भारत सरकार / Government of India
राष्ट्रीय वित्तीय रिपोर्टिंग प्राधिकरण / National Financial Reporting Authority
7th – 8th Floor, Hindustan Times House,
Kasturba Gandhi Marg, New Delhi

Order no.- 020/2024 Dated: 19th August, 2024

ORDER

In the matter of M/s BSR & Associates LLP, CA Aravind Maiya and CA Amit Somani, under section 132 (4) (c) of the Companies Act, 2013

1. This Order disposes of the Show Cause Notice (**'SCN'** hereafter) no. NF- 23/14/2022 dated 17.01.2024 issued to M/s BSR & Associates LLP, Chartered Accountants, firm No: 116231W/W-100024, (**'Firm'** hereafter), an audit firm registered with the Institute of Chartered Accountants of India (**'ICAI'** hereafter), CA Aravind Maiya, ICAI Membership No-217433 (Engagement Partner or **EP** hereafter) and CA Amit Somani, ICAI Membership No- 060154, (Engagement Quality Control Reviewer or **EQCR** hereafter), who are members of ICAI and were EP and EQCR respectively for the statutory audit of Coffee Day Enterprises Limited for the Financial Year (**'FY'** hereafter) 2018-19. (All are collectively called the **Auditor/s or Principal Auditor/s**).

2. This Order is divided into the following sections:

   A. Executive Summary
   B. Introduction & Background
   C. Major lapses in the Audit of Consolidated Financial Statements (**'CFS'** hereafter)
   D. Major lapse in the Audit of Standalone Financial Statements (**'SFS'** hereafter)
   E. Violations of SQC 1 and SA 230 – Lapses in Audit Documentation
   F. Omission and Commission by the Audit Firm
   G. Finding on the Articles of Charges of Professional Misconduct by the Auditors
   H. Penalty & Sanctions

A. EXECUTIVE SUMMARY

3. NFRA suo moto examined the professional conduct of the statutory auditors of Coffee Day Enterprises Limited under Section 132(4) of the Companies Act 2013 (**'the Act'** hereafter), pursuant to the Securities and Exchange Board of India (**'SEBI'** hereafter) investigation report regarding diversion of funds worth Rs 3,535 crores from seven subsidiary companies of Coffee Day Enterprises Limited (**'CDEL'** hereafter), to Mysore Amalgamated Coffee Estate Limited (**'MACEL'** hereafter), an entity owned and controlled by the promoters of CDEL. Coffee Day Enterprises Limited is listed on stock exchanges. A Show Cause Notice was issued to M/s BSR & Associates LLP, the auditor for the FY 2018-19; CA Aravind Maiya, the EP for the audit engagement and CA Amit Somani, the EQCR.

4. NFRA's examination inter alia revealed that the CDEL's Statutory Auditor for audit of Consolidated Financial Statements and Standalone Financial Statements for the FY 2018-19 failed to meet the relevant requirements of the Standards on Auditing (**'SA'** hereafter), the

Standards on Quality Control and provisions of the Act and also demonstrated serious lapses and absence of due diligence in following matters.

4.1 In respect of Audit of CFS of CDEL, M/s BSR & Associates LLP, the EP and EQCR as Principal Auditors did not perform appropriate additional audit procedures to obtain sufficient appropriate audit evidence to issue audit opinion on CFS. In view of the fact that a substantial portion of financial information of the CFS was audited by the Other Auditors, the Principal Auditors did not ensure compliance with the requirements of SA 600 in letter and spirit. The Principal Auditors did not properly evaluate whether their own participation was sufficient to be able to act as the Principal Auditor. Secondly, the additional procedures, wherever performed by the Principal Auditors, were also inadequate and deficient. Details are given hereunder.

- The Principal Auditor was grossly negligent in verifying the business rationale of unusually high amount of Rs 2,226 crores of the loans/advances given to MACEL, a promoter-controlled entity. The EP considered the exposure of CDEL group to MACEL as an important area for audit, but did not perform the required audit procedures, nor ensured appropriate audit procedures by the other auditors disregarding the provisions of para 10 of SA 600. (**Section C- I of this Order**).
- CFS had Rs 842.49 crores of outstanding amounts receivable from MACEL, a related party with very minimal business activities, but the Principal Auditors were grossly negligent in evaluating recoverability and the adequacy of the impairment allowance as per the applicable accounting standards; there was a pattern of diversion of funds of CDEL, the listed entity, to promoters or entities controlled by the promoters through a web of intra group circular transfer of funds where MACEL was used as a main conduit. **(Section C- I of this Order).**
- CFS contained a number of false and erroneous account balances portraying lower amount of receivables; this was achieved through book entries of repayments of intra group loans through cheques received but not encashed as of balance sheet date. The Auditors did not exercise professional judgement & professional skepticism during the audit of loans of Rs 2,549 crores to promoter-controlled entity. These loans were fraudulently understated in the financial statements of CDEL by Rs 1,706 crores, which was orchestrated through passing book entries as repayment by cheques and evergreening via structured circulation of funds within CDEL group companies. The Auditors did not identify and report this huge misrepresentation of financial position. (**Section C- I of this Order**).
- The Firm and the EP failed to exercise professional judgement & skepticism during the audit of the suspected fraudulent diversion of Rs 130.55 crores by CDEL's subsidiary to an individual **(Section C- II of this Order**).
- The Firm, EP and the EQCR failed to evaluate fraud risk in recognition of interest income of Rs 75 crores on loans granted by Tanglin Developments Ltd (a subsidiary of CDEL) to MACEL which resulted in erroneous reporting of CDEL's consolidated profit at Rs 27.93 crores instead of loss of Rs 47.07 crores. **(Section C- III of this Order).**

4.2 In respect of the audit of SFS, the Auditors failed to perform audit procedure to verify the end use of substantial amount of loan of Rs 1,055.73 crores given by CDEL to its subsidiaries and guarantee of Rs 1,015 crores given by CDEL on behalf of its subsidiary for taking loans

from Banks/Financial institutions as required under the Companies (Auditors' Report) Order 2016 read with section 185 of the Act. **(Section D of this Order)**.

4.3 Lapses in audit documentation of SFS and CFS - The Audit Documentation application used by the Firm is not compliant with the requirements of SQC 1 and SA 230 as it allows unauthorised modification of audit work papers. The Auditors modified many audit work papers without recording the name and date of modifications after signing-off the audit work papers and also after issuing the audit report. **(Section E of this Order)**.

5. Based on the proceedings under section 132 (4) of the Companies Act 2013 and after giving the Auditors an opportunity to present their case in person, we found the Audit Firm and its partners, who performed the audit as EP and EQCR, guilty of professional misconduct. Thus, this Order imposes a monetary penalty of Rs ten crores upon M/s BSR & Associates LLP; Rs fifty lakhs upon CA Aravind Maiya; and Rs twenty five lakhs upon CA Amit Somani. In addition, CA Aravind Maiya is debarred for a period of ten years and CA Amit Somani is debarred for a period of five years, from being appointed as an auditor or internal auditor or from undertaking any audit in respect of financial statements or internal audit of the functions and activities of any company or body corporate. This Order will be effective after 30 days from its issuance.

B. INTRODUCTION & BACKGROUND

6. The National Financial Reporting Authority (**'NFRA'** hereafter) is a statutory authority set up under section 132 of the Companies Act 2013 to monitor the implementation and enforce compliance of the auditing and accounting standards and to oversee the quality of service of the professions associated with ensuring compliance with such standards. NFRA is empowered under section 132 (4) of the Act to investigate, for the prescribed classes of companies[1], the professional or other misconduct, and impose a penalty for proven professional or other misconduct, of the individual Chartered Accountants or firms of Chartered Accountants.

7. The Statutory Auditors, whether individuals Chartered Accountants or firms of Chartered Accountants, are appointed by the members of companies as per the provision of section 139 of the Act. The Statutory Auditors, including the EP and the Engagement Team (**'ET'** hereafter) that conduct the Audit are bound by the duties and responsibilities prescribed in the Act, the rules made thereunder, the Standards on Auditing (**'SA'** hereafter), including the Standards on Quality Control (**'SQC'** hereafter) and the Code of Ethics, the violation of which constitutes professional or other misconduct, and is punishable with penalty prescribed under section 132 (4) (c) of the Act.

8. NFRA started its scrutiny, on receipt of information from SEBI in April 2022 about its investigation regarding the diversion of funds worth Rs 3,535 crores (as on 31-07-2019) from seven subsidiary companies of CDEL to MACEL, an entity owned and controlled by the promoters of CDEL.

9. Late V. G. Siddhartha (**'VGS'** hereafter) was Chairman & Managing Director of CDEL; and Late S.V. Gangaiah Hegde, father of VGS was holding 91.75% shares of MACEL during the relevant period.

[1] As defined in Rule 3 of the NFRA Rules 2018.

10. As per the investigation made by the SEBI and examination by NFRA, the outstanding balance payable by MACEL to subsidiary companies of CDEL, which represented the funds diverted from the subsidiaries, was Rs 2,549 crores. In order to hide the diversion of funds, MACEL issued cheques of Rs 1,706.51 crores[2] without adequate balance in its bank account, on the basis of which the subsidiaries reduced the outstanding balance to Rs. 842.49 crore, as depicted in Table 1 below[3]. CDEL's subsidiaries made mere book entries for these cheques received from MACEL as repayment of loans given but the cheques were not encashed before 31.03.2019. These cheques indeed, were not intended to be encashed before the year end and were issued by MACEL for a false indication of adjustment at the end of the accounting year and to portray false position of the loans to related parties. Modus operandi appears to be same as that was found during the case of ICAI versus P.K. Mukherji by the Hon'ble Supreme Court[4].

Table 1 **Rs in crores**

Loans and Advances given by subsidiary companies of CDEL to MACEL (Related Party)				
Sr No	**Name of the subsidiary company from whom funds were given to MACEL**	**Balance shown as on 31.03.2019 as per FS of respective subsidiaries**	**Balance reduced fraudulently***	**Total real outstanding as on 31.03.2019**
(1)	(2)	(3)	(4)	(5=3+4)
1	Tanglin Retail Realty Development Pvt Ltd (**TRRDPL**)	789.35	685.01	1,474.36
2	Coffee Day Global Ltd (**CDGL**)	64.82	222.50	287.32
3	Tanglin Development Ltd (**TDL**)	-11.68	474.00	462.32
4	Coffee Day Trading Ltd (**CDTL**)	0	125.00	125.00
5	Coffee Day Hotels & Resorts Pvt Ltd (**CDH&RPL**)	0	150.00	150.00
6	Giri Vidhyut (India) Ltd (**GVIL**)	0	50.00	50.00
	Total	**842.49**	**1,706.51**	**2,549.00**

(Note-* Lending to MACEL was understated in the books of the subsidiaries, by accounting for cheques issued by MACEL in March 2019 without MACEL having requisite bank balance. These cheques were used by the lenders (CDEL's subsidiaries) to show recovery of related party loans in their books of accounts, without MACEL having adequate bank balance or approved bank credit limit. These cheques were later shown as cleared in the next financial year, i.e., FY 2019-20 by evergreening loans/advances by CDEL's subsidiaries through orchestrated circulation of funds among related parties).

