

IL&FS—A Case of Accounting Misstatement and Financial Mismanagement

*Jagannath M.V.K
Mehul Raithatha**

I) Introduction

The decay in this fraud is much deeper than it appears. In 2018, the Infrastructure Leasing and Financial Services Company Limited (IL&FS) group started crumbling like a pack of cards. The Non-Banking Financial Company (NBFC) sector saw a slump in their business in the period after the Indian Government demonetized 86 percent of the currency under circulation in November 2016 (Reserve Bank of India Bulletin, 2017). Consequently, the NBFC segment in particular and the financial lending market suffered badly by a spate of defaults by infrastructure lenders and NBFC major IL&FS. The default by the group entities on the commercial papers (CPs) due for repayment and on short-term loans sanctioned by the Small Industries Development Bank of India (SIDBI) not only riled the market but also led to issuances of CPs hitting rock bottom (Mudgill, 2018).

The news article titled “*IL&FS Transportation Networks Limited (ITNL) loan default first sign of cracks in IL&FS*” raised eyebrows on the company's affairs. In a startling revelation, the article points out that the first default by group-company ITNL was made in June 2018 and not in August 2018 (Joshi and Ghosh, 2018). Because of the company's apparent cover-up delayed the revelation of its dismal financial situation. The Central Government was prompt to appoint a new board of directors comprising retired bureaucrats, industry veterans, technocrats and appointed Mr. Uday Kotak as the newly appointed Mr. Uday Kotak as the newly constituted board chairperson (Firstpost, 2018). The chronology of events beginning from the first default reported on August 28, 2018, and the subsequent defaults are in Exhibit 1.

Exhibit 1: Chronology of Events Post First Default

S No	Date/Month	Particulars
1	August 28, 2018	First default by IFIN on redemption/repayment of commercial papers (CP)
2	August 30, 2018	Second default by IFIN on repayment of Commercial Papers
3	September 10, 2018	Ratings downgrade by rating agencies ICRA and CARE, of IL&FS' N.C.D.s, from AA+ to B.B.
4	January 1, 2019	NCLT allows the reopening and recasting of the financial statements of IL&FS and its two subsidiaries—IFIN and ITNL for the last five years, based on the plea by the Government
5	January 2019	New board of IL&FS appoints Indian arm of Grant Thornton—Grant Thornton India LLP to conduct forensic audit/investigation of the IL&FS and its group companies to detect the possibility of fraud
6	February 4, 2019	IL&FS classifies 169 of its companies into three categories—green, amber, and red based on their capacity to service their obligations such as operational expenses, interest, and installment obligations of loans, etc.
7	July 2019	The investigative audit report—Project Icarus by Grant Thornton reveals possible kickbacks received by the top management of rating agencies for giving favorable ratings to the company

8	March 2020	NCLAT directs the board of IL&FS to conclude the resolution of all entities in the next three months
---	------------	--

The failure of auditors and rating agencies to detect fraud raises many questions. The investors and lenders (banks, financial institutions) rely on the audit reports of the auditors and ratings provided by the rating agencies for making their investment decisions in the company. Against this backdrop, given the alleged quid-pro-quo relationship between the company's top management and that of the rating agencies and audit firms, how reliable and trustworthy are the company's financial statements and ratings? Further, what measures should investors, analysts, and other stakeholders related to a company take to avoid being frauded by agencies such as the rating firms, audit firms, and even the Big 4 firms and accounting statements?

Case Learning Objectives

The case intends to acquaint the audience with white-collar crimes perpetrated in the corporate world. The learning objectives of the case study are:

- a) Familiarize students with how corporate frauds happen by accounting misstatements and mismanagement by the group's board.
- b) Provide an overview of the various stakeholders in the corporate ecosystem who can influence the corporate culture.
- c) Highlight the increasing nexus between the top management and critical service providing entities such as auditors and credit rating agencies for mutual benefit.
- d) Exhibit the relationship between poor corporate governance standards, unethical practices, and their effects on the company's financial performance.
- e) Highlight the ripple effect of the failure of a systematically important entity in the financing industry on the overall liquidity and ramifications.

II) Company Background

IL&FS is a “Systematically Important Non-Deposit Taking Core-Investment Company” (SI-ND-CIC) registered with the Reserve Bank of India and is the holding company for numerous entities engaged in a plethora of activities such as real estate, transportation, financial services, and energy. The company started its operations in 1987, with the bulk of the investment coming from the Central Bank of India, Housing Development Finance Corporation (HDFC), and Unit Trust of India. The company grew exponentially ever since its inception with as many as 348 subsidiaries, step down subsidiaries (a subsidiary of a company which is a subsidiary of another company) and associates as of August 2018 (at the time of its first major default) and an impressive list of institutional investors such as L.I.C., Orix Corporation of Japan, Abu Dhabi Investment Authority, and State Bank of India (SBI) (Project Icarus, 2019a). A brief snapshot of the prominent group companies and the sectors in which they occurred are shown in Exhibit 2. The company partnered with several government agencies in numerous infrastructure and real estate projects. The association made the company appear like a quasi-government agency. Owing to this perception of the investors, the company could scale monumental heights.

Exhibit 2: A Brief of the Businesses of IL&FS in the Sectors

Infrastructure		Financial Services	
Key Holding Company	Sector	Key entity	Sector
ITNL	Transportation	IFIN	Financial Services
IEDCL	Energy	IIML	Private Equity
IMICL	Maritime	IIAML	Mutual Fund
Schoolnet India Limited	Education	ISSL	Securities Brokerage Business
IEISL	Waste Management and Environmental Services		
TTL	Information Technology		
ITUAL	Urban Development		
IWL	Water		
IECCL	Engineering and Construction		
HPCL	Real Estate		

The prominent group companies, IL&FS Transportation Networks Ltd (ITNL) and IL&FS Financial Services Limited (IFIN), were primarily responsible for the default by the group companies.

Management of the Group Companies

Four individuals largely controlled the IL&FS conglomerate, namely: Ravi Parthasarathy, Chairman of IL&FS; Ramesh Bawa, MD and CEO of IFIN; Hari Sankaran, Vice-Chairman of IL&FS; and Arun Saha, Joint MD and CEO of IL&FS (Outlook, 2019). The group was headed by Mr. Ravi Parthasarathy, a company veteran, who joined the group in 1987 as Chief Executive Officer. Most of the top management admittedly conducted tasks on the instructions of Mr. Parthasarathy.

Credit Culture at IFIN

As per the findings of Project Icarus, the investigative audit report of Grant Thornton India LLP, IFIN followed Credit Approval Memorandum (CAM) for screening the prospective borrower's creditworthiness (Project Icarus, 2019b). The CAM was generated from software once all the requisite details are placed into the system by the staff.

