Audit Quality Review Report by NFRA

Summarised by:

Sampat & Mehta Study Circle – presented on Team – 10 April 2020

Background of NFRA

Authority

- Constituted under Section 132 of the Companies Act, 2013
- Overriding the powers contained in other Acts, NFRA is empowered to
  - Recommendation on the formulation and laying down of accounting and auditing policies
  - Monitor and enforce compliance to Accounting Standards (AS) and Auditing Standards (SA)
  - Overseas the quality of service of the professions associated with compliance to such SA and suggest measures to improve quality of service and other related matters as may be prescribed

In terms of Rule 8 (1) of NFRA Rules, 2018 NFRA may:

- Review working papers (including audit plan, other audit documentation) and communications relating to audit;
- Evaluate sufficiency of Quality Control system of the audit;
- Manner of the system of the documentation by the auditor;
- Perform testing of the audit quality procedure of the auditors

AQRR process - Brief

Auditee	Subsidiary of Listed entity - Financial Service Company
Period	Financial Year 2017-2018
Objective	▪ Compliance with requirements of SA ▪ Assessing the QC system of the Firm (Audit Firm) and the extent to which it was complied
Process followed	▪ NFRA issued Questionnaire ▪ Firm replied to the Questionnaire ▪ NFRA conveyed prima facie observations / comments / conclusions ▪ Firm Replied to the prima facie observations / comments / conclusions ▪ Draft AQRR issued ▪ Firm made representation to the Draft AQRR ▪ Issue of final AQRR by the NFRA (NFRA only examined select issues and reserved right to cover other issues later, if necessary)

Executive Summary of AQRR

SA applicability applied generally in AQRR

- Professional skepticism
- Need to obtain sufficient audit evidence
- Performance of procedure to address the assessed risks

Findings

- Firm did not have adequate justification for issuing audit report asserting that audit was conducted in accordance with the SAs
- Central purpose of audit was not achieved
- Evaluated quality and adequacy of supervisory procedures in the Firm

Regulations covered by AQRR

Act / Source	Particulars
Section 141(3)(i) of CA	Eligibility to appoint as an Auditor Any person whose subsidiary or associate company or any other form of entity is engaged in consulting or specialized services as provided in Section 144
Section 144 of CA	▪ Auditors to provide only such other services as are approved by BoD or Audit Committee, as the case may be. ▪ Non audit services that are prohibited to be performed by the Auditors, directly or indirectly – accounting, book keeping, internal audit, design implementation of financial information system, actuarial services, investment advisory / banking services, outsourced financial services, management services
Explanation to Section 144	Directly or indirectly shall include rendering of service by the audit firm itself or through any of its partners or through its parents or subsidiary or associate entity or other entity, 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 of any of its partners

Regulations covered by AQRR

Act / Source	Particulars
Section 143(10) of the CA	Standards on Auditing issued by ICAI shall be deemed to the auditing standards (SQC 1 is part of the Auditing Standards and hence has force of law)
Section 143(12) of the CA	If there is any reason to believe that fraud is being or has been committed against the Co then report it to Central Government
Section 177 of the CA	BoD of every listed Company shall constitute an Audit Committee
Section 465(2)(c) of the CA	In spite of repeal of CA 1956, any principle of rule of law … practice or procedures or … shall not be affected

Regulations covered by AQRR

Act / Source	Particulars
SQC 1	Quality Controls for the Firm that performs Audit …..
SA 200 (Revised)	Overall objective of the auditor and conduct of the audit as per SA
SA 220 (Revised)	Quality Control for an audit of Financial Statements
SA 230 (Revised)	Audit Documentation
SA 240 (Revised)	Auditor's responsibility relating to fraud in an audit of FS
SA 250 (Revised)	Consideration of Laws and Regulations in an audit of FS
SA 260 (Revised)	Communicating with TCWG
SA 315	Identifying and Assessing the Risk of Material Misstatement through understanding the Entity and its Environment
SA 330	Auditor's responses to Assessed Risks
SA 500 (Revised)	Audit Evidence
SA 570 (Revised)	Going Concern

Regulations covered by AQRR

Act / Source	Particulars
SA 580	Written Representation
SA 705	Emphasis of Matters
AS 13	Accounting for Investments
RBI Master Direction	NBFC – SI - ND and Deposit Taking Company (Reserve Bank) Directions 2016
Code on Ethics for Professional Accountants by IFAC	Independence of auditors not only to exists in fact but also appear to so exists to all reasonable persons
Section 2(2)(iv) of ICAI Act	A member of the Institute are permitted to render other services as in the opinion of the Council may be rendered by practicing CA
Regulation 190A of CA Regulations 1988	Chartered Accountant in practice not to engage in any other business or occupation

Regulations covered by AQRR

Act / Source	Particulars
GN of ICAI	GN on Independence of Auditors Not possible to define the term independence precisely Independence is a condition of mind as well as personal character
GN of ICAI	Guidance Note on Accounting for Derivative Contracts
ICAI Framework	Preparation and Presentation of Financial Statements - Para 35: Substance over Form
ICAI Framework	Framework for Assurance Engagements
Code of Ethics of ICAI – 2009	Para 200.12 – Firm wise safeguards to be kept in the work environment
Code of Ethics of ICAI – 2019	Effective from 1 April 2020
Technical Guide on Audit of NBFC by ICAI	Covers various aspects of audit of NBFC and directives issued by RBI

Areas covered by AQRR

- Compliance with Independence Requirements
- Role of Engagement Partner (EP)
- Communication with TCWG
- Evaluation of Risk of Material Misstatements
- RBI Inspection matters – Shares and Derivative Assets
- RBI Inspection matters – NoF / CRAR
- Management Representation on RBI matters
- Evaluation of the Going Concern assumptions
- Documentation of EQCR Process
- SQC 1 Compliance

Compliance with Independence Requirements

Reply by the Firm

- Management Service is not defined in the Act
- Suggestion to define the term using AICPA Code of Ethics of Professional Misconduct was rejected by the Standing Committee at draft stage
- Firm followed MS to mean as services that comprise or include management responsibilities as defined in IESBA Code of Ethics 2010

Observations / Conclusion by NFRA

- When MS is not defined in the Act the words given in the statute must be understood in the normal / dictionary sense and be given their literal and direct meaning. Context in which the words are used will clearly be important. Principles of Interpretation would require that no extraneous matter should be brought in as part of interpretation. All the words used in the statute to be given their full meaning
- Management Responsibilities can be discharged only by the management and cannot be done by others
- Only truncated part of the Standing Committee was presented with deliberate misrepresentation

Management Consultancy Services – Examples

Reply by the Firm

- Service Provider – Other than Audit Firm but member of the Group (Feb 2018)
- Client – Auditee (Fees 1.5 Cr + Exps 10%)
- Services to be rendered
  - Advisory services relating to growth strategy for Subsidiary Co with focus on new business opportunity
  - Assistance in preparing business plan for prioritized opportunities
  - Assistance in preparing report on organization and financial implications and implementation roadmap to enable Subsidiary to execute on the proposed opportunities
  - General Terms and condition excludes rendering of any Management function / responsibility
- Team was different then the ET for the Audit
- SEC Independence Rules under Regulation S-X relied upon (Management Service is not listed but need pre approval of AC for permitted services)

Observations / Conclusion by NFRA

- Reference to SEC is not applicable and cannot be relied upon being extraneous material
- Expl to Section 144 covers, rendering of services, directly or indirectly
- Services rendered did not have approval of the Audit Committee of the Auditee
- Investment advisory services cover any type of decision of a Company and not restricted to only on investment in securities governed under SEBI
- On plain reading, Self Review is a certain threat in auditor providing investment advisory services

