



राष्ट्रीय वित्तीय रिपोर्टिंग प्राधिकरण
National Financial Reporting Authority

INSPECTION REPORT
2023

Audit Firm: M/s B S R & Co. LLP
Firm Registration No. 101248W/W100022
Inspection Report No.132.2-2023-02
December 19, 2024

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PART A

Executive Summary

Section 132 of the Companies Act 2013 (the Act) mandates the National Financial Reporting Authority (NFRA), inter alia, to monitor compliance with Auditing Standards, to oversee the quality of service of the professions associated with ensuring compliance with such standards, and to suggest measures required for improvement in quality of their services. Under this mandate, NFRA conducted audit quality inspections of the Chartered Accountant Firm M/s BSR & Co LLP in August 2024. The scope included a review of the remedial actions taken by the Firm for the deficiencies reported in the previous report, and a thematic review of three selected audit engagements of financial statements for the years ending 31.03.2022 and 31.03.2023, focusing on three significant audit areas, viz., Internal Financial Control over Financial Reporting on Revenue, Related Party Transactions and Impairment of Non-Financial Assets, due to their inherent higher risk of material misstatement. The Inspection included an on-site visit in August 2024, discussions with the Audit Firm personnel including the engagement teams of select audit engagements, review of policies and procedures and examination of documents. The observations were conveyed to the Audit Firm. An Inspection Report was issued to the Firm, for which a written response was received. The key observations in this report are summarised as follows:

- a. The Audit Firm has remediated the documentation issues noted in the previous Inspection Report regarding its leadership structure. It has also made significant changes to the Firm's independence policy for non-audit services. The non-compliance rate for personnel independence has reduced considerably in the current year. The Audit Firm has changed its sign-off policy on audit work papers in response to the previous year's Inspection Observations. Part B of this Report summarises these changes and other remedial measures the Firm has taken in response to the previous year's Inspection Report.
- b. In one of the engagement files selected for review in the current inspection cycle, a significant deficiency in the verification of related party transactions, failure to ensure compliance with Section 143 (1) (e) of the Act and failure to appropriately evaluate compliance by the Aditee Company with Section 185 of the Act have been observed. These are detailed in Part C of this report.

Inspection Overview

1. Section 132 of the Act, inter alia, mandates the NFRA, to monitor compliance with Auditing and Accounting Standards, to oversee the quality of service of the professions associated with ensuring compliance with such standards, and to suggest measures required for improvement in the quality of their services. The relevant provisions of NFRA Rules prescribe the procedures in this regard, which include evaluation of the sufficiency of the quality control system of Auditors and the manner of documentation of their work. Under this mandate, NFRA initiated audit quality inspections in August 2024. The overall objective of audit quality inspections is to evaluate compliance of the Audit Firm/Auditor with auditing standards and other regulatory and professional requirements, and the sufficiency and effectiveness of the quality control systems of the Audit Firm/Auditor, including:

- (a) adequacy of the governance framework and its functioning.
 - (b) effectiveness of the firm's internal control over audit quality; and
 - (c) system of assessment and identification of audit risks and mitigating measures
2. This year's inspections involve a review of the remedial action taken by the Firm in response to the previous inspection observations and a test check of audit engagements performed by the Audit Firm during the financial years 2022 and 2023.
 3. Inspections are intended to identify areas and opportunities for improvement in the Audit Firm's system of quality control. Inspections are, however, not designed to review all aspects and identify all weaknesses in the governance framework or system of internal control or audit risk assessment framework; nor are they designed to provide absolute assurance about the Audit Firm's quality of audit work. In respect of selected audit assignments, inspections are not designed to identify all the weaknesses in the audit work performed by the auditors in the audit of the financial statements of the selected companies. Inspection reports are also not intended to be either a rating model or a marketing tool for Audit Firms.

