भारत सरकार / Government of India

राष्ट्रीय वित्तीय रिपोर्टिंग प्राधिकरण / National Financial Reporting Authority

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

No. 008/2024 Date: 12.04.2024

ORDER

Order under Section 132 (4) of the Companies Act, 2013 in respect of M/s Pathak H.D. & Associates (FRN 107783W) the Audit Firm, CA Parimal Kumar Jha (ICAI Membership No. 124262) the Engagement Partner and CA Vishal D Shah (ICAI Membership No. 119303) the Engagement Quality Control Review Partner

This Order disposes of the Show Cause Notice (SCN) dated 25.07.2023, issued to M/s Pathak HD & Associates, the Audit Firm, CA Parimal Kumar Jha, who was the Engagement Partner (EP) and CA Vishal D Shah, who was the Engagement Quality Control Review (EQCR) Partner, for the statutory audit of Reliance Capital Limited for the Financial Year 2018-19 (the Audit Firm, EP and the EQCR Partner are collectively called 'Auditors' hereafter). This Order is divided into the following sections:

A. Executive Summary

B. Introduction and Background

C. Major Lapses in the Audit

D. Findings on the Articles of Charges of Professional Misconduct

E. Sanctions and Penalties

A. EXECUTIVE SUMMARY

1. Reliance Capital Limited (RCL hereafter), a company listed on the Bombay Stock Exchange, engaged in financial services, was jointly audited by M/s Price Waterhouse & Co LLP (PW) and M/s Pathak HD & Associates (PHD) for the Financial Year 2018-19. The Director General of Corporate Affairs (DGCoA), Ministry of Corporate Affairs (MCA), Government of India, vide its letter dated 29.05.2020 informed the National Financial Reporting Authority (NFRA) that PW had resigned from the audit, without issuing an audit report for FY 2018-19 and filed a report to MCA under section 143(12)[1] of the Companies Act, 2013 (the Act) on 11.06.2019. On examination of the matter, it was found that while the ex-auditor PW had filed form ADT-4 with MCA, reporting suspected fraud in RCL, the audit report for the FY 2018-19 issued by PHD on 14.08.2019 stated[2] that there were no matters attracting Section 143(12). Hence, we suo motu examined the Audit File of PHD also, under section 132 of the Act, and observed prima facie that there are certain non-compliances with the Act, the Standards of Auditing (SA) and the Code of Ethics, 2009, issued by ICAI. Accordingly, on the

[1] Under section 143(12) of Companies Act, 2013 auditor is required to report any fraud identified in the company.

[2] In the Emphasis of Matter paragraph, referring to the matters reported by PW under section 143(12).

satisfaction that sufficient cause exists to initiate action under Section 132(4) of the Act, the subject matter SCN was issued to the Auditors.

2. As per the Consolidated Financial Statements for FY 2018-19, RCL had loans from Banks of around ₹12,000 crore and other external borrowings of around ₹32,000 crores, consisting of debentures, commercial papers and pass-through certificates. RCL was a Core Investment Company (CIC) investing primarily in its group companies. RCL used the above loans and borrowing to extend loans and investments to other group companies. PW reported suspected fraud regarding loans and investments amounting to approximately ₹12,571 crore to some group companies.

3. Despite the reporting of suspected fraud and the resignation by the other joint auditor (PW), the Auditors did not perform adequate procedures as required by the SAs. The material misstatements in the financial statements due to inadequate provision, unjustified valuation of loans and irrational business practices were concurred by the Auditors in disregard of their responsibilities under the Act and SAs. The Auditors also demonstrated a lack of professionalism by rationalising the actions of the Company and ignoring the fundamentals of accounting and auditing.

4. Based on an examination of records and various submissions of the Auditors, including written and oral, this Order concludes that the Auditors failed to meet the relevant requirements of the SAs and violated the Act, and the Code of Ethics in respect of several significant areas of audit. In the areas of the audit identified in this Order, the Auditor was grossly negligent and failed to obtain sufficient appropriate audit evidence to support their opinion, failed to maintain professional skepticism and due diligence, failed to sufficiently and adequately challenge the management assertions and thus failed to identify and report material misstatements in the financial statements of RCL. The major violations discussed in this order include:

   a. While PHD was functioning as a joint auditor, PW, the other joint auditor, brought some significant matters to PHD's notice through various communications starting from the letter dated 24.04.2019. These matters included potentially irrecoverable loans and investments amounting to approximately ₹12,571 crore to group companies portrayed as recoverable. However, PHD failed to carry out any independent procedures on these matters and discharge the responsibilities of a joint auditor in this regard. (Details in Section C1 of this order).

   b. PHD indulged in self-review by preparing material information for the financial statements of the Company, which subsequently became the subject matter of their audit opinion, and thus violated the Code of Ethics and SAs. (Details in Section C2 of this order).

   c. PHD used the Emphasis of Matter (EoM) para in its audit report in which it concluded that there were no matters attracting section 143(12). The EoM para was in non-compliance with the SAs and was misleading for the users of the financial statements. (Details in Section C3 of this order).

   d. PHD concluded without any regard to the merits of the transactions that there were no matters attracting section 143(12). Despite the evidence of documented irregularities in RCL EP did not question the management. In the absence of tests and evidence, the recoverability of the loans of ₹6557 crore (net of impairment) disclosed in the financial statements was doubtful and hence the management's assertions of the value and rights of these loans were materially misstated in the financial statements, which PHD failed to report. Also, the actual valuation of investments, the rationale for sanctioning loans and investments to potential non-creditworthy entities and the adequacy of provisions remained unverified in all cases. These factors cumulatively contributed to the ROMM due to fraud, which PHD ruled out without adequate audit procedures.

Consequently, the audit opinion of PHD confirming the management's assertions of a true and fair view of the financial statements is without adequate basis. (Details in Section C4 of this order).

e. PHD failed to notice that the loans amounting to ₹6557 crore (net of impairment) were sanctioned by RCL violating its lending policy and also failed to examine the fraud risk factors. It failed to identify and respond appropriately to the risk of material misstatement due to fraud in management override of controls and revenue. (Details in Section C5.1 to C5.3 of this order).

f. PHD failed to evaluate the adequacy of the expected credit loss provisions of ₹ 2577 crore on loans. This has resulted in the non-reporting of material misstatements in the financial statements. (Details in Section C5.4 of this order).

5. Based on the investigation and proceedings under Section 132(4) of the Act and after giving the Auditor adequate opportunity to present their case, we find the Auditors guilty of professional misconduct and impose through this Order, the following monetary penalties, and sanctions, which will take effect after 30 days from issuance of this Order.

   a. Imposition of a monetary penalty of ₹3 crore (Rupees Three Crore) on the Audit Firm M/s Pathak H.D. & Associates.

   b. Imposition of monetary penalties of ₹1 crore (Rupees One Crore) and ₹50 Lakh (Rupees Fifty Lakh) respectively on EP CA Parimal Kumar Jha and EQCR Partner CA Vishal D Shah.

   c. In addition, EP and EQCR partners are debarred for 10 years and 5 years respectively from being appointed as an auditor or internal auditor or from undertaking any audit in respect of financial statements or internal audit of the functions and activities of any company or body corporate.

B. INTRODUCTION AND BACKGROUND

6. NFRA is a statutory authority set up under Section 132 of the Act to monitor the implementation of the auditing and accounting standards and oversee the quality of service of the profession associated with ensuring compliance with such standards. The statutory Auditor, appointed by the members of the company under section 139 of the Act is bound by the duties and responsibilities prescribed in the Act, the rules made thereunder, the SA and the Code of Ethics, the violation of which constitutes professional misconduct. NFRA has the powers of a civil court and is empowered under Section 132(4) of the Act to investigate the prescribed classes of companies and impose penalties for professional or other misconduct of the individual members or firms of chartered accountants.

7. The DGCoA, MCA, Government of India, vide its letter dated 29.05.2020 informed NFRA that the ex-auditor (PW) of RCL had filed a report to MCA under section 143(12) of the Act on 11.06.2019 and resigned from the audit engagement on the same date without issuing an audit report for FY 2018-19. While examining the matter, it was observed that PHD and PW were appointed as joint statutory auditors of RCL for a term of 5 consecutive years at the Annual General Meeting of the Company held on 27.09.2017 and 26.09.2017. PW filed form ADT-4 with the MCA as per the provisions of section 143(12) of the Act and resigned from the audit. Thus, the audit report for the FY 2018-19, dated 14.08.2019, was signed only by PHD. The audit Report contained an Emphasis of Matter paragraph, referring to the matters reported by PW under section 143(12). The EoM stated that *"Based on the facts fully described in the aforesaid note, views of the Company, in-depth examination carried out by the independent legal experts of the relevant records, there were no matters attracting the said Section."*

8. We suo motu decided to examine the audit evidence that led PHD to issue the above report and called for the Audit File[3] and other information from the Audit Firm and EP CA Parimal Kumar Jha (Membership No. 124262). On 23.12.2021 the Audit Firm requested an extension of time for submission of requisite documents and an extension of time up to 07.02.2022 was allowed. The Audit Firm submitted the Audit File and other documents electronically through File Transfer Protocol (FTP) on 07.02.2022. An examination of the Audit File, annual reports of the Company and other communications by PHD to NFRA showed a prima facie case of professional misconduct on the part of the Auditors.

9. On satisfaction that a sufficient cause exists to initiate action under Section 132(4) of the Act, an SCN was issued to the Auditors to show cause as to why necessary action for professional misconduct should not be taken under Section 132(4) (c) of the Act read with NFRA Rules 2018.

10. EP, the Audit Firm PHD, and the EQCR Partner submitted their respective replies to the SCN on 26.08.2023. After a detailed examination of the replies along with the supporting evidence submitted, an opportunity for a personal hearing was provided to the Audit Firm, EP and the EQCR on 30.01.2024. The Auditors attended the personal hearing along with their legal counsel, Adv. Stuti Gujral. The personal hearing was adjourned to 19.02.2024 at the request of EP. On his request, the Letter from DGCoA and workpaper of PW mentioned in the SCN were also provided to the Auditors vide NFRA email dated 30.01.2024. The hearing was held on 19.02.2024, and the Auditors requested additional time. Accordingly, the hearing was continued on 21.02.2024 through Video Conferencing. The Auditors i.e. the firm, EP and EQCR submitted a written summary of their submissions made during the personal hearing, along with copies of the documents relied upon, on 01-03-2024. All the written and oral submissions have also been examined in detail before issuing this Order.

11. Given the actions and omissions as auditor, leading to their apparent failure to comply with the Act and the Standards of Auditing, the Audit Firm, EP and EQCR Partner were charged with professional misconduct, as conceived in Section 132(4) of the Act 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 the statutory auditors are 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 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 the expression of an opinion, or its exceptions are sufficiently material to negate the expressions of an opinion; and

    e. Failure to invite attention to any material departure from the generally accepted procedures to audit applicable to the circumstances.

C. MAJOR LAPSES IN THE AUDIT

12. We have examined in detail the written replies to the SCN, and the oral submissions made by the Auditors to each of the omissions and commissions leading to the above-mentioned charges as per

[3] Vide NFRA letter dated 24.11.2021.

the SCN. The Auditors have denied all the charges mentioned in the SCN. Only the charges that are proved have been included in this Order.

C.1. Violations of the Responsibilities of Joint Auditor

13. PHD and PW were appointed as joint statutory auditors of RCL for a term of 5 consecutive years at the Annual General Meeting of the Company held on 27.09.2017 and 26.09.2017. As per the agreement between the joint auditors, made as per SA 299(Revised)[4], there was no division of audit work among the joint auditors. Hence both the joint auditors were jointly and severally responsible for the entire audit work. While PHD was functioning as a joint auditor, PW brought some significant matters to PHD's notice through various communications[5] starting from the letter dated 24.04.2019. These matters included potentially irrecoverable loans and investments amounting to approximately ₹12,571 crore made to group companies, which were portrayed as recoverable. Despite these communications, EP failed to carry out any independent procedures on these matters as mandated in Para 14, 16 and 17 of SA 299 (Revised) regarding the responsibilities of a joint auditor. Hence EP and the Audit Firm were charged with non-compliance with SA 299(Revised).

