भारत सरकार / Government of India
राष्ट्रीय वित्तीय रिपोर्टिंग प्राधिकरण /National Financial Reporting Authority

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7th Floor, Hindustan Times House,
Kasturba Gandhi Marg, New Delhi

No. NF-21/1/2022 Date: 13.04.2023

ORDER

In the matter of CA M Baskaran, ICAI Membership No. 216637 under Section 132(4) of the Companies Act, 2013 read with Rule 11(6) of National Financial Reporting Authority Rules, 2018.

This Order disposes of the Show Cause Notice of even no. dated 7th December 2022, issued to CA M Baskaran, partner of M/s K. Varghese & Co., (ICAI Firm Registration No: 004525S), Kerala, who is a Professional Member of the Institute of Chartered Accountants of India and was the Engagement Partner for the statutory audit of nine branches of Dewan Housing Finance Corporation Limited(DHFL), for the Financial Year 2017-18. This Order is divided into the following sections:

A. Executive Summary
B. Introduction and Background for the Order
C. Major Lapses and Violations
D. Articles of Charges of Professional Misconduct
E. Penalty and Sanctions

A. EXECUTIVE SUMMARY

1. This Order is being passed as a result of an investigation by the National Financial Reporting Authority (NFRA) into the professional conduct of CA Mathew Samuel for his role as the Engagement Partner (EP) in the audit of two branches of DHFL. DHFL, a housing finance company listed on both NSE and BSE) and operating through a network of branches, was reportedly involved in financial fraud. NFRA took suo motu notice of the matter and carried out an Audit Quality Review (AQR) of the statutory audit of DHFL for FY 2017-18, conducted by Chaturvedi & Shah (CAS), a Mumbai-based Chartered Accountant Firm. During the review, NFRA noticed that 33 Engagement Partners (EP) or branch auditors had signed the "Independent Branch Auditors' Report" for nearly 250 branches. NFRA investigated these EPs under section 132 (4) of the Companies Act, 2013 (the Act), including K. Varghese & Co. (the Audit Firm), which was the "Statutory Branch Auditor" of 17 branches of DHFL for FY 2017-18, with CA M Baskaran, who was the EP for the audit of nine of these 17 branches at Zone Tamil Nadu, RPU Chennai, Chennai, Chennai Metro, Chennai OMR, Chennai Sales Vertical, Chennai Tambaram, Chennai Kodambakkam and Parrys.

2. NFRA's investigations revealed that the appointment of none of the 33 branch auditors was approved at the Annual General Meeting (AGM) of DHFL, as required by the Act. The audit firm and CA M Baskaran accepted the appointment, portrayed themselves as "Branch Statutory Auditor" in all communications with the Company and CAS, and issued an "Independent Branch Auditor's Report". By doing so CA M Baskaran not only accepted a legally invalid appointment but also violated the provisions of the Chartered Accountants Act, 1949 (CAs Act), which requires ensuring a valid appointment as per the Act.

3. In addition, CAS, had relied upon the "Branch Statutory Audit" performed by the EP, CA M Baskaran, NFRA investigated the EP's compliance with the applicable Standards on Auditing (SAs) in the performance of the branch audit and found that the EP, CA M Baskaran, had not complied with the principles and procedures laid down in the SAs, had not maintained proper audit documentation and displayed flawed understanding and interpretations of the various stipulations in the law and standards in an unprofessional manner that established the EP's professional misconduct in terms of Section 132 (4) of the Act.

4. Based on the nature of professional misconduct and other factors this Order imposes on CA M Baskaran a monetary penalty of ₹ 100,000 (One Lakh) and debarment for one year from being appointed as an auditor or internal auditor or from undertaking any audit in respect of financial statements or internal audit of the functions and activities of any company or body corporate.

B. INTRODUCTION AND BACKGROUND

5. NFRA is a statutory authority set up under Section 132 of the Act to monitor the implementation and enforce compliance of the auditing and accounting standards and to oversee the quality of service of the professions associated with ensuring compliance with such standards. NFRA has the powers of a civil court and is empowered under Section 132 (4) of the Act to investigate the prescribed classes of companies and impose penalties for professional or other misconduct of the individual members or firms of chartered accountants.

6. The statutory auditors, both individual and firm of chartered accountants, are appointed by the members of companies u/s 139 of the Act. The statutory auditors, including the Engagement Partners and the Engagement Team that conduct the audit, are bound by the duties and responsibilities prescribed in the Act, the rules made thereunder, the Standards on Auditing (SA), including the Standards on Quality Control and the Code of Ethics, the violation of which constitutes professional misconduct, and is punishable with penalty prescribed under Section 132 (4) (c) of the Act.

7. Following media reports regarding the alleged siphoning of public money of around ₹31000 crore and the Enforcement Directorate's reported action in April 2020 on an alleged banking fraud of about ₹3700 crore by the promoter/ directors of DHFL, NFRA suo-motu initiated an AQR to probe into the role of the Statutory Auditors of DHFL for the FY 2017-18, the year in which the alleged fraud was primarily stated to have occurred. While examining the Audit Files[1] of the statutory audit carried out by CAS, a Mumbai-based CA firm, certain prima facie violations were observed relating to the appointment of Branch Auditors and the conduct of branch audits of DHFL which were relied upon by CAS. Accordingly, NFRA suo motu called for the audit files from EPs who had signed the "Independent Branch Auditors' Report" for nearly 250 branches, under Section 132(4) of the Act, including CA M Baskaran, to whom this Order relates and who acted as the branch auditor for the nine branches.

8. DHFL, a housing finance company listed on both National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE), was required to prepare its Financial Statements for the Financial Year (FY) 2017-18 in accordance with Schedule III and other applicable provisions of the Companies Act 2013 and Accounting Standards (AS) notified under the Companies (Accounting Standards) Rules, 2006.

