYG and SRBC and Affiliates are part of one network and are related to each other in the manner stated under Section 144 of the Companies Act, 2013, and the explanation given therein. Therefore, NFRA rejects the assertions made by the Audit Firm in Para 52 to 55 of their response and reiterates its conclusion in Para 7 of its PFC (reproduced in [Para 11.1.7](#) and [11.1.8](#) above).

**11.2.11** In view of reasons explained in [Para 11.2.8](#) above, all references to and compliance with EYG policy by the Audit Firm are irrelevant for the examination by NFRA for conducting Audit Quality Review in accordance with Section 132 of the Companies Act, 2013.

**11.2.12** As such, NFRA rejects all the assertions of the Audit Firm in Para 56 to 61 of their response and reiterates its conclusions in Para 8 of its PFC (reproduced in [Para 11.1.9](#) above).

**11.2.13** The Audit Firm has given reference to Annexure XXVII of Appendix 12 (Page No. A767) of their response dated 14<sup>th</sup> April, 2021. As the said document does not form part of the Audit File, the same cannot be considered by NFRA for examination. In any event, the said document is irrelevant for choosing a benchmark for determining materiality as the same is applicable for US SEC and Non-SEC clients. It is not at all related to factors to be considered for determining materiality for Companies registered under the Companies Act, 2013.

**11.2.14** As such, NFRA reiterates its conclusion provided in Para 10 of its PFC (reproduced in [Para 11.1.12](#) above).

**11.2.15** In Para 70 of their response, the Audit Firm has stated that *“SRBC submits that based on the reading of the engagement agreement and applying the concept of substance over form, it is clearly evident that the engagement agreement was signed by Jayesh Gandhi as Engagement Partner. In a normal course, the engagement agreement is signed by EP. If that is not the case, it may be necessary to inform TCWG. The differentiation between Engagement Partner and Partner can be drawn in case of signing of other documents but as a matter of substance the above differentiation is not warranted here”*.

The said assertion of the Audit Firm cannot be accepted as the same is not backed by SAs issued by ICAI. The Audit Firm was required to communicate clearly that CA Jayesh Gandhi was EP for conducting the statutory audit of IL&FS Limited for FY18. NFRA reiterates its conclusion provided in Para 11 (a) and (b) of its PFC (reproduced in [Para 11.1.13](#) and [11.1.14](#) above).

**11.2.16** Further, In Para 71 of their response, the Audit Firm has also stated that *“Further, we bring to your attention certain important facts which clearly explains and leaves no scope of doubt that the Audit Firm have adequately communicated with Management and Those charged with Governance that CA Jayesh Gandhi will be the Engagement Partner in the Statutory Audit of IL&FS –*

- *SRBC had received communication from IL&FS on April 17, 2017, wherein IL&FS had requested our willingness and eligibility for the appointment as Statutory Auditors of the Company for FY 2017- 18;*
- *In response to the aforesaid letter, SRBC vide letter dated April 17, 2017 had confirmed its eligibility to be appointed as the Auditor of the Company for FY 2017-18 and the document was signed by Jayesh Gandhi on behalf of the Firm in the Capacity of the Engagement Partner”.*

**11.2.17** The Audit Firm has also referred to the WPs “IL&FS-Standalone Hardcopy Files Folder - 6\_NOC and other appointment formalities.

**11.2.18** In Para 76 of their response, the Audit Firm has stated that *“In the workpaper M18 Client Opening Meeting, it is clearly mentioned that Amit Kanthed (Manager) introduced the team, which clearly indicates that entire team was being introduced in the meeting including Jayesh Gandhi, who was also the part of the opening meeting with the Client. Refer IL&FS-Standalone Canvas Files Folder - 7.1 to 7.2 M18 Client Opening Meeting”.*

**11.2.19** Merely noting in the meeting minutes that Mr. Amit Kanthed introduced the team does not imply itself that Jayesh Gandhi was introduced as EP. Hence, NFRA rejects the said argument of the Audit Firm as there is no mention of Jayesh Gandhi as EP in the referred WP. NFRA reiterates its conclusion in Para 11 (c) of its PFC (reproduced in [Para 11.1.15](#) above).

**11.2.20** Therefore, NFRA concludes that the Audit Firm failed to comply with the requirements of Para 42 (a) of SQC 1 as none of the communications sent by the Audit Firm to the IL&FS Limited clearly identified/stated that CA Jayesh Gandhi was the EP for conducting the statutory audit of the IL&FS Limited for FY18.

**11.2.21** After examining in detail all the responses of the Audit Firm to the PFC, NFRA concluded in the DAQRR as follows:

- i. The Audit Firm failed to document the SQC Policy for the firm as per the requirements of SAs issued by ICAI.
- ii. The SQC Policy submitted by the Audit Firm contains policies and procedures based on the International Standards which is extraneous material and irrelevant for NFRA.
- iii. SQC Policy does not contain policies and procedures pertaining to the Independence of the Audit Firm and its personnel as per Para 18 and 19 of SQC 1 issued by ICAI.
- iv. SQC Policy does not provide details about the actions to be taken by the Audit Firm to mitigate and eliminate the familiarity and self-interest threat.
- v. SQC Policy does not provide details relating to policies and procedures on human resources and hence, the Audit Firm failed to comply with Para 36-38 of SQC 1.
- vi. The Audit Firm's assertion that EYG is not related to SRBC & Co LLP in the manner provided under Section 144 of the Companies Act, 2013, contradicts its own SQC Policy.
- vii. SQC Policy does not provide the criteria to choose a benchmark for determining materiality.
- viii. The Audit Firm failed to communicate the identity and role of the Engagement Partner to the Management and TCWG, thus, failed to comply with the requirements of Para 42 (a) of SQC 1.

### **C. Final Observations and Conclusions of the AQRR**

11.3. NFRA has examined the replies to the DAQRR and the oral submissions by the Audit Firm and concludes as follows:

- 11.3.1** NFRA notes that the Audit Firm has repeated its earlier response. As nothing new/additional to what was submitted earlier is now produced by the Audit Firm, NFRA reiterates its conclusions provided in its DAQRR as modified below.
- 11.3.2** The Audit Firm has stated that *“SRBC submits that NFRA in its DAQRR has tried to distort the facts based on their own interpretation in view of its own conjectures, surmises and imaginative requirements. NFRA has time and again, based on its own prerogative mindset tried to make multiple meanings of the facts that are in place and have denied the submissions made by the Firm”*. NFRA has formed its opinion/conclusions after a detailed examination of the WPs submitted by the Audit Firm in the audit file. Also, NFRA's conclusions are based on the provisions of the Act and the SAs. The contentions of the Audit Firm were rejected as

explained with reasons in the above paras. NFRA does not see any merits in the submissions of the Audit Firm.

**11.3.3** Further, the Audit Firm has also stated that *“NFRA has observed that “As there are no references of SAs and Code of Ethics issued by ICAI in the SQC Policy of the Audit Firm, NFRA also refutes the assertion of the Audit Firm as stated in Para 35 of Preliminary Submissions/Objections of the response of the Audit Firm (Page 10 of 522) that “The Firm has designed and implemented a comprehensive set of audit quality control policies and practices. These meet the requirements of Standard on Quality Control (SQC 1), Code of Ethics and Standards on Auditing (SA's) issued by ICAI.” The said assertions of NFRA are without any support and is simply based on their own understanding of the responses. Further, NFRA has not identified any instance where they cannot find the correlation of Firm's existing policy with requirements on Standard on Quality Control (SQC 1), Code of Ethics and Standards on Auditing (SA's) issued by ICAI. In absence of the same, NFRA's observations are without any justification or reason and are unsupported by materials on record”*. NFRA stated in the above partly quoted observation that there are no references in the SQC Policy of the Audit Firm of SAs and Code of Ethics issued by ICAI . There exist no instances where any specific SAs or references from the ICAI Code of Ethics or Sections of Companies Act, 2013 are referred to in the Policy of the Audit Firm. Instead, as already mentioned in PFC of NFRA, there are multiple instances where references to IESBA Code of Ethics and PCAOB Rules are referred to in the Policy. For instance, the policy states *“An EY member practice can provide otherwise prohibited non-audit services to affiliates of an audit client that are non-audit clients themselves, such as parents, investors and entities under common control (“upstream affiliates”), with the exception of management responsibilities prohibited under Section 305.1...”*. This is in sharp contrast to section 144 of the Companies Act 2013. However, there is no reference or explanation on section 144 or the term *“management services”* used in the section. It is evident from the chapter on ‘Independence’ of this AQRR that the Audit Firm has completely ignored section 144 and simply followed the above-quoted policy of EYG. The quality policy of an Indian audit firm should detail the ethical requirements, including independence norms, applicable in India, specific aspects of acceptance and continuance of client relationships, such as the matters covered in sections 139,141, 144 of the Companies Act etc. Therefore, the quality policy may vary from country to country. For example, independence norms as mandated under Section 144 of the Companies Act are different from those prevailing in many countries. The quality policy has to address such country-specific mandates. Merely stating that the EY's policy is more stringent and meets international standards is not good enough. Hence, NFRA does not accept the assertions of the Audit Firm. Following screenshots are a few other instances where references to law other than Indian law are given in the Policy:

## Appendix B.1. - Illustrative Audit Engagement Letter for Non-Listed Entities in accordance with International Standard on Auditing (ISA) 210, Agreeing the Terms of Audit Engagements

### Instructions

This illustrative audit engagement letter is prepared on the member firm's letterhead and is based on the requirements and guidance set forth in Chapter 2.9 of the Global Assurance Policy Manual.

Matters in brackets [ ] or parentheses ( ) denote information to be inserted or suggests alternative language, respectively. Services other than audit services (e.g., tax services, advisory engagements, agreed-upon procedures) should be the subject of a separate engagement letter.

### Key:

- A. We communicate significant matters identified during the audit to "those charged with governance," which is defined in ISA 260 *Communication With Those Charged With Governance*, as "the person(s) or organization(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager." In most entities, governance is the collective responsibility of a

### Annexure IX to Appendix A

## ETHICS+INDEPENDENCE: Evaluate compliance with ethical requirements, including independence

<b>GAM LAYERS:</b>	Complex, Listed, Group Audit
<b>ISSUER:</b>	EY (Global)
<b>STATUS:</b>	Final
<b>LAST MODIFIED:</b>	22/05/2019
<b>DOCUMENT ID:</b>	GAM ETHICS+INDEPENDENCE
<b>DOCUMENT LOCATION:</b>	Global Audit Methodology / Initial planning / ETHICS+INDEPENDENCE: Evaluate compliance with ethical requirements

### Purpose

We evaluate our compliance with relevant ethical requirements, including independence. We determine compliance for both the Firm and the members of the audit team.

The ethical requirements relevant to our audit are Parts A and B of the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code of Ethics). We also comply with local ethical requirements or codes in the jurisdiction of our audit.

The *EYG Independence Policy* is designed to comply with the IESBA Code of Ethics for independence, objectivity and integrity. The other requirements of the IESBA Code of Ethics are addressed by EY GAM, the Global Assurance Policy Manual (GAPM) (or local Assurance Policy Manual, when applicable) and other EY policies (see ETHICS 1.2).

