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2025:DHC:716-DB

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

% **Judgment reserved on: 22 July, 2024**
Judgment pronounced on: 07 February, 2025

\+ W.P.(C) 1065/2021 & CM APPL. 9896/2021 (Direction)

DELOITTE HASKINS & SELLS LLP ..... Petitioner

Through: Mr. Kapil Sibal, Sr. Adv. with Ms. Prachi Dhanani, Mr. Rohini Jaiswal, Mr. Pratham Vir Agarwal, Mr. Rahul Dwarkadas & Ms. Niyati Kohli, Advs.

versus

UNION OF INDIA & ANR. ..... Respondents

Through**:** Ms. Shiva Lakshmi, CGSC
Mr. Zoheb Hossain, Mr. Vivek Gurnani, Ms. Abhipriya Rai, Mr. Vivek Gaurav, Mr. Kartik Sabharwal, Mr. Pranjal Tripathi, Mr. Suradish Vats, Mr. Kunal Kochhar & Ms. Radhika Puri, Advs. for NFRA.
Mr. Kirtiman Singh, CGSC along with Mr. Waize Ali Noor, Mr. Varun Rajawat, Mr. Ranjeev Khatana and Mr. Varun P. Singh, Advs.

\+ W.P.(C) 12096/2019 & CM APPL. 49556/2019 (Stay)

FEDERATION OF CHARTERED ACCOUNTANTS ASSOCIATION ..... Petitioner

Through: Ms. Manasi Bhushan, Ms. Sanjana Patel, Ms. Khyati Chhabra, Mr. Vikrant Sharma and Ms. Sakshi Sharma, Advs.

versus

UNION OF INDIA AND ORS. ..... Respondents

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Through: Ms. Shiva Lakshmi, CGSC.
Mr. Kirtiman Singh, CGSC along with Mr. Waize Ali Noor, Mr. Varun Rajawat, Mr. Ranjeev Khatana and Mr. Varun P. Singh, Advs.
Ms. Pooja Mehra Saigal, Adv. for Mr. Jatin Dua and Mr. Kaveri Rawal, Advs. for R-3.

\+ W.P.(C) 1522/2020 & CM APPL. Nos.17186/2020, 30096/2023

RUKSHAD DARUVALA ..... Petitioner
Through: Mr. Arun Kathpalia, Sr. Adv. with Ms. Aayushi S. Khazanchi, Mr. Aditya Dhupar, Ms. Bani Brar, Ms. Pooja Deepak and Mr. Vinayak Chawla, Advs.

versus

UNION OF INDIA & ANR. ..... Respondents
Through: Ms. Shiva Lakshmi, CGSC.
Mr. Zoheb Hossain, Mr. Vivek Gurnani, Ms. Abhipriya Rai, Mr. Vivek Gaurav, Mr. Kartik Sabharwal & Ms. Radhika Puri, Advs. for NFRA.
Mr. Kirtiman Singh, CGSC along with Mr. Waize Ali Noor, Mr. Varun Rajawat, Mr. Ranjeev Khatana and Mr. Varun P. Singh, Advs.

\+ W.P.(C) 1524/2020 & CM APPL. Nos. 7533/2020, 10777/2020 17184/2020, 30095/2023

UDAYAN SEN ..... Petitioner

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Through: Mr. Arun Kathpalia, Sr. Adv. with Ms. Aayushi S. Khazanchi, Mr. Aditya Dhupar, Ms. Bani Brar, Ms. Pooja Deepak and Mr. Vinayak Chawla, Advs.

versus

UNION OF INDIA & ANR ..... Respondents

Through: Ms. Shiva Lakshmi, CGSC.
Mr. Zoheb Hossain, Mr. Vivek Gurnani, Ms. Abhipriya Rai, Mr. Vivek Gaurav, Mr. Kartik Sabharwal & Ms. Radhika Puri, Advs. for NFRA.
Mr. Kirtiman Singh, CGSC along with Mr. Waize Ali Noor, Mr. Varun Rajawat, Mr. Ranjeev Khatana and Mr. Varun P. Singh, Advs.

\+ W.P.(C) 11737/2021

S R B C AND CO LLP ..... Petitioner

Through: Mr. Jayant K. Mehta, Sr. Adv. with Ms. Nikita Sethi, Ms. Aayushi Kumar, Mr. Prateek Khanna, Mr. Ravneet Kaur Malik and Ms. Rumella Jain, Advs.

versus

UNION OF INDIA AND ANR ..... Respondents

Through: Ms. Shiva Lakshmi, CGSC
Mr. Zoheb Hossain, Mr. Vivek Gurnani, Ms. Abhipriya Rai, Mr. Vivek Gaurav, Mr. Kartik Sabharwal & Ms. Radhika Puri, Advs. for NFRA.
Mr. Kirtiman Singh, CGSC along with Mr. Waize Ali Noor, Mr. Varun Rajawat, Mr. Ranjeev

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Khatana and Mr. Varun P. Singh, Advs.

\+ W.P.(C) 11738/2021

VINAYAK PUJARE ..... Petitioner

Through: Mr. Jayant K. Mehta, Sr. Adv. with Ms. Nikita Sethi, Ms. Aayushi Kumar, Mr. Prateek Khanna, Mr. Ravneet Kaur Malik and Ms. Rumella Jain, Advs.

versus

UNION OF INDIA & ANR. ..... Respondents

Through: Ms. Shiva Lakshmi, CGSC.
Mr. Zoheb Hossain, Mr. Vivek Gurnani, Ms. Abhipriya Rai, Mr. Vivek Gaurav, Mr. Kartik Sabharwal & Ms. Radhika Puri, Advs. for NFRA.
Mr. Kirtiman Singh, CGSC along with Mr. Waize Ali Noor, Mr. Varun Rajawat, Mr. Ranjeev Khatana and Mr. Varun P. Singh, Advs.

\+ W.P.(C) 11739/2021

RAVI BANSAL ..... Petitioner

Through: Mr. Jayant K. Mehta, Sr. Adv. with Ms. Nikita Sethi, Ms. Aayushi Kumar, Mr. Prateek Khanna, Mr. Ravneet Kaur Malik and Ms. Rumella Jain, Advs.

versus

UNION OF INDIA & ANR. ..... Respondents

Through: Ms. Shiva Lakshmi, CGSC.
Mr. Zoheb Hossain, Mr. Vivek Gurnani, Ms. Abhipriya Rai, Mr. Vivek Gaurav, Mr. Kartik

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Sabharwal & Ms. Radhika Puri, Advs. for NFRA.
Mr. Kirtiman Singh, CGSC along with Mr. Waize Ali Noor, Mr. Varun Rajawat, Mr. Ranjeev Khatana and Mr. Varun P. Singh, Advs.
Mr. Vikram Jetly, CGSC along with Mr. Abhigyan Siddhant, GP.

\+ W.P.(C) 11987/2022 & CM APPL. 35778/2022 (Interim Direction)

JAYESH GANDHI ..... Petitioner

Through: Mr. Jayant K. Mehta, Sr. Adv. with Ms. Nikita Sethi, Ms. Aayushi Kumar, Mr. Prateek Khanna, Mr. Ravneet Kaur Malik and Ms. Rumella Jain, Advs.

versus

UNION OF INDIA & ANR. ..... Respondents

Through: Mr. Vikram Jetly, CGSC along with, Mr. Abhigyam Siddhant, GP & Mr. Shreya Jetly, Adv. for UOI.
Mr. Zoheb Hossain, Mr. Vivek Gurnani, Ms. Abhipriya Rai, Mr. Vivek Gaurav, Mr. Kartik Sabharwal & Ms. Radhika Puri, Advs. for NFRA.

\+ W.P.(C) 1525/2020 & CM APPL. Nos. 10765/2020, 17182/2020 & 30097/2023

SHRENIK BAID ..... Petitioner

Through: Mr. Arun Kathpalia, Sr. Adv. with Ms. Misha Rohatgi Mohta

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and Mr. Amulya Upadhyay, Advs.

versus

UNION OF INDIA AND ANR ..... Respondents

Through: Ms. Shiva Lakshmi, CGSC.
Mr. Zoheb Hossain, Mr. Vivek Gurnani, Ms. Abhipriya Rai, Mr. Vivek Gaurav, Mr. Kartik Sabharwal & Ms. Radhika Puri, Advs. for NFRA.

\+ W.P.(C) 1650/2023 & CM APPL. 6296/2023 (Interim Direction)

NATRAJAN RAMKRISHNA ..... Petitioner

Through: Mr. Jayant K. Mehta, Sr. Adv. with Ms. Nikita Sethi, Ms. Aayushi Kumar, Mr. Prateek Khanna, Mr. Ravneet Kaur Malik and Ms. Rumella Jain, Advs.

versus

UNION OF INDIA & ANR. ..... Respondents

Through: Mr. Ravi Prakash, CGSC along with Ms. Astu Khandelwal, Mr. Taha Yasin, Mr. Ali Khan, Mr. Yasharth Shukla, Mr. Tarveen Singh Nanda, GP & Mr. Ayushman Kishore, Advs.
Mr. Zoheb Hossain, Mr. Vivek Gurnani, Ms. Abhipriya Rai, Mr. Vivek Gaurav, Mr. Kartik Sabharwal & Ms. Radhika Puri, Advs. for NFRA.

\+ W.P.(C) 2194/2023 & CM APPL. 8353/2023, 39638/2023 (Interim Direction)

ADARSH RANKA ..... Petitioner

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2025:DHC:716-DB

Through: Mr. Jayant K. Mehta, Sr. Adv. with Ms. Nikita Sethi, Ms. Aayushi Kumar, Mr. Prateek Khanna, Mr. Ravneet Kaur Malik and Ms. Rumella Jain, Advs.

versus

UNION OF INDIA & ORS. ..... Respondents

Through: Mr. Ravi Prakash, CGSC with Mr. Tarveen Singh Nanda, Adv. for Resp./ UOI

Mr. Zoheb Hossain, Mr. Vivek Gurnani, Ms. Abhipriya Rai, Mr. Vivek Gaurav, Mr. Kartik Sabharwal & Ms. Radhika Puri, Advs. for NFRA.

\+ W.P.(C) 5842/2023 & CM APPL. 22884/2023 (Stay), 40762/2023 (30 Days Delay in C.A.), CM No.63005/2023

SNEHAL N MUZOOMDAR ..... Petitioner

Through: Mr. Shivam Shukla & Ms. Anjali Upadhyay, Advs.

versus

UNION OF INDIA & ANR. ..... Respondents

Through: Ms. Shiva Lakshmi, CGSC for R-1.

Mr. Zoheb Hossain, Mr. Vivek Gurnani, Ms. Abhipriya Rai, Mr. Vivek Gaurav, Mr. Kartik Sabharwal & Ms. Radhika Puri, Advs. for NFRA.

Mr. Prashant Rawat, GP and Mr. Kabir Singh, Adv.

CORAM:
HON'BLE MR. JUSTICE YASHWANT VARMA
HON'BLE MR. JUSTICE DHARMESH SHARMA

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2025:DHC:716-DB

JUDGMENT

YASHWANT VARMA, J.

TABLE OF CONTENTS

Preface 8

Disciplinary Procedure as per the CA Act 12

Section 132 : A Legislative History 31

Broad Structure under the CA Act 96

NFRA Rules 109

Additional Disclosures by NFRA 116

Auditing Industry : Executive Deliberations 150

The Vicarious Liability Argument 171

Section 132 and its retroactive operation 232

NFRA Rules : Lack of Procedural Safeguards 322

Divisions : Separation of Functions 384

SCNs: The Scar of Pre-determination 437

Peripheral Issues 456

Statement of Conclusions 457

Disposition 474

PREFACE

1. This batch of writ petitions instituted by individual **Chartered**

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Signing Date:07.02.2025
18:46:26

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Accountants[1] as well as auditing firms assail the validity of Section 132(4) of the **Companies Act, 2013**[2]. A challenge is additionally raised to Rules 3, 8, 10 and 11 of the **National Financial Reporting Authority Rules**, **2018**[3].

2. For the purposes of the challenge which stands raised to the statutory provisions aforenoted, the petitioners seek a declaration that those provisions be struck down as being unconstitutional on the ground of being arbitrary and ultra vires. In the alternative, the petitioners seek an appropriate declaration to the effect that Section 132(4) of the Companies Act as well as Rules 3, 8 10 and 11 of the NFRA Rules be held not to apply to any audit completed before 01 October 2018. The prayer in the alternative essentially calls upon the Court to read down those provisions as being inapplicable to audits that may have been completed prior to the introduction of Section 132 in the Companies Act and thus avoid a declaration of invalidity being rendered.

3. The petitioners in this batch have individually impugned the notices issued by the **National Financial Regulatory Authority**[4] in terms of which proceedings were sought to be initiated by the respondent for commencement of disciplinary action in respect of perceived acts of "professional or other misconduct" and for consequential imposition of penalties. In some of the writ petitions, final orders of punishment including that of debarment had also come to be passed and which too have been impugned in the instant writ

[1] CAs
[2] Companies Act
[3] NFRA Rules
[4] NFRA

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petitions.

4. The challenge on the basis of constitutional invalidity is founded on a retroactive operation of Section 132 of the Companies Act and which is viewed as empowering the NFRA to initiate disciplinary proceedings not just against individual partners and CAs' but also auditing firms in respect of any audit that may have been conducted including those commenced and concluded prior to the introduction of that provision in the Companies Act.

5. Section 132 came to be incorporated in the Companies Act by virtue of Act 18 of 2013 and came to be operationalized in terms of a notification issued on 01 October 2018. In terms of that notification, the Union Government designated the said date as the point of commencement as well as the date of constitution of the NFRA. It is in the aforesaid backdrop that the petitioners contend that Section 132 and its retrospective operation would be rendered unconstitutional and invalid since it contemplates the imposition of penalties as well as disciplinary action in terms which were not contemplated by the statute prior to 01 October 2018. The challenge to Section 132 also proceeds on the ground of an alleged lack of procedural due process as well as the deprivation of rights and safeguards which were conferred upon a CA or a firm while facing disciplinary action under the **Chartered Accountants Act, 1949**[5] read along with the **Chartered Accountants Regulations, 1988**[6] and the **Chartered Accountants (Procedure of Investigations of Professional and Other**

[5] CA Act.
[6] 1988 Regulations

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Misconduct and Conduct of Cases) Rules, 2007[7].

6. The action of the respondents which stands impugned in this batch is also based on the various provisions contained in Section 132 itself as well as the NFRA Rules. This facet of the challenge is based on the petitioners arguing that in terms of the statutory provisions aforenoted, the NFRA is envisaged to discharge its functions and duties through various independent and separate "divisions". According to the writ petitioners, the statute itself envisages the functions of monitoring and enforcement of accounting standards, overseeing quality of service, suggesting measures, the power to investigate as well as to undertake disciplinary action is contemplated to be discharged by separate divisions of the NFRA. According to the writ petitioners, in the facts of these cases it is apparent that the body which oversaw the audits in question was the same which came to the conclusion that there was a failure to comply with accounting standards itself and initiated proceedings for taking disciplinary action. They thus contend that the very same body that had drawn a report on the basis of which the disciplinary proceedings are sought to be initiated and undertaken has essentially donned the role of both prosecutor and judge. This, according to the petitioners, is sufficient to hold the initiation of action as being in clear violation of fair and due process and in breach of Article 14 of the Constitution.

7. While we had concluded the hearing on this batch of writ petitions on 22 July 2024, the pronouncement of the present judgment was delayed primarily on account of written submissions being

[7] Rules 2007.

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Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

tendered by NFRA only on 06 October 2024. The Court was thereafter constrained to await any response that the petitioners may have wished to submit since those submissions were circulated amongst learned counsels for the petitioners only around that time.

DISCIPLINARY PROCEDURE AS PER THE CA ACT

8. Having noticed the principal grounds of challenge, it becomes appropriate to note that prior to the introduction of Section 132 of the 2013 Act, disciplinary proceedings against a CA was regulated by the provisions contained in the CA Act read along with the 1988 Regulations and the Misconduct Rules 2007. The CA Act incorporated provisions in Chapter V for the purposes of undertaking disciplinary proceedings against a member or a firm. Prior to certain amendments which were introduced in the CA Act in 2006 and 2022, disciplinary proceedings against a member of a firm were to be undertaken by a Disciplinary Directorate which was a body charged with undertaking a preliminary examination of a complaint, a Board of Discipline which was to try cases of professional or other misconduct specified in the First Schedule of the CA Act and the Disciplinary Committee in respect of members found to be guilty of professional or other misconduct mentioned in either the Second Schedule or both the First and the Second Schedules forming part of the CA Act, 1949.

9. By virtue of amendments which came to be ushered by Act 12 of 2022, various amendments came to be introduced in Sections 2 which also and alongside saw the introduction of Sections 21A and 21B in the CA Act. Act 12 of 2022 also introduced provisions pertaining to the registration of firms. As the provisions stood in the CA Act around the

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time when Section 132 came to be introduced, the Council as contemplated under Section 9 of the CA Act, stood empowered to establish a Disciplinary Directorate headed by an officer designated as the Director Discipline for undertaking investigations in respect of any information or complaint received by the Council. In terms of Section 21, the Director Discipline was firstly charged with analyzing the information or complaint and arrive at a prima facie opinion with respect to the alleged misconduct. Wherever a Director Discipline were to form the opinion that a member was guilty of any professional or other misconduct specified in the First Schedule, it was required to place the matter before the Board of Discipline. If the Director Discipline were to be of the opinion that the misconduct would be classifiable either in the Second Schedule or both the Schedules, it was obliged to place the matter before the Disciplinary Committee.

10. The Board of Discipline by virtue of Section 21A of the CA Act was to comprise of persons with experience in law and having knowledge of disciplinary matters, two members of which one would be a member of the Council elected by the said body itself and the other being a member nominated by the Union Government from amongst persons of eminence having experience in the field of law, economics, business, finance or accountancy. The Director Discipline in terms of Section 21A was to function as the Secretary of the Board of Discipline. By virtue of Section 21A(3), the Board of Discipline upon coming to the conclusion that a member was guilty of professional or other misconduct mentioned in the First Schedule, could impose one or more of the following punishments:-

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18:46:26

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A. Reprimand the member

B. Remove the name of the member from the Register

C. Impose such fine as it may think fit subject to the prescription of the fine not exceeding INR 1 lakh.

11. The Disciplinary Committee in terms of Section 21B was comprised of the President or the Vice President of the Council to act as the Presiding Officer and two members to be elected from amongst the members of the Council. The Disciplinary Committee was also envisaged to comprise of two members nominated by the Union Government from amongst persons of eminence having experience in the field of law, economics, business, finance or accountancy. It thus became a five-member body which upon coming to the conclusion that a member was guilty of professional or a misconduct mentioned in the Second Schedule or both the Schedules could proceed to take any one or more of the following actions namely:-

A. Reprimand the member

B. Remove the name of the member from the Register permanently or for such period as it may think fit

C. Impose such fine as deemed appropriate and which could extend to INR 5 lakhs.

12. Post promulgation of Act 12 of 2022, the Director Discipline came to be empowered by statute to undertake an investigation either suo moto or on receipt of information or complaint. In the course of undertaking that investigation, where the Director Discipline were to find that the case merited further inquiry, it was obliged to provide an

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18:46:26

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opportunity to the member or the firm as the case may be, to submit a written statement. Upon the Director Discipline finding prima facie that a case for professional or other misconduct mentioned in the First Schedule was made out, it was required to submit a preliminary examination report to the Board of Discipline. Similarly, if it came to the prima facie conclusion that a professional or other misconduct was found to be established and would fall either in the Second Schedule or both the Schedules, it was required to transmit its preliminary examination report to the Disciplinary Committee.

13. Section 21 further contemplated that if a Director Discipline were to come to form the opinion that no prima facie case was made out either against the member or the firm, it was required to transmit the complaint along with all relevant documents to the Board of Discipline and if that body were to concur with the findings of the Director Discipline, it could direct a closure of the proceedings. If it were to disagree and continue action upon the complaint itself, it could refer the matter either to the Disciplinary Committee or even advise the Director Discipline to undertake a further investigation. Sections 21A and 21B thus encapsulated the procedure which was liable to be adhered to by the Board of Discipline and the Disciplinary Committee while exercising their respective powers to undertake disciplinary action against a member of the firm.