14. The EP denied all the charges and submitted that there are no violations of SAs as the records reflect their repeated and consistent efforts to engage with PW as the joint auditor and such efforts were resisted by PW. Based on the "*intensive audit procedures*" EP concluded that none of the concerns of PW warranted a report under Section 143(12). The Auditors also listed out the WPs to support their contentions and conclusions. On examination of the detailed replies, we observe the following in this regard.

    a. In FY 2018-19[6] RCL had loans from Banks of around ₹12,700 crore and other external borrowings of around ₹32,400 crores, consisting of debentures, commercial papers and pass-through certificates. RCL was a Core Investment Company (CIC) investing primarily in its group companies. On 11.06.2019 PW resigned without issuing an audit report and filed form ADT-4 with the MCA as per the provisions of Section 143(12) of the Act, (i.e., reporting of suspected fraud in the Company). Before the resignation, PW issued a letter dated 24.04.2019 to the Company, copied to the Audit Committee and PHD, regarding its observations concerning loans disbursed, investments, and disposal of Compulsory Convertible Debentures (CCDs) of group companies having a cumulative carrying value of approximately ₹12,571 crore. This letter formed the key basis for PW's reporting of fraud under section 143(12) of the Act. Following this communication, PW and RCL exchanged various communications[7] culminating in the report under 143(12) by PW on 11.06.2019. PHD was copied in these communications. These Group Companies, reported by PW, had serious credit impairment. Many of these group companies used the money to invest in or lend to other group companies with similar credit impairment. The business rationale and recoverability of these loans were not explained.

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[4] SA 299 (Revised) – Joint Audit of Financial Statements

[5] 1. Letter dated 04.05.2019 from CFO, RCL to PW, 2. Letter dated 09.05.2019 from Executive Director, RCL and CFO, RCL to PW, 3. Letter dated 14.05.2019 from PW to RCL, Audit Committee and Copy to PHD, 4. Letter dated 20.05.2019 from PW to RCL, Audit Committee and Copy to PHD, 5. Letters dated 06.06.2019 and 09.06.2019 from CFO, RCL to PW, and 6. 11.06.2019 – Various communications from PW to RCL, Audit Committee, PHD, MCA.

[6] Notes 18 and 19 of Consolidated Financial Statements of RCL for FY 18-19.

[7] 1. Letter dated 04.05.2019 from CFO, RCL to PW, 2. Letter dated 09.05.2019 from Executive Director, RCL and CFO, RCL to PW, 3. Letter dated 14.05.2019 from PW to RCL, Audit Committee and Copy to PHD, 4. Letter dated 20.05.2019 from PW to RCL, Audit Committee and Copy to PHD, 5. Letters dated 06.06.2019 and 09.06.2019 from CFO, RCL to PW, and 6. 11.06.2019 – Various communications from PW to RCL, Audit Committee, PHD, MCA.

b. As per the requirements of paragraph 14(c) of SA 299(Revised) PHD was required to agree or disagree with the significant observations raised by PW when they were brought to their notice. However, the Auditors failed to show any evidence in the Audit File of performing any audit procedures to examine and conclude these matters while it was functioning as a joint auditor.

c. PW's letters dated 24.04.2019 and 14.05.2019 regarding loans and investments were detailed and self-explanatory. The final observations of PW include unresolved issues regarding recoverability, end-use, valuation, unusual mode of transactions and internal control matters. As per the requirements of SA 299 (Revised), EP was required to perform audit procedures and come to an independent conclusion regarding the significant matters. EP examined the issues only after the audit committee specifically *asked* PHD on 12.06.2019 to examine the issues, i.e. one day after PW filed form ADT-4 and resigned from the Company. From 24.04.2019, when the issue was first raised by PW, till 12.06.2019 EP did not perform any audit procedures on these matters as is evident from the Audit File. There is no evidence in the Audit File that the Auditors disagreed with these observations, as mandated by SA 299 (Revised).

15. We also observe that the written communications between PW and the Company, starting from 25.04.2019, were copied to PHD. On an examination of these communications, as documented by EP, we observe that the contents of these letters are readily understandable. For instance, we note the following from the letter dated 24-04-2019 from PW, addressed to the CFO of RCL and copied to the Audit Committee and PHD.

> During our review of loan files for the financial year ended March 31, 2019, we have noted that there are various disbursements to / outstanding balances from group companies with a carrying value aggregating to approximately Rs. 12,571 Crores as at March 31, 2019. On a sample testing of such loans/ CCDs we have noted certain observations on the status / financial strength of the borrower/ issuer of the CCDs. Such Borrowers/ issuers included in Exhibit 1 have one or more of the undermentioned characteristics;
>
> 1. Networth of borrowers/ parties is negative/ Latest available audit reports on the financial statements of the Borrower/party carry an "Emphasis of Matter paragraph" on going concern status of borrower companies.
> 2. There is limited / no revenue and/ or profit as per the last available audited financial statements
> 3. Equity capital is low in comparison to debt raised by the borrower/ parties

> In light of the above, we would like the Management of the Company to respond to our queries, which may also incorporate audit committee's point of view. These evaluations will help us to determine next steps as may be warranted under Companies Act 2013, professional standards including standards on auditing and consequential impact on our reporting responsibility on financial statements, Internal Financial Reporting over Financial Reporting and other regulatory reportings.

16. The following are the excerpts from the PW's letter dated 14.05.2019 addressed to the Audit Committee and CFO, and copied to PHD:

11. Since after the Letter was issued by us, we have also noted that the ratings of various facilities / instruments of the Company have been downgraded by ICRA Limited on April 26, 2019 and Brickwork Ratings on 4 May 2019. In the course of continuing the audit process certain other issues have also been observed by us. Details of these observations are set out in **Annexure 3**.

As on March 31, 2018, Reliance Capital Limited ("**RCL**") held 23,00,000 Compulsory Convertible Debentures (CCD's) of Reliance Business Broadcast News Holding Limited having book value of Rs. 230 crores. On March 22, 2019, RCL sold part of the CCDs having book value of Rs. 129.88 crore at book value to Nationwide Communication Limited ("**NCL**"). Proceeds from such transaction were credited in RCL's HDFC Bank account no. 00010310001681 on March 22, 2019.

Reliance Home Finance Limited ("**RHF**") disbursed loan of Rs. 175 crore to NCL vide agreement no. RHWCCOR000074890. The disbursement of the said loan as per the bank statement of RHF was on March 22, 2019.

Reliance Commercial Finance Limited ("**RCF**") disbursed loan of Rs. 25 crore to NCL vide agreement no. RLCSOR000489804. The disbursement of the said loan as per the statement of account was on March 22, 2019.

17. On a plain reading of these observations of PW, and the similar other observations contained in their communications, we observe that these were enough to alert the Auditors about possible misstatements due to fraud or error and to invoke the professional skepticism expected of them. However, there is no evidence of any revision in the risk assessment or materiality on account of the information received from PW. There is also no evidence of audit procedures performed in response to these communications on or before the 12th of June 2019, the date on which the Audit Committee asked PHD to examine the matters raised by PW. This conduct of the Auditors is a violation of paragraph 14(c) SA 299 (Revised).
18. The Audit Firm's claim that they revised the audit strategy on 11.06.2019, before the Audit Committee meeting on 12.06.2019, is contrary to the facts recorded in the Audit File. The WP[8] relied upon by EP is dated 12th June 2019 and it specifically mentions that *"After discussion with the Audit Committee in their meeting held on June 12, 2019, we conducted a review of the matters raised by PWC in their letter dated May 14, 2019, issued to the management of the Company as part of our audit procedures."* Thus, it is clear from the WP that the Auditors revised the audit strategy and purportedly reviewed the matters raised by PW only at the instance of the Audit Committee. A planning meeting[9] with the audit team was held on 11.06.2019, only after PW resigned. Before PW's resignation neither did EP make any effort to perform audit procedures to evaluate the observations raised by PW, nor was the EQCR partner apprised of the matter.
19. One of the key contentions of EP is that PW did not share the basis/rationale for their letters and there were no new circumstances in FY 18-19 that warranted such a report. EP also argues that PW did not raise such concerns in the previous financial year or during the limited review up to the third quarter of FY 18-19. According to EP, the conclusion of PW *"appears to have been influenced by media news*" and are "*unsustainable*". The Audit Firm goes on to say that it "*also appears that PW was finding an excuse to withdraw from the engagement and found an easy route by filing under 143(12) and resigned…..*". We observe, without any comment on the merits of the actions of PW, that the replies of the Auditors are a serious deviation from the fundamental tenets of professional skepticism and professional behaviour[10] required of an auditor as per SA 200 and the Code of Ethics 2009. PHD was the statutory auditor appointed under the Act and was responsible for carrying out the audit as per SAs and the Act, and reporting whether the financial statements and accounts represented a true and fair view of the affairs of the Company. Examining and commenting on the conduct of the joint

[8] WP Reference- Revised Planning- Audit Strategy pursuant to 143(12)

[9] WP Reference- Discussion with management- Q4 2018-19 - Planning Meeting with the Audit Team

[10] Making disparaging references or unsubstantiated comparisons to the work of others (Paragraph 150.2 of Code of Ethics 2009.

auditor, who is legally on the same footing as that of PHD, is beyond the scope of section 143 of the Act and the SAs.

20. Thus, based on the above, it stands proved that EP and PHD failed to comply with the requirements of SA 299(Revised) regarding the responsibilities of the joint auditor as there is no evidence in the Audit File that the Auditors performed independent procedures on matters brought to their notice and came to any conclusions regarding PW's observations when it was brought to their notice. Hence the charges in para 13 above regarding violation of SA 299 (Revised) are proved.

C.2. Self-Review of Financial Statements

21. EP and PHD were charged with violations of SA 200[11], SA 240[12] and the Code of Ethics[13] applicable to a Chartered Accountant in Practice, based on the following omissions amounting to self-review of financial statements audited by PHD.

    In the Audit Committee meetings held on 12.06.2019, the Audit Committee asked PHD to "*fully examine*" all the transactions referred to by PW and "*provide their well-considered view*" to the committee. EP notes this decision as the "*mandate*" given by the Audit Committee. Thereafter the Audit Committee, on 25.06.2019, noted in their minutes that "*in respect of section 143 (12) of the Companies Act, 2013, **PHD concluded that, in their opinion, the transactions referred to in the PwC letters do not trigger the provisions of section 143(12) of the Companies Act, 2013***." (Emphasis supplied by us). This was based on a presentation made by EP to the Audit Committee, affirming that the transactions referred to in the PC letters do not trigger the provisions of section 143(12***)***. Before this date, there was no evidence of any independent view taken by the Audit Committee or the Board regarding these transactions, despite receiving various communications from PW since 24.04.2019. This conclusion of PHD is reported in the Director's report and financial statements, which in turn were audited and reported (including an EoM referring to the same disclosure) by PHD. In light of the above, EP and PHD were charged with preparing material information for the financial statements of the Company, which subsequently became the subject matter of their audit opinion, amounting to self-review.

22. EP denied the charges. He submitted that there is no self-review since they were expected to examine the matters even if the Audit Committee had not requested them to examine it. EP's submission is that the word "*mandate*" noted in one of their working paper files should not be given any meaning other than the Audit Committee requesting them to perform what was in any case their duty as statutory auditor of the Company. It further submits that the minutes of the meetings dated 12.06.2019 and 25.06.2019 clearly state that the Audit Committee has conducted a detailed examination of matters. Also, the Board of Directors have taken various initiatives such as legal opinions, before concluding the matter.

23. We examine the detailed replies and observe that EP was required to independently form an opinion on the true and fair view of the financial statements. There is a fundamental difference between the statuary auditor reviewing the work of the preparers independently as compared to, the statutory auditors providing inputs for the company's records and later on reviewing the same. The financial statements included classes of transactions and account balances arising out of the transactions

[11] Refer para 14 of SA 200- Overall objective of the independent auditor and the conduct of an audit in accordance with standards on auditing.

[12] Refer para 20 and 21 of SA 240- The auditor's responsibilities relating to fraud in an audit of financial statements.

