

**भारत सरकार / Government of India**  
**राष्ट्रीय वित्तीय रिपोर्टिंग प्राधिकरण / National Financial Reporting Authority**  
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Kasturba Gandhi Marg, New Delhi  
सातवीं मंजिल, हिंदुस्तान टाइम्स हाउस,  
कस्तूरबा गांधी मार्ग, नई दिल्ली  
दिनांक: 30.05.2023

Order No: NF-23/14/2022/05

**ORDER**

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

- 1 This Order disposes of the Show Cause Notice ('SCN' hereafter) no. NF-23/14/2022 dated 3rd November 2022, issued to M/s Sundaresha & Associates, Firm No: 008012S ('Firm' hereafter), an Audit Firm registered with the Institute of Chartered Accountants of India ('ICAI' hereafter) and its partners CA C. Ramesh, ICAI Membership no- 022268 ('EP'/'Ramesh' hereafter) & CA Chaitanya G. Deshpande ICAI Membership No- 230802 ('Chaitanya' hereafter), who are members of ICAI and were members of Engagement Team for the statutory audit of Giri Vidhyuth (India) Limited ('GVIL' or 'the company' hereafter) for the Financial Year ('FY' hereafter) 2019-20.
- 2 This Order is divided into the following sections:
  - A. Executive Summary
  - B. Introduction & Background
  - C. Major lapses in the Audit
  - D. Other non-compliances with Laws and Standards
  - E. Points of Law raised by the Auditors.
  - F. Findings on Articles of Charges of Professional Misconduct by the Auditors.
  - G. Findings on Additional Articles of Charges of Professional Misconduct by the Audit Firm only.
  - H. Penalty & Sanctions

**A. EXECUTIVE SUMMARY**

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

- 4 Post suicide by the group Chairman, CDEL appointed Mr. Ashok Kumar Malhotra, retired Deputy Inspector General of Central Bureau of Investigation and Agastya Legal LLP to investigate inter alia the books of account of CDEL and its subsidiaries. The Auditors of GVIL admitted, in response to SCN issued by NFRA, that they had access to this investigation report, which has details of movement of funds from subsidiaries of CDEL to MACEL and use of pre-signed blank cheques by the then Chairman CDEL, for such purpose. The Auditors had given a Disclaimer of Opinion in the Independent Auditor's Report stating that they were unable to comment on the recoverability, requirement or otherwise of provisions on the loan of Rs 370 crores given to MACEL and advance of Rs 45 crores given to Ms Razia Sultana, in absence of conclusive evidence demonstrated by the company for recoverability of the same.
- 5 NFRA's investigations inter alia revealed that the Auditors of GVIL for FY 2019-20 failed to meet the relevant requirements of the Standards on Auditing ('SA' hereafter) and the provisions of the Companies Act 2013 and demonstrated a serious lack of competence. They failed to evaluate their potential conflict of interest and failed to maintain their independence from GVIL by having audit and non-audit relationships with a large number of Coffee Day Group companies and the family members of the promoters. They blatantly violated the Code of Ethics issued by ICAI, as the percentage of professional fees received from Coffee Day Group (including Promoters) was more than 40% of their total professional fees. The Auditors failed to comprehend that GVIL was a shell company used by promoters for financial maneuvers. The Auditors did not exercise professional judgement & skepticism during audit of (a) Rs 581.16 crores borrowed from subsidiary companies of CDEL; (b) loan of Rs 370 crores fraudulently given to promoter's company MACEL; (c) loan of Rs 105 crores fraudulently given to a related party named SICAL Logistics Ltd; (d) land advance of Rs 45 crores fraudulently given to Mrs Razia Sultana, which was subsequently provided for and written off; (e) bank transactions-failing to detect evergreening of loan through structured circulation of funds; and (f) the going concern risk in GVIL, thus violating SA 570. All these loans and advances were given without any business rationale, without any authorisation and without any written agreements with counter parties. The Auditors failed to perform sufficient appropriate audit procedures while doing audit of related party balances, thus failing to detect & report understatement of related party loans by Rs 350 crores. They failed to report the misstatement of Rs 325 crores in Statement of Cash Flow. The total misstatements in the Financial Statements of GVIL were of Rs 1776.16 crores. The Auditors failed to report absence of Internal Financial Controls in respect of fraudulent diversion of funds, pre-signing of blank cheques and evergreening of loans. They also violated a number of Standards on Auditing and provisions of the Companies Act 2013.
- 6 Based on investigation and proceedings under section 132 (4) of the Companies Act 2013 and after giving them opportunity to present their case, NFRA found the Audit Firm and its Engagement Partners, guilty of professional misconduct and imposes through this Order the following monetary penalties and sanctions that will take effect after 30 days from the date of this Order:
  - a) Imposition of a monetary penalty of Rs One crore only upon M/s Sundaresha & Associates. In addition, M/s Sundaresha & Associates is debarred for a period of Two years from being appointed as an auditor or internal auditor or from undertaking any audit in respect of financial



statements or internal audit of the functions and activities of any company or body corporate. This debarment period will start after completion of two years debarment period imposed in case of Tanglin Development Limited for FY 2018-19 vide NFRA order dated 26.04.2023.

b) Imposition of a monetary penalty of Rs Five Lakhs only upon CA C. Ramesh. In addition, CA C. Ramesh is debarred for a period of Five years from being appointed as an auditor or internal auditor or from undertaking any audit in respect of financial statements or internal audit of the functions and activities of any company or body corporate.

c) Imposition of a monetary penalty of Rs Five Lakhs upon CA Chaitanya G. Deshpande. In addition, CA Chaitanya G. Deshpande is debarred for a period of Five years from being appointed as an auditor or internal auditor or from undertaking any audit in respect of financial statements or internal audit of the functions and activities of any company or body corporate.

## **B. INTRODUCTION & BACKGROUND**

- 7 The National Financial Reporting Authority ('NFRA' hereafter) is a statutory authority set up u/s 132 of the Companies Act 2013 ('Act' hereafter) to monitor implementation and enforce compliance of the auditing and accounting standards and to oversee the quality of service of the professionals associated with ensuring compliance with such standards. NFRA has the powers of a civil court and is empowered u/s 132 (4) of the Act to investigate the prescribed classes of companies<sup>1</sup> and impose penalty for proved professional or other misconduct of the individual members or firms of Chartered Accountants.
- 8 The Statutory Auditors, individual 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 Engagement Partners ('EPs' hereafter) and the Engagement Team that conduct the Audit are bound by the duties and responsibilities prescribed in the Act, the rules made thereunder, the Standards on Auditing ('SA' hereafter), including the Standards on Quality Control ('SQC' hereafter) and the Code of Ethics, the violation of which constitutes professional or other misconduct, and is punishable with penalty prescribed under section 132(4)(c) of the Act.
- 9 On receipt of information from SEBI vide letters dated 01.04.2022 & 29.04.2022 sharing its investigation regarding diversion of funds worth Rs 3,535 crores (as on 31-07-2019) from seven subsidiary companies of Coffee Day Enterprises Limited, a listed company, to Mysore Amalgamated Coffee Estate Limited, an entity owned and controlled by the promoters of CDEL, NFRA started investigation into the role of the statutory auditor under its powers in terms of section 132 (4) of the Companies Act 2013.
- 10 Late V. G. Siddhartha ('VGS' hereafter) was Chairman & Managing Director of CDEL till 29.07.2019. VGS and his family reportedly owned around 10,000 acres of coffee estates through

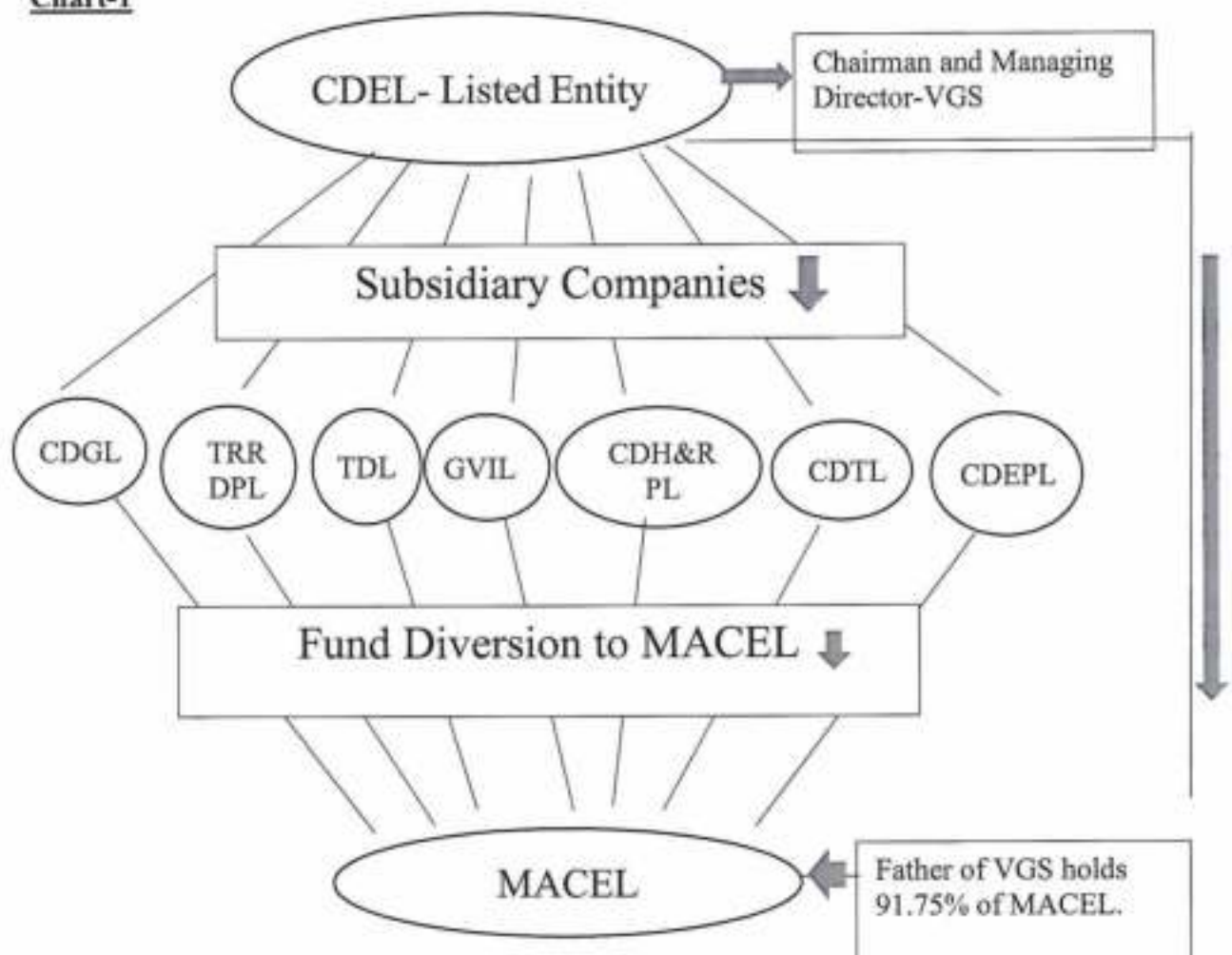
<sup>1</sup> As defined in Rule 3 of the NFRA Rules 2018.

As per the investigations made by the SEBI, the outstanding balance payable by MACEL to subsidiary companies of CDEL was as Rs. 842 crores as on 31 March 2019, which had increased to Rs. 3,535 crores on 31 July 2019, detailed in Table 1 as under-

(Rs in crores)

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

### Chart-1





- 13 As per the Financial Statements ('FS' hereafter) of MACEL, Rs 3,535 crores received from the 7 subsidiaries of CDEL was further transferred from MACEL to the personal accounts of VGS, his relatives and entities controlled by him and/or his family members, whose outstanding balances payable to MACEL were Rs 3,401.65 crores as on 31-03-2020. On examination of the FS of MACEL, it transpired that MACEL did not have any business transactions with the 6 of the 7 subsidiary companies except CDGL and 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 MACEL/CDEL.
- 14 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. Giri Vidhyuth (India) Limited ('GVIL' hereafter) was one of the companies used for such diversion of funds.
- 15 GVIL is a wholly owned subsidiary company of Tanglin Development Limited ('TDL' hereafter) which, in turn, is a subsidiary company of CDEL (see Chart 1), which is the listed entity of the Group. GVIL was incorporated in 2001 for carrying on the business of power generation but was yet to commence its operations. As per the Financial Statements for 2019-20, GVIL is not engaged in the business of power generation nor has it any revenue or expenditure related to power generation or business activities. It has no physical assets, no work in progress, no revenue from operations, no employee costs, no significant other expenses, except writing off of Rs 45 crores land advance. There was no business relationship between GVIL & MACEL and almost the entire balance sheet of GVIL consisted of the loans and advances to and from the related parties. The loans and advances made to the related parties (depicted as Assets) of Rs 475 crores constituted 98.76% of the total assets of Rs 480.96 crores; and the Loans and advances taken from related parties (depicted as liabilities) were to the tune of Rs 581.16 crores, which constituted 99.99% of total liabilities of Rs 581.17 crores. GVIL had a negative net worth of Rs 100.21 crores as on 31.03.2020.
- 16 Rule 3 of NFRA Rules 2018 lists out the classes of Companies and body corporates governed by NFRA. This includes unlisted Public Companies having outstanding loans of not less than Rs 500 crores on 31st March of the preceding year. Since GVIL is an unlisted Public Company having borrowings of Rs 577 crores as on 31-03-2019, it falls under the jurisdiction of NFRA.
- 17 M/s Sundaresha & Associates (Firm) was the Statutory Auditor of GVIL for Financial Year 2019-20. As per the Audit program, CA C. Ramesh was the 'signing partner' who signed the Financial Statements & Independent Auditor's Report and CA Chaitanya G. Deshpande was the Engagement Partner (EP). The Audit File of GVIL for the Financial Year ('FY' hereafter) 2019-20 was called for from the Statutory Auditor, to examine the role of the auditor and for investigation under section 132(4) of the Act. Based on the examination of the Audit File and other material on record, NFRA issued a Show Cause Notice ('SCN' hereafter) to the Auditors



on 03.11.2022 asking them to show cause by 03.12.2022 why penal provisions of section 132(4)(c) of the Companies Act 2013 should not be invoked for professional misconduct of :

- a) Failure to disclose a material fact known to the Auditors 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 the Auditors 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.