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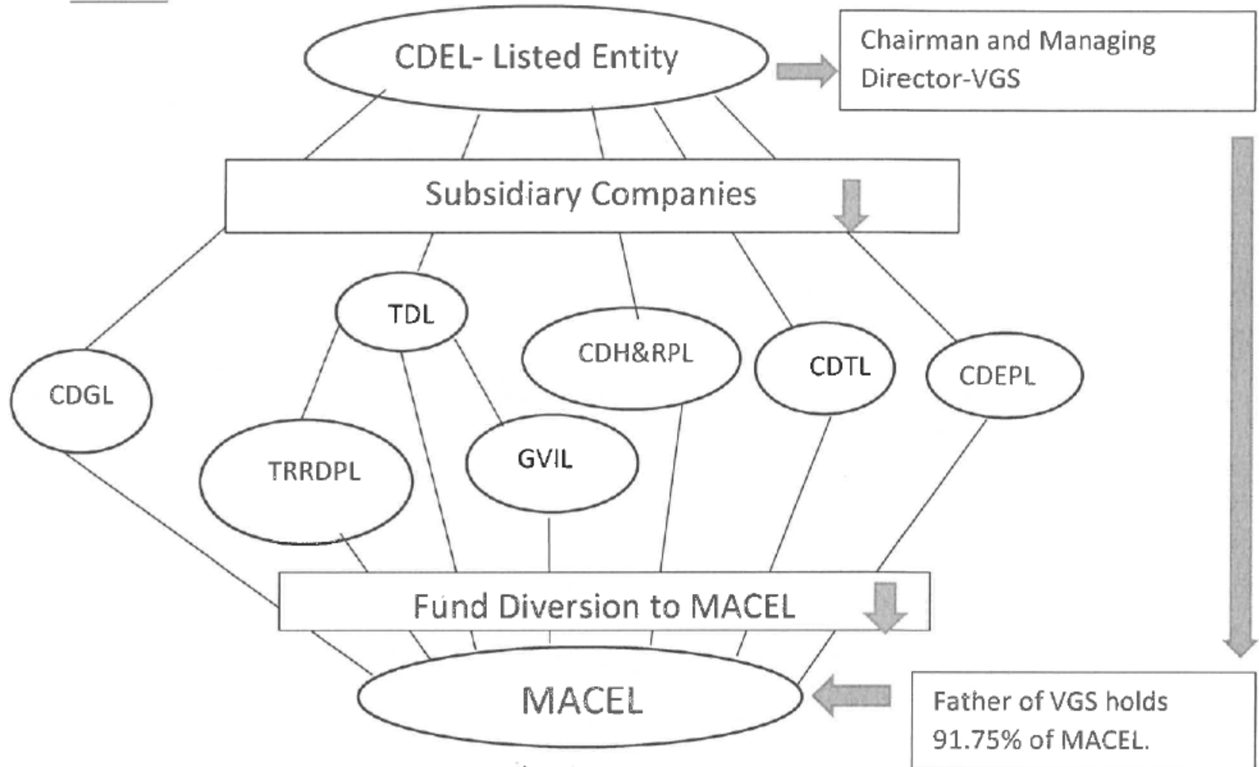
[2] Net of cheques issued and cheques received.

[3] Please refer paragraph 22 of NFRA order no.: NF-23/14/2022 dated 13.04.2023 available on NFRA website.

[4] Institute Of Chartered Accountants Of ... vs P. K. Mukherji and Anr on 26 February, 1968, 1968 AIR 1104, 1968 SCR (3) 330, AIR 1968 SUPREME COURT 1104.

11. The linkage of the entities described in Table 1 is depicted in the Chart 1 below:

Chart-1



12. On examination of the Consolidated Financial Statements of CDEL and MACEL, it transpired that except for CDGL, MACEL did not have any business transactions with 6 of the 7 subsidiary companies. MACEL was used as a conduit to transfer funds from CDEL's subsidiaries to the personal accounts of VGS, his relatives and entities controlled by him and/or his family members, as loans and advances that were never returned to CDEL/MACEL.

13. The modus operandi of the alleged diversion of funds discovered by the SEBI during its investigation was that "*VGS used to ask the Authorized Signatories to sign a bunch of cheques which were kept in his possession and used them as and when required*". Such pre signed blank cheques of bank accounts of various Coffee Day Group companies were used for the diversion of funds. In the following year, i.e., FY 19-20, VGS expired and the diversion of funds as detailed above was exposed.

14. CDEL is the parent Company of the Coffee Day Group. The Company owns and operates a resort and renders consultancy services. The Company is also engaged in the trading of coffee beans. The Company, primarily through its subsidiaries, associates and joint venture companies is engaged in business in multiple sectors such as coffee-retail and exports, leasing of commercial office space, financial services, integrated multimodal logistics, hospitality and Information Technology (IT) / Information Technology Enabled Services (ITeS).

15. **M/s BSR & Associates LLP was the statutory auditor (hereinafter also referred as Principal Auditor) of CDEL for the Financial Year 2018-19. CA Aravind Maiya was the EP and CA Amit Somani was EQCR. In the subsequent year, i.e. FY 19-20, M/s BSR & Associates LLP, resigned as Statutory Auditors, citing low fee as the reason for**

resignation. The Audit report was signed on 24/05/2019 and the EP resigned from M/s BSR & Associates LLP on 28/05/2019 and has since surrendered his certificate of practice.

16. After detailed scrutiny of the information shared by SEBI, NFRA suo motu initiated proceedings under section 132(4) of the Act and the Audit File of CDEL for the Financial Year 2018-19 was called for. Based on an examination of the Audit File and materials on record, each of which was shared with the noticees, a Show Cause Notice ('SCN' hereafter) dated 17.01.2024, under section 132(4) of the Act, was issued and served upon the Auditors, charging them with the following professional misconduct:

a) Failure to disclose a material fact known to them 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 them to appear in a financial statement with which the Statutory Auditors are concerned in a professional capacity.

c) Failure to exercise due diligence and being grossly negligent in the conduct of professional duties.

d) Failure to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion, and

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

17. The Auditors were initially allowed 30 days to submit a reply to SCN. On 02.02.2024 they sought an extension till 29th March 2024, which was allowed. The Auditors submitted their replies on 29th March 2024. On 05.04.2024 an opportunity of Personal Hearing (**PH**) was also provided to the Auditors and PH was fixed on 17.05.2024. On their request of postponement, the PH was rescheduled on 30.05.2024 for the EP; and on 31.05.2024 for the Firm and the EQCR. The EP attended PH on 30.05.2024; and the Firm and the EQCR attended PH on 31.05.2024 along with their legal representatives Advocate Ajay Bahl and others of M/s AZB & Partners. They reiterated their written submissions during the PHs and sought 15 days to submit additional replies which was allowed. The Firm, the EP and the EQCR submitted additional replies on 14.06.2024. We have carefully considered the written replies and oral submissions made during the PHs. Accordingly, this Order is based on the examination of the facts of the matter, charges in the SCN, written replies and oral submissions of the Auditors, and material available on record, each of which had been shared with the Auditors at the stage of the SCN. Only the charges that are established are discussed in this Order.

C. MAJOR LAPSES IN THE AUDIT OF CONSOLIDATED FINANCIAL STATEMENTS (CFS)

18. Before taking up the charges individually, we note that the main thrust of the Principal Auditors' reply has been that they were the Auditors of the listed company viz., CDEL, which was the parent entity with 46 subsidiaries, 4 associate companies and 3 joint ventures. The majority of these were audited by other firms of statutory auditors (**'Other Auditors'** hereafter). The Principal Auditors stated that they relied on the work of Other Auditors as per SA 600.

19. The CFS had Rs 842 crores of loans and advances to related parties and these loans were arising from the financial statements of the subsidiaries which were audited by the audit firms (Other Auditors) other than the Principal Auditor. These loans were considered as recoverable loans in the Consolidated Financial Statements primarily based on the audited financial statements of the subsidiaries and net worth certificate of CMD of CDEL issued by statutory auditor of one of the components of CDEL. The Principal Auditor, while vehemently asserting that he relied on the audit work of the Other Auditors as permissible under SA 600, has performed certain audit procedures which were inadequate and deficient as analyzed in the later part of this Order. Further, SFS of CDEL shows investments of Rs 1,937 crores in its subsidiaries. These subsidiaries have extended loans to various related parties. CDEL's investments in subsidiaries amounted to Rs. 1,937 crores as per the Standalone Financial Statements, which is under the full scope of the audit by the Auditors. This investment was 89% of the SFS balance sheet size of Rs 2,166 crores. These subsidiaries in turn provided loans to other related parties, which apparently, did not have the capacity to repay, thereby impairing the investment of CDEL in the subsidiaries. The Auditors had identified significant risk in impairment of investments[5] and therefore the Auditors were required to give special audit consideration to this area of significant risk as per paragraph 4(e) of SA 315. As discussed later in this Order, the repayment of loans/advances by subsidiaries subsequent to the Balance Sheet date and funds for repayments were arranged through circular rotation of funds within the group entities, which the Principal Auditors failed to note despite the Auditors themselves having identified outstanding balances with MACEL, (91.75% of whose shares are held by the father of VGS) as an area of significant related party transactions, but closing their analysis based on management explanations and without applying professional skepticism. Further, in the case of some of these loans by the subsidiaries a false and erroneous position of the outstanding balances was reflected in the balance sheet by passing mere book entries as repayment by the cheques though the cheques were not encashed at the reporting date.

I. Lapses in the audit of fraudulent diversion of funds to MACEL, understatement of such diverted funds and evergreening of loans through circulation of funds

20. The Firm, the EP and the EQCR were charged with violation of section 143(2)[6], 143(9)[7], 143(12)[8] of the Act, the Companies (Auditor's Report) Order 2016 ('**CARO**' hereafter), SA 200[9], SA 240[10], SA 315[11], SA 330[12] and SA 550[13], as they did not identify, assess and respond to the fraud risk and the risk of material misstatements in the financial statements arising due to diversion of funds to the tune of Rs 2,549 crores to MACEL; understatement of transactions with MACEL; and evergreening of loans. They did not report the resultant fraud to the Central

[5] AWP no. 2.14.3.1 of Audit File for SFS.

[6] Section 143(2) of the Act inter alia provides that the auditor shall make a report whether financial statements give true and fair view.

[7] Section 143(9) of the Act provides that Every auditor shall comply with the auditing standards.

[8] Section 143(12) of the Act provides that if an auditor has reason to believe that an offence of fraud has been committed in a company, the auditor shall report the matter to the Central Government.

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

[10] SA 240 - 'The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements'.

[11] SA 315 –'Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment.'

[12] SA 330 – 'The Auditor's Responses to Assessed Risks'.

[13] SA 550 – 'Related Parties'

Government and also failed to report it in the Independent Auditor's Reports and the report under CARO.

21. The EP denied this charge except for the charge relating to related party disclosures. The EQCR also denied this charge. The Firm did not submit a specific reply to any of the charges except the charge relating to audit documentation and stated that the alleged failures of the Engagement Partner and EQCR should not be attributed to the Firm as experienced persons were allocated as EP and EQCR; and appropriate tools, processes and safeguards were provided to the audit team. This issue is further discussed at Section F of this Order. The Firm, however, requested for due consideration to be given to the replies of the EP and the EQCR. Their replies to the charges are evaluated hereunder.

22. The Consolidated Financial Statements of CDEL include substantial transactions and balances with a related party viz., MACEL, 91.75% of which was owned by the father of the then Chairman & Managing Director of CDEL, and these transactions and balances primarily originate in the books of subsidiaries of CDEL. These transactions are summarized in Table 2 below, which has been derived from the CFS of CDEL, and the relevant serial numbers of the notes to the CFS are referred in the first column of this Table.

Table-2. CDEL Group's transactions and balances with MACEL **(Rs in crores)**

Note no.	Particulars	FY 2018-19	FY 2017-18
51 B	MACEL was identified as a related party where significant influence existed and transactions with MACEL during the year were disclosed as under: -		
51 D. I	Loan/ Advance given	2,226.80	724.63
	Loans / advance recovered	1,449.13	724.63
	Interest received	98.06	11.87
	Advance towards purchase of coffee	394.21#	365.01
	Purchase of clean and raw coffee	70.90	39.23
51 D II	Balances outstanding with MACEL were disclosed as under: -		
	Balance of Loan given (Assets)	789.35*	0.00
	Advances for supply of goods & rendering of services	64.82	3.46
	Balance of Loan received (Liability)	11.68	0.00
51 D II	Advance given for purchase of land to Smt. Vasanthi Hegde (Mother of VGS)	275.00	275.00

This pertains to advance given by Coffee Day Global Ltd (CDGL) to MACEL.
* This pertains to loans given by Tanglin Retail Reality Development Private Ltd (TRRDPL) to MACEL.