[13] Refer para 100.9 to 100.11 and 290.163 of Code of Ethics 2009.

reported by PW. The financial statements also included a material disclosure[14] that the matters reported by PW do not attract section 143(12). Since this disclosure and the related account balances were significant, EP needed to conclude appropriately on the true and fair nature of the numbers and the disclosure. In the backdrop of these responsibilities, we observe the following deficiencies in the audit:

a. In section C1 of this order it has been proved that EP did not perform any independent procedures to agree or disagree with the observations of PW until the date of PW's resignation i.e. 11.06.2019. Subsequently, in the Audit Committee meetings held on 12.06.2019, the Audit Committee decided to ask PHD to "*review and fully examine*" all the transactions referred by PW and "*provide their well-considered view*" to the committee. EP noted this decision as the "*mandate*" given by the Audit Committee. Thereafter the Audit Committee, on 25.06.2019, noted in their minutes that "*in respect of section 143 (12) of the Companies Act, 2013,* ***PHD concluded that, in their opinion, the transactions referred to in the PwC letters do not trigger the provisions of section 143(12) of the Companies Act, 2013***.". This was based on a presentation made by EP to the Audit Committee, affirming that the transactions referred to in the PW's letters do not trigger the provisions of section 143(12). Before this date, there is no evidence of any independent views by the Board or Audit Committee, which is mandated under Section 177 of the Act to inter alia perform scrutiny of intercorporate loans and investments, valuation of the assets of the company wherever it is necessary, evaluation internal financial controls and risk management system etc. At this juncture, it is crucial to note the requirements under Rule 13 of the Companies (Audit and Auditors) Amendment Rules, 2015. Neither the Board nor the Audit Committee replied to PW after it sent multiple correspondences specifically referring to Section 143(12). The time limit for a reply expected in this case is 45 days as stipulated in sub-rule (2) of Rule 13. But there were no replies from the Audit Committee or Board.
b. The Company then disclosed in the Directors Report that "*The company did not agree with the reasons given by PWC for the resignation which were grossly inadequate. The observations* ***given by PWC were examined by the continuing Statutory Auditor*** *of the company.* ***As per the report of the continuing Statutory Auditor, the provisions of section 143(12) of the Companies Act, 2013 did not get triggered****. The company had* ***further obtained independent legal opinion*** *from reputed law firm and a senior counsel* ***re-confirming*** *that there were no violations attracting section 143(12) of the Companies Act, 2013."* (Emphasis supplied by NFRA). The Board acknowledged the role of PHD in this disclosure.
c. The above conclusion of EP, as acknowledged by the Audit Committee and the Board, appeared in the financial statements as a material disclosure as follows:

   Note 41 (a) Standalone Financial Statements (SFS): "*The Company's previous auditor, after resigning from the office in June 2019 submitted a report under Section 143(12) of the Companies Act, 2013 with the Ministry of Corporate Affairs. The Company has examined the matter and also appointed legal experts, who independently carried out an in-depth examination of the matter and the issues raised therein and have concluded that there* ***was no matter attracting provisions of Section 143(12) of the Companies Act, 2013****. The matter is under consideration with the Ministry of Corporate Affairs*. (Emphasis supplied by us).

[14] Note 41 (a) Standalone Financial Statements (SFS) - "The Company's previous auditor, after resigning from the office in June 2019 submitted a report under Section 143(12) of the Companies Act, 2013 with the Ministry of Corporate Affairs. The Company has examined the matter and also appointed legal experts, who independently carried out an in-depth examination of the matter and the issues raised therein and have concluded that there was no matter attracting provisions of Section 143(12) of the Companies Act, 2013. The matter is under consideration with the Ministry of Corporate Affairs." A similar note was available in the Consolidated Financial Statements (CFS) as well.

d. This financial statement was then audited and an EoM paragraph was included in the Audit Report referring to the above disclosure note 41(a) by PHD. The EoM para reads as- ***"We draw attention to Note 41(a) of the Standalone Ind AS financial statements*** *referring to filing under Section 143(12) of the Companies Act, 2013 to the Ministry of Corporate Affairs by one of the previous auditors.* ***Based on the facts fully described in the aforesaid note, views of the Company, in-depth examination carried out by the independent legal experts*** *of the relevant records, there were no matters attracting the said Section".*

24. We now examine how the above material information included in the notes to the financial statements of the Company was prepared by the Auditors and subsequently became the subject matter of their audit opinion, amounting to self-review.

a. The legal expert's reports obtained by the management, on 07.08.2019, were not based on an investigation of the merits of the issues raised by PW or any "*in-depth*" examination of the alleged fraudulent loan transactions. They were based only on the correspondence between the Company and PW. The legal opinion was sought and obtained after EP's conclusion dated 25.06.2019 that the matter did not merit reporting under Section 143(12). This legal opinion was called for to determine whether the facts, circumstances and observations set out in various letters issued by PW were adequate and appropriate for invocation of the provisions of Section 143(12) of the Act. Thus, the Audit Committee as well as the Board's views on the merits of the transactions were solely based on the conclusions communicated by PHD on 25.06.2019.

b. As confirmed by EP in his reply, the draft note (finally appearing as Note 41(a) in the Standalone Financial Statements (SFS)) was given by the Company to the Auditors only on 13.08.2019 i.e. after EP gave his conclusion on 25.06.2019 that provisions of Section 143(12) of the Act are not attracted in the matter. As explained in paragraph 23(a) above, there was no independent view by the Board or Audit Committee and no disclosure note was made by the management regarding this matter earlier than this date. Thus, there is no evidence to claim that the disclosure note was not based on PHD's conclusion of the matter. Finally, we note that Auditors audited the same disclosure and stated in its audit report, in the form of an EoM[15], that there was no matter attracting section 143(12) of the Act. This clearly amounted to self-reviewing the information prepared by the Auditors themselves. Such review and conclusion on PW's observations did not come from PHD before the Audit Committee asked them to give a conclusion, even though it was the statutory duty of the auditor to examine and agree or disagree with those observations as per the requirements of SA 299(Revised). The Board or Audit Committee also did not independently form any views on the merits of the allegations raised by PW and went by the conclusions of the PHD.

c. At this juncture it would not be out of place to mention the sequence of events, which is as follows:

i. On 24.04.2019 PW sent a letter highlighting its observations which later formed the basis of fraud reporting by PW under section 143(12) of the Act.

ii. On 11.06.2019, PW resigned as a joint statutory auditor of the Company.

iii. On 12.06.2019 the Audit Committee asked PHD to look into the issues raised by PW and provide their well-considered view.

[15] Refer separate charges in the Order regarding violation of SA 706 (Revised) in issuing an EoM.

iv. on 25.06.2019 PHD concluded that no issues were attracting Section 143(12) of the Act and communicated the same to the Audit Committee. The Audit Committee recorded the conclusions in its minutes, which was submitted to the Board.

v. On 07.08.2019 RCL obtained legal opinions, concluding that there were no facts, circumstances and observations set out in various letters issued by PW which were adequate and appropriate for invocation of the provisions of section 143(12) of the Act.

vi. On 13.08.2019 management made the draft financials including the draft of note 41 containing the conclusion of PHD that there were no matters to be reported under section 143(12) of the Act.

vii. On 14.08.2019 audit report was signed by EP, containing the EoM paragraph based on Note 41(a) to conclude that there were no matters to be reported under section 143(12) of the Act.

d. Thus, the sequence of events as mentioned above confirms that the Audit Committee's conclusion was based solely on EP's presentation to the Committee in which EP concluded that the PW observations did not attract the provisions of section 143(12) of the Act. The opinions of the two legal counsels did not examine the merits of the transactions. Nor did the PHD subject the points raised by PW to the rigours of audit examination commensurate with fraud risk to agree or disagree with them and arrive at its own conclusions before the "mandate" (discussed in more detail in Sections C1 and C.4). Ultimately the same conclusion appeared in the Board's Report with acknowledgement of its origin to PHD. It is also disclosed in the Financial Statements in the form of a material assertion. Finally, PHD audited the same disclosure, based on its own opinion, and provided its audit opinion, in the form of an EoM[16], that there was no matter attracting section 143(12) in the PW observations. The draft note containing the above disclosure was included in the draft financial statements by the management only one day before the signing of the audit report. Thus, it is evident that the disclosure note emanated from information originally prepared by EP.

e. Reporting under Section 143(12) is a duty cast on the auditor. Section 143(12) mandates that if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government. Further, Rule 13 of the Companies (Audit and Auditors) Amendment Rules, 2015 and Form ADT – 4 provide the manner of reporting and SA 240 provides the basic requirements while auditing. These provide that the auditor reporting the suspected fraud will first take it up with the Audit Committee and the Board seeking their views within 45 days and then file the report in the form ADT-4. All these stipulations when read together make it clear that the reporting on fraud in the course of performance of duties as an auditor is applicable when the auditor has reason to believe and has knowledge that a fraud has occurred or is occurring based on evidence obtained and the professional judgements made. Once it is reported to the MCA, the legal determination of the fraud and admitting or ruling out fraud is a regulatory matter. Neither the Company nor the auditor is competent to make a conclusive legal determination[17] of a statutory matter reported by the auditor as per his evidence and mandate provided in the Act. The normal course of action in this situation for any prudent Company could be initiating an independent

[16] Refer separate charges in the SCN regarding violation of SA 706 (Revised) in issuing an EoM.

[17] Refer to Sections 130, 199, 206, 211, 212, 213 etc. of the Act.

investigation into the alleged matters to bring out the truth. However, the points raised by the PW were not responded to by the Audit Committee and the Board within 45 days following which PW reported the matter under section 143 (12) and also resigned on 11.6.2019. The Audit Committee and the Board thereafter asked the PHD on 12.6.2019 to examine the matter and EP shortly thereafter on 25.06.2019 ruled out any fraud based on their interpretation of the Law and limited and inadequate examination of data produced by the RCL. Using this conclusion of PHD the Company management, its Audit Committee and the Board acquitted themselves of their statutory responsibility in respect of an alleged fraud against them. EP and the Audit Firm, PHD, in turn, became a willing accomplice by displaying gross negligence of their statutory responsibility.

25. Thus, in this case, PHD ruled out fraud reported by another joint auditor (PW). Also, they did so on being asked by the Audit Committee. It may be noted that the Audit Committee had not even responded to the points raised by PW within the 45 days statutory limit. The management used PHD's said work (done without adequate rigor) as a disclosure in the financial statements. These financial statements were then audited and an EoM was then included in the Auditor's report that relied on the disclosure made by the management (which itself was based on the Auditor's examination). Thus, the actions of PHD amount to self-reviewing the financial statements. Hence the charges in para 21 are established.

C.3. Use of Emphasis of Matter (EoM)

26. As explained above, EP used an emphasis of matter paragraph in their audit report to state that the report filed by the resigned joint auditor does not attract section 143 (12). EP also documented in the Audit File that the PW's reporting was unwarranted. Its replies to the SCN also underline the same. In this regard, EP and the Audit Firm were charged with issuing an EoM without basis and in violation of Paragraph 8 of SA 706 (Revised).

27. EP denied the charges. On examination of the detailed replies and evidence, we observe the following.

28. In the backdrop of the sequence of events mentioned in paragraph 24(c) above, we now examine the EoM and its shortcomings from the perspective of compliance with the standards. A plain reading of the EoM (quoted in paragraph 23(d) above) shows that the Auditors are taking refuge under the legal opinion for determining that section 143(12) was not attracted. However, a perusal of the sequence of events shows that the determination was made by the Auditors way back on 25.06.2019 (within 12 days of being asked by the Audit Committee), whereas the legal opinion came only on 07.08.2019. Further, the conclusion of the legal experts, that there were no matters attracting section 143(12) was not based on the merits of the issues raised by PW, instead, it was based only on the correspondence between PW and the Company. Also, although it is the admitted position of EP that he has not relied on legal opinions, however, the EoM shows his reliance on the legal opinion because it talks about the examination by legal experts. Hence, this representation in the EoM is misleading for the users of the financial statements and goes to show the unprofessional behaviour of the Auditors.