14. Professional or other misconduct was defined in Section 22 of the CA Act which in turn bids one to proceed to the First and the Second Schedules which set out the various acts or omissions which would amount to misconduct. For purposes of lucidity, we deem it

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appropriate to extract Sections 21, 21A and 21B in the form of a comparative table and which captures how those set of provisions read prior to and after their substitution by Act 12 of 2022:-

Section	Pre-Amendment	Post-Amendment
S. 21	21. Disciplinary Directorate (1) The Council shall, by notification, establish a Disciplinary Directorate headed by an officer of the Institute designated as Director (Discipline) and such other employees for making investigations in respect of any information or complaint received by it. (2) On receipt of any information or complaint along with the prescribed fee, the Director (Discipline) shall arrive at a prima facie opinion on the occurrence of the alleged misconduct. (3) Where the Director (Discipline) is of the opinion that a member is guilty of any professional or other misconduct mentioned in the First Schedule*, he shall place the matter before the Board of Discipline and where the Director (Discipline) is of the opinion that a member is guilty of any professional or other misconduct mentioned in the Second Schedule** or in both the Schedules, he shall place the matter before the Disciplinary Committee. (4) In order to make investigations under the provisions of this Act, the Disciplinary Directorate shall follow such procedure as may be specified.	Disciplinary Directorate. (1) The Council shall, by notification, establish a Disciplinary Directorate consisting of a Director (Discipline), at least two Joint Directors (Discipline) not below the rank of Deputy Secretary of the Institute and such other employees appointed under Section 16, for making investigations either suo motu, or on receipt of an information or a complaint, in such form, along with such fees as may be specified. (2) Within thirty days of receipt of an information or a complaint, the Director (Discipline) shall decide in such manner as may be specified, whether a complaint or information is actionable or is liable to be closed as non-actionable: Provided that the Director (Discipline) may call for additional information from the complainant or the informant, as the case may be, by giving fifteen days time before deciding whether the case is actionable or non-actionable: Provided further that the recommendations of the Director (Discipline) on nonactionable complaints or information shall be submitted to the Board of

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18:46:26

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	(5) Where a complainant withdraws the complaint, the Director (Discipline) shall place such withdrawal before the Board of Discipline or, as the case may be, the Disciplinary Committee, and the said Board or Committee may, if it is of the view that the circumstances so warrant, permit the withdrawal at any stage.]	Discipline within sixty days of its receipt and the Board of Discipline may, after looking into its merits refer such complaint or information to the Director (Discipline) for conducting further investigation. (3) While making investigation into a case which is found to be actionable, the Director (Discipline) shall give an opportunity to the member or the firm, as the case may be, to submit a written statement within twenty-one days which may further be extended by another twenty-one days, for reasons to be recorded in writing. (4) Upon receipt of the written statement under sub-section (3), if any, the Director (Discipline) shall send a copy thereof to the complainant or the informant, as the case may be, and the complainant or the informant shall, within twenty-one days of the receipt of such written statement, submit his rejoinder. (5) Upon receipt of the written statement under sub-section (3) and rejoinder under sub-section (4), the Director (Discipline) shall submit a preliminary examination report within thirty days, if a prima facie case is made out against a member or a firm, as the case may be. (6) In case a prima facie case is made out for any professional or other misconduct mentioned in the First Schedule, the Director (Discipline) shall submit the preliminary examination report

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		to the Board of Discipline and where prima facie case is made out for any professional or other misconduct mentioned in the Second Schedule or in both the First Schedule and the Second Schedule, he shall submit a preliminary examination report to the Disciplinary Committee: Provided that a complaint or information filed by any authorised officer of the Central Government or a State Government or any statutory authority duly supported by an investigation report or relevant extract of the investigation report along with supporting evidence, shall be treated as preliminary examination report: Provided further that where no prima facie case is made out against the member or the firm, the Director (Discipline) shall submit such information or complaint with relevant documents to the Board of Discipline and the Board of Discipline may, if it agrees with the findings of the Director (Discipline), close the matter or in case of disagreement, itself proceed further or refer the matter to the Disciplinary Committee or advise the Director (Discipline) to further investigate the matter. (7) For the purpose of investigation under this Act, the Disciplinary Directorate shall follow such procedure as may be specified. (8) A complaint filed with the Disciplinary Directorate shall

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		not be withdrawn under any circumstances. (9) The status of actionable information and complaints pending before the Disciplinary Directorate, Boards of Discipline and Disciplinary Committees and the orders passed by the Boards of Discipline under Section 21-A and by the Disciplinary Committees under Section 21-B shall be made available in the public domain by the Disciplinary Directorate in such manner as may be prescribed.]
S.21A	1) The Council shall constitute a Board of Discipline consisting of– (a) a person with experience in law and having knowledge of disciplinary matters and the profession, to be its presiding officer; (b) two members one of whom shall be a member of the Council elected by the Council and the other member shall be nominated by the Central Government from amongst the persons of eminence having experience in the field of law, economics, business, finance or accountancy; (c) the Director (Discipline) shall function as the Secretary of the Board. (2) The Board of Discipline shall follow summary disposal procedure in dealing with all cases before it. (3) Where the Board of Discipline is of the opinion that a member is guilty of a professional or other misconduct mentioned in the First	Board of Discipline.—(1) The Council shall, by notification, constitute one or more Boards of Discipline, each consisting of— (a) a person, not being a member of the Institute, with experience in law and having knowledge of disciplinary matters and the profession, to be nominated by the Central Government as its Presiding Officer, from out of a panel of persons prepared and provided by the Council in such manner as may be prescribed; (b) one member, who is a person of eminence having experience in the field of law, economics, business, finance or accountancy and not being a member of the Institute, to be nominated by the Central Government from out of a panel of persons prepared and provided by the Council in such manner as may be prescribed; (c) one member to be nominated by the Council from out of a panel of members of the Institute

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Signing Date:07.02.2025
18:46:26

	Schedule, it shall afford to the member an opportunity of being heard before making any order against him and may thereafter take any one or more of the following actions, namely :– (a) reprimand the member; (b) remove the name of the member from the Register up to a period of three months; (c) impose such fine as it may think fit which may extend to rupees one lakh. (4) The Director (Discipline) shall submit before the Board of Discipline all information and complaints where he is of the opinion that there is no prima facie case and the Board of Discipline may, if it agrees with the opinion of the Director (Discipline), close the matter or in case of disagreement, may advise the Director (Discipline) to further investigate the matter.	to be prepared by the Council, in such manner as may be prescribed; (d) an officer of the Institute not below the rank of a Deputy Secretary shall function as the Secretary of the Board of Discipline: Provided that the Presiding Officer nominated under clause (a) and the member nominated under clause (b) may be the same for different Boards of Discipline constituted under this sub-section. (2) The Board of Discipline shall, while considering the cases placed before it, follow such procedure including faceless proceedings and virtual hearings as may be specified. (3) The Board of Discipline shall, on receipt of preliminary examination report from Director (Discipline), require the member or the firm, as the case may be, against whom such preliminary examination report has been filed, to submit a written statement within twenty-one days which may further be extended by another twenty one days, in exceptional circumstances, for reasons to be recorded in writing. (4) The Board of Discipline shall conclude its inquiry within ninety days of the receipt of preliminary examination report from the Director (Discipline). (5) Upon inquiry, if the Board of Discipline finds that such member is guilty of a

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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		professional or other misconduct mentioned in the First Schedule, it may pass an order within thirty days of such finding, after providing an opportunity of being heard to the member, taking any one or more of the following actions, namely— (a) reprimand the member and record it in the Register of members; (b) remove the name of the member or members from the Register of members up to a period of six months; (c) impose such fine as it may think fit which may extend to two lakh rupees. (6) Where on the basis of evidence brought on record or during the course of an inquiry pertaining to a member, the Board of Discipline is of the opinion that any such member who is a partner or owner of a firm, has been repeatedly found guilty of misconduct mentioned in the First Schedule during the last five years, the following action may also be taken against such firm, namely— (a) prohibit the firm from undertaking any activity or activities relating to the profession of a chartered accountant in practice for such period not exceeding one year; or (b) impose such fine as it may think fit, which may extend to twenty-five lakh rupees. (7) Where a member or a firm fails to pay the fine imposed

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

		under sub-section (5) or sub-section (6) within such time as may be specified, the Council shall remove the name of such member or firm from the Register of members or Register of firms, as the case may be, for such period as it may think fit. (8) The Presiding Officer and members of the Board of Discipline shall be paid such allowances as may be prescribed.]
S. 21B	(1) The Council shall constitute a Disciplinary Committee consisting of the President or the Vice-President of the Council as the Presiding Officer and two members to be elected from amongst the members of the Council and two members to be nominated by the Central Government from amongst the persons of eminence having experience in the field of law, economics, business, finance or accountancy: Provided that the Council may constitute more Disciplinary Committees as and when it considers necessary. (2) The Disciplinary Committee, while considering the cases placed before it shall follow such procedure as may be specified. (3) Where the Disciplinary Committee is of the opinion that a member is guilty of a professional or other misconduct mentioned in the Second Schedule or both the First Schedule and the Second Schedule, it shall afford to the	(1) The Council shall, by notification, constitute one or more Disciplinary Committees, each consisting of— (a) a person, not being a member of the Institute, with experience in law and having knowledge of disciplinary matters and the profession, to be nominated by the Central Government as its Presiding Officer, from out of a panel of persons prepared and provided by the Council in such manner as may be prescribed; (b) two members, who are persons of eminence having experience in the field of law, economics, business, finance or accountancy and not being a member of the Institute, to be nominated by the Central Government from out of a panel of persons prepared and provided by the Council in such manner as may be prescribed; (c) two members to be nominated by the Council from out of a panel of members of the Institute to be prepared by the Council in such manner as may

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

	member an opportunity of being heard before making any order against him and may thereafter take any one or more of the following actions, namely :− (a) reprimand the member; (b) remove the name of the member from the Register permanently or for such period, as it thinks fit; (c) impose such fine as it may think fit, which may extend to rupees five lakhs. (4) The allowances payable to the members nominated by the Central Government shall be such as may be specified.	be prescribed: Provided that the Presiding Officer nominated under clause (a) and the members nominated under clause (b) may be the same for different Disciplinary Committees constituted under this sub-section. (2) The Disciplinary Committee shall, while considering the cases placed before it, follow such procedure including faceless proceedings and virtual hearings as may be specified. (3) The Disciplinary Committee shall, on receipt of preliminary examination report from Director (Discipline), require the member or the firm, as the case may be, against whom such preliminary examination report has been filed, to submit a written statement within twenty-one days, which may further be extended by another twenty-one days in exceptional circumstances, for reasons to be recorded in writing. (4) The Disciplinary Committee shall conclude its inquiry within one hundred and eighty days of receipt of the preliminary examination report from the Director (Discipline). (5) Upon inquiry, if the Disciplinary Committee finds that a member is guilty of a professional or other misconduct mentioned in the Second Schedule or in both the First Schedule and the Second Schedule, it may pass an order within thirty days of such a finding, after providing an

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

		opportunity of being heard to the member, taking any one or more of the following actions, namely— (a) reprimand the member and record it in the Register of members; or (b) remove the name of the member from the Register of members permanently or for such period, as it may think fit; or (c) impose such fine as it may think fit, which may extend to ten lakh rupees. (6) Where on the basis of evidence brought on record or during the course of an inquiry pertaining to a member, the Disciplinary Committee is of the opinion that any such member, who is a partner or owner of a firm has been repeatedly found guilty of misconduct mentioned in the Second Schedule or in both the First Schedule and the Second Schedule, during the last five years, the following actions may also be taken against such firm, namely— (a) prohibit the firm from undertaking any activity or activities relating to the profession of a chartered accountant in practice for such period not exceeding two years; or (b) suspend or cancel the registration of the firm and remove its name from the Register of firms permanently or for such period as it may think fit; or

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

		(c) impose such fine as it may think fit, which may extend to fifty lakh rupees. (7) Where a member or a firm fails to pay the fine imposed under sub-section (5) or sub-section (6) within the specified time, the Council shall remove the name of such member or firm from the Register of members or Register of firms, as the case may be, for such period, as it may think fit. (8) The Presiding Officer and members of the Disciplinary Committee shall be paid such allowances as may be prescribed.]

15. At this juncture we deem it apposite to note that even though the amendments came to be introduced vide Sections 21, 22 and 23 of the Act No. 12 of 2022, however the same have not been notified till date. In this regard, reference may be made to Notification dated 10 May 2022 and which reads as under:-

> "**S.O. 2184(E).—**In exercise of the powers conferred by sub-section (2) of section 1 of the Chartered Accountants, the Cost and Works Accountants and the Company Secretaries (Amendment) Act, 2022 (12 of 2022), the Central Government hereby appoints the 10th day of May, 2022, as the date on which the following provisions of the said Act shall come into force, namely:-
>
> | SI. No. | Provisions |
> |---|---|
> | 1. | Sections 1 to 15 (both inclusive). |
> | 2. | Section 16 [except clause (i)]. |
> | 3. | Sections 17 to 19 (both inclusive). |
> | 4. | Section 24. |
> | 5. | Sections 28 to 35 (both inclusive). |
> | 6. | Section 36 [except clause (i)]. |
> | 7. | Section 37 [except clause (i) & (ii)]. |
> | 8. | Sections 38 to 50 (both inclusive). |

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

9.	Section 51 [except clause (i)].
10.	Sections 52 to 54 (both inclusive).
11.	Sections 59.
12.	Sections 63 to 71 (both inclusive).
13.	Sections 74 to 83 (both inclusive).
14.	Section 84 [except clause (i)].
15.	Sections 85 to 87 (both inclusive).
16.	Sections 92.
17.	Sections 96 to 104 (both inclusive).

[F. No. 12/11/2019-PI]
INDER DEEP SINGH DHARIWAL,
Jt. Secy.

A look at the official website of the Ministry of Corporate Affairs shows that no further notifications have been issued with respect to Act No. 12 of 2022.

16. Of equal significance are the First and Second Schedules of the CA Act which specify with sufficient clarity and precision acts that would amount to professional or other misconduct. Those Schedules are reproduced hereinbelow: -

"SCHEDULE I

Part I

Professional misconduct in relation to chartered accountants in practice

A chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he—

(1) allows any person to practice in his name as a chartered accountant unless such person is also a chartered accountant in practice and is in partnership with or employed by him;

(2) pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner, or a member of any other professional body or with such other persons having such qualifications as may be

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

prescribed, for the purpose of rendering such professional services from time to time in or outside India.

Explanation.—In this item, "partner" includes a person residing outside India with whom a chartered accountant in practice has entered into partnership which is not in contravention of Item (4) of this Part;

(3) accepts or agrees to accept any part of the profits of the professional work of a person who is not a member of the Institute:

Provided that nothing herein contained shall be construed as prohibiting a member from entering into profit sharing or other similar arrangements, including receiving any share, commission or brokerage in the fees, with a member of such professional body or other person having qualifications, as is referred to in Item (2) of this Part;

(4) enters into partnership, in or outside India, with any person other than a chartered accountant in practice or such other person who is a member of any other professional body having such qualifications as may be prescribed, including a resident who but for his residence abroad would be entitled to be registered as a member under clause (v) of sub-section (1) of Section 4 or whose qualifications are recognised by the Central Government or the Council for the purpose of permitting such partnerships;

(5) secures, either through the services of a person who is not an employee of such chartered accountant or who is not his partner or by means which are not open to a chartered accountant, any professional business:

Provided that nothing herein contained shall be construed as prohibiting any arrangement permitted in terms of Items (2), (3) and (4) of this Part;

(6) solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means:

Provided that nothing herein contained shall be construed as preventing or prohibiting—

(i) any chartered accountant from applying or requesting for or inviting or securing professional work from another chartered accountant in practice; or

(ii) a member from responding to tenders or enquiries issued by various users of professional services or organisations from time to time and securing professional work as a consequence;

(7) advertises his professional attainments or services, or uses any

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

designation or expressions other than chartered accountant on professional documents, visiting cards, letter heads or sign boards, unless it be a degree of a University established by law in India or recognised by the Central Government or a title indicating membership of the Institute of Chartered Accountants of India or of any other institution that has been recognised by the Central Government or may be recognised by the Council:

Provided that a member in practice may advertise through a write up, setting out the services provided by him or his firm and particulars of his firm subject to such guidelines as may be issued by the Council;

(8) accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been issued certificate under the Restricted Certificate Rules, 1932 without first communicating with him in writing;

(9) accepts an appointment an auditor of a company without first ascertaining from it whether the requirements of Section 225 of the Companies Act, 1956 (1 of 1956) [or Sections 139 to 141 of the Companies Act, 2013 (18 of 2013) or any other law pertaining to appointment of auditors for the time being in force] in respect of such appointment have been duly complied with;

(10) charges or offers to charge, accepts or offers to accept in respect of any professional employment, fees which are based on a percentage of profits or which are contingent upon the findings, or results of such employment, except as permitted under any regulation made under this Act;

(11) engages in any business or occupation other than the profession of chartered accountant unless permitted by the Council so to engage:

Provided that nothing contained herein shall disentitle a chartered accountant from being a director of a company (not being a managing director or a wholetime director) unless he or any of his partners is interested in such company as an auditor;

(12) allows a person not being a member of the Institute in practice, or a member not being his partner to sign on his behalf or on behalf of his firm, any balance-sheet, profit and loss account, report or financial statements.

Part II

Professional misconduct in relation to members of the Institute in service

A member of the Institute (other than a member in practice) shall be deemed to be guilty of professional misconduct, if he being an

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

employee of any company, firm or person—

(1) pays or allows or agrees to pay directly or indirectly to any person any share in the emoluments of the employment undertaken by him;

(2) accepts or agrees to accept any part of fees, profits or gains from a lawyer, a chartered accountant or broker engaged by such company, firm or person or agent or customer of such company, firm or person by way of commission or gratification.

Part III

Professional misconduct in relation to members of the Institute generally

A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he—

(1) not being a fellow of the Institute, acts as a fellow of the Institute;

(2) does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority;

(3) while inviting professional work from another chartered accountant or while responding to tenders or enquiries or while advertising through a write up or anything as provided for in Items (6) and (7) of Part I of this Schedule, gives information knowing it to be false.

Part IV

Other misconduct in relation to members of the Institute generally

A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he—

(1) is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term not exceeding six months;

(2) in the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work.]

SCHEDULE II

Part I

Professional misconduct in relation to chartered accountants in practice

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

A chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he—

(1) discloses information acquired in the course of his professional engagement to any person other than his client so engaging him, without the consent of his client or otherwise than as required by any law for the time being in force;

(2) certifies or submits in his name, or in the name of his firm, a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by a partner or an employee in his firm or by another chartered accountant in practice;

(3) permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in a manner which may lead to the [belief that he or his firm] vouches for the accuracy of the forecast;

(4) expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest;

(5) 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;

(6) fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity;

(7) does not exercise due diligence, or is grossly negligent in the conduct of his professional duties;

(8) 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;

(9) fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances;

(10) fails to keep moneys of his client other than fees or remuneration or money meant to be expended in a separate banking account or to use such moneys for purposes for which they are intended within a reasonable time.

Part II

Professional misconduct in relation to members of the Institute generally

A member of the Institute, whether in practice or not, shall be

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

deemed to be guilty of professional misconduct, if he—

(1) contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council;

(2) being an employee of any company, firm or person, discloses confidential information acquired in the course of his employment except as and when required by any law for the time being in force or except as permitted by the employer;

(3) includes in any information, statement, return or form to be submitted to the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority any particulars knowing them to be false;

(4) defalcates or embezzles moneys received in his professional capacity.

[(5) acts as an auditor of the company in contravention of the provisions of the Companies Act, 2013 (18 of 2013).]

Part III

Other misconduct in relation to members of the Institute generally

A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional other misconduct, if he is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term exceeding six months."

SECTION 132 : A LEGISLATIVE HISTORY

17. For the purposes of appreciating the challenge that stands raised as also to understand the imperatives which informed the introduction of Section 132, it would be apposite to step back in point of time and refer to some of the executive and legislative deliberations which preceded the incorporation of that section in the statute book. In terms of the disclosures that are made by NFRA in these proceedings, it would appear that the Union Government had for some time been contemplating the setting up and establishment of an appropriate regulatory mechanism to ensure monitoring and compliance of accounting and auditing standards as well as to oversee the quality of

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

service rendered by professionals associated with compliance.

18. The first of those steps can be traced back to the introduction of Section 210A in the Companies Act, 1956 which empowered the Union Government to constitute the **National Advisory Committee on Accounting Standards**[8] to advise it on the formulation and laying down of accounting policies and standards for companies or classes of companies. Section 210A as it stood in the erstwhile companies legislation is reproduced hereinbelow: -

> **"210A - Constitution of National Advisory Committee on Accounting Standards**
>
> (1) The Central Government may, by notification in the Official Gazette, constitute an Advisory Committee to be called the National Advisory Committee on Accounting Standards (hereafter in this section referred to as the "Advisory Committee") to advise the Central Government on the formulation and laying down of accounting policies and accounting standards for adoption by companies or class of companies under this Act.
>
> (2) The Advisory Committee shall consist of the following members, namely:-
>
> (a) a Chairperson who shall be a person of eminence well-versed in accountancy, finance, business administration, business law, economics or similar discipline;
>
> (b) one member each nominated by the Institute of Chartered Accountants of India constituted under the Chartered Accountants Act, 1949 (38 of 1949), the Institute of Cost and Works Accountants of India constituted under the Cost and Works Accountants Act, 1959 (23 of 1959) and the Institute of Company Secretaries of India constituted under the Company Secretaries Act, 1980 (56 of 1980);
>
> (c) one representative of the Central Government to be nominated by it;
>
> (d) one representative of the Reserve Bank of India to be nominated by it;
>
> (e) one representative of the Comptroller and Auditor-General of

[8] NACAS

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

India to be nominated by him;

(f) a person who holds or has held the office of professor in accountancy, finance or business management in any university or deemed university;

(g) the Chairman of the Central Board of Direct Taxes constituted under the Central Boards of Revenue Act, 1963 (54 of 1963) or his nominee;

(h) two members to represent the chambers of commerce and industry to be nominated by the Central Government; and

(i) one representative of the Securities and Exchange Board of India to be nominated by it.

(3) The Advisory Committee shall give its recommendations to the Central Government on such matters of accounting policies and standards and auditing as may be referred to it for advice from time to time.

(4) The members of the Advisory Committee shall hold office for such term as may be determined by the Central Government at the time of their appointment and any vacancy in the membership in the Committee shall be filled by the Central Government in the same manner as the member whose vacancy occurred was filled.

(5) The non-official member of the Advisory Committee shall be entitled to such fees, travelling, conveyance and other allowances as are admissible to the officers of the Central Government of the highest rank.]"

19. The Standing Committee of Parliament on Finance in its 21st Report while commenting upon the Companies Bill, 2009 made the following significant recommendations:-

"(F) Role of Auditors :-

34. Suggestions have been received by the Committee that there is a need to make provisions relating to Audit and Auditors more stringent such as following :-

(a) The clause should specifically prohibit offer of non-audit services both 'directly as well as indirectly'. The term 'directly as well as indirectly' may also be suitably defined in the Bill

(b) The prohibition proposed in the clause should be not only for the audit client company but also for the holding company, subsidiary company and associate company of the audit client company

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(c) A residual clause may be inserted to provide 'any other kind of consultancy services' to take care of any non-audit services not covered in already provided clauses.

(d) Suitable penalty may be provided in case of contravention of these provisions.

(e) (i) Clause 123(10) of the Bill empowers the Tribunal, if it is satisfied that the auditor of a company has acted in a fraudulent manner or abetted/colluded in any fraud, to direct the company to change its auditors. Suggestions have been made that these provisions should be modified to clarify to cover act of fraud or abetment by auditor whether directly or indirectly. It has also been suggested that the Bill may provide that if auditor, whether individual or firm, against whom an order has been passed by the Tribunal under this clause should not be eligible to be appointed as an auditor of any company for a period of five years.