Management Consultancy Services – Examples

Reply by the Firm

- Service Provider – Audit Firm (Jan 2018)
- Client – Auditee (Fees 44 Lakh)
- Services to be rendered
  - Advisory services on convergence of FS to Ind AS
  - Obtain an understanding and discuss Ind AS statutory or reporting requirement with the management
  - Advice on preparation of FS
  - Advice, recommendation, observation on impact analysis report, accounting policies, draft Opening Balance Sheet, Specific Advance classification and Measurement, review of valuation for specific securities
  - Working of ECL
- Team – one of the EP / ET was the lead team member
- Advisory services not applicable for the audit engagement year ie for FY 2017-2018
- Committee of Director's approval obtained
- Scope exclusion

Observations / Conclusion by NFRA

- Engagement is of design and review of financial information and statements which would be subject to review and audit
- Section 144 does not exempt any services which will be considered for implementation in future period
- Its accounting and book keeping services, design and implementation of financial information system
- Services are violative of Code of Ethics
- Para 200.12 of Code of Ethics (2009) provide firm wise safe guards, use of different partners and engagement team
- Code of Ethics 2019 is not in force yet; nevertheless for violence of Act, help of Code cannot be resorted to

Management Consultancy Services – Examples

Reply by the Firm

- Service Provider – Audit Firm (11 June 2018)
- Client – Auditee and Group Cos (Fees 55 Lakh)
- Services to be rendered
  - Advising on applicability of Withholding tax queries
  - Assisting in appeal proceedings before ITAT
  - Analyzing MAT and Advance Tax working
  - Assisting in appeal proceedings before DRP
  - Assisting in briefing legal counsel in appeal before ITAT / High Court
  - Assistance in obtaining legal opinion from the counsel
- Financials were signed on 28 May 2018
- Providing assistance in obtaining legal opinion was restricted to drafting case for opinion and pointing out relevant case laws on the subject

Observations / Conclusion by NFRA

- Analyzing Computation of MAT and Advance Tax deals with source of financial information subject to audit.
- Assisting before ITAT may impact assessment of contingent liabilities under AS 29
- Assisting before ITAT, DRP, High Court may result in self review threat
- Consolidated FS were signed on 28 Jun 2018
- Services create a self review threat
- Services provided did not have the approval of the Audit Committee of the Auditee

Management Consultancy Services – Examples

Reply by the Firm

- Service Provider – Audit Firm (Jan 2018)
- Client – Auditee (Fees 25 Lakh)
- Services to be rendered
  - Transfer pricing services
- No managerial functions
- No material functions were performed by the Audit Firm
- Referred 2019 ICAI Code of Ethics
- US SEC Independence Rule referred

Observations / Conclusion by NFRA

- Engagement Letter (EL) includes reference to another EL which was not provided
- Details were submitted under Affidavit. Submission of sub EL submitted thereafter is questionable
- Transfer pricing study / service is a managerial function and is a source of financial information subject to review and audit
- EL is to assist in complying with preparation of CbCR and Master File which includes matter providing for overview of overall TP policies and global allocation of income and economic activity
- ICAI Code of Ethics has not come into force; cannot override the Act
- Reference to SEC not applicable and cannot be relied upon
- Services provided did not have the approval of the Audit Committee of the Auditee

Management Consultancy Services – Examples

Reply by the Firm

- Service Provider – Audit Firm (2 Jan 2018)
- Client – Holding Co of Auditee (Fees 78 Lakh; 4500/Hr)
- Services to be rendered
  - Advisory services on convergence of FS to Ind AS
  - Obtain an understanding and discuss Ind AS statutory or reporting requirement with the management
  - Advice on preparation of FS and CFS along with disclosures – for 1 April 2017 and 31 March 2018
  - Advice on new transaction
- Team – one of the EP / ET was the lead team member
- Self review threat is not applicable as for FY 2017-18 Audit Firm was not the Auditor
- Last audit was done for the HoldCo for FY 2016-17 under Indian GAAP and hence there is no self review threat

Observations / Conclusion by NFRA

- Engagement is of design and review of financial information and statements which is in the nature of accounting and book keeping service; Services are clearly management services
- Scope includes control evaluation for Subsidiaries, Associates, JV and it includes Auditee which would be subject to review and audit
- Scope includes conversion of Indian GAAP into IndAS is clearly a subject of self review threat
- Engaged in rendering prohibited services stated in Section 144 to the Hold Co while audit of Auditee was going on
- Services are violative of Code of Ethics
- Para 200.12 of Code of Ethics (2009) provide firm wise safe guards, use of different partners and engagement team
- Code of Ethics 2019 is not in force yet; nevertheless for violence of Act, help of Code cannot be resorted to
- Reference to SEC not applicable and cannot be relied upon

Management Consultancy Services per NFRA

- Assistance in appeal before ITAT / High Court, providing representation and litigation services, advising on service tax matters would result in self review threat and compromise of independent audit
- Assistance in compliance to Section 92D – maintaining prescribed documents under TPR – auditor is performing managerial function and such a responsibility also influences the generation of financial information subject to review by audit
- Clearly self review threat when scope includes assist Hold Co, its Sub Cos (includes Auditee) and affiliates in the tax matters for the benefit of client
- Analyzing impact of IndAS, ICDs would influence the financial information and would be subject of review by audit
- By attending meetings with Lawyers / Advisors arranged by the client, auditor is performing managerial function which is a management service and creates a self review threat leading to compromise of independence of audit
- As per Para 290.181 of ICAI Code of Ethics of 2009 a self review threat may be created when the litigation support services provided to a FS audit client include estimation of possible outcome thereby affects the amounts or disclosure to be reflected in the FS

Management Consultancy Services per NFRA

- Even if remuneration for taxation services are disclosed in the FS it is in violation to Section 144
- When it is prohibited services it is immaterial how client uses it
- Services in the nature of Integrity Due Diligence on the Target Company and Key Principal is prohibited services; cannot be rendered indirectly also
- Services provided to Hold Co in December 2014 / April 2015 were also reviewed. Submission of EL subsequently is of no use, even if missed inadvertently
- Assistance in FATCA registration with US IRS to Hold Co – Services are in the nature of management services; threats to independence
- Assistance in determining best possible use of the Hold Co Brand – Service relates to assistance in transfer pricing advisory services involving royalty payment for the right to use the Hold Co Brand; its management services
- Impact analysis report under SEBI Listing Agreement – Assertions given after submission of details under Affidavit has no basis; its managerial services. Services are relating to due diligence services which are related to accounting and book keeping services.