- 18 At the request of the Auditors, the time for submission of reply was extended till 22.12.2022. After availing the extension, the Firm vide letter dated 21.12.2022 submitted its reply to the SCN. Ramesh and Chaitanya, vide letters dated 21.12.2022 and 22.12.2022 respectively, submitted that the reply of the firm may be considered as their reply and that they were not giving separate replies. In the interest of natural justice, the opportunity of personal hearing was also given to the Auditors on 17.03.2023 at 11:00 AM / 2:30 PM. However, both the Firm and the CA C. Ramesh withdrew their requests for personal hearing vide letters dated 28.02.2023. CA Chaitanya G. Deshpande, vide letter dated 08-03-2023, expressed his inability to attend the personal hearing and requested NFRA to decide the case based on his written submissions. Accordingly, this Order is based on examination of the facts of the matter, charges in the SCN, written replies of the Auditors and other materials available on record.

#### **General submissions by the Auditors**

- 19 Referring to Rule 4 of NFRA Rules 2018, the Auditors stated that creditors of GVIL are largely group companies, hence no public interest is involved in GVIL. We note that Rule 4 defines functions and duties of NFRA. Rule 4(1) of NFRA Rules 2018 provides, "*The Authority shall protect the public interest and the interests of investors, creditors and others associated with the companies or bodies corporate governed under rule 3 by establishing high quality standards of accounting and auditing and exercising effective oversight of accounting functions performed by the companies and bodies corporate and auditing functions performed by auditors*". As mentioned in para 16 of this Order, GVIL is within the scope of Rule 3 of the NFRA Rules 2018, therefore, it is NFRA's duty to protect the public interest and the interests of investors, creditors and others associated with GVIL.
- 20 The Auditors stated that diversion of funds "*can emerge only from an investigation of all group companies and are not capable of being detected within the scope of work of a Statutory Auditor of GVIL & TDL*". In this connection, we note that the Audit Firm (M/s Sundaresha & Associates) & its related Audit Firm (M/s ASRMP & Co.) were statutory auditors of six companies (mentioned in Table-1) of the Coffee Day group, which were used for diversion of Rs 3380 crores



i.e., 95% of total diverted funds of Rs 3535 crores. Accordingly, it is clear that they had access to the records of these six companies. It is examined under the respective charges whether the process of statutory audit could detect diversion of funds.

- 21** In response to many charges, the Auditors have relied on their Disclaimer and stated that they had disclaimed the Financial Statements as a whole. It is important to examine whether an Auditor, who had issued a Disclaimer of Opinion for one matter, is responsible for other unreported material misstatements in the Financial Statements. As per para 27 of SA 705 – “Modifications to the Opinion in the Independent Auditor’s Report”, *“Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor shall describe in the basis for opinion section the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion, and the effects thereof”*. Para A24 of the explanatory material to the Standard further explains that *“An adverse opinion or a disclaimer of opinion relating to a specific matter described within the Basis for Opinion section does not justify the omission of a description of other identified matters that would have otherwise required a modification of the auditor’s opinion. In such cases, the disclosure of such other matters of which the auditor is aware may be relevant to users of the financial statements”*. Thus, it is clear that in case an Auditor gives disclaimer of opinion for one matter, it does not mean that the Auditor will be free of responsibilities for other unreported material deficiencies/ misstatements in the financial statements. It is important that the Auditors report all material misstatements so that the impact of all misstatements on the financial statements is known and the users of financial statements are not under the misleading impression that the financial statements carry only the reported misstatements. Vide the SCN dated 03.11.2022, the Auditors were charged for matters which were not reported by them in the Independent Auditor’s Report. Therefore, their reliance on the Disclaimer for one matter, to evade responsibility for all other unreported issues has no merit.
- 22** The Auditors have also submitted that they have inadvertently missed certain evidences which were not available in the Audit File submitted to NFRA and submitted some additional documents (total 64 pages) for consideration. We now examine whether these additional documents can be accepted as audit evidence. In this context, we refer to the following paragraphs of SA 230<sup>2</sup> which emphasizes the importance of timely preparation of audit documentation and its archival within a reasonable time after the issuance of the audit report:
- a) Paragraph 7 of SA 230: The auditor shall prepare audit documentation on a timely basis. The explanatory material to the Standard at Para A1, inter alia, states that Documentation prepared after the audit work has been performed is likely to be less accurate than documentation prepared at the time such work is performed.
  - b) Paragraph 8 of SA 230: The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:
    - (a) The nature, timing, and extent of the audit procedures performed to comply with the SAs and applicable legal and regulatory requirements; (b) The results of the audit procedures

<sup>2</sup> Standard on Auditing 230, Audit Documentation.

performed, and the audit evidence obtained; and (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

- c) Paragraph 9 of SA 230: In documenting the nature, timing and extent of audit procedures performed, the auditor shall record: (a) The identifying characteristics of the specific items or matters tested; (b) Who performed the audit work and the date such work was completed; and (c) Who reviewed the audit work performed and the date and extent of such review.
- d) Paragraph 14 of SA 230: The auditor shall assemble the audit documentation in an Audit File and complete the administrative process of assembling the final Audit File on a timely basis after the date of the auditor's report.
- e) Paragraph 16 of SA 230: In circumstances where the auditor finds it necessary to modify existing audit documentation or add new audit documentation after the assembly of the final audit file has been completed, the auditor shall, regardless of the nature of the modifications or additions, document: (a) The specific reasons for making them; and (b) When and by whom they were made and reviewed.
- f) The explanatory material to the Standard at Para A21 states that SQC 1<sup>3</sup> requires firms to establish policies and procedures for the timely completion of the assembly of audit files. An appropriate time limit within which to complete the assembly of the final Audit File is ordinarily not more than 60 days after the date of the auditor's report.
- g) The explanatory material to the Standard at Para A22 states that the completion of the assembly of the final Audit File after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions.

- 23** We further note that while submitting the Audit File<sup>4</sup> to NFRA, through a duly notarized affidavit dated 21.07.2022 signed by CA Pradeepa Chandra C., partner of the Firm, it was averred that *"The Audit File for the financial year 2019-20 as defined in Para 6(b) of SA 230 has been submitted" .... "It is certified that the above information is true and complete in all respects, and nothing has been concealed"*. The Auditors are expected to know what constitutes "Audit File" as per SA 230 and accordingly, all audit work papers were expected to be available in the Audit File submitted to NFRA. The submission by the Auditors of additional documents now, subsequent to the submission of Audit File, to defend the charges in the SCN, points to the incorrect averments made in the affidavit submitted by the Firm.

<sup>3</sup> Refer para 74 & 75 of Standard on Quality Control 1, Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements

<sup>4</sup> Audit file is defined in para 6(b) of SA 230 Audit Documentation as "one or more folders or storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement",



- 24 Therefore, considering the provisions of the auditing standards and the affidavit filed by the Firm, we do not find any merit in the submission of the Auditors regarding the additional documents and we treat the same as an afterthought to cover up the deficiencies in the Audit.
- 25 Further, the Auditors have submitted that Standards of Auditing are not reference material to decide on charges of professional misconduct against an auditor, on the contrary they are guidance to an auditor to act professionally while arriving at an opinion and referred to para 5, A47 and A52 of SA 200. We have gone through the same. We notice that the legal mandate to adhere to the Standards is laid out in section 143(9) & 143(10) of the Act<sup>5</sup>. Section 143(9) of the Act provides that “every auditor *shall* comply with the auditing standard”. (Emphasis supplied). The fundamental principles of SAs are contained in the Requirements section of the SAs and are represented by use of word “*shall*” and are therefore mandatory in nature. Thus, there is no scope for deviation from the SAs.

### C. MAJOR LAPSES IN THE AUDIT

#### C.1 Continuation of Audit engagement disregarding Independence requirements

- 26 The Auditors were charged with non-compliance with requirements relating to independence of the Auditor as mentioned in SQC 1, SA 200 and SA 220. The professional fees received by the Auditors along with their related audit firms, from the Coffee Day Group including its promoters, had exceeded the maximum threshold of 40% of the total professional fees, which is in violation of the Code of Ethics, SQC 1, SA 200 and SA 220, as explained below.
- 27 SQC 1 requires the Audit Firm to establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel (including experts contracted by the firm and network firm personnel) and, where applicable, others are subject to independence requirements, maintain independence where required by the Code. Such policies and procedures should enable the firm to (a) Communicate its independence requirements to its personnel and, where applicable, to others subject to them; and (b) Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement. It also provides that “The firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide it with reasonable assurance that it will undertake or continue relationships and engagements only where it: (i) -----, (ii) ----- and (iii) Can comply with the ethical requirements”.
- 28 SA 200, which provides overall objectives of the independent auditor, requires the auditor to comply with relevant ethical requirements, including those pertaining to independence, relating to financial statements audit engagements. Relevant ethical requirements ordinarily comprise the Code of Ethics issued by the ICAI. The Code describes independence as comprising both

<sup>5</sup> Section 143(9) of the Act provides that every auditor shall comply with the auditing standard. Further proviso to section 143(10) of the Act provides that until any auditing standards are notified, any standard or standards of auditing specified by the Institute of Chartered Accountants of India shall be deemed to be the auditing standards.

independence of mind and independence in appearance. The Auditor's independence from the entity safeguards the auditor's ability to form an audit opinion without being affected by influences that might compromise that opinion. Independence enhances the auditor's ability to act with integrity, to be objective and to maintain an attitude of Professional Skepticism.

- 29 SA 220 requires the partners to form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the auditors are required to:
- Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;
  - Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and
  - Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.
- 30 The SCN stated the details of partners/proprietor in these firms, relationship of the partners with each other and their financial interest in the respective firms as under:

**Table no. 2**

| M/s Sundaresha & Associates |                         |                  |                 | M/s ASRMP & Co     |                  |                 |
|-----------------------------|-------------------------|------------------|-----------------|--------------------|------------------|-----------------|
| Sr. No.                     | Name of Partners        | Salary Per Month | Share in profit | Name of Partners   | Salary Per Month | Share in profit |
| 1                           | Magha Sundaresha Andani | 170000           | 72%             | A. S. Sundaresha   | 200000           | 81%             |
| 2                           | Another partner -A      | 50000            | 9%              | Another partner -X | 25000            | 7%              |
| 3                           | Another partner -B      | 170000           | 9%              | Another partner -Y | 70000            | 6%              |
| 4                           | Another partner -C      | 85000            | 5%              | Another partner -Z | 60000            | 6%              |
| 5                           | Another partner -D      | 75000            | 5%              |                    |                  |                 |

Note- \*After retirement of another partner - Z w.e.f. 30.09.2019, share of CA A S Sundaresha was increased to 87%. Further, CA A. S. Sundaresha also has one proprietorship firm i.e., M/s Sundaresha & Co.

- 31 The SCN stated that CA A. S. Sundaresha, promoter and founder of M/s Sundaresha & Associates, retired from this firm w.e.f. 31.03.2017. CA Magha Sundaresha Andani, daughter of CA A. S. Sundaresha, has major share in the revenue of M/s Sundaresha & Associates. M/s ASRMP & Co was formed w.e.f. 01.04.2018 and CA A. S. Sundaresha has major share in the revenue of M/s ASRMP & Co. The Auditors had intimated vide letter dated 21.07.2022 that all these firms are related firms. All these audit firms operate from the same address.
- 32 The Audit Firm vide letter dated 10.09.2022 furnished below mentioned details of bills raised during FY 2019-20 and FY 2020-21 (relevant to service rendered in FY 2018-19 and FY 2019-20):

**Table no-3**

Rs. In Lacs

| Particulars                                   | M/s Sundaresha & Associates |         | M/s ASRMP & Co |         | M/s Sundaresha & Co |         | Grand Total |         |
|-----------------------------------------------|-----------------------------|---------|----------------|---------|---------------------|---------|-------------|---------|
|                                               | 2018-19                     | 2019-20 | 2018-19        | 2019-20 | 2018-19             | 2019-20 | 2018-19     | 2019-20 |
| Fee received from CCD Group as % of Total fee | 30.83%                      | 36.66%  | 82.14%         | 83.62%  | 21.60%              | 33.70%  | 31.00%      | 41.68%  |



Note: CCD group refers to Coffee Day Group and GVIL is one of the companies of CCD Group.