Project Icarus pointed numerous deviations from the company's set credit appraisal norms, which were reportedly performed on the instructions of the top management. One such deviation occurred when Mr. Rajesh Kotian, the then Deputy Director of IFIN, corresponded with the Assets and Structured Finance (ASF) team via email on September 11, 2017. Allegedly, the email was purportedly written on the suggestion of Mr. Arun Saha to relax the credit norms for the loans sanctioned to the vendors of IL&FS Transportation Networks Limited (ITNL) as these loans were to be guaranteed by ITNL itself. When the communication mentioned above took place, Mr. Arun Saha was the Joint Managing Director and CEO of IL&FS. Briefly, loans were given to third parties who were vendors of the group companies of ITNL at its behest, fully knowing the third parties' adverse financial position.

The report also pointed out that the deviations were documented in the C.A.M., and the sanctioning authorities overrode the same. To quote an instance pointed out in the Project Icarus report, a loan amounting to INR 600 million was disbursed to Kohinoor Technologies Private Limited, a constituent of the Kohinoor group, on March 25, 2015. The Credit Approval Memorandum noted that the loans by the other group companies of the Kohinoor group are overdue with IFIN. In a strikingly similar instance, a loan of INR 550 million was disbursed on March 30, 2015, to Congo Developers and Traders Private Limited, a group company of the Raheja group. The loan was disbursed despite the adverse comments noted by the ASF team on the less-than-satisfactory history of the company. (Project Icarus, 2019d).

There are numerous instances wherein loans granted on deviating from the company's established norms eventually turned bad, slipping into the Non-Performing Asset (NPA) category, causing loss to the company. Evergreening of loans, an unhealthy practice resorted to by lending institutions to avert slippage of accounts into the NPA category, by giving fresh loans to the defaulting borrowers to repay the existing loans rampantly existed in the company. Project Icarus points to innumerable cases/instances wherein loans were given to numerous defaulting companies to facilitate the closure of existing irregular loans. To put these in numbers, loans amounting to INR 85500 million (288 instances/accounts) disbursed to external parties during the period financial year 2013 to 2019 have been

repaid via fresh loans sanctioned to the tune of INR 77770 million. The figures corresponding to the internal parties during the same period were INR 17130 million (16 instances/accounts), which were repaid via fresh loans to the tunes of INR 16910 million (Project Icarus, 2019e).

III) Financial Performance of the Company

The company posted profits consistently over the past many years before posting huge losses in 2018 (see Exhibit 3). While the company made a profit of INR 2925.79 million for the fiscal year 2016–17, it made huge losses to the tune of INR 23947.76 million on account of the impairment of financial assets and impairments for the fiscal year 2017–18.

Exhibit 3: Snapshot of the Financial Performance of the Company (on a Consolidated Basis) Over the Years

Balance Sheet

(Amount in INR millions)

	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18
Equity capital	5845.91	7334.03	9831.53	9831.53	9831.53
Reserves and funds	57274.48	59343.22	62594.68	65417.19	44448.20
Total capital	63120.39	66677.25	72426.21	75248.72	54279.73
Long term borrowings	380601.72	486486.22	546651.81	597640.34	652935.11
Current liabilities and provisions	159592.97	201054.41	235557.70	296402.12	370893.51
Total Liabilities	657163.39	818000.29	927136.78	1044697.66	1158145.14
Non-current investments	47554.38	51528.63	49979.15	51432	56413.66
Loans and advances					
i) Loans to related firms	25198.21	28691.91	33918.44	35219.94	37290.22
ii) Loans to external parties	85819.42	88638.33	84901.15	97919.39	123510.7
Total Assets	657163.39	818000.29	927136.78	1044697.66	1158145.14

Source: Compiled by the author using Audited financial statements of IL&FS

Income Statement/Profit and Loss

(Amount in INR millions)

	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18
Income from financial services	112961.39	110659.07	140611.28	154927.57	176724.96
Other income	2645.35	5746.32	10366.84	16637.67	11262.88
Provision on non-performing assets	405.63	508.30	589.71	405.81	1756.80
Profit before tax	7446.22	7043.80	5208.49	6177.15	-21092.25
Profit after tax reported by company	3982.52	3674.26	489.15	2925.79	-23947.76

Source: Compiled by the author using Audited financial statements of IL&FS

The findings of the forensic audit conducted by Grant Thornton India LLP are suggestive of the fact that the financial performance of the company, as reflected in the audited balance sheets over the years, is a result of tinkering and manipulation of key items such as provisions (Project Icarus, 2019f). The forensic audit procedures included forensic data analysis on the information provided to detect any unusual trends or patterns and discrepancies. The discrepancies and unusual trends were probed further by calling for the supporting documents of such transactions. Grant Thornton also conducted public domain searches to corroborate the data provided by the company, with the data available in the public domain. The forensic auditor also held detailed discussions with the Audit and Structured Finance (ASF) team and Credit Risk Management Group (CRMG) to understand the credit policies, practices, and procedures followed in the company. Various documents, including inspection reports by the Reserve Bank of India, bank statements of the borrowers, minutes of the meetings, internal audit reports, Credit Approval Memorandum (CAM), etc., were studied in detail.

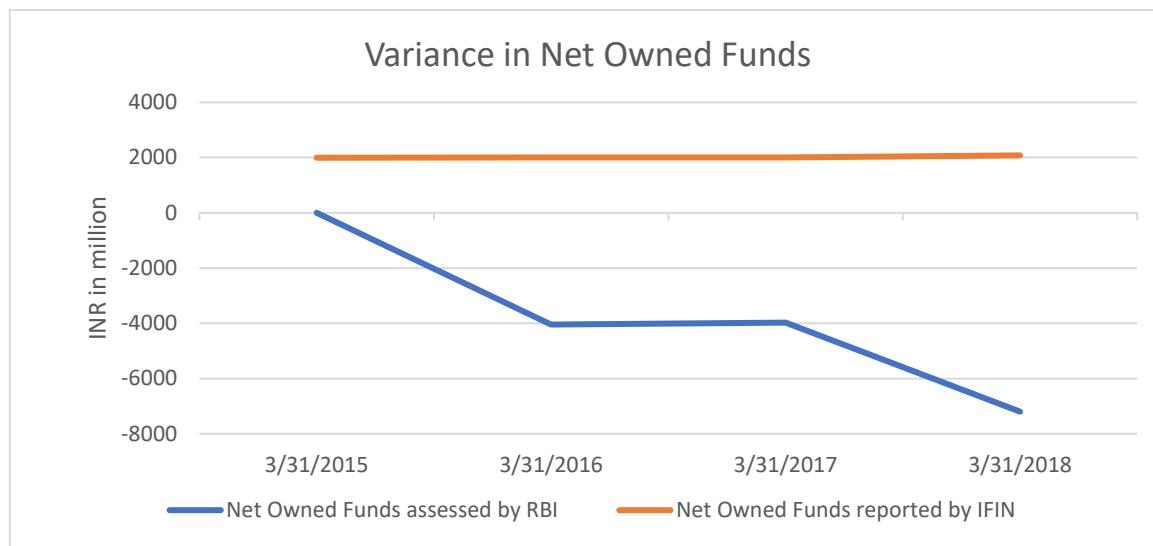
The forensic audit findings pointed to deviations from accounting and reporting norms, details of which are discussed in various sections in the case study. The forensic auditor also found instances of potential non-compliance