11.3.4 In its response, the Audit Firm has attached the screenshot of the EYG independence policy of India which states that *"There are certain independence requirements applicable in India that differ from or are more restrictive than the EYG Independence Policy. This document is a summary of those specific independence requirements applicable to EY member practices, professionals, and engagements in India. The*

requirements shown below must be followed **in addition to the requirements in the EYG Independence Policy**. **For EYG Independence Policy Sections for which there are no additional requirements shown below, the EYG Independence Policy requirements apply**". (Emphasis Added)

**11.3.5** The above-quoted independence policy itself states that Policy specifically to India is in addition to EYG Independence Policy and if there is something not included in India Policy, EYG Policy requirements shall apply. Firstly, the EYG Independence Policy states that it is completely based on international standards e.g. IESBA Code, US SEC Independence requirements, US PCAOB independence regulations, etc. (the same is evident from the below screenshot of EYG Independence Policy submitted by the Audit Firm to NFRA). As already stated in the DAQRR, as per the Companies Act, 2013, audits shall be conducted in India as per relevant Indian Law **ONLY**. As such, all the requirements mentioned in EYG Independence Policy stand void and irrelevant for conducting the audit in India. Moreover, the Independence Policy specifically for India does not contain any reference to SAs and the Code of Ethics as issued by ICAI. The India Policy does not talk about anything related to how the Audit Firm will ensure safety against the threats to auditor independence such as self-interest threats, self-review threats, Familiarity threats etc. Also, there is nothing that talks about prohibited services provided by an auditor which hampers the independence of the auditor as per Section 144 of the Companies Act, 2013. Therefore, NFRA does not accept the Audit Firm's assertion that *"we submit that policies and procedures submitted by us includes all the requirements of Indian Laws, rules and regulations and is been constructed in a way which addresses all the requirements of Standards of Auditing and Code of Ethics issued by ICAI"*.

#### **EYG Independence Policy**

The EYG Independence Policy is organized as follows:

- ▶ The Introduction outlines the applicability of the EYG Independence Policy and sets forth independence roles and responsibilities
- ▶ Parts 1 and 2 provide independence requirements applicable to professionals and EY member practices
- ▶ Part 3 provides independence requirements governing audit and non-audit engagements with audit clients (including clients for whom EY performs financial statement review engagements)
- ▶ Part 4 contains independence requirements in relation to assurance clients (i.e., clients for whom EY performs assurance engagements, other than financial statement audits and reviews)
- ▶ Part 5 provides independence requirements in relation to financial audit (including review) engagements and other assurance engagements for which the reports are restricted for use and distribution
- ▶ Certain Sections located throughout the Policy include incremental subsections that highlight additional independence requirements of the US SEC independence regulations and PCAOB rules. For US SEC audit clients (including US SEC issuers and other entities subject to US SEC independence restrictions, whose financial statements or other information is being audited, reviewed, or attested, and any of its affiliates), these incremental requirements must be followed in addition to the general requirements contained in the Section.<sup>3</sup> The US SEC subsections are indented, italicized and are numbered with an "S." For instance, the US SEC subsection to Section 101 is numbered Section 101S.
- ▶ Part 6, the Glossary, contains definitions of independence terms that are used throughout the EYG Independence Policy. These defined terms are underlined when they are first used in a Section.

#### **Supplementary Guidance**

Supplementary Guidance provides detailed explanations, interpretation and application guidance related to the EYG Independence Policy requirements. The numbering of the guidance closely follows the numbering of the related Policy section for easy reference. For instance, Supplementary Guidance to Section 101 is numbered G101.

#### **Other independence material**

Other independence material consists of useful independence documents, for example:

- ▶ Regulatory materials and international standards (e.g., IESBA Code, US SEC independence regulations, US PCAOB independence regulations, etc.).
- ▶ Certain country or Region independence information releases.

**11.3.6** The Audit Firm has stated that *“It is incomprehensible that NFRA can make an assumption that merely because an entity adheres to a policy it must also be using a brand name. Such an assumption has no basis, whatsoever, in law and is arbitrary”*. Using the policy of a foreign entity and describing it as ‘we use the global policy’ is simply using the name of the foreign entity for all practical purposes. NFRA rejects the said assertion of the Audit Firm for the detailed reasons explained in the Chapter related to ‘Independence’ in this AQR. Further, the policy nowhere mentions SRBC’s name, instead describes EYG as the “Organization” and states that “The organization is committed to building a better working world, and EY’s Global Code of Conduct (Global Code) and values underpin this purpose.” ... “Everyone who works with the organization is required to behave in accordance with the principles contained in the Global Code, the India guidance document on the Global Code of Conduct, and all other rules, regulations and policies issued by the organization from time to time.” The issuer of the policy is stated “Hiresh Wadhvani, Partner and Chief Operating Officer; Sandeep Kohli, Partner and Talent Leader” both are partners of EYG. These are only some of the many instances from the policy which describe EY as the only organization and the name of the firm SRBC is nowhere recognised in the policy. Hence it is evident as daylight that SRBC is using the name of EY for all practical purposes, except for signing the audit reports and other documents legally required to be issued in the name of the Audit Firm.

**11.3.7** Further, the Audit Firm has also stated that *“NFRA must appreciate the fact that Audit Firm has itself by way of a comparison with the requirements of Standards on Quality Control issued by the Institute of Chartered Accountants of India, had submitted how each and every aspect of the standard is covered in the Firm’s SQC Policy. NFRA has overlooked the analysis submitted by us and has concluded that the policy is not in compliance with the requirements. We had also requested NFRA to provide such instances, if it has identified any, where the Firm’s policy is in contradiction or has not covered any specific aspect required under Quality Control standards. NFRA has not provided any such comments and accordingly it proves our point that NFRA’s observation is completely unfounded and is based on misrepresentation of facts as they are. Further, SRBC denies any insinuation or allegation that it has not complied with any particular standards issued by ICAI. Further, it is denied that the equivalence of International Standards to, or their even greater rigour in comparison to Indian Standards is not relevant for the purposes of examination of certified financial statements by NFRA. On the contrary, as explained above, the Firm has explained how each and every aspect of the standards is covered in the Firm’s SQC Policy and as such NFRA’s observation are completely unfounded and based on misrepresentation or misunderstanding of facts”*. “SRBC, however, would like to point out that “Local independence regulations and professional standards” for SRBC is ICAI Standards on Auditing and ICAI code of Ethics, as no other standards are applicable for audits covered under Companies Act, 2013.”

**11.3.8** As already stated in DAQRR and reiterated in the above paras, there are no references to the SAs, Code of Ethics and Sections of Companies Act, 2013 in the SQC Policy submitted by the Audit Firm. EYG Policy which contains references to international standards and Law cannot be considered a valid document for the audits conducted in India. Moreover, despite the observations of NFRA in DAQRR, the Audit Firm did not provide any instance where they have referred to Indian Law and covered the omissions detailed in para 11.3.5 in the SQC Policy. All the assertions/allegations/submissions of the Audit Firm are not supported by any valid evidence. Hence, NFRA rejects the above-said baseless submissions of the Audit Firm.

**11.3.9** Because of the reasons explained in Para 11.3.5, NFRA also rejects the following assertions of the Audit Firm:

- i. *“The EYG Independence policy attached in Annexure VIII of Appendix 12 (Page No. A275 to A355 of response to PFC) includes policy around all the threats of independence as given under Code of Ethics issued by ICAI and specifically deals with the safeguards to eliminate those threats”.*
- ii. *“In our view, we believe that our Firm’s policies and procedures, are more stringent and are in compliance with all the aspects of Standard on Quality Control (SQC) and Code of Ethics issued by ICAI. The comparison of our Firm’s policies and procedures with the required quality controls policies are given in Appendix 12 of the response referred above”.*

**11.3.10** Further, the Audit Firm has also stated that *“We request NFRA to provide us any specific instances in view of NFRA, our policies are not in line with the SQC and Code of Ethics issued by ICAI. We assure you that we will analyze the same, and if required we will implement / amend our policies based on comments / valuable suggestions given by NFRA”.* NFRA has already provided instances in the above paras where it is clearly mentioned that the Indian Policy neither covers all the aspects/requirements of SAs as issued by ICAI nor does it contain any references to the Code of Ethics of ICAI and the Companies Act, 2013.

**11.3.11** In Para 11.2.8 above, NFRA has already explained that any references to international law are extraneous for the conduct of the audit of Indian entities. Compliance with international law and not with Indian law is a violation of Section 143 (2), 143 (9) and 143 (10) of the Companies Act, 2013. Therefore, an assertion like the EYG Independence Policy was much more rigorous in comparison to Indian SAs and the Code of Ethics of ICAI is irrelevant for conducting audits in India. The replies of the Audit Firm in this regard are contradictory to its various submissions. E.g.,

- a. On one hand, the Audit Firm makes assertions such as *“It is clarified that SRBC is not aware of any entity by the name of “EY”*” (page 24 of the reply to DAQRR) and *“SRBC*

or any of SRB Network entities does not use EY brand and trademark for obtaining **or providing audit services**” (page 22 of the reply to DAQRR) (Emphasis added).

- b. On the other hand, it asserts that “our firm i.e., S R Batliboi and its affiliates have adopted the EY Global Policy (hereinafter referred to as EYG Policy) in practice” (page 501 of the reply to DAQRR), “The EYG Independence Policy establishes mandatory requirements and prohibitions with respect to the most common independence matters related to member practices, network firms, and their professionals” (Page 505 of the reply to the DAQRR)
- c. The Firm’s SQC Policy states “This document is a summary of those specific independence requirements applicable to EY member practices, professionals, and engagements in India. The requirements shown below must be followed in addition to the requirements in the EYG Independence Policy”... “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”. .....As employees of a member firm of EY Global, you are bound by EY Globe’s Guidelines on the use of social media.”
- d. Thus, it is clear that the Firm EY controls the Firm SRBC and its employees by imposing mandatory policies and rules on the latter. SRBC adopts and applies the EY policies in providing audit services in India and abroad. Still, the Audit Firm states it is not aware of any entity by the name of “EY”. While it says it does not use EY brand for providing audit services, all the quality policies of the firm governing audit are dictated by EY and are accepted by the Audit Firm in providing the audit services. The Audit Firm has neither a quality policy of its own nor a separate identity, except in papers. The Audit Firm has failed in establishing its independence and laying down clear policy for adherence to specific Indian regulatory requirements.

**11.3.12** It is important to highlight that the EYG Policy is completely based upon international law which is conclusively proved by the Audit Firm’s submissions that “The EYG Independence Policy establishes mandatory requirements and prohibitions with respect to the most common independence matters related to member practices, network firms, and their professionals. The **EYG Independence Policy is designed to comply with the elements of the International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants (“IESBA Code”) related to auditor independence, specifically, the fundamental principles of objectivity and integrity. The EYG Independence Policy also reflects the IESBA Code’s conceptual framework** approach to identify threats to auditor independence, evaluate the threats identified, and address the threats by eliminating the circumstances, reducing the threats to an acceptable level through the application of safeguards or declining or ending the specific professional activity. This **conceptual framework provides a foundation for all independence requirements in the EYG Independence Policy.** It is specifically stated that in case of a conflict between anything included in EYG requirements and the laws applicable in India, the latter shall prevail, which further implies that the **policy is compliant with**

*Code of Ethics as given under IESBA Code of Ethics and also with Code of Ethics issued by ICAI*". It is also proved beyond any doubt that the Audit Firm followed EYG policy without making any changes with respect to India specific requirements (such as section 144, provision of management services etc), making the policy irrelevant for Indian regulatory purposes. (Emphasis Added). Though the Global policy provides room for accommodating local independence regulations and professional standards, the Audit Firm did not make any such modifications in the policy.

**11.3.13** In the light of above-mentioned reasons and explanations, the assertions of the Audit Firm that EYG Independence Policy covers all aspects of SAs and Code of Ethics of ICAI are not tenable, especially as there is no direct reference therein to SAs and Code of Ethics of ICAI. NFRA does not accept the same and concludes that the SQC Policy of the Audit Firm is not in line with the requirements of SAs and Code of Ethics issued by ICAI.