29. Notwithstanding the above misrepresentation in the EoM, it is also not in accordance with the requirements of the standards. As per Para 8 of SA 706 (revised)[18] if the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an EoM paragraph in the auditor's report, provided the

[18] SA 706(Revised) – Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report

auditor would not be required to modify the opinion in accordance with SA 705 (Revised)[19] as a result of the matter. However, as explained in subsequent sections of this Order there were material misstatements since the irrecoverable loans were shown as recoverable by the management. This called for a modification in the audit report as per SA 705 (Revised) as the amounts involved were material. Therefore, the EoM based on Note 41 (a) regarding the PW matter was not in accordance with SA 706 (Revised).

30. As explained in the pre-para the EoM was not the appropriate form of reporting; instead, the Auditors should have modified their report. Without prejudice to the above, however, we examine the EoM para for its compliance with para 9 of SA 706 (Revised). This para makes it clear that the EoM paragraph shall refer only to information presented or disclosed in the financial statements and indicate that the auditor's opinion is not modified in respect of the matter emphasized. Thus, before providing an EoM, it must be ensured that the subject matter of the EoM is appropriately presented or disclosed in the financial statements. The subject matter in note 41(a) was a subsequent event after the reporting period and hence covered under Ind AS 10[20]. This standard requires disclosure for non-adjusting events or adjusting the amounts recognised in its financial statements to reflect adjusting events after the reporting period. The reporting of fraud is normally an adjusting event. However, the Company disclosed its judgment that the matter was not reportable under section 143(12) and hence treated it as a non-adjusting event. The disclosure notes identify two events, i.e. the reporting of fraud by the previous auditors under section 143(12) and the initiation of regulatory action by the MCA. Ind AS 10 requires disclosure of the nature of the event and an estimate of its financial impact or a statement that such an estimate cannot be made. However, the note to the financial statements does not give the nature of these two events, such as the subject matter of the report under section 143(12) and the nature of the action initiated by MCA. The nature and impact of the issues raised by the previous auditor were the crux of the matter and critical. Though the Company took the view that the issues raised by the previous auditor did not fall under section 143(12), the issues pointed out by the resigned auditor (PW) were such that they may result in accounting adjustments such as write-off of the company's assets due to the dubious nature of the loans granted, litigation expenses, compliance cost, loss of goodwill, action by lenders etc. There is neither disclosure in the financial statements of an estimate of such financial impact nor a statement that such an estimate cannot be made. There is no evidence in the Audit File of EP's examination of any of the above-mentioned matters, which shows gross negligence by EP.

31. Thus, the EoM was based on matters which were not adequately disclosed in the financial statements. Apart from referring to Note 41(a) the EoM also contains PHD's finding (which was already documented in the WP well before the Board noted this) that the matters reported by PW do not attract Section 143(12). The EoM did not mention that the audit opinion is not modified in this regard.

32. The above actions of PHD violate SA 706(Revised). Because of these violations, the Audit Report provided a misleading impression to the users. As demonstrated by the Audit File, neither RCL nor PHD fully examined the issues raised and reported by PW to conclude that there was no fraud.

33. Based on the above, the charges of issuing a misleading EoM without adequate basis stand proved.

[19] SA 705(Revised) - Modifications to the Opinion in the Independent Auditor's Report

[20] Ind AS 10, Events after Reporting Periods

C.4. Impact on Financial Statements of Matters Arising out of the Observations of the Resigned Auditor

34. With respect to the issues pointed out by PW before resigning, EP and PHD were charged with the following.

    a. Failure to exercise professional skepticism while examining PW's observations as PHD failed to assess the impact of these transactions on the Risk of Material Misstatements (ROMM) due to fraud.

    b. Failure to challenge the management and also failure to perform audit procedures as required by paragraphs 12 to 14, 23, 24, and 28 to 33 of SA 240.

    c. Failure to examine how the assertions in the financial statements were impacted by such deficiencies. The financial statements were materially misstated, as several irrecoverable loans and investments were portrayed as recoverable, but the same were not reported. Therefore, the Auditor's opinion on the financial statements is without adequate basis.

    d. Failure to assess the end use of loans to understand any issues relating to their recoverability. There is no evidence of independent verification of whether loan funds were used by the borrowers for the same purpose as disclosed by the borrowers at the time of sanction of the loan. Therefore, EP and PHD were charged with failure to comply with Paragraphs 22, 30, and 33 of SA 240.

35. As explained in the previous paragraphs of this Order, Auditors formed a conclusion that the matters reported by PW do not attract Section 143(12) of the Act. Without prejudice to our observations above, we note that the statutory duties of the auditor require them to form an opinion on the financial statements as a whole, including the effect of the matters brought to the notice by the erstwhile joint auditor. We also note that EP formed a conclusion on these matters without performing adequate audit procedures and obtaining sufficient appropriate audit evidence as required by SAs.

36. EP's submission in this regard is that all the observations raised by PW were present in the earlier years as well. According to EP, his observations were based on a thorough and objective examination of the facts of the case, whereas PW appears to have been influenced by news reportage around that time on matters involving other NBFC/HFC entities, to draw illogical and unmerited conclusions about the Company. EP also stated that PHD had carried out a factual verification of the issues raised by PW.

37. We have examined the replies and the work of the Auditors concerning the major observations raised by PW. The major issues raised by PW and the conclusions documented by EP in his presentation to the Audit Committee[21] are as given in the following table, with emphasis added by us where EP agreed and noted the same observations as PW.

Sl. No.	Issue Raised by PW	PHD's Conclusions
1.	As per the latest available financial statements of the borrower, the net worth of the entities was negative. The audit report on the financial	Out of 13 entities mentioned by PW, 11 had negative net worth, out of which 7 entities have issued CCDs to RCL. If these CCDs

[21] Refer WP – Audit Committee Meeting Presentation

	statements of the borrowers carried an EoM on the going concern assumption. (PW has given a list of 13 borrowers aggregating to approximately 12,571 Crore)	are considered equity instruments, then the net worth would become positive. In 1 case exposure of ICD is ₹581 crore, where the net worth is negative ₹7 crore. In the case of the remaining 3 entities total exposure is ₹44 crore, and negative net worth is in lakhs.
2.	As per the latest available financial statements of the borrowers, the debt-equity ratio is more than 10 or negative.	*"**As the net worth in most cases is negative, the debt-equity ratio can't be ascertained**. However, the CCDs if considered equity, the debt-equity ratio would improve substantially."*
3.	The loan balance confirmation circulated to the borrower (on the basis of the authorisation letter provided by the management) has not been responded till date.	*"As per the mails provided to us by the Company, confirmations have been sent to the PW team subsequent to May 14, 2019".*
4.	Based on the records available on the website of the Ministry of Corporate Affairs for the borrower entity, either no/inadequate charge has been created**.**	*"Observation was raised with regard to 7 entities. In case of 6 entities charges were created before 14.05.2019. In case of 1 entity charges has been created on 17.05.2019".*
5.	Credit Appraisal Memo (CAM) does not adequately cover the credit assessment of the borrower entity and the basis of granting the loan.	i. **CAM does not contain appraisal notes of these loans. The Repayment capacities of the borrowers were not analysed. The loan amount sanctioned is disproportionate to the financial strength of the entity**. ii. **All the loans are given for general and corporate purposes.** The purpose of the loan is onward lending**, however**, **no assessment of the ultimate borrower is done**. **iii. Delays have been observed in servicing interest and principal repayment by the borrower. Despite the delays mentioned above, the Company continued to disburse loans to the borrower. The risk analysis section of CAM does not contain in particular the risk involved in the lending and mitigation policies for those risks.** **iv. While sanctioning the loans, the liquidity of the underlying assets has not been considered.** v. **ICDs have been given even in cases where there were material provisions made in the case of investments in CCDs of these entities**.

6.	Based on the latest available financial statements of the borrower: (i) There is no employee cost. (ii) Majority of the assets of the Borrower entity are represented by loans and advances/investments to/in other companies. (iii) There is very minimal capital (less than or equal to 1 crore).	(i). **With regard to 6 entities, there is no employee in these Companies**. (ii) **With regard to 10 entities, the assets are in the form of loans and advances and investments**. (iii) **With regard to 6 entities, the capital is minimal**.
7.	During the year, the Company sold its investment in CCDs (face value ₹2160 crore) of Reliance Land Pvt Ltd at a gain of ₹827 crore. Such investment was considered to have a fair value of ₹1,333 crore as per the restated Ind AS financial statements as at 31-03-2018. The said CCDs were sold to Reliance Value Services Pvt Ltd vide agreement dated 17-09-2018, at its face value. During interim testing, PW observed that the Company has received ₹2,270 crore (i.e. face value of ₹ 2,160 crore and interest of ₹ 110 crore) in 22 tranches of ₹100 crore each and one tranche of ₹70 crore on 29-09-2018. Further, while testing new loan disbursements by the Company, it was observed that the Company, on the same date, had disbursed loans to the following parties. i. Reliance Digitech Limited - Loan disbursed- ₹ 1,170 crore (11 tranches of ₹100 crore each and 1 trench of ₹70 crore) ii. Reliance Venture Asset Management Pvt Ltd- ₹1,100 crore (11 tranches of ₹100 crore each)	**On verification of the relevant bank statements, we have observed that bank statements reveal the ICDs have been given to Reliance Digitech and Reliance Venture Asset Management for an amount of Rs 2,270 crore and was received from Reliance Value Services on the same date i.e. Sept 29, 2018. On detailed examination of bank statements for the FY 2018-19 we have observed 86 such transactions related to some of these parties amounting to ₹ 5,900 crores.**

38. We observe that the matters noted by EP in the Audit Committee presentation (emphasised in the above table) evidence credit impairment of the borrowing entities. This has a direct impact on the recoverability of the loans. However, EP failed to do any testing to rule out that impairment of such loans was not required. The merits of each of the above are discussed below.

a. Regarding the classification of CCDs fully as equity (sl. no. 1 in the table above), EP replied that while Ind AS 32[22] necessitates its categorisation as debt due to the absence of a strict fixed-to-fixed ratio, this classification pertains only to "*surface representation*". We observe that as per Ind AS 32, the contractual terms of the CCDs shall be assessed to find out the substance of the transaction, rather than its legal form, to determine whether it is a financial liability or an equity instrument. Thus, the presentation of the financial instruments is also as per the principle of substance over form. Further, if as per the terms of the contract, CCDs are classified as a compound instrument then the full amount cannot be considered as equity[23]. The value will have to be split between the debt and equity components. There is no evidence of such an assessment done by the Auditors. Thus, EP's conclusion that "*If these CCDs are considered as equity instruments, then the net worth would become positive"* is baseless. This observation of EP gives only a possibility (use of "*if*" condition), and not a professional judgment and conclusion based on recorded evidence to support the audit opinion.
b. Regarding the credit impairment of the borrowers (sl. no. 1 and 2 in the table above) we observe that out of the 13 borrowing entities reported by PW under section 143(12) of the Act, 11 entities were incurring losses, their net worth was completely eroded, and their auditors had reported EoM paragraphs on their being Going Concern. These borrowing entities further invested the borrowed monies in similar entities having weaknesses like negative net worth, losses etc. This posed a serious threat to the recoverability of all these loans. The above and the other factors evidence credit impairment of these loans. But EP conducted no substantive audit procedure or adequate verification to rule out the non-recoverability of these loans; nor was adequate provisioning done. Instead, EP has mentioned in his reply that he relied on comfort letters provided by the promoter group companies, Reliance Innoventures Private Limited and Reliance Infrastructure Limited, in support of the recoverability of these loans highlighted by PW as being impaired. We note that in the WP[24] titled closure document, it is documented that the financial strength of these promoter group entities had weakened significantly and they were under stress hence reliance had **not** been placed[25] on the comfort letter while evaluating the recoverability of loans. Similarly, the WP 'exposure analysis', relied on by EP for the value of the loans and end use, evidences the irrecoverable loans as most of the loans are used for debt servicing by credit-impaired entities. Moreover, not even in a single case did EP document the ultimate utilisation of funds to understand the exact business purpose and the ultimate beneficiary of this web of multiple layers of transfer of money. There is no independent examination of the cash flow projections of any of these entities to understand the repayment capacity. EP has simply copied data from the financial statements (several financial statements are as on 31st March 2018) and other information provided by the management without any independent examination. None of these data establishes cash inflow streams for any of these entities to ensure repayment capacity and the value of these loans shown as recoverable in RCL's financial statements.
c. Regarding the non-availability of direct balance confirmations from the borrowers (sl. no. 3 in the table above), we note that except for a few borrowers, there is no evidence to prove that these confirmations were received directly from the borrowers. Thus, the balance confirmations were

[22]Indian Accounting Standard (Ind AS) 32 Financial Instruments: Presentation

[23] The CCDs issued by RCL are 11% CCDs, so there is an outflow of interest. Thus, the present value of the interest will be considered as a debt and the remaining as equity.

