

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

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सातवीं मंजिल, हिंदुस्तान टाइम्स हाउस,  
कस्तूरबा गांधी मार्ग, नई दिल्ली

मिसिल संख्या : NF-23/14/2022

दिनांक: 26.04.2023

**ORDER**

**In the matter of M/s Sundaresha & Associates and CA C. Ramesh, under Section 132(4) of the Companies Act 2013.**

1 This Order disposes of the Show Cause Notice ('SCN' hereafter) no. NF-23/14/2022 dated 10th November 2022, issued to M/s Sundaresha & Associates, Firm No: 008012S ('Firm' hereafter) and CA C. Ramesh, ICAI Membership no- 022268 ('EP', hereafter) (the Audit Firm and the EP are collectively called as 'Auditors' hereafter) who is a member of the Institute of Chartered Accountants of India ('ICAI' hereafter) for the statutory audit of Tanglin Developments Limited ('TDL' or 'the company' hereafter) for the Financial Year ('FY' hereafter) 2018-19.

2 This Order is divided into the following sections:

- A. Executive Summary
- B. Introduction & Background
- C. Major lapses in the Audit
- D. Other non-compliances with Laws and Standards
- E. Omissions and commissions by the Audit Firm
- F. Points of Law raised by the Auditors.
- G. Articles of Charges of Professional Misconduct by the Auditors
- H. Penalty & Sanctions

**A. EXECUTIVE SUMMARY**

3 Pursuant to Securities and Exchange Board of India ('SEBI' hereafter) sharing in April 2022 its investigation regarding diversion of funds worth Rs 3,535 crores from seven subsidiary companies of Coffee Day Enterprises Limited ('CDEL' hereafter), a listed company, to Mysore Amalgamated Coffee Estate Limited ('MACEL' hereafter), an entity owned and controlled by the promoters of CDEL, NFRA initiated investigations into the professional conduct of the statutory auditors under Section 132(4) of the Companies Act 2013 ('Act' hereafter). Tanglin Developments Limited is a subsidiary company of CDEL.

4 NFRA's investigations inter alia revealed that the TDL's Auditors for the FY 2018-19, had failed to meet the relevant requirements of the Standards on Auditing ('SA' hereafter) in a number of significant aspects and demonstrated a serious lack of competence. They failed to evaluate their potential conflict of interest and failed to maintain their independence from TDL by having audit

and non-audit relationships with a large number of Coffee Day Group companies and the promoters' family members; made an attempt to deceive NFRA by adding more documents to as well as altering the documents in their Audit File which amounted to tampering with the Audit File. The Auditors also failed to exercise Professional Judgement & Skepticism and perform risk assessment procedures to identify, assess and respond to the Risk of Material Misstatements due to fraud in respect of (a) loan transactions of Rs 2614.35 crores with MACEL (b) land advance of Rs 275 crores given to Mrs Vasanthi Hegde (mother of the then chairman of CDEL), (c) land advance of Rs 200 crores given to another individual for lands inter alia owned by Mrs Vasanthi Hegde (which was reportedly repaid) and (d) land advance of Rs 140 crores given to another related party; failed to evaluate understatement of loan by Rs 474 crores fraudulently given to MACEL and evergreening of loans through structured circulation of funds among group companies; failed to evaluate loan of Rs 507.05 crores fraudulently given to Giri Vidhyuth (India) Limited (a subsidiary company); and failed to evaluate loan transactions of Rs 1743.42 crores fraudulently entered into with Tanglin Retail Realty Developments Private Limited (another subsidiary company). The Auditors failed to perform sufficient appropriate audit procedures in respect of recognition of interest income of Rs 75.58 crores from MACEL, without any contract/agreement with MACEL, which did not recognize this interest expense in its Financial Statements. Thus, the total material and pervasive misstatements amounted to Rs 1471.63 crores, despite which the Auditors falsely reported that the Financial Statements of TDL for the FY 2018-19 gave a true and fair view. They also falsely reported that TDL had effective Internal Financial Control over Financial Reporting despite the complete absence of the same.

5 Based on investigation and proceedings under section 132 (4) of the Companies Act and after giving them opportunity to present their case, NFRA found the Audit Firm and Engagement Partner, guilty of professional misconduct and imposes through this Order the following monetary penalties and sanctions with effect from a period of 30 days from issuance of this Order:

- i. Imposition of a monetary penalty of Rs One crore upon M/s Sundaresha & Associates. In addition, M/s Sundaresha & Associates. is debarred for a period of two years 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;
- ii. Imposition of a monetary penalty of Rs Five Lakhs upon CA C. Ramesh. In addition, CA C. Ramesh is debarred for a period of five years 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 & BACKGROUND**

6 The National Financial Reporting Authority ('NFRA' hereafter) is a statutory authority set up under section 132 of the Companies Act 2013 ('Act' hereafter) to monitor 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 for the prescribed classes of companies<sup>1</sup> the professional or other misconduct of individual members or

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<sup>1</sup> As defined in Rule 3 of the NFRA Rules 2018.

firms of Chartered Accountants acting as their statutory auditors and impose penalty for proven professional or other misconduct of such individual members or firms of Chartered Accountants.

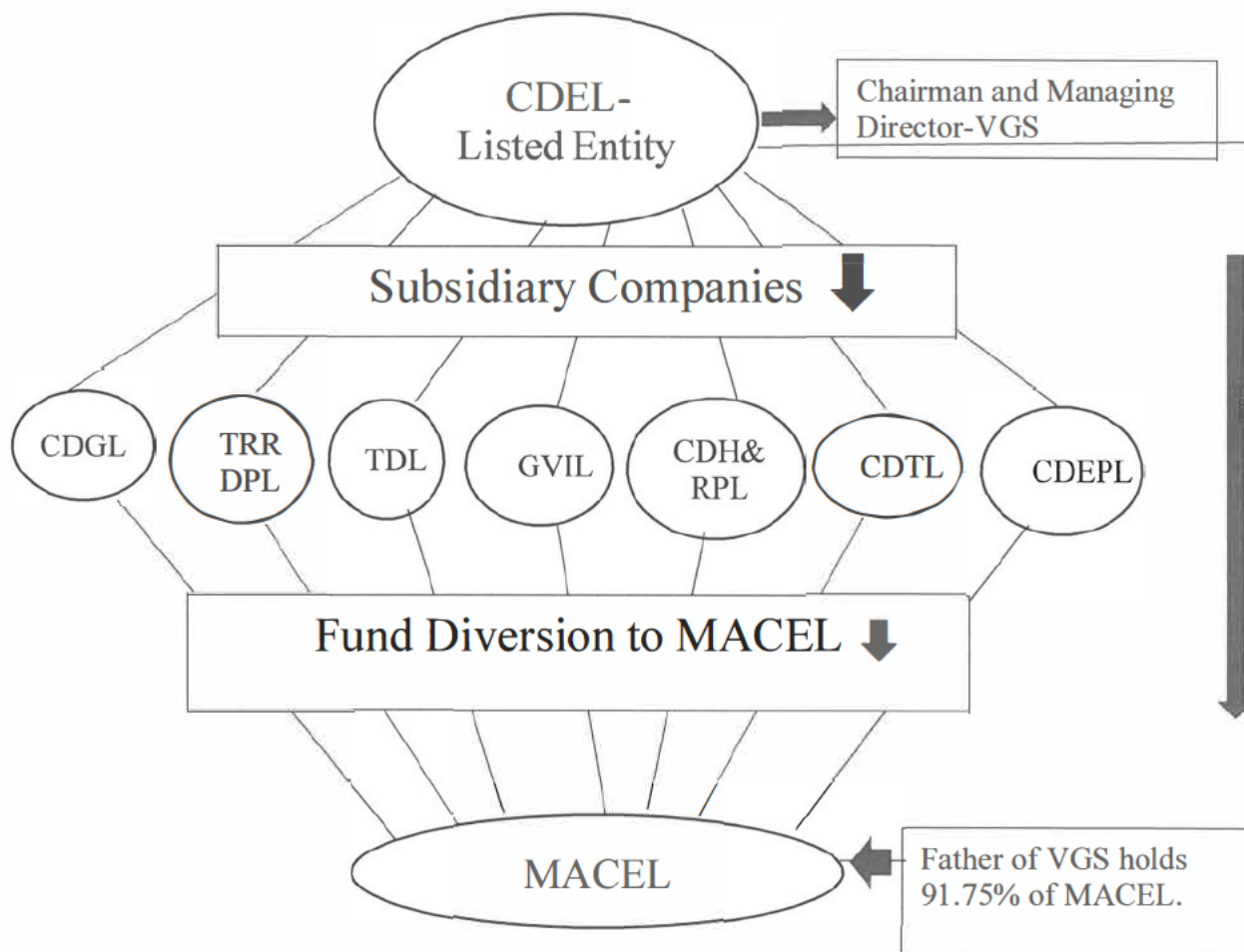
- 7 The Statutory Auditors, individuals and firm of Chartered Accountants, are appointed by the members of companies as per provision of section 139 of the Act. The Statutory Auditors, including the Engagement Partners ('EPs' hereafter) and the Engagement Team that conduct the Audit are bound by the duties and responsibilities prescribed in the Act, the rules made thereunder, the Standards on Auditing ('SA' hereafter), including the Standards on Quality Control ('SQC' hereafter) and the Code of Ethics, the violation of which constitutes professional or other misconduct, and is punishable with penalty prescribed under section 132 (4) (c) of the Act.
- 8 On receipt of information from SEBI vide letters dated 01.04.2022 & 29.04.2022 sharing its investigation regarding diversion of funds worth Rs 3,535 crores (as on 31-07-2019) from seven subsidiary companies of Coffee Day Enterprises Limited, a listed company, to Mysore Amalgamated Coffee Estate Limited, an entity owned and controlled by the promoters of CDEL, NFRA started investigation into the role of the statutory auditors under its powers in terms of section 132 (4) of the Companies Act 2013.
- 9 Late V. G. Siddhartha ('VGS' hereafter) was Chairman & Managing Director of CDEL till 29.07.2019. VGS and his family reportedly owned around 10,000 acres of coffee estates through various entities owned by VGS and operated and managed by MACEL, whose 91.75% shares were held by Late S.V. Gangaiah Hegde, father of VGS.
- 10 As per the investigations made by the SEBI, the outstanding balance payable by MACEL to subsidiary companies of CDEL was Rs 842 crores as on 31 March 2019, which had increased to Rs 3,535 crores on 31 July 2019, detailed as under in Table-1:

Table-1 (Rs in crores)

Sr. No	Names of the Subsidiary Companies of CDEL from which funds diverted to MACEL	Outstanding balance as on	
		March 31, 2019	July 31, 2019
1	Coffee Day Global Ltd (CDGL)	65	1,112
2	Tanglin Retail Reality Developments Pvt Ltd (TRRDPL)	789	1,050
3	Tanglin Developments Ltd (TDL)	-12	620
4	Giri Vidhyuth (India) Ltd. (GVIL)	-	370
5	Coffee Day Hotels and Resorts Pvt Ltd (CDH&RPL)	-	155
6	Coffee Day Trading Ltd (CDTL)	-	125
7	Coffee Day Econ Pvt Ltd (CDEPL)	-	103
Total		842	3,535

11 The linkage of the entities described in above table is depicted in the chart given below:

Chart-1



- 12 As per the Financial Statements ('FS' hereafter) of MACEL, Rs 3,535 crore received from the subsidiaries of CDEL was further transferred from MACEL to the personal accounts of VGS, his relatives and entities controlled by him and/or his family members, whose outstanding balances payable to MACEL were Rs 3,238.95 crores as on 31.03.2019. On examination of FS of MACEL, it transpired that MACEL did not have any business transactions with the 6 of the 7 subsidiary companies except CDGL, and was used as a conduit to transfer funds from CDEL's subsidiaries to the personal accounts of VGS, his relatives and entities controlled by him and/or his family members, as loans and advances that were never returned to MACEL/CDEL.
- 13 The modus operandi of the alleged diversion of funds discovered by the SEBI during its investigation was that "VGS used to ask the Authorized Signatories to sign a bunch of cheques which were kept in his possession and used them as and when required". Such pre-signed blank cheques of bank accounts of various Coffee Day Group companies were used for the diversion of funds.
- 14 TDL is engaged in setting up a fully integrated Information Technology Park ("Industrial Park") and campuses for software development at Bangalore and Mangalore. It had three subsidiaries viz., Giri Vidhyuth India Limited, Tanglin Retail Reality Developments Private Limited and

Way2Wealth Securities Private Limited but prepared Separate Financial Statements opting not to prepare Consolidated Financial Statements in accordance with the exemption available as per para 4(a) of IND AS 110 – ‘Consolidated Financial Statements’. TDL, a subsidiary of the listed entity CDEL, did not have any business relations with MACEL, a related party. VGS was the Chairman of CDEL. MACEL is a company owned (91.75%) by Late S.V. Gangaiah Hegde, father of VGS. Thus, these are related parties within the ambit of Ind AS 24. As per Rule 3 of NFRA Rules 2018, NFRA has powers to investigate Auditors of unlisted Public Companies having paid-up capital of not less than rupees five hundred crores or having annual turnover of not less than rupees one thousand crores or having, in aggregate, outstanding loans, debentures and deposits of not less than rupees five hundred crores as on the 31st March of immediately preceding financial year. TDL, an unlisted Public Company having borrowings/deposits of Rs 2,477.53 crores as on 31.03.2018, falls under the jurisdiction of NFRA.

15 M/s Sundaresha & Associates was the statutory auditor of TDL for the Financial Year 2018-19 and CA C. Ramesh signed the Financial Statements of TDL and the Independent Auditor’s Report. NFRA called from the Statutory Auditor the Audit File of TDL for Financial Year 2018-19 to examine the role of the Auditors and for investigation under section 132(4)(b)(i) of the Act. Based on the examination of the Audit File and other material on record, NFRA issued a Show Cause Notice (‘SCN’ hereafter) to the Auditors on 10.11.2022 asking them to show cause by 10.12.2022 why provisions of section 132(4)(c) of the Companies Act 2013 should not be invoked for professional misconduct of:

- a) Failure to disclose a material fact known to them but not disclosed in a financial statement, and disclosure of which was necessary in making such financial statement where the statutory auditors are concerned with that financial statement in a professional capacity.
- b) Failure to report a material misstatement known to them to appear in a financial statement with which the statutory auditors are concerned in a professional capacity.
- c) Failure to exercise due diligence and being grossly negligent in the conduct of professional duties.
- d) Failure to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion, and
- e) Failure to invite attention to any material departure from the generally accepted procedures of audit applicable to the circumstances.

16 The Auditors sought an extension of time of 45 days for submitting response to SCN, which was allowed. The Audit Firm vide letter dated 18.01.2023 submitted its reply to SCN. The EP vide letter 19.01.2023 submitted that the reply of the firm may be considered as his reply and that he was not giving separate reply.

17 In the interest of natural justice, the opportunity of personal hearing was also given to the Auditors on 17.03.2023 at 2:30 PM. However, the Firm and CA C. Ramesh vide letters dated 28.02.2023 withdrew their requests for personal hearing and further requested NFRA to decide the case based on their written submission. Accordingly, this Order is based on examination of the facts of the matter, charges in the SCN, written replies of the Auditors and other materials available on record.

## General submissions by the Auditors

- 18 The Auditors have submitted that Standards on Auditing are not reference material to decide on charges of professional misconduct against an auditor and are a guidance to an auditor to act professionally while arriving at an opinion and have referred to para 5, A47 and A52 of SA 200. We find this argument strange. The legal mandate to adhere to the Standards is clearly laid down in section 143(9) & 143(10) of the Act<sup>2</sup>. Section 143(9) of the Act provides that “*every auditor shall comply with the auditing standard*” (Emphasis supplied). The fundamental principles of SAs are contained in the Requirements section of the SAs and are represented by use of the word “shall”, indicating unequivocally their mandatory character. Further, ICAI in its Implementation Guide on Reporting Standards issued in Nov 2010 had opined in response to question no-12 relating to the auditor’s responsibility paragraph that “*A key assertion that is made in this paragraph is that the audit was conducted in accordance with the SAs. SA 200<sup>3</sup>, which in a way is the “parent standard” on auditing, prohibits the auditor from representing compliance with SAs in the auditor’s report unless the auditor has complied with the requirements of this SA and all other SAs relevant to the audit. This is a very broad and onerous assertion for an auditor to make. If during a subsequent review of the audit process, it is found that some of the audit procedures detailed in the SAs were not in fact complied with, it may tantamount to the auditor making a deliberately false declaration in his report and the consequences for the auditor could be very serious indeed*”. In this case, the Auditor in its Independent Auditor’s Report dated 20.05.2019 has inter alia asserted that “*We conducted our audit in accordance with the Standards on Auditing specified under section 143(10) of the Act*”. Thus, there is no scope for deviation from the SAs and we reject the argument as baseless and unacceptable.

