

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

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

Errata No. 015/2024

Date: 17.05.2024

Errata

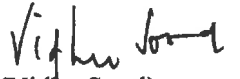
Name of Document: NFRA Order No. 015/2024, dated 16.05.2024, in the matter of M/s Shridhar & Associates (Firm Registration no. 134427W) and CA Ajay Vastani (ICAI Membership No. 132265) under Section 132(4) of the Companies Act 2013 read with Rule 11(6) of National Financial Reporting Authority Rules, 2018.

The following changes were made to the above document after issue.

Third line in Para 8 of the Order refers to Companies (Accounting Standards) Rules, 2006.

This is revised as **“The Companies (Indian Accounting Standards) Rules, 2015”**.

Authorised for issue by the National Financial Reporting Authority,


(Vidhu Sood)
Secretary-NFRA

Date : 17.05.2024
Place: New Delhi

विधु सूद/Vidhu Sood
सचिव/Secretary
राष्ट्रीय वित्तीय रिपोर्टिंग प्राधिकरण
National Financial Reporting Authority
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7th Floor, Hindustan Times House,
Kasturba Gandhi Marg, New Delhi

No. 015/2024

Date: 16.05.2024

ORDER

Order under Section 132(4) of the Companies Act 2013 in respect of M/s Shridhar & Associates (FRN 134427W) and CA Ajay Vastani (ICAI Membership No. 132265)

This Order disposes of the Show Cause Notice ('SCN' hereafter) dated 24.02.2023, issued to M/s Shridhar & Associates the 'Audit Firm', and CA Ajay Vastani, who was the Engagement Partner (the 'EP'), for the statutory audit of Reliance Commercial Finance Limited ('RCFL'), for the Financial Year (FY) 2018-19 (the Audit Firm and the EP are collectively referred to as 'the Auditors' hereafter). This Order is divided into the following sections:

- A. Executive Summary
- B. Introduction and Background
- C. Major Lapses and Violations
- D. Findings on the Articles of Charges of Professional Misconduct
- E. Penalties and Sanctions

A. EXECUTIVE SUMMARY

- 1) Reliance Commercial Finance Limited (RCFL) is a Non-Banking Finance Company (NBFC) listed on both the Bombay Stock Exchange and the National Stock Exchange. Price Waterhouse & Co Chartered Accountants LLP (PW) was initially appointed as the auditor of RCFL for FY 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 filed a report to MCA under section 143(12)¹ of the Companies Act, 2013 (the Act) on 03.06.2019. PW then resigned from the audit on 11.06.2019, without issuing an audit report for FY 2018-19. M/s Shridhar & Associates were appointed by the board of directors of RCFL on 28.06.2019 as statutory auditor of RCFL to fill the casual vacancy caused by the resignation of PW. M/s Shridhar & Associates issued its unmodified opinion on the financial statements of the Company on 14.08.2019 for the FY 2018-19 with an Emphasis of Matter (EoM) paragraph relating to the report filed by ex-Auditors PW, stating that "*Based on the views of the Company and supported by legal opinions there were no matters attracting the said section*".

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

- 2) As per the consolidated financial statements, RCFL's total assets were ₹13,504 crore. The external liabilities included debt of over ₹12,623 crore, consisting of debt securities, borrowings from banks etc. It had a total revenue of around ₹1,780 crore and reported a net loss of ₹1,892 crore for FY 2018-19. PW reported suspected fraud regarding 'Working Capital Term Loans' and 'SME Structures Loans' amounting to approximately ₹8,600 crore and suspected undisclosed related party transactions.
- 3) On examination of the Audit file for the Statutory Audit of RCFL conducted by the Audit Firm Shridhar & Associates, which was called for under Section 132 (4) of the Act, we were of the prima facie view that the Auditors had not discharged their professional duties under the Act as well as the Standards on Auditing (SA). Consequently, the SCN was issued to the Auditors asking them to show cause why action under Section 132(4) of the Act should not be initiated against them for professional misconduct.
- 4) After examining the detailed submissions, 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 Auditors were grossly negligent, failed to apply professional skepticism and due diligence, and did not adequately challenge the management assertions. Major violations proved in this order are as follows:
 - a) The EP accepted the engagement without first communicating with the previous auditor and without waiting for a reasonable time for a reply. The Auditor's deviation from the law and the firm's quality policy shows the absence of due diligence and controls on client acceptance at the engagement level and firm level. (Details in section C.1 of this Order).
 - b) The Auditors issued an inappropriate Emphasis of Matter (EoM) in the audit report to members even though the contents of the disclosure in the financial statement (reporting of suspected fraud by the previous auditor) called for a modification of opinion. The audit report gives a clear impression to the users that the auditor fully agrees with and reiterates the inappropriate disclosure by the Company. The auditors also endorsed the company's legal interpretation that there was no fraud and based on that dismissed any suspicions of fraud even while the matter was pending with MCA. (Details in section C.2 of this Order).
 - c) The auditors did not obtain sufficient appropriate evidence to conclude and report that there was no material uncertainty regarding the going concern status of RCFL. (Details in section C.3 of this Order).
 - d) The auditors did not perform the audit procedures to ensure the reasonability of the Expected Credit Loss provision of ₹537 crore on loans of ₹12,224 crore. (Details in section C.4 of this Order).
 - e) Despite being aware of the report of suspected fraud by the previous auditor, the EP stated in the audit report that there were no matters falling under section 143(12). Therefore, the audit report to the members was misleading. The Auditors also failed to adequately examine the end-use of loans, indications of siphoning of funds from the company, management override of controls, and the business rationale of sanctioning and disbursing loans by the Company. None of these factors was adequately reflected in the Auditor's assessment of risks of material misstatement due to fraud;

consequently, the Auditors failed to perform audit procedures that were responsive to the fraud risk. (Details in section C.5 of this Order)

- 5) Despite the resignation of the previous auditor and a reporting of suspected fraud, the Auditors failed to conduct the audit as per the 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 deficiencies in the audit resulted in the audit opinion being rendered unreliable since the material misstatements in the financial statement assertions remained unreported. The Auditors also demonstrated a lack of professionalism by rationalising the actions of the Company, performing insufficient evaluation of the work of the previous auditor, and ignoring the fundamentals of auditing.
- 6) Based on the investigation and proceedings u/s 132(4) of the Companies Act, and after allowing them to present their case, we find that the Audit Firm and the EP are guilty of professional misconduct and impose, through this Order, the following monetary penalties and sanctions:
 - a. Imposition of a monetary penalty of Rupees Two Crore on the Audit Firm M/s Shridhar & Associates.
 - b. Imposition of a monetary penalty of ₹ Fifty Lakhs on CA Ajay Vastani. In addition, EP CA Ajay Vastani is debarred for 5 years from being appointed as an auditor or internal auditor or from undertaking any audit in respect of financial statements or internal audit of the functions and activities of any company or body corporate.