[1] As defined in para 6 of SA 230

9. As part of NFRA's investigations, K Varghese & Co was asked to provide the Audit File vide NFRA letter dated 10.08.2022, giving 15 days' time. The audit firm submitted the Audit File along with other information in respect of seventeen branches for FY 2017-18 on 25.08.2022.

10. The investigation by NFRA revealed prima facie evidence that the branch auditors had violated both the Companies Act, 2013 and the Chartered Accountants Act, 1949 by accepting the appointment that lacked a valid approval and had also violated the SAs while carrying out the branch audit. On being satisfied that prima facie sufficient cause existed to take action under sub-section (4) of Section 132 of the Act, a Show Cause Notice (SCN hereafter) was issued to CA M Baskaran on 07.12.2022, asking the EP to show cause why action should not be taken for professional misconduct in respect of the performance as the EP, on behalf of K Varghese & Co. the Statutory Auditor of nine branches of DHFL for the FY 2017-18. The EP was charged with professional misconduct on account of:
    a. Failure to ascertain from the Company whether the requirements of Sections 139 of the Act in respect of such appointment have been duly complied with,
    b. Failure to exercise due diligence and being grossly negligent in the conduct of professional duties,
    c. Failure to obtain sufficient information which is necessary for the expression of an opinion, or its exceptions are sufficiently material to negate the expression of an opinion, and
    d. Failure to invite attention to material departure from the generally accepted procedures of audit applicable to the circumstances.

11. The EP was asked to reply to SCN by 05.01.2023 but was granted an extension of time following a request vide e-mail dated 04.01.2023. The EP submitted the reply on 04.02.2023. A "*Supplementary Audit File*" was also submitted by the EP along with the reply to the SCN wherein some additional documents (including the previous year's Trial Balance for FY 2016-17, audit plan, etc.) were submitted. The EP did not avail of the offer of a personal hearing. The various charges levied in the SCN and the response of the EP to the charges are discussed in Part C of this Order.

C. MAJOR LAPSES AND VIOLATIONS BY THE EP

12. The major lapses for which the EP was issued the SCN primarily relate to (i) accepting the audit engagement without a valid authority and thus violating the provisions of the Act and (ii) violations of the Standard of Auditing in conducting the audit.

I. Acceptance of audit engagement without valid authorization and without complying with ethical requirements; and issuing an audit report in violation of the Act

13. The EP was charged with acceptance of an audit engagement without complying with ethical requirements and issuing the audit report without a valid appointment as per the Act, as the appointment of the Audit Firm as "Statutory Auditor for the branches" of DHFL for FY 2017-18 was not done by the competent authority i.e., the shareholders.

14. On examination of the Audit File, we observe that despite a specific requirement in the Chartered Accountants Act, 1949 (CAs Act) to do so, the EP has not verified if the appointment as "Statutory Auditor for the branches" of the Company was done in compliance with Section 139 of the Act. The EP not only accepted an invalid appointment letter issued by an "Authorised

Signatory" without the approval of the Board and shareholders but also issued the audit report without ascertaining the actual objective and scope of the audit. The EP also violated the ethical requirements, as laid down in the Code of Ethics, 2009, which require the EP to ensure professional competence, due care, integrity and professional behaviour in discharging the duties as well as compliance with the Act before accepting the engagement. Thus, the EP also did not comply with Paras 14, 15 and 16 of SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing".

15. In response to the above charges in the SCN, the EP submitted that the appointment of the "*firm was very much valid in the eyes of law*". The EP further submits that:

a. "*Section 139 does not contain any specific provision with regard to the appointment of an auditor of a branch of the company*". "*The concept of a branch auditor of a company is appearing only in Section 143(8) and not anywhere else....the objective of Section 143 is to define the powers and duties of auditor and auditing standards. ...language in Section 143(8) is not intended to lay down the law about the process of appointment of branch auditors. Therefore, it is incorrect to form any interpretation from the language in Section 143(8), that a branch auditor is to be appointed under Section 139.....if the intent of the language in Section 143(8) was to convey that the appointment of branch auditor shall be under the provisions of Section 139, then there was no need of using the words "as such" in the sentence. With the insertion of the words "as such", meaning of the language in Section 143(8) changes altogether. The words "appointed as such" only meant "appointable*".

b. "*If the intent of the law was to ensure appointment of branch auditor as per the provisions of Section 139, then there would have been no exemption for auditors for foreign branches either. ...The Form ADT 1 prescribed under Rule 4(2) of Company (Audit and Auditors) Rules 2014, to be filed by a company on appointment of auditors, does not envisage appointment of branch auditors. If the intent of the law was to appoint branch auditors under Section 139, then there would have been provisions in ADT 1 for reporting to the government on appointment of auditors*".

c. "*...appointment of a branch auditor would depend on the decision of the company auditor. For this reason the tenure of appointment would depend on the inability of the company auditor to do audits of branches on his own. ... ...In view of the above stated multiple reasons embedded in the legal provisions, appointment of branch auditors can only be an administrative matter between the company's auditor and the Board of Directors.*"

d. "*A branch auditor is not a company's auditor. Appointment of auditor dealt within Section 139 is only about the company's auditor, and not about branch auditors. Appointment of branch auditors is not required to be done by the members of the company.*"

e. "*The intent of the Clause (9) is that a Chartered Accountant, before accepting the appointment as an auditor, shall ensure that his predecessor was not eased out by the board of directors or shareholders without due process or that he was not met with injustice. However, such a situation would not arise in every case of appointment of auditors in companies.....when a new auditor is appointed in all those cases listed above, there is no applicability of Clause (9), because the requirement of complying with Section 225, would not arise in such cases. This point precisely establish that a newly appointed auditor was not required to ascertain the validity of appointment in all cases, but was only required to verify appointment related documents where there was application of Section 225, ie when an auditor in office eligible to be reappointed was not reappointed. The facts of the case of appointment of the Respondent's firm, had no connection with situations described for the purpose of application of Section 225 of Act of 1956.....the whole of the provisions in Section*

139 and 140 of Co's Act 2013 are not the comparable provisions in Section 225 of the Co's Act 1956.. .....There was no legal or regulatory requirement up on the Respondent to verify the documents related to appointment as branch auditor of the company".