### C. MAJOR LAPSES IN THE AUDIT

#### C.1 Acceptance of audit engagement disregarding Independence requirements

- 19 The Auditors were charged with non-compliance with requirements relating to independence of auditor as per SQC 1, SA 200 and SA 220<sup>4</sup>. M/s Sundaresha & Associates had provided audits as well as non-audit services to 27 entities of the Coffee Day Group. CA Megha Sundaresha Andani, daughter of CA A. S. Sundaresha, had 72% share in the profits of M/s Sundaresha & Associates, which had five partners. Her father CA A. S. Sundaresha is proprietor of M/s Sundaresha & Co. that had provided audit and non-audit services to 29 entities belonging to Coffee Day Group including its promoters. CA A. S. Sundaresha also had 81% share in the profits of another partnership firm M/s ASRMP & Co., which had four partners. Further, M/s Sundaresha & Associates was actively participating in making audit presentation etc. in respect of statutory audit of CDGL, whereas M/s ASRMP & Co. was the statutory auditor of CDGL. Further, CA Pradeep Chandra C., Partner of M/s Sundaresha & Associates represented as partner of M/s ASRMP & Co. in the Audit Committee meeting of CDGL. All these audit firms operated from the same office address.

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<sup>2</sup> Section 143(9) of the Act provides that every auditor shall comply with the auditing standard. Further proviso to section 143(10) of the Act provides that until any auditing standards are notified, any standard or standards of auditing specified by the Institute of Chartered Accountants of India shall be deemed to be the auditing standards.

<sup>3</sup> SA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing

<sup>4</sup> SA 220, Quality Control for an Audit of Financial Statements.

- 20 The SCN referred to SA 200<sup>5</sup> that requires the auditor to comply with relevant ethical requirements, including those pertaining to independence relating to financial statements audit engagements. Para 18 of SQC 1 requires the Audit Firm to establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements (including experts contracted by the firm and network firm personnel), maintain independence where required by the Code. Para 28 of SQC 1 states, inter alia, that *“The firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide it with reasonable assurance that it will undertake or continue relationships and engagements only where it: (i) -----, (ii) ----- and (iii) Can comply with the ethical requirements”*.
- 21 The SCN also referred to SA 220<sup>6</sup> that requires the Engagement Partners (EP hereafter) to form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, auditors are required to:
- i. Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;
  - ii. Evaluate information on identified breaches, if any, of the firm’s independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and
  - iii. Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.
- 22 The SCN noted that in the Independent Auditor’s Report dated 20.05.2019, the Auditors have reported that, *“We are independent of the company in accordance with the code of ethics issued by the Institute of chartered Accountants of India (ICAI) together with the ethical requirements that are relevant to our audit of the Ind AS financial statements under the provisions of the Act and the rules thereunder, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the ICAI’s code of ethics”*.
- 23 The SCN also noted that as per the Audit Manual of the Firm, there is a requirement of taking Independence confirmation from Firm personnel. Similarly, the EP was required by the Audit Manual of the Firm to evaluate acceptance/continuation of audit engagement and prepare Client/Engagement Acceptance and Continuance Form; however, there is no evidence in the Audit File that the Audit Firm and the engagement team had complied with these Independence requirements as per SQC-1, SA 200 and SA 220.

### **Auditors’ Reply & Our Findings**

- 24 The Auditors denied this charge stating that they had complied with the Independence requirements by reducing self-interest threat & familiarity threat; that their firm & partners do

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<sup>5</sup>Para 14, A14, A16 of SA 200.

<sup>6</sup>Para 11 & 24 of SA 220 -Quality Control for an audit of Financial statements.

not have any financial interest in any of the CCD group companies; that they did not quote lower fees to obtain new engagements; and that they did not have close business relationship with CCD group nor have they stored any confidential information in their server to be used for any personal gain. They further stated that no partner or their family are Directors or Officers in CCD group companies; that CCD group Directors and Officers did not have significant influence over their engagement; that their audit team will be regularly rotated and that they did not provide any prohibited service under section 144 of the Act etc. They also stated that they had ensured that total fees from auditee did not exceed prescribed limits and where the amount formed large portions of total fees they had taken the following safeguards to mitigate the risk:

- a) Firm has exposure to various clients, adding new clients and providing additional services to existing clients without compromising on non-allowed services over the years,
- b) The remuneration of partners is not linked to earning of any single client and
- c) They have sufficient resources and cost can be covered even on loss of any client which forms significant portion of their fees.

**25** The Auditors have also replied that they did not enter into any contingent fees arrangement with an auditee, and ensured that fees are not overdue except from the CCD group (Coffee Day Group), which is partially due on account of financial constraint faced by the group. They have replied in response to charge relating to fraudulent loan transactions with TRRDPL that they are independent of M/s ASRMP & Co. They argued that they have complied with the Standards of Auditing and provisions of the Act.

**26** We have considered the reply. It is important to understand the inter relationship of the three audit firms. As per information obtained from the audit firms, CA A. S. Sundaresha has a sole proprietorship firm, namely M/s Sundaresh & Co. He was also the promoter and founder of M/s Sundaresha & Associates, a partnership firm in practice since 10.11.1997, but he had retired from this firm w.e.f. 31.03.2017. After his retirement, his daughter CA Megha Sundaresh Andani is one of the five partners of this Audit Firm with 72% share in the profit of this firm. CA A. S. Sundaresha has also established another partnership firm namely, M/s ASRMP & Co. w.e.f. 01.04.2018, which was appointed as the statutory auditor of CDGL from FY 2018-19. CA A. S. Sundaresha has 81% share in the profit of M/s ASRMP & Co., which had four partners. All these firms operate from the same office address.

**27** We note from the information obtained from CDGL that CA Pradeepa Chandra C. (Partner of M/s Sundaresha & Associates) worked at M/s ASRMP & Co, Statutory Auditor of CDGL, and gave presentation on behalf of M/s ASRMP & Co. in the Audit Committee Meeting ('ACM' hereafter) of CDGL held on 07.02.2019 and 24.05.2019. These presentations related to review of quarterly results of CDGL by the Auditor, scope of engagement, audit approach and observations of the Auditor on the Statutory Audit of the annual financial statements for FY 2018-19. Further, the presentation given on 24.05.2019 was prepared by CA Megha Sundaresha Andani, partner of M/s Sundaresha & Associates. (As per properties of PDF document containing the presentation).

**28** The inter- relationship among the three firms is corroborated by another fact that CA Pradeepa Chandra C. and CA Chaitanya G. Deshpande (both Partners of M/s Sundaresha & Associates) were involved in the statutory audit of CDGL for FY 2018-19, of which M/s ASRMP & Co. was



the statutory auditor. As per the Audit File of CDGL for FY 2018-19, the above said two partners of M/s Sundaresha & Associates were involved in 47 out of 67 audit areas identified in the audit plan. Out of these 47 audit areas, 44 were not reviewed by any partner of M/s ASRMP & Co. This shows that they were not only supervising the day to day audit work being performed by the article assistants but were practically doing a major part of the audit. This also shows that the audit of CDGL was performed not merely by M/s ASRMP & Co. but by M/s Sundaresha & Associates also. But to hide this fact, both partners of M/s Sundaresha & Associates were named as external reviewers in the audit file of CDGL, a fact that has also been pointed out in our order dated 12.04.2023 in the case of CDGL. These facts together with the fact that all three firms operate from the same office address, indicate their close inter-relationship and lack of independence.

- 29** It is equally important to understand the relationship of these audit firms with Coffee Day Group and its promoters. As per information furnished by these firms and other information available on record, M/s Sundaresha & Associates and M/s ASRMP & Co. were statutory auditors of inter alia six Coffee Day Group companies (except CDH&RPL- as per serial no-5 in Table-1). These companies were involved in the diversion of Rs 3,380 crores i.e., 95.62% of total diverted amount of Rs 3,535 crores. Further, during the Financial Year 2018-19, M/s Sundaresha & Associates provided audit and non-audit services to 27 Coffee Day group entities, M/s Sundaresh & Co. provided audit and non-audit services to 29 Coffee Day entities including promoter's family members and M/s ASRMP & Co. provided audit and non-audit services to four Coffee Day group companies. This indicates that M/s Sundaresha & Associates had accepted the audit engagement of TDL from FY 2018-19 despite serious conflict of interest. The relationship of three related audit firms with Coffee Day Group indicates creation of self-interest and familiarity threat. The Auditors of CDGL had admitted that CA A. S. Sundaresha is associated with Coffee Day Group for a very long time, therefore there is familiarity threat. It is evident that the replies of the Auditors regarding steps taken to reduce the self-interest threat and familiarity threat are mere general statements without detailing the specific steps taken to reduce such threats, despite the three audit firms having audit and non-audit relationships with a large number of Coffee Day Group entities including promoters.
- 30** As per The Code of Ethics 2009<sup>7</sup> ('the Code' hereafter), a professional accountant is required to comply with the fundamental principles i.e. a) Integrity, b) Objectivity, c) Professional Competence and Due Care, d) Confidentiality, and e) Professional Behaviour. The conceptual framework approach of the Code states that the circumstances in which professional accountants operate may give rise to specific threats to compliance with the fundamental principles. It is impossible to define every situation that creates such threats and specify the appropriate mitigating action. Para 100.6 of the Code states that a professional accountant has an obligation to evaluate any threats to compliance with the fundamental principles when the professional accountant knows, or could reasonably be expected to know, of the circumstances or relationships that may compromise compliance with the fundamental principles. Para 100.9 of the Code states that compliance with the fundamental principles may potentially be threatened by a broad range of circumstances which inter alia includes self interest threat and familiarity threat. Chapters 2 of the Code provide examples of circumstances that may create threats for professional accountants in public practice. Para 120.2 of the Code states that relationships that

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<sup>7</sup> The Code of Ethics 2009 was issued by ICAI and applicable during FY 2018-19 and FY 2019-20.

bias or unduly influence the professional judgment of the professional accountant should be avoided. Para 200.4 of the code states that examples of circumstances that may create self-interest threats for a professional accountant in public practice include, but are not limited to, inter alia, “Concern about the possibility of losing a client”. Para 200.7 of the Code states that examples of circumstances that may create familiarity threats include, but are not limited to, inter alia, “Long association of senior personnel with the assurance client”. It is clear that despite having self interest threat and familiarity threat, the Auditors did not evaluate such threats and violated the Code of Ethics. Needless to say that SA 200 mandates adherence to the Code of ethics<sup>8</sup>

- 31** The Audit Engagement for TDL for FY 2018-19 was the first year of this appointment of the Auditors and therefore they were required to perform evaluation in terms of provisions of SQC-1 before accepting this engagement. As per SQC-1, an auditor is required to evaluate at the time of first appointment, whether to accept the clients/engagement and thereafter, such evaluation is required every year for continuance of the client/engagement. Such evaluation requires in- depth analysis of financial parameters of auditee company, background check of promoters, ultimate beneficial owners, key managerial personnel, and ethical requirements etc. Such evaluation is required to be recorded in the Audit File and thereafter the auditor issues engagement acceptance letter to the client intimating the auditor’s decision about acceptance of the appointment. We note that the copies of independence confirmations of the engagement team members and the letter issued to TDL for acceptance of audit engagement, attached by the Auditors along with their reply to SCN, are not available in the Audit File submitted to NFRA. Such additional documents cannot be considered as they are not part of the Audit File. We have dealt with this point further in the charge relating to tampering of the Audit File in section C-2 of this Order. The reply of the Auditors reveals their ignorance of the basic requirement of ensuring independence as stated in the Standards on Auditing, which is unacceptable from the Auditors of public limited companies. The Auditors in this case failed to perform due professional care and did not perform sufficient appropriate procedures to evaluate their independence from Coffee Day Group and its promoters before acceptance of audit engagement of TDL from FY 2018-19. The Auditors were reckless in accepting this audit engagement.
- 32** An Auditor’s independence from the entity being audited safeguards the auditor’s ability to form an audit opinion without influence that might compromise that opinion. Independence enhances an auditor’s ability to act with integrity, to be objective and to maintain an attitude of Professional Skepticism. An auditor is required to be independent, and without any bias with respect to the client so as to ensure impartiality, which is necessary for the dependability of his findings. It is of utmost importance to the profession that the general public to have confidence in the independence of the Auditors. Public confidence would be impaired by any evidence that independence was actually lacking, and it might also be impaired by the existence of circumstances, which reasonable people might believe, are likely to influence independence.
- 33** In this case, the Auditors failed to perform appropriate audit procedures to evaluate and maintain their independence from TDL. In spite of the Auditors having an independence threat, they accepted the audit engagement as statutory auditor of TDL from FY 2018-19 by disregarding and grossly violating the principles of Independence mentioned in the Standards on Auditing and

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<sup>8</sup> Para 14 of SA 200 read with paras A14 to A17.

the Code of Ethics. In view of this, the charge stands proved that the Auditors have violated SQC 1, SA 200 and SA 220.

## **C.2 Tampering of Audit File and related lapses – SA 230, Audit Documentation**

- 34** The Auditors were charged with tampering with the Audit File to deceive NFRA and making the Audit File unreliable, as audit workings have been done in editable Excel files without any security feature to prevent alteration of audit documentation. The Audit File has, inter alia, 14 Excel files, out of which 13 Excel files were modified between 18.08.2022, the date NFRA asked for the Audit File, and 01.09.2022, the date the Audit File was submitted to NFRA. Further, the Excel file namely 'Related Party Transaction Workings', was created on 30-08-2022, after NFRA asked the Auditors to submit the Audit File. Such modifications and additions in the Audit File are not permissible as per SA 230 and amount to tampering. Further, as per SQC-1, SA 200 and SA 220, the Audit Firm and the Engagement Team are required to adhere to ethical principles like integrity & professional behavior. The Audit File is required to be assembled within 60 days of the signing of the audit report. In this case, the audit report was signed on 20.05.2019; accordingly, the Audit File was required to be assembled by 19.07.2019. However, the Auditors continued tampering with the Audit File till 01-09-2022 even after 39 months of signing the Independent Auditor's Report.
- 35** Further, as per para 8 of SA 230, the Auditors were required to 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. As per para 9, 10 & 14 of SA 230, the Auditors were required to document in the Audit File, inter alia, the record of name of person & date of performing audit procedures, name of person performing review, date & extent of review and discussion of significant matters with management & Those Charged With Governance ('TCWG' hereafter) etc. An examination of the Audit File shows that the names of the engagement team members & date of performing audit procedures are not mentioned in any of the audit work papers nor are the names of the team members who reviewed the audit work and the extent of review. No information about engagement team is available in the Audit File. Accordingly, the Auditors were charged with failure to comply with para 14 of SA 200, para 9 of SA 220, para 14, A21 of SA 230 and para 14 & 75 of Standard on Quality Control-1.

### **Auditors' Reply & Our Findings**

- 36** The Auditors denied this charge stating that there has been no tampering of the Audit File. They submitted that maintenance of editable Excel file is not prohibited in SA 230 and modification of audit file is allowed as per para 16 of SA 230; that they have only formatted those files to make it pleasant to view & for easy referencing; that the workings maintained in loose sheets were compiled in Excel format after receipt of NFRA notice, and during this process the date modified could have been changed to the latest date; and that cosmetic changes had been made for better presentation but the contents of the Audit File have not been changed.