- It can be observed from the above data that loans/advances of Rs 2,226 crores given to MACEL in 2018-19 were almost three times of the loans/advance given in the previous year i.e., 2017-18 (Rs 724 crores), and advance towards purchase of coffee beans (Rs 394 crores) was 5.62 times of its annual reported purchases (Rs 70 crores) from MACEL. Therefore, these transactions were unusual and lacked business rationale.

- Further, CDEL borrowed Rs 2,960 crores from Standard Chartered Bank, through its step down subsidiary TRRDPL, which was a 100% subsidiary of Tanglin Developments Limited.

23. On being questioned about these advances to group entities, the EP has stated that they were the Auditors of CDEL and not for the subsidiaries, and they relied upon the audit work and the audit reports issued by other statutory auditors of CDEL group entities as permitted by SA 600 (Using the Work of another auditor). He further stated that he had relied on certain additional audit procedures performed on identified account balances of CDGL and TDL which were considered important from the standpoint of consolidation. The insufficiency of these additional audit procedures conducted by the EP, in addition to relying on the work of the statutory auditors of CDGL & TDL, is discussed in the later part of this Order. The EP stated that he had considered the exposure of CDEL group to MACEL as an important area for audit and performed audit procedures to evaluate the recoverability risk with the objective to test the recoverability of outstanding balances from MACEL. The actual recoverability procedures adopted are also discussed in later paragraphs but we first take up the Auditors' reliance on SA 600. The insufficiency of additional audit procedures is discussed in the later part of this Order.

24. During the personal hearing, we drew the attention of the EP to paragraph 10 of SA 600 which provides that principal auditor would normally be entitled to rely upon the work of component auditors unless there are special circumstances to make it essential for him to visit the component and/or examine the books of accounts and other records of the said component. The EP reiterated his written response[14] that no such special circumstances came to his attention to trigger this requirement. The large quantum of funds given to MACEL have already been enumerated above and we have noted that the Auditor himself has considered the exposure of the CDEL to MACEL as an important/significant area for Audit risk. Despite this, he chose not to question and evaluate why the funds of a listed company were being advanced to promoter group entities and what the end use of these funds was. It is critical to note that the proviso to section 143(1) of the Act gives the right of access to the records of all subsidiaries and associates companies to the auditor of a holding company. Accordingly, the statutory auditor is expected to examine the books of accounts and records of subsidiaries and associates wherever found necessary in situations similar to those of the audit under examination.

The requirements in SA 600 and other SAs have to be seen in light of this overarching requirement of the Act. The CFS of CDEL had substantial amount of Rs 842 crores as loans given by its subsidiaries to MACEL and borrowings from banks/NBFCs of Rs 7,060 crores. The Audit report on CFS says that the principal auditor did not audit the financial statements of forty subsidiaries whose financial statements reflect total assets of Rs. 12,140 crores as at March 31, 2019, total revenues of Rs. 4,091 crores and net cash inflows amounting to Rs. 591 crores for the year ended on that date, as considered in the consolidated financial statements. Considering the total assets and revenue of CFS, significant account balances in the CFS were arising from the financial information of the components audited by the Other Auditors. This fact, coupled with Group Entity Structure having many subsidiaries, with large scale intra group lending activities is nothing but special circumstances to make it essential for the Principal Auditor to visit the component and/or to examine the books of account and other records of the said components. Apart from these factors, the following evidence was also available to the Principal Auditors that indicates misappropriation of funds by the related parties.

[14] Vide written submission dated 14.06.2024 and during PH on 30.05.2024.

a) Table 2 shows an advance of Rs 394.21 crores given by CDGL (a subsidiary) to MACEL for the supply of goods of Rs 70.90 crores only. We note that the advance given was 5.62 times the value of the annual purchase of coffee beans, and this indicates that the transaction was unusual as there was no business rationale for it. .

b) Loans of Rs 1,929.07 crores were further given by TDL to MACEL, which we have already noted as the promoter's entity. TDL, a subsidiary of CDEL, had no business relationship with MACEL[15].

c) The ET obtained the audited balance sheet of MACEL for FY 2017-18 and observed that it had given loans/advances of Rs 2,252.06 crores to related parties, out of which Rs 1,878.59 crores were given to partnership firms of V. G. Sidhartha (VGS), Chairman of CDEL and Malvika Hegde (VGS's wife)[16]. This indicates indirect lending to the Director and/or direct lending to entities in which directors are interested (Section 185 of the Act).

d) EP verified the bank statements of CDEL, with Karnataka Bank, wherein the debits and credits of equal amounts to the same entity could indicate evergreening[17].

25. The Auditors identified significant risk in impairment of investments[18] and the Auditor was required to give special audit consideration to this area as per paragraph 4(e) of SA 315. However, the Auditors did not perform appropriate audit procedures despite knowing that CDEL's subsidiaries had given huge amount of loans and advances to MACEL. This is a kind of special circumstances envisaged under para 10 of SA 600 which was not adequately addressed by the Principal Auditors. The Prescriptions in paragraph 12 and 13 of SA 600 in this regard are not absolute and are to be applied subject to the fundamental requirement of risk of material misstatements (SA 315), professional skepticism, professional judgement (SA 200) and sufficient appropriate audit evidence (SA 500) to support the audit opinion.

26. Further, as required by para 9 of SA 600, the Principal Auditor should have considered whether the auditor's own participation is sufficient to be able to act as the principal auditor. The factors to be considered here are the materiality of the financial information audited by the Principal Auditor and the risk of material misstatements in the financial information of the Components audited by the Other Auditor. This para of SA 600 goes on to require the auditor to consider performing additional procedures as set out in this SA regarding the components audited by other auditor resulting in the principal auditor having significant participation in such audit.

In view of the fact that the substantial percentage of total assets and total revenue were arising from the financial statements audited by the Other Auditors, the Risk of Material Misstatements ('**RoMM**' hereafter) arising from those financial statements were significantly material and, therefore, the Principal Auditor must have performed additional procedures to obtain sufficient appropriate audit evidence to enable him to issue the audit opinion on the CFS.

27. Had the above factors been taken into consideration, the EP could not have relied on the work of the component auditors without performing rigorous procedures to confirm the ultimate use

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[15] Slide no. 19 of AC PPT dated 24.05.2019 – CFS Audit Work Paper (**AWP**) – 4.7.2.0010.
[16] CFS AWP no. – 3.4.5.0010 – MACEL Exposure Recoverability.
[17] SFS AWP no. – 3.4.5.0010 – Related Party WP.
[18] AWP no. 2.14.3.1 of Audit File for SFS.

of the funds of CDEL, the listed entity. Hence the reliance of the Auditors on SA 600 is misplaced and defies professional skepticism.

28. We now look at various other aspects of these loans. These are primarily the end use, recoverability and evergreening of these loans/advances. For illustrating these we take up the loans advanced by various subsidiaries that have been consolidated in the CFS of CDEL audited by the Auditor.

29. Table 2 above shows an outstanding loan balance of Rs 789 crores given by TRRDPL, the auditee company CDEL's subsidiary, to MACEL. But the EP did not evaluate the rationale of these advances, their recoverability etc. The EP's reply in this matter was that his Firm was not the auditor of TRRDPL and that he had relied on the management's explanation that TRRDPL had repaid the money to MACEL in May 2019, i.e., after the close of the FY.

30. Regarding the first part of the Auditor's reply, we have already dealt with the issue of reliance on the work of a component Auditor. As regards the recoverability and reliance on the management's explanation on repayment, we note that the amount of Rs 789 crores was actually never repaid by MACEL to TRRDPL, but accounting entries were created by rotation of funds amongst the coffee day group companies. This modus operandi has been detailed in NFRA Order no. NF-23/14/2022 dated 13.04.2023, in the case of Auditors of MACEL. Had the Auditors been diligent and performed adequate audit procedures to comply with their duties as per the Act, such misstatements would have been identified and reported.

31. Coming to the analysis of the recoverability of the loans and advances, we find that there is no analysis of the item wise recoverability of loans/advances but rather a total analysis. The AWP marked 3.4.5.0010 – 'MACEL Exposure Recoverability' (CFS) speaks of a recoverability analysis. This paper merely notes from the audited balance sheet MACEL's loans and advances outstanding with related parties as being Rs 2,252 crores as on 31/3/2018. In this work paper the auditors note that "*...We have obtained the Net worth certificate of the promoter (attached for reference) which states that the net worth of the promoter is 2,485 crores, after deducting all loans of promoter/ promoter group......* ***Given that the net worth of the Promoter is way more than the amounts payable by MACEL as per the initial table, it is clear that there are no issues with regard to recoverability of the same.***" **(emphasis provided by NFRA).**

32. The Auditors were charged for non-verification of end use of Rs 2960 crores borrowed by TRRDPL from Standard Chartered Bank (**'SCB'** hereafter). TRRDPL is a 100% subsidiary of TDL which in turn is a 100% subsidiary of the auditee company, CDEL. The EP stated that he relied on management's explanation regarding utilization of these funds. The facts of the matter are detailed below.

CDEL and its promoters had 2,80,56,012 shares and 53,04,217 shares, respectively, of a listed company viz., Mindtree Ltd. All these shares were pledged against the group/promoter's borrowings. CDEL and its promoters agreed to sell these shares @ Rs 980 per share to a buyer[19]. The value of shares held by CDEL and promoters was to Rs 2,749.49 crores and Rs 519.81 crores respectively. In order to free these shares from the pledge, TRRDPL borrowed Rs 2,960

[19] Source – Escrow agreement dated 18.03.2019 provided by Standards Chartered Bank.

crores from SCB to repay to the lenders with whom such shares were pledged. As per the EP, out of this amount of Rs 2,960 crores, a sum of Rs 2,172 crores was lent to CDEL and Rs 789 crores was on-lent to MACEL. The EP's reply itself indicates a diversion of fund as Rs 789 crores was transferred to the promoters owned company MACEL against Rs 519.81 crores which was the actual value of shares held by the promoters. The EP should have probed further as to why a substantially higher amount of borrowed funds (Rs 789 crores) than the value of underlying shares of the promoters (Rs 519.81 crores) were given to a related party. Thus, there was clear evidence of diversion of funds before the Auditors.

33. It is surprising that after identifying the CDEL's exposure to MACEL as a significant related party transaction, the recoverability analysis of CDEL's exposure was made by the Auditors based on the net worth of VGS, who was not even a shareholder in MACEL, raising serious questions about using his net worth for a recoverability analysis of MACEL. Besides, there is no independent evaluation of the net worth certificate obtained from M/s Sundaresha and Associates; and evaluation of the independence, competence, capability and objectivity of the expert. This is totally in contravention of the requirements of SA 500. As mentioned in NFRA Order no. NF-23/14/2022 dated 12.04.2023 and NF-23/14/2022 dated 26.04.2023, the independence of this audit firm with CDEL group was itself questionable.

34. It is seen that the Engagement Team had performed a recoverability test in respect of monies due from MACEL[20]. The ET obtained the audited balance sheet of MACEL for FY 2017-18 and observed that it had given loans/advances of Rs 2,252.06 crores to related parties, out of which Rs 1,878.59 crores were given to V. G. Sidhartha's (VGS), Chairman of CDEL and Malvika Hegde's (VGS's wife) partnership firms. The recoverability of the amount payable by MACEL was assessed by the ET on the basis of the net worth of the promoter of CDEL (VGS), certified by M/s Sundaresha & Associates. We have already discussed the recoverability work paper in paragraph 30 & 31 of this Order. There was clear evidence with the ET that CDEL's money had been diverted to the entities owned by VGS and its relatives. Further, VGS was neither a shareholder nor a director of MACEL. There was no logic of considering his net worth for assessing recoverability of dues from MACEL. It shows that in the recoverability analysis the EP was considering VGS to be synonymous with all group entities and his net worth was seen as covering up for all loans and advances.

35. Further, the ET did not evaluate the appropriateness of the methodology used for computation of the net worth of VGS by M/s Sundaresha & Associates. The EP did not perform any procedures for compliance of paragraph 8 of SA 500 (Audit Evidence), that requires evaluation of the competence, capabilities and objectivity of the management expert. The EP did not provide a specific reply to this charge but mentioned that the ET assessed the recoverability risk associated with transactions entered into between CDEL's subsidiaries and MACEL; and component auditors did not raise any issue on this matter. This reply is not accepted as there is no evidence in the Audit File regarding Auditor's evaluation of the appropriateness of the methodology used for computation of the net worth of VGS by M/s Sundaresha & Associates; and evaluation of the competence, capabilities and objectivity of the management expert.