[24] Refer WP- Closure Document

[25] WP- Closure Document states, *"During the year the financial strength of Reliance Innoventures Limited has weakened significantly on account of fall in market capitalization of ADA Group Companies, which were the significant assets of Reliance Innoventures Limited. Accordingly, as on March 31, 2019, reliance has not been placed on the comfort letter while evaluating the recoverability of Loans."*

not in compliance with the requirements of SA 505[26]. Notwithstanding the above, it must be noted that receiving balance confirmation does not evidence the recoverability of the loan, which was the core issue pointed out by PW in its letters. Further, the documents given by EP along with his reply do not form part of the audit file and hence cannot be entertained.

d. Regarding the creation of charges on assets by the borrower entities (sl. no. 4 in the table above), we observe that there is no adequate evidence in the Audit File that the assets on which the charges are stated to be created existed in the books of the borrower entities. Also, there is no assessment of whether the value of the assets on which the charge has been created covers the full value of loans taken from RCL. Since the assets on which charges were created were in the form of loans and investments in credit-impaired entities, EP was required to assess the value of those investments to conclude that charges were appropriate.

39. Apart from the above, we observe the following deficiencies also in the overall work of the Auditors regarding the recoverability of the loans, arising out of issues mentioned in sl. no. 1 to 1, 2, 5 and 6 in the table above.

a. We observe that as per the Credit Appraisal Memo (CAM), the purpose for which the loans were sanctioned was 'General corporate purpose and onward lending'. This means that loans were sanctioned for business purposes or onward lending by the borrower. The WP titled 'Loan End Use Details[27] documents end-use details of 3 borrower entities[28]. The end use was documented as debt servicing/repayment, investments, "Opex" and onward lending. However, the business activities of none of the borrowers were documented to confirm whether the loans sanctioned were utilised for genuine business purposes.

b. As per the WP, out of ₹6577 crore of loans, ₹6252 crore is shown as utilised for debt servicing or repayment. These are potential cases of the evergreening of loans where the previous outstanding loans were repaid out of new loans sanctioned. There is no examination of the bank statements to rule out the possibility of evergreening, despite the indications of circular transactions noted by PW.

c. For all the 3 borrower entities mentioned in the WP[29] the CCDs earlier advanced by the Company were completely written off, yet new loans were sanctioned in the FY 2018-19 pointing to their future non-recoverability.

d. EP's contention that borrower entities have not made continuous default in repayment of their obligations *"except for delays of few days*" is misleading. Contrary to this statement, the Audit File records that there were significant delays, not just a *few days*, in servicing interest and principal ranging from 60 to 151 days.

e. Further, EP's reliance solely on management representation is not in compliance with the requirements of para 3 of SA 580, which states that written representations do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal.

f. Our observations on EP's assessment of the risk of material misstatements in the financial statement due to fraud are given in section C.5 of this order. We observe that no adequate consideration of fraud risk factors was given by the Auditors.

g. Although both PW and PHD, have noted that there were borrowing entities that had no employees, had assets only in the form of loans and advances and investments and had minimal capital, the

[26] SA 505 External Confirmations

[27] Refer - File No 4 – Loans, g. Loan End Use Details

[28] Crest Logistics & Engineers Pvt Ltd , Reliance Venture Asset Management Pvt Ltd and Reliance Digitech Ltd.

[29] WP- 'Loan End Use Details'

Auditors have not performed any audit procedure to rule out the possibility that the loans and advances and investments were not being made in companies, that are like shell companies established to route the funds to other entities. Serious issues of credit impairment, and going concern issues relating to the borrowers were completely ignored by the Auditors, despite the red flags raised by the joint auditor before resignation. This indicated gross negligence and non-compliance with the statutory duties of an auditor.

40. All of the above shows that EP neither did adequate audit procedures, nor challenged the management on the irregularities in the sanction of loans, and reached a conclusion that the issues raised by PW were not attracting the provisions of section 143(12) of the Act. In reaching such conclusions the Auditors violated the applicable SAs as well. In the absence of tests and evidence, there was no assurance about the recoverability of the loans and hence the management's assertions about the value and rights of these loans were materially misstated[30] in the financial statements, which PHD failed to report. Also, the actual valuation of investments, the rationale for sanctioning loans and investments to potential non-creditworthy entities and the adequacy of provisions remained inadequately examined in all cases. These factors cumulatively contributed to the ROMM due to fraud, which PHD ruled out without adequate audit procedures[31], despite having been raised by the resigned joint auditor. The conclusion drawn by the Auditors that there were no material misstatements in the financial statements, either due to fraud or error, is therefore without adequate basis since there is no sufficient evidence showing that the loans of ₹6557 crore (net of impairment) disclosed in the financial statements are fairly presented and are fully recoverable. Consequently, the opinion of PHD confirming the management's assertions is without adequate basis. Hence, the charges mentioned in para 34 and 35 above are proved.

41. Such lapses in adequately responding to audit risks are viewed seriously by international audit regulators. In the matter of Ciro E. Adams, CPA, LLC, and Ciro E. Adams, CPA[32], the US audit regulator PCAOB imposed sanctions on an auditor for failure to obtain sufficient appropriate audit evidence supporting significant accounts, including accounts designated as a fraud risk or significant risk and not complying with multiple PCAOB auditing standards. The sanctions included censuring the Firm and Ciro E. Adams (Adams), revoking the Firm's registration, barring Adams from being an associate person of a registered public accounting firm, and requiring Adams to complete 40 hours of continuing professional education and a civil money penalty of $40,000.

C.5. Other Omissions/Commissions in Obtaining Sufficient Appropriate Audit Evidence in Key Areas of Audit

C.5.1. Verification of Lending Policy

42. EP and PHD were charged with the failure to obtain sufficient appropriate audit evidence as required by SA 500[33] regarding compliance with the Lending Policy despite observing marked deviations from the auditee's lending Policy documented in the Audit File.

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[30] To be read with our observations regarding inadequate ECL provisions explained in subsequent sections of this Order.

[31] To be read with our observations regarding inadequate assessment of ROMM due to fraud explained in subsequent sections of this Order

[32] PCAOB Release No. 105-2023-019 August 8, 2023.

[33] Refer to Para 6 to 11 of SA 500 Audit Evidence.

43. EP submitted that the decision-making process lies in the hands of its management and the auditor has no role in these decisions. PHD submits that it understood that the policy and the weaknesses in internal control had been reported in the qualified opinion on its report on Internal Controls over Financial Reporting (ICFR).

44. In this regard we observe as follows:

a. In the WP "Audit Planning Memorandum" EP identified Loans as a Significant Risk/Fraud Risk. A review of the Lending Policy was one of the audit procedures **planned** to address the risk. Accordingly, EP documented the Lending Policy. The testing of compliance with the policy by EP was limited to loan approval by the authorised officer as per the policy. We note that the Lending Policy[34] of the Company states that "*The lending would be based on the Company's judgement on, ability to pay, logical reasons for why the borrower has opted for the Company, the possibility of recovery on time, opportunities, future potential etc……The basic financial ratio, diversification of earning, alternate source of repayment, borrowers' trade cycle, market reputation, and capital structure, would be considered either on a discrete or aggregate basis. While the financials would be taken into consideration in making the judgement, the same would not be the sole criterion for sanction or otherwise. Thus, the Company would go beyond numbers while extending any financial assistance. The probabilities and the reasons for which repayment may not happen as expected would be explored/tested while making such call*."

b. However, the disbursements made by the Company were not in line with the above requirement of the Lending Policy, as evidenced by the observations made by PW and the CAMs documented by EP (e.g. borrowers like Reliance Venture Asset Management, Reliance Digitech, and Reliance Alpha). The presence of the lending policy in the Audit File and documentation of the glaring deviations from the policy evidence that Auditors were aware of the deviations. The policies and procedures set by those charged with governance form the basis of the internal controls of a Company. Such deviations from the policy are evidence that the internal controls over loan sanction and monitoring were not functioning properly in the Company. These deviations also indicate management override of controls in loan sanctioning and hence a fraud risk. A qualified opinion under ICFR does not absolve EP of his responsibility to report on this non-compliance. On the contrary, it shows that weaknesses in loan sanctioning and monitoring were overlooked by EP who chose to take refuge under the qualified opinion in ICFR which mentions only a weakness in loan documentation.

c. EP responded that the Lending Policy is a management decision and that the auditor has no role in its verification, is misplaced and shows a poor understanding on his part, of the requirements of the Standards and the Law. Section 143(1)(a) of the Act requires the auditor to inquire into whether loans and advances made by the company have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members. Thus, though the Company has the discretion to determine the terms and conditions of sanctioning the loans, the auditor must inquire whether or not those loans are prejudicial to the interest of the Company. RCL is a Core Investment Company. Its business involves transacting in loans to group concerns, its major income is from interest and the strength of the Company is derived from its loans and investments. Thus, if the Company is investing in entities which are credit impaired/ financially weak, in violation of its own lending policy, then it is prejudicial to the interest of the stakeholders. The recoverability of the loans was also required to be assessed properly and adequate provisions needed to be made in the accounts where necessary. Not evaluating this work

[34] Refer WP 'File No. 4 – Loans, c. Lending Policy'

of the auditee shows gross negligence and a lack of professional skepticism on the part of the Auditors.

45. In light of the above, all the charges in paragraph 42 of failure to obtain sufficient appropriate audit evidence regarding compliance with lending policy stands proved.

C.5.2. Direct Confirmation

46. EP and PHD were charged with non-compliance with requirements of para 26 of SA 330[35] in analysing contradictory audit evidence. While it was documented[36] that the ICD given by RCL amounting to ₹581 crore was not reflected in the books of Reliance Integrated Services Limited (RISL), there was a balance confirmation for this amount documented in the Audit File.

47. EP submitted that the matter was conveyed to the Company and the Company informed that RISL netted off the loan from RCL and the onward lending it made to Reliance Communications and it is a matter of presentation only. This is a post-dated rationalisation and cannot be accepted for the reasons discussed below.

48. We observe that the total balance sheet size of RISL for the FY 2017-18 was only ₹20.7 crore, without the above-said transaction. This is only 3.5% of the loan amount of ₹581 crore. Thus, the balance sheet size is negligible as compared to the loan amount. During the oral hearing, EP submitted that RISL had created a charge on the assets in favour of RCL. Neither the liability towards RCL nor the assets represented by the loan to Reliance Communications appear in the audited balance sheet of the borrower. Yet a charge was created on its assets, and the balance confirmation was provided! Moreover, RCL convinced the Auditors by rationalising this fully illegal accounting treatment which flays the standards in this regard. No Standard of Accounting permits a loan taken from and given to separate legal entities to be 'netted off' in the balance sheet. Such a practice would lead to gross misstatements of accounts and any explanations and rationalisations for the same are indications of fraud risk factors as explained in SA 240. The replies of EP and the facts show the absence of due diligence and gross negligence. Despite the presence of a report under Section 143(12), these factors did not prompt EP to revise the risk assessment or perform additional procedures to rule out the existence of any material misstatements due to fraud or error, such as the authenticity of the confirmations or validity of the charges in all the cases. Thus, EP ignored the contradictory evidence and did not perform any further procedures to confirm the facts in accordance with the requirements of para 26 of SA 330 and failed to obtain sufficient appropriate audit evidence as required by SA 500 to support the audit opinion.

