

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

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

Order No. - 005/2024

Date: 22.02.2024

ORDER

In the matter of CA Ratan Laxminarayan Rathi, ICAI Membership No. 014739 under Section 132(4) of the Companies Act 2013 read with Rule 11(6) of National Financial Reporting Authority 2018

1. This Order disposes of the Show Cause Notice ('SCN' hereafter) no. NF-23/18/2022 dated 04.07.2023, issued to CA Ratan Laxminarayan Rathi, proprietor of M/s R.L. Rathi & Co. (ICAI Firm registration no. 108719W), Pune, Maharashtra, who is a member of the Institute of Chartered Accountants of India ('ICAI' hereafter) and was the Engagement Partner ('EP' hereafter) for the statutory audit of **Bilcare Limited**, Maharashtra ('Bilcare' or 'the company' hereafter) for the Financial Years ('FY' hereafter) 2014-15, 2015-16 and 2016-17.
2. This Order is divided into the following sections:
 - A. Executive Summary
 - B. Introduction & Background
 - C. Lapses in the conduct of audit
 - D. Article of Charges of Professional Misconduct by the EP
 - E. Penalty & Sanctions

A. EXECUTIVE SUMMARY

3. The National Financial Reporting Authority ('NFRA' hereafter) initiated action under section 132 (4) of Companies Act 2013 ('Act' hereafter) against CA Ratan Laxminarayan Rathi, the Engagement Partner, for professional or other misconduct in the statutory audit of Bilcare Limited for the FYs 2014-15, 2015-16 and 2016-17. This was following to the information received from Securities Exchange Board of India ('SEBI' hereafter), that the Financial Statements ('FS' hereafter) of Bilcare for the FYs 2014-15, 2015-16 and 2016-17, did not present a true and fair view as the company did not recognise the full interest cost on its Borrowings from banks, which were classified as Non-Performing Assets ('NPA' hereafter) by those banks.

As Bilcare was listed on Bombay Stock Exchange ('BSE' hereafter) and therefore falls under NFRA domain¹.
4. As is set out in this Order, the EP failed to meet relevant requirements of the Standards on Auditing ('SA' hereafter) in several significant respects, was grossly negligent and failed to apply professional skepticism and due diligence in the audit.
5. The Financial Statements of Bilcare were materially misstated due to partial recognition of interest cost on Borrowings classified as NPAs by the Banks in the FYs 2014-15 and 2015-16

¹ Vide Rule 3(1)(a) of National Financial Reporting Authority Rules, 2018.

and non-recognition of interest cost in the FY 2016-17, resulting in under-statement of losses ranging from ₹ 56.5 crores to ₹ 114.32 crores which were approximately 30% to 173% of the reported losses.

The EP instead of issuing modified opinion, issued unmodified opinion for the FYs 2014-15 to 2016-17, and referred the matter in an Emphasis of Matter ('EoM' hereafter) paragraph in the Auditor's report for the FY 2016-17, which is in contravention of SA 706².

6. The EP also failed to obtain sufficient appropriate audit evidence to verify the revenue, which is an item fraught with risk of fraud. In addition, the EP did not carry out proper audit of Related Party Transactions ('RPTs' hereafter) of Bilcare including loans & advances which were as high as 106.87% of the revenue. Moreover, with respect to granting of loans & advances to the related parties, the EP issued a false Companies (Auditor's Report) Order ('CARO' hereafter) report.
7. The Standards require the EP to determine appointment of Engagement Quality Control Reviewer ('EQCR' hereafter), but the EP failed to do the same.
8. Based on our investigation and proceedings under section 132 (4) of the Companies Act and after giving him opportunity to present his case, we find the EP guilty of professional misconduct and impose through this Order a monetary penalty of ₹ 3,00,000/- (Rupees Three Lakhs only). In addition, the EP is debarred for 2 years (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. This Order will take effect after 30 days from its issue.

B. INTRODUCTION & BACKGROUND

9. The NFRA is a statutory authority set up u/s 132 of the Companies Act 2013 to monitor 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 is empowered u/s 132 (4) of the Act to investigate prescribed classes of companies and impose penalty for professional or other misconduct of the individual members or firms of chartered accountants.
10. The statutory auditors, both individuals and firms of Chartered Accountants, are appointed by the members of company u/s 139 of the Act. The statutory auditors, including the Engagement Partners and the Engagement Team that conduct the audit, are bound by the duties and responsibilities prescribed in the Act, the rules made thereunder, the Standards on Auditing, including the Standards on Quality Control and the Code of Ethics, the violation of which constitutes professional misconduct, and is punishable with penalty prescribed u/s 132 (4) (c) of the Act.
11. NFRA took up investigation under section 132(4) of the Act after receipt of a letter dated 16.06.2022 from SEBI about understatement of losses by Bilcare due to non-recognition of interest cost on loans classified as NPA.
12. Vide NFRA letter dated 27.07.2022, the Audit Files and other Documents for the FYs 2014-15 to 2016-17 were called from the EP, who submitted the same for the FYs 2015-16 and 2016-17 on 14.09.2022, and stated that the audit files for FY 2014-15 were not available as more than seven years had lapsed since the conclude of the audit. As disclosed by the Company under Significant Accounting Policies of the financial statements in its annual report of the FYs 2014-