**11.3.14** The Audit Firm in its response has stated that *"NFRA is insisting on the assertion that Audit Firm should have explicitly mentioned that Mr. Jayesh Gandhi is the Engagement Partner, which has already been communicated with the Company vide various mediums, as already submitted by us in our response to PFC and reiterated below. Further, nowhere in the SAs it is mentioned that it should be conveyed in a specific way or only in writing. It should be noted that by conduct during the audit and participation of Mr. Jayesh Gandhi in the audit process and all the formal communications taken place at the commencement or during the process of audit clearly conveys that he was acting in the capacity of Engagement Partner"*. As per Para 42 of SQC 1, the Audit Firm is required to communicate the **identity and role of the EP** to the client's management and TCWG. There is no proof of such communication in the audit file which clearly states that CA Jayesh Gandhi was the EP. As such, the said assertion of the Audit Firm is not tenable.

**11.3.15** The arguments of the Audit Firm in respect of the communication of the identity of CA Jayesh Gandhi as EP to the management and TCWG are not tenable as there is no clear evidence in the audit file where CA Jayesh Gandhi's identity as the EP was communicated to the Management. The Audit Firm's statement *"however time & again we had met with management and there have been clear communications around Mr. Gandhi being an EP of the engagement"* is not supported by any evidence placed in the audit file and hence, is not acceptable.

- 11.4 Based on the above observations, NFRA concludes that:
- (i) The Audit Firm failed to document the SQC Policy for the firm as per the requirements of SAs issued by ICAI.
  - (ii) The SQC Policy submitted by the Audit Firm contains policies and procedures based on the International Standards which is extraneous material and irrelevant for NFRA to the extent it does not refer to Indian laws and standards.

- (iii) SQC Policy does not contain policies and procedures pertaining to the Independence of the Audit Firm and its personnel as per Para 18 and 19 of SQC 1 issued by ICAI.
- (iv) SQC Policy does not provide details about the actions to be taken by the Audit Firm to mitigate and eliminate the familiarity and self-interest threat.
- (v) SQC Policy does not provide details relating to policies and procedures on human resources and hence, the Audit Firm failed to comply with Para 36-38 of SQC 1.
- (vi) The Audit Firm's assertion that EYG is not related to SRBC & Co LLP in the manner provided under Section 144 of the Companies Act, 2013, contradicts its own SQC Policy.
- (vii) SQC Policy does not provide the criteria to choose a benchmark for determining materiality.
- (viii) The Audit Firm failed to communicate the identity and role of the Engagement Partner to the Management and TCWG, thus, failing to comply with the requirements of Para 42 (a) of SQC 1.

## 12. Engagement Quality Control Review (EQCR)

### A. Prima Facie Observations and Conclusions

12.1. NFRA has conveyed the following in its Prima-facie Conclusions (PFC):

**12.1.1** Vide its communication dated 19th November, 2019, NFRA asked queries regarding Engagement Quality Control Review (EQCR) (Part I Section G-1). The Audit Firm in its response dated 30th December 2019, has, inter-alia, stated that *“The EQCR was involved in all the significant matters of discussion along with the engagement partner and the team during the course of audit. As per the Firm’s policy, the EQCR’s involvement is required in all the stages of planning, execution and conclusion. The same was documented in the EQR checklist which was signed by him. Key audit matters as per Para 28 of SA 220, was not applicable to the entity and hence no evaluations regarding the same were made.”* The Audit Firm has further stated that *“The EQR checklist refers to the Summary Review Memorandum (SRM) wherein all the major issues arising during the audit and its resolutions were discussed and documented. The same was signed off electronically by the EQR and the hard copy of the same was also signed by him.”*

**12.1.2** Para 70 of SQC-1 provides examples of the policies and procedures that should be designed to ensure objectivity of the EQCR. For example, the engagement quality control reviewer does not otherwise participate in the engagement during the period of review. Para 20 of SA 220 states that the engagement quality control reviewer shall perform an Objective evaluation of the significant judgments made by the engagement team, and the conclusions reached in formulating the auditor’s report.

- i Upon examination of the WPs in the audit file, NFRA find that EQCR Partner (Mr. N. Ramakrishna) has merely acted as an ordinary member of the ET and did not perform any independent and objective evaluation of significant judgments. NFRA notes that there are no comments/observations from the EQCR Partner (Mr. N. Ramakrishna) documented on any of the matters discussed in the audit file. For example, WP ‘CFS Hard Copy File-File 1 (Part 1 of 3)- Flap A9 - Audit summary memorandum (ASM) (Page no. A9.29 and A9.39)’ (that documents audit strategy along with significant risks), lists the team member who participated including Mr. N. Ramakrishna. Even though the document is signed by him, no Comments /discussions/inputs from Mr. N. Ramakrishna are recorded in the document. Similarly, WP ‘CFS Hard Copy File - File 1 (Part 1 of 3) - Flap A9 Summary Review Memorandum (SRM) (Page no. A9.43 to A9.113)’, is signed by Mr. N. Ramakrishna but no comments/discussions/inputs from him are recorded in the document.
- ii . The EQCR Partner’s name is merely quoted in the list of the participants from the Engagement Team (ET) in the WPs and he has signed those WPs along with the EP

and other members of the ET. There were no specific observations or details of work done by EQCR partner on the pages where he signed in the said documents.

**12.1.3** Vide its letter dated 19th November, 2019, NFRA had asked the Audit Firm regarding the significant points discussed by the EQCR Partner with Engagement Partner (EP) however, the Audit Firm has failed to refer to any WP that identifies or documents any discussion about significant matters and conclusions drawn between EQCR and the EP. The summary review memorandum for statutory audit of Standalone Financial statements (SFS) (WP ‘IL&FS - Standalone Hard Copy Files Folder – 17\_Summary review Memorandum.pdf’) referred by the Audit Firm does not document any discussion between the EQCR Partner and the EP. Further, on perusal of the EQCR checklists (WP ‘SFS Hard Copy File - File 1 (Part 1 of 2) – Flap AA6 - EQR Checklist Page no. A6 to A6.18’) and WP ‘CFS Hard Copy File - File 1 (Part 1 of 3) - Flap A6-QR Checklist (Page no. A6 to A6.24)’), NFRA notes that both the WPs, as indicated in the below table, consisted of the EQCR checklists created at various stages.

#### C 7\_EQR checklist (CFS)

- Audit Program EQR Checklist: Signed on 12th October 2017
- Interim Execution EQR Checklist: Signed on 12th October 2017
- Year-End EQR Checklist: Signed on 29th August 2018

#### 7\_EQR checklist (SFS)

- Audit Program EQR Checklist: Signed on 12th October 2017
- Year-End EQR Checklist: Signed on 29th August 2018 (sic)

NFRA notes that, contrary to the assertion made by the Audit Firm that “*As per the firm’s policy, the EQCR’s involvement is required in all the stages of planning execution and conclusion*”, there is no checklist available for the audit of Standalone Financial Statements (SFS). The interim checklist prepared for the audit of Consolidated Financial Statements (CFS) seems to be a mere formality since it was prepared and signed at the time of planning of the audit itself.

The program plan “EY Canvas Task”, as defined by the Audit Firm states that the EQCR was required to prepare three checklists, namely, a) Scope and Strategy Checklist, b) Interim Execution Checklist, and c) Year End Execution, Conclusion and Reporting Checklist. However, as evident from the above, the EQCR partner was casual while performing the quality review.

Thus, the EQCR partner had failed to perform the review in accordance with the Audit Firm’s policies and procedures.

**12.1.4** NFRA notes that the EQCR partner has throughout the checklist simply quoted “*I have evaluated the team’s documented judgments and conclusions in relation to these matters and have assessed them as appropriate.*” NFRA notes that the word “documented” cannot be interpreted to mean a standard line. 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. Clearly, the report has been issued overlooking the significance and requirement of Para 67 of SQC 1.

**12.1.5** 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. It has been detailed in para 12.1.1.10 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. Thus, EQCR process required objective evaluation and separate working needs to be done for the purpose of evaluation of significant judgments and to verify the results. Even though the checklist refers to various WPs, claimed to be reviewed by the EQCR Partner, NFRA notes that the EQCR Partner has not carried out independent analysis or review even in a single document.

**12.1.6** The following issues examined by NFRA are substantive evidence of the inadequacy of the EQCR system. For example, in the matter of:

i **Independence:** Para 21 of SA 220 specifically states that the EQCR shall consider the engagement team’s evaluation of the firm’s independence in relation to the audit engagement. However, EQCR Partner failed to evaluate the firm’s independence in relation to the audit engagement, since

(a) the Audit Firm had engagements with the Company persisting even before the appointment as statutory auditors creating self-interest threats and violating the Code of Ethics

(b) the Audit Firm accepted prohibited non audit engagements after its appointment as the statutory auditor resulting in a “business relationship” with the Company thus violating Rule 10 (4) of the Companies (Audit and Auditors) Rules, 2014; and

(c) the Audit Firm had violated the provisions of Section 144 of the Companies Act, 2013 by the indirect provision of prohibited non audit services, as detailed in Chapter 2 of this AQRR.

ii **Loans and Advances:** The ET failed to obtain sufficient appropriate audit evidence while reporting on the clause 3 (iii) of CARO, 2016. Major concerns have been

observed with regard to the insufficiency of controls in credit appraisal process. EQCR Partner failed to perform any independent objective evaluation of issues including rollovers of ₹928 crore and assignment of ₹2,704 crore that were even listed in SFS – Summary Review Memorandum.

- iii **Investment:** The ET had failed to obtain the investment policy of the Company and perform any procedures to verify the authenticity of the data used by the Valuer to prepare his valuation report. There were significant deficiencies noted with regard to the impairment testing. The ET had relied on the management expert's valuation reports, management assumptions and assessment in regard to impairment without independently verifying the veracity of the same.
- iv **Borrowing:** The Audit Firm reported on clause 3 (viii) of CARO, 2016 without sufficient appropriate audit evidence. The Audit Firm did not exercise due diligence and had failed to audit in compliance with Guidance Note on CARO, 2016. Para 20 of SA 220 states that the EQCR shall perform an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached in formulating the auditor's report. The EQCR checklist referred by the Audit Firm states that for review of CARO, 2016, the EQCR Partner has referred to the signed Audit Report for FY 2017-18. This clearly implies that the EQCR Partner did not conduct an objective evaluation of the judgments made by the ET for reporting on CARO, 2016. He had simply referred to the signed audit report without understanding the basis and appropriateness of judgements made for such reporting. This further NFRA's conclusion that the engagement quality review process was documented just for the sake of formality, since the EP had signed the Audit Report for FY 2017-18 without ensuring an objective evaluation by the EQCR of the judgments of the ET for reporting on CARO, 2016,.
- v **Revenue:** With regard to revenue recognition, it has been observed and noted by NFRA that the Audit Firm failed to perform any test of details to verify the occurrence of revenue, completeness of revenue transactions, and the accuracy of the revenue record. The Audit Firm had also failed to comply with Para 26 of SA 240 to identify and assess the risks of material misstatement in revenue and had failed to obtain sufficient appropriate audit evidence in respect of revenue generated by Company. There was no independent objective evaluation by EQCR with respect to these issues.
- vi **RBI Compliances:** The Audit Firm concluded that the Company had breached capital requirements placed by the RBI for a CIC-ND-SI. Despite the fact that this had very serious implications for the Company, the EQCR Partner did not conduct an objective evaluation of the judgments made by the ET and how it was subsequently reported for the readers of the financial statements. Not even the checklist maintained by the EQCR Partner has any reference to WPs in this regard.

vii **Materiality:** Para 70 of SQC-1 clearly states that the firm’s policies and procedures should ensure that the EQCR does not otherwise participate in the engagement during the period of review and does not make decisions for the engagement team.

## **B. Observations made in the DAQRR**

12.2. After examining the replies to the PFC, NFRA has conveyed the following in its DAQRR:

**12.2.1** NFRA notes that in response dated 14th April 2021, the Audit Firm has referred to the same WPs, that it had referred to in its communication dated 30<sup>th</sup> December, 2019 (response to NFRA’s Questionnaire). Therefore, NFRA’s conclusions as per the PFC report stand.