- 37 Having considered the reply, we observe that in terms of SA 230, modification in the audit file after the assembly period is allowed only to clarify any existing audit documentation arising from comments received during monitoring inspections performed by internal or external parties (para A24 of SA 230). In such cases, the Auditor is required to document the specific reason of making them, when and by whom they were made and reviewed (para 16 of SA 230). On examination of the Audit File, we could not find any recorded reason or document justifying the modification as required under para 16 of SA 230.
- 38 It is evident from the reply of the Auditors that they modified the existing audit work papers and created new work papers. Once modifications are made in Excel files, it is impossible to find out what was modified. Further, creation of new Excel file from the workings in loose sheets itself is a proof of tampering of audit documentations. We note that a large number of audit documents were modified and at least one new audit work paper was created after NFRA called the Audit File for examination. After being confronted in the SCN, the Auditors have given an evasive reply that only cosmetic changes were made and that the contents were not changed.
- 39 Further, the Auditors have submitted 12 additional documents (109 pages) and requested to consider these stating that they had inadvertently missed certain evidences in their Audit File as they were not aware of NFRA's expectations in relation to verification of the Audit File.
- 40 Acceptance of the Auditors submission at this stage is fraught with the risk of relying on documents that may not have been considered during the audit and will open the floodgates for other auditors to take similar pleas in future proceedings. It is important to look into SA 230, which emphasizes the importance of timely preparation of audit documentation and its archival within a reasonable time after the issuance of the audit report. We highlight below some of the paras of the SA 230: -
- a) Paragraph 7 of SA 230: The auditor shall prepare audit documentation on a timely basis. The explanatory material at Para A1 states that Documentation prepared after the audit work has been performed is likely to be less accurate than documentation prepared at the time such work is performed.
  - b) Paragraph 8 of SA 230: 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.
  - c) Paragraph 9 of SA 230: 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.

- d) Paragraph 14 of SA 230: 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.
- e) Paragraph 16 of SA 230: In circumstances where the auditor finds it necessary to modify existing audit documentation or add new audit documentation after the assembly of the final audit file has been completed, the auditor shall, regardless of the nature of the modifications or additions, document: (a) The specific reasons for making them; and (b) When and by whom they were made and reviewed.
- f) The explanatory material to the Standard at Para A21 states that SQC 1<sup>9</sup> requires firms to establish policies and procedures for the timely completion of the assembly of audit files. An appropriate time limit within which to complete the assembly of the final Audit File is ordinarily not more than 60 days after the date of the auditor's report.
- g) The explanatory material to the Standard at Para A22 states that the completion of the assembly of the final Audit File after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions.

41 Similar requirements exist in para 7, 14, A21 & A22 of ISA 230 (UK & Ireland), para 7, 14, A21 & A22 ASA 230 (Australia) and para 15 of AS 1215 (PCAOB, U.S.)

42 Even internationally, as seen from the following paragraphs, alteration, backdating of work papers/reviews, substitution or addition of the new work papers, placing blank audit papers so as to perform audit procedures (commonly referred to as Audit File Tampering) subsequent to issuance of audit report or the assembly of final Audit File by the Auditors are not accepted, as it would leave scope for large scale production of additional documents as an afterthought upon commencement of disciplinary proceedings.

43 In the Matter of KPMG Assurance and Consulting Services LLP and Sagar Pravin Lakhani (Engagement Partner) relating to tampering of audit file, PCAOB<sup>10</sup> (Public Company Accounting Oversight Board - Audit Regulator of United States of America), observed that "*PCAOB standards require that [a]udit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement . . . [t]o 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*".... "*PCAOB standards further require an auditor to archive a complete and final set of audit documentation as of a date not more than 45 days after the report release date (i.e., the documentation completion date). Any documentation added after the documentation completion date must indicate the date the information was added, the name of the person who prepared the additional documentation, and the reason for adding it.*" ... "*Accordingly, KPMG India violated QC § 20 and QC § 30 by failing to implement, communicate, and monitor adequate policies and procedures to provide the Firm with reasonable assurance that its personnel complied with PCAOB audit documentation standards including standards*

<sup>9</sup> Refer para 74 & 75 of Standard on Quality Control 1, Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements

<sup>10</sup> PCAOB Release No. 105-2022-033 dated 06.12.2022.

concerning documentation of the date audit work was completed, of the date audit work was reviewed, and of any changes to the work papers after the documentation completion date”. For this misconduct, a civil money penalty in the amount of \$1,000,000 was imposed on KPMG Assurance and Consulting Services LLP, and a civil money penalty in the amount of \$75,000 was imposed on Sagar Pravin Lakhani besides suspending Lakhani from being an associated person of a registered public accounting firm for a period of one year, censuring both and requiring KPMG India to undertake and certify the completion of certain improvements to its system of quality control.

- 44 In another similar case of Deloitte Canada<sup>11</sup> relating to tampering of audit file, PCAOB observed “PCAOB standards require auditors to prepare audit documentation that accurately reflects when audit work was completed and reviewed. Prior to November 2016, Deloitte Canada’s electronic work paper system (“system” or “work paper system”) allowed Firm personnel to document their performance and review of work by manually selecting preparer and reviewer sign-off dates for each work paper. In November 2016, the Firm updated its work paper system and removed Firm personnel’s ability to manually select sign-off dates. Under the new system, when an auditor entered a sign-off, the current date was automatically generated. At the time the Firm adopted its new system, personnel from the Firm’s National Office were aware of a risk that individuals could override the new system by changing their computer date settings to backdate work paper sign-offs. Despite that awareness, the Firm did not take sufficient steps through written policies, guidance, training, or otherwise to address that risk. During the 16 month-period following the adoption of the new work paper system, Firm personnel overrode the system and backdated their work paper sign-offs in at least six issuer audits and two quarterly reviews subject to PCAOB standards. This conduct occurred while teams were assembling a complete and final set of work papers for retention, or earlier, in these engagements. Additionally, some auditors on these engagements deleted and replaced sign-offs in order to ensure that reviewer sign-offs were dated after preparer sign-offs. Collectively, this conduct obscured the dates on which work had actually been completed and reviewed”. For this misconduct, PCAOB imposed a civil money penalty of \$350,000 on the firm besides censuring the firm, requiring it to take corrective actions to establish, revise, or supplement, as necessary, its quality control policies and procedures, including monitoring procedures, to provide the Firm with reasonable assurance that personnel comply with PCAOB audit documentation requirements, including those concerning the dating of the completion of work performed and the dating of the review of work papers and also directed the firm to ensure that all Firm professionals involved in any “audit,” have received four (4) hours of additional training concerning compliance with PCAOB audit documentation standards.
- 45 There have been many other instances of such wrong doings being penalized by the PCAOB, e.g., KPMG Singapore- Tan Joon Wei (2021), BDO-Mexico (2019), and Deloitte Brazil (2016) etc.
- 46 We further note that while submitting the Audit File<sup>12</sup> to NFRA, through a duly notarized affidavit dated 30.08.2022 signed by CA Pradeepa Chandra C., a partner of the Audit Firm, it

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<sup>11</sup> PCAOB Release No. 105-2021-014 dated 29.09.2021.

<sup>12</sup> Audit file is defined in para 6(b) of SA 230 Audit Documentation as “one or more folders or storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement”.

was averred that *“The Audit File for the financial year 2018-19 as defined in Para 6(b) of SA 230 has been submitted” .... “It is certified that the above information is true and complete in all respects, and nothing has been concealed”*. The Auditors are expected to know what constitutes an “Audit File” as per SA 230 and accordingly, all audit work papers were expected to be available in the Audit File submitted to NFRA. The submission by the Auditors of additional documents now, subsequent to the submission of Audit File, to defend the charges in the SCN, points to the incorrect and misleading averments made in the affidavit submitted by the Firm.

- 47 Therefore, considering the provisions of the auditing standards and the affidavit filed by the Firm, we do not find any merit in the submission of the Auditors regarding the additional documents and we treat the same as an afterthought to cover up their deficiencies in the Audit and as additional evidence of tampering of the Audit File.
- 48 The Auditors also replied that the dates of conducting the audit are available in the time sheet maintained separately by each article assistant. In respect of non-availability of the timings of the audit procedures claimed to have been performed by other engagement team members including the EP, the Auditors replied that their documentation in the Audit File is required only if it is critical to the audit procedure performed and when may have an impact on the audit opinion. The Auditors added that they did not carry out any audit procedure for which timing was critical to audit opinion and referred to FAQ 25 of Implementation guideline to SA 230 issued by ICAI, which provides guidance for audit documentations and states:

*“Recording the identifying characteristics serves a number of purposes. For example, it enables the engagement team to be accountable for its work and facilitates the investigation of exceptions or inconsistencies. Identifying characteristics will vary with the nature of the audit procedure and the item or matter tested. For example:*

- For a detailed test of entity-generated purchase orders, the auditor may identify the documents selected for testing by their dates and unique purchase order numbers.*
- For a procedure requiring selection or review of all items over a specific amount from a given population, the auditor may record the scope of the procedure and identify the population (for example, all journal entries over a specified amount from the journal register).*
- For a procedure requiring systematic sampling from a population of documents, the auditor may identify the documents selected by recording their source, the starting point and the sampling interval (for example, a systematic sample of shipping reports selected from the shipping log for the period April 1 to September 30, starting with report number 12345 and selecting every 125th report).*
- For a procedure requiring inquiries of specific entity personnel, the auditor may record the dates of the inquiries and the names and job designations of the entity personnel.*
- For an observation procedure, the auditor may record the process or matter being observed, the relevant individuals, their respective responsibilities, and where and when the observation was carried out”*.

- 49 A perusal of the above shows that nowhere it has been stated by the ICAI that the timing of performing audit procedures is to be documented only if it is critical to the audit opinion. In this regard, the reply of ICAI to question no- 23 of above guidelines is also relevant. It states as follows:

*“Q23. What should the auditor record in documenting the nature, timing and extent of audit procedures performed?”*

*A 23. The auditor should record:*

- The identifying characteristics of the specific items or matters tested;*
- Who performed the audit work and the date such work was completed; and*
- Who reviewed the audit work performed and the date and extent of such review.*

*SA 220 (Revised) requires the auditor to review the audit work performed through review of the audit documentation. The requirement to document who reviewed the audit work performed does not imply a need for each specific working paper to include evidence of review. The requirement, however, means documenting what audit work was reviewed, who reviewed such work, and when it was reviewed”.*

50 Thus, it is clear that even the ICAI had also advised to document the timing of performing audit procedures in the Audit File. Therefore, the reply of the Auditors is misconceived. We cannot also give credence to the claim that the dates of conducting the audit by article assistants are available in time sheet maintained separately, because these records have not been maintained as part of the Audit File as required under SA 230.

51 The clear evidence of the Auditors tampering with the Audit File without valid reasons displays unprofessional behavior unbecoming of a professional auditor. We have already seen in the cases decided by PCAOB that internationally any attempt to tamper with the audit file is taken very seriously by the auditing regulators and entails significant regulatory sanctions.

52 In view of the above analysis, we conclude that the charge that the Auditors have violated SQC 1, SA 200, SA 220 and SA 230 is proved.

### **C.3 Failure to understand the audited entity, to perform risk assessment procedure to identify, assess & respond to Risk of Material Misstatement due to fraud, and to prepare Audit Plan**

53 The Auditors were charged that they did not understand TDL, the audited entity, did not perform risk assessment procedure to identify & assess Risk of Material Misstatement (‘RoMM’ hereafter), did not respond to such RoMM and did not prepare audit plan evidencing noncompliance with SA 300, SA 315 & SA 330<sup>13</sup>. They were required to obtain an understanding of the nature of TDL including its operations, its ownership and governance structures, the types of investments that TDL was making and how it was financed, to understand the classes of transactions and account balances. The Auditors were required to establish an overall audit strategy to set the scope, timing and direction of the audit to guide the development of the audit plan. There is no evidence in the Audit File that they had performed these basic audit procedures.

54 The SCN noted that TDL had a very high debt equity ratio of 27.89, huge related party transactions, very high borrowing costs, and had given very high land advances to related parties, as evident from Table -2 as under:

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<sup>13</sup> SA 300 - Planning an Audit of Financial Statements. SA 315 - Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and its Environment. SA 330 - The Auditor’s Response to Assessed Risks.



Table -2

Rs in crores

Sr No	Particulars	2018-19	2017-18
1	Net worth	80.84	70.28
2	Total borrowings/deposits	2,254.45	2,477.54
3	Borrowings from Bank & Financial Institutions and rental security deposits.	1,532.60	1,703.83
4	Borrowings from related parties	721.85	773.71
5	Debt equity ratio	27.89	35.25
6	Profit before tax	3.83	17.09
7	Total assets	2,386.38	2,620.61
8	Loans to related parties	614.05	505.09
9	Land advance given to related parties	417.87	618.61
10	Revenue from operations	142.51	134.26
11	Other income	90.57	15.60
12	Finance costs	178.27	97.01
13	Total expenses	229.25	132.77
14	Finance cost as % of total expenses	77.76%	73.06%

- 56 The SCN noted that the Auditors were required<sup>14</sup> to perform risk assessment procedures to provide a basis for the identification and assessment of RoMM at the financial statements & assertion levels and to respond to identified RoMM but there was no evidence in the Audit File that they had performed such procedures to identify & respond to RoMM despite the unusual balances as mentioned in Table-2. Thus, they were charged with non-compliance with SA 300, SA 315 and SA 330.

#### Auditors' Reply & Our Findings

- 57 While denying this charge, the Auditors have stated that the audit was well planned and attached a copy of the audit plan along with reply to SCN. They stated that they had conducted audit of TDL during FY 2017-18 also and were reappointed as statutory auditors for FY 2018-19 to 2021-22. They claimed to have obtained the Memorandum of Association ('MOA' hereafter) to understand the framework of the company while performing the statutory audit for FY 2017-18 and thereafter changes to MOA were tracked in the minutes of the company. According to them, there was no change in the nature of operations, ownership, governance structures, types of investment and how it was financed during the year. Transactions during the year have been subjected to audit. Regarding high debt equity ratio, they replied that loans were taken on the basis of market value of TDL's assets, which was approx. Rs 2600 crores, whereas cost of assets built over last 15 years was substantially low. They mentioned that it is not unusual for an infrastructure company to make large amount of land advance for purchase of land.
- 58 The Auditors further submitted that they had obtained an understanding of TDL by having discussion with management and TCWG (Those Charged With Governance) over the years. They claimed to have undertaken analytical & substantive procedures and also tested controls. They claimed to have undertaken some procedures to reduce RoMM like obtaining documentation of land advance, verification of large loans & utilization thereof, confirmation

<sup>14</sup> Para 5 of SA 315 and para 5 of SA 330.

from bankers & related parties and valuation report of tech park etc. According to them, RoMM arises due to test check nature of audit, whereas they had covered most material loans and transactions. They finally stated that they had complied with SA 300, SA 315 and SA 330.