² SA 706 'Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report'

15 and 2015-16, it prepared the FS in accordance with the Indian Generally Accepted Accounting Principles ('IGAAP' hereafter)³ and for the FY 2016-17, it prepared the FS in accordance with Indian Accounting Standards ('Ind AS' hereafter)⁴ as notified by Ministry of Corporate Affairs. On examination of the Audit Files and other documents, it was observed that the audit had *prima facie* been conducted in disregard of most of the SAs and relevant requirements of the Act. Despite this, the EP had issued an unmodified audit opinion in his Independent Auditor's Report.

13. On being satisfied that a sufficient cause existed to take action under sub-section (4) of section 132 of the Act, an SCN was issued to the EP on 04.07.2023, asking him to show cause why action should not be taken for Professional Misconduct in the Statutory Audit of Bilcare for the FYs 2014-15 to 2016-17. The EP was charged with professional misconduct of:
 - a) failure 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;
 - b) failure to report a material misstatement known to him to appear in a financial statement with which the EP is 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.
14. The reply to the SCN was submitted by the EP on 04.08.2023. The EP also availed the opportunity of a personal hearing on 08.12.2023. During the personal hearing, the EP stated that he had submitted the complete replies and nothing had to be added. However, he requested to take a lenient view considering his age, illness and retirement from the profession. He further requested to compound the offence, if proven.
15. We have perused all the material on record including the written responses of the EP in response to the charges levelled against him. Our findings are discussed in the following paragraphs.

C. Lapses in the conduct of audit

Non-recognition of interest cost on Bank Borrowings classified as NPAs

16. The EP was charged with failure to evaluate the appropriateness of accounting policy adopted by the company for not recognising full interest cost on borrowings classified as NPA by the Banks. The company recognised interest cost on such borrowings at an average rate of 10%, whereas original interest rates as per disclosures in the financial statements were ranging from 10.75% to 18%. The difference in interest cost (0.75% - 8%) was disclosed as contingent liabilities during the FYs 2014-15 and 2015-16. During FY 2016-17, the interest cost on the borrowings classified as NPA, amounting ₹ 114.32 crores, as documented by the EP, was neither considered as a liability, nor disclosed as contingent liability. Due to this, the losses were understated during the

³ Applicable financial reporting framework was the 'Accounting Standards (AS)' prescribed by Ministry of Corporate Affairs under Companies (Accounting Standards) Rules 2006 (as amended thereafter).

⁴ Applicable financial reporting framework was the 'Indian Accounting Standards (Ind AS)' prescribed by Ministry of Corporate Affairs under Companies (Indian Accounting Standards) Rules 2015 (as amended thereafter).

FY 2014-15 to 2015-16, by ₹ 56.5 crore to ₹ 114.32 crore, ranging from 30.76% to 173.4% of the reported loss. Following table depicts the picture based on the details, the company disclosed in the notes to accounts of the FS for the FYs 2014-15 to 2016-17:

Particulars / FY	₹ in Crores except %)		
	2014-15	2015-16*	2016-17*
Total long-term borrowings ⁵	949.23	842.08	714.42
Default in repayment of borrowings ⁵	877.31	490.18	380.22
Recognised interest cost	103.18	53.07	41.23 [#]
Interest cost disclosed as contingent liability (A)	56.5	62.46	-
Non-recognised / non-disclosed interest cost ⁶ (B)	-	-	114.32
C=A+B	56.5	62.46	114.32
Reported Loss after Tax (D)**	(183.68)	(147.87)	(65.93)
Sum of non-recognised interest cost and interest cost disclosed as contingent liability, as % of Reported Loss (E=C/D in %)	30.76%	42.24%	173.40%
Reported Loss if the interest cost was fully recognised	(240.18)	(210.33)	(180.25)

*Some of the loans were restructured in 2015-16 and 2016-17 along with significant haircut and waiver of interest

**Figures as obtained from the Annual reports, and it may be different with the figures conveyed by SEBI.

[#]This amount does not include the interest cost on the borrowings classified as NPA.