(f) (i) This clause provides for disqualification of an auditor in case he has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed. Suggestions have been received that this clause may also be modified to cover such relationship whether 'directly or indirectly' to prevent any misuse of these provisions by the auditors.

(g) (i) At present as per provisions of section 210A of the Companies Act, 1956, the National Advisory Committee on Accounting Standards (NACAS) has the mandate to recommend/advise the Central Government on the formulation and laying down of accounting policies and accounting standards for adoption by companies or class of companies.

(ii) The Companies Bill, 2009 has sought to enhance the role of NACAS. The Bill (Clause 118) empowers NACAS to make recommendations to the Central Government both on accounting standards as well as auditing standards. It has also been proposed in the Bill to change the title of this Committee to National Advisory Committee on Accounting and Auditing Standards (NACAAS).

(iii) Suggestions have been received expressing that in view of economic challenges being faced by many countries across the globe and failure of some of big companies in recent past casting a doubt on the role of management and auditors, there is a need to promote an independent regulatory regime which may have the power to:-

(a) recommend the standards to the Government for:

(A) corporate financial reporting,

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

(B) corporate audit and

(C) quality of service of professionals associated with ensuring compliance with such

standards;

(b) oversee, monitor and supervise the bodies involved in setting standards mentioned in (a) above;

(iv) It has also been suggested that the responsibility for setting financial reporting standards and auditing standards and monitoring their strict compliance should rest with the Government or a statutory authority set up by the Government. It has been expressed that setting up of such a regulatory Body would ensure healthy functioning of corporate sector, particularly in respect of financial reporting, audit and quality of service by the relevant professionals, eventually benefitting the business, investors, employees, and other stakeholders and enhance the country's economic strength in competitive international markets."

35. On being asked, the Ministry examined the afore-said suggestions in detail, particularly in the light of provisions of clause 118 of the Bill, which seeks to provide for widening the role of NACAAS (established at present under section 210A of the Companies Act) to recommend both accounting as well as auditing standards. The Ministry, while agreeing to the different suggestions, have submitted as follows :

"It may also be useful to consider giving of regulatory powers to NACAAS at appropriate stage to enforce the compliance with standards in respect of matters, after they are notified under the Companies Bill/Act and also for overseeing and monitoring the bodies involved in setting relevant standards, including on the quality of services of members of such bodies."

36. The Ministry have also suggested in this regard that :

"The Central Government should have the power to constitute the NACAAS, provide for manner of appointment, selection and nomination etc of members of NACAAS by way of making suitable rules."

37. The Committee acknowledge the Ministry's acceptance of the Committee's views and suggestions for ensuring independence of auditors, providing safeguards to retain credibility of the audit process and creation of a supervisory mechanism for this purpose. The Committee would recommend that the proposed body namely, NACAAS would be given sufficient mandate not only to set and oversee auditing and accounting standards, but also to monitor the quality of audit

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> **undertaken across the corporate sector. It should, therefore, be manned by professionals. Its role may be expanded depending upon experience gained.**"

20. The need to sufficiently empower the NACAS also appears to have formed the subject matter of consideration of that Committee as would be evident from the following extracts of the 57th Report of the Standing Committee on Finance (2011-12):-

> "(c) National Advisory Committee on Accounting and Auditing Standards (NACAAS) proposed to be renamed as National Financial Reporting Authority (NFRA) with a mandate to ensure monitoring and compliance of accounting and auditing standards and to oversee quality of service of professionals associated with compliance.
>
> The Authority shall consider the International Financial Reporting Standards and other internationally accepted accounting and auditing policies and standards while making recommendations on such matters to the Central Government which will improve the competitiveness of our companies with other companies. The Authority is also proposed to be empowered with quasi judicial powers to ensure independent oversight over professionals."

21. The then Hon'ble Minister of State in the Ministry of Corporate Affairs in the course of discussion which ensued in the Lok Sabha, which was considering the motion for passing of the Companies Bill, 2011, explained the proposed mandate of the NFRA as follows:-

> "NFRA is the authority that will have foresight over the monitoring, quality and service of Chartered Accountants and will take strict action against professional misconduct. NFRA will be a quasi-judicial body and the purpose will be to harmonize the global best practices so that people have confidence in the accounting systems and accounting standards in India. NFRA, I hope, will also go a long way and make assure that there is transparency in all the accounting work that we do here."

22. However, the NFRA as a regulatory body, did not come into being until much later. From the material that has been placed for our

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

consideration, it further transpires that comments with respect to the proposed conferment of disciplinary power upon the NFRA were also sought from the **Institute of Chartered Accountants of India**[9]. The ICAI appears to have expressed various reservations with respect to such a power being vested in the NFRA. The comments of the ICAI appear to have been duly examined by the Companies Law Committee which had been set up by the Ministry of Corporate Affairs in June 2015 and which in its report submitted on 1 February 2016 observed as under:-

> "3.19. The Institute of Chartered Accountants of India (ICAI) have expressed their reservations over the constitution of NFRA as follows:
>
> **a) Multiple Regulatory Bodies**: Creating NFRA would result in two regulatory bodies (ICAI and NFRA) governing the same audit profession. This would result in duplication of efforts, added huge costs with no significant incremental benefits. This would also change the self-regulated profession to an externally regulated body.
>
> **b) The ICAI Context**: NFRA might seem necessary to ensure that standard setting and enforcement are not carried out by the same body (ICAI). However, it would be pertinent to mention that the ICAI, has been created by an Act of Parliament for this specific dual role (like SEBI).
>
> The constitution of NFRA needs to be re-examined in the mentioned contexts where relevant mechanisms and units have been enabled by and/or within the ICAI organisation to deliver the twin objectives of robust policy making and unbiased enforcement in a timely manner.
>
> **c) Relevance of NFRA in the context of the Companies Act 2013**: The objective of NFRA is to regulate audit quality and protect public interest. These, in any case, are also the main objectives of ICAI which strives to be a world class regulator. It is pertinent to note that the new Companies Act 2013 has significantly enhanced provisions, pertaining to Accounts, Audit and Corporate Governance which can deliver the above objectives very well.

[9] ICAI

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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Specific aspects to regulate audit quality include integration of financial statement reporting with Internal Financial Controls, restrictions on auditors rendering conflicting services, audit rotation, audit limits and penalties on the audit profession have been included in the new Act. Similarly entity level discipline is sought to be enhanced by significant controls over related party transactions, acceptance of deposits, code of independent directors, mandatory internal audits for large enterprises, enhanced board responsibility etc. These controls enshrined in the Act, in addition to the efforts of ICAI will enable higher audit quality especially for public interest entities. Incremental benefits by creating NFRA need to be reexamined before notification of Section 132.

d) Auditing Standards: ICAI as a world class regulator would be more aligned to market needs, international practices and risks to be able to define and improve Auditing standards rather than NFRA.

e) Disciplinary Mechanism: The Disciplinary Committee of ICAI normally completes the process in a reasonable period of about three to four years.

f) International benchmarks: The Public Companies Accounting Oversight Board (PCAOB) of the US may be regarded as a possible closely comparable body to NFRA, if notified. It is relevant to note that PCAOB has evoked mixed responses in its ability to improve audit quality. The PCAOB budget for 2016 is estimated at $250 million and is enabled by 750 audit staff. The Challenges of availability of trained and qualified audit staff and the cost thereof may need to be appreciated ahead of the decision to notify NFRA.

g) NFRA reporting and market perception: As a regulatory oversight body, it would be incumbent on NFRA to share their findings, at least in part, on their audits to the public. A particular issue would be on the ability and maturity of stakeholders and markets to distinguish between audit defects as identified by NFRA (highly likely) and a total audit failures (less likely).

h) Uniform administration: Scale based differentiation of regulating authority may result in conflicting judgements on the same issue. Seamless coordination may always not be possible between NFRA and ICAI due to the multiplicity of disciplinary issues that may be handled by both agencies.

i) Challenges in adjudication : The setting up and managing a standard setting, review and quasi-judicial authority requires sustained effort on timely availability of adequate competent personnel which may be a challenge for NFRA.

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

3.20. Further ICAI offered their following suggestions on the above:-

"The years commencing 2015 are vastly different for the auditing profession in terms of the perception of the auditor's roles and responsibilities. Additionally, the CA fraternity is in the process of coping with new changes such as penalties, rotation, restricted services, Internal Financial Controls over Financial Reporting and other aspects imposed by the Companies Act. The profession would, rightly, need some more time to understand and assess the expectations of a NFRA regime which, in our view shall not be notified.

The ICAI has sufficient regulatory, supervisory, organisational and budgetary independence as regards the audit profession although we both a standard setter and a regulator. We would continue to discharge our obligations to ensure the highest standards of audit quality as well as to protect public interest."

23. The proposed introduction of Section 132 again formed subject matter of consideration of the Standing Committee on Finance which in its 37th Report observed as follows:-

"3.18. Sec 132 of the Act provides for the creation of National Financial Reporting Authority (NFRI) for matters relating to accounting and auditing standards under the Act. However this section is yet to be notified

The key functions of NFRA as envisaged by the Act include:

• Recommendations to the Central Government on the formulation and laying down of accounting and auditing policies and standards for adoption by companies or their auditors.

• Monitor and enforce the compliance with accounting standards and auditing standards in such manner as may be prescribed.

• Oversee the quality of service of the professions associated with ensuring compliance with such standards, and suggest measures required for improvement in quality of service and such other related matters as may be prescribed.

• Have the power to investigate, either suo motu or on a reference made to it by the Central Government, for specified class of bodies corporate or persons, into the matters of professional or other misconduct committed by any member or firm of Chartered accountants."

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

24. In terms of a Press Release which thereafter came to be issued on 01 March 2018, the Union Cabinet is stated to have approved the establishment of the NFRA. This was followed by a notification dated 21 March 2018 in terms of which sub-section (3) and (11) of Section 132 came to be enforced. The delay in the constitution of the NFRA also appears to have formed the subject matter of debate and discussion in the Lok Sabha in its proceedings which were held on 23 March 2018. This becomes apparent from the consideration of the discussion surrounding question no. 4799. Similar queries were raised in the Rajya Sabha on 03 April 2018. Responding to the questions so raised, the then Minister of Corporate Affairs made the following statement:-

> "(a) to (c):- Section 132 of the Companies Act, 2013 (Act) provides for setting up of National Financial Reporting Authority (NFRA). The draft rules w.r.t. such section were prepared and public consultation was done during 2013-14 alongwith various other rules being considered under Companies Act, 2013 at that stage. In view of reservations and apprehensions expressed by the Institute of Chartered Accountants of India (ICAI), it was decided to establish such body after examining/addressing relevant issues including through consultation with ICAI. The matter was also considered by Companies Law Committee set up during June 2015 which submitted its report in February 2016 and The Hon'ble Standing Committee on finance (which examined the Companies (Amendment) Bill, 2016). After due examination and necessary approvals, the Government has approved the proposal for establishment of National Financial Reporting Authority (NFRA) and creation of one post of Chairperson, three posts of full-time Members and one post of Secretary for NFRA on 28th February, 2018. The Provisions of subsection (3) and (11) of section 132 of the Act have been brought into force w.e.f. 21.03.2018 alongwith NFRA (Manner of appointment and other Terms and Conditions of Service of Chairperson and Members) Rules, 2018."

It was thereafter on 01 October 2018 that the NFRA came to be finally constituted.

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

25. Of significant importance is the judgment rendered by the Supreme Court in **S. Sukumar vs. The Secretary, Institute of Chartered Accountants of India**[10] wherein the following directions were passed: -

> "The Union of India may constitute a three-member Committee of experts to look into the question whether and to what extent the statutory framework to enforce the letter and spirit of Sections 25 and 29 of the CA Act and the statutory Code of Conduct for the CAs requires revisit so as to appropriately discipline and regulate MAFs. The Committee may also consider the need for an appropriate legislation on the pattern of Sarbanes Oxley Act, 2002 and Dodd Frank Wall Street Reform and Consumer Protection Act, 2010 in US or any other appropriate mechanism for oversight of profession of the auditors. Question whether on account of conflict of interest of auditors with consultants, the auditors profession may need an exclusive oversight body may be examined. The Committee may examine the Study Group and the Expert Group Reports referred to above, apart from any other material. It may also consider steps for effective enforcement of the provisions of the FDI policy and the FEMA Regulations referred to above. It may identify the remedial measures which may then be considered by appropriate authorities. The Committee may call for suggestions from all concerned. Such Committee may be constituted within two months. Report of the Committee may be submitted within three months thereafter. The UOI may take further action after due consideration of such report."

26. That takes us to the report of the **Committee of Experts**[11] which came to be constituted by the Ministry of Finance pursuant to the aforenoted direction in *S. Sukumar.* That report which came to be submitted on 25 October 2018 includes the following instructive passages with respect to the imperative need for the constitution of an independent audit regulator as well as the global trend of audit regulation and oversight being no longer tethered to peer review: -

> "Auditors are to resolve agency problems. Moreover, independent

[10] (2018) 14 SCC 360
[11] COE

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

audits are fundamental to taking informed and correct investment decisions. Availability of trustworthy financial information on the performance of companies is important to proper functioning of market economy. Serious concerns arise if auditors' independence is compromised, or the trust reposed on them is betrayed.

Determining whether an auditor is independent in fact as well as in appearance is complex. This is especially so because audit firms across jurisdictions often provide services as part of one common `network'. Consequently, separate firms belonging to the same network could provide audit as well as non-audit services to the same audit client or its holding company or subsidiaries across the same or different countries. This can give rise to the problem of conflict of interest where independence of the auditor may be compromised. Therefore, measures like sufficient disclosure on total fees, imposing cap on non-audit fees from the audit client, revisiting the scope of prohibited non-audit services are needed to address the issue of conflict of interest, especially at the network level.

These networking arrangements also create an impression that the Indian audit firms which are affiliated with these international networks constitute Multi- national Accounting Firms (MAFs). However, on closer scrutiny it turns out that these Indian audit firms are set up as partnerships or Limited Liability Partnerships (LLPs) under Indian laws and all their partners are members of the ICAI. Therefore, there is neither any violation of section 29 (reciprocity) nor any violation of section 25 (companies not to engage in accountancy) of the Chartered Accountants Act, 1949. Neither can such Indian audit firms simply be equated to multi-national corporations. Consequently, the term `MAF' is a misnomer.

However, such Indian audit firms admittedly follow various internal processes, policies and methodology adopted by their respective networks internationally. This is aimed at maintaining consistent standards in audit quality globally within a network. While such networks bring better business opportunities in a global economy, they should be subject to necessary checks and balances.

Legal measures need to be supplemented with adequate institutional reforms. Time and again corporate scandals and accounting frauds have nudged institutional reforms across jurisdictions. One such fundamental reform that has happened globally in the last two decades is a shift away from the Self-Regulatory Organisation (SRO) model towards an independent regulatory structure for the audit profession.

In the aftermath of *Enron*, the U.S. enacted the *Sarbanes Oxley Act*,

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

2002. The Supreme Court in its judgment dated February 23, 2018 has referred to this statute to examine the need of an oversight mechanism for the audit profession. This law inter alia provided for the setting up of the Public Company Accounting Oversight Board (PCAOB) as an independent audit regulator to oversee the audits of public companies. Similarly, U.K., also has a two-tier structure, where the Financial Reporting Council (FRC) is the independent regulator for the audit profession.

In the Indian context, the Satyam incident has been a wake-up call for policy- makers. Pursuant to the global trend of shift from SRO model to an independent regulatory model for audit profession, the Companies Act, 2013 provided for the setting up of the National Financial Reporting Authority (NFRA).

However, the continued opposition to the establishment of NFRA has delayed the implementation of this critical reform. Consequently, although Companies Act, 2013 was enacted in August 2013, the section establishing NFRA was notified only on March 21, 2018 along with the NFRA Chairperson and Members Appointment Rules, 2018. Once NFRA becomes fully operational, it will be adequately equipped to handle the contemporary challenges in relation to auditors, audit firms and networks operating in India.

Finally, it is important to facilitate a business-friendly environment for corporates as well as professionals in India. It is therefore vital that Indian laws and regulations on professional services keep pace with changing market dynamics. Opening up professional services to competition is necessary and therefore, audit firms should be allowed to advertise with some restrictions. Further, in a global economy use of international brand names for audit firms must be allowed. Laws must be rationalised to promote Multi-Disciplinary Practices (MDPs) to allow firms to offer a bouquet of high quality professional services at par with international standards. The Advocates Act, 1961 needs to be rationalised to facilitate development of Indian law firms as well as Indian audit firms into MDPs. Adopting these three measures i.e., advertising, branding and MDPs will not only enhance the standards of services offered to corporates, but also facilitate the audit firms to expand in size/operation enabling them to compete internationally."

27. It is the aforesaid legislative interventions which ultimately led to the NFRA coming to be established with the avowed objective of monitoring and enforcing compliance of companies auditing standards,

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

reviewing quality of service, suggesting measures required for improvement in the quality of service rendered by persons associated with the audit profession, the framing of recommendations pertaining to formulation and laying down of accounting and auditing policies, standards connected therewith and additionally being empowered to investigate either suo motu or on a reference made by the Union Government and to take and draw such proceedings as may be warranted to examine matters pertaining to professional or other misconduct.

28. In order to holistically examine the challenge which stands raised, we place hereinbelow a table which captures the various amendments which came to be made to Section 132 over the course of time and commencing from the introduction of Act 18 of 2013: -

"SECTION 132 – LIST OF AMENDMENTS

As introduced by Act No. 18 of 2013	**As amended by Companies Act 2017 [Act No. 1 of 2018]**	**As amended by Companies Act 2019 [Act No. 22 of 2019]**	**The Section as it reads currently**
132.Constitution of Natural Financial Reporting Authority.— (1) The Central Government may, by notification, constitute a National Financial Reporting Authority to provide for matters relating to accounting and auditing standards	In section 132 of the principal Act,— (i) in sub-section (4), in clause (c), in sub-clause (A), in item (II), for the words "ten lakh rupees", the words "five lakh rupees" shall be substituted; (ii) in sub-	*a*) after sub-section (1), the following sub-section shall be *inserted*, namely— "(1-A) The National Financial Reporting Authority shall perform its functions through such divisions as may be	**132. Constitution of National Financial Reporting Authority.** **(1)** The Central Government may, by notification, constitute a National Financial Reporting Authority to provide for matters relating to accounting and auditing standards under this Act. **(1A)** The National

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

under this Act. **(2)** Notwithstanding anything contained in any other law for the time being in force, the National Financial Reporting Authority shall— (a) make recommendations to the Central Government on the formulation and laying down of accounting and auditing policies and standards for adoption by companies or class of companies or their auditors, as the case may be; (b) monitor and enforce the compliance with accounting standards and auditing standards in such manner as may be prescribed; (c) oversee the quality of service of the professions associated with ensuring compliance with such standards, and suggest measures	section (5), for the words, brackets and figure "the Appellate Authority constituted under sub-section (6) in such manner as may be prescribed", the words "the Appellate Tribunal in such manner and on payment of such fee as may be prescribed" shall be substituted; (iii) sub-sections (6), (7), (8) and (9) shall be omitted.	prescribed."; (*b*) after sub-section (3), the following sub-sections shall be *inserted*, namely— "(3-A) Each division of the National Financial Reporting Authority shall be presided over by the Chairperson or a full-time Member authorised by the Chairperson. (3-B) There shall be an executive body of the National Financial Reporting Authority consisting of the Chairperson and full-time Members of such Authority for efficient discharge of its functions under sub-section (2) [other than clause (*a*)] and sub-section (4)."; (*c*) in sub-section (4), in clause (*c*), for sub-clause (B), the following sub-clause shall	Financial Reporting Authority shall perform its functions through such divisions as may be prescribed.] **(2)** Notwithstanding anything contained in any other law for the time being in force, the National Financial Reporting Authority shall— (a) make recommendations to the Central Government on the formulation and laying down of accounting and auditing policies and standards for adoption by companies or class of companies or their auditors, as the case may be; (b) monitor and enforce the compliance with accounting standards and auditing standards in such manner as may be prescribed; (c) oversee the quality of service of the professions associated with ensuring compliance with such standards, and suggest measures required for improvement in quality of service and such other related

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

required for improvement in quality of service and such other related matters as may be prescribed; and (d) perform such other functions relating to clauses (a), (b) and (c) as may be prescribed. **(3)** The National Financial Reporting Authority shall consist of a chairperson, who shall be a person of eminence and having expertise in accountancy, auditing, finance or law to be appointed by the Central Government and such other members not exceeding fifteen consisting of part-time and full-time members as may be prescribed: Provided that the terms and conditions and the manner of appointment of the chairperson and members shall be		be *substituted*, namely— "(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.".	matters as may be prescribed; and (d) perform such other functions relating to clauses (a), (b) and (c) as may be prescribed. **(3)** The National Financial Reporting Authority shall consist of a chairperson, who shall be a person of eminence and having expertise in accountancy, auditing, finance or law to be appointed by the Central Government and such other members not exceeding fifteen consisting of part-time and full-time members as may be prescribed: [(**3A)** Each division of the National Financial Reporting Authority shall be presided over by the Chairperson or a full-time Member authorised by the Chairperson. **(3B)** There shall be an executive body of the National Financial Reporting Authority consisting of the Chairperson and full-time Members of such Authority for efficient discharge of its functions under sub-section (2) [other than

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

such as may be prescribed: Provided further that the chairperson and members shall make a declaration to the Central Government in the prescribed form regarding no conflict of interest or lack of independence in respect of his or their appointment: Provided also that the chairperson and members, who are in full-time employment with National Financial Reporting Authority shall not be associated with any audit firm (including related consultancy firms) during the course of their appointment and two years after ceasing to hold such appointment. **(4)** Notwithstanding anything contained in any other law for the time being in force, the National			clause (a)] and sub-section (4).] Provided that the terms and conditions and the manner of appointment of the chairperson and members shall be such as may be prescribed: Provided further that the chairperson and members shall make a declaration to the Central Government in the prescribed form regarding no conflict of interest or lack of independence in respect of his or their appointment: Provided also that the chairperson and members, who are in full-time employment with National Financial Reporting Authority shall not be associated with any audit firm (*including related consultancy firms*) during the course of their appointment and two years after ceasing to hold such appointment. **(4)** Notwithstanding anything contained in any other law for the time being in force, the National Financial Reporting Authority