Independence – Approval of Audit Committee

Reply by the Firm

- Section 144 – Approval of the BoD or AC is required only when permissible services are rendered by the auditor to the auditee Co
- Services provided by entity, other than auditor firm, approval is not required
- Section 177 prescribes only monitoring and review of the independence of the auditors; does not require approval of the AC
- Approval can be granted either by the BoD or AC

Observations / Conclusion by NFRA

- Prohibition specified in Section 144 are not restricted only to listed or specified Companies
- Under Section 177 AC is empowered to review and monitor the independence of the auditors
- When AC is specifically stated in Section 144, not taking any approval of the AC for rendering non audit services would make the provision redundant
- Not a single instance of approval by the AC was provided

Role of Engagement Partner

Reply by the Firm	Observations / Conclusions by NFRA
▪ Considering the size of the audit, two EPs were kept ▪ EP1 was signing partner and EP2 was review partner ▪ No specific bar in SA or SQC 1 in having more than one EP ▪ Either of the EP1 or EP2 participated in the Audit Committee meetings	▪ All the important paper work of audit viz independence evaluation, risk assessment, audit planning, audit procedure, audit evidence, communication WTCG was not directed / supervised / reviewed by Signing EP ▪ No support in SA or SQC 1 and firm's SQC to have 2 EPs. If permitted there can be 5 or 10 EPs which would be absurd – Violated SA 220 and SQC1 ▪ Para 42 of SQC says – the firm should assign responsibility for each engagement to an EP (this is also stated in the Quality Policy of the audit firm also) ▪ Definition of EP clearly refers to a single individual [Para 6(b) of SQC 1 ▪ Familiarity threat and non compliance to Para 27 of SQC1 is not ruled out based on response submitted. (Para 27 – For audit of listed entities EP should be rotated after pre-defined period, not more than 7 years)
Closing procedure check list was reviewed with ET and initialed by both EPs	EP1's sign was seen only in Closing Memorandum – a form of report sent by EP2 to EP1, contains summary of procedures adopted during the course of audit

Role of Engagement Partner

Reply by the Firm	Observations / Conclusions by NFRA
▪ Identity and Role of the EP was communicated to TCWG orally, not mandatory to convey in writing ▪ No mandatory requirement to keep in writing the communication with TCWG	▪ Identity and role of EP are communicated to key members of the client's management and TCWG – Para 42(a) of SQC ▪ Responsibilities of EP are clearly defined and communicated to that partner – Para 42(c) of SQC 1 ▪ Assuming there can be two EPs the Firm did not show compliance to Para 42(a) and 42(c) ▪ Communication of identity and role of EP to TCWG is a key communication mandated by SA / SQC1 and without saying it has to be in writing. Oral communication has no value.
No mandatory requirement in professional standards to have a time recording system	▪ Schedule of hours charged by EP was not provided ▪ Records were not kept for 7 years by EP Para 82 of SQC 1 ▪ Time record keeping by auditor is mandatory in light of Para 9 of SA 230 that requires auditor to record the nature, timing and extent of audit procedure performed (Para 9 states – the auditor shall record who performed the work and date, who performed the review and date and extent of such review)

Communication with TCWG

Reply by the Firm	Observations / Conclusions by NFRA
▪ Discussion had through out the year with TCWG ▪ Not all work is required to be documented	▪ No record of any communications addressed to AC/ Management / TCWG ▪ No document minuting discussions held with TCWG is available in audit file
Written communications with TCWG are – EL, presentation made to AC during half yearly and annual audit review meeting	Presentation made on half yearly review was on different engagement
All information is provided by the Management and hence no separate documentation is required	SA 260 requires to communicate TCWG about all important and serious issues. This is distinct from the documents / evidence provided by the Company to the Firm
Did not find any non compliance with laws and regulations	▪ Para 22 of SA 250: Auditor shall communicate with TCWG matters involving non compliance with laws and regulations unless those are clearly non-consequential ▪ Para 23 of SA 250: If non compliance is intentional and material the communication with TCWG shall be as soon as practicable

Communication with TCWG

Reply by the Firm	▪ Observations / Conclusions by NFRA
Work is done at client's place so communication is on daily basis	▪ If all work is done at client's place and communication with management was on daily basis then no documentation at all would be required. ▪ SA 260 – Para 23: In case matters required by this SA is communicated orally then auditors should keep documentation as to when and to whom they were communicated. ▪ Documentation of oral communication includes copy of minutes prepared by the entity as a part of audit documentation – Para A54.

Communication with TCWG

Reply by the Firm	Observations / Conclusions by NFRA
Following was not noticed and hence not communicated ○ Significant deficiency in internal control ○ Material uncorrected misstatement ○ Significant matters arising during audit in connection with entity's related party ○ Subsequent events which might affect the FS ○ Events or conditions that may case significant doubt on the entity's ability to continue as a going concern ○ Fraud and Risk of Material Mis-management	Details of non-compliance noted by RBI ○ Negative Net Owned Fund as on 31 March 2015 of INR 45.93 Cr (on 14 Sep 16) and as on 31 March 2016 INR 4,123 Cr (on 1 Nov 2017) ○ Overall CRAR of negative 0.40% as on 31 March 2015 and 42.61% on 31 March 2016 (communicated on 1 Nov 2017) ○ Non compliance was reiterated by RBI vide E mail dated 27 March 2017 ○ RBI vide letter dated 13 March 2018 stated that negative NOF and CRAR was communicated to the Company but the same had further deteriorated on account of new exposure to group companies against RBI advice ▪ Serious issues like non compliance to RBI guidelines, issues relating to going concern, NPAs etc are required to be communicated to the TCWG

Evaluation of Risk of Material Misstatement

Reply by the Firm	Observations / Conclusions by NFRA
In working paper reference was made to international standards instead of Auditing Standards prescribed in Section 143(9): Because of resources available at global level, those standards are virtually identical to Indian SA	Reference to Global Standards notwithstanding similarity to Indian Standards does not meet compliance to Section 143(9) – Unlike other countries, in India, it has force of law. (Domestic SA give reference to Global SA which is excluded / modified) (Substance over Form??)
▪ Communication on 30 Sep 2017 was a routine one since appointment was done ▪ ET had discussion on 13 Oct 2017. In meeting of 13 Oct 2017 EP2 participated • Details of Scope etc have been prepared subsequently	▪ Minutes of the ET discussion did not disclose participation by the EP ▪ EP1 is the engagement partner who had not participated in the discussion of the ET ▪ Matters were communicated to all concerned in Sep 17 while meeting for discussion took place on 13 Oct 2017

Evaluation of Risk of Material Misstatement

Reply by the Firm	Observations / Conclusions by NFRA
Firm had changed the risk assessment from 'normal' to 'greater than normal'	▪ Assessment of ROMM is a complete sham ▪ Important issues identified by the whistle blower and RBI inspection had not been considered at all in evaluation of ROMM ▪ Framework for Assurance Engagements forming part of SA of ICAI spells out elements and objectives of assurance engagements, component of engagement risk, reasonable assurance (Para 48-52) (Para 2 of the Framework states that it does not establish Standards or provide procedural requirements for the performance of assurance engagement) ▪ Considering requirement of SQC1 and SA Firm was required to deal with categorization and minimization of engagement risk. It is not a correct reading to state that this is not requirement of SQC1 and SA

Evaluation of Risk of Material Misstatement

Reply by the Firm	Observations / Conclusions by NFRA
Size of Co is not the factors in determining risk – SA 325 Para A117 to 125)	▪ The fact that Auditee is a SI – NBFC should have qualified auditee being put into high risk category. Category of SI-NBFC was not considered in risk assessment ▪ NBFC's whose asset size is above 500 Cr are considered as Systematically Important NBFC because activities of such NBFC has a bearing on overall economy – Ref FAQ 8 of RBI (This reply of RBI was to a question What is SI NBFC) ▪ Not the size of the Assets, but its linkage to the economy at the macro level is relevant for risk categorization

Evaluation of Risk of Material Misstatement

Reply by the Firm	Observations / Conclusions by NFRA
Firm identified ROMM due to fraud at the financial statement level and at the assertion level for class of transactions, account balances and disclosures	▪ WP did not contain any relevant information to enable the auditor to evaluate the recognition of interest from NPA, consideration of interest generated from advances depending upon NPA classification ▪ Information available in the WP – Total Loans sanctioned manually 74,860 Mil against Total Loans disbursed during the year of 90,496 Mil. This shows almost all Loans were sanctioned manually and afterwards regularized in the system. This should have alerted the Auditor the possibility of fraud that need to be reported under Section 143(12)