17. The EP replied that the banks had stopped charging interest on NPA accounts due to RBI norms and discussions for restructuring of NPA accounts were positive and there were indications that part of the interest component could be waived. Accordingly, the management decided to consider average rate of 10% (then Banking Lending Rate) for recognising interest cost to reflect true & fair view. Therefore, this accounting policy was sufficient compliance of AS 1 read with AS 29. The EP quoted various clauses of AS 1, 4, 5, 29 and Framework 2000, to establish that the management can deviate from the Fundamental Accounting Policies and can make its own accounting policies, provisions and estimates of the liabilities by disclosing it in the FS to reflect true and fair view. The EP added that, in the extant case, there was no present obligation on the company, as the company was under discussions with the banks regarding waiver of liability and decided to recognise the interest cost @ 10% against the legally agreed interest rates of 10.75% to 18% with the Banks, while the balance interest cost was disclosed as contingent liability. The EP also referred to a Management Representation letter in this regard.

The EP further emphasized that Board of Directors was responsible for preparing the FS by using estimates and its best judgement to provide for the liability on account of interest on NPA accounts as explained above. After negotiations with the Banks, the company was able to restructure / settle some of the borrowings in the FY 2015-16 with substantial haircuts in principal amounts and complete waiver of interest cost thereon. Accordingly, the company was complying with the applicable accounting policies.

For FY 2016-17, the EP stated that the management was confident of getting waiver of interest cost and principal amounts, therefore they did not provide for any interest cost on the borrowings classified as NPA and disclosed this fact in the FS. In addition to the same, he reported this matter through EoM. The EP also added that there was no reason for him to doubt the honesty and fair judgements of the management about the outcome of negotiations, and that subsequently on

⁵ As per Annexure A to Note no. 5 and Annexure A to Note no. 13(a) of the FS of the FY 2014-15, 2015-16 and 2016-17.

⁶ As per page no. 19 of work paper FY1617_F008 and EoM para in the Auditor's Report of the FY 2016-17.

31.03.2023, the company had paid all the bank loans/ FD holders etc. in cash and sold the entire undertaking as a going concern.

Therefore, the EP stated that there was no misstatement in the FS in the FYs 2015-16 and 2016-17, as the management had used due diligence and fair estimates for not recognising interest cost in the FS.

18. We observe that interest cost on the borrowings classified as NPA should be treated as liability and not as contingent liability, and recognized on accrual basis unless settled / extinguished, as per the following provisions of AS Framework applicable for FY 2014-15 and FY 2015-16 and Ind AS Framework applicable for the FY 2016-17: -

In the AS Framework, interest cost is to be dealt with the following provisions –

- a) 'Accrual' is one of the fundamental accounting assumptions which needs to be followed. As per Para 10 (c) of AS 1 '*Disclosure of Accounting Policies*', Costs are to be recognised when incurred, not as money is paid and it should be recorded in the FS of the periods to which they relate to. Para 5 of AS 5 states that all items of expense which are recognised in a period should be included in the determination of net profit or loss for the period.
- b) AS 29 '*Provisions, Contingent Liabilities and Contingent Assets*' stipulates that liability is a present obligation arising from past events, and the settlement of which results in outflow of resources (Para 10.2). Further, as per Para 61 of Framework for the preparation and presentation of Financial Statements, 2000 (Framework, 2000), present obligation may be settled in a number of ways, for example, by:
 - a) payment of cash;
 - b) transfer of other assets;
 - c) provision of services;
 - d) replacement of that obligation with another obligation; or
 - e) conversion of the obligation to equity.An obligation may also be extinguished by other means, such as a creditor waiving or forfeiting its rights."
- c) As per Para 10.4 (b) of AS 29, *A contingent liability is a present obligation that arises from past events but is not recognised because:*
 - i. *It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or*
 - ii. *A reliable estimate of the amount of the obligation cannot be made.*

In the Ind AS framework, interest cost is to be dealt with the following provisions –

Ind AS 109 '*Financial Instruments*', which *inter alia* deals with the recognition and measurement of financial liabilities such as Bank Borrowings, states that an entity shall remove a financial liability (or a part of a financial liability) from its balance sheet only when it is extinguished, i.e. when the obligation specified in the contract is discharged or cancelled or expired (Para 3.3.1). Para 4.2.1 and 5.3.1 require an entity to recognise, initially and subsequently, all financial liabilities at amortised cost with certain exceptions.

19. **In the Ind AS framework, removal and/or replacement of financial liability as the outcome of restructuring of loans is to be dealt with as follows:**

In the case of restructuring of loans, an existing financial liability could only be extinguished and new financial liability recognised, if there were 'significant modifications' in the terms of the existing loan agreements (para 3.3.2 of Ind AS 109).

'Substantial modification' of the terms has defined in Para B3.3.6 of appendix B of Ind AS 109 as, "*the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability....*".