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

Financial Reporting Authority shall— (a) have the power to investigate, either suo motu or on a reference made to it by the Central Government, for such class of bodies corporate or persons, in such manner as may be prescribed into the matters of professional or other misconduct committed by any member or firm of chartered accountants, registered under the Chartered Accountants Act, 1949 (38 of 1949): Provided that no other institute or body shall initiate or continue any proceedings in such matters of misconduct where the National Financial Reporting Authority has initiated an investigation under this section; (b) have the same powers as are vested in a civil			shall— (a) have the power to investigate, either suo moto or on a reference made to it by the Central Government, for such class of bodies corporate or persons, in such manner as may be prescribed into the matters of professional or other misconduct committed by any member or firm of chartered accountants, registered under the Chartered Accountants Act, 1949: Provided that no other institute or body shall initiate or continue any proceedings in such matters of misconduct where the National Financial Reporting Authority has initiated an investigation under this section; (b) have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely:- (i) discovery and production of books of account and other documents, at such place and at such time as may be

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

court under the Code of Civil Procedure, 1908 (5 of 1908), while trying a suit, in respect of the following matters, namely:— (i) discovery and production of books of account and other documents, at such place and at such time as may be specified by the National Financial Reporting Authority; (ii) summoning and enforcing the attendance of persons and examining them on oath; (iii) inspection of any books, registers and other documents of any person referred to in clause (b) at any place; (iv) issuing commissions for examination of witnesses or documents; (c) where professional or other misconduct is proved, have the power to make			specified by the National Financial Reporting Authority; (ii) summoning and enforcing the attendance of persons and examining them on oath; (iii) inspection of any books, registers and other documents of any person referred to in clause (b) at any place; (iv) issuing commissions for examination of witnesses or documents; (c) 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 not less than [1][five lakh rupees], but which may extend to ten times of the fees received, in case of firms; [(B) debarring the member or the firm from— I. being appointed as an auditor or internal

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

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 engaging himself or itself from practice as member of the Institute of Chartered Accountant of India referred to in clause (e) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 (38 of 1949) for a minimum period of six months or for such higher period not exceeding ten years as may be decided by the National Financial Reporting			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.] Explanation.-For the purposes of his sub-section, the expression "professional or other misconduct" shall have the same meaning assigned to it under section 22 of the Chartered Accountants Act, 1949. **(5)** Any person aggrieved by any order of the National Financial Reporting Authority issued under clause (c) of sub-section (4), may prefer an appeal before [the Appellate Tribunal in such manner and on payment of such fee as may be prescribed]. (6)[Omitted] (7)[Omitted]

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

Authority. Explanation.—For the purposes of this sub-section, the expression "professional or other misconduct" shall have the same meaning assigned to it under section 22 of the Chartered Accountants Act, 1949 (38 of 1949). **(5)** Any person aggrieved by any order of the National Financial Reporting Authority issued under clause (c) of sub-section (4), may prefer an appeal before the Appellate Authority constituted under sub- section (6) in such manner as may be prescribed. **(6)** The Central Government may, by notification, constitute, with effect from such date as may be specified therein, an Appellate			(8)[Omitted] (9)[Omitted] **(10)** The National Financial Reporting Authority shall meet at such times and places and shall observe such rules of procedure in regard to the transaction of business at its meetings in such manner as may be prescribed. **(11)** The Central Government may appoint a secretary and such other employees as it may consider necessary for the efficient performance of functions by the National Financial Reporting Authority under this Act and the terms and conditions of service of the secretary and employees shall be such as may be prescribed. **(12)** The head office of the National Financial Reporting Authority shall be at New Delhi and the National Financial Reporting Authority may, meet at such other places in India as it deems fit. **(13)** The National Financial Reporting Authority shall cause to be maintained

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

Authority consisting of a chairperson and not more then two other members, to be appointed by the Central Government, for hearing appeals arising out of the orders of the National Financial Reporting Authority. **(7)** The qualifications for appointment of the chairperson and members of the Appellate Authority, the manner of selection, the terms and conditions of their service and the requirement of the supporting staff and procedure (including places of hearing the appeals, form and manner in which the appeals shall be filed) to be followed by the Appellate Authority shall be such as may be prescribed.			such books of account and other books in relation to its accounts in such form and in such manner as the Central Government may, in consultation with the Comptroller and Auditor-General of India prescribe. **(14)** The accounts of the National Financial Reporting Authority shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and such accounts as certified by the Comptroller and Auditor-General of India together with the audit report thereon shall be forwarded annually to the Central Government by the National Financial Reporting Authority. **(15)** The National Financial Reporting Authority shall prepare in such form and at such time for each financial year as may be prescribed its annual report giving a full account of its activities during the financial year and forward a copy thereof to the Central Government and the Central Government

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(8) The fee for filing the appeal shall be such as may be prescribed. **(9)** The officer authorised by the Appellate Authority shall prepare in such form and at such time as may be prescribed its annual report giving a full account of its activities and forward a copy thereof to the Central Government and the Central Government shall cause the annual report to be laid before each House of Parliament. **(10)** The National Financial Reporting Authority shall meet at such times and places and shall observe such rules of procedure in regard to the transaction of business at its meetings in such			shall cause the annual report and the audit report given by the Comptroller and Auditor-General of India to be laid before each House of Parliament.

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

manner as may be prescribed. **(11)** The Central Government may appoint a secretary and such other employees as it may consider necessary for the efficient performance of functions by the National Financial Reporting Authority under this Act and the terms and conditions of service of the secretary and employees shall be such as may be prescribed. **(12)** The head office of the National Financial Reporting Authority shall be at New Delhi and the National Financial Reporting Authority may, meet at such other places in India as it deems fit. **(13)** The National Financial			

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

Reporting Authority shall cause to be maintained such books of account and other books in relation to its accounts in such form and in such manner as the Central Government may, in consultation with the Comptroller and Auditor-General of India prescribe. **(14)** The accounts of the National Financial Reporting Authority shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and such accounts as certified by the Comptroller and Auditor-General of India together with the audit report thereon shall be forwarded annually to the Central Government by the National Financial Reporting Authority.			

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(15) The National Financial Reporting Authority shall prepare in such form and at such time for each financial year as may be prescribed its annual report giving a full account of its activities during the financial year and forward a copy thereof to the Central Government and the Central Government shall cause the annual report and the audit report given by the Comptroller and Auditor-General of India to be laid before each House of Parliament			

29. The power which stands conferred on the NFRA to investigate in terms of Section 132(4) is, however, restricted to such class of bodies corporate or persons as may be prescribed. The classes of companies and bodies corporate which are subject to the regulation of the NFRA is prescribed by Rule 3 of the NFRA Rules and which reads as follows:-

> "3. Classes of companies and bodies corporate governed by the Authority.— (1) The Authority shall have power to monitor and enforce compliance with accounting standards and auditing standards, oversee the quality of service under sub-section (2) of section 132 or undertake investigation under sub-section (4) of such section of the auditors of the following class of companies and

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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bodies corporate, namely:-

(a) companies whose securities are listed on any stock exchange in India or outside India;

(b) unlisted public companies having paid-up capital of not less than rupees five hundred crores or having annual turnover of not less than rupees one thousand crores or having, in aggregate, outstanding loans, debentures and deposits of not less than rupees five hundred crores as on the 31st March of immediately preceding financial year;

(c) insurance companies, banking companies, companies engaged in the generation or supply of electricity, companies governed by any special Act for the time being in force or bodies corporate incorporated by an Act in accordance with clauses (b), (c), (d), (e) and (f) of sub-section (4) of section 1 of the Act;

(d) any body corporate or company or person, or any class of bodies corporate or companies or persons, on a reference made to the Authority by the Central Government in public interest; and

(e) a body corporate incorporated or registered outside India, which is a subsidiary or associate company of any company or body corporate incorporated or registered in India as referred to in clauses (a) to (d), if the income or net worth of such subsidiary or associate company exceeds twenty per cent. of the consolidated income or consolidated net worth of such company or the body corporate, as the case may be, referred to in clauses (a) to (d).

(2) Every existing body corporate other than a company governed by these rules, shall inform the Authority within thirty days of the commencement of these rules, in Form NFRA-1, the particulars of the auditor as on the date of commencement of these rules.

(3) Every body corporate, other than a company as defined in clause (20) of section 2, formed in India and governed under this rule shall, within fifteen days of appointment of an auditor under sub-section (1) of section 139, inform the Authority in Form NFRA-1, the particulars of the auditor appointed by such body corporate:

Provided that a body corporate governed under clause (e) of sub-rule (1) shall provide details of appointment of its auditor in Form NFRA-1.

(4) A company or a body corporate other than a company governed under this rule shall continue to be governed by the Authority for a period of three years after it ceases to be listed or its paid-up capital or turnover or aggregate of loans, debentures and deposits falls below the limit stated therein."

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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30. As is evident from Rule 3 extracted hereinabove, the NFRA stands empowered to monitor and enforce compliance with accounting and auditing standards, overseeing the quality of service which is a function envisaged under Section 132(2) or undertake an investigation in terms of sub-section (4) of that provision and exercise regulatory powers on the following five classes of companies and bodies:-

(a) Companies whose securities are listed on any stock exchange in India or abroad.

(b) Unlisted public companies having a paid-up capital of not less than INR 1500 Crores or having an annual turnover of not less than INR 1000 Crores or in aggregate having outstanding loans, debentures and deposits of not less than INR 1500 Crores;

(c) Insurance and banking companies as also those engaged in the generation or supply of electricity as well as bodies corporate or companies governed by any special Act;

(d) Any body, corporate or company or person in respect of which a reference may be made to the NFRA by the Union Government in public interest; and

(e) A body corporate incorporated or registered outside India and which may be a subsidiary or associate of any company or body corporate falling within the ambit of classes (a) to (d) referred to above. Such a body corporate is further qualified by the condition that it's income or net worth would exceed 20% of the consolidated income or net worth of an entity which could fall within the classes (a) to (d) specified above.

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

31. Pursuant to the provisions contained in clauses (2) and (3) of Rule 3, every existing body corporate other than a company governed by that Rule is obliged to furnish the particulars of its auditors in Form NFRA-I.

32. Apart from the various functions and obligations which have been placed upon the NFRA by virtue of Section 132(2), one of its principal statutory responsibilities is to undertake an investigation and inquiry in respect of professional or other misconduct. This power flows from sub-section (4) of Section 132 which empowers the NFRA to undertake disciplinary action against a member or firm of chartered accountants registered under the CA Act. By virtue of the Proviso appended to Section 132(4), no institute or body is entitled to initiate or continue proceedings in respect of misconduct once the NFRA has commenced an investigation in terms of that Section. Section 132(4) thus confers a power upon the NFRA to initiate an investigation either suo moto or on a reference made to it by the Union Government. The penalties which it could impose, in case where professional or other misconduct is proved, is set out in Section 132(4)(c). As is manifest from a reading of that provision, the NFRA stands empowered to impose not just monetary penalties but also debar a member or the firm from being appointed as an auditor, internal auditor or undertaking an audit in respect of financial statements of any company or body corporate for a minimum period of six months or such larger period not exceeding 10 years as may be determined by the NFRA.

33. It becomes pertinent to note that the expression “professional or other misconduct” is not separately or independently defined or

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

explained by Section 132. In terms of the Explanation appearing at the end of sub-section (4), the said expression is to be understood and draw meaning from Section 22 of the CA Act. By virtue of Section 132(5) a person aggrieved by any order passed by the NFRA and traceable to Section 132(4)(c) is entitled to institute an appeal before the appellate tribunal.

34. It would be relevant to note that post amendments which had come to be introduced in Sections 21, 21A and 21B of the CA Act, the said statute enabled the Director (Discipline) as well as the Board of Discipline and the Disciplinary Committee to require the member or the firm as the case may be to participate in proceedings that those authorities would have commenced in the course of investigation and inquiry. This is evident from a reading of Section 21(3), 21A (3) and 21B(3) of the CA Act. Although and by virtue of Act 12 of 2022, Chapter IVA came to be incorporated in the CA Act which required every firm to be registered with the Council and for a register of firms to be maintained, the CA Act did not independently incorporate any provision in terms of which a firm could be prohibited or debarred from undertaking an audit or be subjected to penalties that are envisaged under Section 132(4)(c).

35. Section 20C of the CA Act, while stipulating situations where a name of a firm could be removed from the register did not envisage that power to be exercised basis a decision that may have been taken by either the Board of Discipline or the Disciplinary Committee. The only contingencies in which a firm could be prohibited or be subjected to a fine were those which find mention in Sections 21A(6) and 21B(6). As

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

is manifest from a reading of those provisions, a firm could be visited with those penalties in case where it were found that a member who was a partner or owner of a firm had been repeatedly found guilty of misconduct.

FACTUAL MATRIX

36. Having broadly sketched out the statutory scheme which prevails, this would constitute an appropriate juncture to notice some of the salient facts which preceded the institution of the present writ petitions.

37. **Deloitte Haskins & Sells LLP**[12] had issued an audit report for **IL & SL Finance Service Limited**[13] for **Financial Year**[14] 2017-18 on 28 May 2018. The audit of IFIN was stated to be a joint audit which it conducted along with **BSR and Associates LLP**[15] and the audit report itself being jointly signed by DHS and BSR. On 12 February 2019, NFRA addressed an email to DHS requiring it to submit the audit file and audit report drawn by it in respect of IFIN for FY 2017-18. In terms of a subsequent mail, the aforesaid request was reiterated by NFRA with it being observed that the aforesaid audit file was required to enable it to perform and undertake an initial review of the compliance by DHS with the applicable auditing standards. The audit record is stated to have been submitted by DHS to NFRA on 11 March 2019. On 28 June 2019, NFRA conveyed its prima facie observations and conclusions to DHS. DHS submitted a response dated 03 August

[12] DHS
[13] IFIN
[14] FY
[15] BSR

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

2019 refuting the various prima facie observations which had been conveyed by NFRA.

38. Post the exchange of the aforesaid communications, the NFRA furnished the **Draft Audit Quality Review Report**[16] on 25 September 2019. It was in this report that NFRA asserted that it had on due consideration come to form the opinion that acts of professional and other misconduct stood committed by DHS, Mr. Udayan Sen, an erstwhile partner of the firm and who was the engagement and signing partner, Mr. Shrenik Baid, the additional partner on the IFIN Audit and Mr. Rukshad Daruvala, the **Engagement Quality Control Review**[17] Partner. On the very same date, the Union Government is stated to have issued an order referring to various aspects relating to the affairs of IFIN as well as its subsidiary and associate companies for investigation by the NFRA in terms as contemplated under Section 132(4) of the 2013 Act.

39. On 30 October 2019 some of the engagement team members who had performed the IFIN audit for FY 2017-18 made a representation before the NFRA. This was followed by written submissions being tendered by DHS to the NFRA in response to the various observations, comments and conclusions appearing in the DAQRR. NFRA, thereafter, circulated the **Audit Quality Review Report**[18] where significant conclusions relating to fraud and collusion with IFIN management came to be alleged. On 17 January 2020, based on the conclusions contained in the aforenoted AQRR, NFRA issued a **Show**

[16] DAQRR
[17] EQCR
[18] AQRR

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

Cause Notice[19] under Section 132(4) upon Mr. Udayan Sen. Separate SCNs dated 24 and 28 January 2020 came to be issued against Mr. Shrenik Baid and Mr. Rukshad Daruvala, respectively. The aforenoted partners of DHS assailed the validity of the SCNs by filing writ petitions before this Court. Those writ petitions also questioned the constitutional validity of Section 132(4) of the Companies Act as well as the jurisdiction of NFRA to investigate matters of professional and other misconduct in respect of audits which had come to be concluded prior to Section 132 coming into force.

40. On 01 May 2020, NFRA furnished a **Draft Supplementary Audit Quality Review Report**[20] to Mr. Udayan Sen pertaining to the audit conducted in respect of IFIN where additional allegations came to be levelled. A copy of the DSAQRR was also forwarded to DHS on 14 May 2020. DHS on receipt of DSAQRR filed its reply on 25 July 2022. This was followed by NFRA issuing yet another **Supplementary Audit Quality Review Report**[21] in which it alleged that the appointment of DHS as the statutory auditor of IFIN was void. It was further alleged that the writ petitioner was not only guilty of professional and other misconduct but also that it had colluded with IFIN management. This was followed by the issuance of the notice dated 06 January 2021 under Section 132(4) in terms of which investigation was commenced.

41. The aforesaid action came to be assailed by way of a CM filed in the pending writ petition on which the following order came to be passed on 12 March 2021:-

---

[19] SCN
[20] DSAQRR
[21] SAQRR

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

"**CM APPL. 9896/2021 (of petitioner for directions)**

1. This matter has been listed on urgent mentioning and the file has been received by us post Court commencement hours.

2. We have heard the senior counsels for the petitioner/applicant and the counsel for the respondents."

3. While the senior counsels for the petitioner applicant seeks a direction to the respondent no. 2/ National Financial Reporting Authority (NFRA) to not act in furtherance of the impugned notice dated 6th January, 2021 and the e-mails dated 5th March, 2021 and 9th March, 2021 (received after filing of this application) till such time as this Court finally hears and decides the petition, the counsel for the respondents draws attention to the earlier orders passed in this petition on the application for interim relief, to the effect that the steps taken by the respondents shall be subject to the final outcome of the petition.

4. Having considered the application and finding that the petition is listed for final hearing on 24th March, 2021 and considering the professional reputation of the petitioner/applicant is at stake and irreparable injury which the petitioner/applicant is likely to suffer in the event of any action taken and/or being publicised, we are of the view that the respondents should restrain themselves from precipitating the matter till 24th March, 2021. We order accordingly.

5. The counsel for the respondents, without prejudice to his right and conditions, contends that though the petitioners has been given sufficient time to file its reply to the impugned notice but at best are entitled to further reasonable time and not to stay of any further proceedings, since the said relief has already been declined.

6. We are today concerned only with this application and deem it appropriate that the matter otherwise, whether to grant time or not and/or what orders are to be finally passed on this application, be left to the Bench before which the matter comes up on 24th March, 2021.

7. Thus, directing as aforesaid, list on 24th March, 2021, as already scheduled."

42. The same was made absolute in terms of our order passed on 14 November 2022 as seen hereinbelow:-

"1. We are informed that the pleadings are complete.

2. Counsel for the parties will file their written submissions, not exceeding five pages each, at least three days before the next date

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

of hearing.

3. List the matter on 25.01.2023.

4. Interim orders dated 28.01.2021 and 12.03.2021 are made absolute during the pendency of the writ petition. CM No.2979/2021 and CM No.9896/2021 shall, accordingly, stand disposed of."

43. It is apposite to note that the original DAQRR and which culminated in the issuance of the AQRR dated 12 December 2019 apart from laying allegations pertaining to violation of SA570 and the issues emanating from the treatment of the audit of that entity as a going concern, additional allegations pertaining to the independence of the audit firm also came to be levelled. This becomes evident from a reading of the following parts of the AQRR:-

"2.2 SQC 1 Compliance: Policies & Procedures

2.2.3 NFRA has closely examined all the documents and information submitted by the Audit Firm. The information submitted has been provided over 396 pages covering the basic information. Many documents have further references to many other documents. As explained by the Audit Firm itself, the basic structure seems to have been obtained from their Global Network Office. This is itself in the form of numerous documents with a large number of inter-references. All this is to be supplemented by the Level 3 India Specific Policies. Besides a perusal of the documents clearly shows that it is only a portion of the total QC documentation that has been provided and that there are numerous other documents which are all said to be a part of policy documentation. Overall, it is clear that the total QC policy documentation will be considerably in excess of the approximately 500 pages that has been referred to in part 2.5 of the Audit Firm's letter dated 03rd August 2019.

2.2.4 The documentation of the Quality Control Policies and Procedures of an Audit Firm should be in the form of a single document that is both comprehensive and concise, and contains, in a systematic, structured and coherent manner, all the dos and don'ts that need to be adhered to by employees of the Audit Firm.

2.2.5 On the contrary, the policy documentation now provided by the Audit Firm, which is admittedly only partial since the numerous

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

other documents that have been referred to at various places therein have not been provided, is clearly unstructured and unsystematic, and put together by the assembling of a wide range of documents. Most of the documents seem to be from the Global Network Entity and has not been developed with reference to Indian laws, rules and regulations.

2.2.6 Clearly there is a surfeit of information relating to laws and regulations in foreign countries which the majority of the workforce of the Audit Firm in India will have no occasion whatsoever to deal with in the course of their employment.

2.2.7 In response to the prima facie conclusions of the NFRA that the policies and procedures relating to independence, which are required to be an integral part of the QC Manual, are not present in the section titled “Independence” in Annexure 2, the Audit Firm has stated that the policies and procedures for independence, including threats to independence, are covered by DPM 1420-Independence. The said document (DPM 1420-Independence), which runs to 150 pages, has been carefully gone through. It is seen that this document is based completely on US laws; it has no reference whatsoever to Indian laws.

2.2.8 NFRA is reinforced in its conclusion that the Audit Firm does not have a policy document as required by SQC1. Such documents as have now been produced to the Authority do not conform, for the reasons already made clear, to the requirements of SQC1. These documents also have a very substantial part completely unrelated to any operations in India. The sheer volume of the documents, and their substantial irrelevance to Indian conditions, laws and operations, will make it a certainty that the employees of the Audit Firm will be left completely without any guidance about what exactly is to be understood as the approved policy in any situation. The absence of a policy document as required by SQC1 is a serious non-compliance with the SAs.

2.2.9 NFRA concludes that the Audit Firm should, without any further delay, prepare a comprehensive, concise and systematically structured policy document to confirm to SQC1 and provide the same to the Authority for its perusal at the earliest.