- 59** Having considered the reply, we observe from Table-2 that the balance sheet size of TDL had reduced by Rs 234.23 crores i.e., from Rs 2620.61 crores in FY 2017-2018 to Rs 2386.38 crores in FY 2018-19, the Finance cost had increased substantially from Rs 97.01 crores to Rs 178.27 crores, other income had increased substantially from Rs 15.60 crores to Rs 90.57 crores and debt equity ratio reduced from 35.25 to 27.89. This is indicative of a major shift in the manner of borrowings and the manner of investments by TDL during FY 2018-19. Despite this major change, the Auditors contended that there was no change in the types of investment and how it is financed during FY 2018-19. This proves that they did not perform sufficient risk assessment procedure to identify and assess RoMM. Further, risk assessment procedures are required to be performed every year by understanding the company and its environment. There is no evidence in the Audit File about performing any risk assessment procedure at planning stage during the Audit for the FY 2018-19. Further, as per the Memorandum of Association submitted alongwith reply to SCN, TDL was not authorized to give loans to MACEL, GVIL and TRRDPL as financing activities are not covered in the Objects clause of the MOA. TDL was only authorized to invest surplus money (short term investment) in investments, shares or stocks of a company (as per clause 3(B)(11) of MOA), which is not the case in TDL. The Auditors failed to understand this major non-compliance by TDL.
- 60** There is no audit plan available in the Audit File. The Auditors were required to plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work. As per SQC-1, the Audit Firm was required to communicate the identity & role of Engagement Partner to TDL and assign appropriate staff with necessary competence to perform the audit of TDL. Appropriate staff was not assigned for the audit of TDL as details of engagement team are not available in the Audit File. The Auditors have attached a copy of audit plan along with reply to SCN stating that they maintained a combined audit plan for TDL and GVIL in a single Excel workbook. As audit plan is not available in the Audit File submitted to NFRA and there is no evidence of maintenance of such a combined audit plan either in TDL audit file or in GVIL audit file, this reply is not accepted. Further, the submission of the Auditors regarding discussion with management and TCWG over the years is not supported with any audit evidence in the Audit File. With respect to the submission about analytical and substantive procedures having been performed by the Auditors by collecting documents mentioned above, it is observed that these documents were not available in the Audit File and were submitted later alongwith the reply to SCN. Therefore, these additional documents cannot be treated as audit evidences for the reasons mentioned earlier in this Order.
- 61** As per SA 300, an auditor is required to establish an audit strategy including nature, timing and extent of planned risk assessment procedure. As per SA 315, an auditor is required to perform risk assessment procedures to provide a basis for identification and assessment of RoMM at the financial statement and assertion level. As per SA 330, an auditor is required to respond to the assessed RoMM. These are mandatory logical sequential audit procedures required for effective performance of an audit engagement, which the Auditors failed to perform. They failed to even understand TDL so as to perform an effective audit.

62 From the above analysis, we find that the Auditors failed to perform these basic audit procedures in this case, and thus violated SA 300, SA 315 and SA 330.

**C.4 Lapses in audit of fraudulent loan transactions with MACEL (Rs 2614.35 crores), fraudulent understatement of loans (Rs 474 crores) and evergreening of loans through structured circulation of funds**

63 It was charged that the Auditors failed to exercise Professional Skepticism<sup>15</sup> and Judgement<sup>16</sup> while auditing loan transactions, which were not only fraudulently given to MACEL but also fraudulently understated at year end by receipt of cheques without adequate bank balance with MACEL. These cheques were realised in next year i.e., FY 2019-20 by evergreening of loans done through structured circulation of funds amongst the Coffee Day Group entities. Thus, the Auditors failed to report fraudulent loan transactions of Rs 2614.35 crores with MACEL, fraudulent understatement of loans of Rs 474.00 crores given to MACEL and evergreening of loans through structured circulation of funds. Accordingly, the Auditors were charged with failure to comply with SA 200, SA 240, SA 250, SA315, SA 330, Section 143(1), 143(12) & 179(3) of the Act and The Companies (Auditors Report) Order 2016 (CARO).

64 MACEL, an entity owned by family members of promoters of TDL, has no business relationship with TDL. Loan transactions of Rs 2614.35 crores with MACEL were more than the balance sheet size of TDL i.e., Rs 2386.38 crores, therefore, these were unusual transactions. Disbursal of loans to MACEL was an indication of fraudulent diversion of funds. The Auditors were required to exercise Professional Skepticism and Judgement to evaluate the appropriateness of disbursal of such large amount of loans to a group entity without any business relationship/transaction, examine terms & conditions of such loans including tenure of loans & rate of interest etc. The Auditors were also required to evaluate the purpose and utilisation of loans given to MACEL. There is no evidence in Audit File that the Auditors had done any evaluation and asked any question to TCWG on this matter.

65 As per section 179(3) of the Act, the Board of Directors (BOD) has to exercise its powers to borrow funds & grant loans by resolutions passed at meetings of the Board. There is no record in Audit File that the Board of Director of TDL had passed any resolution to borrow funds & grant loans to MACEL.

66 On 31.03.2019, MACEL had issued four cheques of total amount of Rs 124 crores from its Corporation Bank account and four cheques of total amount of Rs 350 crores from its Karnataka bank account to TDL without having adequate bank balances and bank credit limits. Analysis of subsequent clearance of these cheques in FY 2019-20 shows that smaller funds were rotated among group companies for clearance of these cheques. Thus, loan receivable from MACEL

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<sup>15</sup>Professional skepticism is defined at para 13(l) of SA 200 as – ‘An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence’. Para 15 of SA 200 provides that ‘The auditor shall plan and perform an audit with professional skepticism recognising that circumstances may exist that cause the financial statements to be materially misstated’.

<sup>16</sup> Para 16 of SA 200 provides that ‘The auditor shall exercise professional judgment in planning and performing an audit of Financial Statements. Para 13 (k) of SA 200 defines Professional Judgement as ‘The application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement’.

worth Rs 462.32 crores were converted to loan payable to MACEL worth Rs 11.68 crores in the Financial Statements of TDL as on 31-03-2019. By virtue of these cheques an asset of Rs. 462.32 crores was converted into a liability of Rs. 11.68 crores in the balance sheet as on 31.03.2019. This was a material misstatement on the Asset side of the Balance Sheet signed by the Auditors.

- 67 Rotation of smaller funds to project settlement of larger funds was evidence of serious financial manipulation and crisis in MACEL as well as TDL. Diversion of funds in a circular manner coupled with accounting manipulation and fraud were clear evidence that a fraud had been committed in TDL. One of the important substantive audit procedures is to examine the Bank Statements with reference to the major transactions and verify subsequent clearance of cheques received but not credited till 31.03.2019. There is no evidence in Audit File that the Auditors performed any procedure to verify clearance of these cheques, which is evidence that the Auditors did not perform audit of bank transactions.
- 68 SA 240<sup>17</sup> provides that the objectives of auditor are to identify and assess the risk of material misstatement in the FS due to fraud, obtain audit evidence and respond to identified or suspected risk. It requires the auditor to maintain professional skepticism recognizing the possibility of existence of material misstatement due to fraud, to evaluate the business rationale (or lack thereof) of the significant transactions that are outside the normal course of business or otherwise appear unusual and evaluate whether such transactions may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of funds. There is no evidence in the Audit Files that any audit procedure was performed to comply with SA 240. There is no evidence in the Audit File that the Auditors asked any question to TCWG and Management about these fraudulent transactions, indicating that the Auditors did not perform audit with professional skepticism as required under SA 200.
- 69 Cheques worth Rs 474 crores received up to 31.03.2019 but not credited in bank accounts constituted 19.86% of TDL's total assets of Rs 2386.38 crores. This indicated a Risk of Material Misstatement due to fraud. The Auditors were required to perform audit procedures as per SA 315 and SA 330. There is no evidence in the Audit File that the Auditors performed such audit procedures to identify and respond to RoMM due to fraudulent reduction of related party loans, fraudulent diversion of funds and evergreening of loans through structured circulation of funds.
- 70 The Auditors had a statutory duty to report the fraud to the Central Government under section 143(12) of the Act. Diversion of funds to MACEL, understatement of loans to MACEL and evergreening of loans were indicators of commission of fraud in TDL. However, the Auditors did not comply with section 143(12) of the Act. On the contrary, the Auditors reported<sup>18</sup> that no material fraud by or on the company had been noticed or reported during the course of audit.
- 71 The Auditors were also charged with non-compliance with SA 250 as they failed to report violation of Prevention of Money Laundering Act 2002 ('PMLA' hereafter)<sup>19</sup>. Diverting funds

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<sup>17</sup> Para 10, 12 and 32(c) of SA 240, The Auditor's responsibilities relating to Fraud in an Audit of Financial Statements.

<sup>18</sup> Para X of Annexure -A (CARO report) of Independent Auditor report dated 20.05.2019.

<sup>19</sup> As per section 3 of PMLA act 2002, 'Whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime including its concealment, possession, acquisition or use and projecting or claiming it as untainted property shall be guilty of offence of money-laundering'. 'Proceeds of Crime', as defined at section 2 (u) of PMLA Act, means any property derived or obtained, directly or indirectly, by any person as a result of criminal activity relating to a scheduled offence.

fraudulently to MACEL (an entity owned and controlled by promoters' family) is covered in section 420 of the Indian Penal Code<sup>20</sup>, which is a predicate offence for money laundering under section 3 of the PMLA. The Auditors did not report this violation in Independent Auditor's Report and also did not consider its impact on the FS while making conclusions, thereby violating SA 250.

- 72 As per section 143(1) of the Act, the Auditor was also required to inquire whether these transactions were represented merely by book entries and were prejudicial to the interest of the company. As explained above, loans/advances to MACEL did not have any economic or business rationale and were done through rotation of smaller amounts to legitimize transactions of larger amounts, hence were merely book entries. The Auditor did not report these fictitious accounting entries and was thus charged to have violated section 143(1) of the Act.

### **Auditors' Reply & Our Findings**

- 73 The Auditors admitted that there was no specific approval for funds advanced to MACEL, but argued that this is covered in a blanket approval of Rs 10,000 crores given through special resolution in Extra-ordinary General Meeting held on 23.01.2019 and board resolution passed on 21.01.2019. In this connection, we observe that while passing the special resolution, the shareholders of TDL had authorised the Board of Directors ('Board' hereafter) of TDL to invest/lend up to Rs 10,000 crores. However, there is no record that any specific resolution was subsequently passed by the Board of TDL to lend money to MACEL or any other entity. Further, the loan given to MACEL was not for its main object i.e., Infrastructure business as defined in MOA. Thus, loans given to MACEL were unauthorised transactions.

- 74 The Auditors argued that there was no diversion of funds by referring to definition of diversion in Black's Law Dictionary i.e. "*A deviation from the natural course of things esp. unauthorised alteration of a watercourse to the prejudice of a lower riparian owner, or **the unauthorised use of funds***". (Emphasis supplied). Further, they also cited para 2.2.1 of RBI master circular on wilful defaulter i.e.

*"2.2.1 Diversion of funds, referred to at para 2.1(b) above, would be construed to include any one of the undernoted occurrences:*

*(a) utilisation of short-term working capital funds for long term purposes not in conformity with the terms of sanction;*

*(b) deploying borrowed funds for purposes/activities or creation of assets other than those for which the loan was sanctioned;*

*(c) **transferring funds to the subsidiaries/Group companies or other corporates by whatever modalities;***

*(d) routing of funds through any bank other than the lender bank or member of consortium without prior permission of the lender;*

*(e) investment in other companies by way of acquiring equities/debt instruments without approval of lenders;*

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List of schedule offences in Part A of the schedule under PMLA Act 2002, covers section 420 of Indian Penal Code i.e. 'Cheating and dishonestly inducing delivery of property'.

<sup>20</sup> Section 420 of IPC states, 'Whoever cheats and thereby dishonestly induces the person deceived to deliver any property to any person, or to make, alter or destroy the whole or any part of a valuable security, or anything which is signed or sealed, and which is capable of being converted into a valuable security, shall be punished with imprisonment of either description for a term which may extend to seven years, and shall also be liable to fine.'

*(f) shortfall in deployment of funds vis-à-vis the amounts disbursed/drawn and the difference not being accounted for.” (Emphasis supplied).*

- 75 We note that the definition of diversion quoted by the Auditors as per Black’s Law Dictionary includes ‘*the unauthorised use of funds*’. Similarly, diversion of funds defined in RBI’s master circular includes ‘*transferring funds to the subsidiaries/Group companies or other corporates by whatever modalities*’. This charge in the SCN relates to transfer of funds to a promoter owned entity MACEL- without proper authorisation. Accordingly, such transactions meet the definitions of diversion of funds quoted by the Auditors. We further observe that the charge of fraudulent diversion of funds is with reference to the intent of the company management/promoters as funds were transferred from TDL to MACEL without any business purpose of TDL, without any contract/agreement and without obtaining any security. This indicates fraudulent intention of promoters to siphon off money from public space to the promoters.
- 76 The Auditors have tried to portray these transactions as current account transactions and not as loans. However we note that this submission is contradictory to their own reply (page no 38 of reply) relating to utilization of borrowings, wherein they have stated that the loan taken from IFCI Ltd was used for giving loan to MACEL. Further, TDL in its Financial Statements had shown ‘balance with MACEL’ as ‘Loan’.
- 77 The Auditors have further stated that loan of Rs 2614 crores was not given to MACEL and maximum amount outstanding at any point of time was Rs 912 crores. They stated that TDL had provided credit to MACEL, and the latter had repaid the amount. We observe that the Auditors have admitted that TDL had no business relationship with MACEL. Despite that TDL had given loans worth Rs 2,614 crores to MACEL (as per Financial Statements of MACEL). Further, the repayment of loans given to MACEL was done by evergreening of loans as discussed in subsequent paras. We are of the view that repayment of such a fraudulently disbursed loan does not legitimise non compliances committed during its disbursement.
- 78 The Auditors further stated that loan taken from financial institution was advanced to MACEL and the related cost was reimbursed by MACEL. They claimed that the Loan taken by TDL was used for the purpose for which it was availed and fund was routed through banking channel, therefore cannot be alleged as fraudulent diversion of funds. In this connection, we observe that there is no record in the Audit File about the purpose of loans taken from the financial institutions viz IFCI, therefore this part of the reply is an afterthought of the Auditors. It is unacceptable that TDL borrowed funds from financial institutions for the purpose of diversion to promoter owned entity MACEL without any business purpose. Further, routing of fund through banking channel does not provide it immunity from fraud. In fact, big corporate frauds like this one, happen through banking channel only.
- 79 Regarding understatement and evergreening of loans, the Auditors have replied that they did not have access to the books and bank statements of MACEL, TRRDPL and CDGL. They argued that as Statutory Auditor of TDL, they would not be aware that cheques to TDL were issued without sufficient balance in MACEL. They stated that all the cheques were realized and none of the cheques bounced. They checked the clearance of cheques and they are not required to delve into the examination of source of funds for clearance of those cheques. They further stated that even if it was a well thought out plan by the company, the evergreening of loans could not

have been identified by us as auditors of TDL with regular audit procedures and they are not auditor of MACEL to verify MACEL's books or statements. The Auditors further argued that discovery of evergreening of loans can emerge only from an investigation of all group companies and are not capable of being detected within the scope of work of a statutory auditor of TDL.

- 80 We note the Auditors' claim to have verified subsequent clearance of cheques in TDL's bank account. We reproduce below excerpts from the Bank Reconciliation Statement (BRS) of TDL, as available in the Audit File. The rotation of funds of equal, round amounts on the same day (03.05.2019) is too obvious to be not noticed by anybody, more so by an auditor.:

Table-3

Rs in crores

Corporation Bank A/c CBCA 228 (Projects)						
Date	Party Name	Voucher type	Instrument Date	Bank Date	Debit	Credit
31-03-2019	MACEL	Receipt	31-03-2019	03-05-2019	40.00	
31-03-2019	MACEL	Receipt	31-03-2019	03-05-2019	40.00	
31-03-2019	MACEL	Receipt	31-03-2019	03-05-2019	40.00	
31-03-2019	MACEL	Receipt	31-03-2019	03-05-2019	4.00	
31-03-2019	TRRDPL	Payment	31-03-2019	03-05-2019		40.00
31-03-2019	TRRDPL	Payment	31-03-2019	03-05-2019		40.00
31-03-2019	TRRDPL	Payment	31-03-2019	03-05-2019		40.00
31-03-2019	TRRDPL	Payment	31-03-2019	03-05-2019		4.00
				Total	124.00	124.00

- 81 Further, this circulation of funds among MACEL, TDL and TRRDPL can be easily observed from the bank statement of MACEL as depicted hereunder:

Table- 4

(Rs in crores)

Date	Particulars	Cheque no	Payment	Receipt	Balance
03-May-19	TDL	963770	40.00		00.11
03-May-19	TRRDPL	892227		40.00	40.11
03-May-19	TDL	963772	40.00		00.11
03-May-19	TRRDPL	892226		40.00	40.11
03-May-19	TDL	963773	4.00		36.11
03-May-19	TRRDPL	892235		4.00	40.11
03-May-19	TDL	963771	40.00		00.11
03-May-19	TRRDPL	892228		40.00	40.11

- 82 Tables 3 and 4 depict that MACEL had issued four cheques of total amount of Rs 124 crores on 31st March 2019. In next year, on 03.05.2019, MACEL paid Rs 40 crores to TDL starting a series of sham transactions in a circular manner by rotating the funds among TDL, MACEL & TRRDPL for clearance of the four cheques of total amount of Rs 124 crores. Such as MACEL paid Rs 40 crores to TDL, which then paid Rs 40 crores to TRRDPL, which then paid Rs 40 crores to MACEL, which then paid Rs 40 crores to TDL, which then paid Rs 40 crores to TRRDPL, which then paid Rs 40 crores to MACEL, which then paid Rs 4 crores to TDL, which then paid Rs 4 crores to TRRDPL, which then paid Rs 4 crores to MACEL, which then paid Rs 40 crores to TDL, which then paid Rs 40 crores to TRRDPL, which then paid Rs 40 crores to MACEL. There was no economic rationale in these transactions, which were designed to

fabricate the books of accounts. This indicates fraudulent intent of TDL/MACEL to understate related party balances in the books of TDL in FY 2018-19, and thereafter evergreening of loans was done through structured circulation of funds. This fraud could have been detected by the Auditors from the bank statement of TDL had they applied professional skepticism during the course of audit.