**12.2.2** In its response dated 14th April 2021, the Audit Firm did not provide any justifiable evidence to substantiate that the EQCR had done an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached in formulating the auditor’s report. The Audit Firm quoted para A4 of SA 230 and para A13 of SA 230 and asserted that *“after resolving the review comments, the previous copies and superseded documents are not required to be retained as final audit documentation. These documents are either updated or replaced with final documents post resolving the review comments of the EP and EQCR. On basis of the above para A13 of SA 230, EQCR had signed off the documents reviewed by him”*.

The Audit Firm also asserted that *“Further, SA 230 is applicable to auditor and since EQCR is not an auditor, requirements of SA 230 is not applicable to EQCR. EQCR is required to review working as per SA 220 and there is no requirement for separate working for the purpose of evaluation of significant judgments and to verify the results.”*

NFRA notes that the Audit Firm has implicitly agreed to NFRA’s PFC observation that *“there are no comments/observations from the EQCR Partner (Mr. N. Ramakrishna) documented on any of the matters discussed in the audit file”*. Further, the assertion of the Audit Firm that SA 230 does not apply to EQCR and that there is no requirement in auditing standards to retain the inputs/observation/comments provided by EQCR, once the same has been resolved, is incorrect and misleading based on the following:

- i 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.

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 erroneous and not acceptable.

- ii Para 25 of SA 220, states that the engagement quality control reviewer shall document, for the audit engagement reviewed:
  - a. The procedures required by the firm’s policies on engagement quality control review have been performed;
  - b. The engagement quality control review has been completed on or before the date of the auditor’s report; and
  - c. 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.
- iii As stated in Para 8.1.5 (PFC) above, the word “documented” cannot be interpreted to mean a standard line (“*I have evaluated the team’s documented judgments and conclusions in relation to these matters and have assessed them as appropriate*”). The documentation is required to include specific reference to the facts of the case, observations made by EQCR Partner (given the facts of the case) 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.
- iv It is 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).
- v The documentation policy of the Audit Firm recognises the position of the SAs and 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) (Emphasis added). This makes it clear that the practices actually followed by the Audit Firm with respect to EQCR are violative of its own policies, which stipulate that the EQCR should document his review procedures.

- 12.2.3** Therefore, 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 as 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 WPs provided by the Audit Firm. The Audit Files does not provide any evidence of the proper and complete performance of EQC reviewer’s work.
- 12.2.4** Further, the Audit Firm has also asserted that based on the requirements of the Para 25 of SA 220, *“the EQCR needs to confirm various assertions given in program for engagement quality review checklist which consists of 3 checklist i.e a) Scope and Strategy Checklist, b) Interim Execution Checklist, and c) Year End Execution, Conclusion and Reporting Checklist. Refer IL&FS-Standalone Hardcopy Files Folder - 7\_EQR checklist and IL&FS-Consolidation Hardcopy Files Folder - C 7\_EQR checklist”*.
- 12.2.5** With regard to NFRA’s observation that the interim checklist prepared for the audit of Consolidated Financial Statements (CFS) seems to be a mere formality since it was prepared and signed at the time of planning of the audit itself, the Audit Firm asserted that *“SRBC acknowledges that there was inadvertent error in dating the document. The correct date of signing is 2nd July 2018 wherein interim review was conducted by audit team along with EQCR. This can be evident from audit strategy memorandum of CFS which was signed by EQCR on 2nd July 2018 and forming part of audit working papers submitted to you. Refer IL&FS-Consolidation Hardcopy Files Folder - C 12\_Audit summary memorandum. We would also like to inform that EQCR time log reflects the time spent by EQCR on the said date.”*

On perusal of the EQCR checklists, NFRA notes that there are 3 checklists for the CFS of FY 2017-18 and 2 checklists for the SFS of FY 2017-18

**C 7\_EQR checklist (CFS)**

- Audit Program EQR Checklist: Signed on 12th October 2017
- Interim Execution EQR Checklist: Signed on 12th October 2017
- Year-End EQR Checklist: Signed on 29th August 2018

**7\_EQR checklist (SFS)**

– Audit Program EQR Checklist: Signed on 12th October 2017

– Year-End EQR Checklist: Signed on 30th May 2018

Considering the fact that the Interim Execution Checklist indeed includes references to a WP dated 02nd July 2017 (Audit Strategy Memorandum), NFRA is ready to accept that the dating of the documents may have been an inadvertent error. However, NFRA notes that such an error raises questions, as to whether both the checklists were rather signed and prepared on the same date as a mere formality. Therefore, NFRA perused all the WP that were stated to be reviewed in the Audit Program EQR Checklist (signed on 12th October, 2017).

NFRA notes that the EQCR partner, in the Audit Program EQR Checklist (signed on 12th October, 2017), had stated that “*I have reviewed M18 260GL-TPE Update and PIE - India - CFS and ILFS - TPE and found it appropriate*”. WP ‘ILFS – TPE’ relates to a Team Planning Event (TPE) held on 29th Sep 2017 and WP ‘M18 260GL-TPE Update and PIE - India – CFS’ related to a TPE held on 16th Jan 2018 for an update on team planning.

The reference to a WP, which was created and is based on an event dated 16th Jan 2018, proves that the Audit Program EQR Checklist was created after 16th Jan 2018. The checklist was clearly backdated and signed along with the Interim Execution EQR Checklist (asserted to be signed on 02nd July 2018). Therefore, it only makes sense that the stated “inadvertent error” was due the fact that the Audit Program EQR Checklist and Interim Execution EQR Checklist were signed on the same date and as a mere formality.

In light of the above, NFRA concludes that the EQCR checklists are a mere formality and there was no EQC review done for the audit of the Company for FY 2017-18.

**12.2.6** Moreover, NFRA notes that the EQC reviewer failed to point out the deficiencies noted in other paras of this DAQRR (Independence, Loans & Advances, Investment, Revenue, RBI Compliances, and Materiality).

**12.2.7** Therefore, NFRA concluded in the DAQRR that the

(a) EQCR Partner has:

(i) failed to objectively evaluate the significant judgements of the ET and conclusions reached by them;

(b) Audit Firm has:

- (i) failed to comply with the requirements of the SAs regarding EQC review and issued audit report without objective evaluation from the EQCR Partner;
- (ii) failed in complying with various provisions of SQC 1, SA 220 and SA 230.

### C. Final Observations and Conclusions of the AQR

12.3. NFRA has examined the replies to the DAQR submitted and oral submissions by the Audit Firm and concludes as follows:

- 12.3.1 Vide its communication dated 27<sup>th</sup> September 2021, the Audit Firm has stated that “*At the onset, SRBC submits that we have always been cooperative and provided explanation supported by file references as sought by NFRA from time to time. However, on plain reading of DAQR it seems that the conclusion drawn by NFRA, with each passing stage, have been issued without considering the facts of the case, relevant audit documentation and responses filed by us in the same matter. It is seemingly evident that NFRA has not in any way referred to our responses and has merely reproduced the allegations made in PFC without any basis and hence, in our view, pre-mediated and/or biased, at best, in all material aspects*”. NFRA formed its DAQR after considering the facts, relevant WPs, and responses of the Audit Firm. However, as the submissions of the Audit Firm lack any evidence of factual support, NFRA is not in a position to accept it. Rejection of the submissions on merits cannot be treated as a non-consideration of the submissions.
- 12.3.2 Para 20 of SA 220 says, “*The engagement quality control reviewer shall perform an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached in formulating the auditor’s report. This evaluation shall involve: (a) Discussion of significant matters with the engagement partner; (b) Review of the financial statements and the proposed auditor’s report; (c) Review of selected audit documentation relating to the significant judgments the engagement team made and the conclusions it reached; and (d) Evaluation of the conclusions reached in formulating the auditor’s report and consideration of whether the proposed auditor’s report is appropriate. (Ref: Para. A26-A28, A30-A32)*”. (Emphasis Added)
- 12.3.3 It is clear from Para 20 of SA 220 that the EQC Reviewer is required to discuss with the EP regarding significant matters and is also required to **evaluate** the conclusions formed by the ET while conducting the audit. There is no WP in the audit file that shows any such discussion that took place between the EQC Reviewer and EP. Also, there is no WP that shows evaluation by the EQC Reviewer. Mere Yes/No checklist cannot be considered as the compliance with the said Para of SA 220. Therefore, the Audit Firm’s assertion that “*the definition of engagement quality control review does not spell out any requirements with respect to separate workings to be done by EQCR for the purpose of evaluation of significant judgements*” is not tenable. In this regard, it is observed that:

- a. The Audit Firm's stand that an objective evaluation of significant judgments made and conclusions reached by the engagement team is possible by simply ticking a checklist, 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 the reviewer's objectivity and independence. In this regard, Para 70 and 71 of SQC 1 refer 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 contribution of the EQCR becomes difficult to measure and accountability difficult to establish.
- b. In the case of large, listed companies like IL&FS Limited, 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 some of the WPs of the ET is 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 ensure that no significant matter is overlooked or ignored, and cannot in itself act as conclusive evidence of the review being actually performed by the EQCR. Simply signing some of the documentation of the ET also does not provide convincing evidence that the EQCR has performed an independent examination. The Audit Firm's explanations in this regard are therefore not acceptable in the absence of any evidence.
- c. The work of EQCR involves application of professional judgment and it would be unlikely that in all cases the EQCR also reached the same professional judgment as the ET. In works involving professional judgments, the need for documentation of the judgments separately from that of the ET is obvious and is mandated in the SAs. In this context, as explained elsewhere in this AQRR by NFRA, documentation requirements of SA 230 become important for the EQCR as well. Thus, it is clear that the documentation by an EQCR 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, but should document how he used in his evaluation the data and the factors considered by the ET to agree or disagree with the conclusions reached by the Audit Firm. The EQCR team is required to document the reasons and the bases for its conclusions, the review procedures adopted, the professional judgments made, the areas in which the EQCR challenged the audit team, the significant matters the EQCR discussed with the audit team, the areas of disagreements, the resolutions reached, and the additional evidence/documents/explanations considered in such cases. Merely providing "Yes or "No" responses in the checklist and signing the WPs of ET does not give any such evidence.

- 12.3.4 In Annexure XXIV to Appendix A of the Firm Quality Policy submitted by the Audit Firm to NFRA, it is mentioned that *“The partner in charge of the engagement discusses significant matters arising during the audit engagement with the engagement quality reviewer”*. Non-availability of any WP which shows such discussion is conclusive proof that the Audit Firm did not follow the requirements of an objective EQCR.
- 12.3.5 Further, in Para 13 of their response dated 27<sup>th</sup> September 2021 (Page 543 of 552), the Audit Firm has provided a table showing compliance with SAs. NFRA notes that the table does not mention that the EQC Reviewer had any discussion with EP as per the requirement of Para 20 of SA 220.
- 12.3.6 Therefore, from all the above instances it is clear that the EQC Reviewer is not required to perform just a Yes/No exercise while reviewing the work of the ET. There are many situations where EQC Reviewer is expected to record his observations/conclusions beyond just doing the re-reading.
- 12.3.7 In Para 15 to 17 of its response, the Audit Firm has quoted various Paras from SAs regarding the applicability of SA 230 on EQCR and has stated that SA 230 on audit documentation does not envisage and does not intend to cover EQCR.