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[20] AWP: 3.4.5.0010 – 'MACEL Exposure Recoverability' (CFS).

36. Table 2 shows an advance of Rs 394.21 crores given by CDGL (a subsidiary of CDEL) to MACEL whereas the actual supply of goods was only Rs 70.90 crores. On being questioned about the purpose of an advance of such a large amount to a related party, the EP replied that the said advance was given for purchase of coffee beans and there was nothing to demonstrate that transaction was unusual. We note that the advance given was 5.62 times the value of annual purchase of coffee beans and this in itself demonstrates that the transaction was unusual. The EP stated that the excess money was recovered along with interest ignoring the fact that an advance for purchase cannot be 5.62 times the value of the purchase, and the fact that it was refunded with interest only shows that it was a financial transaction disguised as an advance for purchases. The monies of a listed company like CDEL cannot be made available to the promoter group in the garb of advances for supply of goods. Looking to the figures of earlier years too, we find that raw coffee supplied by MACEL to CDGL was in the region of Rs 39 to 46 crores (2015-16 to 2017-18). In these circumstances, not questioning an advance of substantially high amount of Rs 394 crores and not evaluating the rationale for release of this huge advance is gross negligence, lack of professional skepticism and absence of due diligence on the part of the Auditors. This advance was discussed by the Auditors with the Audit Committee of CDEL on 24.05.2019 (the same day as the Audit report was signed) stating that the Auditors had inspected the relevant ledgers and agreements for related party transactions, however the Auditors did not question the Audit Committee why such abnormally high advance was given to the promoter's company MACEL.

37. An Auditor needs to make an assessment of the recoverability of loans/advances, without which the assertions in the financial statement relating to 'valuation' of these loans cannot be ensured. Assessing recoverability includes an examination of the repayment capacity of the borrower and his intent to repay. This in turn requires looking into the purpose of the loans, the end use of the loans for the stated purpose, the business rationale and the reasonable terms and conditions of the loans and advances. Any kind of circular rotation of funds among group companies as can be observed from the bank statements of CDEL, CDGL and TDL which claimed to have been verified by the Auditors, indicating evergreening, is evidence that the loans are not recoverable and the value stated in the financial statements is overstated and reflects inadequate impairment allowance. The principal auditor obtains reasonable assurance on such matters through discussions with the other auditors, specific testing of the transactions and scrutiny of the work of the other auditors, and by performing additional procedures as required by SA 600. It is evident that such an examination was not done in this case as the Auditors failed to notice and report the web of circular transactions designed to siphon funds out of the listed company. Having knowledge of the business of the group and having identified these loans and advances as an area of risk, the EP was required to holistically assess the financial statements of the group and to sufficiently co-ordinate audit work with other auditors to ensure that the transactions and balances represent genuine business transactions in pursuance of the stated objectives of the entity. Routing funds under different pretexts, such as loans, advances for supply etc., to group entities without adequate justification and rationale should have made the Principal Auditors more vigilant and professionally skeptical. Para 19 of SA 600 requires that there should be sufficient liaison between principal auditor and other auditors including the issue of written communication to the other auditors.

38. The EQCR was also asked to show cause on the same issues and the stand taken by him is that he understood this transaction from the ET and the EP and enquired from the EP about the recoverability of this amount; and that the EP had replied that they (Engagement Team) were preparing a detailed recoverability assessment; and that the funds had been recovered in May 2019. The reply of EQCR is not satisfactory as he also did not question the appropriateness of this transaction and the EP's reliance on the management explanation that funds had been recovered. The EQCR was also aware of the diversion of funds to the promoter entity as this fact is disclosed in the documents reviewed by the EQCR i.e. financial statements and the presentation given by the EP to the Audit Committee of CDEL on 24.05.2019.

39. Further, the audit procedures performed by the EP and the EQCR to verify the arm's length basis of the above-mentioned related party transactions were not appropriate and sufficient. The Auditor has not verified the arm's length pricing of raw coffee supplied of Rs 70 crores by MACEL to CDGL and necessity of giving unusually high amount of advance of Rs 394 crores by CDGL to MACEL. The Auditor has only checked the arm's length basis of interest rate charged on such advances but the business rationale of giving such a huge advance to promoter's entity[21] for a limited purchase of coffee beans was not evaluated. Paragraph 32(c) read with paragraph A47 of SA 240 provides guidance to the auditor to identify significant transactions that lacks business rationale.

40. These unusual transactions and circumstances evidence the lack of professional skepticism on the part of the auditor and his complete reliance on the management's explanation without doing sufficient audit procedures and questioning the diversion of funds within the entities of the group which is so evident in this financial arrangement at the behest of the promotors.

41. In respect of the charge relating to the recoverability of monies from MACEL, the EP replied that CDGL and TDL had already recovered major portion of the loans; the management had informed the Auditor that TRRDPL had repaid loan of Rs 789 crores in May 2019; and the EP claimed that he was not aware of evergreening of loans. The Audit file does not evidence verification of the bank statements to check recovery of loans from the promoter company. The Auditors blindly relied on management explanation. All recoveries within the group were actually through evergreening of loans as detailed in NFRA Orders no NF-23/14/2022 dated 13.04.2023, NF-23/14/2022 dated 12.04.2023, and NF-23/14/2022 dated 26.04.2023. in the cases of MACEL, CDGL and TDL. **It is important to note that it has been recorded in the Audit File that bank statements of CDGL and TDL had been verified[22].** Any verification of bank statements should have clearly evidenced the circular flow of funds and the evergreening arrangements within the group. This matter of evergreening is further discussed in paragraph no. 45 to 47 of this Order.

42. The CDEL did not disclose Related Party Transactions between -

a) MACEL and CDGL of Rs 266.54 crores;
b) MACEL and CDH&RPL of Rs 150 crores;

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[21] AWP – 3.4.5.0020-ALP.xlsx.

[22] AWP no. 3.2.4.4.2 'Review of Bank Reconciliation Statements' (CFS).

c) MACEL and CDTL Rs 250.02 crores;
d) MACEL and GVIL of Rs 200 crores.

The Auditor did not report this misstatement in the CFS. The EP has admitted this mistake. Evidently, a diligent auditor would not miss out such high quantum RPTs, especially when exposure of the Auditee company to MACEL was marked as a significant area for Audit.

43. Further, there were discrepancies between the amount of related party transactions with MACEL disclosed by CDEL and recorded by the Auditor in the Audit File which was admitted by the EP in his reply. CDEL had disclosed in Related Party Disclosure (RPD) that loans and advance of Rs 2,226.80 crores were given to MACEL which repaid Rs 1,449.13 crores to CDEL. Contrary to this, one audit work paper recorded these amounts as Rs 3,116.94 crores loans given to MACEL and 2,456.90 crores loans repaid by MACEL; in another audit work paper these amounts are recorded as Rs 3,243.38 crores loans given to MACEL and 2,328.51 crores loans repaid by MACEL; and in the financial statements of respective companies these amounts are disclosed as Rs 2,579.33 crores loans given to MACEL and Rs 1,124.98 crores loans repaid by MACEL excluding transactions with TDL. The EP admitted discrepancies in the amounts pertaining to related party transactions recorded in two audit work papers and stated that audit work papers were not updated to reflect final numbers. These in themself are indicative of the lack of due diligence in a significant area of Audit.

44. There was non-disclosure of the current account limit of Rs 665.06 crores provided by TRRDPL to MACEL. The EP stated that the limit was provided but the loan was actually not granted and therefore the limit was not required to be disclosed. This reply is not accepted as para 18(b) of Ind AS 24 (Related Party Disclosures) mandated CDEL to disclose commitments also; and TRRDPL had disclosed this limit in its related party disclosure.

Fraudulent understatements of loans and advances given to MACEL (Rs 1,706.51 crores) and evergreening of loans and advances

45. Responding to the charge of failure to perform appropriate audit procedure to identify and evaluate large scale evergreening of loans and understatements of diversion of funds to MACEL, the EP stated that he did not review the transactions between CDEL and TDL in the manner NFRA has considered, as the money was advanced and returned during the year and these transactions were eliminated during consolidation, TDL being a wholly owned subsidiary.

46. The above reply is not accepted, especially in light of the fact that the EP had verified these bank statements, wherein the evergreening of loans is apparent. An excerpt from the bank statement of CDEL with Karnataka Bank is given below:

Table-3 Bank Statement of CDEL with Karnataka Bank (Rs in crores)

Date	Name of Company	Withdrawal	Deposits
24.12.2018	TDL		50
	TDL	50	
27.12.2018	TDL		50
	TDL		5
	TDL	50	
	TDL	5	
08.02.2019	TDL		50

11.02.2019	TDL	50	
13.02.2019	TDL		50
	TDL	50	

It can be observed from Table no. 3 that on 24.12.2018, Rs 50 crores received from TDL was returned to TDL; on 27.12.2018 Rs 50 crores & Rs 5 crores received from TDL were returned to TDL; Rs 50 crores received from TDL on 08.02.2019 was returned on 11.02.2019 to TDL; on 13.02.2019 Rs 50 crores received from TDL was returned to TDL.

In respect of evergreening of loans as was apparent in CDGL, TDL and TRRDPL, the EP replied that he was not aware of alleged evergreening of loans by these companies; the Firm was not the auditor of these companies and that the auditors of these companies did not highlight any such issues. This reply is not accepted as the ET has verified this bank statement available in the Audit File. the AWP no. 3.2.4.4.2 'Review of Bank Reconciliation Statement' (Consolidated Financial Statements), *"We have obtained and review the bank reconciliations. We have traced the amount as per bank on 31 March 2019 to the bank statement / confirmations. We have traced the reconciling items to the subsequent bank statements. We have reviewed the date of deposits for all uncleared cheques deposited in the BRS to assess if they should be disclosed as cheques in hand. Also, we have checked if there are any stale cheques"*. As regards the reliance on the work of the component Auditor, the matter has already been discussed in paragraphs no. 23 to 27 of this Order.

As mentioned in the preceding para, the Auditors had verified bank statements of CDGL. An Examination of the bank statement of CDGL's account with Yes Bank shows evergreening of loans by structured circulation of funds between CDGL and MACEL. For example, from the Table 4, which is an extract of the CDGL's bank account with Yes bank, it can be seen that CDGL received four cheques of Rs 65.50 crores in March 2019 from MACEL, which were cleared on 04.04.2019 by evergreening of loan through circulation of funds between MACEL and CDGL. It demonstrates that three payments amounting to Rs 65.50 crore were received from MACEL on 4th April 2019 and three payments of Rs.65.50 crore were made by CDGL to MACEL on the same day, the receipts and payments matching exactly.

Table 4: Bank Statement of CDGL with Yes Bank **(Date - 04.04.2019)**

Particulars	Rs in crores		
	Payment	Receipt	Balance
Receipt from MACEL		24.50	-50.48
Payment to MACEL	21.90		-72.38
Receipt from MACEL		23.90	-48.48
Payment to MACEL	24.01		-72.49
Receipt from MACEL		17.10	-55.39
Payment to MACEL	19. 59		-74.98
Total	**65.50**	**65.50**	

47. Similar evergreening through circulation of funds could be observed from the bank statement of CDGL with IndusInd Bank as well. CDGL received five cheques for a total amount of Rs 25 crores on 30.03.2019 from MACEL, which were cleared on 02.04.2019 a in circular manner.

For example, MACEL paid Rs 6.70 crores to CDGL, which then paid Rs 6 crores to MACEL, which then paid Rs 5 crores to CDGL and so on. There were other similar examples also.