with the RBI regulations, including RBI's advice to discontinue lending to group companies, misrepresentations made through financial statements, lapses in the documentation of loans granted to several companies, and creation of lender's charge thereon, etc. Adherence to prescribed provisioning norms as laid down by the regulator would have led to the company reporting significantly lesser profits, which could have reflected the company's actual situation and true financial position. The same is discussed in the subsequent sections.

Net Owned Funds

The company—IFIN being a non-deposit-taking systematically important NBFC, came under the ambit of regulations laid down by the Reserve Bank of India (RBI). As per the extant guidelines, loans and advances and investments to subsidiaries or group companies are to be deducted from the paid-up capital and reserves while calculating the Net Owned Funds (NOF) of a Non-Banking Financial Company as per Section 45-IA of the RBI Act of 1934. Grant Thornton found significant divergences between NOF calculations as per RBI's guidelines and as actually calculated by IFIN. The NOF calculations by IFIN deducted the investments and loans, and advances made to its subsidiaries only. In contrast, RBI had advised the company to calculate the NOF after deducting the investments and loans & advances made to the group companies and subsidiaries of IL&FS as a whole. The NOF would have been negative for IFIN had the directions of RBI been followed. The company lent substantially more than what it should have otherwise done by following the directions of RBI regarding the calculation of NOF. The scale of the divergence is graphically depicted in Exhibit 4.

Exhibit 4



Source: Compiled by the author using Audited financial statements of IL&FS

Provisioning on Loans

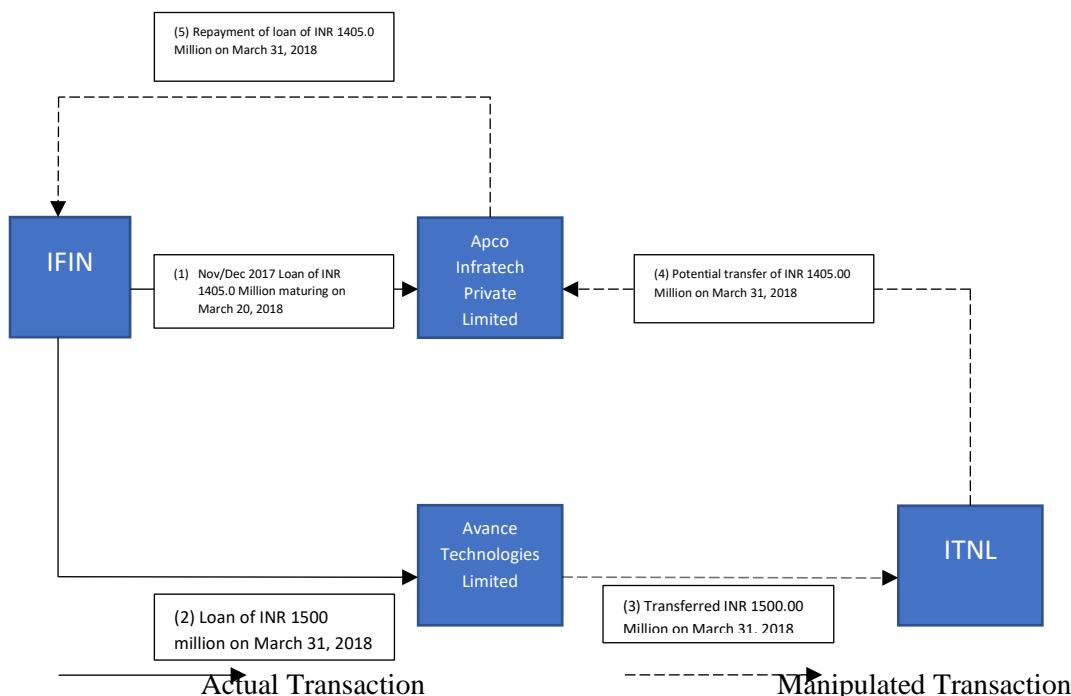
There are two approaches in dealing with provisions: one concerning the group company, IL&FS; and the second, concerning IFIN, being a financial institution. IL&FS being the umbrella entity of the conglomerate or group, invested substantially in its subsidiaries, step down subsidiaries, and group concerns. During its inspection post-default by the group companies, the regulator, RBI, found no investment policy of the company or group in the first place, and the provisions were found to be severely under-reported, thereby increasing the reported profits. On similar lines, the company did not create provisions for the diminution in the value of the investments made in the group concerns. The profits were inflated and did not reflect the true picture of the company's financial performance. Consequently, the new management of the company appointed in October 2018, had to make huge provisions of INR 95429 million, INR 2072.3 million, and INR 96804.7 million for the impairment in the values of loans in the group concerns, receivables from the group concerns, and investments in the group concerns respectively (IL&FS, 2019).

On the other hand, IFIN, being a financial institution, had to provide a prescribed percentage of 0.25 percent of the outstanding loan amount as a provision to the company's profit and loss account. For loans that have turned recalcitrant or have been classified as Non-Performing Asset, the provision increases substantially. In such cases, 100 percent of the outstanding loan amount has to be created as a provision if securities do not back the loss and doubtful assets, thereby adversely impacting the company's profits (Reserve Bank of India Master Direction, 2015). To avert this

problem, the company resorted to blatant evergreening of loans. Despite RBI's stern warning to the banks and financial institutions against resorting to evergreening of loans, Grant Thornton found that IFIN and ITNL resorted to such malpractice several times.

For instance, a loan disbursed by IFIN (the lender) to Advance Technologies Ltd (ATL—the third party) was utilized by the latter to fund IL&FS Transportation Networks Ltd (ITNL). The series of transactions is pictorially depicted in Exhibit 5.

Exhibit 5



Source: Project Icarus, report of the investigation conducted by GT

Exhibit 5, excerpted from Project Icarus by Grant Thornton, gives an idea of the extent to which evergreening was resorted to, manipulating the creditors and investors to believe in the state of the affairs of the company by showing a false picture.