- 83 Similar fraudulent rotation of funds among related parties were observed when cheques of Rs 350 crores issued by MACEL to TDL (in FY 2018-19) were cleared on 10-04-2019. A glimpse of the same is depicted in the bank statement of MACEL given hereunder in Table 5:

Table-5 (Rs in crores)

Date	Cheque no	Party name	Debit	Credit	Balance
10-04-2019		CDGL		85.00	85.02
10-04-2019		CDGL		5.00	90.02
10-04-2019	467643	TDL	90.00		0.02
10-04-2019		GVIL		90.00	90.02
10-04-2019	467653	GVIL	50.00		40.02
10-04-2019		GVIL		50.00	90.02
10-04-2019	467641	TDL	90.00		0.02
10-04-2019		GVIL		90.00	90.02
10-04-2019	467642	TDL	90.00		0.02
10-04-2019		GVIL		90.00	90.02
10-04-2019	467645	TRRDPL	90.00		0.02
10-04-2019		TDL		90.00	90.02
10-04-2019	467644	TDL	80.00		10.02
10-04-2019		GVIL		80.00	90.02

- 84 As depicted in Table 5, MACEL had issued four cheques of Karnataka Bank of total amount of Rs 350 crores to TDL on 31.03.2019, which were cleared on 10.04.2019 in a series of sham transactions by rotating smaller funds among TDL, MACEL and GVIL to legitimize transactions of Rs 350 crores. Such as on 10.04.2019, CDGL paid Rs 90 crores to MACEL, which then paid Rs 90 crores to TDL, which then paid Rs 90 crores to GVIL, which then paid Rs 90 crores to MACEL, which then paid Rs 50 crores to GVIL, which then paid Rs 50 crores to MACEL, which then paid Rs 90 crores to TDL, which then paid Rs 90 crores to GVIL, which then paid Rs 90 crores to MACEL, which then paid Rs 90 crores to TDL, which then paid Rs 90 crores to GVIL, which then paid Rs 90 crores to MACEL, which then paid Rs 90 crores to TRRDPL, which then paid Rs 90 crores to TDL, which then paid Rs 90 crores to MACEL, which then paid Rs 80 crores to TDL, which then paid Rs 80 crores to GVIL, which then paid Rs 80 crores to MACEL. Fraudulent understatement of loans by Rs 350 crores given to MACEL and evergreening of loans through structured circulation of funds is clearly evident from above bank statement. This fraud could have been detected by the Auditors from the bank statement of TDL during the course of audit had they applied the professional skepticism expected of them.
- 85 Further, we do not agree with the submission of the Auditors that statutory auditor is not required to delve into source of funds, specially when circulation of funds was clearly visible from the bank statements. The Auditors' argument is that while looking at 'Credit' column in the bank statement for verification of realization of cheques, they are not required to look at source of



funds i.e., 'Debit' column on the same page of bank statement. This argument is not logical. An Auditor is required to perform audit with professional skepticism (SA 200). Evergreening of loans through structured circulation of funds was visible from bank statements of TDL. Therefore, the Auditors were required to evaluate this evergreening of loans while verifying realization of cheques received in 2018-19. We note that the Auditor has failed to exercise professional skepticism and due diligence while verifying bank statements. Therefore, we are of the view that the Auditors' inert passivity in the face of visible evergreening of loans and understatement of related party borrowings does not insulate them from their gross failure in performance of this audit.

- 86 The Auditors have argued that discovery of evergreening of loans can emerge only from an investigation of all group companies and is not capable of being detected within the scope of work of a statutory auditor of TDL. There is no merit in this argument as the Auditors were having access to the books of accounts and bank statements of TDL, GVIL, CDGL and TRRDPL, therefore they were in a position to detect this evergreening of loans had they picked up the tell-tale signs, as illustrated in the preceding paragraphs and tables. As discussed, Rs 40 crores was rotated among MACEL, TDL and TRRDPL. Similarly, Rs 90 crores was rotated among MACEL, CDGL, TDL, TRRDPL and GVIL. The Audit Firm had audited TDL & GVIL (a subsidiary company of TDL) whereas CDGL & TRRDPL (a subsidiary company of TDL) were audited by M/s ASRMP & Co., a related audit firm of the Auditors. Two partners of this Audit Firm M/s Sundaresha & Associates (CA Pradeep Chandra C. and CA Chaitanya G. Deshpande) were part of the team which conducted audit of CDGL. Therefore, evergreening of loans through structured circulation of funds was evident and could easily be detected by the Auditors, had the audit been performed with professional skepticism.
- 87 Thus, it is clear that there was a well-thought-out plan to bring down related party loans by just passing accounting/book entries on or before 31.03.2019 to show that loans had been repaid by the related party. Thus, the actual loans outstanding from MACEL of Rs 462.32 crores as on 31.03.2019 was fraudulently shown as loan due to MACEL of Rs. 11.68 crore resulting in understatement of loan to MACEL by Rs 474.00 crores (Rs. 462.32 crore plus Rs 11.68 crores).
- 88 MACEL's account was maintained as current account with regular receipt and payment and no specific approval of the Board was obtained before disbursement of funds. No agreement was entered into with MACEL for such huge transactions. Grant of huge amount of loans without any written agreement & without approval of the Board, to an entity owned by the promoters' family & not having any business relationship with TDL, were proof of fraudulent transactions. In light of glaring lack of evidence to support a valid business reason for such transfer of funds and clear indications that TDL's funds were being misappropriated, resulting in a material misstatement of the Financial Statements, fraud, and the Auditors' failure to perform requisite additional auditing procedures and question such transactions, we conclude that the Auditors did not exercise the necessary professional skepticism to determine whether these transactions posed a risk of material misstatement due to fraud and failed to obtain sufficient appropriate audit evidence in respect of these circular transactions. The Auditors failed to report this fraud to the Central Government u/s 143(12) of the Act.
- 89 The Auditors denied that provisions of PMLA apply in this case and stated that all related party transactions had been disclosed in the FS, there was no concealment and accordingly the question

of fraud does not arise. Funds are transferred to group companies and sources of funds are identified and verified. While citing section 420 of the Indian Penal Code (IPC) they stated that there was no cheating & dishonesty and there was no delivery of property or destruction of valuable security, accordingly section 420 of IPC is not applicable. While citing section 3 of PMLA they stated that amount received from group companies/lenders was advanced to MACEL, source & application of funds are clear, all transactions were done through banking channel and Bankers have not flagged these transactions as suspicious therefore section 3 of PMLA is not applicable. While citing para 16 of SA 250, they stated that they had obtained management representation relating to laws and regulations in relation to audit of FS. Accordingly, there is no violation of SA 250.

- 90 We observe that disclosure of related party transactions in the Financial Statements and its routing through banking channel does not provide immunity to such transactions from PMLA. The fact is that Rs 474 crores was diverted to promoter owned company-MACEL and attempts were made to conceal this diversion by fraudulently understating this balance in the financial statements. Total fraudulent transactions with MACEL during the year were Rs 2614.35 crores. There was large scale evergreening of loans through structured circulation of funds involving many group companies. All this was done without proper authorization by the Board of Directors, without entering into any agreement and without obtaining any security. Money has ultimately moved to promoter owned company-MACEL. These are ample proof of cheating and dishonesty. Therefore, this is a clear case of money laundering as per PMLA, which Auditors failed to report in the Independent Audit Report.
- 91 The Auditors' contention that section 143(1) of the Act provides certain rights to auditor and does not cast any duty on the auditor is not acceptable as the auditor is required by section 143(1)(b) to inquire whether the transactions of the company which are represented merely by book entries are prejudicial to the interest of the company. Obviously, the Auditors have failed to comply with these provisions in this case.
- 92 In view of the foregoing analysis, we conclude that the charge that the Auditors have violated section 143(1)(b), 143(12) of the Act, CARO, SA 200, SA 240, SA 250, SA 315, SA 330 and failed to report violation of section 179(3) of the Act by TDL, is proved.

#### **C.5 Lapses in audit of fraudulent recognition of Interest income of Rs 75.58 crores:**

- 93 The Auditors were charged with failure to exercise professional skepticism and judgement and failure to perform risk assessment procedure while performing audit of interest income of Rs 75.58 crores. TDL had recognized interest income of Rs 76.84 crores, which included interest of Rs 75.58 crores received/receivable from MACEL. However, no such interest payment was shown in the Financial Statements of MACEL either as interest expenses or in the related party disclosure. Further, there was no agreement for payment of interest. In such a situation, recognition of interest income was not appropriate. Interest income constituted 32.97% of the total income of Rs 233.08 crores. TDL has reported profit of Rs 3.83 crores. Had this interest income of Rs 75.58 crores from MACEL not been recognized, TDL would have reported a loss of Rs 71.75 crores (Rs 75.58 crores - Rs 3.83 crores).

- 94 The SCN noted that there is no evidence in the Audit File that the Auditors had checked the loan agreement with MACEL for charging of interest, rate of interest to be charged, calculation of interest of Rs 75.58 crores. The Auditors had not verified receipt of the interest amount in TDL's bank account. This interest income was required to be entered in the ledger account of MACEL maintained in the books of accounts of TDL, and being a material revenue item, the Auditors were required to verify the same. There is no evidence in the Audit file about the performance of any such audit procedure.
- 95 The SCN referred to SA 240 that requires the auditor to presume that there is risk of fraud in revenue recognition and evaluate which type of revenue, revenue transactions or assertions give rise to such risks. In case the auditor concludes that such presumption is not applicable, the auditor is required to document the reason for that conclusion. The Auditors had neither presumed fraud risk in revenue recognition nor evaluated interest income. The Auditors also did not record in the Audit File that fraud risk presumption was not applicable. Accordingly, the Auditors were charged with violation of SA 200, SA 240, SA 315, SA 330 and 143 (12) of the Act with reference to overstatement of Rs 75.58 crores in interest income in the Statement of Profit and Loss.

#### **Auditors' Reply & Our Findings**

- 96 The Auditors replied that they did not have access to MACEL books and were unable to comment on any accounting queries arising from the books of MACEL and disclosures thereof in the Financial Statements. They further stated that no loan was given to MACEL and it was a current account facility and interest cost was transferred to MACEL. They stated that TDL has accounted for interest income; that interest income was disclosed in the note on related party transactions; that they had obtained balance confirmations; and that there was no difference between the books of TDL & MACEL, hence there was no fraud.
- 97 The Auditor's reply that MACEL's account was maintained as current account is not accepted as already discussed in Section C.4 of this Order. We note that presumption of fraud in recognition of interest income requires critical evaluation of the genuineness of revenue recognition. There was no agreement for charging of interest from MACEL. The interest income shown as recoverable from MACEL was **98.34%** of total interest income of TDL (Rs. 75.58 crore out of Rs. 76.84 crore). The materiality of the quantum of the interest income recoverable required the Auditor to carry out sufficient audit due diligence and procedure. The Audit File shows that the Auditors did not verify the ledger account of MACEL maintained in the books of TDL. The Auditors did not perform any audit procedure to rule out the possibility of fraud. It is clear from the reply that the Auditors have solely relied on the balance confirmation for audit of recognition of huge interest income.
- 98 The importance of revenue recognition can be understood from the fact that SA 240, which deals with the auditor's responsibilities relating to fraud in an audit of financial statements, made it mandatory for auditors to presume fraud in recognition of revenue. The risk of material misstatement due to fraud is a significant risk and the auditor is required to obtain an understanding of the entity's related controls including control activities. The risk of fraud in revenue recognition is greater in listed companies where performance is measured in terms of year-over-year revenue growth or profit. TDL is a subsidiary company of a listed company,

CDEL. Fraudulent recognition of interest income of Rs 75.58 crores has resulted in overstatement of revenue and profit of TDL and in turn profit of the listed company CDEL. This has materially impacted the financial performance of TDL and CDEL. We note that the Auditors had shown their gross negligence by not obtaining sufficient appropriate audit evidence in this important matter. Accordingly, we find that the Auditors violated section 143(12) of the Act, SA 200, SA 240, SA 315 and SA 330, hence this charge stands proved.

**C.6 Lapses in audit of fraudulent diversion of funds of Rs 507.05 crores to Giri Vidhyuth (India) Limited ('GVIL' hereafter)**

99 The Auditors were charged with failure to exercise professional skepticism and judgement and failure to perform risk assessment procedure while performing audit of loans of Rs 507.05 crores given to GVIL, which was fraudulent diversion of funds. GVIL was fully owned subsidiary of TDL and the Audit Firm was the statutory auditor of GVIL also for FY 2018-19. During 2018-19, TDL had given total loans of Rs 856.91 crores to GVIL, which had repaid loans of Rs 350 crores to TDL and outstanding loan was Rs 507.05 crores as on 31.03.2019. Further, GVIL gave loan of Rs 200 crores to MACEL, which was reportedly repaid by MACEL during the year. GVIL was not engaged in any business activity but was used by TDL as a conduit for diversion of funds, as is evident from the summary of Balance Sheet of GVIL given in Table 6: -

Table-6

Sr No	Particulars	Rs in crores	
1	Loan taken from TDL	507.05	
2	Loan taken from TRRDPL, a fellow subsidiary	70.00	
3	Other liabilities	0.01	
4	Negative net worth	(17.12)	
5	Total of loan + liabilities – net worth		559.94
6	Loan given to Sical Logistics Ltd (SICAL), a related party	150.00	
7	Bank balance	370.00	
8	Investment in shares of SICAL	39.94	
9	Total assets		559.94
10	Revenue from operation		Nil

100 The SCN noted that there was no record in the Audit File that Board of Directors of TDL had passed any resolution under section 179(3) of the Act to borrow funds & grant loans to GVIL. Further, the loan given to GVIL was unusual keeping in view the nature and size of GVIL, which should have attracted suspicion about the nature and purpose of these financial transactions and the terms & conditions of loan were required to be evaluated alongwith utilisation of loan for the intended purpose. There is no evidence in the Audit File that any such audit procedure was performed nor was any risk assessment procedure was performed to identify & respond to RoMM. (SA 200, SA 240, SA 315 and SA 330).

101 The SCN noted that the Auditors had the statutory duty to report the offence of fraud to the Central Government under Section 143 (12) of the Act. Disbursal of loan to GVIL, a company which did not have any business activity, was an indication of fraud. Further, as statutory auditor of GVIL, the Audit Firm knew that GVIL had no real business but was used as a conduit for

diversion of funds. It shows that the Auditors were in knowledge of the diversion of funds, i.e., fraud being committed in the company. Despite that the Auditors failed to report the same to the Central Government. On the contrary, the Auditors reported that no material fraud by or on the company had been noticed or reported during the course of audit. They were charged with non-compliance with section 143 (12) of the Act, the CARO, SA 200, SA 240, SA 315 & SA 330.