B. INTRODUCTION AND BACKGROUND

- 7) 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 Standards on Auditing (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.
- 8) RCFL was required to prepare its Financial Statements for FY 2018-19 under Schedule III and other applicable provisions of the Act and Indian Accounting Standards (Ind AS) notified under the Companies (Accounting Standards) Rules, 2006.
- 9) Following the information from DGCoA, as described in the executive summary of this Order, we *suo motu* decided to examine the audit evidence that led the Audit Firm to issue an unmodified audit opinion. We called for the Audit File² and other information from the Audit Firm on 24.11.2021. After two extensions, the Audit Firm submitted the Audit File and other documents electronically through File Transfer Protocol (FTP) on 07.03.2022. From the Audit File, it was observed that M/s Shridhar & Associates were appointed as statutory auditors by the Board of Directors of RCFL on 28.06.2019 to fill the vacancy

² Vide NFRA letter dated 24.11.2021.c

caused by the resignation of PW. The examination of the Audit File, annual reports of the Company and other communications by the Audit Firm to NFRA showed a prima facie case of professional misconduct on the part of the Auditor.

10) 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 against them should not be taken under Section 132(4)(c) of the Act read with Rule 11 of NFRA Rules 2018 for professional misconduct of:

- a. Failure to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary in making such financial statement where 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 the EP is concerned in a professional capacity.
- c. Failure to exercise due diligence and being grossly negligent in the conduct of professional duties.
- d. Failure to obtain sufficient information which is necessary for the expression of an opinion, or its exceptions are sufficiently material to negate the expressions of an opinion;
- e. Failure to invite attention to any material departure from the generally accepted procedures of audit applicable to the circumstances, and
- f. Failure to accept a position as auditor previously held by another chartered accountant after first communicating with him in writing.

11) The Auditors sought three extensions for submitting their response to the SCN which was given. The Firm and the EP, submitted their combined reply to the SCN on 04.05.2023. The SCN also provided an opportunity for a personal hearing to the EP and the Audit Firm which was availed by them on 30.01.2024 with their legal counsels Advocate Rohan Jaitley and Advocate Areeb Y. Amanullah. The Audit Firm and the EP also made written submissions on 15.02.2024 and 16.02.2024 respectively in addition to the reply to the SCN and the oral submissions. All the written and oral submissions have been examined in detail before issuing this Order.

C. MAJOR LAPSES AND VIOLATIONS

12) The major basis for charges in the SCN included client acceptance without complying with requirements of the law, failure to examine significant matters reported by previous auditors, use of Emphasis of Matter (EoM) in the Audit Report that violates SA 706, use of management experts in violation of SA 500, failure in the evaluation of the appropriateness of the going concern assumption, lapses in the verification of the expected credit loss etc.

13) Replies of the Auditors to the charges in the SCN are examined and discussed under the following broad categories. Only the violations/actions/omissions proved to result in one or more professional misconduct as per the articles of charges in the SCN are covered in this Order.

C.1. Acceptance of Audit Engagement

C.2. Emphasis of Matter in the Audit Report

C.3. Going Concern

C.4. Expected Credit Loss

C.5 Matters Reported by the Previous Auditor and Violations of SA 240

C.6 Key Audit Matters

C.7 Audit Documentation

C.8 Role of the Audit Firm

C.1 Acceptance of Audit Engagement

- 14) The Auditors were charged with professional misconduct of accepting an audit engagement without complying with the requirements of Clause 8 of Part 1 of the First Schedule to the Chartered Accountants Act, 1949, which requires an auditor to communicate with the previous auditor before accepting the position.
- 15) The Auditors denied the charges. They submitted that the EP had a telephonic discussion on 30.06.2019 with the previous auditor. In this discussion, the previous auditor stated that they would send their no-objection. After the discussion, their acceptance letter to the Company was given on 01.07.2019. The Auditors also submitted that the “*Clause does not explicitly require the auditor to get a written response before accepting the appointment*”. It is further submitted that the NOC from the previous auditor was received on 05.07.2019 and “*On July 10, 2019, we signed an engagement letter dated July 1, 2019 which was received from the client and sent to the client on the same day*”.
- 16) We observe from the Audit File that M/s Shridhar & Associates was appointed by the Board of RCFL on 28.06.2019. The ADT-1 form, filed by RCFL, intimating the appointment of the auditor to MCA, records the date of appointment of the auditor as 28.06.2019. Further, RCFL issued a Letter of Appointment dated 29.06.2019 to the Audit Firm. On the same date, the Audit Firm gave its Consent to act as auditor. The Audit File contains a letter dated 29.06.2019 addressed to the previous auditor, seeking a No Objection Certificate (NOC) for accepting the engagement. There is no evidence of sending this letter to the previous auditor.
- 17) The EP then issued the Engagement Letter (EL) on 01-07-2019 confirming the acceptance of the audit. The EL was acknowledged by a Director of RCFL on the same day. The NOC letter from the previous auditor (PW) is dated 05.07.2019, which refers to

a letter dated 03.07.2019 from Sridhar & Associates received by PW via email on 03.07.2019. The above facts are evidence that the engagement was accepted before the communication with the previous auditor.

- 18) Also, the audit work was started by the Engagement Team (ET) before receiving NOC as evidenced by WPs in the audit file³ on audit planning, such as the understanding of the entity and its environment etc., which were signed by the preparer and reviewer on 04.07.2019. Other work papers at the planning stage are not dated and signed and hence there is no evidence that the work is carried out after the receipt of NOC.
- 19) Based on the above facts and evidence, we observe that the following requirements of the Chartered Accountants Act, Code of Ethics, SA 300⁴ and the Quality Policy under SQC-1 were violated by the Auditor:
- a. Clause 8 of Part-1 of the First Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he accepts a position as auditor previously held by another chartered accountant **without first communicating with him in writing**. The Code of Ethics 2009 makes it clear that *“the object of the incoming auditor, in communicating with the retiring auditor is to ascertain from him whether there are any circumstances which warrant him not to accept the appointment”*. This objective will be met only upon receiving the return communication from the previous auditor. The Code also states that in case there is a delay in receiving the reply from the outgoing auditor *“the auditor appointed can act, after waiting for a reasonable time for a reply”*. This requirement on the Code is also reflected in various decisions of the Disciplinary Council of the ICAI.
 - b. Paragraph 12 of SA 300 requires that the auditor shall communicate with the predecessor auditor, in compliance with relevant ethical requirements, **prior to** starting an initial audit.
 - c. In line with the above requirements, the Audit Firm’s quality control manual, prepared under SQC-1, states: *“The firm shall issue its engagement letter and/or consent to act as an auditor only after performing necessary due diligence procedure, risk assessment procedure and receiving the professional clearance from predecessor auditor”*.
- 20) Accordingly, based on the above facts, we conclude that the EP accepted the engagement without first communicating with the previous auditor and without waiting for a reasonable time for a reply. The deviation from the Law and the firm’s quality policy shows the absence of due diligence and controls on client acceptance at the engagement level and firm level. Hence, it is proved that the Audit Firm and the EP are guilty of professional misconduct as defined in Clause 8 of Part-1 of the First Schedule to the Chartered Accountants Act, 1949.