From Exhibit 6, it would not be an aberration to state that had loans to the extent of INR 85500 million to the external parties not been sanctioned and disbursed; the NPAs would have seen a spurt of INR 77770 million, thereby adversely affecting the profitability of the company (IFIN in the current context).

Exhibit 6
(Amount in INR million)

Reconciliation of the NPA Position of the Group						
S No	No. of instances	External Parties Amount of loans disbursed	Amount of loans repaid via fresh loans disbursed by IFIN	No. of instances	Internal Parties Amount of loans disbursed	Amount of loans repaid via fresh loans disbursed by IFIN
1	78	19160	17400	0	0	0
2	49	15810	14460	0	0	0
3	63	22890	20850	5	3330	6020
4	45	18570	16660	5	4800	3770

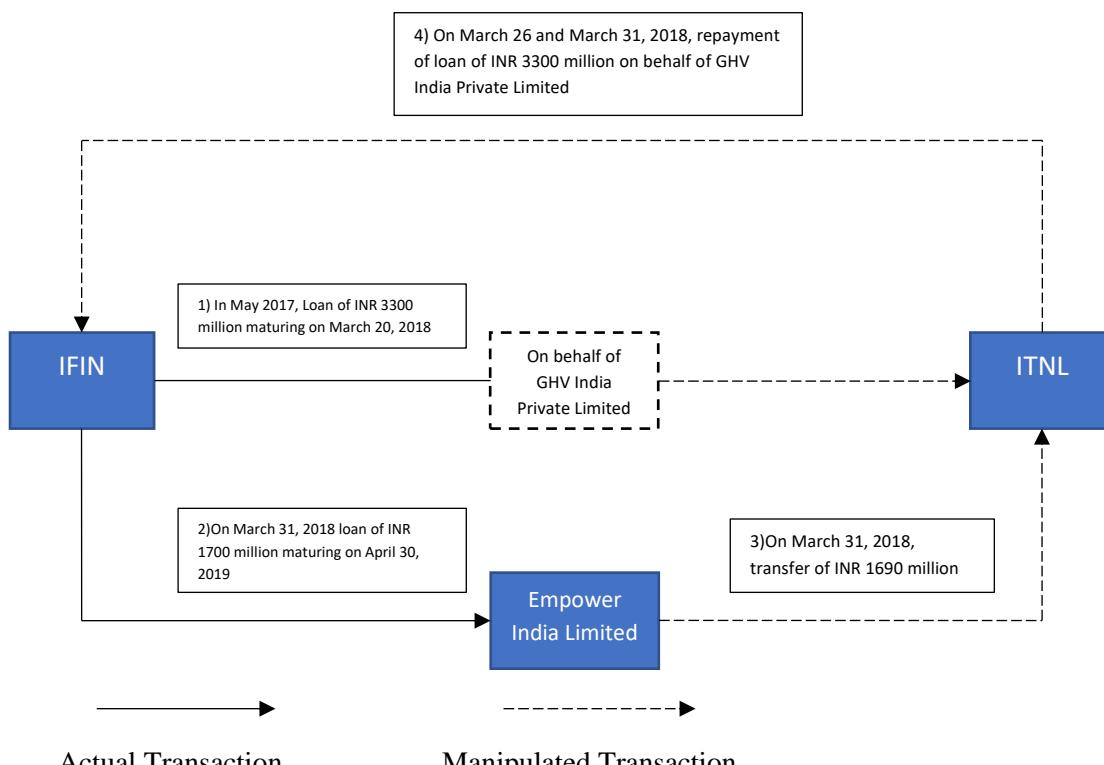
5	46	5700	5050	6	9000	7120
6	7	3370	3350	0	0	0
	288	85500	77770	16	17130	16910

Source: Project Icarus, report of the investigation conducted by GT

Inter-Company Transactions

IFIN was engaged in lending for infrastructure projects, apart from consultancy and loan syndication business (Project Icarus, 2019g). The business from lending to group firms or subsidiaries increased over the years leading to 2018 when it was around 37 percent of its total loan book size. In an apparent attempt to hoodwink the investors and regulators, the company camouflaged the loans to internal companies, i.e., the group companies and subsidiaries, as loans to external parties to route it to its own companies eventually. One of such round-tripping transactions is pictorially depicted in Exhibit 7.