Evaluation of Risk of Material Misstatement

Reply by the Firm	Observations / Conclusions by NFRA
▪ When RBI inspection report was made available on 1 Nov 2017 engagement risk was assed at higher level ▪ NBFC prudential norm with respect to asset classification and provisioning are not adhered to – was considered as significant risk (not fraud) and therefore recognition of interest in revenue is considered as material risk. ▪ Non recognition of interest on NPA was tested ▪ Provision for NPA was substantially tested ▪ Manual entries were considered as presumed risk of fraud and procedures have been performed around the same.	▪ As an Auditor of NBFC, it has certain special responsibilities to the RBI. Meeting of NOF criteria, CAR and CRAR is to be commented upon. Negative remarks to be reported to RBI directly. This is explained in greater details in Technical Note on Audit of NBFC by ICAI, also Para A19 of SA 250. ▪ On 27 March 2017 RBI sent an E mail to Auditee with reference to letter dated 29 Nov 2016 for the FY 2014-15 stating compliance submitted with reference to group exposure, diminution in quoted / unquoted investments, interest reversal on OCD, are not accepted. Take necessary action to bring CRAR to minimum 15%.

Evaluation of Risk of Material Misstatement

Reply by the Firm	Observations / Conclusions by NFRA
	▪ Availability of RBI communication which is ignored by the Firm shows complete lack of due diligence and professional skepticism. Proper enquiry should have been made with TCWG and RBI. Enquiry was limited with the management, no independent corroboration found. ▪ RBI Letter dated 24 Nov 2016 was not confined to NOF or CRAR matter. It flagged numerous other issues like rolling over of loans (not making required provisions), evergreening, deficiencies in the credit policy, non-disclosure of restructured loans and advances etc. Each of this individually and collectively was serious enough to warrant upgrading of risk and audit planning

Evaluation of Risk of Material Misstatement

Reply by the Firm	Observations / Conclusions by NFRA
	▪ Based on re-computation of NOF to negative by RBI for March 2015 and 2016 Firm should have used statutory definition applied by RBI to compute NOF for March 2017 and 2018. ▪ Vide mail dated 20 Dec 2017, RBI recomputed Gross and Net NPA to 13.17% and 12.34% as against 3.30% and 2.36%. This facts are noted in the WP "Memo on RBI Matters" should have enhanced audit procedure substantially but instead Firm accepted the Company's representation to RBI. ▪ WP justified the NPA computed by the Company on the basis of Security Cover and related exposures. Dependence on collateral security for realization cannot be considered as the only factor to justify the classification to non-NPA – as stated by RBI in its Directive

Evaluation of Risk of Material Misstatement

Reply by the Firm	Observations / Conclusions by NFRA
▪ RBI E mail dated 27 March 2017 was not referred in planning documentation since it was an interim communication. Finality was established only on 1 Nov 2017 when definite timeline of 31 March 2019 was given to comply NOF and CRAR criteria. Such timeline was not stated in E mail of 27 March 2017	▪ Inspection Report dated 1 Nov 2017 was for 31 Mach 2015 while E mail dated 27 March 2017 was for 31 March 2016. Firm is trying give continuity to the two communications for two different financial years, which is deliberate misinterpretation. ▪ Report dated 1 Nov 2017 was only extension of the time limit set in 27 March 2017 (which was clearly 'immediate'). ▪ Supervisory concerns repeated in report of succeeding year do not make it ongoing correspondence

Evaluation of Risk of Material Misstatement

Reply by the Firm	Observations / Conclusions by NFRA
▪ The disclosure of NOF / CRAR is not a requirement of AS	Audit report states that we have audited….. which comprises BS, PL.. and other explanatory information. FS includes explanatory notes annexed to BS, PL etc. NOF / CRAR disclosure is required to be appended to the BS as per RBI Master Direction 2016 Framework on Preparation and Presentation of the FS issued by ICAI and notified under the Act states that FS contains notes and other information. Thus, it is a direct requirement of law and deemed requirement of AS (Para 2 of the Framework states that "Framework is not an AS")

Evaluation of Risk of Material Misstatement

Reply by the Firm	Observations / Conclusions by NFRA
▪ Management override of control over sanctioning the loans and advances – Firm's observation: Co's internal control process requires grant to be approved by more than 10 people. Therefore, in professional judgment, susceptibility of sanctioning of loans to management override of controls was remote and hence not considered as fraud risk (applied Para 47 of SA 240). ▪ However, EMS audit tools correctly identifies this as fraud risk. All the workflows emanates from EMS Tools and therefore presumed risk of fraud has been documented.	▪ In terms of Para 12 of SA 240 and Para 15 of SA 200 auditor should have maintained professional skepticism through out the audit, recognizing the possibility that misstatement due to fraud could exist notwithstanding past experience of honesty and integrity of the entity's management and TCWG ▪ Para 27 of SA 240 – assessed risk of material misstatement due to fraud is a significant risk; relates to significant non-routine transaction or judgmental matters (para A131 of SA 315) ▪ Identification has influenced the testing of controls and substantive procedure employed by the Firm. Testing of NPA and credit for accrual of interest on such loan has been tested but from the NPA list provided by the Management. ▪ However, basic question, whether the list of NPA provided was comprehensive and did not leave out any case that need to be considered has not been subject of testing. ▪ No testing was done to cover the complete universe of Loan

Evaluation of Risk of Material Misstatement

Reply by the Firm	Observations / Conclusions by NFRA
▪ Manual entries were considered as presumed risk of fraud and procedures have been performed around the same.	▪ SA 240, 325 or 330 do not state that management override of controls cannot be a risk of material misstatement at assertion level. ▪ Due to the unpredictable way such override could occur, it is a ROMM due to fraud and hence a significant risk. SA further requires auditor to minimize this risk at assertion level. ▪ No tests were performed on "journal entries made to unrelated accounts and "journal entries posted after closing date for quarter". This is despite the fact that these events are listed in the Audit Firm's software and are also a requirement under Para A43 of SA 240 (Impact?)

Evaluation of Risk of Material Misstatement

Reply by the Firm	Observations / Conclusions by NFRA
	▪ No testing was carried out for journal entries "made either before or during the preparation of the financial statements that do not have account numbers", as required under Para A 43 of SA 240 (Impact?) ▪ No JEs were selected as per criteria listed in A43 of SA 240 (Impact?) ▪ The fact that manual override had to be undertaken is indicative of need to relax the condition of viability, creditworthiness of the borrower, collateral required etc. The Firm does not provided any evidence in support of procedure performed or review of CAM to understand the reasons for manual override in specific areas

Evaluation of Risk of Material Misstatement

Reply by the Firm	Observations / Conclusions by NFRA
Company's reply to RBI inspection was examined. In 31 March 2018 appropriate treatment was given and disclosure was also given. This is confirmed by RBI final report dated 19 Jun 2018	Shelter cannot be taken for evidence created after date of audit report (RBI inspection report dated 19 Jun 2018)
No discussion by the NFRA with the Audit Firm during the process of review	▪ The auditor is required to 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; the results of the audit procedures performed, and the audit evidence obtained; and significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. The audit documentation, therefore, should be adequate in itself for all purposes ▪ From beginning and every successive stage sufficient opportunities given to present the case and clarficiation