- 33 As per Code of Ethics<sup>6</sup>, the Auditors were required to comply with the fundamental principles i.e. (a) Integrity, (b) Objectivity, (c) Professional Competence and Due Care, (d) Confidentiality and (e) Professional Behavior. As per para 200.3 of Code of Ethics, self-interest is one of the threats which may potentially threaten these fundamental principles.
- 34 Para 200.4 of Code of Ethics gives examples of circumstances which may create self-interest threat, which includes, *'undue dependence on total fees from a client subject to council guidelines issued from time to time in this regard'*. Para 290.193 of Code of Ethics states, *'when the total fees generated by an assurance client represent a large proportion of a firm's total fees, the dependence on that client or client group and concern about the possibility of losing the client may create a self-interest threat. The significance of the threat will depend upon factors such as: (a) The structure of the firm; and (b) Whether the firm is well established or newly created. The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:*
- a) Discussing the extent and nature of fees charged with the audit committee, or others charged with governance;*
  - b) Taking steps to reduce dependency on the client;*
  - c) External quality control reviews; and*
  - d) Consulting a third party, such as a professional regulatory body or another professional accountant.'*
- 35 As per para 290.194 of Code of Ethics, *'A self-interest threat may also be created when the fees generated by the assurance client represent a large proportion of the revenue of an individual partner. The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:*
- a) Policies and procedures to monitor and implement quality control of assurance engagements; and*
  - b) Involving an additional professional accountant who was not a member of the assurance team to review the work done or otherwise advise as necessary.'*
- 36 As per para 7.6 "Ceiling on the Fees" of Chapter 7 "Self-Regulatory Measures Recommended By The Council", *"To ensure that the professional independence of a member in fulltime or part-time practice does not appear to be jeopardized he should, as far as possible, take care to see that the professional fees for audit and other services received by the firm in which he is a partner, by him and his partners individually and by firm or firms in which he or his partner are partners from one or more clients or Companies under the same management does not exceed 40% of the gross annual fees of the firm, firms and partners referred to above. Companies under the same management here would refer to the definition of this expression as provided in section 370(1-B) of the Companies Act, 1956."*

<sup>6</sup> Para 100.4 of Code of Ethics 2009 issued by the Institute of Chartered Accountants of India.

- 37 The SCN stated that as per audit manual of the Firm, *"Total fees generated by an auditee should not represent a large proportion of the firm's total fees. The fees generated by an auditee should not represent a large proportion of the revenue of an individual partner, which may create self-interest threat."*
- 38 The SCN pointed out that the total fees generated by all related audit firms of the Auditors from CCD group represented a large proportion of the total fees of the three related audit firms. In view of the requirements mentioned above, the Auditors were required to evaluate the significance of self-interest threat and take safeguards to reduce self-interest threat to an acceptable level. However, there is no evidence in the Audit File that the Auditors performed any audit procedure to reduce the self-interest threat to an acceptable level. The SCN charged that the Auditors did not comply with the requirement of SQC 1, SA 200 and SA 220 referred above.
- 39 The Auditors have denied the charge stating that M/s Sundaresha & Associates was established in 1997 and its partner CA Megha Sundaresh is the daughter of CA AS Sundaresha, who is partner of M/s ASRMP & Co. and proprietor of M/s Sundaresha & Co. Apart from this, there is no connection or relationship between the firms and M/s Sundaresha & Associates is functionally a separate independent entity. They further replied that the partners are related but Firms are not related. Regarding the same office address, they replied that they have a separate section for their Firm, for which rent was being paid. None of the partners of the Firm is a partner of other two firms, therefore 40% fees limit is to be assessed for M/s Sundaresha & Associates only, which is not breached.
- 40 In order to decide on the subject, it is important to first understand the inter relationship of these three audit firms. As per information obtained from the audit firms, CA A. S. Sundaresha has a sole proprietorship firm, namely M/s Sundaresha & Co. He was also the promoter and founder of M/s Sundaresha & Associates, a partnership firm in practice since 10.11.1997, but he had retired from this firm w.e.f. 31.03.2017. After his retirement, his daughter CA Megha Sundaresha Andani is one of the five partners of this Audit Firm with 72% share in the profit of this firm. Thereafter, CA A. S. Sundaresha established another partnership firm namely, M/s ASRMP & Co. w.e.f. 01.04.2018, which was appointed as the statutory auditor of CDGL from FY 2018-19. CA A. S. Sundaresha had 81% share in the profit of M/s ASRMP & Co., which had four partners. His share in profit was increased to 87% after retirement of one partner. All these firms operate from the same office address.
- 41 From the information obtained from CDGL, we note that CA Pradeepa Chandra C. (Partner of M/s Sundaresha & Associates) worked at M/s ASRMP & Co, Statutory Auditor of CDGL, and gave presentation on behalf of M/s ASRMP & Co. in the Audit Committee Meeting ('ACM' hereafter) of CDGL held on 07.02.2019 and 24.05.2019. These presentations related to review of quarterly results of CDGL by the Auditor, scope of engagement, audit approach, observations of the Auditor on the Statutory Audit of the annual financial statements for FY 2018-19 and applicability of Ind AS 116 for FY 2019-20. A perusal of the Audit File shows that the presentation given by CA Pradeepa Chandra C. before the Audit Committee of CDGL, on 24.05.2019 was authored by CA Megha Sundaresha Andani (Partner of M/s Sundaresha &



Associates). This clearly shows the sharing of resources between these two audit firms and their interrelationship.

- 42 The inter- relationship among the three firms is corroborated by another fact that CA Pradeepa Chandra C. (Partner of M/s Sundaresha & Associates) was involved in the statutory audit of CDGL for FY 2019-20 and FY 2018-19 but was named as external reviewer in the Audit files. Further, CA Chaitanya G. Deshpande (Partner of M/s Sundaresha & Associates) was also involved in the statutory audit of CDGL for FY 2018-19 and of GVIL for FY 2018-19 & 2019-20. This shows that the partners of M/s ASRMP & Co. and M/s Sundaresha & Associates jointly performed the Audit of Coffee Day Group Companies, a fact that has also been pointed out in our Order dated 12.04.2023 in the case of CDGL for FY 2018-19. These facts together with the fact that all three firms operate from the same office address, indicate their close inter-relationship and lack of independence from each other. Therefore, in our view, these audit firms are not independent of each other and they need to evaluate their independence from Coffee Day Group accordingly.
- 43 It is equally important to understand the relationship of these audit firms with Coffee Day Group and its promoters. As per information furnished by these firms and other information available on record, M/s Sundaresha & Associates and M/s ASRMP & Co. were statutory auditors of inter alia six Coffee Day Group companies (except CDH&RPL- as per serial no-5 in Table-1). These six companies were involved in the diversion of Rs 3,380 crores i.e., 95.62% of total diverted amount of Rs 3,535 crores. Further, during the Financial Year 2019-20, M/s Sundaresha & Associates provided audit and non-audit services to 28 Coffee Day group entities, M/s Sundaresha & Co. provided audit and non-audit services to 27 Coffee Day entities including promoter's family members; and M/s ASRMP & Co. provided audit and non-audit services to three Coffee Day Group companies. The relationship of the three related audit firms with Coffee Day Group indicates creation of self-interest and familiarity threat. The Auditors of CDGL had admitted that CA A. S. Sundaresha had been associated with Coffee Day Group from a very long time, therefore there is familiarity threat. This indicates that M/s Sundaresha & Associates had continued the audit engagement of GVIL for FY 2019-20 despite serious conflict of interest.
- 44 The Auditors replied that they had complied with independence requirements by reducing self-interest threat and familiarity threat and mentioned that their firm & partners do not have any financial interest in any of the CCD group companies; that they did not quote lower fees to obtain new engagements; that they did not have close business relationship with CCD group; and that no confidential information stored in their server was used for any personal gain. They further stated that, no partner or their family members were director or officer in CCD group companies; that CCD group directors and officers did not have significant influence over their engagement; that the audit team will be regularly rotated; that they ensured that total fees from auditee did not exceed prescribed limits; and that where the amount forms large portions of total fees, they have taken following safeguards to mitigate the risk:
  - a) The Firm has exposure to various clients, adding new clients and providing additional services to existing clients without compromising on non-allowed services over the years,
  - b) The remuneration of partners is not linked to earning of any single client and

c) They have sufficient resources and the cost can be covered even on loss of any client which forms significant portion of their fees.

- 45 The Auditors argue that they have complied with the requirement of auditing standards and the Act as they did not enter into any contingent fee arrangement with an auditee, and ensured that fees are not overdue except CCD group fees which is partially due on account of financial constraint faced by the group.
- 46 The Auditors' reliance on steps taken to reduce self-interest threat and familiarity threat are general statements without detailing specific steps taken to reduce such threat, despite the three audit firms having audit and non-audit relationships with a large number of Coffee Group entities including promoters. It can be noticed from Table-3 above that the fees received/receivable from CCD group as a percentage of the total fees earned by the three firms, has significantly increased from 31% (FY 2018-19) to 41.68% (FY 2019-20). We find that the Auditors failed to take necessary steps to reduce the independence threat despite a substantial increase in their dependence on the Coffee Day Group.
- 47 An Auditor's independence from the entity being audited, safeguards the auditor's ability to form an audit opinion without being affected by influences that might compromise that opinion. Independence enhances an auditor's ability to act with integrity, to be objective and to maintain an attitude of Professional Skepticism. An auditor is required to be independent, aside from being in public practice (as distinct from being in private practice), he must be without bias with respect to the client since otherwise he would lack that impartiality necessary for the dependability of his findings, however excellent his technical proficiency may be. It is of utmost importance to the profession that the general public have confidence in the independence of the Auditors. Public confidence would be impaired by any evidence that independence was actually lacking, and it might also be impaired by the existence of circumstances, which reasonable people might believe, is likely to influence independence.
- 48 From the above analysis, it is clear that the Auditors failed to perform appropriate audit procedures to evaluate and maintain their independence from GVIL. In spite of the independence threat, they continued as Statutory Auditors of GVIL for FY 2019-20, thus disregarding and grossly violating the principles of Independence mentioned in the Standards of Auditing and the Code of Ethics. In view of this, the charge that the Auditors have violated SQC 1, SA 200, SA 220 and the Code of Ethics stands proved.
- 49 In case of Marcum Bernstein & Pinchuk LLP, relating to independence of auditors, PCAOB<sup>7</sup> has observed, *"an accountant is not independent of an audit client if, at any point during the audit and professional engagement period, the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement."*..... *"MarcumBP failed to implement, effectively apply, and*

<sup>7</sup> PCAOB Release No. 105-2016-016 dated 18.05.2016 and PCAOB Release No. 105-2019-022, PCAOB Release No. 105-2019-023 both dated 10.09.2019.



*appropriately monitor quality control policies and procedures sufficient to provide reasonable assurance concerning the Firm's independence". In this case, PCAOB censured the audit firm, imposed monetary penalty and required the audit firm to undertake a review of its policies, procedures, staffing, and training with respect to auditor independence.*

- 50 Similarly, in AWC (CPA) Limited, WONG Chi Wai, CPA, and WONG Fei Cheung, CPA, PCAOB observed *"As the engagement partner, Albert Wong was responsible for AWC's compliance with independence requirements. .... Albert Wong took, or omitted to take, actions during the Kandi 2012 Audit, that he knew, or was reckless in not knowing, would directly and substantially contribute to the Firm's violation of independence requirements, in contravention of PCAOB Rule 350".* For misconducts including independence violations, PCAOB censured the audit firm & partner, revoked the audit firm's registration & barred the partner from being an associated person of a registered public accounting firm, and imposed a civil money penalty on the audit firm and the partner.

## C.2 Failure to understand nature of business of Giri Vidhyuth (India) Limited (GVIL)

- 51 The Auditors were charged with failure to exercise professional skepticism and professional judgement while performing the audit of GVIL, thus failing to obtain an understanding of the nature of GVIL including its operations, its ownership and governance structures, the types of investments that GVIL was making and how it was financed. The Audit File did not evidence performance of any audit procedure to understand the nature of GVIL, thus resulting in violation of SA 315<sup>8</sup>.
- 52 Para 28 of SQC 1 states, inter alia, that *"The firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide it with reasonable assurance that it will undertake or continue relationships and engagements only where it: (i) Has considered the integrity of the client and does not have information that would lead it to conclude that the client lacks integrity; (ii) ----- and, (iii) Can comply with the ethical requirements".*
- 53 Para 29 of SQC 1 states that with regard to the integrity of the client, the Firm should have considered the integrity of a client, matters that the firm considers include, for example: (a) The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance; (b) The nature of the client's operations, including its business practices; (c) ----; (d) ----; (e) ----; (f) Indications that the client might be involved in money laundering or other criminal activities.
- 54 The SCN points out that the GVIL is a wholly owned subsidiary company of Tanglin Development Limited which, in turn, is a subsidiary company of Coffee Day Enterprises Limited, the listed entity of the Group. GVIL was incorporated in 2001 for carrying on the business of power generation but was yet to commence its operations. As per the Financial Statements for the FY 2019-20 and 2018-19, GVIL is not engaged in the business of power generation nor has

<sup>8</sup> See para 11(b) of SA 315, Identifying and assessing the risk of material misstatement through understanding the entity and its environment.



it any revenue or expenditure related to power generation or business activities. It has no physical assets, no work in progress, no revenue from operations, no employee costs, no significant other expenses, except writing off of Rs 45 crores land advance. There was no business relationship between GVIL & MACEL. The loans and advances made to the related parties (depicted as Assets) were worth Rs 475 crores, which constituted 98.76% of the total assets of Rs 480.96 crores. The Loans and advances taken from related parties (depicted as liabilities) were to the tune of Rs 581.16 crores, which constituted 99.99% of total liabilities of Rs 581.17 crores. GVIL had a negative net worth of Rs 100.21 crores. These details from the Financial Statements show that GVIL was like a shell company being used as a conduit for the financial maneuvers to divert funds from listed company to entities controlled by the Promoter of listed entity and to mislead stakeholders and regulators. This has resulted in material and pervasive misstatements in the Balance Sheet.