³ WPs ‘B-20’ and ‘B-30’

⁴ SA 300 - Planning an Audit of Financial Statements

C.2 Emphasis of Matter in the Audit Report

- 21) The Auditor was charged with misusing the EoM section to report his finding regarding the reporting of suspected fraud by the previous auditor. RCFL had included a disclosure note no. 44 (i) in the Standalone Financial statements (SFS) for FY 2018-19, which reads as follows:

"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 (MCA). The Company was informed by its previous auditors that a report under Section 143 (12) of the Companies Act, 2013 in Form ADT-4 has been filed with the MCA in June 2019. The Company has examined the matter and has concluded that the issues raised by the previous auditors, do not merit reporting under the said Section. The Company also appointed legal experts, who independently carried out an in-depth examination of the matter and the issues raised by the previous auditor. The legal experts have concluded and confirmed that there was no matter attracting Section 143(12) of the Companies Act, 2013. MCA has sought certain information on this matter and the Company is in process of providing the same."

- 22) The Auditors included an EoM paragraph in their audit report which states as follows:

"We draw attention to Note No. 44 (i) of the standalone Ind AS financial statements referring to filing of Form ADT-4 under Section 143(12) of the Companies Act, 2013 to the Ministry of Corporate Affairs (MCA) by the previous auditor. Based on the views of the Company and supported by legal opinions there were no matters attracting the said section."

- 23) In this regard, the Auditors were charged with:

- a) Issuing an EoM on a disclosure which was not fit for referring in an EoM, since the subject matter was not properly presented or disclosed in the financial statements and was factually incorrect. The Auditors were also charged with using EoM for giving an opinion on the subject matter of the disclosure.
- b) Failure to state that the audit opinion is not modified in this respect, as required by SA 706 (Revised).
- c) Failure to challenge the management about non-disclosure of adjusting or non-adjusting events as envisaged by Ind AS 10⁵ as a fraud report under section 143(12) of the Act has been filed by the previous auditor after the financial reporting date and hence it falls under the purview of Ind AS 10. The reporting of fraud is an adjusting event. However, the Company has treated it as a non-adjusting event by disclosing that the matter was not reportable under section 143(12).

⁵ Ind AS 10, Events after Reporting Period

- 24) The Auditors denied the charges, except for the submission that “[we] agree that there was a typographical miss in stating that “the opinion was not modified in respect of this matter”. We have examined and discussed in the following paragraphs the detailed replies and evidence in this regard.
- 25) Paragraphs 7 and 9 of SA 706 (Revised) make it clear that the EoM shall refer only to information appropriately 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 and the disclosures fully describe the matter. However, this is not the case here due to the following reasons:
- a. The subject matter in note 44(i) was a subsequent event after the reporting period and hence covered under Ind AS 10⁶. 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 could 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 no disclosure in the financial statements of an estimate of such financial impact nor is there 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.
 - b. 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

⁶ Ind AS 10, Events after Reporting Periods

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 an Auditor is competent to make a conclusive legal determination⁷ of a Statutory matter reported by the previous Auditor as per his judgement and under the mandate provided in the Act. The normal course of action in this situation for any prudent Company could be initiating an independent investigation into the alleged matters to bring out the truth. There is no evidence of any such examination by the Company. The Company went on to rule out any fraud by using a legal opinion stating that section 143 (12) was not applicable in the case. Nowhere in the legal opinion have the legal experts gone into the details and merits of the transactions reported by PW. This makes it clear that there is no consideration of the actual issues in the legal examination and also there is no detailed independent examination by the Company. Hence the disclosure, which gives the impression that there is no suspected or actual fraud based on the Company's examination, was incorrect, inappropriate and misleading to the users of the financial statements.

- c. The Auditors in their reply to SCN rightly submit that an auditor does not make a legal determination of whether fraud has occurred. This being the case, the impact of fraud, if any, on the financial statements could be ascertained only after the legal determination of the offence by the competent authority, which is not the case of RCFL or the legal experts appointed by it. Pending such legal determination, the Auditors should have issued a modified opinion, since the impact of the potential fraud was not known to them.
- d. Moreover, the disclosure in note 44 (i) is factually incorrect in stating that the previous auditor had submitted a report under section 143(12) of the Act with the Ministry of Corporate Affairs after resigning from office in June 2019, while in fact, the previous auditor had submitted the report on 03.06.2019 before resigning on 11.06.2019. This shows gross negligence by EP.
- e. The EoM shows the Auditor's reliance on the legal opinion because it endorses the examination by legal experts appointed by the Company. However, the EP submitted in his reply to the SCN that he did not rely on the legal opinion. This is contrary to his EoM and noting in the Audit File which reads as "*.... In light of that, we have relied on the legal opinion and concluded that 143(12) is not attracted*". Such a reliance, placed on the legal opinion at the time of the audit, was not in compliance with the requirements of SA 500, Paragraph 8, which require that when audit evidence has been prepared using the work of a management expert, the auditor shall obtain an understanding of the work of that expert along with evaluation of the appropriateness of that expert's work as audit evidence for the relevant assertion. No

⁷ Refer to Sections 130, 199, 206, 211, 212, 213 etc. of the Act.

such evaluations were carried out by the auditors. Therefore, the Auditors did not have an adequate basis for issuing the EoM.

- f. Further, the EoM does not state that the auditor's opinion is not modified in respect of the matter emphasized. Such an omission in one of the most significant parts of the audit report cannot be ruled out as a typographical error.
 - g. After describing the disclosure note in the first sentence of their EoM, the Auditors added one sentence stating, "*Based on the views of the Company and supported by legal opinions there were no matters attracting the said section*". The Auditors chose not to state that their audit opinion was not modified in this regard⁸. This gives a clear impression to the users that the Auditor fully agrees and reiterates the disclosure. This could potentially be seen as the Auditors endorsing the company's legal interpretation and dismissing any suspicions of fraud while the matter was pending with MCA. Thus, the action of the Auditors amounts to non-performance of any procedures and evidence, ruling out on issues of suspected fraud and a misplaced ruling on the suspected fraud.
- 26) Thus, based on the above facts, we conclude that the Auditors issued an inappropriate EoM in the audit report to members when the contents of the disclosure in the financial statement called for a modification of opinion. The audit report gives a clear impression to the users that the auditor fully agrees with and reiterates the inappropriate disclosure by the Company. The Auditors endorsed the Company's legal interpretation and dismissed without any procedures, the suspicions of fraud, while the matter was pending with MCA. Thus the Auditors did not comply with the requirements of SA 706 (Revised) and SA 200 and the charges in paragraph 21 and 23 are thus proved.