Audit Quality Inspection Approach

4. Selection of Audit Firms for the 2023 inspections was based upon the extent of public interest involved, as evidenced by the size, composition and nature of the audit firm, the number of audit engagements completed in the year under review: complexity and diversity of preparer's financial statements (henceforth, Companies) audited by the firm and other risk indicators. **M/s BSR & Co. LLP**, a KPMG sub-licensee, was one of the audit firms selected as per the above parameters.
5. The selection of individual audit engagements of the Audit Firm, BSR & Co. LLP, was largely risk-based, based on financial and non-financial risk indicators identified by NFRA. Accordingly, the Audit Files in respect of three (3) Audit Engagements relating to the statutory audit of financial statements for the years ending 31.03.2022 and 31.03.2023 were reviewed during the inspection.
6. The scope of the inspection was as follows:
 - a. Review of the remedial measures and improvements made in response to the previous inspection observations for firm-wide quality controls to evaluate the Audit Firm's adherence to SQC 1, Code of Ethics and the applicable laws and rules.
 - b. Review of individual Audit Engagement Files- A sample of three (3) individual audit engagement files pertaining to the annual statutory audit of financial statements for the years ending 31.03.2022 and 31.03.2023 was selected. Three significant audit areas were identified in respect of each audit engagement viz., internal financial control over financial reporting pertaining to revenue, related party transactions and impairment of non-financial assets, due to their inherent higher risk of material misstatement.

The selected sample of three individual audit engagements is not representative of the Firm's total population of the audit engagements completed by the Firm for the year under review.

Inspection Methodology

7. An entry meeting for the current year's thematic inspection was held with M/s BSR & Co. LLP on 11.06.2024 at the NFRA office. Discussions were held with the engagement teams of the three audit engagements selected for review. The on-site inspection was carried out in August 2024 for a review of the improvements in response to the previous inspection report.
8. The areas of weaknesses or deficiencies of the Audit Firm, included in the inspection reports, should be viewed as areas of potential improvement and not as a negative assessment of the work of the Audit Firm unless specifically indicated otherwise.

Audit Firm's Profile

9. M/s BSR & Co. LLP, a Limited Liability Partnership, is a member of M/s BSR & Affiliates, which is registered with ICAI (The Institute of Chartered Accountants of India). It is a network of eight audit firms, which operates through a registered office and a number of branch offices at different locations across India. The Firm is a sub-licensee of the KPMG International Network. The Firm was a statutory auditor of 304 entities falling under NFRA's purview.

Acknowledgment

10. NFRA acknowledges the cooperation of the Audit Firm during all stages of the inspection.

PART B

Review of Firm-Wide Audit Quality Control System – Compliance with Previous Year's Inspection Observations

A. Leadership Responsibilities for Quality within the Firm

11. During the previous inspection, we observed the absence of a documented leadership and governance structure within the firm. In response, the firm has documented its leadership structure, the charter governing the leadership functions, and started documenting the minutes of the key decisions of the audit leadership team. The Firm has issued internal communications conveying these decisions and committed to us that it will continue to issue periodic communications by various leadership team members commensurate with their assigned responsibilities.

B. Independence requirements

a) Audit Firm's Independence

12. During the previous inspections, we observed potential violations of independence norms arising out of the provision of prohibited non-audit services by the global network entities of the Audit Firm.