RBI Inspection – Shares and Derivatives

Reply by the Firm	Observations / Conclusions by NFRA
▪ As per the valuations done during 2014-15, 2015-16 and 2016-17, no provision was required to be made since the independent valuation of the investment in the shares supported the carrying value of the long term investment ▪ With regard to the Company treating the shares as Long term investments, Paras 9 and 10 of Chapter V of Prudential Regulations of the Master Direction 2016 are relevant. These provide that criteria shall be spelt out by the BoD, on the date of investment ▪ At the time of conversion of loan into shares CoD specifically stated that intention is to hold the shares for long term. ▪ Policy states that investments may be held out of recovery measures	▪ The shares were acquired in settlement with the borrower who defaulted. In such a case shares cannot be accounted as per AS 13 ▪ There is no mandate in the RBI Directions for treating equity instruments obtained on restructuring as long term investments. The RBI Directions also provide that the method of valuation of such shares held in current investments should be the lower of "breakup value" and "earning value" ▪ Investment policy of the Auditee was not in Audit File that means ET had not examined it to conform the policy of classification into long term ▪ Invoking the pledge of illiquid shares of doubtful value, would not amount to a recovery measure, because nothing was recovered immediately; nor there was any hope of recovery in the short run

RBI Inspection – Shares and Derivatives

Reply by the Firm	Observations / Conclusions by NFRA
▪ The RBI in its Inspection Reports has not questioned the company's treatment of acquisition of shares on invocation as investments ▪ Acquisition of shares was not part of the restructuring ▪ In the event of default it invoked the collateral to protect its interest ▪ 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 instalments / rate of interest (due to reasons other than competitive reasons)	▪ There was no closure of the loan by repayment thereof in cash. The loan was substituted by the elaborately designed "put option" mechanism, implicit in which were several concessions. Thus, the liability of the borrower was not extinguished, even partially. Hence this was not a recovery measure, through enforcement of underlying securities ▪ The CoD approval memorandum quoted by the Audit Firm in support of treating shares as long-term investment is not found in the Audit File ▪ Investments is assets held by an enterprise for earning income by way of dividends, interest and rewards, for capital appreciation or for other benefits to the investing enterprise. Given the facts of the X Co's shares, none of these benefits could have realistically been contemplated when the pledge of shares was invoked.

RBI Inspection – Shares and Derivatives

Reply by the Firm	Observations / Conclusions by NFRA
▪ Transaction cannot be termed as restructuring as per RBI Prudential Norm as restructuring generally includes modification of terms of advance, alteration of repayment period / amount, change in instalments / interest rates	▪ The RBI had, as early as in 2015, when the transaction first took place, directed the Company to make provision for the entire value of X Co's shares as of 31.3.2015, treating it as current investment ▪ Principle of Substance over Form to be applied. Repayment would happen in 2020 instead of 2014, interest is forgone, reduction in principal value .. Clearly shows that this is restructuring. ▪ RBI Policy states that restructuring has to be based on financial viability and reasonable assurance of repayment from the borrower based on accepted viability benchmark, promoters guarantee is obtained; it would be evergreening if done without assessment of viability ▪ Ultimate Guarantor Co3 is a fellow subsidiary of the Auditee

RBI Inspection – Shares and Derivatives

Reply by the Firm	Observations / Conclusions by NFRA
▪ The GN on Derivatives issued by the ICAI fully applies to the put option agreement, it covers all Derivatives except those specifically notified as excluded ▪ Para 11 of the GN provides the examples to which GN is applicable. GN further states that those examples are illustrative and not exhaustive. Para 13 of GN – Three ingredients of Derivative is satisfied by the Put Option ▪ In item (iii) of Para 11, there is a specific mention of traded contracts, and in all the other items, there is no such specific mention of the traded contracts clearly implying that unquoted derivative quotes are also covered under the GN. Nowhere in the GN is it explicitly stated that unquoted derivatives are not covered under the scope of the GN as has been alleged	▪ The statement that the list is illustrative only and not exhaustive, cannot be interpreted to mean that instruments which do not share the tradability characteristic of the instruments in the list, could be included (list includes traded derivative contracts such as traded equity index options, traded stock futures and options) ▪ Para 17 defines the Fair value as the Exit Price that would be received if transferred to knowledgeable counter party. Thus, this value should also incorporate the creditworthiness of the Option Writer. This evidence has not been obtained. ▪ Para 11 of the GN states.. GN thus applies to…describing final scope of GN after taking into account everything which precedes it. Thus, GN does not apply to FI which does not share the tradability features

RBI Inspection – Shares and Derivatives

Reply by the Firm	Observations / Conclusions by NFRA
The RBI report refers to the permitted use of the Black Scholes Model to value an option that is not traded	This does not mean that the Black Scholes Option Model can be used in a situation where the underlying itself is not traded as in this particular case ▪ Valuation of Put Option of X Co's shares was most important element of the financials. It's value of 184 Cr is 1043% of the PBT; removal of this value would have resulted in meagre profit of 17 Cr. Given the declining trend of the profitability the Firm should have applied extra skepticism and challenged the Management on Data Source, Computation method of the valuation Model, fundamental principles behind the computation, adjustment if any need to be done to the Model ▪ Black Scholes model determines the value of the option as a function of current stock price, the strike price, time to expiration, interest rate that may be earned from safe investments, and the expected volatility of the log returns of the underlying security ▪ In WP there is no evidence of source of assumption such as risk free interest (7.086% taken from Bloomberg), Standard Deviation of 11.01% without naming the source. Value of Put Option at 209 Cr is mere an arithmetical exercise

RBI Inspection – Shares and Derivatives

Reply by the Firm	Observations / Conclusions by NFRA
▪ Firm is not required to keep all the agreements verified during the course of audit in the audit file ▪ Assessment of the Option Writer (Co1) was not necessary as its credit risk was guaranteed by Co2 ▪ Guarantee of Co2 was based on MoU signed with Co3 with whom the land parcels were mortgaged. On sample basis original title deeds of land mortgaged and charge creation document was verified	▪ The Shareholder's and Option Agreements did not form part of the Audit File. There is, hence, no evidence that the Auditor had verified or checked the agreements ▪ Copy of E mail dated 23 May 2018 with Annexures that was produced was not part of Audit File ▪ Put Option writer was a Company. Their financials have not been examined. To obtain appropriate audit evidence about creditworthiness of the Option Writer Co, financials should have been seen ▪ Co 2 has given guarantee to the Auditee but guarantee document is not in Audit File. Total liability to the group is 443 Cr while Guarantee is of only 300 Cr. ▪ Basic requirement of checking the charge that has been registered on land parcels have not been verified to evaluate whether realization would be sufficient to meet the obligation of Guarantor

RBI Inspection – Shares and Derivatives

Reply by the Firm	Observations / Conclusions by NFRA
	▪ No explanation in Audit File as to why ultimate guarantee is based on revenue generated by Auditee group Co3 (who agreed to sale land parcels through Borrower group Co and agreed to share 20% of sale proceeds) ▪ WP submitted do not support the Audit Firm's submission of verifying "original" title deeds of land mortgaged and charge creation document. Details of how the original title deeds were obtained and/or copies thereof are not available when it was equitable mortgage ▪ Firm failed to recognize the transaction as restructuring but also non recognition of NPA when there was no proof of viability benchmark. Also no disclosure was made in the financials when specifically asked by RBI