- 55 The SCN pointed out that the Auditors were required by SA 200<sup>9</sup> to exercise professional judgment in planning and performing an audit of financial statements. There is no evidence in the Audit File that the Auditors had critically analysed the Financial Statements of GVIL to understand its nature, operations, ownership, governance structures, loan & advances made and money borrowed by it. Thus, the Auditors were charged with failure to exercise professional judgement while planning and performing the audit.
- 56 In view of the analysis given above and their statutory duty to plan and perform the audit with Professional Skepticism<sup>10</sup>, the Auditors were expected to question Those Charged With Governance (TCWG) and the Management about the authority under which such borrowing and lending activities were undertaken. As a prudent Auditor they were also expected to examine the Memorandum of Association of GVIL, to ascertain whether its object clause permitted it to indulge in borrowing and lending activities. Examination of the Audit File indicates that the Auditors did not perform such audit procedures. Compliance with their statutory duty defined in SA 200 & 315 would have revealed that GVIL has no business activities and was used by promoters only for the purpose of diversion of funds. The SCN pointed out that there was no evidence in the Audit File that the Auditors had complied with SA 200 & 315.
- 57 The Auditors denied the charge stating that they had been appointed the Auditors for FY 2016-17 to 2020-21. They had collected Memorandum of Association (MoA) & Articles of Association (AoA) during first year of audit, to understand business & framework of GVIL. While citing para 9 of SA 315, they stated that since it was not their first year of audit in FY 2019-20, some procedures like Minutes summary, Review of ROC filings and Ledger review etc., were undertaken to enhance their understanding of GVIL. There was no change in the nature of operations, ownership, governance structures, types of investment and how it was financed.

<sup>9</sup> Para 16 of SA 200 provides that 'The auditor shall exercise professional judgment in planning and performing an audit of financial statements. Para 13 (k) of SA 200 defines Professional Judgement as 'The application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement'.

<sup>10</sup> Professional skepticism is defined at para 13(l) of SA 200 as – 'An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence'. Para 15 of SA 200 provides that 'The auditor shall plan and perform an audit with professional skepticism recognising that circumstances may exist that cause the financial statements to be materially misstated'.



They audited the current year transactions and transfer of funds to MACEL and the recoverability thereof was the basis of their Disclaimer of Opinion. They attached copies of MoA & AoA along with reply to SCN.

- 58 Having considered the reply, it is noted that additional documents submitted along with reply to SCN cannot be accepted as audit evidence as already discussed in para 22 to 24 of this Order. The Audit File does not evidence their claim that additional documents were obtained & verified during first year of audit. Further, prudent Auditors are required to refresh their understanding about the entity during audit of second year and subsequent years. There is no record in the Audit File about their understanding of the nature of business of GVIL, its ownership, governance structures etc.
- 59 The Auditors further submitted that as GVIL did not commence operations, it had no physical assets, Work-in-Progress, revenue, employee cost etc. and invested in an Infrastructure Company to further its objective. They submitted that in the earlier years GVIL had borrowed Rs 511.16 crores from TDL, its holding company. They further stated that section 186 of the Act allows the holding company (TDL) to advance loans to its subsidiary company without further approvals, which implies that a subsidiary can borrow from its holding company without restriction. They admitted to the fact that GVIL's shareholders did not pass any special resolution as required under the Act, for such borrowings. According to the Auditors, GVIL is of the view that since TDL itself has given the loan, approval of shareholders is implied to have been taken. Further, in respect of the loan of Rs 70 crores taken from fellow subsidiary company (TRRDPL), the Auditors replied that it is within the Rs 200 cores limit approved by special resolution passed in Extraordinary General Meeting held on 22.03.2015. The Auditors further replied that there is no legal requirement under the Act to report noncompliance with section 180 of the Act.
- 60 We note that GVIL had passed a special resolution in an Extraordinary General Meeting held on 22.03.2015 permitting borrowings up to Rs 200 crores. But this limit was exceeded when the borrowings reached Rs 581 crores, without taking further approvals of the company. The Auditors' stand that a wholly owned subsidiary company is not required to take approval for taking loan from its holding company is misconceived as no such exemption is available under section 180(1)(c) of the Act, which requires a special resolution of shareholders for borrowing in excess of the paid-up share capital & free reserves. It may be remembered that GVIL had a negative networth as on 31.03.2019 and 31.03.2020.
- 61 In respect of the loan of Rs 370 crores given to MACEL, the Auditors submitted that in absence of conclusive evidence demonstrated by GVIL regarding recoverability of loan, they had given a disclaimer of opinion. In respect of advance of Rs 45 crores given to Razia Sultana & its subsequent provision as a doubtful advance, their stand was that they had included this in the disclaimer of opinion as no supporting documents were provided. The Auditors further submitted that GVIL is not a shell company and mentioned about the permissions obtained by GVIL from government authorities for setting up of power evacuation plant and a substation in 2003. However, GVIL could not execute the projects due to many hurdles and thereafter decided to invest in infrastructure company SICAL Logistics Ltd (SICAL). They relied on clause iii(B)(2)



of MOA of GVIL which, in their view, permitted loans to be made to any other body corporate and stated that they had verified the MOA.

- 62 We note that approvals required under section 179 and 186 of the Act were not obtained while giving loans of Rs 370 crores to MACEL, Rs 105 crores to SICAL and Rs 45 crores to Razia Sultana. Despite that the Auditors had noted in the audit work paper 'CARO review' that "*Loan advanced does not exceed the limit, hence it is concluded that sec 186 is complied with*". This shows that appropriate audit procedures were not performed to verify whether the transactions of borrowing and lending were approved by the Board of Directors of GVIL. Further, we perused clause iii(B)(2) of MOA of GVIL and found that clause B pertains to Objects incidental or ancillary to the attainment of Main Objects. GVIL's Main Objects relate to business of power projects. Whereas Loans given to MACEL and SICAL did not relate to or were not ancillary to the business of power projects which had not yet taken off. It shows that loans given by GVIL to MACEL and SICAL were beyond its powers mentioned in the MOA, which the Auditors failed to observe. This shows that the Auditors did not even attempt to understand or had a totally flawed understanding of GVIL.
- 63 We note that GVIL was formed in 2001 for power sector business, it obtained some approvals for setting up of a power plant/substation and later on dropped the projects. GVIL had no operations. It had invested in shares of SICAL and had given loans/advance to SICAL, MACEL and Razia Sultana, all of which were totally unrelated to its business as per MOA. These borrowings and lending were all unauthorised including those with related parties. MACEL is a promoter owned entity to which a huge amount of Rs 370 crores was diverted. These facts are proof of GVIL being used as a shell company by the promoters of listed company for financial manoeuvres.
- 64 While citing para 11 of SA 200 & para 3 of SA 315, the Auditors submitted that they had given a disclaimer of opinion as they could not obtain reasonable assurance in respect of the amounts receivable from MACEL & Razia Sultana, which were the only material transactions during the year. We note from Disclaimer of Opinion section of the Independent Auditor's Report that there is no disclaimer that the Auditors did not understand GVIL or funds were fraudulently diverted to MACEL, SICAL and Razia Sultana.

**C.3 Lapses in audit relating to fraudulent diversion of funds worth Rs 520 crores, understatement of related party loan by Rs 350 crores and evergreening of loans**

- 65 The Auditors were charged with failure to perform audit with professional skepticism, failure to perform risk assessment procedures to identify, assess and respond to the risk of material misstatements due to fraudulent diversion of Rs 520 crores, understatement of related party loan by Rs 350 crores and evergreening of loans.
- 66 It was seen that GVIL had disbursed interest free loans/advance of Rs 410 crores to MACEL during 2019-20, of which Rs 40 crores was repaid by MACEL and the balance Rs 370 crores was outstanding as on 31-03-2020. Given the nature and size of GVIL, this disbursement was unusual and without any business rationale. A total of Rs 3535 crores was transferred from



MACEL to the personal accounts of VGS, his relatives and entities controlled by him and/or his family members. The Auditors were charged that they, as the Statutory Auditors, had the statutory duty to identify the GVIL's relationship with MACEL keeping in mind the size and materiality of this loan and the fact that the same was given without any business rationale. Due diligence and professional skepticism on their part could have easily revealed and established that MACEL was owned by the Promoter family and that the funds were diverted to an entity controlled by the owner. The Auditors were also required to be prudent and evaluate the terms and conditions of this loan. There is no evidence in the Audit File that such evaluations were performed by the Auditors.

- 67 It was pointed out that GVIL disbursed interest free loans/advances of Rs 150 crores to SICAL during 2018-19, of which Rs 105 crores was outstanding as on 31-03-2020. Considering the nature and size of GVIL, this loan too was unusual and given without any business rationale. The Auditors were required to evaluate the terms and conditions of this interest free loan and its recoverability. The Auditors had recorded in the Audit File that the counter party had a running business with regular turnover but they did not report about recoverability of this loan whereas they had reported about the recoverability of other loans in the Independent Auditor's Report.
- 68 The SCN points out that an advance of Rs 45 crores for purchase of land was given to Ms Razia Sultana during the year and a full provision for doubtful advance of Rs 45 crores against this advance was recognised during the year itself. This advance and full provisioning within the year itself was unusual and indicative of diversion of funds. This advance should have been evaluated by the Auditors to ascertain its purpose and terms & conditions. However, the Audit file does not evidence performance of any such evaluation.
- 69 The loans were given to MACEL and SICAL without charging any interest and without obtaining any security. These funds were sourced by borrowings from TDL (Rs 511.16 crores) and TRRDPL (Rs 70 crores), which are subsidiary companies of CDEL (a listed company) at nil rate of interest. It clearly indicates that the funds of a listed company were diverted, through GVIL, to the promoter-controlled entity and fellow subsidiary without any interest and security. These transactions should have aroused the suspicion of a prudent Auditor, but there is no evidence in the Audit File that they questioned the TCWG or Management about the same. The Auditors were charged with failure to perform audit with professional skepticism resulting in non-compliance with SA 200 & SA 550.
- 70 The requirement of section 179(3) of the Act regarding approval of the Board of Directors for taking and disbursing loans was not complied with and there was no evidence in the Audit file regarding the Auditors' examination of this aspect. Again, the requirements of Section 186 of the Act relating to loans and investments made by a company, inter alia, require benchmarking of the loan amount with the share capital & free reserve, rate of interest on loan and resolutions of Board of Directors & Members before sanctioning of loans etc. The intent behind such provisions is to protect the interest of shareholders, creditors and other stakeholders. Section 186(11) of the Act provides exemption from the provisions of section 186 to infrastructure companies. GVIL claimed that it was entitled to this exemption as it was engaged in infrastructure business. Examination showed that GVIL was incorporated in 2001 for infrastructure business,

however even after lapse of 19 years, it was not engaged in infrastructure business. Therefore, GVIL was not entitled for exemption under section 186(11) of the Act. The Auditors did not raise the obvious question to the TCWG and management as to how GVIL could claim exemption u/s 186 (11) when it was not engaged in the infrastructure business.

- 71 The SCN detailed the misstatements in Related Party Disclosures and also pointed to evergreening of loans through structured circulation of funds. Examination of the Financial Statements of GVIL and MACEL for FY 2019-20 revealed contradictions in the figures of inter-company loan transactions as detailed below:

**Table no. -4**

(Rs in crores)

| Particulars                   | As per Financial Statements of GVIL | As per Financial Statements of MACEL | Difference |
|-------------------------------|-------------------------------------|--------------------------------------|------------|
| Loans given by GVIL to MACEL  | 410                                 | 750                                  | 340        |
| Loans repaid by MACEL to GVIL | 40                                  | 380                                  | -340       |
| Balance on 31.03.2020         | 370                                 | 370                                  | 0          |

- 72 The Table 4 above depicts the loan transactions between GVIL and MACEL in their respective Financial Statements. This created serious doubt about the completeness of the Financial Statements of GVIL and MACEL. On examination of the respective bank statements of GVIL and MACEL, both with Karnataka Bank, we find that on 10.04.2019, GVIL received Rs 90 crores from TDL, which triggered a chain of apparently sham payments such as: GVIL paid Rs 90 crores to MACEL, which then paid Rs 50 crores to GVIL, which then paid Rs 50 crores to MACEL, which then paid Rs 90 crores to TDL, which then paid Rs 90 crores to GVIL, which then paid Rs 90 crores to MACEL and so on. Further, on 10.05.2019, GVIL received Rs 10 crores from MACEL, thereafter GVIL paid Rs 10 crores to MACEL, which then paid Rs 10 crores to GVIL and so on. It went on for 36 times making the transactions total to Rs 360 crores on the same day.
- 73 As pointed out in the SCN, these transactions were done in a circular manner by rotating smaller amount amongst three companies, resulting in 'Ever Greening of Loans'. This was an indication of severe financial crisis in Coffee Day group and an indication of misstatements in the Financial Statements of GVIL.
- 74 The Bank statement of GVIL showed that it had paid a total of Rs 760 crores to MACEL and also received a total of Rs 440 crores from MACEL, out of which Rs 50 crores receipt appears to be accounted for in 2018-19 thereby making closing balance of Rs 370 crores. However, funds of Rs 350 crores received from TDL on 10.04.2019 and given to MACEL on 10.05.2019 were not accounted for in FY 2019-20 in the books of GVIL as is evident from the ledger account of MACEL. This resulted in understatement of related party transactions disclosures by Rs 350 crores.
- 75 The above information indicated that the company had not disclosed Related Party Transactions in its entirety resulting in violations of para 18 (a) of Ind AS-24 on Related Party Disclosures and



the Auditors were charged for failure to report this in the Audit Report. The Auditors were required<sup>11</sup> to enquire about related party relationships and transactions. However, it is evident from above table that related party transactions were not correctly disclosed, indicating their failure to comply with SA 550. It is evident from above analysis that the Auditors did not exercise due diligence in audit of related party transactions of GVIL.