13. In response, the Audit Firm and its Global Network Firm KPMG India have decided to implement the Non-Assurance Services (NAS) Policy for NFRA Regulated entities, effective 1st April 2023. After a transition period, the firm implemented this policy fully, effective 1st January 2024. The Firm has issued media communications and internal communications regarding the policy. The Firm has also instituted a monitoring mechanism at the Engagement Partner level for compliance with the policy.
14. As per the Policy, all entities of M/s BSR & Affiliates, KPMG Assurance and Consultancy Services LLP (“KPMG India”) and all the other KPMG India entities will not provide any non-assurance services to NFRA-regulated audit clients from 1st January 2024. The policy excludes non-audit services provided by network firms to a Holding Company, which is in the private equity business. However, it is stated in the policy that permissible non-assurance services to such holding companies may be provided, in so far as the service does not relate to the Firm’s audit client or its subsidiaries.
15. Overseas Network entities of KPMG are not mentioned in the policy. The Audit Firm submitted in this regard that the overseas KPMG entities cannot provide any non-audit services (either directly or by involving KPMG India or BSR entities) to Indian audit clients and/or their holding/ subsidiary entities in India, which are covered as per the new policy. We observe that for the KPMG entities, the non-audit services to overseas subsidiaries of Indian companies are governed by the International Ethics Standards Board for Accountants (IESBA) framework. The extent of compliance in this regard with Section 144 of the Act needs to be reviewed by the Audit Firm.
16. The policy also excludes assignments covered by guidance notes on reports or certificates for special purposes¹ issued by the ICAI.
17. We will continue to monitor the Audit Firm for the potential impact, if any, on Independence because of the above-listed exclusions and other kinds of non-audit services. The effectiveness of the policy can only be evaluated during the subsequent Inspection Cycles since the period of implementation available for verification during this inspection was less than a year.

b) Personnel Independence

18. In the previous inspection, we noticed high percentages of instances of non-disclosure of financial relationships as per the Firm’s policy identified as a part of the Independence compliance audit (ICA) of the Firm and issues in sample size for ICA. The Audit Firm has revamped its monitoring processes for disclosure of investments by its personnel. The Firm has made arrangements with CDSL, NSDL, CAMS and K Fintech for automated updating of investment details to the Firm’s personal independence compliance system. During the subsequent period, the Firm has also increased the number of ICAs, and sample sizes. It is

¹ As per the GN, “In some cases, Government and other authorities under various statutes or notifications require reports or certificates from practitioners in support of statements or other information provided by an entity. Such reports or certificates can also be required to be issued to fulfill a contractual reporting obligation or may be required by the management or those charged with governance of an entity for its own special purposes”. These reports and certificates are assurance engagements governed by the Framework for Assurance Engagements issued by the ICAI (refer to paragraph 9 of the GN).

demonstrated to us that the non-compliance rate has been reduced from 45% to 15% for the latest audit cycle.

19. In response to other observations regarding independence requirements, the Firm has introduced system-enabled controls requiring the engagement team to confirm their independence, specific independence confirmation from partners on compliance with requirements under the Companies Act, and evaluation of personal independence of KPMG Experts engaged in an Audit. We will continue to monitor the new system and procedures.

C. Audit Documentation

20. We observed during the previous Inspection that the Audit Documentation tool used by the Firm does not ensure the integrity of audit documentation since it allows for Audit Work Paper (AWP) modifications, after signing off by the Engagement Partner (EP). Despite the modifications, the earlier sign-off provided by the EP, preparers and reviewers remains unchanged. It does not mandate sign-off or review again by the EP after modification.
21. In response, the Firm has issued a policy for mandatory review & sign-off on work papers that have been modified since it was first reviewed & signed off before the archival of the audit files.
22. We observe that the policy needs further refinement since it does not mandate documentation of the changes and review history. The Firm has agreed to make the necessary modifications. We will continue to monitor the documentation policies and practices.

D. Other Observations of Previous Inspection

23. We note that the Firm has implemented remedial measures for all other observations in the previous inspection report. However, we will continue to monitor these measures since the period of implementation of many of them is less than a year as on the date of this inspection.

PART C

Review of Individual Audit Engagement Files Focusing on Selected Areas of Audit

24. This section discusses deficiencies observed in a few selected audit engagements. The inspection covered three individual audit engagements and focused on three audit areas viz., internal control over financial reporting pertaining to revenue, related party transactions and impairment of non-financial assets for detailed review. Certain critical audit procedures performed by the Firm's engagement team in respect of these audit areas were reviewed viz., identification and assessment of risk of material misstatement, internal controls, design and execution of audit procedures in response to assessed risk (test of controls, test of details, sample sizes, analytical reviews etc.), accounting estimates, accounting policies, disclosures and evaluation of identified misstatements. The observations are discussed below.