C.3 Going Concern

- 27) RCFL prepared its financial statements on the assumption that the Company was a Going concern. However, the Audit File did not contain sufficient basis for the Auditors to conclude and report that there was no material uncertainty regarding the going concern status of RCFL. The disclosure made by the Company in this regard was inadequate. The Auditors were hence charged with non-compliance with the requirements of paragraphs 16(b), 19 and 23 of SA 570 (Revised)⁹ regarding the procedures to be performed in the evaluation of the going concern assumption.
- 28) On going through the audit file we find that at WP A42-1, there is a clear finding that "*The company's ability to meet its obligations is significantly dependent on material uncertain events... due to above significant event, we have given material uncertainty para related to going concern.*".

Despite this, the Auditors denied the charges and submitted that "*...there is an error in our documentation in WP A 42-1 where we have documented that "The company's ability to meet its obligations is significantly dependent on material uncertain events... due*

⁸ Refer to Appendix 3 and 4 of SA 706 (Revised) for illustrative examples of EoM.

⁹ SA 570 (Revised), Going concern

to above significant event, we have given material uncertainty para related to going concern. The facts are that there were no material uncertain events since the Company had already initiated Intercreditor Agreement (ICA) for the resolution of its debt which proposal was accepted by more than 75% of the lenders of RCFL... ”

29) The above submission of the Auditors are unacceptable and an afterthought due to the following reasons:

- a. Apart from the above mentioned documentation in the Audit File, regarding going concern the EP in his presentation¹⁰ to the Audit Committee on August 14, 2019 (the date of signing the Audit Report) stated that *“These events or conditions, along with other matters indicate the existence of material uncertainty relating to going concern.*

The Company's ability to meet its obligations is significantly dependent on material uncertain events”

Interestingly, this presentation before the Audit Committee has been relied upon by the Auditor in his response to SCN.

- b. The Auditors identified three significant events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern. These events were (a) near complete freeze on bank’s lending to NBFCs (b) operating loss during the year and (c) temporary liquidity mismatch.
- c. There is no examination in the Audit File of how the ICA will ensure the going concern status.

30) The above facts show that the Auditors had identified conditions present that may cast significant doubt on the entity's ability to continue as a going concern, and indicated material uncertainty. In such a scenario, Para 16 of SA 570 (Revised) requires that the auditor shall obtain sufficient appropriate audit evidence through audit procedures to determine whether a material uncertainty exists. The procedures include the evaluation of management's plan for future actions (Para 16 (b) of SA 570 (Revised)) and if a cash flow forecast is prepared by the management, then analysis of this forecast by evaluating the reliability of underlying data and evaluating the adequacy of the underlying assumptions (Para 16 (c) of SA 570 (Revised)). None of these requirements are met by the Auditors as explained below.

- a. RCFL stated in note 55 of the SFS that *“During the year, due to sudden adverse developments in the financial sector all categories of lenders in India (including Banks, Mutual Funds, etc.) have put near complete freeze on additional lending to Non-Banking Finance companies (NBFCs) and have been insisting on reducing the existing level of borrowings which has severely impacted the financial flexibility of majority of NBFCs. These developments have also adversely impacted our Company resulting into operating loss for the year and temporary liquidity mismatch. The Company has taken steps to meet such temporary liquidity mismatch by securitisation of its loan portfolio.*

¹⁰ Submitted along with the reply to SCN, not forming part of the Audit File. The date of the Audit Committee meeting is mentioned in paragraph 7.2.1 (17) of the reply to SCN.

The Company has also engaged with all its lenders to enter into an Inter-Creditor Agreement (ICA) for the resolution of its debt in accordance with the circular dated June 7, 2019 issued by the Reserve Bank of India on Prudential Framework for Resolution of Stressed Assets. Majority of our lenders have already entered into the ICA. The Company is confident of implementing its Resolution Plan during Financial Year 2019-20. In view of the steps taken by the Company, the accounts of the Company have been prepared on "Going Concern" basis." There is no evidence of independent examination of these contentions of the management, as required by Para 16 of SA 570 (Revised). Though the ET obtained the cash flow forecast prepared by the management, it did not perform any audit procedure to evaluate the reliability of the underlying data and adequacy of the assumptions. The ET neither obtained nor analysed any detailed maturity profile (fortnightly and monthly) of assets and liabilities over the next 12 months to support the forecast given by the company nor did they examine the probability of a positive outcome of restructuring of loans and the ICA (para 16(b) of SA 570(Revised)).

- b. As per Paragraph 18 of SA 570, a material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that, in the auditor's judgment, appropriate disclosure of the nature and implications of the uncertainty is necessary for the fair presentation of the financial statements. Thus, on noticing the significant events or conditions that may cause material uncertainty, the ET needs to consider:
- i. the magnitude of potential impact, i.e., will the impact of these events effectively put the entity out of business or what is the worst-case scenario?
 - ii. The likelihood of occurrence, i.e., does the management have a realistic contingency plan or how do they plan to deal with the impact on day-to-day operations?

None of the above requirements were considered by the ET. The scenario mapping is essential here and should form part of management's assessment of the going concern, which is absent in this case.

- c. RCFL had entered into the ICA for the resolution of its debts. The Auditor, in their reply to SCN, stated that there was no material uncertainty in going concern owing to the ICA, but in fact they had not evaluated the ICA. The existence of ICA containing a debt resolution plan in itself cannot evidence the absence of material uncertainty on the going concern status. As per Paragraph 26 of Ind AS 1¹¹ when an entity has a history of profitable operations and ready access to financial resources, the entity may conclude that the going concern basis of accounting is appropriate without detailed analysis. This is not the case here since RCFL did not have ready access to financial resources as evidenced by the need for entering into ICA, default on debt obligations and absence of fresh credit lines. In such cases, Ind AS 1 states that the management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate. This was not done by the management. Nor did the Auditor evaluate the contents and assumptions of the ICA.