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, which is equally applicable to EQCR being an integral part of the audit process. 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 to EQCR is a narrow reading of the SAs and not tenable. It is mentioned in SA 230 that *“Standard on Auditing (SA) 230, “Audit Documentation” should be read in the context of the “Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services”, which sets out the authority of SAs and SA 200, “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing”*. (Emphasis Added)

Para 2 of SA 200 says, *“SAs are written in the context of an audit of financial statements by an auditor. They are to be adapted as necessary in the circumstances when applied to audits of other historical financial information”*. (Emphasis Added)

Para 13 (d) of SA 200 says, *“Auditor” is used to refer to the person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable, the firm. Where an SA expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term “engagement partner” rather than “auditor” is used. “Engagement partner” and*

*“firm” are to be read as referring to their public sector equivalents where relevant”.*  
(Emphasis Added)

From the above-cited Paras from SAs, it is clear that SAs are mandatory in nature and are to be complied with by an **auditor** as necessary. Auditor not only means the EP but it **also includes Audit Firm as well as person(s) conducting the audit**. Firstly, **EQC Reviewer** is also a person who is **part of the statutory audit** as without him the statutory audit cannot be said to be completed and hence, the requirements of applicability of **ALL** SAs must be complied with by him. Furthermore, it was the responsibility of the Audit Firm as well to ensure the documentation of the EQCR properly and effectively in compliance with SA 230.

As such, the Audit Firm’s contention that SA 230 was not applicable for EQCR is not acceptable.

- 12.3.8 Vide its response dated 27<sup>th</sup> September 2021, to the DAQRR of NFRA, the Audit Firm has stated that *“We would like to inform that all interim procedures had been documented in year-end EQR checklist itself and thus SRBC had not separately filled Interim Execution checklist. Interim execution checklist mainly contains procedures in relation to post interim event which had been covered in year-end EQR checklist”* (emphasis added).

Contradictory to its above-mentioned statement that “SRBC had not separately filled Interim Execution checklist”, the Audit Firm, in its response to PFC of NFRA, had stated that *“SRBC would also like to state that EQCR had participated and reviewed audit of CFS and after that EQR checklist was signed. Refer IL&FS-Consolidation Hardcopy Files Folder - C 7\_EQR checklist. SRBC acknowledges that there was inadvertent error in dating the document. The correct date of signing is 2nd July 2018 wherein interim review was conducted by audit team along with EQCR”* (emphasis added).

These contradictory statements by the Audit Firm, one stating that there was no separate interim checklist and the other stating that the interim checklist was dated incorrectly and the correct date of signing the interim checklist was 2<sup>nd</sup> July 2018, indicate that the exercise of preparing checklists and EQCR was a mere formality and no substantive work was done by the EQCR Partner as required under the SAs.

- 12.3.9 Furthermore, in case it is true that all interim procedures had been documented in the year-end EQR checklist itself and that the Audit Firm did not separately fill the Interim Execution checklist, it violates the requirements of Para 25 of SA 220. In its response to PFC of NFRA, the Audit Firm mentioned that *“EQCR needs to confirm various assertions given in program for engagement quality review checklist which consists of 3 checklist i.e a) Scope and Strategy Checklist, b) Interim Execution Checklist, and c) Year End Execution, Conclusion and Reporting Checklist”*. As such, the Audit Firm’s

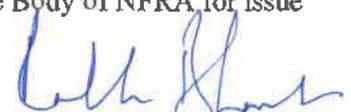
contention that they had documented interim procedures in the year-end Checklist is a clear violation of their stated audit procedure as well.

12.3.10 Also, in Para 12.2.5 of its DAQRR (reproduced in para 12.2.5 above), NFRA has clearly explained how the cross-referencing of the future dated WPs was identified by NFRA while conducting examination of the WPs. This shows that the whole practice of EQCR was perfunctory and a mere formality.

12.4. The fact that many large scale violations by IL&FS and the audit firm have been found by NFRA, as detailed in different chapters of this AQRR, and yet the EQC Reviewer did not find a single issue to comment and endorsed everything done by the engagement team, is strong evidence that the review was done perfunctorily and as a mere formality. Failure to do a meaningful review has led to the overlooking of the lapses in the areas of investments, loans and advances, ROMM, independence norms, RBI compliance, consolidation of components etc. made by the engagement team and thereby compromising the quality of the audit. Such lapses are taken seriously by the international audit regulators as well. The UK's audit regulator FRC, for example, observed in the audit quality inspection report of Deloitte (July 2021) that "On two of the audits, there was insufficient evidence of the involvement of the Engagement Quality Control Reviewer (EQCR). On one of these audits, there was insufficient evidence of the EQCR's review and challenge, for certain areas of significant risk. In the other audit, the EQCR did not discuss matters arising with the key audit partner of a significant component, or clarify why this was not considered necessary, as required by Auditing Standards. While conversations were held between the EQCR and the key audit partner for another significant component (on the same audit), there was insufficient detail of the matters discussed, or the extent of evaluation by the EQCR."

12.5. Thus, NFRA concludes that the EQCR Partner did not objectively evaluate the significant judgements of the ET and conclusions reached by them. The EQC Reviewer did not discharge his professional duties in accordance with the SAs 220 and 230. Therefore, the Audit Firm failed to comply with requirements of the SQC 1, SA 220 and 230 regarding EQCR and issued an audit report without an objective evaluation from the EQCR Partner, thereby seriously compromising the quality of the audit.

Approved by the Executive Body of NFRA for issue



(Rakesh Bhanot)

Secretary

राकेश भनोट / RAKESH BHANOT  
सचिव / Secretary  
राष्ट्रीय वित्तीय रिपोर्टिंग प्राधिकरण  
National Financial Reporting Authority  
नई दिल्ली / New Delhi

**Annexure 1: Chronology of the Events/Communications Leading to the AQRR**

<b>S. No.</b>	<b>Date</b>	<b>From</b>	<b>To</b>	<b>Subject</b>
1	12-Feb-19	NFRA	SRBC	Request to submit the Audit File for FY 17-18
2	25-Mar-19	SRBC	NFRA	Submission of Audit File for FY 17-18
3	01-Oct-19	NFRA	SRBC	Request to submit separate laptop for audit file of FY 17-18
4	01-Oct-19	NFRA	IL&FS	Request for documents regarding IL&FS
5	06-Oct-19	NFRA	IL&FS	Request for documents regarding IL&FS
6	07-Oct-19	IL&FS	NFRA	Documents provided by IL&FS as requested on 1 Oct & 6 Oct 2019
7	09-Oct-19	IL&FS	NFRA	Documents provided by IL&FS on 7 Oct 2019 were split in 3 parts
8	11-Oct-19	NFRA	SRBC	Request to submit Affidavit regarding list of related parties, audit & non-audit fees, peer review report, hours logged for FY 17-18 latest by 25th Oct 2019
9	14-Oct-19	SRBC	NFRA	Submission of separate laptop for FY 17-18
10	17-Oct-19	NFRA	SRBC	Verification of date of the audit file and procedures/IT safeguards pertaining to the integrity of dates
11	21-Oct-19	SRBC	NFRA	Request for extension of time to submit a reply to NFRA email dated 17 Oct 2019 by two weeks
12	22-Oct-19	NFRA	SRBC	Approval of time extension by NFRA for email dated 21 Oct 19 by 4 Nov 19
13	26-Oct-19	SRBC	NFRA	Received response for email dated 11th Oct 2019
14	31-Oct-19	NFRA	IL&FS	Request to submit Investigation reports, RBI Inspection reports, Forensic audit report
15	02-Nov-19	IL&F	NFRA	Received RBI Inspection Reports

16	05-Nov-19	SRBC	NFRA	Received response for email dated 17th Oct 2019 regarding the dating of the audit file and audit procedures/IT safeguards
17	19-Nov-19	NFRA	SRBC	Issued Questionnaire to SRBC
18	06-Dec-19	SRBC	NFRA	Request for time extension for responding to Questionnaire
19	10-Dec-19	NFRA	SRBC	Approval of time extension by NFRA for email dated 6 Dec 19 by 30 Dec 19
20	30-Dec-19	SRBC	NFRA	Response to Questionnaire issued on 19th Nov 2019 along with 8 Box Files
21	02-Jun-20	SRBC	NFRA	Submission of another laptop of Audit File for FY17-18
22	26-Aug-20	NFRA	SRBC	Supplementary questionnaire issued
23	06-Sep-20	SRBC	NFRA	Received response of supplementary questionnaire issued on 26th Aug 2020
24	16-Oct-20	NFRA	IL&FS	Request to confirm whether SRBC was appointed as concurrent auditor of the Company
25	19-Oct-20	IL&FS	NFRA	Received response for communication dated 16th Oct 2020
26	02-Dec-20	NFRA	SRBC	Clarification requested regarding General Contingency Provision (GCP)
27	02-Dec-20	NFRA	IL&FS	Request for information- BM for FY17, FY18, FY19 and ACM for FY19
28	10-Dec-20	IL&FS	NFRA	Received information regarding BM and ACM requested on 2nd Dec 2020
29	12-Dec-20	SRBC	NFRA	Received response regarding clarification on GCP
30	21-Dec-20	NFRA	SRBC	Issued Prima Facie Conclusions on AQR
31	14-Apr-21	SRBC	NFRA	Received response for PFC
32	19-Jun-21	NFRA	SRBC	Request to provide clarification regarding the nonavailability of Zip files in the audit file submitted through FTP

33	25-Jun-21	SRBC	NFRA	Received response regarding Zip files
34	23-Jul-2021	NFRA	SRBC	Issue of DAQRR
35	27-Sept-21	SRBC	NFRA	Reply to DAQRR
36	17-May-22	SRBC	NFRA	Oral hearing before NFRA made by SRBC Team
37	22-Jun-22	NFRA	SRBC	Issue of AQRR

## Appendices: Lists of Non-audit Services Referred in the PFC/DAQRR/AQRR

### Appendix 1

	<p><b>List 1</b></p> <p>All the engagements discussed in List 1 contain services provided by the Audit Firm and its network entities to the Auditee company, prior to the engagement date. In all of the engagements discussed below, NFRA has found that the Audit Firm has violated provisions regarding independence given in the Code of Ethics, issued by ICAI.</p>
1.	<p><b>Invoice Date: 22nd May 2015</b></p> <p>Invoice Amount: ₹ 5,00,000</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP</p> <p>Client Company: IL&amp;FS Engineering and Construction Company Limited</p> <p><b>Services as per Invoice submitted by the Audit Firm:</b></p> <p>Professional fees for study of the Global IFC Eco-system, review existing development, understand implications for India basis, identify opportunities for developing IFC, economic benefits through IFC Activities and study regulatory framework for the FY 14-15</p> <p><b>Observations of NFRA:</b></p> <p><b>a.</b> The Audit Firm has in Column N of Annexure III_B IL&amp;FS submitted to NFRA in their response to Questionnaire dated 26<sup>th</sup> August, 2020, noted type of non-audit service provided by EYG LLP as “<b>Risk Advisory Services</b>”.</p> <p><b>b.</b> As explained in chapter 2 the need to maintain independence in mind and in appearance is paramount. Further, the relationship between the Audit Firm and the client should be such that no unbiased person would be forced to the conclusion that, on an objective assessment of circumstances, there is unlikely to be an abridgement of the auditor's independence.</p> <p><b>c.</b> Further as explained in chapter 2 above, all cases involving provision of any non-audit service to an audit client must be passed through the tests of 5 categories of threats to independence, as explained in the Code of Ethics. In a situation of even the slightest doubt, the conclusion must be that the threat exists and is real.</p>

d. Section 200.4 of the Code of Ethics lists the examples of circumstances that may create self-interest threats for a professional accountant in public practice, which includes having a close business relationship with a client.

e. Section 290.32 of the Code of Ethics states that in the case of a financial statement audit engagement the engagement period includes the period covered by the financial statements reported on by the firm. When an entity becomes a financial statement audit client during or after the period covered by the financial statements that the firm will report on, **the firm should consider whether any threats to independence may be created by:**

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

- **Previous services provided to the audit client**

**Similarly, in case of an assurance engagement that is not a financial statement audit engagement, the firm should consider whether any financial or business relationships or previous services may create threats to independence.**

f. Further Section 290.157 of Code of Ethics provides the list of activities which may create self-review or self-interest threat. The listed activities include preparing source documents or originating data, in electronic or other form, evidencing the occurrence of a transaction.

g. Para 17(a) of SA 260 (revised) states that in the case of listed entities, the auditor shall communicate with those charged with governance A statement that the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms have complied with relevant ethical requirements regarding independence; and

i. All relationships and other matters between the firm, network firms, and the entity that, in the auditor's professional judgment, may reasonably be thought to bear on independence. This shall include total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity. These fees shall be allocated to categories that are appropriate to assist those charged with governance in assessing the effect of services on the independence of the auditor; and

ii. The related safeguards have been applied to eliminate identified threats to independence or reduce them to an acceptable level. (Ref: Para. A29–A32)

h. IL&FS being a debt listed entity, the Audit Firm should have furnished this information to TCWG and which is very relevant for ensuring the independence of the Audit Firm as envisaged under Standards of Auditing and Code of ethics of ICAI.