- 76 As per SA 315 and SA 330<sup>12</sup>, the Auditors 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 & assertion levels and to respond to such RoMM. There is no evidence in the Audit File that they had performed such procedures to identify risk of misstatement due to fraudulent diversion of funds. Resultantly they did not identify and respond to the RoMM which is non-compliance with SA 315 & 330.
- 77 SA 240 provides<sup>13</sup> that the objectives of auditor are to identify and assess the risk of material misstatement in the Financial Statements due to fraud, obtain audit evidence and respond to identified or suspected risk. It also requires the auditor to maintain professional skepticism recognizing the possibility of existence of material misstatement due to fraud. It further requires the 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. There is no evidence in the Audit File of performing any audit procedure to comply with SA 240.
- 78 The SCN points out that the Auditors had the statutory duty to report the offence of fraud to the Central Government under Section 143 (12) of the Act. Disbursal of loans and advances without any business rationale, complete absence of internal control and also violating provisions of the Act were indications of diversion of funds, which was a fraud on the company, ultimately fraud on the stakeholders of listed company viz. CDEL. The Auditors knew that funds were being diverted to MACEL, which is an entity controlled by VGS and his relatives. It is evident from the Financial Statements of GVIL that it had no business relations with MACEL. The Auditors were in knowledge of the diversion of funds, i.e., 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, the Auditors failed to report the same to the Central Government. On the contrary, they reported in The Companies (Auditors Report) Order 2016 (CARO) that no material fraud by or on the company had been noticed or reported during the course of audit. Accordingly, the Auditors were charged with violation of section 143 (12) of the Act.
- 79 The SCN pointed out that diverting funds fraudulently to MACEL (an entity owned and controlled by promoters' family) is covered under section 420 of the Indian Penal Code<sup>14</sup>, which

<sup>11</sup> See para 12 and para 13 of SA 550, Related Parties.

<sup>12</sup> Para 5 of SA 315 and para 5 of SA 330, Auditors Response to Assessed Risk.

<sup>13</sup> Para 10, 12 and 32(c) of SA 240, Auditor's Responsibilities relating to Fraud in an Audit of Financial Statements.

<sup>14</sup> Section 420 of IPC states, 'Whoever cheats and thereby dishonestly induces the person deceived to deliver any property to any person, or to make, alter or destroy the whole or any part of a valuable security, or anything which is signed or sealed, and which is capable of being converted into a valuable security, shall be punished with imprisonment of either description for a term which may extend to seven years, and shall also be liable to fine.'



is a predicate offence for money laundering under section 3 of the Prevention of Money Laundering Act 2002 (PMLA)<sup>15</sup>. The Auditors did not report this violation in the Independent Auditor's Report and also did not consider its impact on Financial Statements while making conclusions thereby violated SA 250 - Consideration of Laws and Regulations in an Audit of Financial Statements.

- 80 The Auditors were also charged with non-compliance with section 143 (3) (i) of the Act, as they did not report complete absence of Internal Financial Control in the company which was evident from fraudulent diversion of funds, non-recoverability of loans from SICAL and use of pre-signed blank cheques. VGS used to ask authorized signatories to sign a bunch of blank cheques, which were kept in his possession and used as and when required. These pre-signed cheques were used for diversion of funds in the name of loans and advances. These pre-signed cheques were also used for 'Ever Greening of Loans'. As per SA 315, an auditor is required to obtain an understanding of the control environment. In smaller entities (like the Auditee Company) the owner-manager may be in a position to override controls because the system of internal control is less structured. The Auditors did not perform any test of controls to obtain an understanding of the control environment in GVIL.
- 81 The Auditors denied all these charges and stated that in respect of Rs 511 crores borrowed from TDL (Holding Company), the transaction was covered by the exemption under section 186 available to holding company (TDL), to lend to its subsidiary company (GVIL) without any restriction. The Auditors admitted that the procedural aspect of passing a special resolution was not done in respect of loan taken from TDL. In respect of Rs 70 crores borrowed from TRRDPL, they submitted that it was within the limit of Rs 200 crores approved by the shareholders on 22.03.2015. The Auditors further replied that there is no reporting obligation on the Statutory Auditor regarding compliance with section 179 of the Act. This reply of the Auditors is not acceptable because neither was the Board approval under section 179(3) of the Act taken for both the loans nor was a special resolution passed for the borrowings from TDL.
- 82 Regarding the loan given to MACEL, the Auditors submitted that there is no need to have a written agreement for loan transactions with related parties. Besides, they relied on the Disclaimer of Opinion in their Audit report regarding recoverability of this loan. In respect of the loan given to SICAL, the Auditors relied on the fact that it was a listed company; had a running business with a turnover of Rs 856 crores; had a positive networth; and 30% of the loan had been recovered during the year itself. Thus, the loan to SICAL did not warrant any comment regarding its recoverability. In respect of the loan advance given to Razia Sultana, the Auditors stated that they were not provided with sufficient appropriate audit evidence/explanations by TCWG to evaluate the loan given and the provision for doubtful advance thereof. Therefore, they had given a disclaimer of opinion for the said loan in the audit report.

<sup>15</sup> As per section 3 of PMLA act 2002, 'Whoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime including its concealment, possession, acquisition or use and projecting or claiming it as untainted property shall be guilty of offence of money-laundering'. 'Proceeds of Crime', as defined at section 2 (u) of PMLA Act, means any property derived or obtained, directly or indirectly, by any person as a result of criminal activity relating to a scheduled offence. List of schedule offences in Part A of the schedule under PMLA Act 2002, covers section 420 of Indian Penal Code i.e. 'Cheating and dishonestly inducing delivery of property'.



- 83 The Auditors have thus relied on the Disclaimer of opinion regarding the recoverability of loans/advance given to MACEL & Razia Sultana. The SCN had charged the Auditors for failure to perform Audit procedures and professional skepticism in evaluating the fraudulent disbursement of interest free loans to MACEL, SICAL & Razia Sultana, and on the recoverability of loan given to SICAL. The Charges in the SCN do not include any matter which have been reported in the Disclaimer of Opinion by the Auditors.
- 84 As mentioned in para 70 above, the Auditors failed in pointing out that the Financial Statements have erroneously claimed that the company qualifies for the exemptions provided under section 186(11) of the Act. This exemption was claimed to justify loans given at nil rate of interest as against a minimum interest rate prescribed under section 186(7) of the Act. This exemption was available to companies inter alia engaged in the business of financing industrial enterprises or providing infrastructural facilities. Clearly GVIL did not qualify for this as it was not engaged in such business activities and in fact was defunct. As a prudent auditor, this misstatement should have been pointed out but on the contrary the Auditors reported in the 'CARO review' work paper that '*loans advanced does not exceed the limit, hence it is concluded that sec 186 is complied with.*' This shows gross negligence in performance of the Audit and a total lack of understanding of the provisions of the Act.
- 85 In respect of loan worth Rs 370 crores given to MACEL, approval of Board of Directors and Shareholders was not taken, a fact admitted by the Auditors. The implied approval relied upon in their reply is not legally tenable and indicates the casual approach of the Auditor while dealing with statutory approvals. Further, GVIL had no business relations with MACEL, nor was there any agreement with MACEL regarding this loan taken without any security. This is ample proof of fraudulent diversion of funds and fraud on the company. The Auditors were duty bound to exercise professional skepticism during the course of audit, which they failed to do. Though the Auditors have given disclaimer about recoverability of this loan but surprisingly kept mum about fraudulent diversion of Rs 370 crores to the promoter owned company, MACEL.
- 86 In respect of the loan of Rs 105 crores given to SICAL, the Auditors believe that it is covered in the limit of Rs 200 crores approved by shareholders in 2015. We notice that in FY 2018-19, loan of Rs 150 crores was given to SICAL in addition to Rs 550 crores loan given to MACEL, which indicates that this limit was breached in FY 2018-19 also. Further, shareholders had given a general approval, authorizing the Board of Directors (BOD) to finalize the terms & conditions of loan/investment within a limit of Rs 200 crores. The Board did not make any formal authorization /approval. As in the case of MACEL, there was no business relation with SICAL, no security was taken for the said loan and there was no agreement spelling out the terms of the loan. Further, the analysis of the Financial Statements of SICAL, as relied upon while responding to the SCN, is not available in the Audit File (The Auditors have only recorded that counter party has a running business with regular turnover). Therefore, we treat this part of the reply as an afterthought of the Auditors to justify their failure during performance of the Audit.
- 87 In respect of loan advance of Rs 45 crores given to Razia Sultana and subsequent recognition of provision for doubtful advance for the same, it is noted that there is no material on record

regarding the purpose of such advance, terms & conditions of such advance, identity of land, GVIL's plan to utilize that land and the reason of making provision for such advance. Though the Auditors have given disclaimer about recoverability of this advance, surprisingly they were silent on fraudulent disbursement of advance. The absence of critical information regarding this loan and the lack of professional skepticism in questioning the TCWG and the Management on the same is indicative of the Auditors turning a blind eye to disbursement of this loan.

- 88 In respect of evergreening of loans, the Auditors have submitted that they are not privy to books of MACEL and they do not have any mandatory responsibility to examine the manner in which funds were managed by GVIL in the subsequent year to clear the cheques issued in the year under audit; that they are not required to examine the source of funds used for clearing the cheques; and that they had no reason to suspect evergreening of loans and circular transactions. We note that evergreening of loans through structured circulation of funds is evident from the bank statements of GVIL, which the Auditors have admittedly verified. The Auditors replied that they are not required to verify the source of funds used for clearance of cheques, which were received in by GVIL in FY 2018-19 but cleared in FY 2019-20. To evaluate this argument, it is necessary to have a look on the bank statement in respect of a GVIL's bank account with Karnataka Bank, which is depicted below:

Table no. - 5

(Rs in Crores)

| Date       | Particulars | Instrument no. | Withdrawal | Deposits | Balance |
|------------|-------------|----------------|------------|----------|---------|
| 10.04.2019 | TDL         |                |            | 90.00    | 90.00   |
|            | MACEL       | 112476         | 90.00      |          | 00.00   |
|            | MACEL       |                |            | 50.00    | 50.00   |
|            | MACEL       | 112475         | 50.00      |          | 00.00   |
|            | TDL         |                |            | 90.00    | 90.00   |
|            | MACEL       | 112477         | 90.00      |          | 00.00   |
|            | TDL         |                |            | 90.00    | 90.00   |
|            | MACEL       | 112478         | 90.00      |          | 00.00   |
|            | TDL         |                |            | 80.00    | 80.00   |
|            | MACEL       | 112479         | 80.00      |          | 00.00   |
|            | MACEL       |                |            | 30.00    | 30.00   |
|            | SICAL       | 112474         | 30.00      |          | 00.00   |
| 10.05.2019 | MACEL       |                |            | 10.00    | 10.00   |
|            | MACEL       | 112482         | 10.00      |          | 00.00   |
|            | MACEL       |                |            | 10.00    | 10.00   |
|            | MACEL       | 112483         | 10.00      |          | 00.00   |
|            | MACEL       |                |            | 10.00    | 10.00   |
|            | MACEL       | 112484         | 10.00      |          | 00.00   |
|            | MACEL       |                |            | 10.00    | 10.00   |
|            | MACEL       | 112485         | 10.00      |          | 00.00   |
|            | MACEL       |                |            | 10.00    | 10.00   |
|            | MACEL       | 112486         | 10.00      |          | 00.00   |
|            | MACEL       |                |            | 10.00    | 10.00   |
|            | MACEL       | 112488         | 10.00      |          | 00.00   |
|            | MACEL       |                |            | 10.00    | 10.00   |
|            | MACEL       | 112489         | 10.00      |          | 00.00   |
|            | MACEL       |                |            | 10.00    | 10.00   |
|            | MACEL       | 112491         | 10.00      |          | 00.00   |
|            | MACEL       |                |            | 10.00    | 10.00   |
|            | MACEL       | 112492         | 10.00      |          | 00.00   |
|            | MACEL       |                |            | 10.00    | 10.00   |
|            | MACEL       | 112490         | 10.00      |          | 00.00   |
|            | MACEL       |                |            | 10.00    | 10.00   |
|            | MACEL       | 112494         | 10.00      |          | 00.00   |
|            | MACEL       |                |            | 10.00    | 10.00   |
|            | MACEL       | 112495         | 10.00      |          | 00.00   |
|            | MACEL       |                |            | 10.00    | 10.00   |
|            | MACEL       | 112496         | 10.00      |          | 00.00   |



|  |       |        |       |       |
|--|-------|--------|-------|-------|
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 112497 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 112498 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 112499 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 112493 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 112500 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 112487 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 472701 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 472702 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 472703 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 472704 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 472705 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 472706 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 472708 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 472709 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 472710 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 472711 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 472707 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 474713 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 474714 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 474716 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 474715 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 474712 | 10.00 | 00.00 |
|  | MACEL |        | 10.00 | 10.00 |
|  | MACEL | 474717 | 10.00 | 00.00 |

- 89 The above bank statement depicts that funds were circulated between MACEL and GVIL on 10-04-2019 & 10.05.2019 to clear cheques issued in FY 2018-19 for evergreening of loans of Rs 780 crores. It is surprising that the Auditors while looking at one column (Withdrawal or Deposit) in this bank statement, did not look at another column (Deposit or Withdrawal) in the same page of the bank statement. As GVIL had no operations, there are no other entries in the bank statement besides these circular entries. It is humanly impossible that a reasonable, prudent person scrutinizing these statements could not observe these circular transactions. The Auditor is required to perform audit with professional skepticism (SA 200). Evergreening of loans through structured circulation of funds was clearly visible from the above bank statement. While the fraud was apparent earlier, it got established after the financial mess was unveiled post the death of VGS in the first half of the financial year. The Auditors were required to evaluate this evident evergreening of loans while verifying clearance of cheques issued in 2018-19. It is clear that the Auditors have failed to exercise professional skepticism and due diligence while

verifying the bank statement. Therefore, we are of the view that the Auditors' inert passivity in the face of known evergreening of loans does not insulate them from their gross negligence in performance of Audit.