¹¹ Indian Accounting Standard (Ind AS) 1 - Presentation of Financial Statements

- d. Apart from the three events or conditions noted by the ET, there were other conditions affecting the going concern¹², which were not considered by the Auditors. The Capital to Risk Assets Ratio (CRAR) of the company was below the minimum regulatory requirement as prescribed by RBI. Breach of the capital adequacy norm has the potential to affect the going concern of the Company since its continued existence was contingent on meeting the CRAR requirements. The regulatory proceedings consequent to the reporting of suspected fraud by the previous auditor was another event affecting the going concern. These events were neither disclosed in the notes to the financial statements on the going concern nor assessed by the Auditors in perspective.
- e. Thus, the requirements of SA 570 (Revised), as stated above, were not met by the Auditor.
- 31) We further observe that note no. 55 of the Financial Statements on the going concern assumption does not fully disclose the events or conditions and the mitigation plan. The disclosure note does not list all the significant events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. The breach of capital adequacy regulatory norms, which has the potential to affect the going concern is absent in the disclosure. How the company will be able to infuse the required capital to meet the RBI requirement of minimum CRAR of 15%, is also absent in the disclosure. The disclosure made by the Company did not discuss the details of financing arrangements such as the magnitude, timelines, the availability of refinancing etc. The Company does not disclose the magnitude of financing arrangements, the expiration and the total financing arrangements, or the impact or the availability of refinancing by way of securitization. The Company only describes some adverse situations and planned mitigation measures and then goes on to say that the financial statements have been prepared on a going concern basis. It neither characterizes this situation as a material uncertainty nor rules out material uncertainty.
- 32) Contrary to Company's disclosure, the Auditors stated in the Independent Auditor's Report that the "*Company's ability to meet its obligations is significantly dependent on material uncertain events including restructuring of loans and Intercreditor Agreement (ICA) for the resolution of its debt.*" Here, the restructuring of loans and ICA are portrayed as material uncertain events while the disclosure by the Company considers these events as mitigation measures and does not describe them as "*material uncertain events*". Such inconsistencies and non-compliance with SAs render the Audit Opinion misleading.
- 33) Such lapses have been viewed seriously by international regulators as well. For example, the Public Company Accounting Oversight Board (PCAOB), the US Regulator, charged¹³ Bravos & Associates CPA's ("Firm") and Thomas W. Bravos, CPA ("Bravos") in connection with the audit of UAHC for FYE June 30, 2013, where Bravos authorized the issuance of the Firm's unqualified audit report, which included going concern explanatory language regarding those Financial Statements. However, Respondents did not have a reasonable basis for making these statements and issuing their audit report".

¹² Paragraph A3 of SA 570(Revised).

¹³ PCAOB release No. 105-2015-028 dated 23.07.2015.

For misconduct including this and others, PCAOB censured the firm by revoking its registration and imposed a civil monetary penalty of \$ 10000 on the firm. Bravos was barred from being an associated person of a registered public accounting firm

- 34) Based on the above discussion, we conclude that the Auditors did not obtain sufficient appropriate evidence to conclude and report that there was no material uncertainty regarding the going concern status of RCFL. Hence the charges in paragraph 27 stand proved.

C.4 Expected Credit Loss (ECL)

- 35) The value of 'Loans given to borrowers' shown in the financial statements of RCFL as on 31st March 2019 amounts to ₹ 12,223.86 crores in the balance sheet which constitutes around 90% of its balance sheet size. The Auditors were charged with the following regarding the verification of ECL on these loans.
- a. Failure to obtain sufficient appropriate audit evidence to verify whether the ECL estimate and its related disclosures in the financial statements were reasonable and whether the financial statements were materially misstated.
 - b. Failure to report the absence of adequate provision for originated credit-impaired loans as per Ind AS 109.
 - c. Failure to exercise professional skepticism in accordance with the requirements of SA 200 in auditing complex accounting estimates of ECL.
 - d. Failure in assessing and documenting the impact of material weakness in internal control on ECL. There is no separate test of the design, implementation and operating effectiveness of internal controls on ECL as required by SA 540 and SA 315.
- 36) The Auditors denied the charges and stated that all the required procedures were performed, and the evidence was obtained. The WP references¹⁴ provided by them in their response to substantiate the work done by them, only reflect verification of the arithmetical accuracy by the Auditors of the ECL computation as done by the management, audit plan for verifying underlying working data used to calculate ECL rates, PD and LGD to ensure the accuracy of working and ECL provision and a list of loans advanced to 29 ADAG group companies and the ECL amount thereon.
- 37) On perusal of the WPs as referred by the Auditors in their response, we note that the audit file does not contain evidence of the substantive procedures and test of details claimed to have been performed. The reply is silent about the impact of the control weakness in the credit appraisal mechanism on ECL, as required by Paragraph 26 of SA 315. Extracts of the key WPs relied on by the Auditors in support of their claims, are reproduced below, to bring home this fact.

¹⁴ WPs – B-30 (pertaining to planning), E-4 (Arithmetical accuracy of ECL computation), E-2.3.1 (List of 29 ADAG group companies and why the loans given to them has been written off mentioned)

Prepared by Neel Kamdar	Reviewed by Ajay Vastani	E-2.3.1
Reliance Commercial Finance Ltd Statutory Audit for year ended March 31, 2019		
Summary of E.2.1 / E.2.2 / E.2.3		
Work done Obtained list of parties noted by previous auditors and verified ECL impairment created on those parties We have verified PD and LGD rates and underlying assumptions We have verified as per IND AS 109 requires an entity to determine expected credit loss (ECL) amount on a probability-weighted basis (refer Credit quality) Based on model and parties which were under IBC which were write-off and parties which were in stage 2 or stage 3 accelerated provision was created Based on ECL model we have verified below :		
a) Process overview b) Segmentation c) Historical defaults rates d) Lifetime PD and remaining maturity e) Staging, Exposure at Default and Loss Given at Default d) ECL computation		
Reliance Commercial Finance Limited Statutory Audit for the period ending March 31, 2019	E-4	Prepared by: Neel Kamdar Checked by: Ajay Vastani
Test of Expected Credit Loss Provision		
Objective To verify the ECL computation prepared by the management and the provision created based on the. To obtain sufficient and appropriate evidence to form an opinion as to whether ECL provision are free from material misstatements.		
Methodology Obtained the ECL computation from Management Based on Discussion with Management we have checked the Statement of Accounts of borrowers on sampling basis, the provision is created by management for parties where there was a fragile hope of recovering the outstanding amount. Hence, for such parties there was an acceleration in the amount of provision Therefore, we have checked for the accelerated rate wherever applicable. (99% for Stage 3) Verified the ECL rates for all the LAN depending on PD (Probability default) & LOD (Loss given default) derived by the management for each product category		

Except for the listing of the ECL numbers, and probably verifying the arithmetical accuracy of additions and multiplications, no other procedures as listed in the above WPs are evidenced in the Audit File. The stated procedure of “Process overview” is limited to copying some extracts from RCFL’s ECL model. Other than documenting the data provided by the management there is no independent verification, no documentation of relevant discussions with the management or their experts who prepared the ECL model, no analytical procedures such as comparing the provision coverage with relevant external data and no evidence of verifying compliance with requirements of Ind AS 109. For instance, there is no evidence of the following in the Audit File.

- a. How the Auditors ruled out the possible management bias in the ECL model and calculations.
- b. Verification of the forward-looking information used by the management and whether the management's use of such information reflected a proper consideration of expectations of future developments and that the length of the forecast period was appropriate. Several of the Borrowers had issues with their going concern status, as noted by the previous auditor. There was no examination of how these events have impacted the 'significant increase in credit risk' criteria underlined by Ind AS 109.
- c. Whether the management's decisions on the range of scenarios and scenario weightings captured the appropriate extent of ECL required by Ind AS 109, including the effect of possible economic conditions.
- d. There is no evidence of the challenge of the ECL model and the underlying data sources. Given the high-risk factors and complexity of the ECL estimates the Auditors were required¹⁵ to assess the need for employing experts in verifying ECL. However, there is no documentation in the Audit File regarding the skills and competencies of the ET members who were conversant with ECL

¹⁵ Para 14 of SA 540

calculations. There is no evidence of the involvement of any auditor's expert or management expert.