48. The above mentioned evergreening of loans through structured circulation of funds between CDGL and MACEL had been done to understate the amounts of advance given by CDGL to MACEL by Rs 222.50 crores as on 31.03.2019. These cheques, issued in March 2019 by MACEL to CDGL, remained uncleared and were unreconciled items of Bank Reconciliation Statements of CDGL on 31.03.2019. CDGL again provided funds to MACEL for clearance of these cheques in FY 2019-20. The Auditors failed to detect the fraud committed through evergreening during their verification of the subsequent clearance of cheques in CDGL's bank statements. Accordingly, the auditors also failed to raise alarms about the possibility of the similar frauds in other subsidiaries of CDEL. Further, it is relevant to mention that as per CFS of CDEL, there was unusually high amount of cash and cash equivalent account balance (Rs 1453.79 crores), which was almost 20% of the total borrowing of Rs 7,060.35 crores. This represents mostly the amount of uncashed cheques used in evergreening and was additional red flag to verify bank reconciliation statements of subsidiaries, which was not done properly. Thus, it is proved that the Auditors failed to exercise due diligence and professional skepticism despite presence of a number of red flags about fraud risk. In order to hide diversion of funds to MACEL, the promoters indulged in such activities in other subsidiaries of CDEL also. The total understatement in respect of amount recoverable from MACEL was of Rs 1,706.51 crores as the amount recoverable from MACEL was fraudulently reduced from Rs 2,549 crores to Rs 842.49 crores[23]. It is also important to note that in the case of ICAI Vs. P K Mukharji, the Hon'ble Supreme Court has held the auditor guilty of professional misconduct and reprimanded for his failure to report falsification of account balances by way of book entries.

49. The Auditors were required to exercise professional skepticism and judgement[24] and evaluate the business rationale of these transactions. As per paragraph 5 of SA 315, they were required to perform risk assessment procedures to provide a basis for the identification and assessment of Risks of Material Misstatement (RoMM) at the financial statements and assertion levels. As per paragraph 5 of SA 330, they were required to respond to the identified RoMM. SA 240 prescribes auditor's responsibilities relating to fraud in audit of financial statements. Paragraph10 of SA 240 provides that the objectives of auditor are to identify and assess the ROMM in the Financial Statements due to fraud, obtain audit evidence and respond to identified or suspected risk. Paragraph 12 of SA 240 requires the auditor to maintain professional skepticism recognizing the possibility of existence of material misstatement due to fraud. Paragraph 32 (c) of SA 240 further requires auditor to evaluate the business rationale (or lack thereof) of the significant transactions that are outside the normal course of business or otherwise appear unusual and evaluate whether such transactions may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of funds. As per paragraph 11 of SA 550, they were required to perform audit procedures and related activities to identify the risk of material misstatement associated with related party relationships and transactions.

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[23] Please refer paragraph 22 of NFRA order no.: NF-23/14/2022 dated 13.04.2023 available on NFRA website.
[24] Please refer paragraph 15 & 16 of SA 200.

50. From the above facts and details of numerous and large advances made to related parties, the absence of business rationale for the same, the modus of circular movement of funds which is apparent and evident from the bank statements available with the Auditors, the immediate reliance on management explanation regarding these transactions, the recoverability analysis based on the net worth of the chairman of the group,- all of these point to the failure on the part of the Auditors of CDEL, to exercise professional skepticism and judgement and perform appropriate audit procedure to detect and report fraudulent diversion of funds. The facts enumerated clearly show that the Independent Auditor's Report falsely reported that financial statements of CDEL gave a true and fair view. It is clear that they knew that funds were being diverted to MACEL, an entity owned by promoters of CDEL and the fraud being committed in the company. It is also evident from above analysis that despite being aware that an offence of fraud had been committed in the company, they failed to report the same to the Central Government under Section 143 (12) of the Act. On the contrary, they reported[25] that no material fraud by or on the company had been noticed or reported during the course of audit. Thus, the EP and the Firm violated section 143 (12) of the Act, the Companies (Auditors Report) Order 2016, SA 200, SA 240, SA 315, SA 330 and SA 550. It is also proved that the EQCR did not exercise due diligence and showed gross negligence during review of the significant judgements of the EP in this matter. There were clear indications of the CDEL Group activities not being conducted in an orderly manner, the auditor should have probed the matter to the bottom as has been said by Lord Alverstone, Chief Justice in his address to the jury in the case reported at [1904] 31 Accntt. LR 1 London Oil Storage Co. Ltd v. Seear, Hasluck and Co.

II. Lapses in audit of suspected diversion of funds of Rs 130.55 crores by CDGL to M/s Classic Coffee Curing Works ('CCCW' hereafter)

51. The Firm, and the EP were charged with failure to exercise professional skepticism and judgement; and non-performance of appropriate audit procedures in accordance with SA 200, SA 240, SA 315, SA 330, and SA 550 in respect of capital advance of Rs 130.55 crores given by CDGL (subsidiary of the auditee company CDEL) to CCCW.

52. The Auditors had identified a capital advance of Rs 173.30 crores made by CDGL as a significant account balance. This advance included a sum of Rs 130.55 crores advanced to CCCW[26]. As per para 20 of SA 315, an auditor requires an understanding of *inter alia* control activities related to significant account balance which the auditor finds relevant in his risk assessment process, which was not complied by the EP. The Auditors recorded that "*The Company has paid Rs550 million and Rs 800 million through Classic Coffee to MACEL as per the agreement entered for buying a land identified by them. The same is recovered subsequently.*" We find that this is factually incorrect, as this amount was given to an individual and not to MACEL. It was repaid in May 2019, through round tripping of funds. The detailed facts are explained hereafter.

- M/s Classic Coffee Curing Works is a subsidiary partnership firm in which CDGL (subsidiary of CDEL- the auditee company) has 99% share and Coffee Lab Limited has 1%

[25] Paragraph X of Annexure -A (CARO report) of Independent Auditor's Report dated 24.05.2019 on SFS.
[26] AWP no. 2.3.1 'Significant accounts and relevant assertions' (CFS), and AWP no. 4.3.1.0010 BS AR.pdf.

share. As per the SFS of CDGL, it disbursed a loan of Rs 130.55 crores to CCCW during FY 2018-19. As per FS of CCCW, it disbursed 'Capital Advance' of exact Rs 130.55 crores to 'Kumar Hegde H C' during 2018-19. The balance sheet size of CCCW as on 31.03.2019 was Rs 132.36 crores and other than this capital advance, its balance sheet size would be Rs 1.81 crores. It becomes clear that CCCW was a partnership firm with a small capital. Money from a subsidiary of a listed company was routed through this partnership firm to an individual. But the Auditors state that the money was advanced to MACEL. Thus, the Auditors conclusion was incorrect and false, as money was not given to MACEL but paid to 'Kumar Hegde H C'. As such it is misleading on the part of the Auditor to say that the money was advanced to MACEL.

- The Auditor did not check the bank statement of CDGL to verify the management's explanation that Rs 130.55 crores was recovered by CDGL from CCCW. Being principal auditor of the holding company, the Auditor had a right of access to these bank statements of CDGL as per permitted under section 143(1) of the Act. However, he did not do so. We have obtained and reviewed that bank statement of CDGL which shows that CDGL provided additional funds to MACEL, which were rotated seven times among CDGL, MACEL, CCCW and Kumar Hegde to show repayment of this amount. The Bank statement of CDGL and MACEL shows that on 09.05.2019, CDGL paid Rs 20 crores to MACEL, which then paid Rs 20 crores to Kumar Hegde, thereafter CDGL paid Rs 20 crores to MACEL which then paid Rs 20 crores to Kumar Hegde and so on....... In this manner a total of Rs 135.55 crores were paid by CDGL to MACEL and by MACEL to Kumar Hegde. From these transactions, Kumar Hegde repaid the capital advance of Rs 130.55 crores to CCCW/CDGL. However, the end use of capital advance given in 2018-19 to Kumar Hegde is not known. Repayment of this capital advance is through 'round tripping of funds' resulting in siphoning of Rs 130.55 crores from CDGL. Therefore, the ET's statement in final analytical procedures is false, as money was not recovered by CDGL but in next FY 2019-20, CDGL again provided Rs 20 crores to MACEL, which was circulated to show repayment of capital advance to CDGL. Had the Auditors performed the audit procedures before making conclusion about recovery of this advance, they would have detected this fraud.

53. The EP's reply is premised on the argument that the Firm was neither the auditor of CCCW nor was CCCW a scoped-in entity for audit of CDEL; that the alleged circulation was not known to the ET; that the auditor of CDGL did not raise any alert; and that CCCW had acknowledged receipt of money from Kumar Hegde in the agreement.

54. The EPs reliance on the work of another Auditor and the shortcomings in this defense have been discussed earlier in pre paras and are not being repeated for brevity. In addition, we also note that without checking any bank statements and confirming the receipt of monies, the EP chose to completely rely on the management explanation regarding recovery of capital advance despite identifying this as significant account balance.

55. The EP has admitted that reference to MACEL in the Audit File was an error, but claimed it to be inadvertent. Making a mistake about the entities to whom monies are advanced when they are related parties, shows complete lack of due diligence on the part of the EP.

56. In view of the above, the charge is proved that the EP and the Firm violated SA 200, SA 240, SA 315, SA 330, and Section 143 (12) of the Act.

III. Lapse in performing risk assessment procedure in respect of Interest Income of TDL amounting to Rs 75 crores

57. The Firm, the EP and the EQCR were charged with failure to perform risk assessment procedures in respect of interest income of Rs 75 crores, thus violating SA 240, and SA 315. TDL is a subsidiary of the auditee company CDEL. During the year TDL recognized an interest income of Rs 75 crore from MACEL without any underlying agreement for the same. On the other hand, MACEL did not account for this corresponding interest expenditure.

58. The Auditors selected the Interest income of TDL for risk assessment[27]. However, the Audit File does not evidence procedures to assess the risk. After earmarking this item for risk assessment, the Standards- specifically, paragraph 26 of SA 240, requires the Auditors to presume the risk of fraud in revenue recognition and as per SA 315, they were required to perform risk assessment procedures.

59. The EP's response again is that the Firm was not the auditor of MACEL and thus was not aware that MACEL had not recognized interest expense; that the interest income in question was recognized in the profit & loss account and cash flow statement of TDL; that the work paper referred by NFRA has only listed various streams of revenues but does not mean that the ET presumed fraud risk in each of those listed income stream.

60. This reply is not acceptable as TDL had recognized an interest income of Rs 75 crores on advance of Rs 2,614 crores given to MACEL in FY 2018-19, as compared to only Rs 1.32 crores interest income recognized in the previous year on advances of Rs 3,410 crore given to MACEL. This huge jump in interest income itself is an unusual item and above the materiality limit of Rs 28.4 crores determined by the Auditors for CFS, which should have caught the attention of a diligent Auditor. It would not be out of place to mention that the profit TDL was only Rs 3.83 crores and if the interest income of Rs 75 crores is excluded, then TDL would actually have a loss of Rs 71.17 crores. Further, even CDEL, which had reported profit of Rs 27.93 crores[28] as per CFS, would have had to report a loss, and the recognition of interest income by TDL helped in the CDEL not reporting a loss of Rs 47.07 crores but a profit of Rs 27.93 crores. The base of this profit (i.e., the interest income of Rs 75 crores from MACEL) is not reflected in the accounts of the source i.e., MACEL, thereby making the financials of CDEL, the listed company, unreliable. Audit of revenues, especially from the angle of fraud, is an important and integral part of any Audit. The negligence shown by the Auditors in not ruling out the fraud in recognition of this major item of revenue, which was critical in determining the profitability of TDL and CDEL, is nothing short of gross negligence, considering that the amount was shown as earned from a group company, and could have been easily verified by the Auditor, considering its criticality. It is surprising that despite this interest income being significant to CFS, the EP did not presume the fraud risk in its recognition by TDL and CDEL. The risk of fraud was evident and the Auditors- the EP, the EQCR and the Firm- failed to exercise due diligence in not recognizing this fraud risk, and therefore violated SA 240, and SA 315.

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[27] In AWP no. 2.0.3 'Other risk assessment decisions' (CFS).

[28] Profit before exceptional item, share of profit of equity accounted investees and tax.