16. We have examined the replies of the EP. We find that:
    a. As per Section 143 (8) of the Act, "*Where a company has a branch office, the accounts of that office shall be audited by either..... or any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139*". It is clear from this that the appointment of a Branch Statutory Auditor is required to be made under Section 139 of the Act i.e., by the members at an annual general meeting. In Section 143 (8) the phrase "appointed as such" refers back to the requirement for the auditor to be "qualified for appointment as an auditor of the company under this Act." In this case, "as such" shows that the branch auditor must be appointed in the capacity of an auditor qualified for appointment under the Act. This clearly means that the branch auditor must meet the requirements of the qualification for an auditor under the Act and must be appointed to the role of auditor under Section 139 of the Act. The use of "as such" clarifies that the auditor must be appointed specifically as an auditor of the company and that their qualifications for appointment must meet the requirements set out in the Act. There is no room for any other interpretation or to examine the intention of the law when the plain meaning of the law is sufficiently clear and not contradicting any other parts of the Act. It is also pertinent to refer to A Ramaiya's Guide to The Companies Act, 19th Edition, wherein it is explained that "*considering under the Act, the auditor of a company is appointed by shareholders, it follows that the above mentioned*[2] *position would continue and thus the decision whether a branch should be audited by the company's auditor or by any other auditor has to be taken by the shareholders in a general meeting*".
    b. The EP's contention that Form ADT 1, to be filed by the Company on the appointment of statutory auditors, does not cover the appointment of branch auditor and hence the law "*does not envisage appointment of branch auditors*" is baseless. The contents of a form prescribed under the Act have no impact on the substantive requirements of the Act, which unambiguously provides for the appointment of the branch auditor under Section 139 of the Act. Other contentions of the EP such as *"...appointment of a branch auditor would depend on the decision of the company auditor. For this reason the tenure of appointment would depend on the inability of the company auditor to do audits of branches on his own"* lack any basis in the Act or in the professional standards and hence merit no examination.
    c. The EP has not provided any working paper evidencing compliance with Clause 9 of Schedule I of the Chartered Accountants Act, 1949 and the Code of Ethics issued by ICAI. Under Section 22 of the Chartered Accountants Act, 1949 read with Clause (9) of Part I of the First Schedule to the said Act (the meaning of which is conceived in Section 132(4) as professional misconduct)[3] a chartered accountant in practice shall be deemed to be guilty of professional misconduct if an appointment as auditor of a company is accepted without first ascertaining from it whether the requirements of Section 225 of the Companies Act, 1956 (equivalent

[2] The general meeting may authorise the Board of Directors to make the appointment in consultation with companies auditor.

[3] As per Ministry of Corporate Affairs Circular No. 7/2014, dated 01-04-2014, the equivalent sections of the Companies Act 2013 for the above sections of the Companies Act 1956 are sections 139 and 140.

Sections being Section 139 & 140 of Companies Act, 2013) in respect of such appointment have been duly complied with.

d. The ICAI Code of Ethics, 2009 makes it clear that "*Under Clause (9) of Part I of the First Schedule to the Chartered Accountants Act, 1949, the incoming auditor has to ascertain whether the Company has complied with the provisions of the above sections. The word "ascertain" means "to find out for certain". This would mean that the incoming auditor should find out for certain as to whether the Company has complied with the provisions of Sections 224, 224A and 225 of the Companies Act. In this respect, it would not be sufficient for the incoming auditor to accept a certificate from the management of the Company that the provisions of the above sections have been complied with. It is necessary for the incoming auditor to verify the relevant records of the Company and ascertain as to whether the Company has, in fact, complied with the provisions of the above sections*".

e. It is observed that the Resolution for Appointment of Auditor for the financial year 2017-18 passed at the 33rd Annual General Meeting of DHFL – held on 21-07-2017 read with the declaration of Voting Results of the resolution to ratify such appointment only refers to the appointment of CAS (Firm Registration No: 101720W) as the Statutory Auditors of the Company to audit the accounts of all the Company's offices including those of its zonal/ regional and branch offices for the financial year 2017-18. No other branch Statutory Auditors were appointed or ratified by the Company in the said meeting. Only CAS was appointed as the Statutory Auditor for the company as well as all its branches. Thus, the shareholders of the company approved only one Statutory Auditor (viz. Chaturvedi & Sah) for the Company and its branches. Therefore, in absence of any valid appointment, EP's acceptance of the appointment as Statutory Auditor of the branches shows the absence of due diligence.

f. Despite the invalid appointment letter issued by DHFL addressing the Audit Firm, the acceptance letter dated 12.09.2017 issued by the Audit Firm and the "Independent Branch Auditor's Report" issued by the EP for the nine branches of DHFL, including the report required under CARO 2006 described the engagement as Branch Statutory Audit.

17. Therefore, as explained above, we find that the absence of due diligence and display of gross negligence by the EP run afoul of the provisions of the Chartered Accountants Act, 1949 and resulted in professional misconduct as conceived under Section 22, Clause 9 of Schedule I of the Chartered Accountants Act, 1949. The acceptance of an invalid appointment letter for the Statutory Audit of the Branch, the conduct of the audit based on an invalid appointment, convoluted logic and baseless reading of the law to justify the actions show the absence of professional skepticism and gross negligence on the EP's part. Therefore, we find that the charges in paras 13 and 14 above stand proven.