2.3 Compliance with Independence Requirements

2.3.8 The Audit Firm’s submission to the NFRA vide letter dated July 17, 2019 confirms using the same senior personnel, i.e. CA. Nishit Udani and CA. Rakesh Jain, on the audit engagement since 2008-09. Paras 25-27 of SQC1 requires the audit firm to establish criteria for determining the need for safeguards to reduce this familiarity threat. Since the SQC clearly restricts an EP on an engagement for maximum of seven years, the engagement of senior

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

personnel who contribute significant duration of time on audit cannot override this time limit. Clearly, the Audit Firm has failed to counter the familiarity threat or impairment of quality of performance of audit due to using the same senior personnel over a prolonged period.

2.3.9 WP 11104 says that "the visibility of Deloitte leadership with the Senior Management of the company and IL&FS Group is extremely strong. Our partners and directors, who have industry experience of more than 15 years, have access to the Senior Management of the Company. Udayan Sen (Lead Client Service partner), Shrenik Baid (Engagement Partner) and Nishit Udani (Engagement Director) have direct access to the Chairman, Managing Director and CFO of the Company. Hence there is a regular communication with the Senior Management on one to one basis" (emphasis added). Ironically, this statement has been made to support the Audit Firm's assessment that there is no ROMM due to fraud. However, this clearly indicates a familiarity threat to independence that was not properly and adequately dealt with.

2.3.10 In situations where no safeguards are available to reduce the threat to an acceptable level, the Code of Ethics says that the only possible actions are to eliminate the activities or interest creating the threat, or to refuse to accept or continue the assurance engagement. (Section 290.24).

2.3.11 On a consideration of all the above evidence, NFRA concludes that:

a) The Audit Firm has grossly violated the provisions of Section 144 of the Companies Act, 2013;

(b) The Audit Firm has been in serious breach of the Code of Ethics;

(c) These violations have continued over several years;

(d) The violations have undoubtedly fatally compromised the independence in mind required of the Audit Firm;

2.4 Role of Engagement Partner (EP)

2.4.1 The prima facie conclusion of the NFRA, on the above matter, vide its communication dated 28th June, 2019, was that the Engagement Partner, CA. Udayan Sen, being the Engagement Partner as defined by para 6(b) of SQC1, had signed the audit report notwithstanding the documented facts that he had completely failed in discharging his obligations as Engagement Partner.

2.4.2 This prima facie conclusion of the NFRA was based on the list of work papers reviewed by CA. Udayan Sen, which clearly shows that almost all the important work of audit, i.e.,

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

independence evaluation, risk assessment, audit plan, audit procedures, audit evidence, communications with management or those charged with governance (TCWG) was not directed/supervised/reviewed by CA. Sen.

2.4.3 Further, the date-wise schedule of hours charged by CA. Udayan Sen to the engagement as Engagement Partner was not provided, nor was any reference in the Audit File provided in support thereof. The NFRA further noted that the Audit Firm's statement that "Udayan Sen has spent about 180 hours (though manually noted as 80 hours in the Audit File)" was self-contradictory and therefore, bereft of any meaning.

xxxx xxxx xxxx

2.4.5 NFRA has examined the above contentions of the Audit Firm and has concluded as follows:

(a) It would be a facetious argument to say that neither SQC1 nor the SAs prohibit more than one partner of the firm from being assigned to be the Engagement Partner. Not only is no support for such an interpretation provided from anywhere within SQC1 or the SAs, but also no such position is supported by any part of the firm's own SQC1 compliant policy manual. Furthermore, the logical question that this position/argument would lead to is the maximum number of such Engagement Partners that could be permitted in a specific engagement. Could it then be 5 or 10, or even more? Clearly, the absurdity of this argument need not be explained further.

(b) Contrary to the assertion of the Audit Firm, SQC1 clearly provides for only one Engagement Partner for an Engagement. Para 42 of SQC1 says that "The firm should assign responsibility for each engagement to an engagement partner" (emphasis added).

(c) Para 42(a) of SQC1 provides that policies and procedures should ensure that "the identity and role of the engagement partner are communicated to key members of the client's management and those charged with governance". Para 42(c) says procedures should ensure that "the responsibilities of the engagement partner are clearly defined and communicated to that partner". Assuming only for the sake of argument, and not in any way accepting the stand of the Audit Firm that there can be more than one Engagement Partner for an engagement in view of its patent illegality, the Audit Firm has not been able to show any provision in its policies relating to para 42(a) and 42(c) quoted above, or communications to TCWG, or the partners concerned, pursuant to these paras, in the Audit File that support its stand that there could be more than one Engagement Partner for any Engagement.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

(d) The definition of Engagement Partner clearly refers to a single individual (this is so in all the cases where SQC1 or SAs use this term) who bears ultimate responsibility for the performance of the engagement and the report that is issued on behalf of the firm. SA 220 clearly provides that the Engagement Partner shall take responsibility for the overall quality on each audit engagement to which the partner is assigned (para 8). Further paras in the same SA elaborate on the responsibilities of the Engagement Partner. Having more than one Engagement Partner may or may not enhance audit quality. In the present case, the failure to discharge the role of Engagement Partner by CA. Udayan Sen clearly shows that audit quality has badly suffered.

(e) The "integral" designation of Shrenik Baid as the engagement/review partner also discloses a great confusion and lack of clarity about the respective roles of an Engagement Partner and a review partner.

(f) For all the above reasons, NFRA considers that CA. Udayan Sen alone can be accepted as Engagement Partner for this engagement in terms of the definition provided in SQC1 and the SAs.

2.4.6 NFRA has further examined the matter relating to aspects of the engagement that were directed/supervised/reviewed by CA. Udayan Sen in his capacity as Engagement Partner. Contrary to the statement made at document 5/page 10 of the Audit Firm's response, WP No. 29702 (Manual) Closing Procedures Check list has not been initialed by CA. Udayan Sen. CA. Udayan Sen's initials are seen only in that part of the WP No. 29702 which is designated as the closing memorandum. This is in the form of a report sent by CA. Shrenik. Baid to CA. Udayan Sen. This paper is a summary of the procedures adopted during the course of the audit. The very fact that CA. Shrenik Baid had to send such a memorandum to CA. Udayan Sen is itself proof that CA. Udayan Sen had not participated in any of the audit processes listed therein. This is for reason that if CA. Sen had indeed participated in the listed procedures etc., his presence there would have been automatically recorded and the need for such a closing procedures memorandum would not have arisen. No further evidence has been provided by the Audit Firm to counter the conclusions of the NFRA that CA. Udayan Sen was not involved with almost all the important work of the audit engagement.

2.4.7 Also, the Audit Firm's submission to the NFRA vide letter dated July 17, 2019 states that CA. Udayan Sen was not using the time recording system and hence his time spent on this assignment is not available. No estimate of the same was given as it was said to

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

relate to a period many years back. Hence, the Audit Firm and the Engagement Partner are found noncompliant with requirement of keeping records for minimum seven years as per paras 82- 83 of SQC1, and monitoring the workload and availability of the EP as per para 43. Further, the familiarity threat and violation of para 27 of SQC1 cannot be ruled out based on the submitted responses.

2.4.8 On consideration of all the above facts, the NFRA

(a) is reinforced in its conclusion that CA. Udayan Sen, being the Engagement Partner as defined in para 6(b) of SQC1, had signed the audit report notwithstanding the documented facts that he had completely failed in discharging his obligations as Engagement Partner;

(b) Concludes that the Audit Firm committed a grievous violation of SQC1 and SA 220 in naming two partners as Engagement Partners for this Engagement, thereby leading to disastrous loss of accountability and total disregard of all principles of Quality Control.

2.5 Communication with Those Charged With Governance (TCWG)

2.5.1 The prima facie conclusion of the NFRA on the above matter, vide its communication dated 28th June, 2019 was that:

(a) No evidence has been produced from the Audit File to show what was discussed with the management/TCWG prior to the date of the audit report and the financial statement signing date.

(b) There is no record of any communication addressed to the Audit Committee/Management/TCWG by the ET.

xxxx xxxx xxxx

2.5.3 NFRA has examined the above contentions of the Audit Firm and has concluded as follows:

(a) Clearly the Audit Firm has admitted that except the engagement letter given to the company before commencement of the statutory audit, and final presentation made to the Committee on 28th May, 2018, there was no other communication that was made to the Audit Committee/Management/TCWG. The presentation made at the time of the half yearly review represents action on a different engagement.

(b) The Audit Firm's contention that discussions with the management are embedded within each work paper, as prima facie, all information obtained by them from company are provided by the management, and hence would not require separate documentation is not acceptable, since this is a clear admission that

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

nothing really was communicated to TCWG. This argument completely ignores the requirement of SA 260 which is about communication FROM the Audit Firm to the company on all important and serious issues arising from the audit and which is distinct from the documentation and evidence provided by the company to the Audit Firm.

(c) The Audit Firm has also disregarded and violated the requirements of para 49 (read with para A49) of SA 260 which provides that "where matters required by this SA to be communicated are communicated orally, the auditor shall document them, and when and to whom they were communicated. Where matters have been communicated in writing, the auditor shall retain a copy of the communication as part of the audit documentation. Documentation of oral communication may include

a copy of the minutes prepared by the entity retained as part of the audit documentation where those minutes are an appropriate record of the communication".

(d) Apart from the fact that matters that were required to be communicated (para 10 to 13 of SA 260) had not, in fact, been communicated, this was also a case where there were serious issues arising out of the RBI's inspection report that needed to be brought to the attention of TCWG and discussed with them before final decisions on audit evidence, presentation and disclosure in the financial statement etc. were taken. No facts have been provided by the Audit Firm that the requirements of SA 260 and other relevant SAs have been complied with by the Audit Firm.

(e) Similarly, as regards the argument that all work was done in the company's office, and hence communication with the management was on a daily basis, is concerned, this argument, logically, would mean that no documentation at all would be required.

Hence, the unacceptability of such an argument is obvious.

2.5.4 NFRA is, therefore, reinforced in its conclusion that the Audit Firm has grossly failed in complying with the Requirements of the SAs pertaining to communications with TCWG and the management.

2.6 Evaluation of Risk of Material Misstatement (ROMM) Matters

2.6.1 In its prima facie conclusions dated 28th June, 2019, NFRA had, inter-alia, stated that:

(a) WP No.13501 indicates that in contradiction to the requirement of Section 143(9) read with Section 2(7) and Section 143(10) of the Companies Act 2013, the Audit Firm has made references to

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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certain other International Standards instead of compliance to Auditing Standards prescribed u/s 143(9).

(b) WP No. 13501 Minutes of the Engagement Team discussion does not disclose participation of the Engagement Partner CA. Udayan Sen.

(c) The Audit Firm in their WP No.13501 have mentioned different statements with reference to the assessment of fraud risk factors. There are significant contradictions in the assessment of ROMM which lead to the conclusion that the assessment has been carried out in a very casual manner as to result in a complete sham.

(d) WP No.13501 on ROMM provides a staggering conclusion "No fraud risk factors or engagement risk have been identified".

(e) Evidence of mismatch in the date of meeting and the date of communication between the Engagement Team and Engagement Partner has proved that assessment of ROMM is a complete sham. Study of WP No.13501 shows that while the meeting for discussion took place on 13th October 2017, the matters were already communicated to all concerned in September 2017.

(f) Based upon the analysis of the working papers, it was observed that certain important issues having been identified from the whistle blower complaints and RBI inspection reports have not been evaluated at all for the purpose of evaluation of ROMM.

(g) The Audit Firm has changed the risk assessment of the audit assignment from "Normal" to "Greater than Normal" (GTN) through a memo for change in engagement risk to GTN, taking into consideration four factors. Considering the sequence of events relating to the RBI inspections, it must have been assessed as "Much Greater Than Normal" (MGTN) in the previous FY 2016-17 itself.

(h) It was observed that the audit responses planned to reduce or mitigate the identified risks and the actions taken based on the audit responses to such identified risks are insufficient, improper and inadequately carried out.

(i) Numerous details from the working papers have been provided to substantiate the above conclusions of the NFRA. For the sake of brevity and avoiding unnecessary repetition, the details of the same are not extracted and re-produced here.

xxxx xxxx xxxx

2.6.14 To summarise,

(a) The Audit Firm has clearly indulged in a deliberate misrepresentation of a material fact;

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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(b) There has been a complete lack of clarity, and utter confusion has prevailed, in the ROMM assessment;

(c) Important aspects of the auditee company's situation, such as its SI-NBFC status, the very disturbing RBI Inspection Reports on the company, the wide discrepancies in reporting of NPAs, etc., have not been given adequate importance in the ROMM assessment;

(d) Accordingly, the audit responses have been grossly inadequate;

(e) Such procedures as have been performed have had no link to the real ROMM;

(f) In crucial matters, the Audit Firm has relied completely on the management's representations;

(g) The Audit Firm has totally failed in communicating to TCWG/the management the key issues arising out of the audit.

2.7 RBI Inspection Matters – TTSL Shares and Derivatives Assets

2.7.1 With regard to the above matter, the NFRA had communicated the following prima facie observations/comments/conclusions in its letter dated 28th June, 2019:

(a) The Engagement Team (ET) had not obtained any justification/explanation as to how the company had accepted the transfer of unquoted shares of TTSL whose valuation even on the date of transfer was only zero as settlement as against Rs. 323.15 Crores loans outstanding from the Siva Group. Clearly, 100% provision, if not write off, against the said loans was due to be made even on 31st March, 2015, in line with RBI directions.

(b) The so called put option backing the shares was not even a fig leaf for the reasons detailed therein.

(c) The Siva Group, as a counter party was completely un-creditworthy.

(d) The Shareholder's and Option Agreements does not form part of the Audit File. There is, hence, no evidence that the Auditor has verified or checked the agreement.

(e) The Guidelines on Derivatives Contracts do not apply to the put option.

(f) The requirements of Section 143((1)(a) of the Companies Act, 2013 had not been complied with.

(g) The Black Scholes Option Pricing Model was inapplicable in the present case.

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(h) The worksheet supporting the option valuation as per the Black Scholes Model appears to be a calculated fraudulent work paper having no audit substance. The calculations seem, for reasons spelt out in detail, to have been made in order to support the company management's attempt to bypass the RBI directions to provide for 100% of the value of the TTSL shares.

(i) There is a clear conflict of interest in engaging DTTI LLP to verify the valuation of the derivative assets.

(j) As a consequence of all the above, the valuation of the derivative assets (in the form of the put option) of Rs. 184.31 crores is completely unjustified and not based on any objective evidence and appears to be a calculated fraud in support of the management to inflate the profit.

(k) Further, there is no disclosure about the details of the valuation of the derivative assets in the financial statements. Note 9 (f) forming part of the financial statements is completely inadequate and misleading.

(l) Financial statements of the counter party i.e. Shanmugha Real Estate and Properties Private Limited (SREPPL) is not in the Audit File. There is no evidence that this has been examined. There is also no evidence regarding valuation of the land parcel of Hill County Properties Limited (HCPL).

xxxx xxxx xxxx

2.7.6 After considering all the above matters, NFRA concludes as follows:

(a) The Audit Firm did not obtain sufficient, appropriate audit evidence to support the value of the derivative asset included in the Balance Sheet as at 31st March, 2018;

(b) The Audit Firm did not do the due diligence necessary to obtain and critically evaluate such evidence as was provided to it by the management;

(c) Accounting guidelines that are clearly inapplicable have been used to justify the treatment given;

(d) In order to offset the impact of provisioning that could not be deferred any more, on account of RBI insistence, the Audit Firm went along with the management in including a derivative asset of zero value in the Balance Sheet at over Rs 180 crores, and taking credit in the Profit and Loss Account. This resulted in a very material misstatement of the financial statements.

2.8 RBI Inspection Matters : NOF – CRAR

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

2.8.1 With regard to the above matter, the NFRA had communicated the following prima facie observations/comments/conclusions in its letter dated 28th June, 2019:

(a) The minutes/decisions of the Board of Directors taken in 2007 was not available in the Audit File.

(b) The Engagement Team (ET) had not evaluated the management's stand based on the applicable law, or the Regulator's directions. The ET has not displayed the professional skepticism required by the SAs.

(c) The ET had accepted the management's internal documentation of matters discussed in RBI office without asking for or obtaining any confirmation from the RBI about the same.

(d) The ET had failed to take note of the definition of "companies in the same group" as mentioned by the Regulator in its inspection report. This definition is what is given according to para II of the explanation to Section 45 IA of the RBI Act, 1934. The ET had unquestioningly accepted the management's position on this matter that there was no clarity in the definition of "companies in the same group" in the Act and that there were multiple interpretations possible.

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2.8.3 The NFRA has closely gone through all the points made by the Audit Firm and its conclusions are as follows:

(a) As to the value of the minutes of discussions with the officers of the RBI relating to the disclosure to be made under the accounts, and the extent to which credibility can be given to such a "written representation", the detailed conclusions of the Authority have already been provided in Section 2.9 below.

(b) As far as Annexures 4.9A and 4.9B are concerned, these documents cannot be accepted as evidence of due performance of audit procedures by the Audit Firm since they do not form part of the Audit File. There is nothing in the Audit File, or in the submissions made by the Audit Firm, to corroborate the claim made that these documents had been taken into consideration in the audit process. Even if these two documents were taken into consideration, without any in way conceding any status to them as admissible audit evidence, it is clear that are of absolutely no value whatsoever for the following reasons:

(i) The notification bearing reference DNBR.009/CGM(CDS)2015 dated March 27, 2015, that has been referred to in the company's

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

letter dated March 31, 2015, was superseded by Master Directions DNBR.PD.008/03.10.119/2016- 17 dated 1st September, 2016.

(ii) The reply from the RBI dated 5th May, 2015, has no bearing on the definition of calculation of Net Owned Funds (NOF).

(iii) As has been pointed out by NFRA even initially, NOF has been defined by RBI Act, 1934. There is no warrant, therefore, for trying to look for definitions of NOF in other documents.

(c) The contention of the Audit Firm that "companies in the same group" have not been defined by the Companies Act, 1956, is clearly incorrect. The Audit Firm has referred to Section 370(1B) of the Companies Act, 1956 which defines "companies under the same management". However, the Audit Firm has ignored the definition of "companies under the same group" as provided in Section 372(11) of the Companies Act, 1956.

(d) For reasons explained at length under the NFRA prima facie conclusions dated 28th June, 2019, the stand taken by the company about the continuing applicability of the relevant provisions of the Companies Act, 1956, was clearly wrong under law.

(e) Given the above situation it is clear that the Audit Firm has failed to comply with the SA 250 relating to Consideration of Laws and Regulations.

(f) As already explained in the prima facie conclusions, this is also not a situation that comes within the scope of SA 705 relating to Emphasis of Matter since the matter was NOT appropriately presented or disclosed in the financial statements.

2.9 Management's Written Representations relating to RBI Inspections

2.9.1 In its prima facie conclusions dated 28th June, 2019, the NFRA has stated that:

There is no sufficient evidence available in the Audit File to show that the Audit Firm has complied with the requirements of para 9 of SA 500 in the case of the matter of RBI's approval for the disclosure to be made in the accounts.

xxxx xxxx xxxx

2.9.3 NFRA has considered the above responses in detail and its conclusions are as follows:

(a) Admittedly, the issue relating to calculation of NOF and CRAR was a very serious issue about which there had been protracted correspondence between the management and the RBI. Admittedly also, the RBI had not changed its stand on the matter, or in any way accepted the company's position notwithstanding the company's

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

efforts over a long period of time. This background and context should have informed the Audit Firm's evaluation of any evidence, including management representations, that had been provided to it.

(b) The Audit Firm has quoted para 15 of SA 580 and has said that ET did not come across any information that should have caused it to have any concern about management competence, integrity etc. However, at the same time, they have failed to take note of other requirements of SA 580 as follows:

(i) Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that the management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfilment of management's responsibilities, or about specific assertions (para 3).

(ii) In particular, if written representations are inconsistent with other audit evidence, the auditor shall perform audit procedures to attempt to resolve the matter (para 16).

(iii) The Auditor shall disclaim an opinion on the financial statements in accordance with SA 705, if there is sufficient doubt that the written representations are not reliable (para 19).

(c) Clearly, the requirements of SA 580 needed the Auditor to obtain corroborating evidence for the matters covered by the written representation before accepting the same. Clearly, the claims of the management about the outcomes of the meetings that they had with RBI were completely inconsistent with the stand of the RBI that had been in evidence throughout the period when this matter was under discussion. In other words, the written representation forwarding the unacknowledged minutes of the meetings with the RBI officers was inconsistent with this overwhelming past evidence, and the Auditor was duty bound in terms of para 3 and para 16 of SA 580 to perform other audit procedures to attempt to resolve the matter. And in the event of being unable to resolve the matter, a disclaimer of opinion needed to have been made in line with para 19 of SA 580.

2.9.4 The Audit Firm has said that the Audit Committee had considered the management update on their meetings with RBI officials and as such, the Audit Firm is entitled to rely on the information provided to them. It is seen that the said Audit Committee meeting was held on 28.05.2018, the date on which the financial statements were approved by the Audit Committee and the Board and also communicated to the Stock Exchange (after having duly notified the Stock Exchange in advance about the date and agenda of such meetings). Clearly, no significance can be

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

attached to the supposed “ratification” by the Audit Committee of the management update as at this stage.

2.10 Evaluation of the work of Management’s Expert

2.10.1In its prima facie conclusions dated 28th June, 2019, NFRA had, inter-alia, stated that:

(a) The Audit Firm has failed to present their responses specifically against the questions asked by the authority.

(b) WP No.22006.01 reveals that that evaluation of the work of a Management Expert is based upon ISA 500.A38 and not SA-500 which is not in compliance with Section 143(9) read with section 2(7) of the Companies Act, 2013.

(c) Further the said WP ought to evaluate the competence of BDO India LLP, whereas the document includes evaluation of Knight Frank at various places and not of BDO.

(d) The Engagement team has not evaluated the work of the experts or obtained understanding of the work of such expert. The auditor is grossly negligent in performing his obligation in this regard since the engagement team has not performed the actual audit procedures in accordance with the prevailing law and standards.

(e) Having examined WP 13305, the procedures performed on IPE are unclear. With reference to “Manual Approvals” and other IPEs in the nature of “validating” the Audit Firm has failed to fulfill the requirement of Para 9 of SA 500.