- e. In the audit report on internal financial controls over financial reporting, the Auditors issued a qualified opinion stating that the Company's internal financial control system over financial reporting was not operating effectively with respect to the corporate loan book segment due to weak credit appraisal and loan sanctioning mechanism. However, the Auditors did not assess and document the consequences of the above material weakness on the assessment of ECL. There is no separate test of the design, implementation and operating effectiveness of internal controls on ECL as required by SA 540 and SA 315. In the absence of the test of the design, implementation, and operating effectiveness of internal controls on ECL the opinion on internal financial controls over financial reporting is unreliable.
- f. We note from the Audit File¹⁶, that the ET observed that the loan was disbursed to financially unsound borrowers. It is recorded that *“there are companies which created subservient charges against the loans. On checking the financials, those assets included advances made to the group companies or investment in group companies or inter corporate deposits. The creditability of such assets getting realised at the values stated in the financial is a question.”* (Emphasis supplied by us). It is also noted that many borrowers did not have the financial strength to get such loans. For instance, a working capital loan of ₹240 crore to Golden Beach Infra P Ltd (owned by Wadhawan Realtors Pvt Ltd) has been made without any examination of financial statements and there is no information regarding the financial standing of the borrower. Also, there are several significant loans¹⁷ where the standard conditions of sanctions are waived, eligibility is not as per norms, loan amount exceeds the maximum permitted limit, return on investments is below norms, no credit ratings, no ESCROW accounts and no cashflows/income. 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 rate¹⁸ should have been worked out considering the credit impairment. But no such accounting is made in the accounts, leading to understatement in ECL.

38) Based on the above, we conclude that the Auditors did not perform the audit procedures as claimed in their response to SCN. There is insufficient evidence to ensure the reasonability of the ECL of ₹537 crore on loans of ₹12,224 crore. Therefore, the charge in Para 35 above stands proved.

39) 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.

¹⁶ Work papers on Section -E -Loans and Advances-Critical issues and in work paper on impairment on loans and advances E-2.1, E-2.2, work paper E-10

¹⁷ WPs such as E2.5,

¹⁸ Paragraphs 5.4.1 and B5.5.45 of Ind AS 109.

and Keith R. Margetson¹⁹, 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, CPA²⁰ (Partner, EY Canada), PCAOB imposed sanctions for failing to sufficiently test the assumptions underlying the estimate and by failing 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.5 Matters Reported by the Previous Auditor and Violations of SA 240

- 40) The previous auditors, before resigning, filed a report under section 143(12) of the Companies Act, indicating suspected fraud in RCFL. In this regard, the EP and the Audit Firm were charged with the following:
- a. Despite being aware of the report of suspected fraud by the previous auditor, the EP stated in the audit report that there were no matters falling under section 143(12). Therefore, the audit report to the members was misleading.
 - b. Failure to exercise due diligence and professional skepticism and concluding without obtaining sufficient appropriate audit evidence that no reporting is required regarding the matters of suspected fraud reported by the previous auditors to MCA.
 - c. Failure to adequately examine the end-use of loans even after observing that the borrowers had used the funds for onward lending to other group companies which were not creditworthy. On RBI's intervention, the Company wrote off these loans, indicating siphoning of funds from the company.
 - d. Failure to consider other information obtained by the Auditors indicating risks of material misstatement due to fraud (report of the previous auditor as well as the observation made by the Auditors themselves) and the evaluation of the same as required by Paragraphs 23 and 24 of SA 240.
 - e. Failure to evaluate which type of revenue, revenue transactions or assertions give rise to the risk of material misstatement due to fraud as per the requirements of SA 240, Paragraph 26.
 - f. Failure to evaluate the business rationale of sanctioning and disbursing loans by waiving off standard conditions of the lending policy, indicating management override of controls. (Para 32(c) and A47 of SA 240.)
- 41) The Auditors denied all the charges. They submitted it was not necessary to again report the issues since the report of suspected fraud was already filed by the previous auditor, the matter was under MCA's purview, and the Company had the financial statements impact of the observation of PW. They also submitted that the audit report on Internal

¹⁹ PCAOB Release No. 105-2023-023 September 12, 2023.

²⁰ PCAOB Release No. 105-2022-040 December 22, 2022

Financial Control had been qualified because of the Company's weak loan appraisal process.

- 42) We observe that as detailed in Section C3 of this order, the EoM in the audit report evidences that the auditor fully agrees and reiterates the disclosure made by the Company that there are no matters falling under section 143(12). The EoM shows the Auditor's endorsement of the company's legal interpretation dismissing any suspicions of fraud, while the Auditors knew that the matter was under MCA's purview. The action of the auditors amounts to agreeing with RCFL's irregular legal determination and ruling out suspected fraud, and hence inappropriate reporting since the matter was not concluded by the regulator, i.e., MCA. Thus, we do not accept the Auditor's submission that they have only drawn attention to the fact and have not concluded on the matter. Had it been the case, the audit report should have been qualified, instead of mention in the EoM, since the impact of fraud, if any, could not be ascertained by the Auditor, before it was concluded by MCA.
- 43) We also note that the Auditors, under their statutory responsibilities, have to verify independently and report that the financial statements are free from material misstatements and present a true and fair view of the affairs of the Company. Without prejudice to our observations regarding the EoM, we observe that the audit opinion was not based on sufficient appropriate audit evidence regarding the significant matters reported by the previous auditor, as explained in the following paragraphs.
- a) The Auditors specifically noted in the Audit File²¹ several indications of financial distress of the borrowers such as no operating revenues, inadequate securities provided by the borrowers, absence of required documents in the borrower's file, negative worth of borrowers since past few years etc. These are indicators of fraudulent transactions to entities such as shell companies. Despite these observations in the WPs, the Auditors did not examine the fraud risk.
- b) It is evident from the end-use certificate provided by a chartered accountant²² that the loans were diverted²³ to other group companies and were not used for the purpose for which it was sanctioned. It is noted that the loans of ₹5,849.43 crores were used for purposes other than operations. They also listed certain borrowers²⁴ who had ultimately diverted the borrowed funds to financially weak group companies. The Auditors noted²⁵ that "*funds were utilised by R.Com or R.Infra, such amount has been written off or provisions were accelerated*". Such actions of RCFL indicate possible siphoning of the funds from the Company which the Auditors failed to challenge and examine as a fraud risk. The Auditors did not independently verify whether loan funds were used by the borrowers for the same purpose as disclosed in the loan applications. They did not perform further audit procedures to obtain

²¹ WP E-2.1, WP E-2.2, WP E-2.3.

²² WP "E05 and E5 and E5.1" Pg 10

²³ WP E – Critical Issues

²⁴ WP E-3

²⁵ WP "E05 and E5 and E5.1" Pg 11

sufficient evidence to confirm the recoverability, credit risk and existence of these loan balances.