II. Failure to comply with Standards on Auditing (SAs)

18. Notwithstanding our finding in Part I above, that the appointment of the Audit Firm was not as per the provisions of the Law, we now discuss the non-compliance by the EP with the SAs, since the audit work done by the EP has been relied upon in the Audit Report of the Statutory Auditor, CAS. We observe from the various communications between the Company, the Branch Auditor and the Statutory Auditor that the whole Branch Audit engagement was performed by the Branch Auditors as per the scope of work provided by the company in consultation with the Statutory Auditors. The scope describes the engagement as a branch statutory audit under the Act. The Branch Auditors accepted the "Statutory Branch Audit" assigned by the Company and issued the "Independent Branch Auditors' Report" stating therein that the audit was conducted in accordance with the SAs

specified under the Act. **Since these branch audit reports are clearly referred to by Company's Statutory Auditor (CAS) in its report to the members of the Company, we examine here the extent of compliance with the applicable SAs by the Branch Auditor notwithstanding the violation of ethical standards, the Chartered Accountants Act, 1949 and of the Companies Act, 2013 in accepting an invalid appointment as the Branch Auditor.** The principles and procedures laid down in the SAs including professional skepticism, audit documentation, sufficiency and appropriateness of audit evidence, audit planning, materiality, engagement risk, nature, timing and extent of evidence-gathering procedures and reporting are all applicable in the branch audit as well, being an audit of historical financial information. Accordingly, the various violations of the SAs with which the EP was charged in the SCN are discussed in the following paragraphs.

Non-Compliance with SA 210 "Agreeing the Terms of Audit Engagements"

19. The EP was charged with non-compliance with SA 210[4] and displaying an absence of professional scepticism and professional judgment in documenting the objective and scope of the audit, thereby violating SA 200[5] as well. SA 210[6] stipulates that the auditor shall agree to the terms of the audit engagement with management or Those Charged With Governance (TCWG) and that subject to paragraph 11 of the SA, the agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable forms of a written agreement and shall include (a) the objective and scope of the audit of the financial statements; (b) the responsibilities of the auditor; (c) the responsibilities of management; (d) identification of the applicable financial reporting framework for the preparation of the financial statements; and (e) reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

20. Responding to the charges, the EP stated that *"The audit in question is a "company's branch audit" falling within the provisions of Section 143(8) of the companies Act 2013.....the communication dated 12th Sep 2017 (which contained the letter of acceptance and the acknowledged set of appointment letters and scope of audit), was in compliance of Para 11 of SA 210.* Citing para 11 of SA 210, the EP states that *"the regulation in SA 600 and in section 143(8) prescribe in sufficient detail that the terms of the audit engagement shall be as per the scope of audit given by company auditor, and acknowledging the appointment letter with the scope of audit is sufficient compliance of Para 11 of SA 210. Therefore the branch auditor was not required to record them in a written agreement. Details mentioned in SA 210-Para 10, quoted* in [*] the *SCN, are not required to be included in the communication when it is in accordance with the terms in SA 210-Para 11".*

21. We find that the appointment letter acknowledged by the Audit Firm did not contain all the details required by Para 9, 10 and 11 of SA 210. It was deficient in terms of the objective of the audit, the responsibilities of the auditor and the management and the applicable financial reporting framework[7]. Nor was such an audit engagement letter, as prescribed by SA 210, issued by the Audit Firm or EP. The EP's response above shows a flawed understanding of the scope of SA 210.

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[4] SA 210, Agreeing the Terms of Audit Engagements.

[5] Para 15 and 16 of SA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing.

[6] Para 9, 10 and 11 of SA 210

[7] The sample engagement letter in appendix 1 of SA 210 may be referred.

22. Para 11 of SA 210 relied on by the EP to support the contentions, states that if **law or regulation prescribes in sufficient detail the terms of the audit engagement referred to in paragraph 10**, the auditor need not record them in a written agreement, except for the fact that such law or regulation applies and that management acknowledges and understands its responsibilities. While the EP admits that the engagement was a branch statutory audit under section 143(8) of the Act, the EP ignored that para 11 of SA 210 can be invoked only if the terms of audit engagement referred to in paragraph 10 of SA 210 such as the objective of the audit, the responsibilities of management, applicable financial reporting framework and expected form and contents of the audit report are prescribed by the Law, i.e., Section 143(8) of the Act, which is not the case. The EP cannot take shelter behind SA 600[8], the purpose of which is to establish standards to be applied when a 'principal auditor' uses the work of another auditor. SA 600 is not a law or regulation that prescribes in sufficient detail the terms of the branch audit engagement. Hence, the contention that the details mentioned in para 10 of SA 210 are not required to be included in the engagement letter is baseless and not acceptable.

23. The EP accepted the appointment letter issued by DHFL and issued the audit report without complying with the requirements of SA 210. Between 2015-16 and 2016-17, there was a significant change in the circumstances relating to the branch audit. In 2015-16 the AGM decided to have a separate branch auditor and company's auditor, while in subsequent years there was only one auditor (CAS) to audit the Company and all its branches. This calls for the application of para 13 of SA 210 as well. EP's negligence of the provisions of SA 210 resulted not only in accepting an illegal appointment and non-compliance with SA 210 but also in the absence of professional skepticism and professional judgment in understanding the objective and scope of the audit, thereby violating SA 200 also. Therefore, the charges in para 19 above stand proven.