D. MAJOR LAPSE IN THE AUDIT OF STANDALONE FINANCIAL STATEMENTS (SFS)

Lapse in audit of CDEL's compliance with section 185 of the Act

61. The Firm, the EP, and the EQCR were charged with violation of clause (iv) of the Companies (Auditor's Report) Order 2016 as they failed to report CDEL's violation of Section 185 of the Act in respect of loans given by CDEL to its subsidiaries, the proceeds of which were not used for principal business activities of such subsidiaries. Details are given hereafter:

- Section 185 of the Companies Act provides that loans, guarantees and securities can be provided to related parties if a special resolution is passed by the company in general meeting and the loans are utilised by the borrowing company for its principal business activities.
- As per Related Party Disclosures in note no. 33 of its SFS, CDEL had given the following amount of loans/guarantee (Table 5) to its wholly owned subsidiaries.

Table - 5 **Rs in crores**

Name of subsidiary to whom CDEL provided loans/ guarantee	Amount of loans given	Amount of guarantees provided
Tanglin Developments Ltd (TDL)	734.46	1,015.00
Coffee Day Kabini Resorts Private Limited (CDKRPL)	110.67	0.00
Coffee Day Hotels and Resorts Private Limited (CDH&RPL)	210.60	0.00
Total	**1,055.73**	**1,015.00**

62. The Firm, the EP, and the EQCR were also charged with failure to exercise professional skepticism to evaluate fraud risk in respect of loan of Rs 734.46 crores given by CDEL to TDL during the year as per Note 33 of SFS as mentioned above. It may be noted that TDL had given a total amount of Rs 1,929.07 crores as loan to MACEL, a conduit used to divert funds from CDEL and its subsidiaries. The EP's response to this charge was that the loan of Rs 734.46 crores given during FY 2018-19 by CDEL to TDL was utilized by TDL for repayment of its pre-existing loans/debentures, proceeds of which had been used for business activities of TDL; that he had reviewed the matter from the perspective of recoverability; that only Rs 2 crore was outstanding from TDL at the end of the year; and that therefore there was no reason to suspect diversion of funds.

63. TDL, a subsidiary of CDEL, had no business relationship with MACEL, so the underlying business purpose for giving these loans to MACEL is not clear nor is it evidenced in the Audit File. This fact alone made the transaction suspicious. Also, the diversion of funds, especially to a related party, was in the knowledge of the EP as is clear from the information given by him to the Audit Committee on 24.05.2019. Thus, the simplistic approach in this reply of the statutory auditor of a listed company is unacceptable. When a loan of Rs 734 crores is given by a listed company (CDEL) to its subsidiary (TDL) which in turn advances monies to a promoter-controlled entity with which it has no business relationship and for which there is no underlying business rationale, the Statutory Auditor needed to do audit procedures to rule out fraud. A scrutiny of the purpose of loan, a check on its end use and the cash flow of the monies lent was required instead of reliance on management explanation. The notes in the AWP no. 3.4.5.0010

"Related Party Working (Section 185)" merely show this to be a loan given for general corporate purpose. Sufficient audit procedures were not done especially when the outstanding balances were marked as significant work areas for audit and TDL had passed on the money to MACEL. In such a circumstance, paragraph 18 and 19 of SA 550 read with paragraph 25 of SA 315, paragraph 5 & 6 of SA 330 and paragraph 32 (c) of SA 240 require the Auditor to identify and assess the risk of material misstatement associated with related party transactions and perform audit procedures responsive to assess the risk.

64. The EQCR, who was in the know of the issue, was also charged on the same issue as he was in the know of the issue but sufficient review of the matter was not done at his end and the Audit File does not evidence his review of this matter.

65. The Auditors had reported in the Audit Report (CARO) that the Company had complied with the provisions of Section 185 of the Act with respect to loans advanced and investments made and securities and guarantees given. Whereas in the Audit File[29], the EP and EQCR recorded that the loans taken by the WOSs (Wholly Owned Subsidiaries) were for general corporate purposes; and the Company was exempt from the provisions of Section 185. Therefore, it is clear that: -

- The Auditors did not verify whether CDEL had passed a special resolution in the general meeting before giving loans/advances as stated above.
- The Auditors did not verify whether subsidiary companies had used proceeds of loans for their principal business activities.
- The Audit File does not evidence audit procedures performed in respect of the guarantee provided to TDL and loan given to CDKRPL.

66. The EP in his reply stated that it was his **good faith understanding** (based on management explanation and representation letter) that each of these loans/guarantees were for respective business activities of TDL, CDKRPL & CDH&RPL therefore special resolution was not required; and he had no reason to believe that these companies would breach the end use of loan proceeds or divert the funds to MACEL. This reply itself shows the violation of professional ethics as in blindly relying on the management assertions, the Auditor has breached the faith reposed in him by the shareholders who had appointed in a fiduciary capacity to report on the management assertions. His actions not only show lack of due diligence but have led to infraction of the provisions of the law. The transaction wise reply furnished by the EP is discussed below.

a) *Loan of Rs 734.46 crores given to TDL*: The EP stated that TDL had pre-existing third party loans and debentures issued (proceeds of which were used for business purpose) and the monies advanced to TDL were used by TDL for repayment of third-party loans and debentures. We find that this response given now, is not evidenced in the Audit File. In fact, there is no such analysis of verification of business purpose of the loans in the Audit File. The reply is a post-dated rationalisation on the part of the Auditor and cannot be accepted now as clearly this area of work was not attended to by the Auditor.

[29] Excel sheet "section 185' in AWP no. 3.4.5.0010 'Related party wp.xlsx'.

b) *Corporate guarantee of Rs 1,015 crores*: TDL, had taken loan for which corporate guarantee of Rs *1015* crores was given by CDEL. The EP stated that this loan was for general corporate purpose and that the ET had obtained a schedule of guarantees & investment pledged by TDL and cross verified the same from respective financial statements & loan agreements. For this he referred to an Audit Work Paper[30]. A perusal of this AWP shows that it is a calculation sheet of the guarantee premium accounted for but does not contain anything about the end use of loan proceeds. Thus, this reply is not accepted.

c) *Loan of Rs 210.60 crores given to CDH&RPL*: In his reply the EP stated that this loan was largely repaid during the year with a small outstanding of Rs 4.02 crores. The fact of repayment of a *major* part of the loan does not allow any exemption from section 185 of the Act. He further replied that CDEL provided a written representation about compliance with section 185 of the Act. This again is not acceptable as written representations cannot be taken to provide sufficient appropriate audit evidence on their own without independent evaluation by the auditor[31]. Again, the EP stated that the purpose of the loan was for general corporate purpose, which is not accepted as the EP did not verify the end use of the loan proceeds.

d) *Loan of Rs 110.67 crores given to CDKRPL:* The EP stated that against a loan of Rs 110.67 crores, CDKRPL had acquired land of Rs 10 crores and returned the balance amount during same year. The giving of a loan to a related party has certain requirements under the law. The fact that a major amount is repaid does not absolve the auditor from doing the necessary audit procedures required under the law. The asset purchased is less than 10% of the loan amount and the end use of loan proceeds was not verified. As such the reply of the Auditor is not accepted.

67. The EQCR had also been charged with the above violations as his review suffered from the same infirmities as those that the EP was charged with. The replies of the EQCR are summarised below-

(a) He stated that generally compliance matters do not require a significant judgement of the ET. This reply is not accepted as compliance matters also requires significant judgement as happened in this case and discussed in preceding paras.

(b) He stated that no issue in respect of compliance with section 185 of the Act was highlighted by the ET and the EP when he reviewed CARO audit work paper; and

(c) None of the Auditors of the subsidiaries of CDEL highlighted any issues on this matter.

We find that the EQCR had reviewed the relevant work papers in which judgements have been made and recorded compliance with section 185 of the Act. As such his reply in this matter is not accepted.

68. Importantly, Section 185 of the Act prohibits direct or indirect advance of any loan, including any loan represented by a book debt to directors, etc. This section also imposes certain

[30] AWP 3.3.1.00100 – Corporate Guarantee WP 2019 in SFS file.

[31] Refer paragraph3 of SA 580 – Written Representations.

conditions for extending loans or guarantees to entities in which any of the Directors are interested. While reporting compliance with this section the auditor is required to verify the end use of the loans and the principal business objectives of the borrower entities. The absence of due diligence, as discussed in this Order, has resulted in material misstatements being unreported.

69. In view of the above, it is proved that the Firm, the EP and the EQCR failed to report CDEL's non-compliance with section 185 of the Act, and thus violated the CARO.

E. VIOLATIONS OF SQC 1[32] and SA 230 – LAPSES IN AUDIT DOCUMENTATION

70. The Firm and the EP were charged with violation of SQC 1 and SA 230 as Audit Work Papers (**'AWPs'** hereafter) were created and modified after signing the Audit Report; and between signing off of AWPs and signing of Audit Report. Details are given hereafter.

- As per paragraph 77 of SQC 1 the firm should establish policies and procedures designed to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation. Paragraph 79 of SQC 1 requires that the firm designs and implements appropriate controls for engagement documentation to:

  (a) Enable the determination of when and by whom engagement documentation was created, changed or reviewed;
  (b) Protect the integrity of the information at all stages of the engagement, especially when the information is shared within the engagement team or transmitted to other parties via the Internet;
  (c) Prevent unauthorized changes to the engagement documentation; and
  (d) Allow access to the engagement documentation by the engagement team and other authorized parties as necessary to properly discharge their responsibilities.

- As per paragraph 8 of SA 230 the Auditors were required to prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand: (a) The nature, timing, and extent of the audit procedures performed to comply with the SAs and applicable legal and regulatory requirements; (b) The results of the audit procedures performed, and the audit evidence obtained; and (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. As per paragraph 9 of SA 230, they were required to document in the Audit File, *inter alia*, the record of name of person & date of performing audit procedures, name of person performing review and date & extent of review. Paragraph 13 of SA 230 requires that if, in exceptional circumstances, the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report, the auditor shall document:

[32] SQC 1 - 'Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements', SA 230 - 'Audit Documentations' and SA 700 - Forming an Opinion and Reporting on Financial Statements

(a) The circumstances encountered;
(b) The new or additional audit procedures performed, audit evidence obtained, and conclusions reached, and their effect on the auditor's report; and
(c) When and by whom the resulting changes to audit documentation were made and reviewed.

71. During the relevant period, the Firm maintained the Audit Files electronically in eAudIT application of KPMG. The eAudIT application has the functionality where the preparer and reviewer can sign off Audit Work Papers. The Application allows multiple sign offs. The Application allows modification of AWP after signing off by the preparer and reviewer but does not make it necessary for the modifier to sign off the AWP again after such modification. This is not in accordance with paragraph 77 & 79 of SQC and 8, 9 & 13 of SA 230 as the name of the person who modifies the AWP and the timing of modification is not recorded. This inherent defect in the Application also leaves room for leaving blank AWP which can be filled up at a later date and/or audit evidence can be attached at a later date without affecting the signing-off date. Details are as under:

- An examination of the e-Audit File reveals that five (5) AWPs in the SFS Audit File and ten (10) AWPs in the CFS Audit File were created after the date of the Auditor's Report, which was May 24, 2019. Further, AWPs were also modified after the date of signing Auditor's Report. Seventeen (17) AWPs in Audit File of SFS and Thirty-Five (35) AWPs in Audit File of CFS were modified after the signing of the Auditor's Report. Such creation of new AWPs and modification in the existing AWPs after the issue of the Auditor's Reports indicates that sufficient appropriate audit evidence was not obtained on or before the date of the auditor's report.

- Further, Audit Work Papers were modified after signing off the relevant AWPs but before signing of the Audit Report, without keeping any records about who modified AWPs and when the AWPs were modified. From examination of the Audit Files, it is found that there are seven (7) AWPs in the Audit File of SFS and thirteen (13) AWPs in the Audit File of CFS which were not signed off after modification in the AWPs. Also, one (1) AWP in the Audit File of SFS and CFS each were created after signing off by the reviewer leaving room for signing off blank work papers. The identification of the engagement team member & date of modifying the AWPs is not mentioned in modified AWPs. This is in violation of SA 230, as quoted above.