RBI Inspection – Shares and Derivatives

Reply by the Firm	Observations / Conclusions by NFRA
▪ The rights under the put option agreement did not arise in FY 2016 and FY 2017 due to the underlying value of shares ▪ Thereafter, pursuant to the diminution in the value of shares, the put option was triggered during the year ended 31 March 2018 ▪ Had the put option been accounted in the years ended 31 March 2016 and 31 March 2017 as suggested by NFRA, such accounting would have been fraudulent and would have inflated the profit of those years by the value of Put Option as value of Investments in Shares also continued as per V/R	▪ The Shares had to be treated as current investments in terms of the RBI Master Directions and to be valued at the lower of "break-up value" or "earning value" as has been pointed out by the RBI in its Inspection Report, this valuation was to be made as of 31.03.2015 itself ▪ The obtaining of "independent third party valuation reports" and basing the valuation of Co X's shares on these reports was completely unwarranted and incorrect ▪ Put Option Agreement is dated 23 Dec 2015 and exercise period started after 1 year and extended up to expiry. Thus, Put Option is supposed to be triggered on 23 Dec 2016 and thus, its Value, by any method, would have been recorded in 31 March 2017 ▪ Fraudulent accounting has happened in 2018 as high value to Put Option has been given when underlying as well as credit worthiness of the Option Writer is discredited

RBI Inspection – NOF and CRAR

Reply by the Firm	Observations / Conclusions by NFRA
▪ The RBI had not raised any concern about the calculations up to 2016 though the company had been following the same definitions since 2007 ▪ There was no "accounting" aspect involved in the matter. The criteria for "companies in the same group" was a matter of interpretation of law covered under SA 250 ▪ In accordance with the requirements of SA 250, Firm had obtained an understanding of the matter, discussed the same with the management and obtained a signed letter of representation and communicated the same to the AC as part of their year-end presentation	▪ The ET had unquestioningly accepted the management's position on this matter that there was no clarity in the definition of "companies in the same group" in the Act and that there were multiple interpretations possible ▪ The ET had accepted the management's internal documentation of matters discussed in RBI office without asking for or obtaining any confirmation from the RBI about the same ▪ Firm has referred to Section 370(1B) of the CA 1956 which defines "companies under the same management" but ignored the definition of "companies in the same group" as provided in Section 372(11) of the CA 1956

RBI Inspection – NOF and CRAR

Reply by the Firm	Observations / Conclusions by NFRA
▪ Section 45-IA (7) of the RBI Act, 1934, provides that the term "Companies in the same group" shall have the same meaning assigned to them in the CA 1956. ▪ The CA 1956 does not define "companies in the same group". Section 370(1B) defines the companies under the same management, Section 211 refers to AS 21 which defines the Group, Section 108H refers to the definition of Group referred to in MRTP Act ▪ The Firm has provided SA 250 checklist issued by the ICAI duly referenced to the audit work papers to demonstrate compliance with the requirements of SA 250	▪ Explanation to Section 45-IA (7) of the RBI Act provides that the term shall have the same meaning as assigned to them in the CA 1956 ▪ Sections 370 and 372 of CA 1956 clearly define the said term. These sections were made in-operative by the Companies (Amendment) Act, 1999. But, they were neither repealed from the Act nor were the references to those sections in other parts of CA 1956 or RBI Act deleted ▪ Section 465 (2) (c) of the CA 2013 lays down that any rule of law, inter alia, shall not be affected by the repeal of the CA 1956 notwithstanding that such rule of law had been derived from the repealed enactment ▪ Definition of "companies in the same group" is an interpretive issue is completely misleading

RBI Inspection – NOF and CRAR

Reply by the Firm	Observations / Conclusions by NFRA
▪ The matter of NOF / CRAR did not impact the amounts recognized in the Balance Sheet, Statement of Profit and Loss and the Cash Flow Statement or result in any misstatements thereto	▪ The RBI in its Inspection Report of 2015 dated 6 May 2016, has clearly stipulated how the "companies under the same management" should be considered and assessed NOF as negative ▪ Despite the presentation given by the company, RBI in its report dated 14 Sep 2016, has again reiterated its stand and has assessed NOF and CRAR as negative. Further, RBI in its email dated 27 March , 2017 has clearly stated that the compliance submitted by the company "pertaining to major issues like group exposure, … etc. are not accepted" ▪ In a letter written by the Co to the RBI Deputy Governor, the company had stated that the increase in exposure to group companies was due to factors beyond the company's control. Thus, the management had already accepted the definition given by RBI

RBI Inspection – NOF and CRAR

Reply by the Firm	Observations / Conclusions by NFRA
	▪ None of the WP shows challenging the Management stand regarding NOF/CRAR or the alleged interpretive issue of "companies in the same group". There is no independent analysis carried out by the Audit Firm regarding the issues raised by RBI or the legal position in this regard ▪ Firm ignored overwhelmingly clear legal position as brought out by CA 1956, CA 2013, RBI Act 1934, RBI Master Directions 2016 and RBI Inspection Reports and chose to accept the stand taken by the management without questioning it even once ▪ Firm failed to exercise due diligence and professional skepticism, as required by the SA

Written Representation relating to RBI Inspection

Reply by the Firm	Observations / Conclusions by NFRA
▪ Given the profile of the Independent Directors in the Audit Committee and Board of the Company (including shareholder nominated directors who represented reputable shareholders' interests), the Audit Firm had no reasons to doubt their integrity, ethical values, competence, or diligence and commitment of management - Para 15 of SA 580	▪ Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfilment of management's responsibilities, or about specific assertions – Para 3 of SA 580 ▪ In particular, if written representations are inconsistent with other audit evidence, the auditor shall perform audit procedures to attempt to resolve the matter - Para 16

Written Representation relating to RBI Inspection

Reply by the Firm	Observations / Conclusions by NFRA
	▪ The requirements of SA 580 needed the Auditor to obtain corroborating evidence for the matters covered by the written representation before accepting the same ▪ In all its correspondence, RBI had noted the divergence in computation of NOF and CRAR and had provided a corrected computation with negative NOF and CRAR

Written Representation relating to RBI Inspection

Reply by the Firm	Observations / Conclusions by NFRA
▪ AC had considered the management's update on their meeting with RBI officials and hence Firm relied on the representation. If AC had any doubt they would not have approved the FS	▪ AC meeting was held on 28 May 2018, the date when FS were approved and informed to the SE. So no doubt could be raised on the supposed ratification by the AC of the management update as that stage ▪ It is the duty of the external auditor to provide appropriate support to the Audit Committee in the discharge of its functions ▪ Audit Firm was supposed to raise the issues highlighted by RBI with the AC instead of misleading them ▪ Firm had completely supported the stand taken by the management without conducting any independent enquiry. This is despite the fact that the evidence provided by the statutory position, as well as the regulator's observations, were completely inconsistent with the management representations – Para 16 and A23 of SA 580

Written Representation relating to RBI Inspection

Reply by the Firm	Observations / Conclusions by NFRA
	▪ The Audit Firm was in such hurry that in one single day it ensured communication with TCWG, review by EQCR, presentation of Audited Financial Statements to Audit Committee and Board of Directors, and the final signatures on the audit report, with complete disregard to SA 260 (Revised) and SQC 1

Evaluation of Going Concern Assumption

Reply by the Firm	Observations / Conclusions by NFRA
▪ Considering the Indian bullish market and past trend of the performance of the company, Firm was of the view that the going concern assumption was appropriate ▪ During our discussions with the directors, management and review of relevant board minutes, etc., we were not made aware of any doubt which would call into question the financial viability of the parent or any of its subsidiaries through the date of the audit opinion ▪ The RBI had not issued any letter for cancelling the company's Certificate of Registration if 31 March 2019 deadline was not met ▪ Also that the plans for compliance proposed by the management were also approved by the AC	▪ Para 10 (b) of SA 570 (Revised) - the auditor was duty bound to discuss with the management the basis for the intended use of the going concern assumption in a situation where the management had itself not performed such an assessment, as was the admitted situation in this case. This is Requirement portion of the SA, Unconditional and Mandatory ▪ Para 12 requires that the auditor shall evaluate Management's assessment of the entity's ability to continue as a going concern. Para A8 further adds that Management's assessment of the entity's ability to continue as a going concern is a key part of the auditor's consideration of Management's use of the going concern basis of accounting