- 90 The Auditors by their own admission, had access to the investigation report of Mr. Ashok Kumar Malhotra (Retd DIG of CBI) at the time of audit. This investigation report has a finding suggesting evergreening of loans. Para 8.6.2 this report states *"Based on the review we were able to identify transactions where MACEL issued cheques to the subsidiary Companies during the last week of September and March of every financial year. These monies were credited into the Bank accounts of the respective Companies. Consequently, the money due by MACEL was brought down significantly on 30th September and 31st March respectively, which are the reporting dates for the purposes of Audit. However, we noticed that the subsidiaries Company would issue fresh cheques in favour of MACEL in the first week of October or April as the case may be. The net result of such transactions was that balance due by MACEL was lower in the books of accounts on the balance sheet dates viz., 30th September and 31st March of the respective years, due to such temporary arrangements"*. This red flag should have been used by the Auditors to dive deep into the bank statement, which speaks loudly about evergreening of loans through structured circulation of funds.
- 91 In respect of understatement in related party disclosure by Rs 350 crores transactions with MACEL, the Auditors replied that these transactions were accounted for in the books of GVIL in FY 2018-19 as cheques were received in 2018-19 and they had verified clearance of cheques in FY 2019-20. We note that the reply is factually correct that GVIL accounted for payment & receipt of Rs 350 loan to MACEL in FY 2018-19 and actual banking transactions of Rs 350 crores were happened on 10.05.2019. Therefore, this transaction was also required to be disclosed in the Financial Statements for FY 2019-20, which carries an adjacent, separate column for the previous years' (FY 2018-19) transactions. But this was not disclosed in the previous year column. Accordingly, we find that there is understatement in disclosure of Related Party Transactions in previous year column of the Financial Statements for FY 2019-20. This is non-compliance with Ind AS 24, which was not pointed out by the Auditors.
- 92 The Auditors replied that they had enquired into Related Party Transactions (RPT) with due diligence and there is no violation of Ind AS 24 & SA 550. They obtained balance confirmations from related parties and nothing was concealed and have further relied on their disclaimer of opinion in the audit report. They denied that they were in knowledge of any fraud. According to them, the question of reporting fraud u/s 143(12) of the Act does not arise.
- 93 As is clear from the above analysis, sums of Rs 370 crores, Rs 105 crores & Rs 45 crores were fraudulently diverted to MACEL, SICAL and Razia Sultana respectively. Evergreening of loans through structured circulation of funds has also been proved. Therefore, we find that the Auditors failed to report this fraud to the Central Government and in the Independent Auditor's Report resulting in violation of the section 143(12) of the Act and applicable Auditing Standards.
- 94 While denying the charge relating to PMLA, the Auditors have quoted section 420 of IPC, and stated that there is no cheating or dishonesty in RPTs and no delivery of property or destruction



of valuable security, therefore section 420 of IPC is not attracted. While quoting section 3 of PMLA, they replied that both the source and application of funds are clear from the transactions and funds are routed through banking channels. Accordingly, these are not proceeds of crime as mentioned under PMLA. They further replied that these transactions have not been flagged by bankers as suspicious transactions. Accordingly, they claimed to have complied with SA 250. We note that disclosure of Related Party Transactions in the Financial Statements and its routing through banking channel does not provide immunity to such transactions from PMLA. After the death of VGS (in July 2019) the fraud was clearly in the know of the Auditors, but they chose to remain silent. Diversion of Rs 370 crores to a promoter owned entity (MACEL) without proper authorization, without any business purpose, without obtaining any security, without any agreement and evergreening of loans through structured circulation of money are ample proof of cheating and dishonesty with the GVIL. In these fraudulent transactions, funds of the listed company have ultimately moved to a promoter owned entity resulting in misappropriation of public money, which is nothing but cheating and dishonesty. Therefore, this is a clear case of money laundering as per PMLA, which the Auditors failed to report in the Independent Auditor's Report.

- 95 In respect of Internal Financial Control, the Auditors stated that they had verified bank reconciliation statements as part of audit procedure. According to them, verification of unused cheque leaves is a procedure in an investigation and not a generally accepted procedure of audit as per para 5 of guidance note on audit of cash and bank balance issued by ICAI. They further replied that they are Statutory Auditors and not Forensic Auditors and that NFRA has no authority to expand the scope of responsibility of a Statutory Auditor beyond procedures of regular audit procedures laid out in ICAI guidance note on audit of internal controls audit of cash and bank. They stated that investigation report issued by Mr. Ashok Kumar Malhotra and Agastya legal LLP, was sufficient to indicate a probable lapse in internal controls of the group. They relied on the same to conclude on internal control. The Auditors have replied that they have complied with section 143(3)(i) of the Act. They stated that they have not provided any opinion on the adequacy of IFC and provided disclaimer of opinion for the entire financial statement and that disclaimer does not restrict to a specific element which is part of the "Basis for Disclaimer of Opinion". They have further stated that even if they had considered alleged control lapses, their opinion would have been the same i.e., "Disclaimer of Opinion", therefore, their audit conclusion cannot be regarded as inappropriate. Regarding non reporting internal control failure in disbursement of loans, they stated that disbursement is just one limb of balance reflected in the balance sheet as opposed to second limb being recoverability, and they disclaimed entire transaction.
- 96 It is undisputed fact that the Auditors were the Statutory Auditors and not the forensic auditors. However, laws and regulations lay down certain responsibilities on Statutory Auditors with respect to internal financial control and internal controls. Internal financial control over financial reporting is designed and implemented to prevent, and detect fraudulent transactions. In this case, use of pre signed cheques for diversion of funds and evergreening of loans through circulation of funds were enough evidence of complete absence of internal control and internal financial control in the GVIL. Further, we could not find any evidence in Audit File about the Auditors conducting any review of matters indicated in the guidance note issued by ICAI and cited in the reply by the Auditors. We note that the Auditors did not perform any test of control with reference



to use of cheques leaves, management override of control and authorisation of transactions etc. We further note that, being the Auditors of GVIL, TDL and TRRDPL, they also had access to banks statements of these group companies. Further, movement of funds, pre-signing of blank cheques and understatement of loan balances on reporting date had been reported in the investigation report of Mr Ashok Kumar Malhotra. Despite having access to all such information, the Auditors did not report these weaknesses in Internal Financial Controls in their report on Internal Financial Control over Financial Reporting.

- 97 The Auditors should consider, among other things, gaining an understanding of the transaction's business purpose and reviewing agreements, contracts, and other transaction-related documents. There is no audit evidence to support a legitimate business reason for such significant and unusual loans and advances. The funds of GVIL were clearly misappropriated, causing a material misstatement in the Financial Statements. As a result, even when circumstances warranted increased scrutiny and facts strongly implying fraud, magnified after the death of VGS, the Auditors failed to perform any additional auditing procedures. This suggests that the Auditors lacked the necessary professional skepticism to determine whether these transactions posed a risk of material misstatement due to fraud. They failed to obtain adequate audit evidence in relation to these transactions.
- 98 The PCAOB<sup>16</sup> in matters of diversion of funds to related parties, 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"*. 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.
- 99 Similarly, failures to perform audit procedures and exercise professional skepticism in related party transactions and internal control over financial reporting have invited serious action by audit regulators in other jurisdictions too. For example, in case of Cheryl L. Gore, CPA and Stanley R. Langston, CPA, PCAOB<sup>17</sup> had observed that *"Gore failed to obtain sufficient appropriate audit evidence and to perform sufficient procedures concerning whether Issuer A's financial statements accurately disclosed its related party transactions"..... "Gore failed to exercise due professional care, including professional skepticism, and failed to obtain sufficient*

<sup>16</sup> PCAOB Release No. 105-2020-012 and PCAOB Release No. 105-2020-013 both dated 24.09.2020.

<sup>17</sup> PCAOB Release No. 105-2021-020 dated 14.12.2021.



*appropriate audit evidence in connection with Issuer A's identification, accounting, and disclosure of related party relationships and transactions..... Specifically, as part of her risk assessment procedures, she was required to obtain an understanding of the design and implementation of Issuer A's internal control over financial reporting ("ICFR") in connection with related parties, to evaluate the design of those controls that were relevant to the audit, and to determine whether those controls had been implemented. Gore failed to perform any of these procedures during the 2016 Audit"".* This case resulted in debarment and imposition of monetary penalty on the auditors.

- 100 In view of the above analysis, we find that the charge that the Auditors have violated section 143(3)(i), 143(12) of the Act, CARO, SA 200, SA 240, SA 250, SA 315, SA 330 and SA 550 is proved.

#### **C.4 Lapses in evaluation of going concern assumption:**

- 101 The Auditors were charged with the failure to evaluate management's assessment of the entity's ability to continue as going concern thus violated SA 570 - Going Concern. The company has disclosed in the Financial Statements that it expected that the market price of its investment in shares of SICAL Logistics Ltd (a listed fellow subsidiary company) will increase in the long run and had prepared its Financial Statements on going concern basis.
- 102 The SCN stated that GVIL was not doing any business activity and was apparently used for diversion of funds. As per the Financial Statements of GVIL, it has incurred loss of Rs 45 crores and Rs 0.36 crores in FY 2019-20 and FY 2018-19 respectively. It had a negative net worth of Rs 100.21 crores on 31.03.2020. Further, GVIL had invested Rs 56.91 crores in 29,81,570 equity shares of SICAL Logistics Limited in FY 2018-19, recognized an impairment loss of Rs 16.97 crores in FY 2018-19 on this investment and recognized an impairment loss of Rs 38.09 crores in FY 2019-20 on this investment. As of 31.03.2020, the carrying amount of this investment was Rs 1.85 crores. An auditor with professional skepticism would not give credence to the management's assertion that the market price of SICAL's shares would increase in the long run, when they had actually been falling for two consecutive years. As a prudent Auditor they should have asked the management as to how SICAL's performance was likely to improve in the long run. From the Audit File, it is observed that the Auditors did not carry out any audit procedure to evaluate the management assertion. The future business plan of SICAL and its evaluation are also not available in the Audit File.
- 103 The Auditors have denied the charge stating that material uncertainty existed that might cast significant doubt on the GVIL's ability to continue as a going concern and accordingly they have provided material uncertainty para in the Independent Auditor's Report and also in para 2(f) of "Report on other legal and regulatory requirements". While drawing attention to para 19 of SA 570, they have replied that GVIL has given proper disclosures in the Financial Statements that GVIL has accumulated losses, eroded net worth, holding company has extended financial support and fair value of shares of SICAL was expected to be on positive note in long run. They further stated that the holding company is fully operational with substantial assets. They had evaluated

the Financial Statements of SICAL, the business of which was intact and SICAL had positive net worth. Accordingly, they have complied with SA 570.

- 104** As per para 12 of SA 570, an Auditor has the responsibility to evaluate the Management's assessment of an entity's ability to continue as going concern. In this case we note that the Audit File carries no such evaluation. The Auditors' response relying on the Managements assertion regarding improvement in the share prices of SICAL in the long run remains unsubstantiated in the Audit File. The Investment in shares of SICAL had a carrying value of Rs 1.85 crores only, whereas GVIL had no operations, a negative net worth of Rs 100.21 crores, borrowings of Rs 581.16 crores, and a loan of Rs 370 crores given to MACEL that was not recoverable as per the opinion of the Auditors themselves. This was clearly indicative of GVILs inability to realize its assets and discharge its liabilities and thus not being a going concern. The totality of facts shows that GVIL was not a going concern but just a means for achieving diversion of funds to the promoter group entities. Thus, the Auditors failed to evaluate the going concern assessment of GVIL, thus proving the charge of violation of SA 570.
- 105** In the matter of Grant Thornton LLP, Gary Homsley, CPA, and Larry Dana Leslie, CPA relating to inter alia 'Going Concern Evaluation', PCAOB<sup>18</sup> observed that *"The Firm and Homsley also failed, in the FY2015 Audit, to evaluate adequately Erickson's ability to continue as a going concern.....An auditor may identify information about certain conditions or events that, when considered in the aggregate, indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time"*. In this case PCAOB imposed monetary penalty of a \$750,000 on the Firm, barred the Engagement Partner from being associated with a registered public accounting firm and limited the activities of EQCR for two years.