2.10.3The NFRA has examined the above contentions of the Audit Firm and has concluded as follows:

(a) The company has been incorporated in India. Reference to global standards for any reason does not meet the essence of the engagement and is not in compliance with the section 143(9) of the Act.

(b) Repetition of a typographical error in the same document reduces the reliability of the audit work paper. Quoting the name of “Knight Frank” in a working paper for evaluation of competence of “BDO India LLP” makes it totally null and void.

2.10.4 With reference to the compliance with the requirements of SA 500 in relation to using the work of a management’s expert, NFRA has examined the working papers referred in the response of the Audit Firm. The Audit Firm has provided the memos prepared by the Internal Fair Value Specialists of the Firm or Associate Concern of the firm as well the valuation report provided by the various valuation experts.

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

2.10.5 On a consideration of all the above, NFRA does not wish to pursue this matter further at this stage. However, if, on a further examination of the matter, it becomes necessary to take any action, the matter will be considered at that stage.

2.11 Evaluation of the Going Concern Assumption:

2.11.1 In its prima facie conclusions dated 28th June, 2019, NFRA stated as follows:

(a) The Audit Firm had not made the relevant enquiries of the management as required by para 10 of SA 570.

(b) The Audit Firm had failed to capture the significance of the RBI Inspection Report and the non-compliance with the minimum NOF and CRAR requirements to continue the NBFC business and, in doing so, paras 16 onwards of SA 570 had not been complied with.

(c) The Audit Firm had admitted that the company had not made any assessment of the going concern assumptions. Also that the company had not forecasted any future cash flows nor was any future action plan drafted. However, the Audit Firm had concluded that considering the Indian bullish market and past trend of the performance of the company, it was of the view that the going concern assumption was appropriate. This audit procedure and conclusion was in gross violation of SA 570.

(d) The assertion by the Audit Firm that they had discussed with the management and understood the plans they had proposed to comply with the RBI requirements by 31st March, 2019, was false since no such plans were available in the Audit File.

xxxx xxxx xxxx

2.11.3NFRA has considered the response of the Audit Firm and has concluded as follows:

(a) The Audit Firm has not provided any evidence whatsoever to contradict their own admission that company had not made any assessment of the company's ability to continue as a going concern and that the company had not forecasted any future cash flows nor was any future action plan drafted. However, the Audit Firm has asserted that, attempting to draw authority from para A9 of SA 570, that it is not the auditor's responsibility to rectify the lack of analysis by management. They have also quoted the same paragraph to say that the auditor's evaluation of the appropriateness of the management's assessment may be made without performing detailed evaluation procedures if the auditor's other procedures are sufficient to enable the auditor to conclude about the management's use of the going concern assumption.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(b) The above stated argument of the Audit Firm is not only violative of the spirit but also the very letter of SA 570. As clearly provided by para 10(b) of SA 570, the auditor was duty bound to discuss with the management the basis for the intended use of the going concern assumption in a situation where the management had itself not performed such an assessment, as was the admitted situation in this case.

(c) Para 10(b) of SA 570 is under the Requirement portion of the SA. As is the convention relating to the Requirements portion, all such Requirements are made Unconditional and Mandatory by the use of the word “shall”. Given the situation described in the paragraph, the Audit Firm did not have any discretion in the matter. The discussion with the management and enquiry with them by the SA required, had to be complied with and the same had to be documented as per the requirements of the SA relating to documentation. By their own admission, the Audit Firm has not conducted any such discussions and enquiry, neither is any proof of such discussion and enquiry available in the Audit File.

(d) The attempt to draw support for what the Audit Firm has done from para A8 of SA 570 (the para stands renumbered as A9 in The Revised SA 570 only) it itself a gross distortion of what is contemplated and permitted by that paragraph. The context referred to is only a situation where management has not made any detailed analysis. It does not cover a situation as this where, admittedly, no analysis at all was available.

(e) The contention of the Audit Firm that the Independent Directors of the company were, by all, by all accounts knowledgeable in financial and accounting matters, and that the Audit Firm had the right to rely on them and that it was, in any case, their (Independent Directors) responsibility to alert the auditors in case they had any doubt about the going concern assumptions is clearly evidence of the Audit Firm’s gross dereliction of duty. Taken to its logical conclusion, this argument can be used to support a complete abdication of its prescribed duties by Audit Firm.

2.11.4 As far as action plan for compliance with the RBI guidelines on NOF is concerned, the Audit Firm had initially informed the NFRA that they had discussed with the management and understood the plans. They (the Management) had proposed to comply with the RBI Requirements by March 31st, 2019. Since no such plan is available in the Audit File, this claim of the Audit Firm was dismissed by NFRA as being false. The Audit Firm has replied saying that the said plan was placed before the Audit Committee and approved by them and thereafter placed before the Board on May 28, 2018. However, since the Board wanted to submit a more

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

detailed plan to the RBI, they had sought time till June 30, 2018. The Audit Firm contends that this cannot be construed to imply that the plan did not exist on May 28, 2018. In this connection, it is being clarified (though a plain reading of NFRA's earlier contention should not require any clarification at all) that it was never contended by NFRA that a plan did not exist on May 28, 2018. This issue had not come up for NFRA's consideration at all. What was instead asserted by NFRA is that no such plan was found in the Audit File and therefore could not have been discussed with the management on the grounds that any discussion about such a plan between the Audit Firm and the management would also have had to be documented appropriately in the Audit File and the Audit Firm's conclusion thereon also duly recorded. Since no such evidence was available in the Audit File, NFRA had concluded that the Audit Firm's claim that they had discussed the plans with the management and understood the same, was patently false. Some details of the alleged plan have been placed at pages 51 and 52 in response to para 11 and repeated again at pages 68 to 69 of the same response. Both these references and details have to be considered only as an afterthought and a subsequent creation of audit evidence since there is no substance of these matters in the Audit File. The NFRA, therefore, is reinforced in its conclusion that the statement about discussions with the management on the compliance plan is false.

2.11.5 On a consideration of all the above, NFRA concludes that the Audit Firm has completely failed to obtain sufficient, appropriate audit evidence to assess the management's use of the going concern assumption.

2.12 Documentation of EQCR Processes

2.12.1 The prima facie conclusions of the NFRA on the above matter vide its communication dated 28th June, 2019, inter-alia, were that

(a) The work papers do not identify or document any discussion about significant matters between EQCR team and the Engagement Partner.

(b) The EQCR was not carried out in a timely manner at appropriate stages during the engagement.

(c) The EQCR required an in-depth examination to be made of the issues arising out of the RBI inspection and directions. Documenting the EQCR process in this connection, and the conclusions arrived at could not be reduced to mere check box "Yes" or "No" responses.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(d) Modification carried out in the RoMM mentioning the same as both "adverse" and "EOM" is internally inconsistent and self-contradictory.

(e) The EQCR has not noted the absence of any communication at all between the ET and TCWG.

(f) A major inconsistency between the time said to have been spent on the EQCR by the partner and the Director compared with the dates of the EQCR indent and the documents said to have been reviewed by them.

xxxx xxxx xxxx

2.12.3 The NFRA has examined the above contentions of the Audit Firm and has concluded as follows:

(a) The mandatory requirements of the SAs have to be considered holistically and harmoniously. It would not be acceptable to look at any single extract from the SAs that ignores the overall context. It would be, therefore, necessary to consider the "Nature and Purpose of Audit Documentation" (paras 2 and 3 of SA 230) as providing the overall context for audit documentation.

(b) Furthermore, paras 8 to 11 of SA 230 dealing with the Form, Content and Extent of Audit Documentation will also have to be considered.

(c) Going by the above, it can hardly be contended, as Audit Firm has sought to do, that mere check box "Yes" or "No" responses are sufficient to "enable experienced auditor expert having no previous connection with the audit to understand" the work that has been performed by the EQCR Team.

(d) Both paras 24 and 25 of SA 220 lay down what information needs to be documented. The word "document" cannot be interpreted to mean mere 'yes' or 'no' responses to a set of standard questions prepared as a general all purposes template. The documentation needs to have specific reference to the facts of the case in question and must provide the evidence as required by the SAs all taken together.

(e) Therefore, the documentation of the EQCR processes does not provide any evidence of the proper and complete performance of the EQCR work by the EQCR Team.

2.12.4 NFRA, therefore, concludes that the Engagement Quality Control Review was not carried out in the manner stipulated by SQC1 and other applicable SAs."

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

44. The DSAQRR which thereafter came to be issued on 01 May 2020 proceeded to lay various allegations with respect to the treatment of investments and a purported violation of the obligations flowing from SA500 and SA200. These allegations pertained to the valuation ascribed to investments and related party transactions as well the acceptance of those declarations in the course of an audit.

45. The writ petitions which initially came to be preferred before this Court were those instituted by Mr. Udayan Sen and Mr. Shrenik Baid, who were Engagement Partners in DHS in respect of the audit and Mr. Rukhsad Daruvala who was the EQCR Partner in respect of the said audit. When those writ petitions were initially entertained by the Court, on 21 May 2020 interim orders were passed to the effect that if any final orders come to be framed by the NFRA pursuant to the SCNs under Section 132(4) of the 2013 Act, the same would not be given effect to till the next date. On 26 June 2020 the order of 21 May 2020 thereafter came to be extended further.

46. On the writ petition preferred by DHS, the Court on 28 January 2021 had initially provided that any action that may be taken by the respondents would be subject to the outcome of the writ petition. On 12 March 2021 while considering CM No. 9896/2021, however, the Court provided that the respondents would stand restrained from precipitating the matter till the next date of listing. It is these interim orders which have continued on the writ petition.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

47. It would also be apposite to briefly take note of the facts as they obtain in WP(C) 11737/2021. **SRBC & Co LLP**[22], the writ petitioner, is a firm of CAs which was appointed as the joint auditor of **IN&FS Transportation Networks Limited**[23] for FY 2017-18. It is its case, that since certain other entities stood appointed as statutory auditors, a limited review alone for the quarter ending 30 June 2018 was performed by it jointly with those auditors. It is further disclosed that in the Annual General Meeting held on 29 August 2017 the other joint auditor rotated out and as a result of which SRBC came to be appointed as the statutory auditor for FY 2017-18.

48. It is its case that in the course of undertaking the limited review for the quarter ending 30 June 2018, SRBC had observed that ITNL had incurred losses with no significant progress being made with respect to re-financing of loans, realization of claims and monetization of assets. It had also alluded to the subsidiaries of ITNL who had filed notices of cure before relevant authorities and being unable to service their debt resulting in defaults and which in turn had led to the credit rating of the company being downgraded by ICRA. It further asserts that it had in its limited review report itself included a paragraph highlighting material uncertainties relating to ITNL's ability to continue as a going concern and was one of the first auditing firms to highlight this issue. SRBC then alludes to the audit quality review which was initiated by the NFRA in February 2019.

49. Pursuant to the initiation of that review, the petitioner is stated to have submitted the audit file and records to NFRA on 22 March 2019.

[22] SRBC
[23] ITNL

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

This was followed by communications of 17 May 2019 and 03 July 2019 by NFRA calling upon SRBC to respond to the various queries raised therein. After a detailed exchange of correspondence in the course of that audit quality review the NFRA issued its Prima Facie Conclusions on 24 March 2020. This was followed by Supplementary Prima Facie Conclusions which were issued on 17 April 2020. The summary of the Prima Facie Conclusions are reproduced hereinbelow:-

> "**5. Summary of PFC**
>
> The following is a summary of the most important of the PFC. Details of the evidence in support of these PFCs, and the reasoning leading thereto, are provided in the subsequent Sections of this PFC Report.
>
> (a) The initial appointment of SRBC & Co LLP, and the continuation of SRBC & Co LLP, as statutory auditor of ITNL was prima facie illegal and void. Nevertheless, NFRA has proceeded to examine compliance by the Audit Firm with the SAs, in their performance of this Engagement, without prejudice to this prima facie finding.
>
> (b) The Audit Firm has failed to appropriately and sufficiently evaluate the use of the going concern basis of accounting by the Management and has thus failed to note the implications thereof in the Auditor's Report.
>
> (c) In assessing the Risks of Material Misstatements (ROMM), the Audit Firm did not discuss the susceptibility of the financial statements to material misstatement due to fraud, did not identify and assess revenue recognition and management override of controls as presumed risk, which ultimately resulted in several violations of applicable Ind AS and SAs, as highlighted in the PFC Report, thus making the Financial Statements subject to serious material misstatements and therefore unreliable.
>
> (d) ITNL's financial exposure to its subsidiaries, associates and joint ventures amounting to Rs.10,805.15 crore was not properly valued as per the applicable Accounting Standards because the Audit Firm had failed to obtain sufficient appropriate evidence to justify the valuation of ITNL's investment and loans to these entities.
>
> (e) The Company's losses during 2017-18 were understated by at least Rs.1138.1 crore on account of unjustified reversal of ECL on

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

loans given to the SPVs, and on trade receivables. NFRA further concludes that there is a clear attempt to obscure material information in the Financial Statements by vague and misleading disclosures by the management regarding ECL reversal.

(f) The Audit Firm has not evaluated the work done by Management's Expert while adopting the Expert's opinion, and thus the Auditor's opinion expressed under the Companies' (Auditor's Report) Order, 2019 (CARO) clause (iii) stating that the terms and conditions of the Company's loans of Rs. 111.20 crore to joint ventures and to the not-fully owned subsidiaries at zero interest rate are not prejudicial to the company's interest, is not supported by sufficient appropriate evidence and is in violation of requirements of SA 500.

(g) The Audit Firm's EQC partner has failed to report material misstatements known to him to appear in a financial statement with which he is concerned in his professional capacity and has not exercised due diligence to obtain sufficient information to objectively evaluate the significant judgements of the Engagement Team and conclusions reached by them.

(h) The Audit Firm has not determined the persons comprising TCWG. Further, NFRA has not found any communication to TCWG relating to Auditor's independence, and the relationships and other matters between the firm, network firms.

(i) The Audit Firm has failed to maintain documents as per SA 230. The integrity of the Audit File is questionable due to tampering and inconsistency pointed out at several places in the PFC Report."

50. The Supplementary Prima Facie Conclusions then proceeded to observe as under:-

"INTEGRITY OF AUDIT FILE AND AUDIT FIRM'S IT CONTROLS REVIEW

4. To assess the extent of compliance with SQC 1 and SA 230 for the requirements discussed above, NFRA wrote to the Audit Firm on 17-Oct-2019 seeking clarifications and proof of authenticity of date of preparation of WPs. The Audit Firm was asked to provide NFRA the following:

a. The Audit firm's administrative procedures/instructions relating to building up/organizing/closing the Audit File and the safeguards incorporated therein to ensure the integrity of the said Audit File, and to prevent any tampering thereof; and

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Signing Date:07.02.2025
18:46:26

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b. Details of the IT systems and processes that are designed by the Audit Firm to ensure tracking of all additions/deletions/modifications of the electronic portion of the Audit File so as to obtain verifiable and tamper proof time logs of all such actions.

5. The Audit Firm responded to NFRA's letter dated 17-Oct-2019 vide their letter dated 21-

Oct-2019. Following are the key responses:

- *"These are complex IT related matters for which we are seeking suggestions from the Information and Technology team and also from the global teams dealing in IT, as we use the online audit documentation tool, Canvas, under licence from Ernst & Young Global."*
- "*Our documentation and archival policy clearly demonstrates the minimum requirement documentation and archival of the audit file. Please refer to documentation and archival policy document."*
- *"Key points from document and archival policy shared are as follows:*
- *We prepare our documentation using our electronic documentation tool.*
- ***Paper documentation is signed off as reviewed and prepared on the paper documentation**, in accordance with the requirements of SUP-RVW. Whenever possible, **we convert paper documentation into electronic form** via a scanning device (e.g., into a PDF document) or via an EY approved 'app' (e.g., using the camera feature in the EY Engage app) to include in our electronic documentation tool. **We apply procedures to generate an electronic version that is faithful in form and content to the original paper document.***
- *Unless prohibited by auditing standards, laws or regulations, or a document preservation order, **we destroy the paper documentation when the electronically converted document is included in our electronic documentation tool.***
- ***We date documentation as of the actual date** that the documentation is signed, and not as of an earlier date, even when the work or review was partially or completely performed earlier.*
- *Signing off on an audit procedure or task may not be sufficient documentation that a procedure was performed, evidence was obtained or a conclusion was reached. As we*

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

prepare our documentation, we choose our words carefully and ask ourselves whether what we write would be clear to an auditor who has no previous connection to the audit.

- *We sign off and date our documentation only when it is sufficiently complete to be able to conclude on the procedures performed. When sign-offs are made after the auditor's report date, but before the documentation completion date, we add a memo or other documentation explaining the difference in sign-off dates in accordance with DOC+ARC 4.3.*
- *We archive our documentation on a timely basis after the date of the auditor's report and when our procedures and documentation are complete. The documentation completion date is no later than 21 days after the date of our auditor's report / other deliverables.* ***The electronic i.e., CANVAS archival to be commenced after the paper documentation is submitted to the Admin teams.***
- *When finalizing our documentation, we review the electronic and paper documentation to determine that we have a complete and final set of documentation to support our opinion. Administrative changes that may be made to documentation during the assembly or finalization process include:*
    - *Documenting audit evidence that we obtained, discussed and agreed with*
    - *relevant members of the audit team prior to the date of our auditor's report*
    - *Adding an original confirmation response previously received via fax or email (although we also retain the faxed/email copy as it evidences the original work performed)*
    - *Clearing minor review notes (e.g., those that involve cosmetic changes or cross-references to evidence that already exists)*
    - *Accepting revisions in Word documents where the track changes functionality was used*
    - *Performing routine file-assembling procedures such as:*
    - *Deleting or discarding superseded documentation*
    - *Sorting, collating and cross-referencing final documents*

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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- *Signing off on completion checklists relating to the archive process*
- *Preparing the management letter*
- *After the documentation completion date (after archiving our documentation), we do not delete or discard our documentation of any nature before the end of its retention period, even if the documentation has been archived in error."*

6. Contrary to the policies quoted in the response of the Audit Firm, NFRA has observed:

a. instances of **audit evidence dated after the date of Auditor's Report**. Two such instances from the audit file have been laid out in Annexure I;

b. **mismatches between soft copy (EY Canvas files) and hard copies of WPs** provided by the Audit Firm. For example, the copies of WP 'ITNL TPE Minutes March 2018' and WP 'ITNL TPE M18(ppt)' made available in the hard file (Hardcopy File-1, pages A1-86 to A1-88 and A1-90 to A1-123) are not identical to the copies in EY Canvas. **Eleven** such instances from WP 'ITNL TPE Minutes March 2018' have been laid out in Annexure II; and

c. **mismatch between the signoff dates** mentioned in EY Canvas File with workpaper document properties and the dates mentioned within the documents. Four such cases have been laid out in Annexure III.

7. Further, NFRA observed the following from examination of the Audit Firm's working papers in CANVAS, and the Audit File :

a. The Audit Firm maintains separate 'Engagement Codes' for each audit engagement and every audit team member has to submit time-sheet for number of hours worked on respective engagement. However, the same does not happen in practice and no control or monitoring is found in the system of the firm. Therefore, NFRA could not satisfy itself that the audit procedures had been performed, documented and reviewed before the date of Audit Report from an inspection and comparison of the audit file logs of signoff dates with document properties and time-sheets,.

b. Any audit team member can edit a document in electronic audit file at any time **before or after review signoff by the EP.** There is neither any log of when the changes are made nor to what extent changes are made. Therefore, NFRA

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

concludes that the Audit documentation cannot identify, beyond doubt, about who has performed the audit work and the date such work was completed, and who has reviewed the audit work performed and the date and extent of such review.

c. There is no monitoring or control over the policy of modifications that can be made to audit documentation. There is no track of what has been modified in the audit file documentation post the audit report signoff. **Practically, an entirely new documentation of audit can be created with no logging or monitoring or control over the same.** Therefore, NFRA concludes that the audit firm has no controls that can ensure that the audit documentation has been completed in a timely manner without performing any further audit procedures or changes, other than administrative changes, after the audit report date.

d. No review takes place for the files modified after a review by the designated reviewer of the audit team. Therefore, there is sufficient reason to believe that the audit firm's SQC policy is not practiced and adhered to.

8. Based on the above-mentioned observations, NFRA communicated to the Audit Firm vide letter dated 24-Jan-2020, that NFRA would be engaging NFRA's IT consultants to examine the Audit firm's IT systems, and processes related thereto, to verify the integrity of the electronic portion of Audit File. NFRA, through its IT consultants, conducted an in-person review of the Audit Firm's IT systems and procedures of Audit File documentation and archival, along with the respective controls and monitoring procedures. The Audit Firm's IT experts as well as Audit Partner were present to demonstrate and respond to NFRA's queries. The Audit Firm's team was asked the queries as listed in Annexure IV, for which the Audit Firm's team requested time to come back stating the following reasons:

a. The Audit Firm uses the proprietary audit application and audit methodology licensed from Ernst & Young Global Limited (EYG).

b. The Audit Firm requires time to consult with the global IT team, in order to respond to NFRA's queries. Subsequently the Audit Firm had provided replies to the queries vide their emails dated 25- Feb-2020 and 13-Mar-2020.