Non-Compliance with SA 230 "Audit Documentation"

24. The EP was charged with non-compliance with SA 230. EP's audit documentation does not give evidence of the nature, timing and extent of audit procedures performed, results of those audit procedures and conclusions reached during the audit as required by SA 230. In terms of SA 230, the objective of the auditor is to prepare documentation that provides a sufficient and appropriate record of the basis for the auditor's report; and evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements. In the absence of the required documentation, the audit report EP issued to CAS, the Statutory Auditor, was without adequate basis and was in violation of SAs.

25. The EP submits that the observation in the SCN that the EP "*did not follow the applicable SAs for conducting the audit of DHFL Branch for FY 2017-18 is totally misconceived, and because of gross misunderstanding of the scope of the audit undertaken by the Respondent. It may be admitted that there were certain deficiencies in audit file submitted by the Respondent, because of lack of experience in facing such investigations before. However those deficiencies have been rectified in accordance with Para 16 of SA 230, with the submissions of supplementary documents along with this. Since the audit documentation has been corrected, no case of professional misconduct against the Respondent on those reasons, will be legally tenable*". The EP also submitted around 48 pages of additional documents, described as "modification to audit file".

[8] SA 600 – Using the Work of Another Auditor

26. We have examined the EP's contention by reviewing the provisions in SA 230 and find that the same is not acceptable for the following reasons:
    a. As explained by SA 230, the nature and purposes of audit documentation are to provide evidence of the Auditor's basis for a conclusion about the achievement of the overall objectives of the Audit; and evidence that a planned performance of the Audit was done in accordance with SAs and relevant legal and regulatory requirements. SA 230 lists "enabling the conduct of quality control reviews and inspections in accordance with SQC 1; and enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements" among the additional purposes that are served by the audit documentation. Para 7 of SA 230 emphasises the "Timely Preparation of Audit Documentation" i.e. in a manner contemporaneous with the events that are being sought to be documented.
    b. Apart from SA 230, there are other SAs also that require the documentation of events, data, evidence, opinions and conclusions. SA 230 makes it very clear that reliance can be placed only on the audit file as evidence of what was done. Para A5 of SA 230 is explicit: "Oral explanations by the auditor, on their own, do not represent adequate support for the work auditor performed or conclusions the auditor reached, but may be used to explain or clarify information contained in the audit documentation". Para 14 mandates that the auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.
    c. SA 230 requires that the auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand (a) The nature, timing, and extent of the audit procedures performed to comply with the SAs and applicable legal and regulatory requirements, (b) The results of the audit procedures performed, and the audit evidence obtained, and (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.
    d. SA 230 further requires that in documenting the nature, timing and extent of audit procedures performed, the auditor shall record (a) The identifying characteristics of the specific items or matters tested; (b) Who performed the audit work and the date such work was completed; and (c) Who reviewed the audit work performed and the date and extent of such review.
    e. We find that SA 230, para 14, requires the assembly of the audit documentation in an audit file. SQC 1[9] prescribes a maximum time of 60 days for completion of assembly, beyond which no modification other than administrative changes is permitted in the Audit File. In the present case, the EP should have completed the assembly of the audit file within 60 days of the signing of the audit report. The EP's reliance is on para 16 of SA 230, which allows the auditor to modify existing audit documentation or add new audit documentation after the assembly of the final audit file has been completed when the auditor "*finds it necessary*". Para A24 further gives an example of a situation when it needs "*to clarify existing audit documentation arising from comments received during monitoring inspections performed by internal or external parties*". Monitoring envisaged in SA 230 and disciplinary proceedings under section 132(4) of the Act are entirely different actions. The contention of the EP that the audit documentation can be modified when an SCN contemplating disciplinary action is received from the regulator goes against the very basics of SA 230, as explained above, and the principles in SQC 1 regarding audit documentation. The EP cannot take shelter behind this provision to escape the responsibility regarding audit documentation.

[9] Standard on Quality Control (SQC) 1, Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements.

f. The above stipulations and explanations in the SAs make it clear that the audit documentation evidencing compliance with the requirements of the SAs in an audit needs to be completed before signing the audit report. Any changes permitted thereafter are either administrative or exceptional. The EP has not followed these mandatory requirements in maintaining the audit documentation. Any evidence added to the audit file in violation of the standards and after the prescribed archival period is not acceptable. The inevitable conclusion, in this case, is that the EP did not maintain the audit documentation in accordance with the SAs and SQC 1.

27. The EP also contended that since it "*was not required to audit the financial statements of the branch office of DHFL, there was no straight jacket application of the provisions of SA 230*", which permitted the EP to adapt the standard as necessary in the circumstances when applied to audits of other historical financial information rather than financial statements. We find that while adaptations of SAs are permitted in certain cases, they should not be taken as a reason for deviating from the fundamental principles of audit documentation as detailed in the preceding paragraphs.

28. Keeping the above in mind, we have examined the additional documents added by the EP in the interest of fairness and have taken the evidence into consideration wherever it is supporting or corroborating the original audit documentation submitted to NFRA. However, the conclusion is inescapable that additional documentation submitted to NFRA was deficient in terms of the nature, timing and extent of the audit procedures performed, who prepared and reviewed the audit working papers (WPs) and the timing of the audit procedures. For example, the majority of the WPs submitted in the audit file have only the sign and stamp of the Audit Firm. The WP containing Trial Balance as on 31.03.2017 does not have indications of any audit procedure performed or any cross-references to the related WPs where such details are available.