72. The Firm and the EP did not dispute the fact of modifications in AWPs, but denied the charge. The Firm stated that a statutory audit is an iterative and live process, involving among other things, an ongoing flow of draft/final information to and from the audit client, onsite and offsite discussion/reviews between the EP and the ET and addressing of comments by the ET. To facilitate this process, the electronic audit workflow application used in this audit allowed the ET to exercise a degree of discretion and judgement in terms of timing and extent of review and work paper finalization and filing, subject to the principles that (a) sufficient appropriate audit evidence is obtained before the audit sign-off date, and (b) the EP takes full responsibility for that occurring.

The Firm replied that it has established policies and procedures designed to maintain the confidentiality, safe custody, <u>integrity</u>, accessibility and retrievability of engagement documentation as required under paragraph 77 and 79 of SQC 1.

73. We have considered the Firm's reply and note that the Firm has acknowledged that its policies and procedures allow changes (modifications) in AWPs during the pre-archival period (between the date of the audit report and archival date); and between the document sign-off date and date of audit report. It is also undisputed that the Firm's policies and procedures did not make it mandatory for modifiers of AWPs to sign off AWPs after such modifications. The Firm's defense is that its system provides information about modified AWPs in the forms of 'asterix' and 'diagnostic reports' to the EP, who exercises judgment on whether to re-review the modified AWPs or not. We find that there is no mandatory provision in the Firm's policies/procedures to ensure that modifiers sign off AWPs after modification. This leaves a systemic loophole in which AWPs can be modified without retaining any record of when and by whom the AWPs were modified. Further, new documents can also be attached with any AWPs and existing documents can be deleted/replaced from AWPs without any mandatory provision of signing off of the AWPs by the modifiers. Thus, the Firm's system of audit documentation is not compliant with paragraph 77 and 79 of SQC 1.

74. The EP stated that his last working day in the Firm was 28.05.2019 (the audit report was signed on 24.05.2019). It is noted that 1 AWPs in SFS and 2 AWPs in CFS, out of 17 AWPs in SFS and 35 AWPs in CFS, were modified till 28.05.2019. The EP replied that paragraph 8 & 9 of SA 230 do not require that the date of modification or the name of modifier should be stated in the audit file nor is there any restriction on making any modifications to the audit files. This reply is not accepted as paragraph 8 of SA 230 requires the auditor to record nature, timing and extent of audit procedures performed; and paragraph 9 of SA 230 requires an auditor to record who performed the audit work and the date such work was completed. Audit work is completed only after all modifications are done; thus, the name of the modifier and date of modification is required to be recorded in the audit file. In this case, 7 AWPs in SFS audit file and 13 AWPs in CFS audit files were not signed by the modifiers leaving no record of the nature of modifications; the identity of the modifiers; and the date of completion of audit work.

75. The EP further contended that the requirement of recording when and by whom changes to audit file were made is provided in paragraph 13 of SA 230 which applies to matters arising after the date of audit report i.e. (i) the auditor performs new audit procedures; or (ii) the auditor performs additional audit procedures; or (c) the auditor draws new conclusions, in each case, after the date of the auditor's report. According to the EP, in the instant case, there were no exceptional circumstances and no modifications were made to record new audit procedures, additional audit procedures or new conclusions in the Pre-Archival Period. He contended that alleged modifications done in the audit file were either done during audit period (in which there were no restriction); or during pre-archival period during which modifications permitted by paragraph A22 of SA 230 were done.

76. It is noted that only administrative changes are permitted by paragraph A22 of SA 230 such as deleting or discarding superseded documents; sorting, collating and cross-referencing working papers; signing off on completion checklists relating to the file assembly process; and

documenting audit evidence that the auditor has obtained, discussed and agreed with the relevant members of the ET before the date of the auditor's report etc. In the instant case, there is no evidence about the nature of changes made in the modified documents therefore it is not possible to find out what changes were made in the Audit File. For example, AWP no. 3.4.5.0010 'Related party WP.xlsx' (SFS) was last signed off on 20.05.2019 and modified till 27.05.2019. This AWP is an Excel file containing nine Excel sheets; and further 4 PDF documents & one Excel file are embedded in this AWP. This AWP contains evidence of audit procedures performed including judgements made relating to related party transactions; compliance with section 177, 185, 186, and 188 of the Act; and compliance with SEBI (LODR) requirements etc. It is not possible to find out if only administrative changes were made in the Excel sheets; and when the audit evidence in the PDF forms were obtained. Therefore, the EP's reply that only administrative changes were made in this AWP is not supported by any evidence, hence treated as an afterthought having no basis.

77. In respect of the charge relating to the creation of new audit work papers after the AWP sign off date and also after the date of audit report, the EP replied that no new AWP was created however, due to use of the function 'save as' available in MS Office after performing activities permitted in SA 230 like sorting; collating; and cross-referencing, properties of the document shows changed creation date. According to the EP, this is a feature of MS Office widely used across industries and not specific to audit files. He has also provided a list of 5 AWPs from SFS file and 10 AWPs from CFS file to explain that underlying work in the said AWPs had existed in the audit period itself. However, the EP did not demonstrate the necessity of creating new AWP by using the 'save as' feature.

For example, AWP no. 2.5.2.0020 'Inquiry with management.docx' (in SFS audit file) is a MS Word document containing a discussion with the managing director and CFO on 05.04.2019. This document has preparer's & reviewers' sign off of 08.04.2019 but the document property shows creation date as 27.04.2019. Similarly, AWP no. 2.14.2.0010 'Fraud Risk documentation.docx' (in CFS audit file) is a MS Office document regarding points for consideration of fraud risk during audit which was signed off by preparer and reviewers between 24.04.2019 to 23.05.2019 but the document property shows creation date as 03.06.2019.

78. The EP could not demonstrate what kind of sorting/collating/cross-referencing activities were done and why these documents were saved with a different name after 11 to 19 days from the date of reviewers' sign off; and after date of audit report. Such practice of saving AWPs with different names leaves scope for signing off an incomplete AWP and also replacing an AWP with new one even after signing off date, and thus shows weakness in the Firm's procedures and practices.

79. The above proves the Firm's and the EP's violation of paragraphs 77 & 79 of SQC; and paragraphs 8, 9 & 13 of SA 230.

F. OMISSIONS AND COMMISSIONS BY THE AUDIT FIRM

80. M/s BSR & Associates LLP was appointed as statutory auditor of CDEL vide letter dated 01.10.2018. The powers and duties of the statutory auditors have been prescribed in Section 143 of the Act. The duties include making audit report to the members of the company after

taking into account the provisions of the Act, the accounting and auditing standards (subsection 2); stating in her/his report and expressing opinion on matters listed in subsection 3; stating the reasons, if any, the matters required to be included in the audit report under this section is answered in the negative or with a qualification (subsection 4); complying with the auditing standards (subsection 9); and reporting to the Central Government matters which he believes involve the offence of fraud (subsection 12). The Independent Auditors Reports were issued on 24.05.2019 by M/s BSR & Associates LLP under the signature of the EP. Therefore, the Firm was charged for all the misconducts committed by the EP and the EQCR.

- Paragraph 2 of SA 220 stipulates that 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.

- SQC 1 establishes standards and provides guidance regarding a firm's responsibilities for its system of quality control for audits and reviews of historical financial information, and for other assurance and related service engagements. Paragraph 5 of SQC 1 says that the SQC 1 applies to all firms.

81. The Firm denied this charge and stated that the alleged failures of the Engagement Partner should not be attributed to the Firm for the following reasons:

a) The Firm provides necessary and relevant tools, processes and safeguards that are designed to enable the audit team to perform the audit in accordance with the relevant professional standards and legal and regulatory requirements, it being understood that these tools, processes and safeguards do not seek to replace the professional judgement and skepticism to be exercised by the engagement partner in performance of audit work;

b) appropriate tools, processes, and safeguards, forming part of the Firm's system of quality control, were in place during the relevant period and available to the Engagement Partner during the Subject Audit; and

c) attribution of such alleged failures to the Firm ignores the fact that audit standards are non-prescriptive and require that an engagement partner exercises professional judgment and discretion in the execution of any audit.

The Firm also provided a broad overview of the tools and safeguards made available by the Firm to the audit team; and stated that an appropriate degree of diligence, professional judgement, and skepticism was also expected from the EP. Where applicable, areas involving significant judgements were also to be discussed with and considered by the EQCR. The Firm further stated that its processes for EP and EQCR assignment, ensured that an appropriately experienced Engagement Partner and EQCR were allocated.

82. We do not agree with any of the contentions of the Firm in this regard. M/s BSR & Associates LLP is the legal entity appointed under Section 139 of the Act as the auditor of CDEL. Hence

the report issued by the legal entity, signed by EP on behalf of the legal entity, remains 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 audit report issued by the Firm M/s BSR & Associates LLP lacked adequate basis. Hence, apart from the individuals assigned by the Firm to carry out this audit, the Firm (as the appointed statutory auditor having the primary responsibility for the audit) is also answerable for its audit report issued under the Act, as further explained in the following paragraphs.

83. The requirements of Sub-Sections 9 and 10 of Section 143, SQC-1 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.

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

84. When a firm is appointed as an auditor under Section 139, all the responsibilities cast under the Act are primarily of 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.

85. 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 are professional misconduct, as envisaged by the Act.

86. After a detailed examination of facts and circumstances, as discussed in the foregoing paragraphs, we observe that the failure in this audit engagement was due to violations of SAs, failure in the implementation of Standards on Quality Control and relevant provisions of the Act. 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 prescribed in the SAs and SQC -1. Given the fact that the Audit Firm is the appointed auditor under the Act and that the EP remains mandatorily responsible for the individual audits subject to firm-level supervision, both the Audit Firm and the EP have joint and several responsibilities for the Audit. Section 132 (4) that provides for sanctions against both the chartered accountants and the firm of chartered accountants emanates from this basic premise. It is evident from the above discussion that there is not adequate evidence of effective supervision and oversight of this audit by M/s BSR & Associates LLP. Had the Audit Firm discharged its supervisory responsibilities timely and effectively such major lapses in the audit as discussed in the foregoing paragraphs could have been avoided. Further, in this case, the Firm's policies and procedures with respect to audit documentation have also been found to be non-compliant with SQC 1 and SA 230. (section E of this Order).

87. Due to these fraudulent transactions the consolidated financial statements of CDEL were grossly misstated and, therefore, did not present a true and fair view of the company's affairs. As a result, the unmodified audit report issued by the Audit Firm was false and misleading for the users of these financial statements. Had the Auditors properly discussed the audit procedures with the component auditors in response to the identified risks, advised them accordingly, and exercised due professional skepticism throughout the audit, (as required by SA 200), they could have identified the material and pervasive misstatements in the CFS. However, despite identifying and documenting evidence indicating possible misstatements, the auditors relied blindly on the component auditors. This neglect contradicts the basic objectives of an audit as outlined in Section 143 of the Act and SA 200. The lack of professional skepticism in challenging both the management and the component auditors and the failure to address contradictory evidence was apparent in significant areas of the audit. Such omissions and commissions by an experienced audit firm cannot be taken lightly, as they are detrimental to the public interest.

88. As regards to the responsibility of the Audit Firm, we note that globally also this is the accepted position. The various PCAOB (US Audit Regulator) orders underline this fact. For instance, The PCAOB[33], 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[34] imposed civil money penalties of $1,000,000 on **KPMG India** for failure to implement, communicate, and monitor adequate policies and procedures to provide reasonable assurance that Firm personnel would: (1) comply with PCAOB standards concerning appropriately documenting and dating their completion and review of work papers; (2) include all hard copy audit work papers in the complete and final set of audit documentation assembled for retention ("archived"); and (3) appropriately document any changes to archived hard copy work papers after the documentation completion date. PCAOB also monetary penalty of $75,000 on its partner Sagar Pravin Lakhani who was an ET member, besides suspending Lakhani from being an associated person of a registered public accounting firm for a period of one year.