### **Auditors' Reply & Our Findings**

- 102 While denying this charge, the Auditors have contended that these transactions were not diversion as per its definition given in Black's Law Dictionary and RBI circular. This issue has already been discussed in the preceding charge. Accordingly, we find that transaction with GVIL is also diversion of funds.
- 103 The Auditors have further replied that though there is no specific approval for loan given to GVIL, however TDL had obtained blanket approval to lend Rs 10,000 crores to group companies as per special resolution passed u/s 185 of the Act; and TDL is also covered u/s 185 (3)(c) of the Act which allows a holding company to give loan to its wholly owned subsidiary without any further approval. They further stated that there is no reporting obligation on the Auditor u/s 179 of the Act.
- 104 We note that exemption u/s 185(3)(c) of the Act is available to a company for loans given to its subsidiary only if such loans are utilised by the subsidiary company for its principal business activities. GVIL's principal business activity was to execute power projects as mentioned by the Auditors in their reply. GVIL's principal business activity was not financing activity. Accordingly, this contention of the Auditors is not acceptable. Further, we note that not obtaining approval u/s 179 of the Act shows that loan transactions were not authorised by the Board of Directors, which was additional evidence of fraudulent diversion of funds.
- 105 The Auditors further replied that no agreement was entered for funds advanced; and such an agreement is legally not compulsory, therefore the question of verifying terms and conditions does not arise. They stated that GVIL was created to execute power projects, however due to several hurdles, GVIL decided to drop the same. They stated that loan given by TDL to GVIL was for furtherance of its business by investing in SICAL (a group company) through equity and debt in FY 2018-19. They further stated that loan given by GVIL to MACEL was returned at the end of the year. They lastly stated that they were not aware of any offence of frauds as these funds were not diverted from intended purpose.
- 106 We note that the Audit Firm was the Auditor of GVIL also, thus it was privy to all the business and transactions of GVIL. TDL gave loans of Rs 507.05 crores to GVIL, which in turn loaned out a sum of Rs 150 crores to SICAL. GVIL also invested Rs 56.91 crores in 29,81,570 equity shares of SICAL. As regards the balance amount of Rs 300.14 crores (Rs 507.05 crores Rs 150 crores Rs 56.91 crores) advanced to GVIL, the Auditors' reply is silent. There is no record either in the Audit File or in the Financial Statements of TDL, regarding the purpose of such loan. The Auditor in his response has categorically stated that *"There is no agreement between TDL and GVIL in relation to funds advanced. There is no legal compulsion of having an agreement in writing either."*

- 107** GVIL which is a subsidiary of TDL, and is audited by the same firm, further advanced Rs 200 crores to MACEL, a group company. In their reply, the Auditors have stated that MACEL has returned the money to GVIL at the end of the year. The Auditors' contention that MACEL had repaid the loan to GVIL during the year, is factually incorrect as out of Rs 200 crores, a sum of Rs 50 crores was repaid by issuance of cheques in March 2019, which were cleared in FY 2019-20 by evergreening of loans done through structured circulation of funds in the same manner as discussed in preceding charge relating to MACEL<sup>21</sup>. Further, GVIL (100% subsidiary of TDL) had shown bank balance of Rs 370 crores in its Financial Statements (serial no-7 of table-6), whereas as per its bank statement, actual balance was Rs 8,192.50 only. This fact corroborates evergreening of loans mentioned in Chapter C-4 and proves that the Financial Statements of TDL and GVIL were used for diversion of funds to promoters-controlled entity-MACEL.
- 108** From Table 6, it is evident that GVIL was being used by the promoters for financial manoeuvring and manipulation. GVIL had no operations and did not have financial strength to repay this loan. The transfer of huge amounts of borrowed funds to GVIL, without any business purpose, without authorisation of the Board, without any agreement, and without obtaining any security, clearly indicate fraudulent diversion of funds. The Auditors did not exercise professional skepticism and did not perform risk assessment procedures and chose to turn a blind eye to these manipulations while doing the audit of the loan given to GVIL.
- 109** Both GVIL and MACEL did not have the financial strength to repay loans given by TDL as is evident from their operational inadequacy and the fact of evergreening of loans already discussed in this Order. In accordance with para 5.5.1 of Ind AS 109-'Financial Instruments', TDL was required to recognize an impairment loss allowance for expected credit losses on the loans & advances given to these companies. Alternatively, TDL was required to reduce the gross carrying amount of such loans by writing off these loans, based on the recoverability of such loans in terms of Para 5.4.4 of Ind AS 109. Examination of the Financial Statements of TDL and the Audit File shows that TDL did neither. Thus, TDL did not comply with Ind AS 109 and the Auditors did not report the same, therefore the Auditors were charged with non-compliance with section 143(3)(e) of the Act.
- 110** While denying this charge, the Auditors have stated that Loans of MACEL were fully recovered during the year, therefore the question of impairment or write off does not arise. They further stated that GVIL made a strategic investment in fully operational profitable SICAL Logistics Ltd ('SICAL' hereafter). The Loan given to SICAL was partially recovered during the year and was expected to yield a good return in long run. The Loan given by GVIL to MACEL was also recovered during the year. Accordingly, at the time of finalization of audit, there was no indicator of impairment, therefore the question of impairment loss does not arise. According to them, there was no non-compliance with Ind AS 109.
- 111** We have already detailed how the loans were not actually recovered from MACEL but fraudulently understated by Rs 474 crores through receipt of cheques from MACEL. Further, evergreening of loans through structured circulation of funds among group companies including MACEL, GVIL & TRRDPL to clear cheques has also been proved. The financial positions of

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<sup>21</sup> Details are available in NFRA order no. NF-23/14/2022 dated 13.04.2023 available on <https://nfra.gov.in/document-category/orders/>

these companies clearly shows that MACEL had negligible business and GVIL did not have any business. MACEL & GVIL had negative net worth and were used by the promoters as conduits for diversion of funds. There were enough evidences that MACEL and GVIL did not have financial strength to repay loans. Accordingly, recognition of impairment loss allowance and writing off of non-recoverable portion of loans was required to be made, which was not done by TDL. The Auditors have failed to report non-compliance with Ind AS 109. The financial jugglery adopted by the TDL and GVIL was known to them as they were the Auditor for both TDL and GVIL.

112 From above analysis, we find that the charge that the Auditors have violated section 143(3)(e), 143 (12) of the Act, the CARO, SA 200, SA 240, SA 315 and SA 330, is proved.

**C.7 Lapses in audit of fraudulent loan transactions of Rs 1743.42 crores with Tanglin Retail Reality Developments Pvt Ltd ('TRRDPL' hereafter)**

113 The Auditors were charged with failure to exercise professional skepticism and judgement and failure to perform risk assessment procedure while performing audit of loan transactions of Rs 1743.42 crores given to TRRDPL, which were fraudulent in nature. Accordingly, the Auditors were charged with violation of provisions of SA 200, SA 240, SA 315, SA 330, Section 179 (3) of the Act and CARO with respect to unusual loan transactions with TRRDPL.

114 TRRDPL is a fully owned subsidiary of TDL. M/s ASRMP & Co. (a related party of M/s Sundaresha & Associates) was the statutory auditor of TRRDPL for FY 2018-19. As per audit work paper 'Related Party Transaction Workings', TDL had disbursed loans of Rs 750.76 crores to TRRDPL, which repaid the loan during the year. Further, TDL received loan of Rs 992.66 crores from TRRDPL. Therefore, total loan transactions with TRRDPL were worth Rs 1743.42 crores (Rs 750.76 crores + Rs 992.66 crores).

115 TRRDPL was reportedly engaged in the business of property development, however, it can be observed from Table- 7 that TRRDPL was used by TDL for diversion of funds, as it had no business activity and made loans & investment of Rs 2054.20 crores to related parties. Salient features of FS of TRRDPL for FY 2018-19 are as under in Table 7:

Table-7

Sr No	Particulars	Rs in crores	
1	Borrowing through debentures	2960.12	
2	Other liabilities mainly accrued interest & statutory dues	12.94	
3	Net worth of TRRDPL (negative)	(50.96)	
4	Total equity & liabilities (1 to 3)		2922.10
5	Total loans & Investment in related parties	2054.20	
6	Bank balance	863.18	
7	Other assets	4.72	
8	Total assets (5 to 7)		2922.10
9	Revenue from operations		Nil
10	Finance cost		3.30
11	Loss during the year		2.51

- 116 As per audit work paper ‘Related Party Transaction Workings’ in the Audit File of TDL, transactions with TRRDPL were as under in Table 8:

Sr No	Particulars	2018-19
1	Loans outstanding as on 31.03.2018	497.95
2	Loans given during the year	750.76
3	Loans recovered during the year	750.76
4	Loan received during the year	992.66
5	Loan received & outstanding as on 31.03.2019	-494.71
6	Total of loan given & loan taken (2 + 4)	1743.42

- 117 No document is available in the Audit File about any audit procedure performed to examine the receipt and payment of transactions of Rs 1743.42 crores with TRRDPL, which were material keeping in view the nature & size of TDL and TRRDPL. The Auditors were required to exercise Professional Judgement and Skepticism to evaluate the appropriateness of borrowing of funds & grant of loans to TRRDPL by examining loan agreement and its terms & conditions including the term of loan, rate of interest and security obtained etc. Copy of loan agreement is not available in the Audit File. There is no evidence in the Audit File that the Auditors had asked any questions to Those Charged With Governance (TCWG) about the terms & conditions, and security of these loans transactions. Further, these transactions were not approved by the Board of Directors as required under section 179 of the Act.

#### **Auditors’ Reply & Our Findings**

- 118 While denying the charge, the Auditors have replied that M/s ASRMP & Co and M/s Sundaresha & Associates are not related firms. Only one of the partners of the firms is related and they function independently. This issue has already been discussed in the Part C.1 of the order relating to Independence wherein it was established that both the firms are not independent of each other.
- 119 The Auditors further replied that from their discussion with the management over the years, they understand that TRRDPL did not actively undertake operations, however, has substantial investment in infrastructure companies. They replied that there was no loan agreement with TRRDPL for loan taken or loan given but stated that funds were lent to TRRDPL to invest in SICAL, a subsidiary company of TRRDPL and to give loans to SICAL. The Auditors further stated that loans were given to TRRDPL to lend to other group companies to the extent of Rs 500 crores which was recovered at the end of the year.
- 120 We note from para A5 of SA 230 that “*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*”. The Auditors admitted that no agreement was entered into with TRRDPL and the Audit File does not support the above reply. The quantum of these transactions and their materiality should have warranted an Auditor to question and evaluate them rather than rely on discussions which are not in any way documented in the Audit File, therefore explanations given by the Auditor are treated as an afterthought and not accepted.



- 121 In respect of compliance with section 179 of the Act, the Auditors have given the same reply as given in previous charge relating to loan given to GVIL, thus adopt the same analysis. TRRDPL was a non-operational company, thus the loan of Rs 750.56 crores was not used for its principal business activity i.e., infrastructure business, and therefore the benefit of exemption from section 185(3)(c) is not available. Accordingly, the loans given to TRRDPL remain unauthorised.
- 122 Regarding the loan taken during the year, the Auditors stated that the Coffee Day Group held 20% shares in Mindtree Ltd and decided to sell these holdings to L&T in order to repay the group loans which had been secured by pledging shares of Mindtree Ltd. TRRDPL was the nodal intermediary for this sale. Group loans had to be cleared off, for releasing the pledged shares before sale. TRRDPL received a consideration of Rs 3000 crores from Standard Chartered for issue of debentures. Out of this sum, TDL received Rs 775 crores which was used for repayment of loans. TDL repaid Rs 250 crores out of Rs 775 crores to TRRDPL during the year. There was no agreement with TRRDPL for such loan transaction, but the Auditors claimed to have verified related party transactions, obtained balance confirmations, verified Board and EGM minutes to conclude that transactions were within prescribed limits and as per the provisions of SAs and the Act.
- 123 The fact of TRRDPL becoming the nodal intermediary for sale of Mindtree shares is not documented in the Audit File. The Auditors have tried to give rationale to cover part of transactions of Rs. 1,743.42 crores with TRRDPL. Out of Rs 992.66 crores loan taken from TRRDPL, reply is given for Rs 775 crores only and similarly, out of Rs 750.76 crores loan given to TRRDPL, reply is given for Rs 500 crores only. Further, this part amount is not supported by any audit evidence available in the Audit File. These loan transactions were required to be evaluated by the Auditor at the time of performing audit procedures, which is not evident from the Audit File. Therefore, we find that the Auditors have given this reply as an afterthought with intention to shield their deficiencies in audit.
- 124 The bank statements and bank reconciliation statements of TDL and other group companies, given in Chapter C-4 of this Order, all points to the fact that TRRDPL was used by the TDL for evergreening of loans and understatement of loans given to MACEL. This shows that the Financial Statements of TDL and TRRDPL were manipulated to hide diversion of funds to promoter controlled entity-MACEL. It was the Auditors' duty to exercise due diligence while conducting Audit of transactions with TRRDPL. Failure to do so shows their gross negligence in discharging the statutory duty cast upon them by the Auditing Standards and the Act.
- 125 The above proves the charge that the Auditors have violated the CARO, SA 200, SA 240, SA 315, SA 330 and failed to report violation of section 179(3) of the Act by TDL.

**C.8 Lapses in audit of suspected fraudulent diversion of Rs 415 crores given as land advances to related parties**

- 126 The Auditors were charged with failure to exercise professional skepticism and judgement and failure to perform risk assessment procedures while performing audit of fraudulent diversion of funds in the garb of land advance of Rs 415 crores given to related parties. Accordingly, the

Auditors were charged with non-compliance with SA 200, SA 240, SA 315, SA 330 and 143 (12) of the Act.

- 127** TDL had a total outstanding advance of Rs 415 crores given as advance for land. These constitute 17.39% of the total assets of Rs. 2,386.38 crores. These advances were given to 3 parties: (a) Rs 275 crores given to Mrs. Vasanthi Hegde (Mother of VGS-Chairman of holding company CDEL) for purchases of land at Mumbai, (b) Rs 140 crores given to Sivan Securities Private Limited ('SSPL' hereafter), a related party, towards purchase of 26 acres and 38 guntas of land with clear title, (c) Rs 200 crores to Mr Hallappa for purchase of land jointly owned by Mr Hallappa and Mrs Vasanthi Hegde. This Land advance was outstanding at the beginning of FY 2018-19 and was recovered during FY 2018-19.
- 128** The SCN noted that the materiality of such advances for land (17.39% of the assets) necessitated the Auditors to perform substantive audit procedure to obtain audit evidence like agreement to purchase lands, ownership documents of lands, valuation of lands to be purchased and TDL's plan to utilize those lands etc. Return of land advance of Rs 200 crores by Mr. Hallappa was required to be audited by checking receipt of amount in bank account of TDL and reason of return of land advance. Examination of the Audit File shows that the Auditors neither obtained any audit evidence nor performed any substantive audit procedure to evaluate the genuineness of these transactions.
- 129** Release of land advances to related parties, return of land advance, title disputes in the lands coupled with non-availability of critical documentary evidences such as agreements, ownership documents, valuation reports and TDL's plan to utilize those lands etc. were indicators of diversion of funds and required to be reported to the Government of India u/s 143(12) of the Act. There is no evidence in the Audit File that the Auditors had complied with these statutory requirements. This has also resulted in overstatement of Rs 415 crores on the Assets side of the Balance Sheet signed by the Auditors.

### **Auditors' Reply & Our Findings**

- 130** While denying the charge, the Auditors have stated that land advances were made in earlier years and agreements were verified at the time of 1<sup>st</sup> year of audit or in the year advances were made. Copies of documentation need not be maintained in the Audit File every year. They have assessed the status of these advances and disclosures in the Financial Statements of TDL.
- 131** They further stated that the advance to Mrs Vasanthi Hegde was given in October 2017 for procurement of land in Mumbai. They had verified the agreement in 2017-18 and the company was waiting for a clear title. Alongwith the reply to SCN, they attached a copy of agreement between TDL & Mrs. Vasanthi Hegde and one of many sale deeds in favour of Mrs Vasanthi Hegde. In respect of advance given to SSPL, they stated that amount was pending from earlier years and there was no progress in the case before High Court. They had verified these documents and they are not required to maintain documents of the clients as per implementation guideline to SA 230 published by ICAI. In respect of land advance given to Mr Hallappa, they stated that Mr Hallappa, a land aggregator, was supposed to acquire agriculture lands in Chikkamagaluru and Mysore for the Company and convert these lands into non-agriculture land and sell to the

company. Since, identified lands were not found suitable, the advance was returned. Lastly, they mentioned that NFRA has not stated as why it has concluded the transactions to be fraudulent.