	<p>However, sharing of this information with TCWG appears to have not been done by the Audit Firm and no evidence to contrary is available on audit file and there is no audit evidence or communication to TCWG relating to this.</p> <p>i. In the present case the services provided by the network firm clearly falls under Sections 290.157, 200.4 and 290.32 of the Code of Ethics and Para 17(a) of SA 260 hence there exists self-interest threat and hence the Audit Firm and its network firms were found to have violated the Code of Ethics.</p>
2.	<p><b>Invoice Date: 22nd June 2015</b></p> <p>Invoice Amount: ₹ 6,00,000</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP</p> <p>Client Company: IL&amp;FS Engineering and Construction Company Limited</p> <p><b><u>Services as per Invoice submitted by the Audit Firm:</u></b></p> <p>Submission of the Gap Analysis Report (Review of ICFR)</p> <p><b>Observations of NFRA:</b></p> <p>a. The Audit Firm has in Column N of Annexure III_B IL&amp;FS submitted to NFRA in their response to Questionnaire dated 26<sup>th</sup> August, 2020, noted type of non-audit service provided by EYG LLP as “Risk Advisory Services”.</p> <p>b. For the reasons mentioned in para b to h in sl.no. 1 above, in the present case the services provided by the network firm fall under Sections 290.157, 200.4 and 290.32 of the Code of Ethics and Para 17(a) of SA 260 and hence there exists a self-interest threat and hence the Audit Firm and its network firms were found to have violated the Code of Ethics.</p>
3.	<p><b>Invoice Date: 13th July 2015</b></p> <p>Invoice Amount: ₹ 64,00,000</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP Client Company: IL&amp;FS Renewable Energy Limited <b><u>Services as per Invoice submitted by the Audit Firm:</u></b></p> <p>Fees payable for financial modelling services</p>

	<p><b>Observations of NFRA:</b></p> <p><b>a.</b> The Audit Firm has in Column N of Annexure III_B IL&amp;FS submitted to NFRA in their response to Questionnaire dated 26<sup>th</sup> August, 2020, noted type of non-audit service provided by EYG LLP as “<b>Business Advisory Services</b>”.</p> <p><b>b.</b> For the reasons mentioned in para b to h in sl.no. 1 above, In the present case the services provided by the network firm clearly fall under Sections 290.157, 200.4 and 290.32 of the Code of Ethics and Para 17(a) of SA 260 and hence there exists self-interest threat and hence the Audit Firm and its network firms were found to have violated the Code of Ethics.</p>
4.	<p><b>Invoice Date: 13th July 2015</b></p> <p>Invoice Amount: ₹ 5,00,000</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP</p> <p>Client Company: Gujarat International Finance Tec-city Company Limited</p> <p><b><u>Services as per Invoice submitted by the Audit Firm:</u></b></p> <p>Fees for providing tax implications on Operation and Management Services (O&amp;M) model</p> <p><b>Observations of NFRA:</b></p> <p><b>a.</b> The Audit Firm has in Column N of Annexure III_B IL&amp;FS submitted to NFRA in their response to Questionnaire dated 26<sup>th</sup> August, 2020, noted type of non-audit service provided by EYG LLP as “<b>Business Advisory Services</b>”.</p> <p><b>b.</b> For the reasons mentioned in para b to h in sl.no. 1 above, In the present case the services provided by the network firm fall under Sections 290.157, 200.4 and 290.32 of the Code of Ethics and Para 17(a) of SA 260 and hence there exists self-interest threat and hence the Audit Firm and its network firms were found to have violated the Code of Ethics.</p>
5.	<p><b>Invoice Date: 26th November 2015</b></p> <p>Invoice Amount: ₹ 5,00,000</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP</p> <p>Client Company: IL&amp;FS Transportation Networks Limited</p>

	<p><b><u>Services as per Invoice submitted by the Audit Firm:</u></b></p> <p>Fees for work on comments on draft concession agreement, financial modelling (Part 1)</p> <p><b>Observations of NFRA:</b></p> <p><b>a.</b> The Audit Firm has in Column N of Annexure III_B IL&amp;FS submitted to NFRA in their response to Questionnaire dated 26<sup>th</sup> August, 2020, has noted type of non-audit service provided by EYG LLP as “<b>Business Advisory Services</b>”.</p> <p><b>b.</b> For the reasons mentioned in para b to h in sl.no. 1 above, In the present case the services provided by the network firm clearly fall under Sections 290.157, 200.4 and 290.32 of the Code of Ethics and Para 17(a) of SA 260 and hence there exists self-interest threat and hence the Audit Firm and its network firms were found to have violated the Code of Ethics.</p>
6.	<p><b>Invoice Date: 16th December 2015</b></p> <p>Invoice Amount: ₹ 10,00,000</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP</p> <p>Client Company: IL&amp;FS Transportation Networks Limited</p> <p><b><u>Services as per Invoice submitted by the Audit Firm:</u></b></p> <p>Corporate site visit for Environmental and Social Policy Framework(ESPF) audit FY17 (Part 1)</p> <p><b>Observations of NFRA:</b></p> <p><b>a.</b> The Audit Firm has in Column N of Annexure III_B IL&amp;FS submitted to NFRA in their response to Questionnaire dated 26<sup>th</sup> August, 2020, noted type of non-audit service provided by EYG LLP as “<b>Business Advisory Services</b>”.</p> <p><b>b.</b> For the reasons mentioned in para b to h in sl.no. 1 above, In the present case the services provided by the network firm clearly fall under Sections 290.157, 200.4 and 290.32 of the Code of Ethics and Para 17(a) of SA 260 and hence there exists self-interest threat and hence the Audit Firm and its network firms were found to have violated the Code of Ethics.</p>
7.	<p><b>Invoice Date: 18th February 2016</b></p>

	<p>Invoice Amount: ₹ 5,58,700</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP Client Company: ONGC Tripura Power Company Ltd.</p> <p><b><u>Services as per Invoice submitted by the Audit Firm:</u></b></p> <p>Towards Submission of final report on Rewards and Benefits benchmarking study (40% of feevalue) plus additional 10% of Contract Price against Contract Performance Bank Guarantee (CPBG)</p> <p><b>Observations of NFRA:</b></p> <p>a. The Audit Firm has in Column N of Annexure III_B IL&amp;FS submitted to NFRA in their response to Questionnaire dated 26<sup>th</sup> August, 2020, noted type of non-audit service provided by EYG LLP as “<b>Business Advisory Services</b>”.</p> <p>c. For the reasons mentioned in para b to h in sl.no. 1 above, In the present case the services provided by the network firm clearly falls under Sections 290.157, 200.4 and 290.32 of the Code of Ethics and Para 17(a) of SA 260 and hence there exists self-interest threat and hence the Audit Firm and its network firms were found to have violated the Code of Ethics.</p>
8.	<p><b>Invoice Date: 30th May 2016</b></p> <p>Invoice Amount: ₹ 5,20,000</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP Client Company: ONGC Tripura Power Company Ltd. <b><u>Services as per Invoice submitted by the Audit Firm:</u></b></p> <p>Consultancy Services Contract for -Climate Change Advisory Services</p> <p><b>Observations of NFRA:</b></p> <p>a. The Audit Firm has in Column N of Annexure III_B IL&amp;FS submitted to NFRA in their response to Questionnaire dated 26<sup>th</sup> August, 2020, noted type of non-audit service provided by EYG LLP as “<b>Financial &amp; Accounting Advisory Services</b>”.</p> <p>b. For the reasons mentioned in para b to h in sl.no. 1 above, In the present case the services provided by the network firm clearly falls under Sections 290.157, 200.4 and 290.32 of the Code of Ethics and Para 17(a) of SA 260 and hence there exists self-interest threat and hence the Audit Firm and its network firms were found to have violated the</p>

	Code of Ethics.
9.	<p><b>Invoice Date: 30th June 2016</b></p> <p>Invoice Amount: ₹ 5,00,000</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP Client Company: Bengal Aerotropolis Projects Limited</p> <p><b><u>Services as per Invoice submitted by the Audit Firm:</u></b></p> <p>Professional fees on completion of review of Management's Control Self-Assessment documentation of each business process</p> <p><b>Observations of NFRA:</b></p> <p>a. The Audit Firm has in Column N of Annexure III_B IL&amp;FS submitted to NFRA in their response to Questionnaire dated 26<sup>th</sup> August, 2020, noted type of non-audit service provided by EYG LLP as “<b>Financial &amp; Accounting Advisory Services</b>”.</p> <p>b. For the reasons mentioned in para b to h in sl.no. 1 above, In the present case the services provided by the network firm clearly fall under Sections 290.157, 200.4 and 290.32 of the Code of Ethics and Para 17(a) of SA 260 and hence there exists self-interest threat and hence the Audit Firm and its network firms were found to have violated the Code of Ethics.</p>
10.	<p><b>Invoice Date: 20th July 2016</b></p> <p>Invoice Amount: ₹ 5,00,000</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP</p> <p>Client Company: IL&amp;FS Transportation Networks Limited</p> <p><b><u>Services as per Invoice submitted by the Audit Firm:</u></b></p> <p>Fees for work on comments on draft concession agreement, financial modelling (Part 3)</p> <p><b>Observations of NFRA:</b></p> <p>a. The Audit Firm has in Column N of Annexure III_B IL&amp;FS submitted to NFRA in their response to Questionnaire dated 26<sup>th</sup> August, 2020, noted type of non-audit service provided by EYG LLP as “<b>Business Advisory Services</b>”.</p> <p>b. For the reasons mentioned in para b to h in sl.no. 1 above, in the present case the services provided by the network firm fall under Sections 290.157, 200.4 and 290.32 of the Code of Ethics and Para 17(a) of SA 260 and hence there exists self-interest threat and hence the Audit Firm and its network firms were found to have violated the Code of</p>

	Ethics.
11.	<p><b>Invoice Date: 26th September 2016</b></p> <p>Invoice Amount: ₹ 20,00,000</p> <p>Engagement Servicing Firm: Ernst &amp; Young Merchant Banking Services Pvt. Ltd. Client Company: IL&amp;FS Transportation Networks Limited</p> <p><b><u>Services as per Invoice submitted by the Audit Firm:</u></b></p> <p>Professional fee for independent valuation to determine the fair market value of the assets and business proposed to be held by Infrastructure Investment Trust, subsidiary of ITNL</p> <p><b>Observations of NFRA:</b></p> <p><b>a.</b> The Audit Firm has in Column N of Annexure III_B IL&amp;FS submitted to NFRA in their response to Questionnaire dated 26<sup>th</sup> August, 2020, noted type of non-audit service provided by EYG LLP as “<b>Business Advisory Services</b>”.</p> <p><b>b.</b> For the reasons mentioned in para b to h in sl.no. 1 above, in the present case the services provided by the network firm fall under Sections 290.157, 200.4 and 290.32 of the Code of Ethics and Para 17(a) of SA 260 and hence there exists self-interest threat and hence the Audit Firm and its network firms were found to have violated the Code of Ethics.</p>