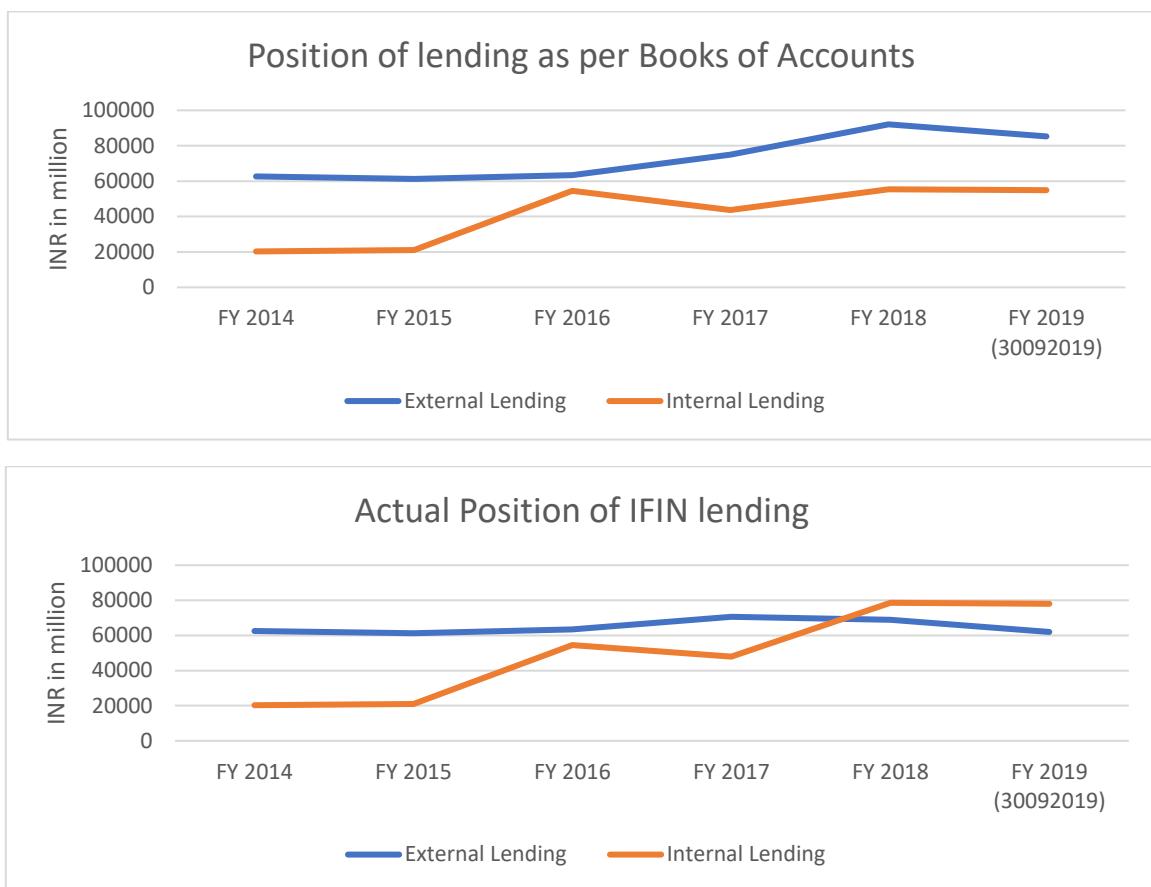
Exhibit 7



Source: Project Icarus, report of the investigation conducted by GT

Comparison between the actual position and the reported position for lending to internal vs. external parties is graphically depicted in Exhibit 8 and 9.

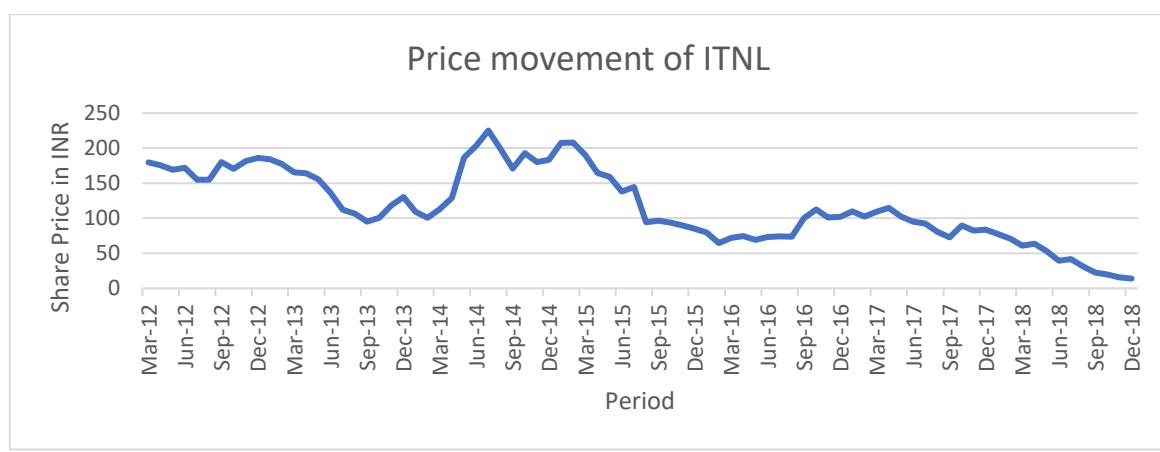
Exhibit 8 and 9



Source: Project Icarus Report by Grant Thornton India LLP

Misrepresentation of figures in the company's financial statements led the investors to buy into the company's performance, which was being shown as good. The timeline of share price movements in the last six years is graphically depicted in Exhibit 10.

Exhibit 10



Source for Stock Prices: Centre for Monitoring Indian Economy (CMIE) Prowess Database

Audit Concepts

Having observed how the fraud has been apparently perpetrated, it is pertinent to view the same through the lens of some of the established audit concepts such as Fraud Triangle and Fraud Diamond.

Fraud Triangle

The Fraud Triangle theory is a prominent audit concept featured in academic literature to explain fraud. As per the Fraud Theory, developed by Donald Cressey in 1953 (Huber, 2017), any fraud has essentially three elements associated with it, which can explain the motives for the perpetration of fraud: Opportunity, Rationalization, Incentive.

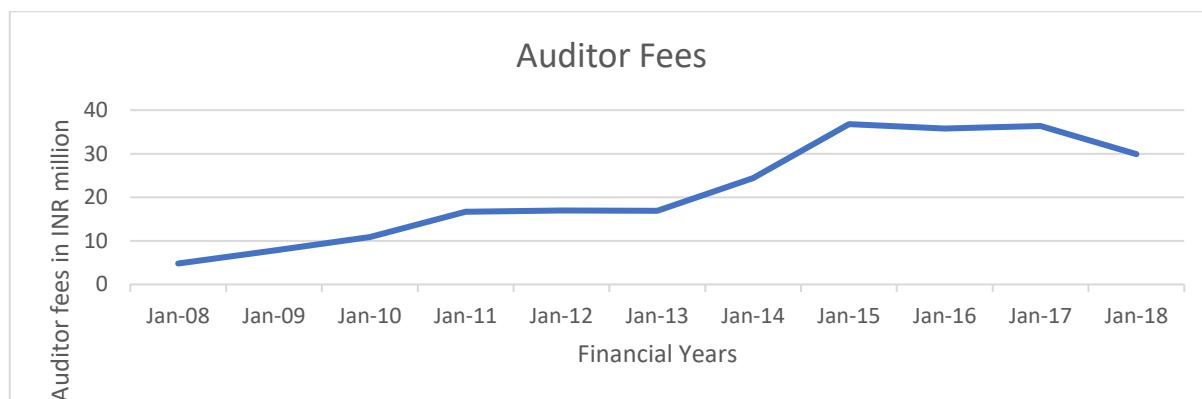
Fraud Diamond

It is an audit concept that can be considered an addition to the dimension of the Fraud Triangle. By adding one more dimension to the aspects associated with the concept of fraud, Wolfe and Hermanson (2004) introduce an additional element—Capability, to the existing elements of fraud. As per the Fraud Diamond, the elements related to fraud are Opportunity, Rationalization, Incentive, and Capability.

Role of Auditors

Deloitte Haskins and Sons and BSR Associates LLP (the partner firm of KPMG in India) continued to be the group's external auditors for an uninterrupted period of 10 years from 2008 to 2018. The external auditors also have been named in the charge sheet filed by Serious Fraud Investigation Office (SFIO). The auditors are alleged to have failed to point out the flouting of guidelines issued by the regulators (RBI, SEBI, etc.) from time to time. Consequently, the stakeholders were misguided as to the affairs of the company. Coincidentally, there was a steep increase in the audit fees charged by the auditor. The audit fees paid for the financial year 2013–14 saw an increase of nearly 45 percent compared to the previous year. Similarly, the audit fees increased by more than 50 percent for the financial year 2014–15 as compared to the previous year (CMIE Prowess Database, 2020). Details of audit fees paid to the auditors from 2008 to 2018 are shown in Exhibit 11.