- 132** Having considered the reply, we observe that even if advances were made in earlier years; the Auditors were required to critically analyse the reason of non-registration of lands in the name of TDL during 2018-19, which was not done. As per the agreement with Mrs Vasanthi Hegde, completion of sale was subject to conversion of land from Agriculture to Non-Agriculture purpose within two years from the date of agreement. Vacant possession of the land was to be handed over to TDL free from encumbrances and litigations. Disbursal of advance of Rs 275 crores i.e., 98.21% of the total cost of Rs 280 crores was an unusual activity given the fact that two years' time was given to Mrs Vasanthi Hegde for conversion of land from agriculture to non-agriculture purpose and making it free from encumbrances and litigations. The Auditors could not give any reply about valuation of lands to be purchased and TDL's plan to utilize those lands. This transaction was required to be evaluated with professional skepticism, whether it was done at Arm's Length basis and was not prejudicial to the interest of TDL. Mrs Vasanthi Hegde was mother of Chairman of Holding Company and related party transactions have high Risk of Fraud. This land was not transferred in the name of TDL during FY 2018-19. Despite all these red flags, the Auditors failed to exercise professional skepticism and failed to perform sufficient and appropriate audit procedure.
- 133** Alongwith reply to SCN, the Auditors have submitted a copy of agreement with Mr Hallappa, for purchase of land including land owned by Mrs Vasanthi Hegde, for which an advance of Rs 200 crores was given by TDL to him. It is not clear as to how Mr Hallappa was authorised to sell the land owned by Mrs Vasanthi Hegde. Further, there seems to be no justification in releasing such huge advance to a person other than owner of the land without proper documentation. The Auditors have replied that it was not feasible to procure the land hence Mr Hallappa returned the advance. We observe that feasibility of land is required to be examined before release of land advance, which was not done in this case. The Auditors could not give any reply about whether they had verified the bank account of TDL to check that Mr Hallappa had refunded this amount to TDL. We found in a similar case of Coffee Day Group matter, that CDGL had shown refund of land advance of Rs 130.55 crores given to one individual (Kumar Hegde) which, as NFRA's investigation revealed, was surreptitiously orchestrated by promoters through round tripping of CDGL's own funds. Two partners of this Audit Firm were also part of the Audit Team which conducted audit of CDGL. NFRA's order dated 12.04.2023 in CDGL matter is available at <https://nfra.gov.in/document-category/orders/>. Mrs Vasanthi Hegde was mother of the Chairman of the Holding Company and related party transactions have high Risk of Fraud. Despite all these red flags, the Auditors failed to exercise professional skepticism and failed to perform sufficient and appropriate audit procedure.
- 134** Similarly, despite not having clear title, Rs 140 crores was given as land advance to SSPL, a related party. There is no record in the Audit file about assessment of valuation of these lands, basis which such huge land advances were given. These indicators were required to be analysed by the Auditors with professional skepticism. However, we could not find any such analysis in the Audit File.
- 135** Release of huge amount to related parties on the pretext of land advance, title disputes of land for which money is advanced and return of advance on the flimsy explanation of non-suitability

of land, were required to be evaluated by the Auditors with professional skepticism. But this was not done indicating that the Auditors had performed the audit in a perfunctory manner.

- 136** In view of above analysis, we find that the charge that the Auditors have violated section 143(12) of the Act, SA 240, 315 and SA 330 is proved.

**D. Other non-compliances with Laws and Regulations**

In addition to the major charges mentioned in Section -C of this Order, the Auditors were also charged with the following non-compliances with Laws and Regulations: -

- a) Lapses in audit of Internal Financial Control over Financial Reporting (IFC) resulting in violation of section 143(1)(i) of the Act.
- b) Failure to ensure compliance with section 134(1) of the Act.
- c) Non-compliance with SA 260, Communication with Those Charged With Governance & SA 265, Communicating deficiencies in Internal Control to Those Charged With Governance and Management.
- d) Non-compliance with SA 500, Audit Evidences & SA 505, External Confirmations.
- e) Non-compliance with SA 550, Related Parties.
- f) Non-compliance with SA 700, Forming an Opinion and Reporting on Financial Statements.

**Auditors' Reply & Our Findings**

- 137** With respect to the charge relating to IFC, the Auditors denied it stating that they are statutory auditors and not forensic auditors. During the course of audit there were no indicators that suggested lapse of internal control. They had undertaken IFC testing covering substantial portion of material items like loans, revenue, advances to related parties etc. They stated that it would not have been possible to detect pre- signed cheques due to time lag between the transaction and audit thereof. Citing para 5 of guidance note on audit of cash and bank balance issued by ICAI, the Auditors replied that they are not required to check unused cheque leaves, utilisation of cheques leaves and bank transactions as suggested by NFRA. While referring to para A46 to A50 of SA 315 about limitations of internal control, the Auditors have stated that there exist certain limitations while assessing the internal control of a company. Transactions were undertaken with necessary approvals and through banking channels and did not indicate any lapse of internal control and they had assessed the control environment of TDL. They mentioned that the alleged lapse can only be called as poor governance and not misstatement by itself.

- 138** We are aware that the Auditors were Statutory Auditors and not Forensic Auditors. However, laws and regulations lay down certain responsibilities of Statutory Auditors with respect to internal financial control and internal controls. Use of pre- signed cheques for diversion of funds and circulation of funds are enough evidence of complete absence of internal control and internal financial control in TDL. Further, we also notice from guidance note issued by ICAI that it expects the auditor to review the segregation of duties relating to authorisation of transactions, handling/issuance of cheques, proper authorisation of banking transactions and safe custody of cheque books etc. The Audit File shows that the Auditors have not performed any such procedures. We note that the Auditors did not perform any test of control with reference to use of cheques leaves, management override of control and authorisation of transactions etc. Internal financial control over financial reporting is designed and implemented to prevent, and detect

fraudulent transactions. However, based on above analysis, we note that controls were totally absent in TDL in the area of release of loans & banking transactions and there was total management override of controls in these areas. Any significant deficiencies or material weaknesses in internal controls must be revealed by the auditor, but we find that instead of reporting absence of IFC, the Auditors falsely reported that TDL had adequate Internal Financial Controls with reference to financial statements and it was operating effectively. Thus, they violated section 143(1)(i) of the Act.

- 139** With respect to compliance with section 134(1) of the Act, the Auditors stated that they had obtained constructive evidence, in the form of receipt of signed copies of the financial statements, before they signed on the same and issued audit report thereon. Further, considering the ‘Doctrine of Indoor Management’, they had ensured the compliance with section 134(1) of the Act. They further stated that the company has complied with section 134(1) of the Act and the Auditor is not required to make any report on this issue.
- 140** As per section 134(1) of the Act, approval of the Financial Statements by the Board and its signing by the persons authorized by the Board are prerequisites before an auditor makes a report on such approved & signed financial statements. Further, the reliance on the “Doctrine of Indoor Management” is misplaced as this Doctrine is applicable to third parties, not having access to the internal records of a company. The Auditors should have obtained a certified copy of the Board resolution approving the Financial Statements and authorizing the Directors to sign the Financial Statements and should have kept the same in the Audit File before its assembly. The Auditors did not do the same. Thus, the charge that the Auditors did not ensure compliance with section 134(1) of the Act by TDL is proved.
- 141** With reference to compliance with SA 260 and SA 265, the Auditors replied that they had communicated orally with TCWG and recorded in closing memorandum sheet in audit tracker and closing memorandum sheet in the Audit File.
- 142** On review of closing memorandum sheet in audit tracker and closing memorandum sheet in Audit File, we note that this sheet does not relate to discussion with TCWG but relates to important points and conclusion made by the auditor. There is no record of any discussion with TCWG in this sheet. Further, we could not find the names of the members of TCWG with whom the discussion was held and the date of discussion is also not mentioned in this sheet. SA 260 requires Auditors to determine TCWG and communicate with TCWG about the responsibilities of the Auditor, overview of the plan, scope & timing of the audit, and deficiencies in Internal Control. Further, large scale diversion of funds & circulation of funds were evident deficiencies in internal control. We note from the Audit File & reply of the Auditors that they neither determined TCWG nor communicated these matters to TCWG, thus did not comply with SA 260 & SA 265.
- 143** SA 500: With reference to non-evaluation of the valuation report of investment in property, having fair value of Rs 2609.60 crores, which was more than the balance sheet size of TDL (Rs 2386.38 crores), the Auditors replied that these properties consisted of land & buildings, whose fair market value was more than their cost as the land was acquired over a decade ago and buildings were constructed over a period of time. Banks & financial institutions provide loans on

the basis of fair market value. While attaching copy of valuation reports, they stated that they had verified valuation report at serial no 39 of audit work paper- Ind AS and SA check list.

- 144** On verification of serial no 39 of audit work paper replied upon by the Auditor, it is seen that this is a verification done by the Auditor to verify the carrying value of the assets in the Balance Sheet i.e. Rs 799.34 crores. The Auditor had verified the capitalisation and depreciation method used in valuation of property showing Rs 799.34 crores. This in no way refers to or evaluates the Fair value of property, which is disclosed at Rs 2609.60 crores as per Ind AS 42 - "Investment Properties". The moot point is that the Auditor did not evaluate this fair value or ask for the valuation report at the time of Audit. There is no evidence in the audit work papers that the Auditors had verified & evaluated the valuation reports related to the properties. Further, the Auditors could not give any reply about evaluation of the valuation expert, valuation methodology and assumptions used in valuation report. Therefore, we find that this charge is proved.
- 145** SA 500 & SA 505: With respect to the charge relating to non-evaluation and non-verification of borrowings of Rs 3569.51 crores taken by TDL during FY 2018-19 & utilization thereof for intended purpose; outstanding borrowings of Rs 2254.45 crores on 31.03.2019 which constituted 94.47% of the total balance sheet size of Rs 2386.38 crores; existence of bank balances of Rs 10.54 crores in current accounts and Rs 176.55 crores in fixed deposits, the Auditors replied that bank confirmations were maintained in hard copy as a separate file. Regarding existence of FDs, they stated that FD confirmation is available in balance confirmations submitted along with reply and master audit working file contains details of FDs. They further contended that loans borrowed by TDL were mostly general corporate purpose borrowings or for repayment of loans of TDL/group companies or for lending to group companies. They stated that they track additional loan taken during the year & utilisation thereof and gave details of Rs 1215 crores loans taken during the year. They stated that these details were maintained in loose sheets which were compiled along with sanction letter, additional documents and attached with their reply to the SCN.
- 146** We have considered the reply. In Section C-2 of this Order, we have detailed why additional documents submitted alongwith the reply to SCN are not acceptable. Direct confirmations from banks are an important audit procedure to ensure existence of account balances, which the Auditors did not perform. Regarding purpose and utilisation of huge borrowing of Rs 3569.51 crores, the Auditors could submit details of borrowings for Rs 1215 crores only. Thus, details of the entire amount are not available in the Audit File. The Auditors have opined that the financial statements of TDL gave true and fair view of its state of affairs. Outstanding borrowings of Rs 2254.45 crores on 31.03.2019 constituted 94.47% of the total balance sheet size of Rs 2386.38 crores. Bank balances of Rs 10.54 crores and fixed deposits of Rs 176.55 crores were also material items of the financial statements. Before opining on the truthfulness and fairness of such material balances in the financial statements, the Auditors were required to obtain sufficient appropriate audit evidence about the existence of these balances, source of creation of FDs and purpose & utilization of huge borrowings, which they failed to do. Therefore, we find that the charge for violation of SA 500 & SA 505 holds.
- 147** With reference to the charge relating to SA 550, the Auditors replied that they had undertaken IFC test check for certain material areas to understand RoMM; that they had obtained

management representation; verified related party transactions; obtained balance confirmations; that all related party transactions were approved by stakeholders and these are recorded in the Audit File. According to them all related party transactions have been disclosed in the Financial Statements.

- 148 On considering the reply and examination of the Audit File, we note that there is no evidence regarding understanding related party relationships and identification of RoMM associated with related party transactions. Further, fraudulent diversion of funds to related parties & circulation of funds among related parties (as already discussed) shows gross failure of the Auditors in identification of RoMM associated with related party transactions. Therefore, we find that the charge that the Auditors violated SA 550 stands proved.
- 149 While responding to the charge relating to non-compliance with SA 700, the Auditors stated that allegations of mistreatment (sic) of financial statements are misconceived. While reiterating their submissions in respect of each alleged misstatement, the Auditors stated that there is no error in the amount reported, presentation, classification and disclosures in the Financial Statements (FS), and accordingly there was no misstatements in the FS.
- 150 We have already detailed the fraudulent diversion of funds to GVIL & MACEL, fraudulent understatement of loans to MACEL, fraudulent diversion of funds through land advances and fraudulent recognition of interest income. Definition of 'Misstatement' given in para 4(a) of SA 450 'Evaluation of misstatements identified during the audit' inter alia includes "Misstatements arisen from error or fraud". Accordingly, misstatements have been correctly pointed out in the SCN. The Financial Statements of TDL for FY 2018-19 contained material & pervasive misstatements of Rs 1471.63 crores, despite that the Auditors had falsely reported that it gave true and fair view of its state of affairs, profit and cash flow. The Auditors were grossly negligent in forming the audit opinion. Accordingly, we find that the Auditors violated SA 700.
- 151 The Auditors are also charged with non-compliance with SA 210, Agreeing the Terms of Audit Engagements. Based on their reply, we drop this charge.

#### **E. Omissions and commissions by the Audit Firm**

##### **Responsibility of the Audit Firm for the audit work done by the Engagement Team**

- 152 The Audit Firm was also charged with various omissions and commissions attributed to the Auditors in section C and D above. Para 2 of SA 220 and para 3 of SQC 1, stipulate that Quality Control Systems, Policies and Procedures are the responsibility of the Audit Firm. The Audit Firm was charged with failure to establish and maintain a system of quality control to provide it with reasonable assurance that:
- a) The firm and its personnel comply with professional standards, regulatory and legal requirements; and
  - b) The reports issued by the firm or engagement partners are appropriate in the circumstances.
- 153 Responding to the charge, the Audit Firm stated that:

- a) They have issued audit report after taking into account the provisions of the Act, Ind AS prescribed u/s 133 and Standards on Auditing u/s 143(10) of the Act. They have taken management representation letter for various aspects relating to this engagement and reported u/s 143(2) of the Act.
- b) They rely on the replies in forgoing para in respect of NFRA's observation on alleged non-compliance with accounting and auditing standards.
- c) They confirmed the "Report on other legal and regulatory requirements" of audit report in compliance to section 143(3) of the Act.
- d) Section 143(4) is not applicable as there were no negative answer or answer with a qualification.
- e) They have complied with the Auditing Standards {section 143(9) of the Act}.
- f) In compliance with section 143(12) of the Act, the Audit Firm replied that there is no fraud identified by them, hence there is no reporting requirement to the Central Government.
- g) The Firm has a Quality Control Manual in place and the same has been adhered to while conducting the audit of CDGL.
- h) Based on the facts and circumstances they had complied with the applicable Standards on Auditing, SQC 1 and ethical requirements. Accordingly, there was no act of omission and commission on their part, which will have impact on their audit opinion.

**154** Statutory Audits are performed by Engagement Team on behalf of the Audit Firm appointed as Statutory Auditor under section 139 of the Act. The Audit Reports are signed on behalf of the Audit Firm and, therefore, the Audit Firm remains responsible for all the acts of omissions and commissions by the Engagement Team as well as for violation of duties and responsibilities specifically required of the Audit Firm. M/s Sundaresha & Associates was appointed as the Statutory Auditor of TDL for FY 2018-19. We have already considered in the earlier paragraphs the point wise replies of the Audit Firm and determined that the Audit Firm and the Engagement Team have been grossly negligent in ensuring that the Audit of TDL was performed in accordance with the applicable laws and regulations; and that the Audit Report issued on behalf of the Audit Firm was not appropriate. Therefore, as per the standards and the legal provisions mentioned above, in addition to the Engagement Team, the Audit Firm is also responsible for the lapses discussed in the preceding paragraphs of this Order.