### **C.5 Lapses in audit relating to Statement of Cash Flows**

- 106** The Auditors were charged with failure to report material misstatement of Rs 325 crores in the Statement of Cash Flows This misstatement has resulted in non-compliance with Ind AS 7<sup>19</sup> in respect of understatement of Cash flows from Operating Activity and overstatement of Cash flows from Investing Activity by Rs 325 crores. As per Ind AS 7, cash advances and loans made to other parties are to be classified under the heading Cash flows from Investing Activities (other than advances and loans made by financial institutions). GVIL is not a financial institution. However, GVIL had mis-classified loans made to other parties worth Rs 325 crores (net) under the heading "Cash flows from Operating Activities" (as negative balances). This has resulted in noncompliance with Ind AS 7.
- 107** The Auditors have denied the charge on the basis that terms and conditions of loans/advances were not finalized, therefore, these transactions cannot be termed as investing activity or financing activity and has to be classified as operating cash flow under elimination method, which is in compliance with Ind AS 7. They further replied that they had given a disclaimer of

<sup>18</sup> PCAOB Release No. 105-2020-019 dated 05.11.2020.

<sup>19</sup> Para 16 (e) of Ind AS 7, *Statement of Cash Flows*.



opinion in respect of compliance with accounting standards specified under section 133 of the Act.

- 108 We note that benefits of cash flow information are described in para 4 & 5 of Ind AS 7 as *"A statement of cash flows, when used in conjunction with the rest of the financial statements, provides information that enables users to evaluate the changes in net assets of an entity, its financial structure (including its liquidity and solvency) and its ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities. Cash flow information is useful in assessing the ability of the entity to generate cash and cash equivalents and enables users to develop models to assess and compare the present value of the future cash flows of different entities. It also enhances the comparability of the reporting of operating performance by different entities because it eliminates the effects of using different accounting treatments for the same transactions and events. Historical cash flow information is often used as an indicator of the amount, timing and certainty of future cash flows. It is also useful in checking the accuracy of past assessments of future cash flows and in examining the relationship between profitability and net cash flow and the impact of changing prices"*.
- 109 Para 6 of Ind AS 7 defines operating, investing and financing activities as under:
- "Operating activities are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities".*
- "Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents".*
- "Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity".*
- 110 Therefore, importance of Cash Flow information and its classification are clearly prescribed in Ind AS 7, which were to be complied by GVIL. It is undisputed fact that GVIL was not engaged in any operation permitted by its MOA. Loans/advances given to MACEL, SICAL & Razia Sultana were not for any operations relating to power projects, the purpose for which GVIL was formed. Such loans/advance were not included in "Cash Equivalent". Therefore, Cash Flow from these transactions have to be considered as "Cash Flow from Investing Activities" and cannot be considered as "Cash Flow from Operating Activities".
- 111 Further, in the Independent Auditor's Report, the Auditors have reported as *"We are unable to comment whether the financial statements comply with the Accounting Standards specified under section 133 of the Act, because of the matters described in the Basis for Disclaimer of opinion section above"*. We note from the "Basis for Disclaimer of Opinion" section of Independent Auditor's Report, that misstatement in Statement of Cash Flows by Rs 325 crores is not reported by the Auditors. In view of the above, we find that reply of the Auditors is not satisfactory and the charge that the Auditors failed to report non-compliance of Ind AS 7 by GVIL is proved.

- 112 In the Matter of Armando C. Ibarra, P.C., Armando C. Ibarra, Sr., and Armando C. Ibarra, Jr. relating to inter alia inappropriate classification in the Statement of Cash Flows, PCAOB<sup>20</sup> observed, *"In 2003, when it returned artwork to the original artist, BoysToys wrote off its investment in fine art as a charge to the income statement. No cash was exchanged as a result of this transaction. In its FY 2003 statement of cash flows, BoysToys reported \$25,320 of positive cash flow from investing activities related to the write off. The return of the fine art represented 100% of BoysToys' cash flows from investing activities and, as a noncash transaction, its classification as an investing activity is inconsistent with GAAP"*. In this case, PCAOB revoked registration of the Audit Firm and barred two of its partners from associating with registered public accounting firm.

#### **D. OTHER NON-COMPLIANCES WITH LAWS AND STANDARDS**

In addition to the major lapses covered under section C of the order, the Auditors were also charged with following lapses in the audit:

- a) Failure to ensure compliance with section 134(1) of the Act.
  - b) Failure to comply with SA 700 - Forming an Opinion and Reporting on Financial Statements.
  - c) Failure to comply with SA 230 - Audit Documentations, SA 260, Communication with Those Charged With Governance & SA 265 - Communicating deficiencies in Internal Control to Those Charged With Governance and Management.
  - d) Failure to comply with SA 300 - Planning an audit of Financial Statements.
  - e) Failure to comply with SA 720 - The Auditor's Responsibilities Relating to Other Information.
- 113 The Auditors were charged with not ensuring that the Financial Statements of GVIL were approved by the Board of Directors (Board) and signed by the Directors authorised to do so as per section 134(1) of the Act. The Auditors replied that *"We have obtained constructive evidence, in the form of receipt of signed copies of the financial statements, before signature of the same by us and issuance of audit report thereon. Further considering the 'Doctrine of Indoor Management', we have ensured the compliance with section 134(1). The Doctrine of Indoor Management lays down that persons dealing with a company having satisfied themselves that the proposed transaction is not in its nature inconsistent with the memorandum and articles, are not bound to inquire the regularity of any internal proceeding. Accordingly, there is no non-compliance with section 134(1) of the Act"*.
- 114 We observe that as per section 134(1) of the Act, approval of the Financial Statements by the Board and its signing by the persons authorized by the Board are prerequisites before an Auditor makes a report on such approved & signed Financial Statements. It was the primary responsibility of the Auditors to ensure that these requirements were adhered to, which the Auditors failed to perform. The reliance on the "Doctrine of Indoor Management" is misplaced as this Doctrine is applicable to third parties, not having access to the internal records of a company. The Auditors should have obtained certified copy of the Board resolution approving the Financial Statements and authorizing the Directors for signing the Financial Statements and should have kept the same

<sup>20</sup> PCAOB No. 105-2006-001 dated 19.12.2006.



in the Audit File before its assembly. The Auditors did not do the same. Thus, this charge is proved.

- 115 The Auditors were charged that they did not consider material misstatements of Rs 1776.16 crores<sup>21</sup>, while making audit conclusions and forming audit opinion, and thus violated SA 700 - Forming an Opinion and Reporting on Financial Statements, which requires the auditor to conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatements, whether due to fraud or error.
- 116 While denying the charge, the Auditors referred to para 17 of SA 700 and para-A1 & 5(a) of SA 705 and replied that the basis for disclaimer of opinion given in audit report represents substantial proportion of financial statements, accordingly, they have complied with SA 700. While repeating the reply given in respect of each of alleged misstatements in Financial Statements, they stated that even if they had considered these alleged misstatements, their opinion would have been the same i.e., disclaimer of opinion.
- 117 We note from the Independent Auditor's Report that Basis of Disclaimer of Opinion does not include (a) fraudulent diversion of funds worth Rs 520 crores, (b) fraudulent borrowing of Rs 581.16 crores, (c) understatement of related party transactions worth Rs 350 crores, and (d) misstatement in statement of cash flows worth Rs 325 crores. Disclaimer of opinion covered only recoverability of Rs 370 crores from MACEL & Rs 45 crores from Razia Sultana. Therefore, we find that the Auditors were grossly negligent in forming the audit opinion and not reporting the fraudulent diversion of funds and other material misstatements of Rs 1776.16 crores in the Independent Auditor's Report. Accordingly, we find that the charge that the Auditors violated SA 700, is proved. Based on the reply, however, we drop the charge relating to violation of SA 320, Materiality in Planning and Performing an Audit.
- 118 The Auditors were charged with noncompliance with SA 230 relating to Audit Documentations and SA 260 & SA 265 relating to communication with Those Charged with Governance (TCWG) as they did not record the date of performing audit procedures, date & extent of review and discussion of significant matters with Management & TCWG. They did not assemble the Audit File within 60 days of signing of audit report; they did not determine TCWG; and did not communicate with TCWG about the responsibilities of the auditor, overview of planned scope, timing of the audit and deficiencies in Internal Control etc. The Audit report was signed on 21.11.2020. Accordingly, the Audit File was required to be assembled by 20.01.2021. When we advised the Firm on 22.06.2022 to send Audit File, the Audit Firm sent the Audit File vide letter dated 21.07.2022 but without the Financial Statement and the Audit Report. After being reminded on 03.08.2022, then only Firm sent the FS and the Audit Report. This indicates that the Audit File was not assembled even after 18 months of signing the audit report.
- 119 The Auditors have denied the charge stating that the record of audit procedures performed and who has performed/reviewed the work is available in 'Audit Programme' in the Audit File and

<sup>21</sup> Breakup of Rs 1776.16 crores = Loans/advance given to (a) MACEL-Rs 370 crores, (b) SICAL-Rs 105 crores and (c) Razia Sultana- Rs 45 crores; borrowings from TDL & TRRDPL -Rs 581.16 crores; understatement of related party transactions - Rs 350 crores; and Misstatement in Statement of Cash Flow -Rs 325 crores.



details of date of conducting audit by article clerks are available in time sheets maintained separately. Regarding the extent of review, they replied that they had checked all the transactions. With respect to charge relating to non-assembly of the Audit File within stipulated period, they replied that they were not aware of the modalities of representation before NFRA and certain documents would have been inadvertently missed during the submission, as FS was in hard copy. They further replied that during the course of audit, observations, discussion with TCWG/management and clarifications received were noted in 'Audit Conclusion' section of the Audit File submitted to NFRA. While drawing attention to para 19 of SA 260, they argued that written communication with TCWG is not compulsory.

- 120 Having considered the reply, we observe that dates of performing audit procedures & its review are required to be documented in the Audit File, which the Auditors failed to do. They replied that article clerks maintain time sheets separately but they could not give any reply in respect of not recording date of audit work done/reviewed by Ramesh and Chaitanya. Further, not keeping the Financial Statements & Audit Report in the Audit File is a proof that the Audit File was not assembled within permitted period. We note from 'Audit Conclusion' section of the Audit File that it does not have any reference relating to discussion with TCWG/Management. Date of discussion & name of person (with whom matters were discussed) were also not recorded. Accordingly, we find that the Auditors did not comply with SA 230, SA 260 & SA 265.
- 121 The Auditors were charged with failure to establish overall audit strategy and development of audit plan as required by SA 300. They were required to undertake the required activities at the beginning of the current engagement e.g., performing procedures required by SA 220, evaluating compliance with ethical requirement, and establishing an understanding of the terms of engagements, establishing overall audit strategy and development of audit plan etc. There is no evidence in the Audit File of performing these activities, showing non-compliance with SA 300.
- 122 While denying the charge, the Auditors have stated that the audit plan was prepared at the inception of audit, each area was allocated to team members, work performed by team members were reviewed by engagement lead and EP reviewed the Financial Statements & working paper before arriving at audit conclusion. In 'Audit Conclusion' section of the Audit File, significant matters and the conclusion are recorded and accordingly, Disclaimer of Opinion was given.
- 123 Having considered the reply, we note from SA 300 that audit plan should include nature, timing and extent of planned risk assessment procedures. We observe from audit plan available in the Audit File that it is a simple list of 12 areas to be covered containing two more columns i.e., who will perform audit procedure and who will review it. It does not contain any details of planning relating to risk assessment procedures. Planning risk assessment procedures is a necessary prerequisite for development of an effective audit strategy and an effective audit plan, which Auditors have failed to do. Quality of performance of an audit largely depends upon the quality of audit plan. We find that the Auditors were deficient in developing an effective audit plan, thus this charge is proved.
- 124 The Auditors were charged with noncompliance of SA 720 which requires them to read the other information in the Annual Report of GVIL. There is no evidence in Audit File that the Auditors



had read the Annual Report of GVIL. The Auditors denied this charge stating that they had verified the draft Annual Report prepared by the company and did not find inconsistency, accordingly no queries were noted in the Audit File.

- 125 We note from SA 720 that the purpose of reading annual report by the Auditors is to ensure that there is no material inconsistency between other information in annual report and financial statements. We further note from para A5 of SA 230 that oral explanation by the auditor, on their own, do not represent adequate support for the work auditor performed or conclusions auditor reached, but may be used to explain or clarify information contained in the audit documentation. There is no record in Audit File that the Auditors had verified draft annual report. This reply is not satisfactory and thus, we find that this charge is proved.

