

EXECUTIVE SUMMARY

SUPPLEMENTARY AUDIT QUALITY REVIEW REPORT DATED 07-12-2020.

Audit Engagement

Audit of IL&FS Financial Services Limited Done by Deloitte Haskins and Sells LLP for the Financial Year 2017-18.

The Process

National Financial Reporting Authority (NFRA) has conducted an Audit Quality Review (AQR) of the statutory audit for the year 2017-18 of ILFS Financial Services Limited (IFIN). The AQR Report (AQRR) has been issued on 12th December 2019. NFRA had examined only some select issues arising out of the Statutory Audit of IFIN for 2017-18 in detail in the AQRR issued on 12th December, 2019. It reserved its right to follow up on the issues that had not been covered in the AQRR by a Supplementary AQRR (SAQRR). NFRA had issued an additional questionnaire on 21st October, 2019. After examining the response of the Audit Firm to the questionnaire NFRA issued a Draft Supplementary AQR report dated 1st May, 2020 for which the Audit Firm provided their replies. Later, the Audit Firm made a presentation followed by a clarification letter on certain matters discussed during the presentation. All this material has been carefully scrutinised in the preparation of this SAQRR, which covers issues which were not covered in the AQRR dated 12th December, 2019.

The Findings

1. The appointment of DHS as the statutory auditor of IL&FS Financial Services Ltd. (IFIN) for the year 2017-18 was illegal, since DHS was not eligible to be appointed as such auditor due to violation of Sec 141(3)(e) (subsisting business relationships on the date of appointment) and Sec 141(3)(i) (provision of non-audit services directly or indirectly) of the Companies Act, 2013.
2. Notwithstanding such lack of eligibility, and without prejudice to such finding, NFRA has examined certain other areas of Audit not covered in AQRR dated 12th December,

2019. Some of the important findings described in detail in the SAQRR are mentioned below. Anyone interested in understanding the matters listed in the succeeding paras in more detail is requested to go through the full AQRR.

3. The SAQRR has showed that DHS has failed to comply with the requirements of the SAs. The instances of failure noticed are of such significance that it appears to NFRA that DHS did not have adequate justification for issuing the audit report asserting that the audit was conducted in accordance with SAs.
4. In this connection, NFRA wishes to draw attention to Response 12 in the ICAI's Implementation Guide on Reporting Standards (November 2010 Edition) which says that **“A key assertion that is made in this paragraph is that the audit was conducted in accordance with the SAs”**; and that **“If during a subsequent review of the audit process, it is found that some of the audit procedures detailed in the SAs were not in fact complied with, it may tantamount to the auditor making a deliberately false declaration in his report and the consequences for the auditor could be very serious indeed”** (emphasis added).
5. IFIN's reported Profit Before Tax for 2017-18 was **Rs 201.96 crore**. This was reported after taking credit/not providing for the following:
 - a. Unjustified Valuation of a Derivative Asset: **Rs 184 crore** (Covered in AQRRR Dated 12th December, 2019);
 - b. Reversal of General Contingency Provision: **Rs 225 crore**;
 - c. Non-provision for Impairment in the value of Investments: **Rs 200.20 crore**. (This total excludes some investments in respect of which NFRA has not been able to arrive at a specific amount for the impairment)
6. In all the above cases, DHS has not obtained sufficient, appropriate audit evidence, as required by the SAs, to support the specific numbers finally reported in the Financial Statements. The total of the 3 items mentioned above alone have led to an inflation of the profits of IFIN by **Rs 609 crore**.
7. Numerous other violations of the SAs have been detailed in the SAQRR. These deal with determination of Materiality amounts on the basis of non-relevant factors, deficiencies in applying analytical procedures, failure to respond to subsequent events and inadequacies in auditing of creation of charges on assets mortgaged with the company.
8. The Engagement Quality Control Review (EQCR) mechanism was found to be completely inadequate for the intended task.

9. NFRA has also extensively studied the IT processes and platform that are used by DHS for their Audit File documentation. NFRA found that the IT processes/platform have deficiencies that are systemic and structural in nature and arise from a complete disregard for basic principles of IT security in the software used. This makes the audit documentation completely unfit for the intended purpose.