20. Partial recognition / non-recognition of interest cost is in contravention of the provisions of AS / Ind AS framework as explained above. Therefore, the company had to recognise the liability of full interest cost on the borrowings, even though classified as NPA by the lenders, until the borrower company is legally released from its contractual liability by the lenders. The contention of the EP that the banks had stopped charging the interest on NPA accounts due to RBI norms is not acceptable, as the prudential norms of RBI restrict the banks to recognise the interest income on the borrowings classified as NPA until they receive any amount on such borrowings. However, such norms also require the banks to maintain a Memorandum Record of Accrued Interest on the NPAs, which clearly reflects that the banks do not legally release the borrowers from their contractual liability to pay interest on their borrowings. It should also be mentioned that the banks depict their loans as asset, while for the borrowers, these amounts are liabilities. The applicable accounting provisions are meant to ensure that the assets are not overstated and liabilities are not understated. Using such arguments not only shows the ignorance of the EP but also a wishful thinking which is un-becoming of a professional.
21. The contention of the EP regarding availability of room for deviation for the management in adoption of accounting policies is not acceptable, as such deviation can only be done within the provisions of the Framework. The contention of the EP that as per the management representation, it was in negotiation with the lending banks for restructuring of the loans, and therefore could not measure the liability, is not acceptable, as the company was required to measure the full liability until new terms of loans had been formally agreed with. We do not find any working of the EP regarding accounting of new liabilities in replacement of the restructured borrowings, in accordance with para 3.3.2 of Ind AS 109 in the financial year 2016-17 and as of Ind AS Transition Date of 1st April 2015. We note that the EP was aware of the material amount of ₹ 114.32 crores of unrecognised financial liability on account of interest cost on the borrowings classified as NPA for FY 2016-17. Therefore, the EP was required to challenge the management about non-compliance with applicable financial reporting framework. The reporting of the matter as EoM by the EP was not in compliance with SA 705 and 706. Therefore, we hold the EP responsible for his failure to report such material misstatement known to him and appearing in the financial statement with which he was concerned in a professional capacity. We also hold him responsible for his failure to consider modifying his report in view of such material misstatements, as elaborated in para 34 to 39 of this Order.
22. Non-evaluation of accounting policy and accounting treatment has been viewed seriously by International Regulators as well. For example, the Public Company Accounting Oversight Board

(‘PCAOB’ hereafter), the US Regulator⁷, in the matter of BMKR LLP (Firm) and CPA Joseph Mortimer (Respondent), revoked the registration of the Firm for two years; imposed monetary penalty of \$ 30,000 collectively on the firm and the respondent; and barred the member from being associated with a registered public accounting firm for their failure *inter alia* to properly evaluate the accounting for certain significant transactions of the company not being in conformity with US GAAP.

Perfunctory Audit of Revenue

23. The EP was charged with failure in obtaining sufficient appropriate audit evidence for the verification of revenue and non-compliance with the provisions of SAs 200, 240 and 315. The company had revenue to the tune of ₹ 255 crores to ₹ 331 crores. SA 200 required the EP to plan and perform the audit with professional skepticism (para 15). SA 315 required the EP to understand the entity, its environment, internal control, and to identify and assess the risk of material misstatement at the assertion level and to evaluate the appropriateness of the accounting policy being followed by the company (para 11, 12 and 25). SA 240 required the EP to presume the fraud risk in revenue recognition and to perform necessary audit procedures to mitigate such risk (para 25 and 26). According to the SCN, there was no audit documentation in support of the EP’s performance of these procedures.
24. The EP replied that he was in compliance with the SA 200, 240 and 315, and stated that the auditor cannot be expected to disregard past experience of honesty and integrity of the management. Considering the smallness of the entity and being the auditor for the past 29 years, he argued that para 11, 12 & 25 of SA 315; and para 25 & 26 of SA 240 were not applicable. He also took the support of paras A144 to A146 of SA 315, as below:

"A144. For entities that have uncomplicated businesses and processes relevant to financial reporting, the documentation may be simple in form and relatively brief. It is not necessary to document the entirety of the auditor's understanding of the entity and matters related to it.

A145. The extent of documentation may also reflect the experience and capabilities of the members of the audit engagement team.

A146. For recurring audits, certain documentation may be carried forward, updated as necessary to reflect changes in the entity's business or processes."

The EP also submitted that in addition to the statutory audit, other audits were also conducted by the different auditors viz. Internal Audit, Cost Audit, Secretarial Audit and periodical audits by the department of Sales tax, Excise and VAT etc., and during the same, he did not observe any suppressions of information, fraud, leakage of revenue, mismanagement, material misstatement or otherwise in the financial statements. The company always maintained sufficient internal controls to block the areas of fraud. Such experience and the honesty of management could not be documented.

The EP also replied that Bilcare being a listed company, quarterly/half-yearly financial statements were duly published after limited review by him; the EP also witnessed steady growth of the company; the company had only two representations from the promoter group and rest all were independent directors; the company was using SAP software for accounting; most of the trade receivables were being realised between 45 to 90 days depending on the terms of contract

⁷ PCAOB Release No. 105-2022-003

etc.; and performed cut-off procedures for verification of revenue as stated in the checklist on sales.