- c) It is also observed that the sample selected by the Auditors for checking the Credit Appraisal Memo (CAM) does not cover all the cases identified by the previous auditor. The sample taken by the Auditors was not representative of the population as required by SA 530²⁶. The extent of this substantive audit procedure was not commensurate with the level of risk and the weak control environment in the auditee company.
- d) The Auditors qualified the report on Internal Financial Control over Financial Reporting basis material weakness in controls observed in the loan appraisal process. RCFL had been sanctioning loans to financially weak companies without any business rationale, indicating management override of controls. It was also noted that there was a significant rise in the quantum of loans sanctioned during the year as compared to the previous year. The working capital term loan increased from approximately ₹2900 crore as of 31.03.2018 to ₹8600 crore as of 28.02.2019. However, the Auditors failed to assess and document the impact of such material weakness on the related financial statement assertions. There is no evidence that the potential risks of misstatements on financial statement assertions were ruled out based on substantive procedures.²⁷ Also, Paragraph 33 of SA 240 requires the Auditors to perform audit procedures to respond to the identified risk of management override of controls, which the Auditors did not do.
- e) The Auditors submitted that they had considered revenue as ‘fraud risk’ as required by SA 240. However, on perusal of the WP²⁸, it is seen that revenue has been identified as a ‘medium risk’ without any basis. There is no rebuttal in the WP as to why revenue is not considered a ‘fraud risk’. At the time of the appointment itself, the Auditors were aware of the reporting of suspected fraud by the previous auditor. Despite this, the auditors did not consider revenue as a presumptive fraud risk and did not appropriately rebut it as required by para 26 of SA 240.
- f) Regarding the requirements of paragraph 30 of SA 240 that the auditor shall design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level, the Auditors submitted that they had considered ‘valuation’ as a relevant assertion and performed procedures to address this assertion. However, we observe that planned procedures²⁹ in this regard was not responsive to risks of material misstatement due to fraud. For instance, the planned procedures for assertions of ‘Valuation’ and ‘Rights’ were as follows.

1. Rights & obligation:	To verify that the entity holds or controls the rights to assets of the entity
	The rights of the Assets is verified by the agreements & sanction letters for the loan granted to the customers

²⁶ SA 530, Audit Sampling

²⁷ Paragraph 17 of SA 330.

²⁸ WP B-30, Page 4

²⁹ WP E1.3

4. Valuation:	Objective: To ascertain whether the any valuation is required and such valuation is properly accounted and necessary provisions are created for any diminution in value.
	Verified the provision created against each and every LAN based on the Stage classification For Stage 3 assets provision creation is accelerated to 14.99%

The above procedures are normal procedures which are not responsive to the risks of material misstatement due to fraud. For instance, these procedures do not adequately address contradictory evidence observed by the Auditor, as noted in preceding paragraphs. The recoverability of the loans specially those advanced to credit impaired related parties was not tested (in terms of examination of intent or capacity to repay) and hence the assertion of valuation remains unverified. The inadequacy of testing of ECL provision has already been explained in this Order. Since these loans were sanctioned in violation of the lending policy, with several deviations including deficiencies in documentation, the assertion of 'rights' also remains questionable.

- 44) Based on the above, we observe the absence of required professional skepticism on the part of the Auditor, leading to insufficient audit procedures. Professional skepticism includes questioning inconsistencies, investigating contradictory evidence, and questioning the reliability of responses to inquiries and other information obtained from management. Audit evidence comprises both information that supports and corroborates management's assertions and any information that contradicts such assertions. In forming an opinion, the Auditor shall consider all relevant audit evidence, regardless of whether it appears to corroborate or contradict the assertions in the financial statements³⁰. On perusal of the reply and WPs in this regard, we note that the Auditors ignored several pieces of evidence that contradict the management assertions regarding the suspected fraud. Despite being aware of the report of suspected fraud by the previous auditor, the EP stated in the audit report that there were no matters falling under section 143(12). Therefore, the audit report to the members was misleading. The Auditors also failed to adequately examine the end-use of loans, indications of siphoning of funds from the company, management override of controls, and the business rationale of sanctioning and disbursing loans by the Company. None of these factors was adequately reflected in their assessment of risks of material misstatement due to fraud and consequently failed to perform audit procedures responsive to the fraud risk.
- 45) Based on the above, all the charges in paragraph 40 are proved.

C.6 Key Audit Matters

- 46) The Auditors were charged with failure to communicate the Key Audit Matter (KAM) with Those Charged with Governance (TCWG) as required by paragraph 17 of SA 701³¹ and failure to document the rationale behind the Auditor's determination of KAM, as required by paragraph 18 of SA 701.

³⁰ Paragraph 26 of SA 330.

³¹ SA 701, Communicating Key Audit Matters in the Independent Auditor's Report

- 47) The Auditors denied the charges. However, in the absence of any evidence produced by the auditors to show compliance with the mandatory requirements of paragraph 18 of SA 701, we deem the charges as proved.

C.7 Audit Documentation

- 48) The Auditors were charged with non-compliance with Paragraph 9 of SA 230 which requires the auditor to document who performed the audit work, the date such work was completed, who reviewed the audit work performed, date and extent of such review. There are several work papers in the audit file which do not mention who the preparer is and who is the reviewer and the date of preparing and reviewing are missing.
- 49) The Auditors submitted that *“Almost all the work papers mentioned preparer name and reviewer name barring few documents which is a clerical mistake”*.
- 50) In the absence of evidence produced by the Auditors, we conclude that the Auditors did not follow the requirements of SA 230 and that the audit documentation, as a whole, does not provide the details as to who performed the audit procedures, the date of completion of the procedures, who reviewed the work and the date of such review. In this regard, we are of the view that proper documentation in an audit is not merely a procedural formality but is a serious issue, which is at the core of the audit and lack of proper documentation may defeat the very purpose of the audit itself.
- 51) Lack of sufficient documentation has been viewed seriously by national and international regulators as well. For example, in the matter of Bharat Parikh & Associates Chartered Accountants, dated 19-03-2019, the US audit regulator PCAOB took a serious view on the lack of sufficient documentation and imposed penalties and sanctions for violations including insufficient documentation. The PCAOB Order states *“Audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement to (a) understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached, and (b) determine who performed the work and the date such work was completed as well as the person who reviewed the work and the date of such review... ..the documentation for each of those audits was insufficient to demonstrate the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached, including in those areas of the audits involving significant risks. For the FY 2016 and 2017 Issuer A audits, the documentation also failed to demonstrate who performed the work and the date such work was completed. Additionally, in each of the Issuer A and Issuer B audits, the audit documentation was insufficient to demonstrate which aspects of the audit and which audit documentation Bharat Parikh reviewed”*.

C.8 Role of the Audit Firm

- 52) M/s Shridhar & Associates in their written submission (made after oral hearing) dated 15.02.2024 submitted that the Firm had provided the EP with adequate staff and provided training to staff members involved in audit and accounting of technical topics. The Firm has also given their responsibility under the respective areas of SQC-1, to state that *“The Engagement Partner is responsible for forming an audit opinion on the financial*

statements.... To facilitate the function of the Engagement Partner in performing his duties, the Noticee No. 1 (The Audit Firm) provided him with adequate staff and provided training to staff members involved in audit and accounting topics....Professional Judgement is followed by the engagement partner and the same is consulted with the quality review partner, Noticee No.1 (The Audit Firm) has provided adequate resources and support to the engagement partner for facilitating him in fulfilling its responsibilities”.