## Appendix 2

	<p><b>List 2</b></p> <p>All the engagements discussed in List 2 contain services provided by the Audit Firm and its network entities to the Auditee company, which were subsisting engagements as on 12th December, 2016 (the date on which <b>Audit Firm's</b> name was approved by the Board of Directors to be appointed as auditors of IL&amp;FS for FY 2017). <u>As explained in chapter 2 above, even assuming for the sake of argument, but not admitting, that the services are not prohibited services under Sections 141(3)(e) and 141(3)(i), there is no approval of the Audit Committee, and so there is a violation of both Sec 141(3)(e) and 141(3)(i) of the Act in all the Invoices discussed below.</u></p>
1.	<p><b>1. Invoice Date: 05th January 2017</b></p> <p>Invoice Amount: ₹ 5,20,000</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP Client Company: IL&amp;FS Financial Services Ltd.</p> <p><b>Services as per Invoice submitted by the Audit Firm:</b></p> <p>Litigation search/background search and asset tracing exercise on 6 Personal Guarantors (“PG”) of the Company</p> <p><b>2. Invoice Date: 17th April 2017</b></p> <p>Invoice Amount: ₹8,46,829</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP Client Company: IL&amp;FS Financial Services Limited</p> <p><b>Services as per Invoice submitted by the Audit Firm:</b></p> <p>Litigation search/background search and asset tracing exercise on 6 Personal Guarantors (“PG”) of the Company.</p> <p><b>Observations of NFRA:</b></p> <p><b>a.</b> The Audit Firm has in Column N of Annexure III_B IL&amp;FS submitted to NFRA in their response to Questionnaire dated 26<sup>th</sup> August, 2020, noted type of non-audit service provided by EYG LLP as “<b>Asset Tracing</b>”.</p> <p><b>b.</b> It is to be noted that Board of Directors of IL&amp;FS Ltd. has in its meeting held on 26<sup>th</sup> April, 2017 noted that “pursuant to provisions of the Act, the Company proposed to appoint SRBC &amp; Co LLP, Chartered Accountants, Mumbai, (Registration No 324982E/E300003) as Statutory Auditors from FY 2018 in terms of the provisions of the</p>

	<p><i>Act and to be ratified at every AGM. In order to ensure smooth transition, the Board of Directors of the Company at its meeting held on December 12, 2016 had advised that SRBC &amp; Co LLP (SRBC) be appointed as Concurrent/Joint Auditor for FY 2017 and work with DHS.”</i></p> <p><b>c.</b> It can be established from point b. above that the Audit Firm was aware of the fact that they would be appointed as statutory auditors of IL&amp;FS Ltd as on 12<sup>th</sup> December, 2016 and despite this fact, they were continuing to have business relationships with the client, which violates Section 141(3)(e).</p> <p><b>d.</b> The said engagement resulted in a “business relationship” with the auditee company that violates the provision of Rule 10 (4) of the Companies (Audit and Auditors) Rules, 2014, as explained above in chapter 2. The invoice covered services prohibited under Section 144 and hence this was a prohibited business relationship that attracted the bar of Section 141 (3)(e) of the Companies Act, 2013.</p> <p><b>e.</b> Further, Section 141(3)(i) of the Act provide disqualification of the auditor if its subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialised services as provided in section 144.</p> <p><b>f.</b> This service also brings out the financial interest of the Audit Firm in the client group and also showcases the dependence of the Audit Firm and its network entities on total fees generated from the client group. The Audit Firm’s compliance with the fundamental principles of independence was completely compromised by the self-interest threat, as explained in para b to h in sl.no. 1 of list 1 above,</p> <p><b>g.</b> In view of the aforementioned points, the Audit Firm incurred the disqualifications as per Sections 141 (3) (e) and 141(3)(i) of the Companies Act, 2013. The appointment of the Audit Firm as Statutory Auditor of IL&amp;FS was ab initio illegal and void for violation of Sections 143 (3) (e) and 141(3)(i) of the Act.</p>
2.	<p><b>1. Invoice Date: 15th May 2017</b></p> <p>Invoice Amount: ₹3,96,750</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP</p> <p>Client Company: IL&amp;FS Transportation Networks Limited</p> <p><b><u>Services as per Invoice submitted by the Audit Firm:</u></b></p> <p>Fees for completion of corporate site visit for Environmental and Social Policy Framework (ESPF) audit FY17 (Part 1)</p> <p><b>2. Invoice Date: 15th May 2017</b></p>

Invoice Amount: ₹3,96,750 plus reimbursement of all direct expenses Engagement Servicing Firm: Ernst & Young LLP

Client Company: IL&FS Transportation Networks Limited

**Services as per Invoice submitted by the Audit Firm:**

Fees for completion of corporate site visit for Environmental and Social Policy Framework (ESPF)audit FY17 (Part 2)

**3. Invoice Date: 18th May 2017**

Invoice Amount: ₹2,64,500

Engagement Servicing Firm: Ernst & Young LLP

Client Company: IL&FS Transportation Networks Limited

**Services as per Invoice submitted by the Audit Firm:**

Fee for management letters for Environmental and Social Policy Framework (ESPF) audit FY17(Part 3)

**4. Invoice Date: 28th August 2017**

Invoice Amount: ₹2,82,372

Engagement Servicing Firm: Ernst & Young LLP

Client Company: IL&FS Transportation Networks Limited

**Services as per Invoice submitted by the Audit Firm:**

Fees on submission of assurance statements for Environmental and Social Policy Framework (ESPF)Audit FY17 (final)

**Observations of NFRA:**

**a.** The Audit Firm has in Column N of Annexure III\_B IL&FS submitted to NFRA in their response to Questionnaire dated 26<sup>th</sup> August, 2020, noted type of non-audit service provided by EYG LLP as “**Financial & Accounting Advisory Service**”.

**b.** In view of the reasons mentioned in sl no. 1 of list 2 above, the Audit Firm incurred the disqualifications as per Sections 141 (3) (e) and 141(3)(i) of the Companies Act, 2013. The appointment of the Audit Firm as Statutory Auditor of IL&FS was ab initio illegal and void for violation of Sections 143 (3) (e) and 141(3)(i) of the Act.

3.	<p><b>1. Invoice Date: 31st May 2017</b></p> <p>Invoice Amount: ₹ 5,85,000</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP</p> <p>Client Company: Gujarat International Finance Tec-city Company Limited</p> <p><b>2. Invoice Date: 23<sup>rd</sup> June 2017</b></p> <p>Invoice Amount: ₹ 9,75,000</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP</p> <p>Client Company: Gujarat International Finance Tec-city Company Limited</p> <p><b>3. Invoice Date: 25th July 2017</b></p> <p>Invoice Amount: ₹ 13,20,000</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP</p> <p>Client Company: Gujarat International Finance Tec-city Company Limited</p> <p><b>4. Invoice Date: 29th August 2017</b></p> <p>Invoice Amount: ₹ 13,95,000</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP</p> <p>Client Company: Gujarat International Finance Tec-city Company Limited</p> <p><b><u>Services as per Invoice submitted by the Audit Firm:</u></b></p> <p>Services for Disk imaging and review of selected 6 (six) employees as identified by the management and market intelligence and site visits others selected 6 (six) contractor/vendors as identified by the management</p> <p><b>Observations of NFRA:</b></p> <p><b>a.</b> The Audit Firm has in Column N of Annexure III_B IL&amp;FS submitted to NFRA in their response to Questionnaire dated 26<sup>th</sup> August, 2020, noted type of non-audit service provided by EYG LLP as “<b>Disk Imaging and Market intelligence</b>”.</p> <p><b>b.</b> In view of the reasons mentioned in sl no. 1 of list 2 above, the Audit Firm incurred the disqualifications as per Sections 141 (3) (e) and 141(3)(i) of the Companies Act, 2013. The appointment of the Audit Firm as Statutory Auditor of IL&amp;FS was ab initio illegal and void for violation of Sections 143 (3) (e) and 141(3)(i) of the Act.</p>
4.	<p><b>Invoice Date: 26th September 2017</b></p>

Invoice Amount: ₹16,22,500

Engagement Servicing Firm: Ernst & Young Merchant Banking Services Pvt. Ltd. Client Company: IL&FS Transportation Networks Limited

**Services as per Invoice submitted by the Audit Firm:**

Fees of Independent valuation to determine the fair market value of the assets and business proposed to be held by Infrastructure Investment Trust

**Observations of NFRA:**

a. The Audit Firm has in Column N of Annexure III\_B IL&FS submitted to NFRA in the response to Questionnaire dated 26<sup>th</sup> August, 2020, has noted type of non-audit service provided by EYG LLP as “**Business Advisory Service**”.

d. In view of the reasons mentioned in sl no. 1 of list 2 above, the Audit Firm incurred the disqualifications as per Sections 141 (3) (e) and 141(3)(i) of the Companies Act, 2013. The appointment of the Audit Firm as Statutory Auditor of IL&FS was ab initio illegal and void for violation of Sections 143 (3) (e) and 141(3)(i) of the Act.

### Appendix 3

	<p><b>List 3</b></p> <p>All the engagements discussed in List 3 contains services provided by the Audit Firm and its network entities to the Auditee company <u>after the appointment of the <b>Audit Firm</b></u>. As explained in chapter 2 above, even assuming for the sake of argument, but not admitting, that the services are not prohibited services under Section 144, <u>there is no approval of the <b>Audit Committee</b>, and so there is violation of both Section 144 and application of Section 141(4) in all the Invoices discussed below.</u></p>
1.	<p><b>Invoice Date: 02nd October 2017</b></p> <p>Invoice Amount: ₹ 5,20,000</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP</p> <p>Client Company: ONGC Tripura Power Company Ltd.</p> <p><b><u>Services as per Invoice submitted by the Audit Firm:</u></b></p> <p>Services for assistance in Certified Emission Reduction units (CERs) verification shall include:</p> <ul style="list-style-type: none"><li>- Assistance in CER verification</li><li>- Awareness/training: Sharing procedures for monitoring and verification with site personnel ofOTPC and implementation of necessary formats for compilation of monitoring data.</li><li>- Pre-verification services: Preparation of Monitoring Report and reports</li><li>- Assistance in first verification: Addressing queries of DOE during first verification/issuanceand support to OTPC in issuance of CERs.</li></ul> <p><b>Observations of NFRA:</b></p> <p><b>a.</b> The Audit Firm has in Column N of Annexure III_B IL&amp;FS submitted to NFRA in their response to Questionnaire dated 26<sup>th</sup> August, 2020, noted type of non-audit service provided by EYG LLP as “<b>Risk Advisory Services</b>”.</p> <p><b>b.</b> The service provided by EYG as described in the invoice “Services for assistance in Certified Emission Reduction units (CERs) verification”, clearly falls under “<b>Management Services</b>” as detailed in chapter 2 above, since the scope of services includes works related to verification, training, implementation, and addressing queries of</p>

