

**EXECUTIVE SUMMARY OF AUDIT QUALITY REVIEW REPORT  
DONE BY NFRA.**

AUDIT OF IL&FS FINANCIAL SERVICES LIMITED DONE BY DELOITTE HASKINS AND SELLS LLP FOR THE FINANCIAL YEAR 2017-18.

1 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 statutory auditor for this engagement was Deloitte Haskins and Sells LLP (DHS). The Non-Convertible Debentures and Non-Convertible Redeemable Cumulative Preference Shares issued by IFIN are listed on the Bombay Stock Exchange (BSE). The auditors of IFIN, therefore, fall under the jurisdiction of NFRA by virtue of Rule 3 of the NFRA Rules, 2018.

2. The AQR was conducted pursuant to Section 132(2)(b) of the Companies Act, 2013, which requires the NFRA to, inter-alia, monitor and enforce the compliance with accounting standards and auditing standards in such manner as may be prescribed.

3. Rule 8 of the NFRA Rules, 2018, provides that, for the purpose of monitoring and enforcing compliance with auditing standards in the act, the 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.

4. The AQR is designed to identify and highlight non-compliance with the requirements of the Standards on Auditing (SAs) and to bring out insufficiencies in the quality control system of the audit firm, as well as shortcomings in the documentation of the audit process. The AQR also evaluates the quality and adequacy of the supervisory procedures of the audit firm. The AQR, therefore, is not to be treated as an overall rating tool.

5. The AQR process commenced on 25<sup>th</sup> February, 2019. It went through several different stages before a draft AQR Report was issued to DHS on 23<sup>rd</sup> September, 2019. After considering the responses of DHS to the draft AQR Report, both at the oral presentation made by DHS to the NFRA on 30<sup>th</sup> October, 2019, and in writing on 4<sup>th</sup> November, 2019, NFRA has finalized the AQR Report.

6. The AQR has disclosed 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 the SAs.

7. This AQR does not cover the entire scope of work involved in the statutory audit. A supplementary report may be issued later to deal with matters that have not now been covered in the report.

8. The AQR points out that:

- a. The independence of the auditor was compromised by the provision of non-audit services for substantial fees; that these non-audit services were clearly prohibited services in terms of Section 144 of the Companies Act, 2013; and the mandatory approval of the Audit Committee that would have been required if the provision of such services was permissible was not obtained;
- b. The Engagement Partner, i.e., the partner designated by DHS as the person in overall charge of the statutory audit work had signed the Audit Report without discharging most of the important duties that the Engagement Partner is required to fulfill; the Audit Firm also violated SQC 1 and SA 220 by naming two partners as Engagement Partners, thereby leading to loss of accountability.
- c. DHS did not display the required professional skepticism, and did not challenge the management on important issues;
- d. DHS failed to appropriately deal with identification, categorization and minimization of Engagement risk, especially looking at the size, nature and economic significance of the Auditee company. The risk of misstatement due to fraud was ruled out by DHS. This led to inadequate audit responses.
- e. DHS accepted the stand of the management about not disclosing the fact that the Net Owned Funds (NOF) and the Capital to Risk Assets Ratio (CRAR) of IFIN as on 31<sup>st</sup> March, 2018 were both negative, and that this situation would lead to cancellation of the NBFC license of the company. DHS certified the accounts showing positive NOF and CRAR, accepting the explanations of the management which were clearly contrary to law.
- f. DHS did not adequately question the going concern assumption on the basis of which the management had prepared the financial statements.
- g. DHS did not question the management and challenge the inflation of profit by over Rs.180 crores through inclusion of the value of a derivative asset which was entirely unjustified.
- h. DHS did not communicate any matter arising out of the audit to those charged with governance of the IFIN, even though mandated by the SAs to do so.
- i. The Engagement Quality Control Review, as said to have been carried out, has been shown to have been a complete sham.

9. NFRA has concluded that the quality control system and processes of DHS are severely

inadequate and ineffective, as has been brought out clearly by the details in the various sections of the AQR Report. DHS has been advised to take necessary action to revamp its quality control system and process, and rigorously ensure compliance with the said revamped system.

10. Separately, NFRA will examine whether disciplinary proceedings under Section 132(4) of the Companies Act, 2013 needs to be initiated.