49. Thus, the charge of non-compliance with requirements of para 26 of SA 330 of analysing contradictory audit evidence stands proved.

C.5.3. Assessment of Risk of Material Misstatement (ROMM) due to Fraud

50. EP and PHD were charged with the failure to issue an audit opinion that was appropriate to the circumstances. EP failed to identify revenue recognition and management override of controls as fraud risk as per the requirements of Paragraphs 26 and 31 of SA 240. Though the EP identified loans as a significant risk in the WPs and also noted the procedures to be performed to address the same,

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

[36] WP 'Exposure Analysis (Loans+Equity+CCD).pdf'

they ignored the contradictory evidence while concluding that the financial statements are free from material misstatements, thus failed to comply with Paragraphs 26 and 27 of SA 330.

51. In response to the above EP submitted that he had applied all the required procedures during the audit to ascertain whether there was a management override of controls. EP submits that the WPs[37] clearly state that revenue has been considered as a significant risk/fraud risk. Further, he states that irrespective of the risk the ET carried out an in-depth examination of records of the Company to comply with the SAs.

52. We find that there is no identification of fraud risk in revenue and management override of controls. There is no WP to identify or rebut risks of fraud in revenue or respond appropriately to risks of fraud in revenue and management override of controls. There is no compliance with Paragraph 32 of SA 240 such as proper testing of journal entries, reviewing accounting estimates for biases or evaluating whether the circumstances producing the bias. The substantive tests claimed to have been performed are limited to noting down the management submissions and records produced by the entity. Audit procedures responsive to a fraud risk are much more intensive than other procedures. The replies of EP show the disregard for the mandatory provisions of SA 240 and SA 330. Management may override controls to intentionally misstate the nature and timing of revenue or other transactions. Specific examination of fraud risk factors (incentive or pressure to commit fraud, a perceived opportunity to do so and some rationalization of the act) is absent. We have already discussed in the preceding pages, the rationalisation on the part of the management in the case of Reliance Integrated Services Private Limited (RISPL). Another instance of rationalisation is in the case of the sale of CCD above fair value, noted by both PW and PHD. RCL sold its investment in CCDs (face value ₹2160 crore, fair value of ₹1,333 crore) of Reliance Land Pvt Ltd at face value to Reliance Value Services Pvt Ltd, showing a gain of ₹827 crore. The transaction amount was then transferred by RCL through multiple layers in multiple tranches, on the same day, between several group companies under different contexts. EP stated that *"Reliance Land Limited was in the process of getting its equity shares listed in the stock exchange. In view of the above, the investment by RCL in Reliance Land Limited had to be restructured by sale of CCD to another group company and the same was done at the face value. The matter was discussed with the management as well as the audit committee and was not considered as a transaction at unusual value".* This reply, which merely refers to the discussion with the management and the Audit Committee without detailing what was discussed and without disclosing why a prima facie unusual transaction (sale at 1.62 times the fair value and transfer in multiple tranches on the same day) was not considered so, indicates that the transaction was recorded in the books to window-dress the accounts of Reliance Land Limited by showing a higher value of its CCDs ahead of the listing of its shares. In this scheme of transactions, RCL booked a profit of ₹827 crore and gave more loans to already credit-impaired entities (Reliance Digitech Ltd and Reliance Venture Asset), who repaid their outstanding loans using this amount. Despite the underlying design of all these unusual transactions, defying accounting and financial rationale, the Auditors accepted the rationalisation given by RCL without necessary examination and verification.

53. As per para 32(c) of SA 240, the auditor is required to evaluate whether the business rationale (or the lack thereof) of unusually significant transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets. The sale of CCD at a value more than its fair value (1.62 times), and then the transfer of funds between multiple entities in multiple tranches on the same day was an unusual transaction. Despite this, the Auditors did not raise any queries or do any independent examination. Thus, the Auditors were grossly negligent and lacked professional skepticism.

[37] Audit Planning Memorandum and Planning Risk Assertion

54. In another instance, even though the Credit Appraisal Memo (CAM) of group companies was recorded in the Audit File, PHD failed to perform any audit procedures to obtain sufficient appropriate audit evidence to rule out management override of controls. In the CAM of Crest Logistics[38], for instance, the loan was sanctioned for ₹511 crore at 11% interest, while an exposure of ₹1368 crore was already outstanding. It was also noted that the PAT for three FYs ending on 31st March 2013, 2014 and 2015 are negative, lowest loss being ₹702 crore. Interest was payable annually. The source of repayment was shown as "NA". There was no explanation as to why the latest financial position of the Borrower was not recorded and how the borrower was expected to repay the interest and principal. There was no examination of the creditworthiness, such as ratings, end use of funds or projected cash flows. The CAM was signed by the CFO. In all cases of CAM the work of the ET was found to be limited to noting down the management's data. There was no further examination of deviations from the credit policy, the process followed to sanction, disbursal etc. to ascertain management override of controls. There is an absence of the procedures prescribed in Paragraph 32 of SA 240 such as testing of journal entries and other adjustments throughout the period, retrospective review of management judgements, evaluation of their business rationale etc. The Auditors claim to have performed these but the same is not evidenced in the Audit File.
55. Thus, the charge of noncompliance with Paragraphs 26 and 31 of SA 240 and Paragraphs 26 and 27 of SA 330 regarding failure to identify and respond appropriately to ROMM due to fraud in management override of controls and revenue stands proved. This has resulted in the issue of an audit opinion without sufficient appropriate audit evidence. All the charges in paragraph 50 above thus stand proved.
56. Such lapses in the audit of revenue and the absence of professional skepticism are viewed seriously by audit regulators across the world. In the matter of Haynie & Company[39], the US audit regulator PCAOB imposed sanctions on an auditor for failure to appropriately evaluate whether the revenue is reported in conformity with the applicable financial reporting framework. The sanctions included censuring the Firm, requiring the Firm to engage an independent consultant to review and make recommendations concerning its system of quality control and a civil money penalty of $400,000.

C.5.4. Verification of Expected Credit Loss (ECL) on Financial Assets in Compliance with Ind AS 109

57. EP and PHD were charged with failure to obtain sufficient appropriate audit evidence regarding the reasonability of the estimate of ECL and related disclosures in the financial statements. This has led to a failure to report material misstatements of under-provisioning and consequent overstatement of profits in the financial statements.
58. In response to this charge, EP submitted that the audit procedures performed were adequate as per SAs. He stated that the values of loans appearing in the financial statements at the year-end were compared with the valuation report provided by the independent valuer which is more than the values reported in the financial statements. This, in his opinion, ruled out the possibility of management bias, thus confirming the reliability of ECL.
59. This stand of EP shows an absence of professionalism and gaps in his knowledge of the matter. The factors determining ECL are detailed in Ind AS 109[40]. The asset-based approach to valuation (as is found in the valuation report) focuses on a company's net asset value (NAV), or the fair market value of its total assets minus its total liabilities, to determine what would be the cost to recreate the

[38] WP m.credit appraisal memo

[39] PCAOB Release No. 105-2024-001 January 23, 2024

[40] Indian Accounting Standard (Ind AS) 109 Financial Instruments

business. There is no evidence that it captures the future income, the possibilities of loss, expected cashflows, or credit concerns of the business. ECL, on the other hand, estimates the expected credit losses that result from default events that are possible within 12 months (in a 12-month ECL scenario) or the expected credit losses that result from all possible default events over the expected life of the financial instrument (in a Lifetime ECL scenario). In this case, these two estimates (NAV and ECL) are not comparable to validate the ECL model. Moreover, in the valuation reports obtained[41] the expert mentioned that the data/information was provided by the management and was used without any verification. Further, it also mentioned that the report should be used only for the estimation of the fair value of CCDs and should not be relied upon for any other purposes.

60. It was the responsibility of EP to test the ECL as per the requirements of the standard. However, there is no original work by EP other than noting down[42] the ECL model of the Company and doing mathematical calculations. For instance, we note the following deficiencies in this regard**.**

a. ECL is an estimate. All estimates have some uncertainty which is one of the risk factors that an auditor considers when evaluating risks of material misstatement posed by a particular estimate. Due to the forward-looking nature of the estimates of ECL, the risks related to uncertainty associated with estimation assume enhanced importance. Companies should have a well-controlled, well-documented process in place that enables them to have a consistent unbiased approach to uncertainty due to estimation and the selection of the point estimate within the range of reasonably possible outcomes. The auditor is required to extensively test these processes as part of control testing, which is absent in this case.
b. There is no evaluation as to whether the management's decisions on the range of scenarios and the weightage given to these scenarios capture the appropriate extent of ECL required by Ind AS 109.
c. There is no examination of the completeness, accuracy and relevance of the inputs and no assessment of the reasonableness of the assumptions used by the management in the ECL calculations and model.
d. The Table below shows the amount of ECL provision made by the Company on certain loans outstanding as on 31.03.2019 and the classification of such loans.

(All ₹ in crore)

Sl. No.	**Name of Borrower**	**Amount of Loan Outstanding**	**Loan Classification (Stage)**	**Amount of ECL**
1.	Crest Logistics & Engineers Pvt Ltd	3,026	2A & 1	766
2.	Reliance Venture Asset Management Pvt Ltd	2,480	2A	1,047
3.	Reliance Digitech Ltd	1,589	1	54
4.	Reliance Alpha Services Pvt Ltd	1,107	2	43
5.	Reliance Integrated Services Pvt Ltd	581	3	581
6.	Reliance Unicorn Enterprises Pvt Ltd	69	2A	31

41 Refer WP Details of Valuation

42 WP h.Expected Credit Loss and other WPs where ECL is noted.

7.	Reliance Media Works Financial Services Ltd	40	1	1
8.	RPL Solar Power Pvt Ltd	31	1	1
9.	RPL Sunlight Power Pvt Ltd	12	1	0
10.	Reliance Broadcast Network Ltd	1	1	0
	TOTAL	8,936		2,524

e. We observe that Ind AS 109 prescribes a 3-stage model for the classification of loans (refer to paragraphs 5.5.3, 5.5.5, 5.4.1, B5.5.33 and other relevant paragraphs of Ind AS 109). The notes to accounts[43] and Key Audit Matters disclose a three-stage distribution of loans as per Ind AS 109. However, as evidenced in the table above, the Company adopted an intermediary stage- viz., stage 2A for certain assets. It was seen that the assets categorised at stage 2A had the characteristics of stage 3 assets which require provisioning of 100%. Finally, these assets were disclosed under stage 2 in the financial statements, resulting in material misstatements in the disclosures, provisions, and net profit.

f. In all the cases of borrowers categorised under stage 2A, as discussed above, there were significant delays in servicing of interest and principal ranging from 60 to 151 days[44]. Still, these loans were not classified at the appropriate stages as required by Ind AS 109. EP's reply that since the interest was repaid in full and as per the accounting policy the quantitative test was no longer applicable to keep exposure in Stage 2 is a rationalisation of the omission. The interest payments were in default during the year of audit and hence it was required to follow the classification norms as applicable to a defaulted loan, which EP failed to do.

g. In the Minutes of the Meeting with the management held on 02.08.2019 it is noted that "*We are unable to obtain sufficient appropriate explanation for the exposure in Crest as the corporate guarantee of Reliance Infrastructure Limited is not acceptable considering the Company itself is under stress. Hence request you to provide some other comfort or else make adequate provision in the books of account*." In the same WP, the Minutes of Meeting held on 13.08.2019 notes that "*considering the stress of Reliance Infrastructure Limited, the Company has entered into an MoU towards acquisition of the assets of Crest to the extent of ₹1,500 crore, and that the Company has got the assets of Crest valued by a registered valuer, which shows a value of assets of more than ₹15,000 crore. Thus, management is confident of recovering the entire exposure*". In this regard, Paragraph 9 of SA 500 requires an auditor to sufficiently evaluate the reliability of any information provided by the auditee company before the use of such information for purposes of audit. However, EP did not perform sufficient audit procedures to test the adequacy of the information provided by the Company. The MoU entered between RCL and Crest Logistics, relied upon by EP, does not document as to which assets, out of the total of assets valuing ₹15000 crore, would be purchased by RCL and the time of such purchase. It only stated that assets for a consideration of ₹1,500 will be purchased. Thus, there was no examination, on the part of EP, of the assets in question or their valuation to ascertain the genuineness of the claims of the management. Thus, the classification of ICD of Crest as stage 1 was not supported by evaluation and hence not justified.