25. We observe that to verify revenue, the auditors are required to perform and document, at least the below mentioned audit procedures in line with the requirements of SAs 200, 240 and 315:
- Understanding of business entity & relevant industry,
 - Understanding of business environment of the company,
 - Understanding of Internal controls governing the generation of revenue,
 - Evaluation of accounting policy being followed by the company in line with the applicable accounting framework,
 - Verification of sales through the customers contracts, credit terms and reconciliation of the same through the cash flow to the bank accounts and through statutory returns,
 - Verification of the periodic revenue figures like daily, monthly, quarterly, half-yearly etc.,
 - Assessment of periodical Cash Flow Statements prepared by the management,
 - Identification of debtors and assessment of time period for realisation of cash from the debtors,
 - Analytical and Cut-off procedures to be performed for verification of revenue,
 - Assessment of Management's performance vis-à-vis the company's expectations, as could be available in the Budgets.
26. We note that despite the above-mentioned mandatory requirements of the SAs, there was no audit documentation of working of the EP on revenue verification, except some documentation on the planning of audit procedures and a checklist in Yes / No format, which does not establish obtaining of sufficient appropriate audit evidence by the EP. The contention of the EP that Bilcare was a small entity and he was its statutory auditor for the past 29 years, and his argument for the need to document the understanding of the entity in relatively brief and simple form in case of Bilcare is not acceptable, as we do not find any audit documentation in this regard. We also note that para A144 of SA 315 referred to by the EP, also requires that the documentation should include the key elements of the understanding obtained by the auditor, including those on which the auditor based the assessment of risk of material misstatement. Such documentation was not done by the EP. The EP's long association with the company and his experience of honesty and integrity of the management cannot relieve him of the duty of exercising professional skepticism, as Para A22 of SA 200 states that *nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism or allow the auditor to be satisfied with less-than persuasive audit evidence when obtaining reasonable assurance*. It is also noted that para 18 and 19 of SA 200 requires the auditor to comply with all the relevant SAs and understand the entire text of SAs including application and other explanatory material. It is evident, therefore, that the EP failed to perform audit in accordance with SAs in so far as audit of revenue is concerned.
27. Non-evaluation of revenue has been viewed seriously by International Regulators as well. For example, the PCAOB, the US Regulator⁸, censured the respondents in the Matter of Thomas

⁸ PCAOB Release No. 105-2019-019

Kober, CPA, for his failure *inter alia* to obtain sufficient appropriate audit evidence about whether the revenue was properly valued and recorded in the proper period.

Non-evaluation of Related Parties Transactions

A. False reporting under CARO

28. The EP was charged with false reporting in clause 3 of CARO, 2015 and 2016 in report of loans and advances granted to related parties. The EP had reported that “...the Company has not granted any loans, secured or unsecured to companies, firms or other parties covered in the register maintained under section 189 of the Companies Act...”, even though, the company had granted the loans, as in the given table below, and the same was also documented⁹ by the EP in the Audit File.

(₹ in Crores except %)

FY	Type of Related Party Transactions							
	Purchases	Sales	Sundry Expense & Income*	Fixed Assets**	Finance (loans & advances)***	Total	Revenue	% of Revenue
2014-15	5.48	16.27	2.69	2.76	239.89	267.09	331.33	80.61%
2015-16	28.86	15.57	9.75	2.76	216.63	273.57	255.98	106.87%
2016-17	2.97	26.27	0.85	2.76	-	32.85	309.66	10.61%

* It reflects sum of sundry expense and income amounts recognised through transactions with related parties.

** It reflects purchase of land for Mr. Mohan H. Bhandari (CMD, Bilcare Limited)

*** It reflects sum of loans & advance amounts to/from through related parties.

The EP did not furnish any reply on this charge and therefore the charge in the SCN is deemed proved.

B. Failure in performing of required audit procedures

29. The EP was charged for his failure to perform necessary audit procedures to verify the related party transactions. As part of the audit procedures, the EP was required to confirm whether the approval for related party transactions had been accorded by the Audit Committee / Board of directors / Shareholders as per sections 177, 185, 186 and 188 of the Act and whether these transactions were in the ordinary course of business and on arm's length basis, which the EP failed to do.
30. The EP, in his reply, has referred to the net (and not the gross) amount of transactions with the related parties and stated that being approx. 7% of revenue, it was not material. The EP further added that since the Approvals and Resolutions of the audit committee were not shared with the EP, but it was duly verified; that there was also no adverse remark in the Secretarial Audit Report and the board of the directors had given a declaration in the annual report that RPTs were in the ordinary course of business and at arm's length basis, therefore not against the interest of the company.
31. SA 550 deals with auditor's responsibilities in respect of related parties. There are specific accounting and disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and actual or potential effects