A. Deficiencies in the verification of Related Party Transactions (RPTs)

25. In the case of one audit (the auditee Company here referred to as Company A), it is observed that:

- a) As of 1st April 2021, Mr. B and C Pvt Ltd were the two promoters of Company A holding 55.2% and 42.41% of the equity shares respectively of Company A.
- b) As on 1st April 2021, Mr. B and his wife were the directors of C Pvt Ltd holding 90% and 10% of the equity capital, respectively. The only income of C Pvt Ltd is dividends received from Company A. It has no other business operations.
- c) As per Notes to Financial Statements of Company A, as on 1 April 2021, Equity Shares held by the Promoters, were pledged as security in respect of borrowings of C Pvt Ltd. These borrowings were repaid on 3 April 2021 and the pledge on the Equity Shares of the Company held by the Promoters was released on 5 April 2021.
- d) To repay C Pvt Ltd's borrowings, Company A paid ₹650 crore to C Pvt Ltd by subscribing to the Compulsorily Convertible Preference Shares (CCPS) issued by C Pvt Ltd. This transaction was partly financed by Company A through a private placement of non-convertible debentures (NCDs) on 26.03.2021 for ₹550 crore at a coupon rate of 12% p.a.
- e) On 31.1.2022, Company A completed its Initial Public Offer (IPO) through an Offer for Sale by Promoters, wherein the Promoters sold their equity shares for a total amount of ₹679 crore. Using this money, Mr A purchased CCPS of C Pvt Ltd from Company A for ₹650 crore on 28.1.2022. Company A used this money to repay the borrowings of ₹550 crores (NCDs), along with interest, raised solely to fund the promoters for their debt servicing.
- f) The Annual Report of Company A for FY 2022 states that Company A redeemed outstanding non-convertible debentures (NCDs) worth ₹ 550 crore, which was part of the Objects of the Offer (IPO). *"The one-off finance cost related to the NCDs, along with the other non-recurring expenses incurred during the year, impacted our profitability"*.
- g) As mentioned above, C Pvt Ltd is the promoter of Company A and the only income of C Pvt Ltd is dividends received from Company A. Therefore, there is apparently no business rationale for the investment of ₹650 crore made by Company A in CCPS of C Pvt Ltd. Since Mr. B was effectively controlling 100% shares of C Pvt Ltd and was also the promoter of Company A as on 1st April 2021, the substance of this fund transfer to C Pvt Ltd is a transfer of the Company's funds to Mr B, the promoter.
- h) The scheme of transactions indicates that Company A issued NCDs (for ₹550 crore) solely to arrange money for transfer to the promoters so that C Pvt Ltd can repay its debts. Other than this, there was no documented business rationale behind issuing NCDs by Company A. Thus, the proceedings from the NCDs (550 crore) and Company A's funds of ₹100 crore were used, in substance, for the personal purpose of Mr B. The

interest on these borrowings and other costs of the NCD issue, which is significant, as disclosed in the annual report, was also incurred for the personal purposes of the Promoter. As per Section 143 (1) (e) of the Companies Act, 2013, the auditor has to inquire whether personal expenses have been charged to the revenue account. The scheme and substance of transactions indicate misuse of the Company's funds and financial strength for the promoter's purposes. No examination and reporting in this regard is evidenced in the Audit File.

- i) Section 185 of the Companies Act 2013 prohibits a Company from providing any direct or indirect loans to its directors or relatives of such directors. In this case, C Pvt Ltd is fully owned by Mr B, the Promoter and Managing Director, and his wife. In substance, providing funds to C Pvt Ltd without any business rationale and its utilization by C Pvt Ltd to repay its debts amounts to indirect loans to the Director and his relative, in violation of Section 185. The Audit Documentation does not evidence verification of this prima facie violation of Law.
- j) Also, the disclosure of this related party transaction in the financial statements of FY 2022 is ambiguous since the investment made is described as investments purchased.