[43] Notes 7 and 51 of SFS.

[44] Refer WP – Details of Interest Delay.pdf (page i3)

h. Past trends as well as forward-looking information are to be used by the management for making judgements about the assumptions regarding rates of Probability of Defaults (PD) and Loss Given Default (LGD). There is no evidence as to what forward-looking information was used by the management. The WPs[45] only document that PD and LGD are as per past trends and historical recovery data, without even mentioning what data has been used to derive past trends. EP's contention that LGD is worked out based on prospects of recovery and its present value is vague and without any supporting evidence.

i. For stressed assets it is documented in the WP titled "Expected Credit Losses" that management uses a different approach by using expected cash flows. The WPs do not document the expected cash flows and how and on what basis the management arrived at those cash flows. Entities like Crest Logistics & Engineers Pvt Ltd, Reliance Venture Asset Management Pvt Ltd, Reliance Digitech Ltd etc. had negative characteristics like recurring losses, negative net worth etc. and the CCDs issued to them were entirely written off by RCL. The loans given to these entities in the current year should have been classified as Purchased or Originated Credit Impaired (POCI) assets and thus the credit-adjusted effective interest rate[46] should have been worked out considering the credit impairment. There is no evidence of this examination. The statement that PD for stressed assets has been considered as per "ICRA rates of stressed assets" makes it clear that no examination of the entity-related trends and forward-looking information has been considered by EP.

j. The above proves that the material control weakness of ECL, read with the deficiencies in the credit risk assessment by the RCL had resulted in an overstatement of profit and hence had a pervasive effect on the Company's financial statements, the effect of which could be in the range of ₹6412 crore[47] on ECL and ₹948 crore on overstatement of interest income[48]. Had the proper test of design, implementation, and operating effectiveness of internal controls on ECL been done, the opinion on internal financial controls over financial reporting would have been adverse.

61. Thus, the entire work relating to the audit of ECL was grossly inadequate and the audit opinion issued was misleading. EP failed to report the understatement in provisions leading to the overstatement of profits in the financial statements. Accordingly, the charges in paragraph 57 above are proved.

62. Such lapses in challenging the management and absence of professional skepticism are viewed seriously by audit regulators across the world. In the matter of K.R. Margetson Ltd. and Keith R. Margetson[49], the US audit regulator PCAOB imposed sanctions on an auditor for failure to appropriately evaluate the reasonableness of a discount rate used in developing the valuation estimate. The sanctions included revocation of registration of the firm, restrictions in acting as EP and a civil money penalty of $30,000. In the matter of Martin Lundie, CPA[50] (Partner, EY Canada), PCAOB imposed sanctions for failing to sufficiently test the assumptions underlying the estimate and by failing

[45] Refer WP – Expected Credit Loss, Audit Closure Document

[46] Paragraphs 5.4.1 and B5.5.45 of Ind AS 109.

[47] As all the 10 financial assets listed in the table above showed objective indicators for credit impairment, these loans may be classified under stage 3 with 100% provision (This excludes the amount of interest income overstated, which is not ascertainable from the audit file).

[48] Total interest charges on credit-impaired assets (₹1089 crore) minus interest on stage 3 assets (₹131 crore). Refer to WP Expected Credit Loss.

[49] PCAOB Release No. 105-2023-023 September 12, 2023.

[50] PCAOB Release No. 105-2022-040 December 22, 2022

to sufficiently test the accuracy and completeness of data on which that estimate was based. Sanctions included debarring from being an associated person of a registered public accounting firm and a civil money penalty of $65,000.

C.6. Omissions and Commissions in Engagement Quality Control Review (EQCR)

63. The EQCR partner was charged with the failure to exercise due diligence to obtain sufficient information to objectively evaluate the significant judgments of the ET and conclusions reached by them and thus failed to perform his duties as mandated by SA 220 and SQC 1.

64. In response to the above the EQCR Partner endorsed all the replies provided by EP and PHD and submitted that the EQCR Partner is not a part of the ET. Being an evaluation function, the EQCR process involves the review of selected work papers prepared by the ET and discussion with the ET to obtain clarifications. The EQCR Partner has to provide his objective view on the judgements made by ET. According to the EQCR Partner, he does not have any role or right to exercise his professional judgment. The role of EQCR is to evaluate the judgements made on significant matters arising during audit engagement and not to provide his view or professional judgements on those matters and he is not bound by SA 230.

65. We examine in detail the written replies to the SCN, and the oral submissions made by the EQCR partner and observe as follows:

    a. The very fact that the EQCR Partner agreed with all the omissions and commissions of the ET, as explained in detail in the above paragraphs, makes the EQCR Partner guilty of professional misconduct of absence of due diligence and gross negligence. The Audit Documentation does not evidence objective evaluation, by the EQCR Partner, of the significant judgments made and the conclusions reached by EP in formulating the audit report. The replies of the EQCR Partner also evidence that the purported review done lacked objectivity as mandated by Paragraphs 7(b) and 20 of SA 220 since the EQCR states that he did not make any professional judgements during his review. Objectivity essentially involves forming independent conclusions and judgements and thereby challenging the ET rather than blindly following the judgments made by the ET. Documenting discussions with the ET is critical in proving the objectivity, which the EQCR Partner did not do.

    b. As per SQC 1 and SA 220, EQCR is an objective evaluation of the significant judgements made by the ET, and the conclusions reached in formulating the auditor's report. It is not an audit of the financial statements. Hence the basis of conclusions documented by the ET regarding various aspects of the audit alone cannot form the basis of conclusions by the EQCR Partner. He needs to apply his objective wisdom to ensure that the ET has complied with all the requirements applicable to the subject matter under review. Thus, the evaluation should be whether the audit procedures performed are appropriate, whether ET had obtained sufficient appropriate audit evidence and whether appropriate conclusions were reached and documented for those audit areas. While doing so, the matters discussed by the EQCR Team with EP, the additional evidence or procedures required by the EQCR Partner etc. shall form part of the documentation so that the work of the EQCR is evidenced and identifiable. Even when the EQCR Partner agrees with all significant matters documented by the ET, there is still a need to document the discussions and procedures of the EQCR and the basis on which the EQCR Partner agreed with the ET. The documentation in such cases should be based only on the principles laid down in SA 230. We observe that the Documentation by the EQCR partly covers the above requirements, insofar as it incorporates certain significant decisions made by the ET, queries raised by the EQCR Partner and the replies provided by EP. However, the subject matter of discussions and documentation, at no stage,

included the serious omissions made by the ET regarding PW matters, the absence of adequate provisions, the inappropriateness of the EoM and the material misstatements in the financial statements. Similarly, an examination of whether the ET's work complies with applicable SAs and Ind AS is also absent.

c. The EQCR Partner submits that the documentation requirements of SA 230 do not apply to his work. This contention is misplaced. The documentation requirement in Para 25 of SA 220 is specific to SA 220. Nowhere in the SAs or SQC 1 does it state that the documentation requirements of Para 73 of SQC 1 and Para 25 of SA 220 (both the requirements are similar) are the ONLY documentation requirements that the EQC Reviewer shall follow. SA 230 explicitly states in para 1 that the specific documentation requirements of other SAs do not limit the application of SA 230. As per SA 230, Audit documentation serves several purposes including evidence that the audit is planned and performed in accordance with the SAs. Therefore, performance by the EQCR of the mandatory requirements of SA 220 shall be evidenced by documentation, adhering to the principles of SA 230, particularly Paras 8, 9 and 10. The mandatory requirements for EQCR are specified in paras 20 and 21 of SA 220. The key procedures specified include a discussion of significant judgements made by the ET, a review of Financial Statements and a review of selected audit documentation. Documentation of a mandatory procedure in an SA is a compulsory requirement of SA 230 and it forms the base of any audit under the Companies Act since SAs need to be statutorily complied with. The argument that EQCR is not part of ET or EQCR is not an auditor does not vitiate this position since it is the statutory responsibility of the auditor to comply with all the SAs including SA 220. Hence it is imperative that to meet the requirements of SA 220 and SQC 1, the documentation done by the EQCR shall have to be per the requirements of SA 230 and SA 220. Documentation prepared as per SA 230 and specific documentation requirements of other SAs provide evidence that the audit is performed following SAs and the applicable legal and regulatory requirements (Para 2 of SA 230). Thus, specific documentation requirements of any SA alone cannot meet this requirement, since mandatory procedures are prescribed in all the SAs. SA 220 is no exception as far as EQCR is concerned.

66. Thus, we conclude that the EQCR Partner failed to objectively evaluate and question EP when EP failed to meet the relevant requirements of the SAs and violated the Act, and the Code of Ethics in respect of several significant areas. Hence the charges in Paragraph 63 above stand proved.

67. We also observe that such lapses have been viewed seriously by international regulators as well. For example, PCAOB[51], the US Regulator, charged Grant L. Hardy (CPA) for his failure in connection with his role as Engagement Quality Reviewer ('EQR' hereafter) in the audit of financial statements of some of the issuer clients and noted that "*Hardy violated PCAOB Auditing Standard No. 7, Engagement Quality Review ("AS 7") by providing his concurring approval of issuance without performing with due professional care the EQRs required by this standard for the Firm's audits of COPsync and Forever Green's December 31, 2010, financial statements and AEG's June 30, 2011, financial statements*." For this misconduct, PCAOB censured the EQR, barring him from being an associated person of a registered public accounting firm for 1 year.

68. PCAOB in the matter of Cheryl L. Gore, CPA and Stanley R. Langston, CPA, charged[52] Stanley R. Langston (CPA) for his failure in connection with his role as Engagement Quality Reviewer in the audit of financial statements of some of the issuer clients and noted in its order dated 14.12.2021 that "*Langston violated AS 1220, Engagement Quality Review, by providing his concurring approval of issuance of the Firm's audit reports without performing the required engagement quality reviews with*

[51] PCAOB release no 105 2015 001 dated 12.01.2015

[52] PCAOB Release No. 105-2021-020 December 14, 2021

due professional care." For this misconduct, PCAOB imposed restrictions on Langston, barring him from being an "engagement partner" or EQC Reviewer for 1 year and also imposed a monetary penalty of $10,000. Furthermore, in another case, PCAOB found[53] that Donald R. Burke, CPA, failed to evaluate properly the engagement team's assessment of, and audit responses to, significant risks identified by the engagement team, including fraud risks. As a result of his failure to perform Engagement Quality Reviews with due professional care, among other things, Donald R. Burke, CPA was suspended from being an associated person of a registered public accounting firm for a period of one year and imposed a $10,000 civil money penalty upon Burke.

C.7. Role of the Audit Firm

69. PHD in its reply to SCN submitted that as a Firm it had discharged all its responsibilities by setting the policies and selecting the right people for the Engagement Performance and Review. According to PHD, the "*firm's role is limited to the extent that the firm is having a robust quality control policies and the same is followed by all the partners of the firm*…". The salient features of the quality control policy are explained in the reply to SCN and PHD then submitted that the detailed replies to the SCN, by EP and EQCR Partner, demonstrate the "*depth of due diligence*" and "*integrity of our audit process*".

70. We do not agree with any of the contentions of PHD in this regard. PHD is the legal entity appointed under Section 139 of the Act as the auditor of RCL. Hence the report issued by the legal entity, signed by EP, is the primary responsibility of the legal entity issuing the report under the Act. We have proved in the previous sections of this order that the report lacked adequate basis. Hence, apart from the individuals delegated by the firm to carry out this audit, the firm (as the appointed statutory auditor has the primary responsibility) is also answerable for its report issued under the Act, as further explained in the following paragraphs.

71. The requirements of Sub-Sections 9 and 10 of Section 143, SQC-1[54] and SAs, which are subordinate legislations, lay down the following in clear terms:

    a. Responsibility for the overall quality of all the audit engagements, by ensuring that the firm's personnel comply with applicable laws, SAs and ethical requirements and issues reports appropriate to the situation, rests with the firm[55].