⁹ Refer to page no. 8 & 9 of workpaper FY1516_F005

on the FS (Para 3). The auditors have the responsibility to perform audit procedures to understand, identify, assess and respond to the risks of material misstatement arising from the entity's related party relationships and transactions, as fraud may easily be committed through related parties (Para 5). There is emphasis on the susceptibility to fraud risk requiring documentation of discussion among the Engagement Team addressing such risk (Para 12) and requirement of enquiry with the management regarding the identification of related parties, including changes from the prior period; nature of the relationships between the entity and these related parties; the type and purpose of the transactions with these related parties during the period (Para 13). The auditor is also required to obtain sufficient appropriate audit evidence to verify that related party transactions are on an arm's length basis, where the management has made an assertion in the FS to the effect that RPTs are conducted on terms equivalent to those prevailing in an arm's length transaction (Para 24) and obtain management representation letter regarding identification of related parties and RPTs and that management have appropriately accounted for and disclosed the RPT in the financial statements as per applicable framework (Para 26).

32. We note that there is no audit documentation regarding the audit procedures performed to identify and ensure completeness of related party relationships and transactions, accuracy of the amount of RPTs, compliance with the laws/regulations and financial reporting framework relating to approvals and disclosures of related parties. Only a checklist in Yes / No format for RPT was enclosed in the audit file, which cannot be said to be sufficient appropriate audit evidence. The EP's reporting regarding RPTs was on the basis of blind reliance on the Directors' report & Secretarial audit report etc. His reference to the net amount of loans & advances being below the materiality level is not an acceptable argument, as the gross amount of the transactions reflects its completeness and netting may hide the real extent of the transactions. No replies by the EP regarding his verification whether these transactions were on arm's length basis, are tantamount to his acceptance of this charge.

Considering the above, the charge regarding failure of the EP in performance of the required audit procedures for verification of RPTs is established.

33. Non-evaluation of related party transactions has been viewed seriously by International Regulators as well. For example, the PCAOB, the US Regulator¹⁰, censured and imposed monetary penalty of \$ 30,000 collectively on the firm and respondents in the Matter of Seale and Beers CPAs, LLC, and Charlie B. Roy, CPA, for their failure *inter alia* to obtain, or ensure that the engagement team obtained, sufficient appropriate audit evidence for significant items reported in the financial statements, including related party transactions and expenses.

Inappropriate Opinion on the Financial Statement for the FYs 2014-15 to 2016-17

34. The EP was charged for not obtaining sufficient appropriate audit evidence, as per Para 11 of SA 700, to form an opinion that the Financial Statements as a whole were free from material misstatements and reflect a true & fair view. The EP was charged with issuing unmodified opinion on the FS for the FYs 2014-15 to 2016-17, despite the existence of material misstatements due to partial recognition / non-recognition of interest cost on borrowings classified as NPA. In this matter, the EP included in his Audit Report of the FY 2016-17 an Emphasis of Matter paragraph, which was also in contravention of the requirements of SA 706.

¹⁰ PCAOB Release No. 105-2017-038

35. The EP replied that, “...we were forming an opinion on the whole set of financial statements taken together, and not on a component or element of those financial statements, and our opinion was formed in the context of the overall 'materiality' of those financial statements. In view thereof we submit that there was no material misstatement and that the financial statements for the FYs 2015-16 and 2016-17 did reflect true and fair view to comply with the provisions of SA 700.” The EP added that substantial NPA loans were settled with many banks during FY 2015-16, therefore as per the company’s estimates and judgements, they determined not to recognise the interest cost on the NPA loans in the FY 2016-17. The EP added with the support of para 18 of SA 700 that on the basis of management representation letter; discussion with the audit committee; restructuring of loans; and disclosures of the same in the financial statements, there was no material misstatement in the FS. Thus, there was sufficient assurance that the financial statements were complied with para 11 of SA 700.

Regarding the inclusion of EoM paragraph, the EP stated that the matter referred in the EoM paragraph had been disclosed by the Company, and in his judgment the matter was of such importance that it was fundamental to the understanding of the users of the FS. Therefore, the EP contended that he had complied with the requirements of SA 706.

36. SA 700 requires an auditor to form an opinion whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework (‘FRF’ hereafter). In order to form that opinion, the auditor shall conclude that he has obtained reasonable assurance about whether sufficient appropriate audit evidence has been obtained and whether uncorrected misstatements are material, individually or in aggregate. Further, the auditor shall evaluate the financial statements being in compliance with the requirements of the applicable FRF by considering qualitative aspects such as entity’s accounting practices and indicators of possible bias in the management’s judgements in accounting practices (Para 11 and 12). Para 16 specifically states that the auditor shall express unmodified opinion only when the auditor concludes that financial statements are prepared in accordance with the applicable FRF.