29. There is no evidence in the Audit File to indicate that the EP had performed audit procedures and documented the conclusion, nature, timing and extent of the procedures performed, in the following cases.
    a. The Audit File does not contain the basic documentation such as Understanding the branch operations, internal controls and responsibilities at various levels in the branch (refer to SA 315), Determination of materiality levels (refer to SA 320) and Understanding of the IT system controls (refer to SA 315). The EP's contentions that the understanding of branch operations done in 2013-14 is sufficient compliance with SA 315 and the "*Trial balance is an IT system output in this case from the ERP that required no validation for its accuracy. ... In this case the very Trial Balance taken from the centrally controlled ERP system was to be attested*" shows utmost disregard of the basic principles of SA 315 and the level of professional ignorance of the EP;
    b. Summary of the accounting policies, observations from previous audits, inspection reports, and internal audit reports (refer to SA 315);
    c. Proof of verification of trial balance items, including assets (substantive audit procedures);
    d. Procedures adopted to verify the loans sanctioned during the year and classification of loans as per regulatory norms (substantive audit procedures); and
    e. KYC verification, anti-money laundering verification, and security verification (substantive audit procedures).

30. The lack of sufficient documentation in an audit is not a mere technical and procedural formality but is a serious issue which strikes at the very root of the audit and may defeat the very purpose of the audit itself. Lack of sufficient documentation has been viewed seriously by national and

international regulators as well. For example, in the matter of Bharat Parikh & Associates Chartered Accountants, dated 19-03-2019, the US audit regulator PCAOB took a serious view on the lack of sufficient documentation and imposed penalties and sanctions for violations including insufficient documentation. The PCAOB Order states "*Audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement to (a) understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached, and (b) determine who performed the work and the date such work was completed as well as the person who reviewed the work and the date of such review……the documentation for each of those audits was insufficient to demonstrate the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached, including in those areas of the audits involving significant risks. For the FY 2016 and 2017 Issuer A audits, the documentation also failed to demonstrate who performed the work and the date such work was completed. Additionally, in each of the Issuer A and Issuer B audits, the audit documentation was insufficient to demonstrate which aspects of the audit and which audit documentation Bharat Parikh reviewed*".

31. Thus, we conclude that the EP did not follow the requirements of SA 230 and that the audit documentation does not give evidence of the nature, timing and extent of audit procedures performed, results of those audit procedures and conclusions reached during the. Hence the charges in para 24 above regarding non-compliance with SA 230 stand proven.

Non-Compliance with SA 700, "Forming an Opinion and Reporting on Financial Statements"

32. The EP was charged with non-compliance with SA 700. As per SA 700,[10] in order to form an opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Such a conclusion shall take into account, inter alia, whether sufficient appropriate audit evidence has been obtained and whether uncorrected misstatements are material, individually or in aggregate. In the Annexures to the audit report, EP noted that for some of the loan files reviewed required documents were not obtained. Also, there is no documentation of whether any unadjusted misstatements were material or not. The EP did not document anywhere how these possible misstatements were evaluated in forming the unmodified opinion and hence was charged with failure to comply with SA 700[11].

33. The EP denied the charges and stated that "*According to Rule 12 (1) of Company (Audit and Auditors) Rules 2014…..for the audit of the branches of a company, the responsibility of auditor as provided in Section 143(1)- 143(4) are on the company's auditor and not on the branch auditor…. It was not an audit report of the company, nor was an audit report on the financial statements, and therefore was not falling within the scope of SA 700.*"

34. The contentions of the EP, we find, are a flawed interpretation of the law. Para 2 of SA 200[12] makes it clear that the SAs are written in the context of an audit of financial statements by an auditor. They

[10] Para 10 to 12 of SA 700, Forming an Opinion and Reporting on Financial Statements

[11] Para 11 of SA 700

[12] SA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing.

are to be adapted as necessary in the circumstances when applied to audits of other historical financial information. Branch auditors appointed under section 143(8) read with Section 139 of the Act are statutorily required to comply with the SAs since section 143(9) requires "every auditor" to comply with the SAs. The interpretation of Rule 12 (1) of Company (Audit and Auditors) Rules 2014 by the EP that "*for the audit of the branches of a company, the responsibility of auditor as provided in Section 143(1)- 143(4) are on the company's auditor and not on the branch auditor*" is utterly misconceived and irrational reading of the law. The said rule, that states "*For the purposes of sub-section (8) of section 143, the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be as contained in sub-sections (1) to (4) of section 143*", only specifies that the company auditor and branch auditor (if there is one) must perform their duties and exercise their powers in accordance with sub-sections (1) to (4) of section 143, as outlined in the Act. It is perverse to interpret this provision to mean that the branch auditor has no responsibilities in certifying the branch accounts.

35. Accordingly, we hold that SA 700 is applicable in this audit and as per the SA 700, the EP is required to evaluate the effect of the misstatements and decide to appropriately modify the opinion. Determination of materiality is therefore important in an audit. It was observed that the Annexure to the audit report titled "*BRANCH AUDITOR AUDIT OF BRANCH'S FINANCIAL INFORMATION SUMMARY MEMORANDUM - AS A WHOLE*", had a specific requirement to certify whether the unadjusted misstatements are material or immaterial. However, under "*Overall Evaluation of Misstatements*" the EP neither certified that "*The unadjusted misstatements ...are immaterial*" nor that "*The unadjusted misstatements ...are material*". Thus, EP did not express any view as to the materiality of the misstatements. Despite this non-evaluation of misstatements, in the same annexure the EP certified that "*the financial information...gives a true and fair view*".

36. There is also no determination of materiality thresholds in the audit file. In the absence of documented conclusions, insufficient audit documentation, determination of materiality and assessment of the risk of misstatements and the test of controls we observe that the audit opinion issued by the EP does not comply with SA 700. Hence, the charges in para 32 above stand proven.

