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NFRA finds big gaps in audit of IL&FS arm

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The National Financial Reporting Authority (NFRA) has found that the initial appointment of the audit firm and its continuation as a statutory auditor of IL&FS Transportation Networks (ITNL) was prima facie illegal and void and that the company's losses were understated.

The statutory auditor for ITNL for 2017-18 (FY18) was S.R. Batliboi (SRB) & Co. LLP, which uses the EY brand and trademark for obtaining and providing audit services and is an independent member firm of Ernst & Young Global.

In its audit quality review report, the NFRA has said that ITNL's financial exposure to its subsidiaries, associates, and joint ventures - amounting to ₹3,346 crore - was not properly valued according to the applicable accounting standards.

"The audit firm has failed to appropriately and sufficiently evaluate the use of the going concern basis of accounting by the management and has thus, failed to note the implications thereof in the auditor's report," NFRA said in its report.

In a press statement, SRB said, "Over the past two years, we have cooperated fully with the NFRA and provided the information requested. We are disappointed with the conclusions in the audit quality review report of ITNL for FY18."

The company said it had performed the audit in accordance with the applicable standards and highlighted the issue relating to the going concern in its limited review report for the June 2018 quarter. "We are presently doing a detailed review of the report," the statement said.

The financial reporting authority found that the company's losses in FY18 were understated by at least ₹2,021 crore on account of unjustified reversal of expected credit loss on loans given to the special purpose vehicle and on-trade receivables, and due to incorrect impairment valuation.

"This is excluding the impact due to incorrect treatment of the letters of comfort amounting to ₹2,654 crore, which should have been correctly treated as financial guarantees as indicated by the accounting standards, the effect of which on profit/loss is not quantified," it said.

The watchdog also said in its report that the audit firm's engagement quality control (EQC) partner failed to report material misstatements known to him to appear in a financial statement with which he was concerned in a professional capacity. The EQC partner did not exercise due diligence to obtain sufficient information to objectively evaluate the significant judgments of the engagement team and conclusions reached by them.

Several firms of the Infrastructure Leasing & Financial Services have been under investigation by various agencies for fund diversion and mismanagement.

The NFRA's audit quality review has also pointed out that the integrity of the audit file was questionable due to tampering and inconsistency. "The audit firm has failed to maintain documents as maintained by the Standard on Auditing 230."

The NFRA has also said that the non-audit services provided were in violation of Section 144 of the Companies Act. Section 144 of the Act prescribes certain services which a statutory auditor is barred from performing.

"Instead of following this accepted principle of interpretation of law, the audit firm has gone ahead with defining the term 'management services' on its own by referring to various extraneous materials," it stated.

The authority has also found the auditor to be in violation of the Institute of Chartered Accountants of India's Code of Ethics 2019.

KEY CONCLUSIONS OF NFRA

- Initial appointment and continuation of SRBC & Co as statutory auditor illegal
- ITNL's financial exposure to its subsidiaries, JVs not properly valued
- Company's losses during 2017-18 were understated by at least ₹2,021 crore
- Audit firm failed to appropriately evaluate the use of the going concern basis of accounting
- Integrity of the audit file found to be questionable due to tampering