Evaluation of Going Concern Assumption

Reply by the Firm	Observations / Conclusions by NFRA
	▪ Para 16 (a) of SA 570 (Revised) - When Management has not yet performed an assessment of the entity's ability to continue as a going concern, the Firm shall request the Management to make the assessment. No such request has been included in the Audit File ▪ Para A3 of SA 570 (Revised) gives examples of 21 events, in a listing that is described as "non-inclusive", of conditions that, individually or collectively, may cast significant doubt about the going concern as option. The Firm has listed only 12 events and given a standard comment of one line for each of them ▪ The checklist given in SA provides that non compliance with capital or other statutory requirements such as solvency or liquidity requirements is an indicator of events that may cast doubt on ability to continue as going concern

Evaluation of Going Concern Assumption

Reply by the Firm	Observations / Conclusions by NFRA
▪ The Directors Responsibility Statement also clearly makes the assertions that the directors had prepared the annual accounts on a going concern basis	▪ A belief that Management and TCWG are honest and have integrity, does not relieve the auditors of the need to maintain professional skepticism or allow the auditor to be satisfied with less than persuasive audit evidence when obtaining reasonable assurance (Para A22 – SA 200) ▪ The assertions in the Directors Responsibility Statement do not amount to an assessment by the Management of the going concern assumption, much less an evaluation of such an assessment by the Firm

Evaluation of Going Concern Assumption

Reply by the Firm	Observations / Conclusions by NFRA
▪ Availability of cash profit after tax for 2017 and 2018, provisions for NPA and standard assets as per RBI norms, positive networth, undrawn facilities with bank of INR 828 Cr as at 31 March 2018, no default in payment, excess of long term funds over long term assets etc were considered on that date that could cause significant doubt about ability to continue as GC. On various matters discussion was held with CFO	▪ None of these points have been analyzed in the WP ▪ All the justifications seems to be afterthought with no backing in the audit file ▪ The evaluation of the going concern assumption as claimed to be done by the Firm is found to be completely insufficient as a guide to future liquidity. It is not supported by any future cash flow statement or an analysis of adverse key ratios - Para A3 of SA 570 (Revised) ▪ The decrease in the Net worth of the company as on 31 March 2018 and the major reduction in the Profit earned during the year, were not given due importance ▪ The Audit Firm failed to test the source of the cash generated and the company's ability to meet the immediately arising future liabilities

Evaluation of Going Concern Assumption

Reply by the Firm	Observations / Conclusions by NFRA
▪ As per Para A9 of SA 570 (Revised) it is not the auditor's responsibility to rectify the lack of analysis by management. When there is a history of profitable operations and a ready access to financial resources, management may make its assessment without detailed analysis	▪ The context referred to is only a situation where management has not made any detailed analysis. It does not cover a situation as this where, admittedly, no analysis at all was available
▪ It will be incorrect to state that the Management did not perform any analysis of cash flows and going concern, when considering the regulatory disclosure requirements in the form of "Asset Liability Management Maturity pattern of certain items of Assets and Liabilities", which was disclosed in the financial statements by the Management	▪ The "Asset Liability Management Maturity pattern of certain items of Assets and Liabilities", which has been disclosed in the financial statements by the Management is not a substitute for future cash flow analysis. No document in audit file that suggest that this authenticity of information is verified ▪ It is the disclosure as per RBI directive and is not a substitute for what the Firm needs to do as per SA ▪ Firm has not provided any evidence to show that they scrutinized or performed any procedures to review the cash flow forecasts for at least a 12-month period

Evaluation of Going Concern Assumption

Reply by the Firm	Observations / Conclusions by NFRA
▪ "Emphasis of Matter" paragraph was included in the audit opinion referring to the matter relating to companies in the same group as per RBI directions is an evidence of discharge of professional responsibility with regard to the going concern issue	▪ The Audit Firm was required to evaluate management's assessment of the going concern assumption and agree with it or disagree with it ▪ There is no evidence adduced from the Audit File to show that the doubts, if any, about the going concern assumption were considered while deciding on the EOM Para ▪ Use of "Emphasis of Matter" paragraph to discharge responsibilities with regard to going concern basis is not supported by SA ▪ EOM Para did not include any reference to the "going concern" issue ▪ Firm was required to evaluate management's assessment of the going concern assumption and agree with it or disagree with it. EOM para does not do any of such thing

Documentation of ECQR Process

Reply by the Firm	Observations / Conclusions by NFRA
▪ SQC 1 does not specify any documentation requirement related to the performance of EQCR procedures ▪ No mandatory documentation of discussions between the EQCR Team and the ET is prescribed in the SAs ▪ The EQCR has reviewed multiple audit work papers and signed the same as an evidence of review. The same has been documented with the help of a checklist, as required by SA 220.	▪ The work papers do not identify or document any discussion about significant matters between EQCR team and the EP ▪ The EQCR was not carried out in a timely manner at appropriate stages during the engagement ▪ Even though the EQCR team has claimed to have reviewed multiple audit work papers, there is not a single paper in the Audit File where the EQCR has carried out independent analysis or review ▪ WP 24340, Provision for General Contingencies, just shows an opening balance of Rs.450 crores and closing balance of Rs.275 crores. The reversal of Rs.175 crores from provision for general contingencies has not been explained. The EQCR team has neither done any independent Analysis nor questioned the ET on the same. The conclusion is, therefore, inescapable that the profits for the year were inflated by Rs. 175 crores, without any basis or justification

Documentation of ECQR Process

Reply by the Firm	Observations / Conclusions by NFRA
▪ The Paras/text given in SA 230 are in the context of "Auditor" and not in the context of "EQCR". A distinction between Auditor and EQCR is more particularly set out in Para 24 and 25 of SA 220. ▪ As per Para 25 of SA 220, what is required is only an affirmation from the EQCR on the compliance with the statements (Para 25 does not envisage a narrative description as required under the clauses of paragraph 24 for the Auditors)	▪ Both Paras 24 (for ET) and 25 (for ECQR Team) of SA 220 lay down what information needs to be documented. The word "document" cannot be interpreted to mean mere 'yes' or 'no' responses to a set of standard questions prepared as a general all purpose template ▪ Footnote to Para 3 of SA 230 gives reference to Para 60,63 and 65 of SQC1 which relates to the policies and procedures of ECQR, Eligibility of ECQR, matter to be included in the EQCR including evaluation of firm's independence, significant risk identified during the engagement, judgements made particularly with respect to materiality and significant risk etc ▪ It is not acceptable to look at any single extract from the SAs that ignores the overall context. It is, therefore, necessary to consider the "Nature and Purpose of Audit Documentation" (Paras 2 and 3 of SA 230) as providing the overall context for audit documentation