Non-Compliance with other SAs

37. The EP was charged with non-compliance with other SAs which include –
    a. Non-compliance with para 6, 7, 8, 9 & 10 of SA 300[13] as the EP failed in establishing an overall audit strategy and development of audit plan etc. in accordance with SA 300. The EP submitted an audit plan made for the year 2013-14 and stated that he "*...had a properly documented audit plan available in the audit file for previous years. Therefore documentation displaying an overall audit strategy and development of an audit plan for FY 2017-18 was felt not necessary, in view of the fact that it was not an audit of financial statements, and because there was room for the audit documentation to be adapted as necessary in the circumstances, as per SA 230*". The replies are not acceptable since SA 300 requires the auditor to include in the audit plan the timing[14] of the audit and to update and change the overall audit strategy and the audit plan as necessary during the course of

[13] SA 300, Planning an Audit of Financial Statements.

[14] Para 7 of SA 300

the audit[15]. The audit plan made in 2013-14 has not been updated to meet the requirements of the audit in 17-18. The EP's contentions that since the audit fee is low, the "*Audit plan and strategy in such cases are not required to be complex that necessitate detailed documentation*" and the audit plan is not required since the scope of work is "*well defined*" have no basis in the SAs and show the EP's absolute disregard to the quality of audit. Moreover, the audit plan now submitted by the EP was not forming part of the Audit File for 2017-18. Such contentions of the EP are against the fundamentals of SA 230 that require the maintenance of an Audit File that can enable an experienced auditor having no connection with the audit to understand the nature, timing and extent of the audit procedures performed to comply with the SAs. To evidence compliance with the requirements of the SAs, it is the fundamental stipulation of SA 230 that the auditor shall assemble the audit documentation in one audit file (and not multiple audit files of different years).

b. Non-compliance with para 5, 6 & 11 of SA 315[16] and para 1, 5 & 6 of SA 330[17] as the audit file lacks any documentation regarding the performance of risk assessment procedures for material misstatements at the financial statement level and assertion level and response to such risks etc. The EP submitted that the "*risk of material misstatement, in the Trial Balance, was only with respect to expenses incurred, as no other line item qualified to be tested for risk of material misstatement because of the accounting model of the company for branches*". In the absence of any documentation in the audit file, the contention is only an afterthought and hence not admitted.

c. Non-compliance with para 10, 11 & 14 of SA 320[18] for determining materiality, performance materiality and documentation thereof. The EP submits that there is no noncompliance since the report of the EP to the company's auditor mentions that "*from the point of view of determining materiality, expenses above 1% of revenue were considered for verification as a bench mark, and where there would be misstatement 2% was the bench mark*". Citing Para A7 of SA 230 which states "*it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file*" the EP states that the "*audit file on record sufficiently demonstrates the process adopted by the Respondent*". The replies show EP's disregard for professional standards and absence of professional behaviour on EP's part. Proper determination, application and revision of materiality are very basic to an audit. Para 5 of SA 320 makes it clear that "The concept of materiality is applied by the auditor both in planning and performing the audit and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report". Mandatory documentation requirements of SA 320 include the factors considered in the determination of materiality and materiality for the financial statements as a whole, the materiality level or levels for particular classes of transactions, account balances or disclosures, performance materiality and any revision of the materiality

[15] Para 9 of SA 300

[16] SA 315, Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment.

[17] SA 330, The Auditor's Responses to Assessed Risks

[18] SA 320, Materiality in Planning and Performing an Audit

amounts as the audit progress. The audit documentation in the present case did not contain any of these details and hence the replies of the EP are not acceptable.

d. Non-compliance with para 5, 6, 8, 14 & 15 of SA 450[19] in the absence of the evaluation of identified misstatements and uncorrected misstatements. The EP submits that there were no instances of identified misstatements and material misstatements and hence SA 450 is not applicable. The reply of the EP is not acceptable in the absence of any documentation or conclusions in the audit file in this regard.

e. Non-compliance with para 6 & 9 of SA 500[20] in not designing and performing audit procedures to obtain sufficient appropriate audit evidence and not evaluating the reliability of information produced by the company. The EP replied that "*it is a matter of judgment for the auditor to design the audit procedure to obtain audit evidences*" and stated that SA 500 has complied. The replies are not accepted since there is no evidence in the Audit File of designing and performing audit procedures, such as an audit plan, the substantive procedures performed and the conclusions drawn.

f. Non-compliance with para 6 of SA 520[21] relating to the design and performance of analytical procedures. The EP submits that SA 520 is not applicable since it is not a financial statement audit. The reply is not accepted since, as explained earlier in this order, the SAs are applicable for the branch statutory audit also.

g. Non-compliance with para 4, 6, 7, 8 & 9 of SA 530 relating to the determination of sample design, sample size and required audit procedures. The EP states that the "*basis of selection of sample was defined in the appointment letter itself, and the skills of judgment and competence of the auditor were applied to draw the required sample data. The audit sampling in this case had provided a reasonable basis for the respondent auditor to draw conclusions about the population from which the sample was selected*" and hence the charges are denied. We find that the conditions in the appointment letter do not evidence basis for EP's work and conclusions. The SAs casts a responsibility[22] on the auditor to design and perform audit procedures to obtain sufficient appropriate audit evidence on which to base the audit opinion. The terms dictated by the company cannot substitute this responsibility. There is no evidence that any of the sampling and the related procedures as detailed in SA 530 have been complied with by the EP, while the audit opinion is based on sample testing. In the absence of any evidence to show compliance with the determination of sample design, sample size and audit procedures performed on it, the contentions of the EP are not accepted.