9. During the in-person review, and after examining the replies furnished, the NFRA's IT consultants observed following vulnerabilities in the electronic platform (EY Canvas Application) with respect to the attributes mentioned in the aforesaid Para 3:

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

a. The details of changes made within a document/ form in the Audit Application are not captured and logged for the application, and since the older versions of the document/form are not available either, it is not possible to track the changes made to a document. All the logs and related reports, including the "Review Notes" added to the Audit File, from the start of the Audit are wiped off by the application before Archival of the Audit File, and therefore the logs and reports are not available for future inspection. [Indicating absence of attributes mentioned in Para 3(a), version history and security and 3(b) system logs and its monitoring]

b. No logging and monitoring of EY Canvas server and database (DB) events. The **Audit Firm** has not clearly answered how access was limited to ensure segregation and access only on a as per need basis, what is the process of maintaining generic IDs, can the server/DB administrators access EY Canvas Audit Files, etc. The Security testing reports, specific to EY Canvas and archival applications and servers, have not been shared. Further, the supporting process documentation has also not been shared so that it is not possible to understand the scope and frequency of security assessments. [Indicating absence of attribute mentioned in Para 3(a), version history and security, and 3(b) system logs and its monitoring]

c. Based on the input received from the Audit Firm, EY development team follows ITIL processes for development and maintains a change management process for all changes to the EY infrastructure globally. The change management process uses a controlled release process with appropriate testing and validation processes. However, the SDLC Process document was not shared for review to sufficiently conclude if security tests such as secure code review and dynamic testing were part of the SDLC process. Further, infrastructure change management process document was also not shared for review. Not building security controls into the design of the application as part of Software Development Life Cycle, while designing upgrades, could lead to an application vulnerable to intentional/unintentional modifications. [Indicating absence of attribute mentioned in Para 3(a), version history and security]

d. An uploaded document, which has been marked as "Prepared" and "Reviewed" by someone, can be replaced with another document not necessarily prepared and reviewed by the same person, without affecting the Sign-offs in the

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

original document. Further, as the details of changes made to a document are not captured, this activity does not get flagged in the application for mandatory review. Also, once a team member has uploaded/ created a document and marked it as "Prepared", the same can be marked to a selected person/ manager for review. Post completion of the review the document is to be Signed-off as "Reviewed". **However, technically it is feasible for the document preparer to mark the document as "Reviewed", bypassing the maker checker authorisations altogether. A reviewed document can be edited at any time but such a change does not mandate a "Re-Review" of the document and capturing of the changes made within the same.** The issues under the abovementioned categories are not addressed, and archival can be completed without performing the above reviews. [Indicating absence of attribute mentioned in Para 3(c) authentication and access control protocols].

e. **Audit Files within EY Canvas Application, and their contents, can be modified post release of Audit Report till the Audit File is Archived. There is no record of the changes made to the audit documents i.e. document modification post sign-off, and no version control for the documents, therefore there is no way to assess if the changes made were authorised or not. There is no monitoring on the time period till which an Audit File can be accessible or editable. ETs can reopen the files and modify the file for additional documentation without any logging or traceability.** This overlooks compliance with requirements of SA 230 as detailed in Para 2. [Indicating absence of attribute mentioned in Para 3(a), version history and security]

f. No logging and monitoring of end user or administrator activities in the Audit Application, to detect and prevent unauthorized activities is inbuilt into the system. Concurrent logins, using same user credentials on different systems, are possible and there is no mechanism in place to detect, alert or prevent such events, leading to serious accountability issues. In case of an incident, root cause analysis (RCA) may lead to inappropriate results, since there would be no IP/Unique system ID logged-in along with user identifier [Indicating absence of attribute mentioned in Para 3(c) authentication and access control protocols]

g. Roles and responsibility matrix for all roles of ET members, including access and the level of access, is not defined completely, such as right to operations

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

add/delete/modify/sign-off/ archive/ retrieve from archive etc. audit documents, for individual roles. [Indicating absence of attribute mentioned in Para 3(c) authentication and access control protocols].

h. Above all, **there is no mechanism to scan and sync the hard copy files to prevent or track any changes made to hard copy files post the archival date. This vulnerability alone is sufficient to totally compromise the entire objective of audit file integrity.**

10. It is, therefore, evident from the above that EY Canvas application, which is the only audit documentation system used by the Audit Firm, completely fails to ensure even the minimum controls essential to meet the requirements of SQC 1 and SA 230 as detailed in Para 1 above. The fundamental aspects of integrity of Audit Files, accountability of the firm and its personnel, maintaining sufficient appropriate audit evidence for the audit planning, performance and basis for conclusions for achieving audit objectives are seriously compromised as a result.

11. As discussed above, NFRA had pointed out several discrepancies in audit documentation that raised doubts about the authenticity and reliability of the audit documentation. The details given above show that the deficiencies are systemic and structural in nature and arise substantially from a complete disregard for basic principles of IT security in the software used. This renders the audit documentation completely unfit for the intended purpose

12. NFRA, further, concludes that **there is a complete failure of the Audit Firm's SQC policy to monitor and control the integrity of the audit files**. Consequently, the audit files maintained by the auditor are not found to meet the compliance requirements of SA 230. In having not rectified these deficiencies, the Audit firm is guilty of serious professional misconduct."

51. This led to the issuance of the DAQRR on 08 March 2021. The petitioner is stated to have submitted response to the DAQRR on 10 July 2021. An oral hearing in connection with the above is stated to have been held on 08 September 2021 and whereafter the AQRR came to be published on 23 September 2021. The summary of the AQRR is, as captured in para 1.8, extracted hereinbelow:-

"Summary of AQRR

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

1.8. The following is a summary of the most important observations of the AQRR. Details of the evidence in support of these observations, and the reasoning leading thereto, are provided in the subsequent Sections of this DAQRR.

1.8.1. The initial appointment of SRBC & Co LLP, and the continuation of SRBC & Co LLP, as statutory auditor of ITNL, was prima facie illegal and void. Nevertheless, NFRA has proceeded to examine compliance by the Audit Firm with the SAs, in their performance of this Engagement, without prejudice to this finding.

1.8.2. The Audit Firm has failed to appropriately and sufficiently evaluate the use of the going concern basis of accounting by the Management and has thus failed to note the implications thereof in the Auditor's Report.

1.8.3. In assessing the Risks of Material Misstatements (ROMM), the Audit Firm did not discuss the susceptibility of the financial statements to material misstatement due to fraud, did not identify and assess revenue recognition and management override of controls as serious potential risks, which ultimately resulted in several violations of applicable Ind AS and SAs, as highlighted in the AQRR, thus making the Financial Statements subject to serious material misstatements and therefore unreliable.

1.8.4. ITNL's financial exposure to its subsidiaries, associates and joint ventures amounting to Rs. 3,346 crore was not properly valued as per the applicable Accounting Standards because the Audit Firm had failed to obtain sufficient appropriate evidence to justify the valuation of ITNL's investment and loans to these entities.

1.8.5. The Company's losses during 2017-18 were understated by at least Rs. 2021 crore on account of unjustified reversal of Expected Credit Loss (ECL) on loans given to the SPV and on trade receivables, and due to incorrect impairment valuation. This is excluding the impact due to incorrect treatment of the letter of comforts amounting to Rs 2654 crore, which should have been correctly treated as financial guarantees as per the accounting standards, the effect of which on profit/loss is not quantified. NFRA further concludes that there is a clear attempt to obscure material information in the Financial Statements by vague and misleading disclosures by the management regarding ECL reversal.

1.8.6. The Audit Firm has not evaluated the work done by Management's Expert while adopting the Expert's opinion, and thus the Auditor's opinion expressed under the Companies' (Auditor's Report) Order, 2019 (CARO) clause (iii) stating that the terms and conditions of the Company's loans of Rs. 111.20 crore to joint ventures and to the not-fully owned subsidiaries at zero

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

interest rate are not prejudicial to the company's interest, is not supported by sufficient appropriate evidence and is in violation of requirements of SA 500.

1.8.7. The Audit Firm's EQC partner has failed to report material misstatements known to him to appear in a financial statement with which he is concerned in his professional capacity and has not exercised due diligence to obtain sufficient information to objectively evaluate the significant judgements of the Engagement Team and conclusions reached by them.

1.8.8. The Audit Firm has not determined the persons comprising TCWG. Further, NFRA has not found any communication to TCWG relating to Auditor's independence, and the relationships and other matters between the firm, network firms.

1.8.9. The Audit Firm has failed to maintain documents as per SA 230. The integrity of the Audit File is questionable due to tampering and inconsistency pointed out at several places in the AQRR.

1.9. While reference has been made in most cases to SAs which have a direct bearing on the issues under consideration, it needs to be borne in mind that certain generally applicable requirements of the SAs, such as the need to exercise professional scepticism, the need to obtain sufficient appropriate evidence, performance of procedures to address the assessed risks, etc., are integral in all individual cases discussed in the AQRR even if they are not specifically included in individual paragraphs of the Report.

1.10. Based on the conclusions in the AQRR, it appears that the Audit Firm has failed to meet the requirements of SA 700, para 11 while forming their opinion on the Company's Financial Statements for FY 2017-18. The instances discussed in this Report are of such significance that, in NFRA's view, the Audit Firm did not have any justification for issuing the Audit Report asserting that the audit was conducted in accordance with the SAs. NFRA draws attention to Response 12 in the ICAI's Implementation Guide on Reporting Standards (November 2010 edition) that says that "a key assertion that is made in this paragraph is that the audit was conducted in accordance with the SAs"; and that "If during a subsequent review of the audit process, it is found that some of the audit procedures detailed in the SAs were not in fact complied with, it may tantamount to the auditor making a deliberately false declaration in his report and the consequences for the auditor could

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> be very serious indeed" (emphasis added). Failure to comply with any of the requirements of applicable SAs indicates that the Audit
>
> Firm has failed to achieve the central purpose of audit, and that there was not an adequate justification for issuing the Audit Report."

52. Since the facts which formed the subject matter of the writ petition preferred by Rukshad Daruvala have been taken note of while dealing with the writ petition preferred by DHS, we do not propose to reiterate the chronology of events preceding the issuance of the SCN under Section 132(4) of the 2013 Act.

BROAD STRUCTURE UNDER THE CA ACT

53. Before we proceed to chronicle the rival submissions which were addressed before us, it would perhaps be apposite to take note of the salient statutory provisions in the context of which the challenge stands raised. We had in the preceding parts of this decision noticed the relevant provisions of the CA Act which are concerned with the subject of misconduct and the procedure for taking disciplinary action against a member of the Council. Although we had an occasion to notice the existence of the Misconduct Rules, 2007 and the 1988 Regulations, this would appear to be an appropriate juncture to notice some of the provisions incorporated in those statutory instruments. The Misconduct Rules, 2007 define a "firm" to be one registered with the ICAI under the relevant 1988 Regulations. As was noticed by us hereinabove, the Chapter pertaining to registration of firms had come to be introduced in the CA Act by virtue of Act 12 of 2022. In terms of Rule 3 of the Misconduct Rules, 2007 a complaint referable to Section 21 of the CA

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

Act was to be filed and presented before the Director (Discipline) in Form I. Rule 3 reads as follows:-

> "3. Procedure for filing complaint
>
> (1) A complaint under section 21 of the Act against a member or a firm shall be filed in Form I, in triplicate before the Director in person or by post or courier:
>
> **Provided** that the complaint sent by post or courier under this sub-rule shall be deemed to have been presented to the Director on the day on which it is received in the Directorate.
>
> (2) A complaint filed by or on behalf of the Central Government or any State Government, shall be authorized by an officer holding a post not below the rank of a Joint Secretary or equivalent and shall be signed by an officer holding a post not below the rank of an Under Secretary or equivalent in the Central or State Government, as the case may be.
>
> (3) A complaint filed by or on behalf of any statutory authority, such as Reserve Bank of India or Securities and Exchange Board of India, shall be authorised by an officer holding a post equivalent to the post of Joint Secretary in the Government of India and shall be signed by an officer holding a post not below the rank of an Under Secretary or equivalent in the Central or State Government, as the case may be.
>
> (4) A complaint filed by or on behalf of a company or a firm, shall be accompanied by a resolution, duly passed by the Board of Directors of the company or the partners of the firm, as the case may be, specifically authorizing an officer or a person to make the complaint on behalf of the company or the firm.
>
> **Explanation**. − In the case of a bank or financial institution, the general resolution or power of attorney authorizing an officer holding a particular position to file complaints on behalf of the bank or financial institution, shall be deemed to be the specific resolution passed by the bank or financial institution concerned, for the purposes of these rules.
>
> (5) In case of complaints filed by any Government, statutory authority, bank or financial institution, a change in the name of complainant at any later stage, shall be duly supported by a specific authorization made by an officer holding a post equivalent to that of the original complainant.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> (6) Every complaint received by the Directorate shall be acknowledged by ordinary post together with an acknowledgement number."

54. As is evident from a reading of Rule 3(1) a complaint under Section 21 of CA Act was envisaged to be one directed against the conduct of either a member or a firm. In terms of sub-rule (2) and (3) of Rule 3, a complaint could also be preferred by the Union or State Governments or even by a statutory authority, such as, the Reserve Bank of India or the Securities and Exchange Board of India.

55. Rule 5 of the Misconduct Rules, 2007 proceeds to spell out the requirements for registration of the complaint and a preliminary examination thereof by the Director (Discipline). Apart from a written complaint, which could be entertained by the Director (Discipline), Rule 7 also expanded the scope of the investigation or inquiry that could be undertaken by providing for any written information containing allegations against a member or a firm being treated as information received under Section 21 of the CA Act and consequently liable to be processed accordingly.

56. The procedure of investigation was set out in Chapter 3 of the Misconduct Rules, 2007. Rule 8 made the following pertinent provisions guiding the consideration of a complaint by the Director (Discipline) either against an individual member or a firm:-

> "8. Procedure to be followed by Director on a complaint
>
> (1) The Director or an officer or officers authorized by the Director, within sixty days of the receipt of a complaint under rule 3, shall, −
>
> (a) if the complaint is against an individual member, send particulars of the acts of commission or omission alleged or a

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

copy of the complaint, as the case may be, to that member at his professional address;

(b) if the complaint is against a firm, send particulars of the acts of commission or omission alleged or a copy of the complaint, as the case may be, to the firm at the address of its head office, as entered last in the Register of Offices and Firms maintained by the Institute, with a notice calling upon the firm to disclose the name or names of the member or members concerned and to send particulars of acts of commission or omission or a copy of the complaint, as the case may be, to such members:

Provided that while disclosing the name or names of the member or members, the firm shall also send a declaration signed or, as the case may be, jointly signed by the member or members concerned to the effect that he or she or they shall be responsible for answering the complaint and that the particulars of acts of commission or omission or the copy of the complaint sent to the firm by the Director had been duly received by him, her or them.

Explanation − A notice to the firm shall be deemed to be a notice to all the members who are partners or employees of that firm as on the date of registration of the complaint.

(2) A member whose name is disclosed by the firm shall be responsible for answering the complaint, provided such a member was associated, either as partner or employee, with the firm, against which the complaint has been filed, at the time of occurrence of the alleged misconduct:

Provided that if no member, whether erstwhile or present, of the firm, own responsibility for the allegation or allegations made against the firm, then the firm as a whole shall be responsible for answering the allegation or allegations and, as such, all the members who were partners or employees of that firm, as on the date of occurrence of the alleged misconduct, shall be responsible for answering the allegation or allegations as contained in the complaint.

(3) A member who has been informed of the complaint filed against him (hereinafter referred to as the respondent) shall, within 21 days of the service of a copy of the complaint, or within such additional time, not exceeding thirty days, as may be allowed by the Director, forward to the Director, a written statement in his defence.

(4) On receipt of the written statement, if any, the Director may send a copy thereof to the complainant and the complainant shall, within 21 days of the service of a copy of the written statement, or within such additional time, not exceeding thirty days, as may be allowed

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

by the Director, forward to the Director, his rejoinder on the written statement.

(5) On perusal of the complaint, the respondent's written statement, if any, and rejoinder of the complainant, if any, the Director may call for such additional particulars or documents connected therewith either from the complainant or the respondent or any third party or parties, as he may consider appropriate:

Provided that if no reply is sent by the respondent within the time allowed under sub-rule (3) or by the complainant within the time allowed under sub-rule (4), the Director shall presume that the respondent or the complainant, as the case may be, have nothing further to state and take further action as provided under this Chapter."

57. Upon conclusion of examination of the complaint the Director (Discipline) was enjoined to follow the procedure as stipulated in Rule 9. The said provision is extracted hereinbelow:-

"9. Examination of the Complaint

(1) The Director shall examine the complaint, written statement, if any, rejoinder, if any, and other additional particulars or documents, if any, and form his prima facie opinion as to whether the member or the firm is guilty or not of any professional or other misconduct or both under the First Schedule or the Second Schedule or both.

(2) (a) Where the Director is of the prima facie opinion that, −

(i) the member or the firm is guilty of any misconduct under the First Schedule, he shall place his opinion along with the complaint and all other relevant papers before the Board of Discipline;

(ii) the member or the firm is guilty of misconduct under the Second Schedule or both the First and Second Schedules, he shall place his opinion along with the complaint and all other relevant papers before the Committee.

(b) If the Board of Discipline or the Committee, as the case may be, agrees with the prima facie opinion of the Director under clause (a) above, then the Board of Discipline or the Committee may proceed further under Chapter IV or V respectively.

(c) If the Board of Discipline or the Committee, as the case may be, disagrees with the prima facie opinion of the Director under

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

clause (a) above, it shall either close the matter or advise the Director to further investigate the matter.

(3) Where the Director is of the prima facie opinion that the member or the firm is not guilty of any misconduct either under the First Schedule or the Second Schedule, he shall place the matter before the Board of Discipline, and the Board of Discipline, −

(a) if it agrees with such opinion of the Director, shall pass order, for closure.

(b) if it disagrees with such opinion of the Director, then it may either proceed under chapter IV of these rules, if the matter pertains to the First Schedule, or refer the matter to the Committee to proceed under Chapter V of these rules, if the matter pertains to the Second Schedule or both the Schedules, or may advise the Director to further investigate the matter.

(4) The Director shall, after making further investigation as advised by the Board of Discipline under sub-rule (2) or (3) of this rule or by the Committee under sub-rule (2), shall further proceed under this rule."

58. In terms of Rule 14 the Board of Discipline was required to follow a summary procedure for disposal of cases as is evident from the following:-

"**14. Procedure to be followed by the Board of Discipline**

(1) The Board of Discipline shall follow summary disposal procedure in dealing with all cases before it, as laid down in this Chapter.

(2) If the Board of Discipline decides to proceed further under clause (b) of sub-rule (2) of rule 9 or under clause (b) of sub-rule (3) of rule 9, it shall expeditiously cause to deliver to the respondent and the complainant, a copy each of the following:−

(a) prima facie opinion formed by the Director; and

(b) particulars or documents relied upon by the Director, if any, during the course of formulation of prima facie opinion.

(3) The Board of Discipline shall inform the respondent to file a written statement, within such time as may be specified:

Provided that the Board of Discipline may give him additional time for submitting his written statement on application by the

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

respondent on his adducing sufficient reasons to the satisfaction of the Board of Discipline for seeking additional time:

Provided further that such additional time shall not be given more than once and if the respondent still does not submit a written statement, the Board of Discipline shall presume that he has no further submissions to make and shall proceed to decide the case on merits.

(4) The respondent shall send a copy of his written statement, along with supporting documents, to the Director and the complainant within the stipulated time.

(5) The complainant or the Director may, after receipt of the written statement, submit a rejoinder to the Board of Discipline, with a copy to the respondent, along with supporting documents, if any.

(6) The Presiding Officer of the Board of Discipline shall fix a date, hour and place of hearing, which shall not ordinarily be later than 45 days from the date of receipt of prima facie opinion and the Board of Discipline shall cause a notice to be sent of such date, hour and place to the Director, respondent and complainant and require them to appear before it in person to make oral submissions, if any.

Explanation 1.– For the purpose of this rule, the appearance includes, unless and otherwise directed, appearance by an advocate or through any authorized representative, who may be a Chartered Accountant, Cost Accountant or Company Secretary.

[Explanation 2 - For the purpose of this rule, the appearance also includes the appearance through video-conference, modalities for which may be as formulated by the Institute from time to time**.]**

(7) On the date of hearing, if the respondent, in spite of the service of notice, under sub-rule (6), does not appear either in person **1**[or through video conference in terms of the modalities formulated under these Rules] or through his authorized representative, the Board of Discipline may proceed ex-parte and pass such orders as it may think fit or direct fresh notice to be served.

(8) The Board of Discipline may, on such terms as it thinks fit, and at any stage of the proceedings, adjourn the hearing:

Provided that such adjournment shall not be given more than once at any stage of the proceedings.

(9) The Board of Discipline shall consider the written representations, including the written statements, rejoinder and supporting documents, and the oral submissions, if any made by the Director, the complainant and the respondent and arrive at a finding

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

on whether the respondent is guilty or not of any professional or other misconduct."

59. By virtue of Rule 15, once the Board of Discipline had come to arrive at a finding of guilt in terms contemplated under Rule 14(9), the said authority was obligated to afford an opportunity of hearing to the respondent before proceeding to pass an order of punishment as contemplated under Section 21A(3) of the CA Act. The functioning of the Disciplinary Committee was regulated by similar provisions enshrined in the Misconduct Rules, 2007. Since it would be Rule 18 which would be pertinent for our purposes, the same is extracted hereunder:-

"18. Procedure to be followed by the Committee

(1) The Committee shall be guided by the principles of natural justice and shall follow the procedure in dealing with all cases before it, as laid down in this Chapter (2) If the Committee decides to proceed further under clause (b) of sub-rule (2) of rule 9 or if it receives a reference from Board of Discipline under clause (b) of sub-rule (3) of rule 9, it shall expeditiously cause to deliver to the respondent and the complainant, a copy each of the following, −

(a) prima facie opinion formed by the Director, and

(b) particulars or documents relied upon by the Director, if any, during the course of formulation of prima facie opinion.

(3) The Committee shall inform the respondent, as the case may be to file a written statement, within such time as may be specified:

Provided that the Committee may give him additional time for submitting his written statement, on application by the respondent on his adducing sufficient reasons to the satisfaction of the Committee for seeking additional time:

Provided further that such additional time shall not be given more than once and if the respondent still does not submit a written statement, the Committee shall presume that he has no further submissions to make and shall proceed to decide the case on merits.

(4) The respondent shall send a copy of his written statement, along with supporting documents and a list of witnesses, to the Director and the complainant within the stipulated time.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(5) The complainant or the Director may, after receipt of the written statement, submit a rejoinder to the Committee, with a copy to the respondent, along with supporting documents, if any.

(6) The Presiding Officer of the Committee shall fix a date, hour and place of hearing, which shall not ordinarily be later than 45 days from the date of receipt of prima facie opinion and the committee shall cause a notice to be sent of such date, hour and place to the Director, respondent and complainant and require them to appear before it in person to make oral submissions, if any.