Exhibit 11: Auditor fees paid in INR millions



Source for Audit fees paid: Centre for Monitoring Indian Economy (CMIE) Prowess Database

Board Remuneration and Board Meetings

The erstwhile board met five times during April to September in the financial year 2018–19 before the new board's constitution. The board met six times in the previous financial year 2017–18, all attended by Mr. Hari Sankaran, Mr. Ravi Parthasarathy, and Mr. Arun Saha. The secretarial audit conducted for the financial year 2018–19 points out that the directors interested in the agenda were present during the board meetings, which is in contravention of section 184 of the Companies Act, 2013 of India.

The board comprised 18 directors, including executive and non-executive directors, nominee directors, and independent directors. The remuneration to three directors, namely Mr. Hari Sankaran, Mr. Ravi Parthasarathy, and Mr. Arun Saha, was 30 times or more than the median remuneration of all the company employees during the fiscal year 2018–19. This disparity in remuneration is in stark contrast to the corresponding fiscal year 2017–18. The ratio was 141 times the median salary of Mr. Ravi Parthasarathy and 41 and 37 times in the case of Mr. Hari Sankaran and Mr. Arun Saha, respectively. All three directors were in the executive roles of the company or their group entities. It is pertinent to mention that the remuneration of Mr. Ravi Parthasarathy increased by a whopping 144 percent during the fiscal year 2017–18 as compared to its previous year, as compared to the median increase of 10.90 percent for the employees across the company (IL&FS, 2017, IL&FS, 2018, IL&FS 2019). The meteoric rise in the pay to the company's top executives comes even in the back of a 13 percent decline in the company's net profit (after tax) and a marginal decline of 1 percent in the top line of the company during the corresponding period. Details of changes in the key management personnel's remuneration over the last three years are shown in Exhibit 12.

Exhibit 12

Name of the Key Management Personnel/Directors	2016–17		2017–18		2018–19	
	Ratio of Remuneration of the Director (Times)	% increase over last year	Ratio of Remuneration of the Director (Times)	% increase over last year	Ratio of Remuneration of the Director (Times)	% increase over last year
Hari Sankaran	54.94	(1.71)	140.97	144	39.82	-
Ravi Parthasarathy	38.01	(4.51)	41.41	3.86	30.26	-
Arun K Saha	32.25	7.39	37.35	10.42	29.86	-

Source: Created by the author using Audited financial statements of IL&FS

Role of Rating Agencies

The role of the external rating agencies, namely Investment Information and Credit Rating Agency (ICRA Limited), Credit Analysis and Research Limited (CARE), Brickwork, India Ratings, and Credit Rating Information Services of India Limited (CRISIL), has been put under the scanner by the forensic auditor/investigator and Enforcement Directorate (ED), Serious Fraud Investigation Office, Securities, and Exchange Board of India (SEBI). These rating agencies mentioned above have rated some instruments of the group companies or their subsidiaries, step down subsidiaries at some point in time from 2008 to 2018. Further, international rating agencies such as Fitch and Moody's also have assigned ratings to the company/group entities during the aforestated period (National Herald, 2019a).

The top executives of the two rating agencies, ICRA and CARE, have were asked to proceed on leave for an uncertain period; no sooner do the rating agencies come under the scanner (National Herald, 2019b).

In the instant case, some of the findings (National Herald, 2019c) and allegations leveled on the company's management and the rating agencies are mentioned as under:

- a) The company went for rating shopping. The company and its group constituents vied for top-notch ratings. If any rating agency did not assign them the expected ratings, the group would approach another rating agency that would fit their bill.
- b) It is found through the email communications between the senior officers/Key Management Personnel of the various group companies among themselves discussing inflating the forecasting financial figures to get better ratings from the rating agencies. The rating agencies were furnished with the inflated forecasted figures, which were accepted in the rating report.
- c) The aspect of alleged private favors received by some of the top executives' merit mentions. A prominent instance is that of the senior director of Fitch, who was found to have professionally conducted in a manner that violates the company's code of conduct and is reportedly shown the door.

Corporate Frauds—One-off Event or a Deeper Systemic Malaise?

The unfolding of the IL&FS crisis laid bare the corporate governance issues in one of the biggest corporate houses of the country. However, a series of other corporate frauds that took place at around the same time raises some questions about corporate governance in such large corporates. In this section, we examine the similarities and differences in another fraud perpetrated at around the same time when the IL&FS defaults took place.

The collapse of IL&FS triggered distress in the non-banking financial company (NBFC) sector, as lenders—banks and financial institutions having exposure to IL&FS were wary of lending any further to the sector. Considering the freeze in lending to the NBFC sector, it was apprehended that firms would default if their short-term borrowings were not rolled over. After the IL&FS crisis, another major NBFC, Dewan Housing Finance Corporation Limited (DHFL), also defaulted on its payment obligations. However, a major exposé by Cobrapost in January 2019 exposing the fraudulent practices led to investigations into the affairs of the company. The investigations unearthed the fraudulent practices and activities that led to the eventual string of defaults on its obligations. The fraud perpetrated at DHFL bears a stark resemblance with IL&FS in many ways. The similarities and differences are enlisted in Exhibit 13 and 14.

Exhibit 13: Similarities between IL&FS and DHFL collapse

Particulars	IL&FS	DHFL
Supersession of board by the regulator or Government	IL&FS board was superseded by the government-appointed board on October 01, 2018, immediately after its defaults in September 2018.	RBI superseded DHFL board on November 20, 2019 ¹ , post its default and investigations into the company's affairs.
Involvement of top management	The investigations point to the active role of the top management in the fraud perpetrated at IL&FS. Top executives of the company were arrested on allegations of money laundering. ²	The investigations led to the conclusion that the top management was involved in the fraud. The promoters – Kapil Wadhawan and Dheeraj Wadhawan, were arrested based on multiple allegations of fraud, money laundering. ³
Group structure	The company has a very complex structure comprising 348 companies in the form of subsidiaries, step-down subsidiaries, associates, joint ventures.	DHFL has several subsidiaries engaged in diversified business ranging from investment in capital markets, mutual funds business, education loans, mortgage loans business, to name a few.
Diversion of funds	It was found during course of investigative and forensic audit that the company resorted to diversion of funds to its group concerns through round-tripping of funds.	Forensic audits and investigations found multiple instances of fund diversions by the company. ⁴
Role of auditors and rating agencies	The role of external auditors and rating agencies in detecting the fraud has been questioned.	External auditors of the company and rating agencies who have rated the instruments issued by the company had never raised any concerns or red flags.