#### **E. OMISSION AND COMMISSION BY THE AUDIT FIRM**

**In addition to being jointly responsible for the lapses in audit performed by the EP and other members of the engagement team, the Audit Firm was charged with omissions and commissions solely attributed to it. These are discussed below.**

**Lapses in constitution of Engagement Team ('ET' hereafter) and assigning responsibility among ET members (Additional Lapse on the part of the Audit Firm only)**

- 126 The Firm was charged with non-compliance with SQC 1 by splitting the responsibility of an EP between two partners as against the requirement to assign responsibility for each engagement to 'an engagement partner'. The firm should establish policies and procedures requiring that: (a) The identity and role of the engagement partner are communicated to key members of the client's management and those charged with governance; (b) The engagement partner has the appropriate capabilities, competence, authority and time to perform the role; and (c) The responsibilities of the engagement partner are clearly defined and communicated to that partner.
- 127 The SCN states that as per audit program, the Firm has assigned the responsibility of this engagement to CA Chaitanya D. Deshpande and responsibility of signing the audit report to CA C. Ramesh, thereby splitting the responsibility of one engagement into two partners. Splitting the fundamental responsibilities of one engagement between two partners is against the principle of SQC 1 resulting in non-compliance with SQC 1.
- 128 The Firm replied that Chaitanya was engagement lead, who executed day to day audit procedures and Ramesh was partner in-charge of engagement. The term 'Signing partner' is used internally in their office. While citing para 3 of SQC 1, the Firm replied that there is no bar on deputing more than one engagement partner to a particular engagement. The Firm further stated that bigger companies have joint auditors and each joint auditor has its own engagement partner, which supports that an engagement can have multiple engagement partners.
- 129 It can be noted that the term 'Engagement Partner' (EP) is defined in SQC 1 as *"the partner or other person in the firm who is a member of the Institute of Chartered Accountants of India and is in full time practice and is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority*

*from a professional, legal or regulatory body*". As per this definition, the EP has to take complete responsibility for the engagement, its performance, and for the audit report. Further, it is noticed from the Audit File that Chaitanya was doing only day to day work whereas responsibility of engagement was on Ramesh, who signed the audit report. Though as per SQC 1, one engagement can have only one EP, in this case the audit firm appointed one signing partner and one EP. CA C. Ramesh was appointed as signing partner and CA Chaitanya G. Deshpande was shown as EP in the audit plan. Chaitanya has not disputed this position in his reply. Therefore, we hold that CA C. Ramesh, as well as CA Chaitanya G. Deshpande were members of engagement team and are jointly and severally responsible for all lapses. The audit firm is also responsible for lack of due diligence in this regard for constituting their Engagement Team with multiple EPs in violation of SQC 1.

- 130 We observe from the reply that there was no clarity about the EP who was required to take ultimate responsibility for the Audit Engagement. This led to a situation where the entire audit was conducted in a perfunctory manner and no single ET member took the ultimate responsibility of the audit engagement. This has adversely affected the performance of audit engagement as evident from the preceding paras. Therefore, we find that this charge is proved.

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

- 131 In addition to lapses in constitution of the engagement team, the Audit Firm was also charged with various omissions and commissions attributed to the Auditors in section C and D above. Para 2 of SA 220 and para 3 of SQC 1, stipulate that Quality Control Systems, Policies and Procedures are the responsibility of the Audit Firm. The Audit Firm was charged with failure to establish and maintain a system of quality control to provide it with reasonable assurance that (a) The firm and its personnel comply with professional standards and regulatory and legal requirements; and (b) The reports issued by the firm or engagement partners are appropriate in the circumstances.
- 132 Responding to the charge, the Audit Firm stated:
- a) They have issued audit report after taking into account the provisions of the Act, Ind AS prescribed u/s 133 and Standards on Auditing u/s 143(10) of the Act. They have taken management representation letter for various aspects relating to this engagement and reported u/s 143(2) of the Act. They rely on the replies in forgoing para in respect of NFRA's observation on alleged non-compliance with accounting and auditing standards.
  - b) They confirmed the "Report on other legal and regulatory requirements" of audit report in compliance to section 143(3) of the Act.
  - c) They had provided Disclaimer of Opinion because of the significance of the matters described in the Basis for Disclaimer of Opinion section of their audit report on the Financial Statements and Internal Financial Control over Financial Reporting. They have given a para on material uncertainty on the going concern status of the Company.
  - d) They were unable to comment whether books of accounts as required by the law have been kept by the Company; and whether the Financial Statements comply with the Accounting



Standards specified u/s 133 of the Act, because of the matters described in the Basis for Disclaimer of Opinion section of their audit report.

- e) The Balance Sheet, the Statement of Profit and Loss (Including Other Comprehensive Income), the Statement of Changes in Equity and Statement of Cash Flows dealt with by their Audit Report are in agreement with the books of account.
- f) In compliance with section 143(12) of the Act, the Audit Firm replied that there is no fraud identified by them, hence there is no reporting requirement to the Central Government.
- g) The Firm has a Quality Control Manual in place and the same has been adhered to while conducting the audit of CDGL.

**133** We have considered the reply. Statutory Audits are performed by Engagement Team on behalf of the Audit Firm appointed as Statutory Auditor under section 139 of the Act. The audit reports are signed on behalf of the Audit Firm and, therefore, the Audit Firm remains responsible for all the acts of omissions and commissions by the Engagement Team as well as for violation of duties and responsibilities specifically required of the Audit Firm. M/s Sundaresha & Associates was the Statutory Auditor of GVIL for FY 2019-20. We have already considered in the earlier paragraphs, the point wise replies of the Audit Firm and determined that the Audit Firm and the Engagement Team have been grossly negligent in ensuring that the Audit of GVIL was performed in accordance with the applicable laws and regulations and that the Audit Report issued on behalf of the Audit Firm was not appropriate. Therefore, as per the standards and the legal provisions mentioned above, in addition to the Engagement Team, the Audit Firm is also responsible for the lapses discussed in the preceding paragraphs of this Order.

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

**134** The Auditors have stated that no accounting and auditing standards have been prescribed on the recommendation of NFRA, hence question of monitoring such standards by NFRA does not arise and issuance of SCN is beyond the powers of NFRA. This contention of the Auditors is not acceptable. The NFRA's authority to monitor and enforce compliance with the accounting and auditing standards is derived from section 132 of the Act. All the Accounting Standards and Auditing Standards have the force of law and are required to be mandatorily complied with from the date of their respective applicability, while conducting statutory audits.

**135** The Auditors stated that investigation by NFRA is a prerequisite to prove professional or other misconduct. As neither any investigation was conducted nor investigation report was shared with them, therefore the SCN is not legally tenable. The SCN, we observe, was issued after duly examining the material contained in the Audit File and other materials on record in accordance with Rule 11 of the NFRA Rules 2018 and the conclusions reached in this Order are based on due consideration of the Auditors' replies on each point of charge in the SCN.

**136** The Auditors stated that as per their knowledge, no action has been taken against GVIL or its Key Management Personnel, for any alleged wrongdoing/alleged fraud of the Company by the authorities under the Companies Act 2013, IPC or PMLA. Therefore, issuance of the SCN is bad in law. This argument is not logical as this SCN has been given to the Auditors in accordance with section 132(4) of the Act in respect of their lapses during conducting Statutory Audit of

GVIL for which only they remain responsible. Action by NFRA is not dependent on actions of other authorities.

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

**137** Based on the foregoing discussion and analysis, we conclude that the Auditors have committed Professional Misconduct as defined under Section 132 (4) of the Companies Act 2013 in terms of section 22 of the Chartered Accountants Act 1949 (CA Act) as amended from time to time, and as detailed below:

- a) The Auditors committed professional misconduct as defined by clause 5 of Part I of the Second Schedule of the CA Act, which states that an auditor is guilty of professional misconduct when he *"fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary in making such financial statement where he is concerned with that financial statement in a professional capacity"*. This charge is proved as explained in Section - C-3 to C-5 and D (b) above.
- b) The Auditors committed professional misconduct as defined by clause 6 of Part I of the Second Schedule of the CA Act, which states that an auditor is guilty of professional misconduct when he *"fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity"*. This charge is proved as explained in Section - C-3 to C-5 and D (b) above.
- c) The Auditors committed professional misconduct as defined by clause 7 of Part I of the Second Schedule of the CA Act, which states that an auditor 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 explained in Section – C and D above.
- d) The Auditors committed professional misconduct as defined by clause 8 of Part I of the Second Schedule of the CA Act, which states that an auditor is guilty of professional misconduct when he *"fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion"*. This charge is proved as explained in Section – C-2 to C-5 and Section - D above.
- e) The Auditors committed professional misconduct as defined by clause 9 of Part I of the Second Schedule of the CA Act, which states that an auditor is guilty of professional misconduct when he *"fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances"*. This charge is proved as explained in Section C and D above.

#### **H. ADDITIONAL ARTICLES OF CHARGES OF PROFESSIONAL MISCONDUCT BY THE AUDIT FIRM**

**138** In addition to above, the Audit Firm has committed Professional Misconduct as defined Section 132 (4) of the Act as failure to exercise due diligence and being grossly negligent in the conduct of professional duties in respect of matters explained at Section – E above as the Audit Firm



failed to exercise due diligence and was grossly negligent in the conduct of professional duties, thus, violated SQC 1.

- 139 Therefore, we conclude that all the charges of professional misconduct in the SCN (Except charges relating to noncompliance with SA 320, which has been dropped) stand proved based on the evidence in the Audit File, the Audit Report dated 21.11.2020 issued on behalf of the Firm, the submissions made by the Auditors and the Financial Statements of GVIL for the FY 2019-20.

## I. PENALTY & SANCTION

- 140 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.
- 141 Existence of “**Shell Companies**” for effecting sham or unlawful transactions is injurious to the economic health of India. Auditors of shell companies have greater responsibilities of exposing promoters’ nefarious actions to use such shell companies for illegal and/or unethical activities.
- 142 This Order has detailed all the lapses in Audit and the non-compliances with the Standards on Auditing made by the Auditors. The constant refrain of the Auditors throughout their reply has been that they had given the Disclaimer of Opinion indicating non recoverability of advances made to MACEL and Razia Sultana. The death of VGS happened in July 2019 and the Auditors had sufficient time to evaluate all the areas spelt out in this Order where the Standards have not been adhered to. The Auditors had access to the investigation report of Mr. Ashok Kumar Malhotra, which contained complete details of diversion of funds and its modus operandi, including signing of blank cheques. Despite this, they did not report fraudulent diversion of funds, just to preserve their professional relationship with the promoters of the auditee company. The Standards on Auditing do not free an Auditor from reporting all other misstatements once a Disclaimer on a particular aspect is given. The Auditors have failed in their statutory duty and have tried to hide behind one Disclaimer of opinion, which was incomplete as they did not cover all aspects of infraction of the Laws and the Standards. All of this weighs heavily on our mind while determining the quantum of penalty.
- 143 Section 132(4)(c) of the Companies Act 2013 provides that National Financial Reporting Authority shall, where professional or other misconduct is proved, have the power to make order for—
- (A) imposing penalty of— (I) not less than one lakh rupees, but which may extend to five times of the fees received, in case of individuals; and (II) not less than ten lakh rupees, but which may extend to ten times of the fees received, in case of firms;
  - (B) debarring the member or the firm from—(I) being appointed as an auditor or internal auditor or undertaking any audit in respect of financial statements or internal audit of the functions and activities of any company or body corporate; or (II) performing any valuation as provided under section 247, for a minimum period of six months or such higher period not exceeding ten years as may be determined by the National Financial Reporting Authority.

- 144 As per information furnished by M/s Sundaresha & Associates vide letter dated 10.09.2022, the statutory audit fees of GVIL for 2019-20 was Rs [REDACTED] and total professional fees received by the Audit Firm during FY 2019-20 was Rs [REDACTED]. CA C. Ramesh and CA Chaitanya G. Deshpande earned total professional fee of Rs [REDACTED] and Rs [REDACTED] respectively during FY 2019-20.
- 145 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 a monetary penalty of Rs One Crore upon M/s Sundaresha & Associates. In addition, M/s Sundaresha & Associates is debarred for a period of Two years from being appointed as an auditor or internal auditor or from undertaking any audit in respect of financial statements or internal audit of the functions and activities of any company or body corporate. This debarment period will start after completion of two years debarment period imposed in case of Tanglin Development Limited for FY 2018-19 vide NFRA order dated 26.04.2023.
  - Imposition of a monetary penalty of Rs Five Lakhs upon CA C. Ramesh. In addition, CA C. Ramesh is debarred for a period of Five years from being appointed as an auditor or internal auditor or from undertaking any audit in respect of financial statements or internal audit of the functions and activities of any company or body corporate.
  - Imposition of a monetary penalty of Rs Five Lakhs upon CA Chaitanya G. Deshpande. In addition, CA Chaitanya G. Deshpande 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.
- 146 This order will become effective after 30 days from the date of issue of this order.

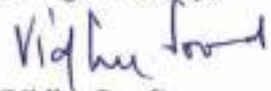
Signed  
(Dr Ajay Bhushan Prasad Pandey)  
Chairperson

Signed  
(Dr Praveen Kumar Tiwari)  
Full-Time Member

Signed  
(Smita Jhingran)  
Full-Time Member

Authorised for issue by the National Financial Reporting Authority,

Date: 30.05.2023  
Place: New Delhi

  
(Vidhu Sood)

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



To,

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Copy To: -

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