D. ARTICLES OF CHARGES OF PROFESSIONAL MISCONDUCT BY THE EP

38. Given the above-mentioned actions of commissions and omissions, it is established that CA M Baskaran did not comply with the stipulations in the Chartered Accountants Act, 1949 regarding the acceptance of the statutory audit engagement and showed gross negligence and absence of due diligence while accepting the appointment as an auditor that was legally invalid. In addition to accepting a legally invalid appointment, the EP also did not ensure the audit quality and was grossly negligent in performing his professional duties by not adhering to the requirements laid

[19] SA 450, Evaluation of Misstatements Identified during the Audit

[20] Sa 500, Audit Evidence

[21] SA 520, Analytical Procedures

[22] SA 500 and SA 530, among other SAs.

down by the relevant SAs. This led to the issuance of the audit report that displayed the absence of a sound basis and quality in the audit work. Specifically, the following failures on the part of EP CA M Baskaran as contained under the Articles of Charges in the SCN are established.

a) Failure to ascertain from the audited Company whether the requirements of Sections 139 of the Act in respect of such appointment had been duly complied with, as explained and proved in part C1 above (As per Section 22 and Clause 9 of Part I of the First Schedule to the CAs Act);

b) Failure to exercise due diligence and being grossly negligent in the conduct of professional duties, because of the lapses and omissions as explained and proved in parts C1 and C2 above (As per Section 22 and Clause 7 of part I of the Second Schedule to the CAs Act);

c) Failure to obtain sufficient information which is necessary for the expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion, because of the lapses and omissions as explained and proved in part C2 above, (As per Section 22 and Clause 8 of part I of the Second Schedule to the CAs Act); and

d) Failure to invite attention to material departure from the generally accepted procedures of audit applicable to the circumstances of the audited Company, because the EP certified in the report that the audit was done as per SAs mandated under section 143 of the Act and committed the lapses and omissions as explained and proved in part C2 above (As per Section 22 and Clause 9 of Part I of the Second Schedule to the CAs Act).

Thus, we find that EP M Baskaran committed professional misconduct, as defined in the respective clauses of the CAs Act, the meaning of which is conceived under Section 132 (4) of the Companies Act as amounting to professional misconduct.

E. PENALTY AND SANCTIONS

39. Section 132(4) of the Companies Act, 2013 provides for penalties in a case where professional misconduct is proved. The law lays down a minimum punishment for such misconduct.

40. The financial statement includes material information from the Branches of the Company, where a substantive part of the lending activities is carried out.

41. A Branch Statutory Auditor is duty-bound to examine and ascertain the integrity of the underlying information forming Financial Statements of such entities[23] in the larger public interest.

42. The EP in the present case was required to ensure compliance with SAs to achieve the necessary audit quality and lend credibility to the reports issued to facilitate the Company's Auditor to form their opinion on the Financial Statements. As detailed in this order starting from the acceptance of the Audit to the conduct and conclusion of the audit, there were substantial deficiencies in the Audit and abdication of responsibility on the part of EP, CA M Baskaran, which establishes the professional misconduct. Despite being a qualified professional, we find that the EP, CA M Baskaran has not adhered to the Standards of Audit. On the contrary, the EP has tried to cover up the deficiencies by resorting to arguments not supported by law or evidence.

[23] As defined in Rule 3 of NFRA Rules 2018

43. The EP's flawed interpretation of the law, evident in the EP's convoluted logic and reading of the standards, shows a lack of understanding of legal principles and a tendency to undermine their proper application. This unprofessional attitude, particularly in the context of the audit of public interest entities, if allowed to persist, will cause severe harm to the interests of the users of the financial statements. Under the circumstances, we proceed to impose the sanctions keeping in mind the deterrence, proportionality, and signalling value of these sanctions.

44. As demonstrated by the discussions above, there are gaps in EP's understanding of SAs that need to be addressed. To enhance CA M Baskaran's skills as an auditor capable of carrying out the audit of public interest entities, CA M Baskaran would benefit from further training in the area of SAs. Therefore, we recommend that CA M Baskaran to undertake relevant training on SAs to improve proficiency in this area. By doing so, CA M Baskaran will be better equipped to provide high-quality audit services.

45. Considering the fact that professional misconducts have been proved and considering the nature of violations and principles of proportionality and keeping in mind the deterrence, proportionality, signalling value of the sanctions and time required for improvement in knowledge gaps we, in the exercise of powers under Section 132(4)(c) of the Companies Act, 2013, proceed to order the following sanctions:

    i. Imposition of a monetary penalty of **₹ 100,000 (One Lakh)** upon CA M Baskaran;

    ii. CA M Baskaran is debarred for **one year** from being appointed as an auditor or internal auditor or from undertaking any audit in respect of financial statements or internal audit of the functions and activities of any company or body corporate.

46. This order will become effective after 30 days from the date of issue of this order.

Signed
(Dr Ajay Bhushan Prasad Pandey)
Chairperson

Signed
(Dr Praveen Kumar Tiwari)
Full-Time Member

Signed
(Smita Jhingran)
Full-Time Member

Authorised for issue by the National Financial Reporting Authority,

Date: 13.04.2023
Place: New Delhi

(Vidhu Sood)
Secretary

सचिव / Secretary
राष्ट्रीय वित्तीय रिपोर्टिंग प्राधिकरण
National Financial Reporting Authority
नई दिल्ली / New Delhi

To,
CA M Baskaran,
Membership No. 216637,
Partner, K. Varghese & Co., Chartered Accountants, (Firm Registration No: 004525S),
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Copy To: -

(i) Secretary, Ministry of Corporate Affairs, Government of India, New Delhi.
(ii) Securities and Exchange Board of India, Mumbai.
(iii) Compliance Officer, DHFL.
(iv) Secretary, Institute of Chartered Accountants of India, New Delhi.
(v) IT-Team, NFRA for uploading the order on the website of NFRA.