Exhibit 14: Differences Between IL&FS and DHFL Collapse

Particulars	IL&FS	DHFL
Family ownership	The company was founded by the joint investment of a few financial institutions, insurance companies. The top management and board do not	The company was found and promoted by Rajesh Kumar Wadhawan and post his demise; the company was run by sons of the promoter –

¹ Bloomberg Quint Desk, “DHFL Headed to Insolvency as Board Superseded by RBI,” *Bloomberg Quint*, November 21, 2019, accessed on September 26, 2021, <https://www.bloombergquint.com/business/rbi-supersedes-the-board-of-dhfl#:~:text=The%20Reserve%20Bank%20of%20India,Dewan%20Housing%20Finance%20Corporation%20Ltd.&text=Finance%20Corporation%20Ltd.,and%20intends%20to%20refer%20the%20non%2Dbank%20lender%20for%20resolution>window%20or%20financial%20service%20providers>.

² Gunasekar Arvind and Dey Stela, “2 Former Top Executives Arrested in IL&FS Money Laundering Case,” *NDTV*, June 20, 2019, accessed on September 26, 2021, <https://www.ndtv.com/india-news/2-former-top-executives-arrested-in-il-fs-money-laundering-case-2056017>

³ Rajpur Rashmi, “ED arrests DHFL promoters Kapil and Dheeraj Wadhawan,” *The Economic Times*, May 15, 2020, accessed on September 26, 2021, <https://economictimes.indiatimes.com/news/politics-and-nation/ed-arrests-dhfl-promoters-kapil-dheeraj-wadhawan/articleshow/75746250.cms?from=mdr>

⁴ Choudhary Shrimi, “DHFL diverted Rs 12700 Cr into 79 shadowy firms linked to promoters: ED,” *Business Standard*, January 30, 2020, accessed on September 26, 2021, [https://www.business-standard.com/article/companies/dhfl-diverted-rs-12-700-cr-into-79-shadowy-firms-linked-to-promoters-ed-120013000018_1.html#:~:text=Dewan%20Housing%20Finance%20\(DHFL\)%20diverted,the%20Enforcement%20Directorate%20\(ED\).](https://www.business-standard.com/article/companies/dhfl-diverted-rs-12-700-cr-into-79-shadowy-firms-linked-to-promoters-ed-120013000018_1.html#:~:text=Dewan%20Housing%20Finance%20(DHFL)%20diverted,the%20Enforcement%20Directorate%20(ED).)

	have representation of any family or related persons.	Kapil Wadhawan and Dheeraj Wadhawan.
Resolution of financial distress	The insolvency resolution framework for the company, as proposed by the Government, was cleared by the National Company Law Appellate Tribunal (NCLAT) in March 2020. ⁵ The resolution is outside the ambit of the Insolvency and Bankruptcy Code (IBC).	Insolvency of the company was resolved by way of resolution (approving the resolution plan of Piramal Enterprises) under the Insolvency and Bankruptcy Code (IBC), vide order of the National Company Law Tribunal, dated June 07, 2021.

IV) Conclusion and Way Forward

The fraud and earnings misstatement of IL&FS is a new addition to the increasing number of white-collar crimes perpetrated in corporate India over the last two to three decades. The list includes high-profile and prominent cases like the Satyam scandal, Punjab National Bank (Nirav Modi case, Kingfisher Airlines, Punjab, and Maharashtra Co-Operative Bank Scam) PMC Scam (which was recently unearthed), Dewan Housing Finance Corporation Limited (DHFL), to name a few. Such corporate scandals erode investor wealth, shatter their confidence, and raise questions on key market players like regulators, auditors, rating agencies, investment bankers, etc.

⁵ Noronha Gaurav, “NCLAT clears insolvency resolution framework for IL&FS proposed by govt,” *The Economic Times*, March 13, 2020, accessed on September 26, 2021, <https://economictimes.indiatimes.com/news/company/corporate-trends/nclat-clears-insolvency-resolution-framework-for-ilfs-proposed-by-govt/articleshow/74603641.cms?from=mdr>

References

- Alam, S. (2018, October). IL&FS Scam: Ravi Parthasarathy: The New Robber Baron. *gfiles*. Accessed on 2020, July 17. <https://www.gfilesindia.com/ilfs-scum-ravi-parthasarathy-the-new-robbbaron/>
- Centre for Monitoring Indian Economy Database. Accessed on 2020, July 12.
- Datta, P. (2018, September 28). IL&FS debt fiasco: Not a Lehman moment for India but a wake-up call for the Government. *Business Today*. Accessed on 2020, July 4. <https://www.businessstoday.in/opinion/prosaic-view/infrastructure-leasing-and-finance-debt-fiasco-not-a-lehman-moment-for-india-but-a-wakeup-call-for-the-government/story/282997.html#:~:text=The%20problem%20is%20in%20the,companies%20and%20banks%20as%20shareholders.>
- Firstpost*. (2018, October 1). IL&FS Crisis: Government supersedes management; 6-member board appointed with Uday Kotak as Chairman. Accessed on 2020, July 3. <https://www.firstpost.com/business/ilfs-crisis-govt-supersedes-management-6-member-board-appointed-with-uday-kotak-as-chairman-5292671.html>.
- Grant Thornton India LLP (2019a, May 9). *Project Icarus*: IL&FS Securities Services Limited, pp 140. Accessed on 2020, July 4. https://www.ilfsindia.com/media/2572/final_affidavit-5th-progress-report-vol-ii_ocr_compressed.pdf.
- Grant Thornton India LLP (2019b, May 9). *Project Icarus*: IL&FS Securities Services Limited, pp 152. Accessed on 2020, July 6. https://www.ilfsindia.com/media/2572/final_affidavit-5th-progress-report-vol-ii_ocr_compressed.pdf.
- Grant Thornton India LLP (2019c, May 9). *Project Icarus*: IL&FS Securities Services Limited, pp 158. Accessed on 2020, July 6. https://www.ilfsindia.com/media/2572/final_affidavit-5th-progress-report-vol-ii_ocr_compressed.pdf.
- Grant Thornton India LLP (2019d, May 9). *Project Icarus*: IL&FS Securities Services Limited, pp 180,181. Accessed on 2020, July 6. https://www.ilfsindia.com/media/2572/final_affidavit-5th-progress-report-vol-ii_ocr_compressed.pdf.
- Grant Thornton India LLP (2019e, May 9). *Project Icarus*: IL&FS Securities Services Limited, pp 178. Accessed on 2020, July 6. https://www.ilfsindia.com/media/2572/final_affidavit-5th-progress-report-vol-ii_ocr_compressed.pdf.
- Grant Thornton India LLP (2019f, May 9). *Project Icarus*: IL&FS Securities Services Limited, pp 195. Accessed on 2020, July 12. https://www.ilfsindia.com/media/2572/final_affidavit-5th-progress-report-vol-ii_ocr_compressed.pdf.
- Grant Thornton India LLP (2019g, May 9). *Project Icarus*: IL&FS Securities Services Limited, pp 146. Accessed on 2020, July 12. https://www.ilfsindia.com/media/2572/final_affidavit-5th-progress-report-vol-ii_ocr_compressed.pdf.
- Grant Thornton India LLP (2019h, May 9). *Project Icarus*: IL&FS Securities Services Limited, pp 146. Accessed on 2020, July 4. https://www.ilfsindia.com/media/2572/final_affidavit-5th-progress-report-vol-ii_ocr_compressed.pdf.
- Grant Thornton India LLP (2019i, May 9). *Project Icarus*: IL&FS Securities Services Limited, pp 156. Accessed on 2020, July 4. https://www.ilfsindia.com/media/2572/final_affidavit-5th-progress-report-vol-ii_ocr_compressed.pdf.
- Huber, W. (2017). Forensic accounting, fraud theory, and the end of the fraud triangle. *Journal of Theoretical Accounting Research*, 12(2).
- IL&FS. Annual Report Year ended 2019, March 31. Accessed on 2020, July 12. <https://www.ilfsindia.com/media/2768/32ndannualreport2019final.pdf>.
- IL&FS. Annual Report Year ended 2019, March 31. Accessed on 2020, July 14. <https://www.ilfsindia.com/media/2768/32ndannualreport2019final.pdf>.
- IL&FS. Annual Report Year ended 2018, March 31. Accessed on 2020, July 14. <https://www.ilfsindia.com/media/2768/32ndannualreport2019final.pdf>.