As the FS were not in conformity with the requirements of applicable financial reporting framework viz. AS / Ind AS framework due to partial recognition / non-recognition of interest cost on borrowings classified as NPA and there was failure on the part of the EP in obtaining sufficient appropriate audit evidence for the verification of revenue and RPTs, the EP could not issue unmodified opinion. The understanding of the EP is also misplaced in respect of Para 18 of SA 700 referred to by him in his reply. This para states that “*if the financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor shall discuss...*”. Since the FS were not prepared in accordance with the AS / Ind AS framework, therefore, para 18 is not relevant to the EP’s case.

37. Regarding the inclusion of EoM paragraph, we note that SA 706 stipulates that an EoM paragraph shall refer to only that information which is not materially misstated and presented or disclosed in the FS (para 6). It is also stipulated that inclusion of an EoM paragraph in the auditor’s report is not a substitute for issuing of modified opinion (Para A3). Therefore, an EoM paragraph can only be incorporated by the auditor when he obtains sufficient appropriate audit evidence, and concludes that the matter is not materially misstated and appropriately presented or disclosed in the financial statements. The EP had included in the Independent Auditor’s Report of the FY 2016-17 the EoM para on non-recognition of interest cost on the borrowings classified as NPA, which was a misstatement and therefore could not be included in EoM.

38. The EP relied heavily upon the management and was consistently taking recourse to the management disclosures and representations etc., without applying professional skepticism, which shows the negligent attitude of the EP. When the law and the standards are clear, there is no reason for the auditor to place blind reliance on the management representations, and not to apply professional scepticism.
39. Considering the above, the charge that the EP issued inappropriate audit opinion is established and we hold that the EP failed to obtain sufficient appropriate audit evidence while forming audit opinion on FS and therefore failed to comply with the provisions of SA 700 and 706.

Non-implementation of Quality Control Measures at the Engagement Level

40. The EP was charged with failure to determine the appointment of Engagement Quality Control Reviewer ('EQCR' hereafter) in the audit of Bilcare Limited for the FYs 2014-15 to 2016-17 as required by Para 19(a) of SA 220.
41. The EP replied that he had a small proprietorship firm which had four to six employees throughout the practice. Further, Bilcare Limited was the only listed client of the firm and he used to supervise and finalise the audit engagement. The EP referred to the relaxations to smaller firms (para 41, 72 and 92 of SQC 1) and asserted that provisions of EQCR are discretionary / diluted for smaller firms due to use of the word 'may' in the SQC 1. The EP also added that KPMG was engaged in transition work of AS framework to Ind AS framework for the company, which should be considered as appointment of EQCR because independent expert work was done by them.
42. The replies of the EP show lack of his understanding about the provisions of SAs and SQC 1, as the appointment of EQCR is a mandatory requirement for the audit of listed entities and every audit firm is required to ensure the compliance of the same. For smaller firms, para 72 of SQC states that "*Suitably qualified external persons may be contracted where sole practitioners or small firms identify engagements requiring engagement quality control reviews. Alternatively, some sole practitioners or small firms may wish to use other firms to facilitate engagement quality control reviews...* This provision is made to provide an alternative to the smaller firms to comply with the mandatory requirements of SQC 1 and SA 220, and not to provide any exemption. Accordingly, the contention of the EP that provisions of EQCR is discretionary, cannot be accepted. Further, the contention of the EP to consider the appointment of KPMG as EQCR is also misplaced, as KPMG was engaged in the FY 2016-17 for the transition work of AS framework to Ind AS framework and not for the EQCR purpose. Such replies of the EP show his complete misunderstanding, and are not be expected from a person who claims to be in practice for over 29 years.
43. Considering the above, we find that the EP was grossly negligent in his failure to determine the appointment of EQCR in compliance with the provisions of SA 220.
44. Failure to appoint an EQCR has been viewed seriously by International Regulators as well. For example, the PCAOB, the US Regulator¹¹, censured and imposed monetary penalty of \$ 10,000 on the firm and respondents in the Matter of Brace & Associates, PLLC and Kari Brace, CPA, for their failure *inter alia* to comply with the requirements of Engagement Quality Review.