#### **F. POINTS OF LAW RAISED BY THE AUDITORS**

**155** The Auditors stated that NFRA was established in October 2018 and NFRA Rules were notified on 14.10.2018, therefore these are applicable from FY 2019-20. We note that NFRA's authority to monitor and enforce compliance with the accounting and auditing standards is with reference to such standards as were established by law even earlier and were fully binding on Statutory Auditors. Hence, no new obligation is created on the Auditors as these standards were to be mandatorily followed even prior to NFRA's establishment. The constitution of NFRA has only changed the forum to check the compliances. The Auditors have stated that the accounting and auditing standards that have been notified as on date, are not on the recommendations of NFRA and thus issuance of SCN u/s 132(4) of the Act is beyond the powers of NFRA. This contention of the Auditors is not acceptable. The NFRA's authority to monitor and enforce compliance with the accounting and auditing standards is derived from section 132 of the Act. All the Accounting



Standards and Auditing Standards have the force of law<sup>22</sup> and are required to be mandatorily complied with, from the date of their respective applicability, while conducting statutory audits.

156 The Auditors have stated that the issue of SCN is based on belief/suspicion and not on conclusive evidence. We do not agree with this. The SCN was based on facts of the matter and the documents in the Audit File submitted by the Auditors. The words 'believe/suspicious' were used in the SCN to convey a prima-facie view in the SCN, to be further probed and established with an open mind after offering an opportunity in the interest of natural justice to the Auditors to rebut the charges and provide their reply to the SCN. No conclusions were reached before analysis of the reply of the Auditors.

157 There is also no truth in the Auditors' contention that no investigation was conducted by NFRA. The SCN was issued after duly examining the material contained in the Audit File and other materials on record in accordance with Rule 11 of the NFRA rules 2018 and the conclusion reached in this Order are based on due consideration of the Auditors' replies on each point of charge in the SCN.

#### **G. ARTICLES OF CHARGES OF PROFESSIONAL MISCONDUCT BY THE AUDITORS**

158 As discussed in the foregoing paragraphs, the Auditors have made a series of serious departures from the Standards and the Law, in their conduct of the audit of TDL for FY 2018-19. Based on above discussion, it is proved that the Auditors had issued unmodified opinion on the Financial Statements without any basis. The poor quality of Audit, tampering of the Audit File, the cover up in terms of submission of additional documents that did not exist in the Audit File, incomplete documentation and attempt to mislead through false and evasive replies further compound the professional misconduct on the part of the Auditors. Based on the foregoing discussion and analysis, we conclude that the Auditors have committed Professional Misconduct as defined under Section 132 (4) of the Companies Act 2013 in terms of section 22 of the Chartered Accountants Act 1949 (CA Act) as amended from time to time, and as detailed below:

i. The Auditors committed professional misconduct as defined by clause 5 of Part I of the Second Schedule of the CA Act, which states that an auditor is guilty of professional misconduct when he *"fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary in making such financial statement where he is concerned with that financial statement in a professional capacity"*.

This charge is proved as the Auditors failed to disclose in their report the material non-compliances by the Company as explained in Section - C-4 to C-8 and Section - D (a) above.

ii. The Auditors committed professional misconduct as defined by clause 6 of Part I of the Second Schedule of the CA Act, which states that an EP is guilty of professional misconduct when he *"fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity"*.

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<sup>22</sup> Section 143(9) of the Act provides that every auditor shall comply with the auditing standard. Further proviso to section 143(10) of the Act provides that until any auditing standards are notified, any standard or standards of auditing specified by the Institute of Chartered Accountants of India shall be deemed to be the auditing standards.

This charge is proved as the Auditors failed to disclose in the audit report the material misstatements made by the Company as explained in Section - C-4 to C-8 and Section - D (a) above.

- iii. The Auditors committed professional misconduct as defined by clause 7 of Part I of the Second Schedule of the CA Act, which states that an EP is guilty of professional misconduct when he *“does not exercise due diligence or is grossly negligent in the conduct of his professional duties”*.

This charge is proved as the EP failed to conduct the audit in accordance with the SAs and applicable regulations, failed to report the material misstatements in the financial statements arising from diversion of funds & circulation of funds and failed to report non-compliances made by the Company, as explained in Section – C and D above.

- iv. The Auditors committed professional misconduct as defined by clause 8 of Part I of the Second Schedule of the CA Act, which states that an EP is guilty of professional misconduct when he *“fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion”*.

This charge is proved as the Auditors failed to conduct the audit in accordance with the SAs and applicable regulations as well as due to his total failure to report the material misstatements and non-compliances made by the Company in the financial statements, as explained in the Section – C-3 to C-8 and Section - D above.

- v. The Auditors committed professional misconduct as defined by clause 9 of Part I of the Second Schedule of the CA Act, which states that an EP is guilty of professional misconduct when he *“fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances”*.

This charge is proved since the Auditors failed to conduct the audit in accordance with the SAs as explained in the Section C and D above.

**159** Therefore, we conclude that all the charges of professional misconduct in the SCN (except charges relating to noncompliance with SA 210, which has been dropped) stand proved based on examination of the evidence in the Audit File, the Audit Report dated 20.05.2019 issued by the EP on behalf of the Firm, the submissions made by the Auditors and the Financial Statements of TDL for the FY 2018-19.

**160** It will be useful to look at how Audit regulators in other countries have dealt with similar violations that we have observed in this case particularly with regard to diversion of funds through round tripping among Related Parties, absence of internal financial control, lack of independence, failure to provide impairment of loans and failure to write off non-recoverable loans etc.

**161** The PCAOB<sup>23</sup> in matters of diversion of funds to related parties on the pretext of purchase of material, observed that *“The transactions—between one of the Issuer’s wholly-owned Chinese subsidiaries (“Subsidiary”) and a Chinese purchasing agent (“Agent”)—involved the Subsidiary’s transfers of loan proceeds to the Agent as prepayments to buy equipment and*

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<sup>23</sup> PCAOB Release No. 105-2020-012 and PCAOB Release No. 105-2020-013 both dated 24.09.2020.

*materials that the Agent never delivered. The loans were obtained from Chinese lenders for the purpose of making these purchases. While the Agent returned a portion of the prepayments—some in unusual same-day, round-trip transfers—it did not return most of them”.... “By failing to adequately respond to the known fraud risks, Marcum’s engagement team breached its duty to perform the Audits with the due professional care and professional skepticism required by PCAOB standards. The team also failed to adequately understand the business rationale (or the lack thereof) for the significant unusual transactions and failed to obtain sufficient appropriate audit evidence to support Marcum’s opinion on the Issuer’s financial statements”.* For this misconduct, PCAOB censured Audit firm Marcum LLP (“Marcum”); imposed a civil money penalty of \$250,000 on Marcum; prohibiting Marcum from audit works for a period of three years. PCAOB also imposed a penalty of \$25,000 on the Engagement partner John E. Klenner besides barring him from being an associated person of a registered public accounting firm.

- 162** Similarly, failures to perform audit procedures and exercise professional skepticism in related party transactions and internal control over financial reporting have invited serious action by audit regulators in other jurisdictions too. For example, in case of Cheryl L. Gore, CPA and Stanley R. Langston, CPA, PCAOB<sup>24</sup> had observed that *“Gore failed to obtain sufficient appropriate audit evidence and to perform sufficient procedures concerning whether Issuer A’s financial statements accurately disclosed its related party transactions”..... “Gore failed to exercise due professional care, including professional skepticism, and failed to obtain sufficient appropriate audit evidence in connection with Issuer A’s identification, accounting, and disclosure of related party relationships and transactions... .. Specifically, as part of her risk assessment procedures, she was required to obtain an understanding of the design and implementation of Issuer A’s internal control over financial reporting (“ICFR”) in connection with related parties, to evaluate the design of those controls that were relevant to the audit, and to determine whether those controls had been implemented. Gore failed to perform any of these procedures during the 2016 Audit”*”. This case resulted in debarment and imposition of monetary penalty on the auditors.
- 163** In a matter relating to impairment allowance for loans in the case of Grant Thornton LLP, PCAOB<sup>25</sup> had observed that *“Grant Thornton, among other things, failed to exercise due professional care, including appropriate professional skepticism, and failed to obtain sufficient appropriate audit evidence concerning the reported value of Bancorp’s net loans, the effectiveness of Bancorp’s controls relating to its allowance for loan ... .. a known significant risk and significant accounting estimate. As a result of its failures to perform the audit in conformity with PCAOB standards, Grant Thornton failed to obtain sufficient appropriate audit evidence to support its audit opinions on Bancorp’s financial statements and ICFR”.* For misconducts including this one, PCAOB censured Grant Thornton LLP (“Grant Thornton”), imposed on Grant Thornton a civil money penalty in the amount of \$1,500,000; and required Grant Thornton to undertake certain remedial actions.
- 164** In cases relating to independence of auditors, PCAOB<sup>26</sup> has penalized audit firms and their partners. In Marcum Bernstein & Pinchuk LLP case, PCAOB observed *“an accountant is not*

<sup>24</sup> PCAOB Release No. 105-2021-020 dated 14.12.2021.

<sup>25</sup> PCAOB Release No. 105-2017-054 dated 19.12.2017.

<sup>26</sup> PCAOB Release No. 105-2016-016 dated 18.05.2016 and PCAOB Release No. 105-2019-022, PCAOB Release No. 105-2019-023 both dated 10.09.2019.

*independent of an audit client if, at any point during the audit and professional engagement period, the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement."..... ".....MarcumBP failed to implement, effectively apply, and appropriately monitor quality control policies and procedures sufficient to provide reasonable assurance concerning the Firm's independence". In this case, PCAOB censured audit firm, imposed monetary penalty and required audit firm to undertake a review of its policies, procedures, staffing, and training with respect to auditor independence.*

- 165** Similarly, in AWC (CPA) Limited, WONG Chi Wai, CPA, and WONG Fei Cheung, CPA, PCAOB observed *"As the engagement partner, Albert Wong was responsible for AWC's compliance with independence requirements. Although Albert Wong knew at the time of the Kandi 2012 Audit that Mui had accepted a Power-of-Attorney from Kandi in order to handle the New York State agency matter, he failed to evaluate whether Mui's activities on Kandi's behalf constituted prohibited non-audit services that would impair Mui's independence, as well as AWC's and its associated persons. Albert Wong took, or omitted to take, actions during the Kandi 2012 Audit, that he knew, or was reckless in not knowing, would directly and substantially contribute to the Firm's violation of independence requirements, in contravention of PCAOB Rule 350"*. For misconducts including independence violations, PCAOB censured audit firm & partner, revoked the audit firm's registration & barred partner from being an associated person of a registered public accounting firm, and imposed a civil money penalty on the audit firm and the partner.
- 166** In a case relating to fraud in revenue recognition, in the Matter of Scott J. Reams, CPA, Brandon R. Keyes, CPA, and James C. Budge, CPA, PCAOB<sup>27</sup> has observed that *"The Engagement Partners also failed to gather sufficient appropriate audit evidence to evaluate commission revenue that Freedom recognized on the Belize Affiliate trade orders"----- "The Belize Affiliate paid certain fixed monthly fees to Freedom. There was a risk of material misstatement that the Belize Affiliate could make payments to Freedom for no purpose other than to create fictitious fee income for Freedom. The Engagement Partners, however, failed to obtain sufficient appropriate audit evidence concerning the nature of these fees and whether they had a legitimate business purpose. Further, the Engagement Partners failed to obtain and evaluate documentation supporting the business purpose, if any, of these fixed monthly fees"*. In this case PCAOB has imposed monetary penalties on engagement partner and two other partners of the Audit Firm besides barring them from being an associated person of a registered public accounting firm.

## **H. PENALTY & SANCTIONS**

- 167** Section 132(4) of the Companies Act, 2013 provides for penalties in a case where professional misconduct is proved. The seriousness with which proved cases of professional misconduct are viewed is evident from the fact that a minimum punishment is laid down by the law.

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<sup>27</sup> PCAOB Release No. 105-2022-038 dated 20.12.2022.

- 168 Independent Auditors of Public Limited Companies<sup>28</sup> serve a critical public function of enabling the users of Audited Financial Statements to take informed economic decisions. Quality audits bolster stakeholder's confidence in the credibility of financial reporting.
- 169 But stakeholder's confidence is not automatic. Trust must be earned, and it must be preserved. Auditors' Integrity and Diligence are of utmost importance to preserve the trust of users in Auditing Profession, which plays an important role in the economic development of India.
- 170 In the instant case, the Auditors, chose to preserve their professional relationship with the promoters of the auditee company, instead of discharging their statutory duty to protect public interest by exercising professional skepticism and questioning the promoters' dubious activities and transactions leading to diversion of shareholders and stakeholders' money on a large scale. Had they performed the required audit procedures with due professional skepticism, many of the dubious transactions would have been perhaps detected. But by failing to do so, they foreclosed this possibility causing immense harm to shareholders and stakeholders.
- 171 Further, when NFRA called for the Audit File for examination, the Auditors tampered with the Audit File. This is extremely serious because it obstructs the NFRA's ability to protect public interest. This case underlines the need for all Auditors regardless of seniority to be aware of their individual responsibility to act honestly and with integrity in all areas of their work.
- 172 The Auditors were required to ensure compliance with Standards on Auditing, Laws and Regulations to achieve the necessary audit quality and lend credibility to Financial Statements to facilitate their users. As detailed in this Order, substantial deficiencies in Audit, abdication of responsibility and inappropriate conclusions on the part of the Auditors establish their professional misconduct and lack of due diligence. Despite being qualified professionals, the Auditors have not adhered to the Standards and have thus not discharged the duty cast upon them.
- 173 Section 132(4)(c) of the Companies Act 2013 provides that National Financial Reporting Authority shall, where professional or other misconduct is proved, have the power to make order for—
- (A) imposing penalty of— (I) not less than one lakh rupees, but which may extend to five times of the fees received, in case of individuals; and (II) not less than ten lakh rupees, but which may extend to ten times of the fees received, in case of firms;
- (B) debarring the member or the firm from—(I) being appointed as an auditor or internal auditor or undertaking any audit in respect of financial statements or internal audit of the functions and activities of any company or body corporate; or (II) performing any valuation as provided under section 247, for a minimum period of six months or such higher period not exceeding ten years as may be determined by the National Financial Reporting Authority.

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<sup>28</sup> As defined in Rule 3 of NFRA Rules 2018

- 174 As per information furnished by M/s Sundaresha & Associates vide letter dated 10.09.2022 and Income & Expenditure account of the Firm, the statutory audit fees of TDL for 2018-19 was Rs [REDACTED], total professional fees received by M/s Sundaresha & Associates was Rs [REDACTED] and total professional fees received by CA C. Ramesh was Rs [REDACTED]
- 175 Considering the proved professional misconduct and keeping in mind the nature of violations, principles of proportionality and deterrence against future professional misconduct, we, in exercise of powers under Section 132(4)(c) of the Companies Act, 2013, hereby order:
- (i) Imposition of a monetary penalty of Rs One crore upon M/s Sundaresha & Associates. In addition, M/s Sundaresha & Associates is debarred for a period of two years 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.
- (ii) Imposition of a monetary penalty of Rs Five Lakhs upon CA C. Ramesh. In addition, CA C. Ramesh is debarred for a period of five years 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.
- 176 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: 26.04.2023  
Place: New Delhi

  
(Vidhu Sood)  
Secretary

To,

- (1) M/s Sundaresha & Associates,  
Chartered Accountants,  
Firm No: 008012S,  
E-mail: enquiry@casunassociates.com  
No.27/7,1st Floor, Professional Court,  
15<sup>th</sup> Cross, 3rd Block, Jayanagar,  
Bengaluru - 560 011 (Karnataka)

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

- (2) CA C. Ramesh,  
ICAI Membership no- 022268  
E-mail: cuddapahramesh@gmail.com  
No. 23 Anand II<sup>nd</sup> Floor,  
Hare Krishna Road, High Grounds,  
Bengaluru - 560 001 (Karnataka)

Copy To: -

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