- IL&FS. Annual Report Year ended 2017, March 31. Accessed on 2020, July 14.
<https://www.ilfsindia.com/media/2768/32ndannualreport2019final.pdf>.
- Insolvency and Bankruptcy Board of India.* (2020, March 12). NCLAT Order. Accessed on 2020, October 3.
- Joshi, M. and Ghosh, S. (2018, September 27). ITNL Loan default first sign of cracks in IL&FS. *Livemint*. Accessed on 2021, March 3.
<https://www.livemint.com/Industry/qnbEvOyWWBYGmcXXocOkSN/ITNLloandefaultfirst-signofcracks-inILFS.html>.
- Mahanta, V. and Dave, S. (2019, June 26). Indian Accounting Standards may pose challenge for new IL&FS management. *The Economic Times*. Accessed on 2020, July 12.
<https://economictimes.indiatimes.com/industry/banking/finance/indian-accounting-standards-may-pose-challenge-for-new-ilfs-management/articleshow/69951042.cms?from=mdr>.
- Moneylife.* (2019, May 31). SFIO Files Charge Sheet Against IFIN; Names Auditors, Directors, Key Employees, and Companies. Accessed on 2020, July 4. <https://www.moneylife.in/article/sfio-files-charge-sheet-against-ifin-names-auditors-directors-key-employees-and-companies/57320.html>.
- Mudgill, A. (2018, October 1). IL&FS default: Commercial Paper issuances hit an 8-year low in Sept. *Economic Times*. Accessed on 2020, July 3. <https://economictimes.indiatimes.com/markets/stocks/news/ilfs-default-commercial-paper-issuances-hit-an-8-year-low-in-sept/articleshow/66029320.cms?from=mdr>.
- National Herald.* (2019a, July 19). Jailed Arun Saha centrifugal force in fixing rating agencies at IL&FS. Accessed on 2020, July 12. <https://www.nationalheraldindia.com/india/jailed-arun-saha-centrifugal-force-in-fixing-rating-agencies-at-ilandfs>.
- National Herald.* (2019b, July 19). Jailed Arun Saha centrifugal force in fixing rating agencies at IL&FS. Accessed on 2020, July 12. <https://www.nationalheraldindia.com/india/jailed-arun-saha-centrifugal-force-in-fixing-rating-agencies-at-ilandfs>.
- National Herald.* (2019c, July 19). Jailed Arun Saha centrifugal force in fixing rating agencies at IL&FS. Accessed on 2020, July 12. <https://www.nationalheraldindia.com/india/jailed-arun-saha-centrifugal-force-in-fixing-rating-agencies-at-ilandfs>.
- National Herald.* (2019d, July 19). Jailed Arun Saha centrifugal force in fixing rating agencies at IL&FS. Accessed on 2020, July 12. <https://www.nationalheraldindia.com/india/jailed-arun-saha-centrifugal-force-in-fixing-rating-agencies-at-ilandfs>.
- National Herald.* (2019, January 21). Two more former top IL&FS officials arrested. Accessed on 2021, March 11.
<https://www.nationalheraldindia.com/india/two-more-former-top-ilandfs-officials-arrested>.
- Outlook.* (2019, August 21). E.D. lays bare IL&FS cabal modus operandi of Rs 7400 crore loot and scoot (IANS Exclusive). Accessed on 2020, July 4. <https://www.outlookindia.com/newscroll/ed-lays-bare-ilampfs-cabal-modus-operandi-of-rs-7400-cr-loot-and-scoot-ians-exclusive/1601002>.
- Panda, S. K. (2020, January 1). IL&FS is a test case for group resolution, says Uday Kotak. *Business Standard*. Accessed on 2020, July 3. https://www.business-standard.com/article/finance/il-fs-is-a-test-case-for-group-resolution-says-uday-kotak-120010100023_1.html.
- Panda, S. (2021, January 23). "IL&FS board addresses nearly Rs 32000 crore of debt by December. *Business Standard*. Accessed on 2021, March 11. https://www.business-standard.com/article/companies/il-fs-board-addresses-57-of-targeted-recovery-value-of-over-rs-56-000-cr-121012200570_1.html.
- Reserve Bank of India. 2017, November. *RBI Bulletin* November 2017 – The impact of demonetization on the financial sector. Accessed on 2020, October 8.
- Reserve Bank of India. (2015, March 27). *RBI Master Direction* - Notification No. DNBR.009/ CGM(CDS)-2015. Accessed on 2020, October 8. <https://rbidocs.rbi.org.in/rdocs/content/pdfs/3PNNSI270315.pdf>.
- The Hindu.* (2019, June 20). Two more former top IL&FS officials arrested. Accessed on 2021, March 11.
<https://www.nationalheraldindia.com/india/two-more-former-top-ilandfs-officials-arrested>.
- Wolfe, D. T., and Hermanson, D. R. (2004). The fraud diamond: Considering the four elements of fraud.