¹¹ PCAOB Release No. 105-2017-042

Non-submission of Audit File for the FY 2014-15

45. The EP was charged with non-submission of the audit file for the FY 2014-15, as the EP failed to submit the audit files to NFRA despite two reminders. As per the requirement of SA 230, an auditor is compulsorily required to document and assemble the audit file for every specific assignment within the prescribed time limit and keep it safeguarded.
46. The EP replied that the audit of Bilcare Limited for the FY 2014-15 was concluded and signed by him on 29th May 2015, and this date is more than seven years from the date of first notice of NFRA, i.e. dated 27th July 2022. He added that his firm adopted the practice of scrapping the documents after the statutory retention period of 7 years in view of lack of office and storage space.
47. We note that para A23 of SA 230 states that *the retention period of audit engagements ordinarily is no shorter than seven years*. Therefore, it should not be construed as the maximum period of retention. As per the replies of the EP, the mandatory period of seven years for retention of the audit file has already lapsed on 28th May 2022. The NFRA letter calling for the Audit File was sent 60 days thereafter. Therefore, the issue of non-submission of the audit file for 2014-15 is not being pursued any further.

D. Articles of Charges of Professional Misconduct by the EP

48. As discussed in the foregoing paragraphs, the EP has made departures from the Standards and the Law, in his conduct of the audit of Bilcare Limited for the FYs 2014-15, 2015-16 and 2016-17. In light of the foregoing discussion, our findings on each article of charge listed out in the SCN, are stated below:

- (a) The EP committed professional misconduct as defined by clause 5 of Part I of the Second Schedule of the CA Act, which states that a CA 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 EP failed to disclose in his report the material non-compliances by the company as explained in Para 16-22 above.

- (b) The EP committed professional misconduct as defined by clause 6 of Part I of the Second Schedule of the CA Act, which states that a CA 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".

This charge is proved as the EP failed to disclose in his report the material non-compliances by the company as explained in Para 16-22 above.

- (c) The EP committed professional misconduct as defined by clause 7 of Part I of the Second Schedule of the CA Act, which states that a CA 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 exercise due diligence in the audit of the company in accordance with the SAs and applicable regulations, as explained in Para 16-44 above.

- (d) The EP 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 EP failed to conduct the audit in accordance with the SAs and applicable regulations and failed to analyse and report the appropriateness of accounting policy for recognition of interest cost on NPA loans in the financial statements as explained in Para 16-44 above.

- (e) The EP 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 EP failed to conduct the audit in accordance with the SAs as explained in Para 16-44 above.

Therefore, we conclude that the charges of professional misconduct enumerated in the SCN dated 04.07.2023 stand proved based on the evidence in the Audit File, the Audit Report issued by EP, the submissions made by EP, the annual report of Bilcare for the FYs and other materials available on record.

E. PENALTY & SANCTIONS

49. It is the duty of an auditor to conduct the audit with professional skepticism and due diligence and report his opinion in an unbiased manner. Statutory audits provide useful information to the stakeholders and public, based on which they make their decisions on their investments or do transactions with the public interest entity¹².
50. Section 132(4) of the Companies Act, 2013 provides for penalties in a case where professional misconduct is proved. The seriousness with which proven cases of professional misconduct are to be viewed, is evident from the fact that a minimum punishment is laid down by the law.
51. The EP in the present case was required to ensure compliance with SAs to achieve the necessary audit quality and lend credibility to Financial Statements. As we have explained in this Order, deficiency in the conduct of Audit, abdication of responsibility and inappropriate conclusions on the part of CA Ratan Laxminarayan Rathi establish his professional misconduct.
52. 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 five lakh rupees, but which may extend to ten times of the fees received, in case of firms.
- (B) debaring 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.

¹² Public interest entity as defined in Rule 3 of NFRA Rules 2018

53. As per the information furnished by CA Ratan Laxminarayan Rathi vide email dated 20.12.2023, the audit fees of Bilcare for the FYs 2014-15 to 2016-17 was ₹ [REDACTED] in each FY (including consolidated FS audit work). Total professional fees received by M/s R.L. Rathi & Co. from Bilcare Limited for the FYs 2014-15 to 2016-17 was ₹ [REDACTED] in each FY.
54. Considering the proven professional misconduct, 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 3,00,000/- (Rupees Three Lakhs only)** upon CA Ratan Laxminarayan Rathi;
- II. In addition, CA Ratan Laxminarayan Rathi is debarred for **2 years (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;
55. This Order will become effective after 30 days of its issue.


Sd/-
(Dr Ajay Bhushan Prasad Pandey)
Chairperson

Sd/-
(Praveen Kumar Tiwari)
Full-Time Member

Sd/-
(Smita Jhingran)
Full-Time Member

Authorised for issue by the National Financial Reporting Authority,

Date: 22.02.2024
Place: New Delhi


(Vidhu Sood)
Secretary

To,

CA Shri Ratan Laxminarayan Rathi, ICAI (MRN 014739)
M/s R L Rathi & Co., ICAI (Firm Registration Number: 108719W)
Dealing Chambers, 3rd Floor, 573/1, JM Road,
Pune, Maharashtra - 411004
Email: rathiratan@vmail.com

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

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) Bilcare Limited.
- (v) IT-Team, NFRA for uploading the order on the website of NFRA.