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[53] PCAOB release no. I 05-2021-012 dated 29.09 200 I

[54] 220 - Quality Control for an Audit of Financial Statements, deals with the overall quality of an audit engagement. SA 220 provides that:

"2. Quality control systems, policies and procedures are the responsibility of the audit firm. Under SQC 1, the firm has an obligation 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 and regulatory and legal requirements; and

(b) The reports issued by the firm or engagement partners are appropriate in the circumstances.

This SA is premised on the basis that the firm is subject to SQC 1. "

Standard on Quality Control (SQC) 1 delineates the responsibilities of the Firm regarding audit quality. Audit quality is the foundation of any statutory audit. Further, SAs, such as SA 200, SA 220, SA 230, SA 260 (Revised), SA 610(Revised), SA 620 and SA 700(Revised) refer to SQC-1 when it comes to specific aspects of audit such as documentation, communication with those charged with governance, engagement of Auditor's expert, evaluating the adequacy of internal audit function of the Company, and general quality aspects.

[55] SQC- lays down these core principles a Firm must adhere to ensure minimum required quality in any audits undertaken at the firm level. It emphasises that "3. The firm should establish a system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements, and that reports issued by the firm or engagement partner(s) are appropriate in the circumstances". SQC-1 then mandates in detail the stipulations at the firm level

b. Within the above framework, the individual engagement partners are personally responsible[56] for the quality of specific engagements to which they are assigned by the firm as per its policies.

72. When a firm is appointed as an auditor under Section 139, all the responsibilities cast under the Act are primarily on the firm. As mandated by Section 132, the responsibility of overseeing the quality of service of the professions associated with ensuring compliance with auditing standards rests with NFRA. Monitoring and enforcing compliance with standards of auditing (SA) is another statutory duty cast on NFRA.

73. Taking the above cardinal factors into account, Section 132 (4) of the Act empowers NFRA to investigate the matters of professional or other misconduct committed by any member or firm of chartered accountants, registered under the Chartered Accountants Act, 1949. Violation of the Act, SAs or SQC 1 is one of the key ingredients of professional misconduct, as envisaged by the Act.

74. Thus, after a detailed examination of facts and circumstances, we observe that the failure in this audit engagement was due to violations of SAs, the Act and Ethical Principles laid down in the Code of Ethics. Hence the role of the Audit Firm, whose responsibilities are mandated by the Act, is equally important as that of EP and EQCR Partners, whose responsibilities are delineated in the SAs and SQC -1. Given the fact that the Audit Firm is the legal body appointed as the auditor and EP mandatorily takes responsibility for the individual audits subject to firm-level supervision, both have joint and several responsibilities for the Audit. Section 132 (4) emanates from this basic premise. However, there is not adequate evidence of effective supervision and oversight by PHD. Providing the ET with a quality policy alone is not good enough to establish effective supervision as envisaged in SQC-1. Had the Audit Firm discharged its supervisory responsibilities timely and effectively such major lapses in the audit could have been avoided.

75. We note that globally also this is the accepted position. The PCAOB (US Audit Regulator) orders quoted by NFRA in its various disciplinary orders underline this fact. For instance, The PCAOB,[57] for charges including violations of auditing standards related to the audit of financial statements of Medicis Pharmaceutical Corporation and subsidiaries, imposed civil money penalties of $2,000,000 to the firm Ernst & Young LLP, $50,000 to Jeffrey S. Anderson, the Partner with final responsibility of the subject matter audit engagement, $25,000 to Robert H. Thibault, the independent review partner, and $25,000 to Ronald Butler, the second partner, supervised by Anderson. The partners were also barred from being associated with a registered public accounting firm. In another case, the PCAOB[58] imposed civil money penalties of $1,000,000 on KPMG India and $75,000 on its partner Lakhani for lapses in audit documentation by the partner, who was an ET member. PCAOB also suspended Lakhani from being an associated person of a registered public accounting firm for a period of one year.

76. The "Firm and Engagement Performance Metrics" published by PCAOB on October 12, 2022[59], provides a detailed study of engagement level and firm-level quality matrices. Engagement-level metrics provide information about a particular engagement of the firm, and Firm-level metrics address

[56] Paragraphs 3, 4 and 8 of SA 220.

[57] PCAOB Release No. 105-2012-001 February 8, 2012.

[58] In the Matter of KPMG Assurance and Consulting Services LLP and Sagar Pravin Lakhani, PCAOB Release No. 105-2022-033 December 6, 2022.

[59] https://assets.pcaobus.org/pcaob-dev/docs/default-source/about/advisory/documents/iag-october-2022/firm-and-engagement-performance-metrics-and-related-attachments.pdf?sfvrsn=e362f3a_3

an audit firm's overall strategy in complementing the engagement-level matrices. The study covers all major jurisdictions, including India, in the world and top tier Audit Firms. The study reveals that many metrics can be applied at both the engagement and firm level and some metrics may only be reported at either the engagement level or the firm level. (Refer to Page 5 of the report). The report lists key Audit Quality Indicators reported by 9 leading audit firms[60] (refer to page 14 of the report). This Audit Quality Indicators make it clear that in, actual practice across the world, the Audit Firm has an equally important role as that of EP to ensure overall quality in any audit undertaken by the Firm.

D. FINDINGS ON THE ARTICLES OF CHARGES OF PROFESSIONAL MISCONDUCT

77. Given the above actions or omissions as the Auditors, it is proved that EP, EQCR Partner and PHD did not exercise due diligence in ensuring the audit quality expected in an audit of a public interest entity and were grossly negligent in the conduct of their professional duties by not adhering to the requirements as laid down by the relevant statutes. Based on the above discussion, it is proved that EP and PHD had issued audit opinion on the Financial Statements without adequate basis, which was concurred by the EQCR Partner. The poor quality of the audit, incomplete documentation and attempt to mislead through evasive replies further compound the professional misconduct of the Auditors. Based on the discussion and analysis, we conclude that EP, PHD and EQCR Partner have committed Professional Misconduct as defined in the Act, as below:

    a. EP and PHD committed professional misconduct as defined by Section 132 (4) of the Companies Act, 2013, read with Section 22 and Clause 5 of Part I of the Second Schedule of the Chartered Accountants Act, 1949 (No. 38 of 1949) as amended from time to time, 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 PHD and EP failed to disclose in their report the material non-compliances the Company made as explained in sections C1 to C5 and C7 above.

    b. EP and PHD committed professional misconduct as defined by Section 132 (4) of the Companies Act, 2013, read with Section 22 and Clause 6 of Part I of the Second Schedule of the Chartered Accountants Act, 1949 (No. 38 of 1949) as amended from time to time, 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 EP and PHD failed to disclose in their report the material misstatements made by the Company as explained in Paras C1 to C5 and C7 above.

    c. EP, EQCR Partner and PHD committed professional misconduct as defined by Section 132 (4) of the Companies Act, 2013, read with Section 22 and Clause 7 of Part I of the Second Schedule of the Chartered Accountants Act, 1949 (No. 38 of 1949) as amended from time to time, 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".

[60] Various reports issued by nine firms were reviewed to identify firm level metrics disclosed in public reports. These firms are BDO USA, LLP, CohnReznick LLP, Crowe LLP, Deloitte & Touche LLP, Ernst & Young LLP, Grant Thornton LLP, KPMG LLP, PricewaterhouseCoopers LLP, and RSM US LLP.

This charge is proved as EP, EQCR Partner and PHD conducted the Audit of a Public Interest Entity in total disregard of their statutory duties, evidenced by multiple critical omissions and violations of the standards. The instances of failure to conduct the audit in accordance with the SAs and applicable regulations, and failure to report the material misstatements in the financial statements and non-compliances made by the Company are as explained in Paras C1 to C7 above.

d. EP, EQCR Partner and PHD committed professional misconduct as defined by Section 132 (4) of the Companies Act, 2013, read with Section 22 and Clause 8 of Part I of the Second Schedule of the Chartered Accountants Act, 1949 (No. 38 of 1949) as amended from time to time, which states that a CA 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 since EP, EQCR Partner and PHD failed to conduct the audit in accordance with the SAs and applicable regulations as well as due to their total failure to obtain sufficient appropriate audit evidence to support their opinion on the financial statements as explained in Paras C1 to C7 above.

e. EP and PHD committed professional misconduct as defined by Section 132 (4) of the Companies Act, 2013, read with Section 22 and Clause 9 of Part I of the Second Schedule of the Chartered Accountants Act, 1949 (No. 38 of 1949) as amended from time to time, which states that a CA 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 EP and PHD failed to conduct the audit in accordance with the SAs as explained in Paras C1 to C7 above but falsely reported in their audit report that the audit was conducted as per SAs.

78. Therefore, we conclude that the charges of professional misconduct in the SCN, as detailed above, stand proved based on the evidence in the Audit File, the audit reports on the standalone financial statements and consolidated financial statements for the FY 2018-19, the submissions made by EP, EQCR Partner and PHD and the Annual Report of RCL for the FY 2018-19.

E. SANCTIONS AND PENALTIES

79. 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.

80. In FY 2018-19 RCL had loans from Banks of around ₹12000 crore and other external borrowings of around ₹32000 crores, consisting of debentures, commercial papers and pass-through certificates. RCL was a Core Investment Company (CIC) investing primarily in its group companies. Given the high degree of public interest in this listed entity, it was the duty of the Auditors to conduct the audit with the highest level of professional skepticism and due diligence and report their opinion in an unbiased manner. Despite the resignation of the joint auditor and a reporting of suspected fraud, PHD, EP and EQCR Partner failed to conduct the audit as per standards on auditing. The material misstatements in the financial statements due to inadequate provision, unjustified valuation of loans and irrational business practices were concurred by the Auditors in disregard of their responsibilities under the Act and SAs. The Auditors also demonstrated recklessness and unprofessionalism by rationalising the actions of the Company, inappropriately evaluation of the work of the resigned

auditor, and ignoring the fundamentals of accounting and auditing. Such actions of the Auditors necessitate stricter sanctions and penalties taking into account the letter and spirit of the law.

81. Because professional misconduct has been proved and considering the nature of violations and principles of proportionality, we, in the exercise of powers under Section 132 (4) (c) of the Companies Act, 2013, order:

    a. Imposition of a monetary penalty of ₹3 crore (Rupees Three Crore) on the Audit Firm M/s Pathak H.D. & Associates.

    b. Imposition of monetary penalties of ₹1 crore (Rupees One Crore) and ₹50 Lakh (Rupees Fifty Lakh) respectively on EP CA Parimal Kumar Jha and EQCR Partner CA Vishal D Shah.

    c. In addition, EP and EQCR partners are debarred for 10 years and 5 years respectively 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.

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

Sd/-

(Dr. Ajay Bhushan Prasad Pandey)

Chairperson

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

Authorised for issue by the National Financial Reporting Authority,

Vidhu Sood

Date: 12.04.2024 (Vidhu Sood)

Place: New Delhi Secretary

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

To

M/s Pathak H.D. & Associates (FRN 107783W) 814-815 Tulsian Chambers, 212 Nariman Point, Mumbai-400021. Email: phd@phd.ind.in	Shri Parimal Kumar Jha Engagement Partner, (Membership No. 124262) 814-815 Tulsian Chambers, 212 Nariman Point, Mumbai-400021. Email: phd@phd.ind.in	Shri Vishal D Shah, EQCR Partner, (Membership No. 119303) D 206, Anand Nagar, Forjett street, Tardeo Road, Opp. Bhatia hospital, Mumbai – 400026. Email:13vishalshah@gmail.com phd@phd.ind.in

Copy to:

(i) Secretary, Ministry of Corporate Affairs, Government of India, New Delhi.

(ii) Secretary, Institute of Chartered Accountants of India, New Delhi.

(iii) Reserve Bank of India.

(iv) Securities and Exchange Board of India.

(v) Reliance Capital Limited, Mumbai.

(vi) IT-Team, NFRA for uploading the order on the website of NFRA.