PART D**Chronology of Events**

Sr. No.	Date	Event/Correspondence
1.	22.12.2023	Publication of Inspection Report on the website of NFRA as per Rule 8 of NFRA Rules 2018.
2.	22.03.2024	Intimation of follow-up/thematic Inspection from NFRA to the Audit Firm.
3.	27.05.2024	Audit firm submitted three engagement files at NFRA office.
3.	11.06.2024	Briefing Meeting with BSR held at NFRA office.
4.	12.06.2024 to 21.07.2024	Off-Site Inspection
5.	23.07.2024	NFRA communication to Audit Firm regarding the Action taken in previous inspection observations
6.	08.08.2024	On-site inspection and discussion of engagement observations with Engagement Teams.
7.	03.09.2024	Communication of Engagement-Specific Observations.
8.	10.09.2024 and 12.09.2024	Response on Engagement specific observations received from the Audit Firm.
9.	22.10.2024	Inspection Report sent by NFRA to the Audit Firm.
10.	31.10.2024	Submission of reply by BSR to Draft Inspection Report.
11.	19.12.2024	Publication of Inspection Report on the website of NFRA as per Rule 8 of NFRA Rules 2018.

Appendix A: Audit Firm's response to this inspection report

Pursuant to Section 132(2) of the Companies Act, 2013 and Rule 8 of NFRA Rules, 2018, the Authority is publishing its findings relating to non-compliance with SAs and the sufficiency of the Audit Firm's quality control system. As part of this process, the Audit Firm provided a written response to the Inspection Report, which is attached hereto. NFRA, based on the request of the Audit Firm has excluded the information from this report which was considered proprietary.

B S R & Co. LLP

Chartered Accountants

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31 October 2024

The Secretary
National Financial Regulatory Authority
7th-8th Floor, Hindustan Times House
18-20 Kasturba Gandhi Marg
New-Delhi – 110001

Respected Madam,

Subject: Response to NFRA Inspection Report 2024 in respect of B S R & Co. LLP

We acknowledge the receipt of Inspection Report 2024 ('2024 Report') in respect of B S R & Co. LLP ('the Firm') vide your email dated 22 October 2024.

1. At the outset, we acknowledge that the process of inspection is very important and provides an opportunity for any audit firm to constructively consider the regulatory perspective and bring out qualitative improvements in its existing systems and processes. We support NFRA's overall objective to enhance audit quality through its inspection process.
2. We thank the Hon'ble NFRA and the entire team of inspectors for acknowledging the steps taken by the Firm to address the observations made in the previous inspection report (Inspection Report 2022).
3. We have taken note of the further feedback provided in 2024 Report and will continue to constructively engage with Hon'ble NFRA in evaluating and implementing any further improvements required to our policies and practices.
4. With regard to engagement specific observation (Executive Summary - point b and Part C - paragraph 25 of the Inspection Report), we would like to humbly submit that while we have performed detailed procedures in relation to the said transaction from inception to its conclusion, including, verification of underlying documents and communication to Those Charged with Governance, we have noted your observations and comments and are committed to further improve our documentation of audit procedures and conclusions reached.

While we have already provided our detailed responses with regard to engagement specific observations during the inspection process, we would like to summarise certain key aspects considered by us during the course of our audit:

- (i) Subscription of the CCPS were approved by various stakeholders as required under the Companies Act, 2013 (including by the shareholders of the Company at the Extra-ordinary General Meeting)
- (ii) The transaction and its nature was disclosed in the financial statements and in the offer documents for understanding of the users of financial statements/offer documents

Registered Office:

B S R & Co. LLP

- (iii) Company A was a closely held company (when the said transaction was entered into) with less than 1 percent external shareholders, other than the promoter group
 - (iv) Section 185 of the Companies Act, 2013, is not applicable to the transaction as the terms of the CCPS lack the fundamental characteristics to be classified as a loan
5. We would like to reiterate that audit quality is the most important priority for us, and we remain committed to investing resources, time and efforts towards it.

Thanking you,



(Sudhir Soni)
Head of Audit