- 53) We do not agree with any of the contentions of Shridhar & Associates in this regard. Audit Firm is the legal entity appointed under Section 139 of the Act as the auditor of RCFL. 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.
- 54) The requirements of Sub-Sections 9 and 10 of Section 143, SQC-1³² 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 firm³³.
 - b. Within the above framework, the individual engagement partners are personally responsible³⁴ for the quality of specific engagements to which they are assigned by the firm as per its policies.
- 55) 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.

³² 220 - 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 SQC1 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.

³³ 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

³⁴ Paragraphs 3, 4 and 8 of SA 220.

- 56) 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.
- 57) 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, 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 Shridhar & Associates. Providing the ET with resources alone is not good enough to establish effective supervision as envisaged in SQC-1. Moreover, while SQC 1 applies at the firm level, individual audit engagements continue to be joint and several responsibility of the firm and the EP, given the requirements in the Companies Act. Had the Audit Firm discharged its supervisory responsibilities timely and effectively such major lapses in the audit could have been avoided.
- 58) 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,³⁵ 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 PCAOB³⁶ 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.
- 59) The “Firm and Engagement Performance Metrics” published by PCAOB on October 12, 2022³⁷, 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 an audit firm’s overall strategy in complementing the engagement-level matrices. The study covers all major jurisdictions, including India, in

³⁵ PCAOB Release No. 105-2012-001 February 8, 2012.

³⁶ In the Matter of KPMG Assurance and Consulting Services LLP and Sagar Pravin Lakhani, PCAOB Release No. 105-2022-033 December 6, 2022.

³⁷ https://assets.pcaobus.org/pcaob-dev/docs/default-source/about/advisory/documents/iag-october-2022/firm-and-engagement-performancemetrics-and-related-attachments.pdf?sfvrsn=e362f3a_3

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 firms³⁸ (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

60) As discussed, the Auditors have made a series of departures from the Standards and the Law, in conduct of the audit of Reliance Commercial Finance Limited for FY 2018-19. Based on the above discussion, it is proved that the Audit Firm issued an audit opinion on the Financial Statements without any adequate procedures and evidence. Based on the discussion and analysis, we conclude that the EP and the Audit Firm have committed Professional Misconduct as defined in the Act, as below:

- a) M/s Shridhar & Associates and the EP CA Ajay Vastani 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 the Auditors failed to disclose in their report the material non-compliances the Company made as explained in sections **C.2 to C.5 and C.8** above.

- b) M/s Shridhar & Associates and CA Ajay Vastani 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 an Auditor is guilty of professional misconduct when he “fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity”.

This charge is proved as the Auditors failed to disclose in their report the material misstatements made by the Company as explained in Paras **C.2 to C.5 and C.8** above.

- c) M/s Shridhar & Associates and CA Ajay Vastani 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 an Auditor is guilty of

³⁸ 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.

professional misconduct when he “does not exercise due diligence or is grossly negligent in the conduct of his professional duties”.

This charge is proved as the Auditors, 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 C.1 to C.8 above.

- d) M/s Shridhar & Associates and CA Ajay Vastani 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 an Auditor is guilty of professional misconduct when he “fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion”.

This charge is proved as the Auditors failed to conduct the audit in accordance with the SAs and applicable regulations as well as due to their total failure to report the material misstatements and non-compliances made by the Company in the financial statements as explained in Paras C.2 to C.5 and C.8 above.

- e) M/s Shridhar & Associates and CA Ajay Vastani 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 an Auditor is guilty of professional misconduct when he “fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances”.

This charge is proved since the Auditors failed to conduct the audit in accordance with the SAs as explained in Paras C.1 to C.8 above but falsely reported in their audit report that the audit was conducted as per SAs.

- f) M/s Shridhar & Associates and CA Ajay Vastani 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 First Schedule of the Chartered Accountants Act, 1949 (No. 38 of 1949) as amended from time to time, which states that an Auditor is guilty of professional misconduct when he “fails to communicate with outgoing Auditor”.

This charge is proved since the Auditors failed to accept the audit in accordance with the law as explained in Para C.1 and C.8 above.

- 61) Therefore, we conclude that the charges of professional misconduct in the SCN, as detailed above, are established based on the evidence in the Audit File, the audit reports on the financial statements for the FY 2018-19 dated 14th August 2019 and the submissions made by the Auditors, and the Annual Report of Reliance Commercial Finance Limited for the FY 2018-19.

E. PENALTY AND SANCTIONS

- 62) 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.
- 63) As per the financial statements, RCFL's total assets were ₹ 13,504 crore and total external liabilities were around ₹12,623 crore as of 31.03.2019. The external liabilities included a debt of over ₹ 10,284 crore, in the form of debt securities and borrowings from banks, commercial papers etc. 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 previous auditor and a reporting of suspected fraud, the Auditors failed to conduct the audit as per standards on auditing. The major lapses started from the acceptance of the initial appointment of Shridhar & Associates as statutory auditors and continued throughout the risk assessment, audit of loans, evaluation of going concern and reporting. 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 deficiencies in the audit resulted in rendering the audit opinion unreliable as the material misstatements in the financial statements assertions remain unreported. The Auditors also demonstrated a lack of professionalism by rationalising the actions of the Company, inappropriately evaluating the work of the previous auditor, and ignoring the fundamentals of auditing. Such actions of the Auditors necessitate stricter sanctions and penalties taking into account the letter and spirit of the law.
- 64) 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 Rupees Two Crore upon M/s Shridhar & Associates.
 - b. Imposition of a monetary penalty of Rupees Fifty Lakhs upon CA Ajay Vastani and in addition, CA Ajay Vastani is debarred for 5 years from being appointed as an auditor or internal auditor or from undertaking any audit in respect of financial statements or internal audit of the functions and activities of any company or body corporate.

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


Sd/-
(Dr Ajay Bhushan Prasad Pandey)
Chairperson

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

Sd/-
(Smita Jhingran)
Full-Time Member

Authorised for issue by the National Financial Reporting Authority.

Date: 16.05.2024
Place: New Delhi


(Vidhu Sood)
Secretary

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

To,

(1) M/s Shridhar & Associates
Firm Registration No: 134427W
701, 7th Floor, Ambasadán
Plot No. 325, Linking Road,
Khar (W), Mumbai - 400052
Email: info@shridharandassociates.com
(2) CA Ajay Vastani,
Membership No. 132265,
401, Laxmi Villa Apartment,
M.G Road, Near Kala Hanuman Mandir,
Kandivali (W) – Mumbai - 400067
Email: vastaniajay@gmail.com

Copy To: -

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