Documentation of ECQR Process

Reply by the Firm	Observations / Conclusions by NFRA
	▪ Paras 8 to 11 of SA 230 dealing with the Form, Content and Extent of Audit Documentation will also have to be considered ▪ Para 3 of SA 230 clearly states that Audit documentation serves a number of additional purposes including enabling the conduct of quality control reviews and inspections in accordance with SQC 1 ▪ Para 25 of the SA 220 states that EQCR shall document: EQCR has been completed on or before the date of audit report and reviewer is not aware of any unresolved matters that would cause the reviewer to believe that significant judgment ET made and the conclusion reached were not appropriate ▪ Mere confirmation relating the issues covered by Para 25 is not sufficient ▪ Para 36 of the Firm's SQC Policy - Documentation of an engagement quality control review shall contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand the procedures performed by the engagement quality reviewer, and others who assisted the reviewer, to comply with the provisions of this section

Documentation of ECQR Process

Reply by the Firm	Observations / Conclusions by NFRA
	▪ The work papers do not identify or document any discussion about significant matters between EQCR team and the EP ▪ The EQCR has not noted the absence of any communication at all between the ET and TCWG ▪ The EQCR was not carried out in a timely manner at appropriate stages during the engagement ▪ The EQCR required an in-depth examination to be made of the issues arising out of the RBI inspection and directions. Documenting the EQCR process in this connection, and the conclusions arrived at, could not be reduced to mere check box “Yes” or “No” responses

Documentation of ECQR Process

Reply by the Firm	Observations / Conclusions by NFRA
	▪ Firm has stated that communication with TCWG on all the RBI related matters were carried out through a Presentation to the AC (W.P. No. 30301) on 28 May, 2018. On the same date, the audit was finalised, the accounts were approved by the Audit Committee, as well as the Board of Directors. ▪ The EQCR partner reviewed all the documents pertaining to the RBI matters and also reviewed and finalized all the closing documents including the 'EQCR close indent' and the final Auditors Report. However, the total man hours logged by the EQCR team on 28 May 2018 is just one hour. It may further be noted that the EP was in the AC meeting whereas the EQCR team was not part of the AC meeting. Hence any interaction between the EQCR team and EP was not possible on that day ▪ EQCR has failed in appraising the quality of the work performed. The EQCR has also failed miserably in providing an objective evaluation of the significant judgements the ET made and the conclusions they reached in formulating the report. Thus, the Firm has failed in complying with various provisions of SQC1, SA 220 and SA 230

Documentation of ECQR Process

Reply by the Firm	Observations / Conclusions by NFRA
▪ The definition of "Auditor" as given in SA 200 states that the term is used to refer to the person or persons conducting the audit, usually the EP or other members of the ET or, as applicable, of the firm	▪ EQCR team members also carry out the audit of the client and are members of the Firm ▪ Even the Firm in its presentation to management on 19th January, 2018 (WP 13902) has shown EQCR as Audit Support Team and part of ET
▪ Firm has initiated certain refinements to the EQCR process such as requiring the maintenance of minutes of discussions between the EQCR team and the ET. This is likely to apply for the audits from year ending 31st March, 2020	▪ The refinement in the EQCR process that the Firm intends to apply is an acknowledgement of the merit of the issues raised by NFRA

SQC 1 Compliance – Policies and Procedures

Reply by the Firm	Observations / Conclusions by NFRA
▪ The SQC Policies within the DPM Level I and DPM Level 2 policies are compliant with ISQC 1, and the DPM India Level 3 Policies, which are India specific will prevail over the DPM Level 1 and DPM Level 2 policies in case of any conflict ▪ DPM Level 1, Level 2 and the DPM India Level 3 read together address the requirements of SQC 1 as issued by the ICAI ▪ The DPM Level 1 and DPM Level 2 Policies and the DAAM are available to all practitioners on the network's intranet	▪ Policy is itself in the form of numerous documents with a large number of inter-references. All this is to be supplemented by the Level 3 India Specific Policies. Besides, a perusal of the documents clearly showed that it was only a portion of the total QC documentation that had been provided and that there are numerous other documents which are all said to be a part of policy documentation. Overall, it was clear that the total QC policy documentation would be considerably in excess of the approximately 500 pages ▪ Documentation of the Quality Control Policies and Procedures of an Audit Firm should be in the form of a single document that is both comprehensive and concise, and contains, in a systematic, structured and coherent manner

SQC 1 Compliance – Policies and Procedures

Reply by the Firm	Observations / Conclusions by NFRA
▪ The DPM India Level 3 Policies are available on the Audit Knowledge Management (AKM) website ▪ SQC 1 does not require the quality control procedures to be in a single document ▪ While Para 3 of SQC 1 states that 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," Para 107 states that "how such matters are documented is the firm's decision."	▪ Most of the documents seemed to be from the Global Network Entity and had not been developed with reference to Indian laws, rules and regulations ▪ These documents also have a very substantial part completely unrelated to any operations in India. The sheer volume of the documents, and their substantial irrelevance to Indian conditions, laws and operations, would make it a certainty that the employees of the Firm will be left completely without any guidance about what exactly is to be understood as the approved policy in any situation ▪ The supposed equivalence of International Standard to, or their even greater rigour in comparison with, Indian Standards is entirely irrelevant for the purposes of NFRA

SQC 1 Compliance – Policies and Procedures

Reply by the Firm	Observations / Conclusions by NFRA
▪ DPM Level 1, DPM Level 2 and DPM Level 3 Policies, read in a holistic and harmonious manner, incorporate all the policies as required by SQC 1	▪ The complete breakdown of QC system evident in this case is serious enough to support the suspicion that the Audit Firm had aligned itself completely with the interests of the management of the Auditee ▪ NFRA concluded that the Audit Firm should, without any further delay, prepare a comprehensive, concise and systematically structured policy document to conform to SQC 1 and provide the same to the Authority for its perusal at the earliest
▪ Policies and Procedures for independence, including threats to independence, are covered by DPM 1420-Independence. These Policies are communicated to all concerned and are hosted on the Risk and Reputation Office (RRO) web page	▪ The policies and procedures relating to independence, which are required to be an integral part of the QC Manual, are not present in the Section titled “Independence” ▪ The said document (DPM 1420-Independence), which runs to 150 pages, was carefully gone through. It is seen that this document is based completely on US laws; it has no reference whatsoever to Indian laws ▪ Audit Firm does not have a policy document as required by SQC 1

Matters for Consideration – not part of NFRA report

- Para 290.172 of ICAI Code of Ethics – 2009: **Taxation services** comprises broad range of services including compliance, planning, provision of formal taxation opinion, assistance in resolution of tax dispute are generally not seen to create the threat to independence

- Para 290.181 of ICAI Code of Ethics – 2009: Self review threat may be created when **litigation support services** provided to a financial statement audit client include the estimation of possible outcome and thereby affects the amounts or disclosures to be made in the financial statements. Significance of such threat depend upon factors such as (i) materiality of the amount (ii) degree of subjectivity inherent in the issue (iii) nature of the engagement

- Para 290.183/186 of ICAI Code of Ethics – 2009: Provision of **Legal Services** to financial statement audit client – Person rendering the services must be eligible to practice law before the Courts. Legal due diligence and restructuring may create self review threats which can be reduced to an acceptable level by providing the services by non ET member, client takes the ultimate decision and service is merely execution of the decision taken by the client

Matters for Consideration – not part of NFRA report

- SA 220 as well as SQC 1 contains same definitions – EP, EQCR, ET, Firm, Inspection, Listed Entity, Monitoring, Networking Firm, Networking, Partner, Personnel, Professional Standards, Staff) – Why duplication?
- Reasonable Assurance as per SQC1 – a high, but not absolute, level of assurance
- Whether to read SA like a Bare Act?
- RBI found many non-compliance since 2015 then why it did not cancel NBFC License till non-compliance was corrected?
- BoD / AC responsibility on non-compliance to RBI policy for many years?