	<p>DOE, which are all management functions.</p> <p><b>c.</b> The date of the Engagement Letter has not been provided by the <b>Audit Firm</b>. As the invoice date is subsequent to the date on which the Board of IL&amp;FS first considered the appointment of the Audit Firm, it is clear that there was a subsisting business relationship as on that date (12<sup>th</sup> December, 2016) The said engagement resulted in a “business relationship” with the auditee company that violates the provision of Rule 10 (4) of the Companies (Audit and Auditors) Rules, 2014, as explained above. The EL covered services prohibited under Section 144 and hence this was a prohibited business relationship that attracted the bar of Section 141 (3) (e) and 141 (3) (i) of the Companies Act, 2013.</p> <p><b>d.</b> As explained in chapter 6 above, non-audit services provided by either SRBC Affiliate Network entities, or EYG member entities would come within the meaning of “indirectly” providing such services as covered by explanation (ii) to Section 144.</p> <p><b>e.</b> Besides, keeping the nature of the above services in view, since the above services are prohibited services as per Section 144 of the Companies Act, 2013, the Audit Committee could not have approved the same. As such, the Audit Firm’s assertion that since the services are not prohibited under Section 144 of the Companies Act, 2013, the audit committee approval was not applicable is not acceptable. Moreover, the Audit Firm had simply stated that the services are ‘not prohibited’ under Section 144 of the Companies Act, 2013, without providing any reasons in support of their statement. Even if the Audit Firm’s contention that the services were not prohibited by Section 144 is accepted, there is a clear violation of Section 144 of the Act since the Audit Committee’s approval was not obtained.</p> <p><b>f.</b> In view of the aforementioned points, the Audit Firm by undertaking this engagement after their appointment as Statutory Auditor of IL&amp;FS has incurred the disqualifications as per Section 141 (3) (e) and 141 (3) (i) of the Companies Act, 2013 and thereby violating Section 141 (4) of the Companies Act, 2013. The initial appointment of the Audit Firm was, therefore, illegal and void ab initio, and, due to the continuing violation of the Act, the Audit Firm should have vacated its office as statutory auditor and such vacation shall have been deemed to be a casual vacancy in the office of the auditor.</p>
2	<p><b>1. Invoice Date: 21st November 2017</b></p> <p>Invoice Amount: ₹1,60,480</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP. Client Company: Lalpur Wind Energy Private Limited</p> <p><b><u>Services as per the Invoice submitted by the Audit Firm:</u></b></p> <p>Services in relation to the improvement of existing policies and procedures including third party management including selection, on-boarding and monitoring</p> <p><b>2. Invoice Date: 21st November 2017</b></p>

	<p>Invoice Amount: ₹1,97,060</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP. Client Company: Tadas Wind Energy Private Limited</p> <p><b><u>Services as per the Invoice submitted by the Audit Firm:</u></b></p> <p>Services in relation to the improvement of existing policies and procedures including third party management including selection, on-boarding and monitoring</p> <p><b>3. Invoice Date: 22nd November 2017</b></p> <p>Invoice Amount: ₹97,940 plus reimbursement of all direct expenses Engagement Servicing Firm: Ernst &amp; Young LLP.</p> <p>Client Company: Ratedi Wind Power Private Limited</p> <p><b><u>Services as per Invoice submitted by the Audit Firm:</u></b></p> <p>Services in relation to improvement of existing policies and procedures including third party management including selection, on-boarding and monitoring</p> <p><b>Observations of NFRA:</b></p> <p><b>a.</b> The Audit Firm has in Column N of Annexure III_B IL&amp;FS submitted to NFRA in their response to Questionnaire dated 26<sup>th</sup> August, 2020, has noted type of non-audit service provided by EYG LLP as “<b>Business Advisory Service</b>” (sl no 1 above) and as “<b>Training</b>” for sl no. 2 and 3 above.</p> <p><b>b.</b> The above service provided by EYG falls under “<b>Management Services</b>” as these services include assuming management responsibilities since it includes policy matters, monitoring and training, which are all management functions.</p> <p><b>c.</b> In view of the aforementioned points in Sl. No. 1 of list 3 above, the Audit Firm by undertaking this engagement after their appointment as Statutory Auditor of IL&amp;FS has incurred the disqualifications as per Section 141 (3) (e) and 141 (3) (i) of the Companies Act, 2013 and thereby violating Section 141 (4) of the Companies Act, 2013. The initial appointment of the Audit Firm was, therefore, illegal and void ab initio, and, due to the continuing violation of the Act, the Audit Firm should have vacated its office as statutory auditor and such vacation shall have been deemed to be a casual vacancy in the office of the auditor.</p>
5	<p><b>EL Date: 29<sup>th</sup> March, 2018</b></p> <p>EL Amount: ₹30,00,000 plus reimbursement of all direct expenses Engagement Servicing Firm: SRBC &amp; Co LLP</p> <p>Client Company: IL&amp;FS Engineering and Construction Company Limited (Associate of</p>

IL&FSLimited)

**Services as per EL submitted by the Audit Firm:**

**“In connection with your conversion from accounting principles generally accepted in Indian GAAP (“IGAAP”) to Indian Accounting Standards (“Ind AS”), we will provide accounting support and assistance with conversion of your standalone and consolidated financial statements for the year ended 31 March 2017 from IGAAP to Ind AS. Our works conducted in a phased manner being a) diagnostic, b) solution development and c) implementation. Specifically, in each phase, we will perform the following procedures:**

- a) Discuss with you as you summarize your current IGAAP accounting practices throughout the organization.
- b) Provide guidance to your personnel in completing your analysis identifying differences between your current accounting policies and practices and Ind AS requirements.
- c) Provide management with the firm “generic” templates and best practices on Ind AS project management.
- d) Review and provide observations and feedback to management on its project charter, timeline, structure, work program, quality of project planning documentation and assigned roles and responsibilities.
- e) Discuss with you accounting policy options available under Ind AS and their implications.
- f) Discuss requirements, implementation issues and example journal entries related to Ind AS accounting treatments selected by you.
- g) Review and provide observations on the application of Ind AS standards on the principles used by you in your quantification/sensitivity analysis of alternative Ind AS accounting treatments. Provide Ind AS technical materials and guidance of a general nature.
- h) Assist you in understanding available accounting options under Ind AS.
- i) Review and provide observations in the drafting of your opening Ind AS balance sheet as of 1 April 2016 and comparative financial statements for the year ended 31 March 2017, including calculations of the balances, reconciliations and financial statement disclosures.
- j) Review and provide observations on your technical accounting memoranda and proposed accounting policies under Ind AS.”

	<p><b>Observations of NFRA:</b></p> <p>a. As the said engagement was accepted on 29<sup>th</sup> March, 2018, i.e. prior to the signing of the auditor’s report for CFS, and the services are deemed to be provided during the tenure of the Audit Firm as Statutory Auditor of IL&amp;FS Limited for FY18, the said engagement resulted in a “business relationship” with the auditee company that violates the provision of Rule 10 (4) of the Companies (Audit and Auditors) Rules, 2014, (service other than 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). The EL covered services prohibited under Section 144 (services include accounting services such as review of accounting memoranda, drafting of accounting policies, calculation of balances, reconciliations and suggesting journal entries (Section 144(a). Services are also in the nature of providing management decisions (144(h).) and hence this was a prohibited business relationship that attracted the disqualifications as per Section 141 (3) (e) of the Companies Act, 2013.</p> <p>b. The Audit Firm incurred the disqualifications as per Section 141 (3) (e) of the Companies Act, 2013, after being appointed as the statutory auditor of the Company: this attracts the provision of Section 141 (4) of the Companies Act, 2013, and accordingly the Audit Firm should have vacated its office as statutory auditor and such vacation should have been deemed to be a casual vacancy in the office of the auditor.</p> <p>c. In view of the above, in terms of applicable provisions of the Companies Act, 2013, it can be concluded that the appointment of the Audit Firm as the statutory auditor of the Company for FY18 became ultra vires the Act upon continuing this engagement.</p>
6	<p><b>1. Invoice Date: 5<sup>th</sup> June, 2018</b></p> <p>Invoice Amount: ₹2,83,200</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP.</p> <p>Client Company: Infrastructure Leasing and Financial Services Ltd</p> <p><b>2. Invoice Date: 6<sup>th</sup> June, 2018</b></p> <p>Invoice Amount: ₹3,77,600</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP.</p> <p>Client Company: Infrastructure Leasing and Financial Services Ltd</p> <p><b>3. Invoice Date: 14<sup>th</sup> June, 2018</b></p> <p>Invoice Amount: ₹2,48,364</p> <p>Engagement Servicing Firm: Ernst &amp; Young LLP.</p> <p>Client Company: Infrastructure Leasing and Financial Services Ltd</p>

	<p><b><u>Services as per Invoice submitted by the Audit Firm:</u></b></p> <p>Professional fees for Environmental and Social Policy Framework (ESPF) Assurance FY18</p> <p><b>Observations of NFRA:</b></p> <p>a. The Audit Firm has in Column N of Annexure III_B IL&amp;FS submitted to NFRA in their response to the Questionnaire dated 26<sup>th</sup> August, 2020, has noted type of non-audit service provided by EYG LLP as “<b>Financial &amp; Accounting Advisory Service</b>”.</p> <p>b. The audit firm did not provide any further details of the work, except for an unsupported statement that these are not prohibited services. However, the service provided by EYG as described in the invoice “Professional fees for Environmental and Social Policy Framework (ESPF) Assurance FY18”, prima facies falls under Clauses (a) of Section 144, as appear from the classification given by the Audit Firm.</p> <p>c. In view of the above and points in Sl. No. 1 of list 3 above, the Audit Firm by undertaking this engagement after their appointment as Statutory Auditor of IL&amp;FS has incurred the disqualifications as per Section 141 (3) (e) and 141 (3) (i) of the Companies Act, 2013 and thereby violating Section 141 (4) of the Companies Act, 2013.</p> <p>d. The services also attract self-interest threat.</p>
7	<p><b>EL Date: 16<sup>th</sup> June, 2018</b></p> <p>EL Amount: ₹20,00,000 plus reimbursement of all direct expenses Engagement Servicing Firm: SRBC &amp; Co LLP</p> <p>Client Company: IL&amp;FS Energy Development Company Limited (Direct Subsidiary of IL&amp;FS Limited)</p> <p><b><u>Services as per EL submitted by the Audit Firm:</u></b></p> <p><b>“We will provide technical accounting support services under Ind AS in connection with the aforesaid transaction as described below:</b></p> <p>a. Assist you in your analysis of factors or considerations that are relevant to a specific financial reporting issue or the application of an accounting standard.</p> <p>b. Review and provide observations on your mapping of all relevant facts of the proposed/ concluded transaction under evaluation.</p> <p>c. Identifying the applicable accounting guidance for management evaluation.</p>

d. Assist management on practical application of relevant accounting guidance.

e. Assist you in performing technical analysis and review and provide observations on your documentation of your conclusions.”

**Observations of NFRA:**

a. Identifying the applicable accounting guidance and assisting the management in its practical application is the same as “**accounting and book keeping services**”, which are prohibited from being provided by a statutory auditor, as per clause (a) of Section 144 of Companies Act, 2013.

c. As the said engagement was accepted on 16<sup>th</sup> June, 2018, i.e. prior to the signing of the auditor’s report for CFS, and the services are deemed to be provided during the tenure of the Audit Firm as Statutory Auditor of IL&FS Limited for FY18, the said engagement resulted in a “business relationship” with the auditee company that violates the provision of Rule 10 (4) of the Companies (Audit and Auditors) Rules, 2014, as explained above. The EL covered services prohibited under Section 144 and hence this was a prohibited business relationship that attracted the bar of Section 141

(3) (e) and 141 (3) (i) of the Companies Act, 2013.

d. By rendering services pertaining to the Company’s Ind-AS in connection with an analysis of factors or considerations that are relevant to a specific financial reporting issue or the application of an accounting standard, the Audit Firm put itself in a position where it would audit and evaluate professional judgements that it had previously rendered as a management’s consultant. The accounts of IEDL have to be consolidated with those of IL&FS under Section 129(3) of the Act. This attracted a **self-review threat** that is prohibited as per the ICAI Code of Ethics.

e. In view of the above and the points in Sl. No. 1 of list 3 above, the Audit Firm by undertaking this engagement after their appointment as Statutory Auditor of IL&FS has incurred the disqualifications as per Section 141 (3) (e) and 141 (3) (i) of the Companies Act, 2013 and thereby violating Section 141 (4) of the Companies Act, 2013.

In view of the above points, and in terms of applicable provisions of the Companies Act, 2013, it is concluded that the appointment of the Audit Firm as the statutory auditor of the Company for FY18 became ultra vires the Act upon accepting this engagement and, therefore, illegal.