89. The "Firm and Engagement Performance Metrics" published by PCAOB on October 12, 2022, 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 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

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[33] PCAOB Release No. 105-2012-001 February 8, 2012.
[34] PCAOB Release No. 105-2022-033 December 6, 2022.

9 leading audit firms (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.

Similar misconducts have been viewed seriously at international level as mentioned below:

90. The PCAOB[35] in matters of **diversion of funds** to related parties on the pretext of purchase of material, observed that *"The transactions—between one of the Issuer's wholly-owned Chinese* subsidiaries *("Subsidiary") and a Chinese purchasing agent ("Agent")—involved the Subsidiary's transfers of loan proceeds to the Agent as prepayments to buy equipment and materials that the Agent never delivered. The loans were obtained from Chinese lenders for the purpose of making these purchases. While the Agent returned a portion of the prepayments—some in* ***unusual same-day, round-trip transfers****—it did not return most of them" .... "By failing to adequately respond to the known* ***fraud risks****, Marcum's engagement team breached its duty to perform the Audits with the due professional care and professional skepticism required by PCAOB standards. The team also failed to adequately understand the* ***business rationale*** *(or the lack thereof) for the significant unusual transactions and failed to obtain sufficient appropriate audit evidence to support Marcum's opinion on the Issuer's financial statements"* **(Emphasis supplied)**. For this misconduct, PCAOB censured Audit firm Marcum LLP ("Marcum"); imposed a civil money penalty of $250,000 on Marcum; prohibiting Marcum from audit works for a period of three years. PCAOB also imposed a penalty of $25,000 on the Engagement partner John E. Klenner besides barring him from being an associated person of a registered public accounting firm.

91. Financial Regulatory Commission (FRC), the Audit Regulator of UK in the matter of **PRICEWATERHOUSECOOPERS LLP** and JESSICA MILLER[36] imposed total financial sanction of £4,900,000 and £105,000 on the firm and the partner respectively for deficiencies in audit of London Capital & Finance PLC like failure in identifying and assessing the risk of material misstatement, the exercise of professional skepticism with particular regard to the risk of fraud, and the auditing of loan debtors, prepayments, revenue, financial instrument disclosures, going concern and related party transactions. In the same case, FRC imposed financial sanction of £4,410,000 on Ernst & Young and £47,250 on its partner Neil Parker for a different financial year but for similar deficiencies in audit[37].

92. FRC in the matter of **PricewaterhouseCoopers LLP** and Richard Hughes[38] decided that a financial sanction of £1,750,000 is payable by PwC and £42,000 by Mr Hughes for deficiencies in audit of BT Group plc. FRC found that Respondents did not act with the requisite professional skepticism; did not obtain sufficient appropriate audit evidence; and did not prepare audit documentation that was sufficient to enable an experienced auditor, having no previous

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[35] PCAOB Release No. 105-2020-012 and PCAOB Release No. 105-2020-013 both dated 24.09.2020.

[36] https://media.frc.org.uk/documents/Final_Settlement_Decision_Notice_-_PwC_a7QG1OD.pdf

[37] https://media.frc.org.uk/documents/Final_Settlement_Decision_Notice_-_EY_xIEI8DD.pdf

[38] https://media.frc.org.uk/documents/Final_Decision_Notice_against_PricewaterhouseCoopers_LLP_PwC_and_Richard_Hughes.pdf

connection with the audit, to understand the nature, timing and extent of the audit procedures performed in relation to the BT Italy Adjustments generally.

93. FRC in the matter of **KPMG Audit Plc** and Mr Turner[39] imposed total financial sanction of £2,450,000 on KPMG Audit Plc and £70,000 on Me Turner for deficiencies in audit of Carillion like they failed to exercise an adequate degree of professional skepticism, failed to consider and respond to the risk of fraud, failed to obtain sufficient appropriate audit evidence regarding the accounting treatment adopted for receiving a further sum as a contribution to 'exit fees' payable to the former outsourcing provider, from a new service provider.

94. FRC in the matter of **KPMG LLP** and ADRIAN WILCOX[40] imposed financial sanction of £1,462,500 and £48,750 on the firm and the Partner respectively for deficiencies in audit of M&C Saatchi plc. like failure to audit with sufficient professional skepticism the release of WIP credits (a type of client payment on account), which increased revenue; and A failure to document the auditors' reasoning, or complete their enquires with management, in relation to the retention of rebates under a contract which, on its face, appeared to require such rebates to be passed back to a client.

95. FRC in the matter of **KPMG LLP** and MS NICOLA QUAYLE[41] imposed financial sanction of £877,500 and £45,500 on the firm and the partner respectively for deficiencies in audit of Eddie Stobart Logistics plc. like failure to failed to obtain sufficient appropriate audit evidence in respect of revenue, and failure to properly evaluate adequacy of disclosures etc.

96. Similarly, failures to perform audit procedures and exercise professional skepticism in related party transactions have invited serious action by audit regulators in other jurisdictions too. For example, in case of Cheryl L. Gore, CPA and Stanley R. Langston, CPA, PCAOB[42] had observed that "*Gore failed to obtain sufficient appropriate audit evidence and to perform sufficient procedures concerning whether Issuer A's financial statements accurately disclosed its* ***related party*** **transactions"**..... "*Gore failed to exercise due professional care, including professional skepticism, and failed to obtain sufficient appropriate audit evidence in connection with Issuer A's identification, accounting, and disclosure of related party relationships and transactions........ Gore failed to perform any of these procedures during the 2016 Audit*". (**Emphasis supplied**). This case resulted in debarment and imposition of monetary penalty on the auditors.

97. PCAOB[43], charged Grant L. Hardy (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 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*

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[39] https://www.frc.org.uk/news-and-events/news/2023/10/sanctions-against-kpmg-llp-kpmg-audit-plc-and-two-former-partners/

[40] https://media.frc.org.uk/documents/20231114_Rule_108_Final_Settlement_Decision_Notice.pdf

[41] https://media.frc.org.uk/documents/Final_Decision_Notice_and_KPMG_again_KMPG_and_Ms_Quayle.pdf

[42] PCAOB Release No. 105-2021-020 dated 14.12.2021.

[43] PCAOB release no 105-2015-001 dated 12.01.2015.

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.

98. PCAOB[44] in another matter of **Deloitte LLP**, censured the firm and imposed penalty of \$350,000 on the firm for its failure to establish, implement and communicate appropriate quality control policies and procedures to provide the firm with reasonable assurance that *the* work performed by engagement personnel complied with applicable professional standards, regulatory requirements, and the firm's standards of quality.

G. FINDINGS ON ARTICLES OF CHARGES OF PROFESSIONAL MISCONDUCT BY THE AUDITORS

99. As discussed, the Firm, the EP and the EQCR have made a series of serious departures from the Standards and the Law, in conduct of the audit of CDEL for FY 2018-19. Based on the above discussion, it is proved that they had failed to report fraudulent diversion of funds to related parties and failed to exercise due diligence in performance of audit. Based on the foregoing discussion and analysis, we conclude that they have committed Professional Misconduct as defined under Section 132 (4) of the Companies Act 2013 in terms of section 22 of the Chartered Accountants Act 1949 (**'CA Act' hereafter**) as amended from time to time, and as detailed below:

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

   This charge is proved as the Firm and the EP failed to disclose in their report the material non-compliances by the Company as explained in Section - C & D above.

b) The Firm and the EP committed professional misconduct as defined by clause 6 of Part I of the Second Schedule of the CA Act, which states that a chartered accountant in practice 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 Firm and the EP failed to disclose in the audit report the material misstatements made by the Company as explained in Section – C & D above.

c) The Firm, the EP and the EQCR committed professional misconduct as defined by clause 7 of Part I of the Second Schedule of the CA Act, which states that a chartered accountant in practice is guilty of professional misconduct when he *"does not exercise due diligence or is grossly negligent in the conduct of his professional duties"*.

   This charge is proved as the Firm, the EP and the EQCR failed to conduct the audit in accordance with the SAs and applicable regulations, failed to report the material

[44] PCAOB Release No. 105-2021-014.

misstatements in the financial statements arising from diversion of funds & circulation of funds and failed to report non-compliances made by the Company, as explained in Section – C, D, E and F above.

d) The Firm and the EP committed professional misconduct as defined by clause 8 of Part I of the Second Schedule of the CA Act, which states that a chartered accountant in practice 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 Firm and the EP failed to conduct the audit in accordance with the SAs and applicable regulations as well as due to his total failure to report the material misstatements and non-compliances made by the Company in the financial statements, as explained in the Section - C, D, E and F above.

e) The Firm and the EP committed professional misconduct as defined by clause 9 of Part I of the Second Schedule of the CA Act, which states that a chartered accountant in practice 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 Firm and the EP failed to conduct the audit in accordance with the SAs and related Quality Control Standards and Code of Ethics as explained in Section - C, D, E and F above.

H. PENALTY & SANCTIONS

100. 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.

101. The foregoing discussion in this Order is replete with the instances of the lapses in Audit, the infraction of the law and non-adherence to the standards of Audit, Quality Control Standards and Code of Ethics by the Auditors of a listed company viz., CDEL. The Auditors did not report fraudulent diversion of funds despite having enough evidence that public money was moved to a promoters' entity which had no business connection with the listed company. The Auditors put on their blinkers and when asked to explain sought refuge in the provision of SA 600, relying on the work of Auditors of the subsidiaries, while CDELs investments in these subsidiaries constituted a staggering figure of Rs 1,937 crores constituting 89% of the standalone balance sheet. This was in addition to the fact that they themselves had listed the exposure to promoter entities as a significant and important area of Audit. Providing of loans by the listed company to a related party in the garb of an advance for purchases, the amount itself being over five times the value of purchases, was not questioned by the Auditor for its business rationale. The Auditors' reliance on management explanation and using the ruse of a good faith understanding of management explanation, resulted in their having totally flayed the professional skepticism required of a prudent Auditor.

102. As detailed in this Order, substantial deficiencies in Audit, abdication of responsibility and the issuance of a false and misleading unmodified audit report was to the detriment of the users of

financial statements. Despite being qualified professionals, the Auditors have not adhered to the Law and the Standards and have thus not discharged the statutory duty cast upon them.

103. Section 132(4)(c) of the Companies Act 2013 provides that National Financial Reporting Authority shall, where professional or other misconduct is proved, have the power to make order for—

(A) imposing penalty of— (I) not less than one lakh rupees, but which may extend to five times of the fees received, in case of individuals; and (II) not less than five lakh rupees, but which may extend to ten times of the fees received, in case of firms;

(B) debarring the member or the firm from—(I) being appointed as an auditor or internal auditor or undertaking any audit in respect of financial statements or internal audit of the functions and activities of any company or body corporate; or (II) performing any valuation as provided under section 247, for a minimum period of six months or such higher period not exceeding ten years as may be determined by the National Financial Reporting Authority.

104. As per information furnished by M/s BSR & Associates LLP vide letter dated 28.03.2023 and email dated 25.05.2024, the statutory audit fees of CDEL for 2018-19 was Rs lakhs and total professional fees of the Audit Firm during FY 2018-19 was Rs Crores. It is also noted that the Firm is part of KPMG international network. CA Aravind Maiya and CA Amit Somani earned a total professional fee of Rs lakhs and lakhs respectively during FY 2018-19.

105. Considering the proved professional misconduct and keeping in mind the nature of violations, principles of proportionality and deterrence against future professional misconduct, we, in exercise of powers under Section 132(4)(c) of the Companies Act, 2013, hereby order imposition of monetary penalty of Rs ten crores upon M/s BSR & Associates LLP; Rs fifty lakhs upon CA Aravind Maiya; and Rs twenty five lakhs upon CA Amit Somani. In addition, CA Aravind Maiya is debarred for a period of ten years and CA Amit Somani is debarred for a period of five years, from being appointed as an auditor or internal auditor or from undertaking any audit in respect of financial statements or internal audit of the functions and activities of any company or body corporate.

106. This Order will be 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

Authorized for issue by the National Financial Reporting Authority,

Vidhu Sood
(Vidhu Sood)
Secretary

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

Date: 19.08.2024
Place: New Delhi