[Explanation 1. – For the purpose of this rule, the appearance includes, unless and otherwise directed, appearance by an advocate or through any authorized representative, who may be a Chartered Accountant, Cost Accountant or Company Secretary.

[Explanation 2. - For the purpose of this rule, the appearance also includes the appearances through video-conference, modalities for which may be as formulated by the Institute from time to time**.]**

(7) During the first hearing, the Committee shall read out the charge or charges to the respondent along with the summary of prima facie opinion arrived at by the Director, and ask the respondent whether he pleads guilty to the charge or charges made against him:

Provided that if the respondent does not appear for the first hearing even after one adjournment, the reading out of charge or charges along with the summary of prima facie opinion shall be made in his absence and the case proceeded with in accordance with the provisions of this Chapter.

(8) If the respondent pleads guilty, the Committee shall record the plea and take action as per provisions under rule 19.

(9) If the respondent does not plead guilty, then the Committee shall fix a date for examination of witnesses and production of documents.

(10) The Committee may, on application of the Director, issue notice for appearance to any of his witnesses directing him to attend or to produce any other document or material evidence.

(11) On the date so fixed, the Committee shall proceed to take all such evidence as may be produced by the Director, including oral examination of witnesses and production of documents:

Provided that the Committee may permit the cross- examination of any witness to be deferred until any other witness or witnesses have been examined or recall any witness for further cross-examination.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(12) After the presenting of evidence by the Director is over, the complainant shall be given an opportunity, if present during the hearing, to present any additional evidence after satisfying the Committee that such evidence is relevant and has not been brought forward during the presentation by the Director.

(13) The respondent shall be then called upon to enter upon his defence and produce his evidence.

(14) If the respondent applies to the Committee to issue any notice for compelling attendance of any witness for the purpose of examination or cross-examination, or the production of any document or any material object, the Committee shall issue such notice unless it considers that such application should be refused on the ground that it is made for the purpose of vexation or delay or for defeating the ends of justice and such ground shall be recorded by it in writing.

(15) The witnesses summoned at the instance of the complainant under sub-rule (12) or the respondent under sub-rule (14) shall not be eligible for reimbursement of expenses incurred for attending the hearing.

(16) After evidences have been presented, the Director and the respondent shall present their arguments before the Committee:

Provided that after the Director has presented his argument, if the complainant, provided he is present during the hearing, feels that any vital argument has been left out by the Director, may present the argument, after convincing the Committee of the same.

(17) The Committee shall consider the evidences and arguments produced before it and arrive at a finding on whether the respondent is guilty or not of any professional or other misconduct.

(18) The Committee may, at the request of any of the parties before it or due to other reasons, and on such terms as it thinks fit, and at any stage of the proceedings, adjourn the hearing:

Provided that such adjournment shall not be given more than once at any stage of the proceedings.

Explanation. - For the purpose of this rule, inability of the complainant, advocate, authorized representative or witness, to appear shall not be treated as a valid reason for adjournment of a hearing."

60. Proceeding on lines akin to Rule 15 the Disciplinary Committee, upon arriving at a finding of guilt, was enjoined to follow the procedure as prescribed in Rule 19 and which reads as under: -

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

"**19. Orders of the Committee**

(1) On arriving at a finding under sub-rule (8) or sub-rule (17) of rule 18 that the respondent is guilty of professional or other misconduct, the Committee shall give the respondent an opportunity to be heard before passing any order under sub- section (3) of section 21B of the Act:

Provided that if the respondent does not appear before the Committee at the time directed to do so when given such an opportunity to be heard, the Committee shall presume that he has nothing more to represent before it and shall pass orders under sub-section (3) of section 21B of the Act.

(2) On arriving at a finding under sub-rule (17) of rule 18 that the respondent is not guilty of professional or other misconduct, the Committee shall pass orders closing the case.

(3) The Committee shall send, free of charge, to the Director, respondent and the complainant, a certified copy of the final order."

61. Turning then to the 1988 Regulations, of relevance would be Regulation 12 and which was concerned with the complaints and inquiries relating to misconduct pertaining to proceedings initiated or pending prior to 17 November 2006. Regulation 12 is extracted hereinbelow:-

"**12. Complaints and enquiries relating to misconduct of members**

[Applicable to a complaint or information pending before the Council or any inquiry initiated by the Disciplinary Committee or any reference or appeal made to a High Court prior to 17.11.2006]

(1) Subject to the provisions of this regulation, a complaint against a member under Section 21 shall be investigated and all other enquiries relating to misconduct of such member shall be held by the Disciplinary Committee:

Provided that if the subject matter of a complaint is, in the opinion of the President, substantially the same as or has been covered by any previous complaint or information received, the Secretary shall file the said complaint without any further action and inform the Complainant accordingly.

(2) A complaint under Section 21 shall be in the appropriate Form* duly verified and shall be in triplicate.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(3) Such complaint shall contain the following particulars namely:—

(a) the acts and omission which, if proved, would render the person complained against guilty of professional or other misconduct;

(b) the oral and or documentary evidence relied upon in support of the allegations made in the complaint.

(4) Every complaint, other than a complaint made by or on behalf of the Central or any State Government, shall be accompanied by a deposit of one hundred rupees which will be forfeited if the Council, after considering the complaint, comes to the conclusion that no prima facie case is made out and moreover that the complaint is either a frivolous one or is made with malafide intention.

(5) The Secretary shall return a complaint, which is not in the appropriate Form or which does not contain the aforesaid particulars, to *the Complainant* for representation after removing the objections thereto and within such time as the Secretary may specify.

(6) Ordinarily within sixty days of the receipt of a complaint under Section 21, the Secretary shall:—

(a) if the complaint is against a member, send a copy thereof to such member at his professional address as entered in the Register;

(b) if the complaint is against a firm, send a copy thereof to the firm at the address of its head office, as entered in the register of offices and firms, with a notice calling upon the firm to disclose the name of the member who is answerable to the charge of misconduct and requiring it to send a copy of the complaint to him.

Explanation - A notice to the firm shall be deemed to be a notice to all the members who are partners or employees of that firm.

(7) A member against whom the complaint is made (hereinafter referred to as the Respondent) may, within fourteen days of the service of a copy of the complaint under sub-regulation (6), or within such time as may be extended by the Secretary, forward to the Secretary in triplicate, a written statement in his defence verified in the same manner as the complaint.

(8) On receipt of the written statement, if any, the Secretary shall send a copy thereof to the Complainant and the Complainant may,

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

within 14 days of the service of a copy of the written statement, or within such time as may be extended by the Secretary, forward to the Secretary, in triplicate, his rejoinder on the written statement, duly verified in the same manner as the complaint.

(9) On receipt of the Complainant's rejoinder, if any, the Secretary shall send a copy thereof to the Respondent and the Respondent may within 14 days of the service of a copy of the rejoinder, or within such time as may be extended by the Secretary, forward to the Secretary, in triplicate, his comments on the rejoinder, duly verified in the same manner as the complaint.

(10) On a perusal of the complaint, the written statement, if any, the Complainant's rejoinder on the written statement, if any, and the Respondent's comments on the Complainant's rejoinder, if any, the President may call for such additional particulars or documents connected therewith either from the complainant or the Respondent as he may consider expedient.

(11) (i) If on a perusal of the complaint, the written statement, if any, the Complainant's rejoinder to the written statement, if any, and the Respondent's comments on the Complainant's rejoinder, if any, and other relevant documents, the Council is prima facie of opinion that the Respondent is guilty of professional and or other misconduct, the Council shall cause an enquiry to be made in the matter by the Disciplinary Committee.

(ii) If, on the other hand, the Council is prima facie of opinion that the Respondent is not guilty of any professional or other misconduct, the complaint shall be filed and the Complainant and the Respondent shall be informed accordingly.

(12) (i) Any notice issued by the Secretary under this regulation shall be sent to the member or the firm, as the case may be, by registered post with acknowledgement due.

(ii) If any such notice is returned unserved with an endorsement to the effect that the addressee had refused to accept the notice, the notice shall be deemed to have been served.

(iii) If the notice is returned with an endorsement to the effect that the addressee cannot be found at the address given, the Secretary shall ask the Complainant to supply to him the correct address of the member or the firm, as the case may be.

(iv) A fresh notice shall be issued to the member or the firm at the correct address.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(13) The provision relating to a notice shall apply 'mutatis mutandis' to a letter."

62. Although supplementary and additional provisions pertaining to inquiries and disciplinary action stood embodied in Regulations 15, 16 & 17, we do not deem it appropriate to extract those provisions here since those too were confined to proceedings initiated or pending prior to 17 November 2006.

NFRA RULES

63. While we had an occasion to notice Section 132 as embodied in the Companies Act in the earlier parts of this decision, for purposes of completeness we now turn our gaze upon the NFRA Rules and to the salient provisions contained therein. Rule 2 which constitutes the definition clause defines the word "division" in clause (g) as under:-

> **"2. Definitions.** (1) In these rules, unless the context otherwise requires,-
>
> **xxxx xxxx xxxx**
>
> g) "Division" means a division established by the Authority for the purpose of organising and carrying out its functions and duties;"

64. The functions and duties of the NFRA are elaborated upon and spelt out in Rule 4 which reads as follows:-

> **"4. Functions and duties of the Authority**. (1) 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.
>
> (2) In particular, and without prejudice to the generality of the foregoing, the Authority shall:
>
> (a) maintain details of particulars of auditors appointed in the companies and bodies corporate specified in rule 3;

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(b) recommend accounting standards and auditing standards for approval by the Central Government;

(c) monitor and enforce compliance with accounting standards and auditing standards;

(d) oversee the quality of service of the professions associated with ensuring compliance with such standards and suggest measures for improvement in the quality of service;

(e) promote awareness in relation to the compliance of accounting standards and auditing standards;

(f) co-operate with national and international organisations of independent audit regulators in establishing and overseeing adherence to accounting standards and auditing standards; and

(g) perform such other functions and duties as may be necessary or incidental to the aforesaid functions and duties.

(3) The Central Government may, by notification, and subject to such conditions, limitations and restrictions as may be specified therein delegate any of its powers or functions under the Act, other than the power to make rules, to the Authority."

65. Rule 7 speaks of the functions which the authority is obliged to discharge for the purposes of monitoring and enforcing compliance with Accounting Standards. That provision reads as under:-

"7. Monitoring and enforcing compliance with accounting standards. (1) For the purpose of monitoring and enforcing compliance with accounting standards under the Act by a company or a body corporate governed under rule 3, the Authority may review the financial statements of such company or body corporate, as the case may be, and if so required, direct such company or body corporate or its auditor by a written notice, to provide further information or explanation or any relevant documents relating to such company or body corporate, within such reasonable time as may be specified in the notice.

(2) The Authority may require the personal presence of the officers of the company or body corporate and its auditor for seeking additional information or explanation in connection with the review of the financial statements of such company or body corporate.

(3) The Authority shall publish its findings relating to non-compliances on its website and in such other manner as it considers fit, unless it has reasons not to do so in the public interest and it records the reasons in writing.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(4) Where the Authority finds or has reason to believe that any accounting standard has or may have been violated, it may decide on the further course of investigation or enforcement action through its concerned Division."

66. As an extension of the power that stands conferred upon the NFRA by virtue of Section 132(2)(b) of the Companies Act which is concerned with the monitoring and enforcement of compliance with Accounting Standards, Rule 8 makes the following provisions:-

"8. Monitoring and enforcing compliance with auditing standards. (1) For the purpose of monitoring and enforcing compliance with auditing standards under the Act by a company or a body corporate governed under rule 3, the Authority may: –

(a) review working papers (including audit plan and other audit documents) and communications related to the audit;

(b) evaluate the sufficiency of the quality control system of the auditor and the manner of documentation of the system by the auditor; and

(c) perform such other testing of the audit, supervisory, and quality control procedures of the auditor as may be considered necessary or appropriate.

(2) The Authority may require an auditor to report on its governance practices and internal processes designed to promote audit quality, protect its reputation and reduce risks including risk of failure of the auditor and may take such action on the report as may be necessary.

(3) The Authority may seek additional information or may require the personal presence of the auditor for seeking additional information or explanation in connection with the conduct of an audit.

(4) The Authority shall perform its monitoring and enforcement activities through its officers or experts with sufficient experience in audit of the relevant industry.

(5) The Authority shall publish its findings relating to non-complainces on its website and in such other manner as it considers fit, unless it has reasons not to do so in the public interest and it records the reasons in writing.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(6) The Authority shall not publish proprietary or confidential information, unless it has reasons to do so in the public interest and it records the reasons in writing.

(7) The Authority may send a separate report containing proprietary or confidential information to the Central Government for its information.

(8) Where the Authority finds or has reason to believe that any law or professional or other standard has or may have been violated by an auditor, it may decide on the further course of investigation or enforcement action through its concerned Division."

67. Similarly, with regard to the statutory obligation of the NFRA to oversee the quality of service rendered by professionals associated with auditing, Rule 9 provides as follows:-

"9. Overseeing the quality of service and suggesting measures for improvement.

(1) On the basis of its review, the Authority may direct an auditor to take measures for improvement of audit quality including changes in their audit processes, quality control, and audit reports and specify a detailed plan with time-limits.

(2) It shall be the duty of the auditor to make the required improvements and send a report to the Authority explaining how it has complied with the directions made by the Authority.

(3) The Authority shall monitor the improvements made by the auditor and take such action as it deems fit depending on the progress made by the auditor.

(4) The Authority may refer cases with regard to overseeing the quality of service of auditors of companies or bodies corporate referred to in rule 3 to the Quality Review Board constituted under the Chartered Accountants Act, 1949 (38 of 1949) or call for

any report or information in respect of such auditors or companies or bodies corporate from such Board as it may deem appropriate.

(5) The Authority may take the assistance of experts for its oversight and monitoring activities."

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

68. The power of investigation and the conduct of disciplinary proceedings are regulated by Rules 10 and 11, which are reproduced hereinbelow:-

> **"10. Power to investigate**. (1) Where the Authority has-
>
> (a) received any reference from the Central Government for investigation into any matter of professional or other misconduct under sub-section (4) of section 132 of the Act;
>
> (b) decided to undertake investigation into any matter on the basis of its compliance or oversight activities; or
>
> (c) decided to undertake suo motu investigation into any matter of professional or other misconduct, after recording reasons in writing for this purpose, it shall forward the matter to its Division dealing with enforcement for carrying out investigation and other action.
>
> (2) If, during the investigation, the Authority has evidence to believe that any company or body corporate has not complied with the requirements under the Act or rules which involves or may involve fraud amounting to rupees one crore or more, it shall report its findings to the Central Government.
>
> (3) On the commencement of these rules-
>
> (a) the action in respect of cases of professional or other misconduct against auditors of companies referred to in rule 3 shall be initiated by Authority and no other institute or body shall initiate any such proceedings against such auditors:
>
> Provided that no other institute or body shall initiate or continue any proceedings in such matters of misconduct where the Authority has initiated an investigation under this rule;
>
> (b) the action in respect of cases of professional or other misconduct against auditors of companies or bodies corporate other than those referred to in rule 3 shall continue to be proceeded with by the Institute of Chartered Accountants of India as per provisions of the Chartered Accountants Act, 1949 and the regulations made thereunder.
>
> **11. Disciplinary proceedings.** (1) Based on the reference received from the Central Government or findings of its monitoring or enforcement or oversight activities, or on the basis of material otherwise available on record, if the Authority believes that sufficient cause exists to take actions permissible under sub-section (4) of section 132, it shall refer the matter to the concerned

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

division, which shall cause a show-cause notice to be issued to the auditor.

(2) The show-cause notice shall be in writing, and shall, inter alia, state-

(a) the provisions of the Act or rules under which it has been issued;

(b) the details of the alleged facts;

(c) the details of the evidence in support of the alleged facts;

(d) the provisions of the Act, rules or the accounting standards or auditing standards thereunder allegedly violated, or the manner in which the public interest is allegedly affected;

(e) the actions that the Authority proposes to take or the directions it proposes to issue if the allegations are established;

(f) the time limit and the manner in which the auditor is required to respond to the show-cause notice;

(g) the consequences of failure to respond to the show-cause notice; and

(h) the procedure to be followed for disposal of the show-cause notice.

(3) The show-cause notice shall enclose copies of documents relied upon and extracts of relevant portions from the report of investigation or other records.

(4) The show-cause notice shall be served on the auditor in the following manner, namely -

(a) by sending it to the auditor at the address provided by him or provided by the Institute of Chartered Accountants of India (if required by the Authority) by registered post with acknowledgement due; or

(b) by an appropriate electronic means to the email address of the auditor provided by him or it or provided by the Institute of Chartered Accountants of India (if required by the Authority):

Provided that where the auditor is a firm -

(a) a notice to a firm shall be deemed to be a notice to all the partners or employees of that firm as on the date of service of notice;

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

(b) the notice shall call upon the firm to disclose the name or names of the partner or partners concerned who shall be responsible for answering the allegations;

(c) the partner whose name is disclosed by the firm shall be responsible for answering the notice against the firm, and if no partner, whether erstwhile or present, of the firm owns responsibility for the allegations made against the firm, then the firm as a whole shall be responsible for answering the allegations, and all the partners and employees of that firm as on the date of occurrence of alleged misconduct, shall be responsible for answering the allegations.

(5) The Division shall dispose of the show-cause notice within a period of ninety days of the assignment through a summary procedure as may be specified by the Authority, by a reasoned order in adherence to the principles of natural justice including where necessary or appropriate an opportunity of being heard in person, and after considering the submissions, if any, made by the auditor, the relevant facts and circumstances, and the material on record.

(6) The order disposing of a show-cause notice may provide for-

(a) no action;

(b) caution;

(c) action for imposing penalty against auditor under sub-clause (A) of clause (c) of sub-section (4) of section 132 or for debarring the auditor from engaging as such under sub-clause (B) of clause (c) of sub-section (4) of section 132 or both.

(7) The order passed under sub-rule (6) shall not become effective until thirty days have elapsed from the date of issue of the order unless the Division states otherwise in the order along with the reason for the same.

(8) The order passed under sub-rule (6) shall be served on the auditor in the manner specified in sub-rule (3) and a copy of the same shall be sent

(i) in all cases to - (a) the Central Government; and (b) the Institute of Chartered Accountants of India;

(ii) in the case of a company referred to in sub-section (5) of section 139 to the Comptroller and Auditor General of India;

(iii) in the case of a listed company to the Securities and Exchange Board of India; (iv) in the case of a bank or a non-banking finance company to the Reserve Bank of India;

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(iv) in the case of a bank or a non-banking finance company to the Reserve Bank of India;

(v) in the case of an insurance company to the Insurance Regulatory and Development Authority of India;

(vi) in case the auditor is resident outside India to concerned regulator of such country; and the same shall be published on the website of the Authority."

ADDITIONAL DISCLOSURES BY NFRA

69. Pausing here, we also take note of a salient aspect which was noticed by us in our order of 12 September 2023. It becomes pertinent to note that during the course of hearing of this batch of writ petitions it had been alleged by the petitioners that the complement of persons which had formed the opinion that disciplinary proceedings were liable to be initiated against the petitioners was the same or identical to that which had authored the AQRR. The petitioners had in that context laid stress upon the expression "division" as it occurs in various parts of Section 132 of the Companies Act as well as the NFRA Rules to contend that the statute clearly contemplated a division of functions between the review of an audit and the formation of opinion to initiate disciplinary proceedings.

70. The respondents, on the other hand, had contended that the executive body of the NFRA was clearly entitled in law to discharge all functions and duties as placed upon the NFRA as a whole. It was in the aforesaid context that we had called upon the respondents to file an additional affidavit and to disclose complete details of the personnel who had penned the AQRR in each case as well as the complement of persons who had initiated action under Section 132(4).

71. The order dated 12 September 2023 is reproduced hereinbelow:-

Signature Not Verified
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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

"1. One of the issues which had arisen in the course of hearing submissions addressed on behalf of the petitioners was of the Audit Quality Review Report [AQRR] and the ultimate initiation of disciplinary proceedings being regulated and controlled by the same authority.

2. Our attention was drawn to the provisions of Section 132 of the Companies Act, 2013 [the Act] as well as the National Financial Reporting Authority Rules 2018 ["2018 Rules"] and which allude to Divisions of the Authority carrying out investigation, inquiry and disciplinary proceedings. In order to obtain clarity on the factual position as it existed at the time when the impugned Show Cause Notices had been issued, we had invited Mr. Hossain, learned counsel to obtain instructions.

3. Mr. Hossain, on instructions, apprises us today that as contemplated under Section 132 of the Act, all functions relating to auditors falling under the purview of the National Financial Reporting Authority ["the Authority"] and which include monitoring, enforcement, investigation, disciplinary action are carried out by or on behalf of the Authority by the Executive Body. Mr. Hossain further submitted that it would be the contention of the Authority that the Executive Body stands duly empowered to take appropriate measures as contemplated under Section 132(4) of the Act.

4. In fact, and according to Mr. Hossain, the Executive Body would in itself constitute a Division as defined and contemplated under the Act and the 2018 Rules. It was further contended that neither Section 132 nor the 2018 Rules contemplates a strict "separation of powers" or a bifurcation of functions relating to investigation, inquiry and conduct of disciplinary proceedings.

5. On facts, it was stated that the body which drew up the AQRR is the one which initiated proceedings under Section 132(4) of the Act.

6. Mr. Hossain, in light of the submissions aforenoted, is accorded liberty to file an additional affidavit placing on the record the details with respect to proceedings drawn and initiated by the Authority and drawn against the petitioners here. That affidavit shall place on the record complete details of the personnel who penned the AQRR in each particular case as well as the complement of persons who initiated action under Section 132(4) and ultimately passed the orders impugned.

7. Mr. Kathpalia, learned senior counsel is continuing with his submissions. Let the matter be called again on 09.10.2023 as part heard in the category of "End of Board" matters."

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72. Pursuant to the aforesaid order an additional affidavit came to be filed by the NFRA and where the following disclosures are made:-

> "1. One of the issues which had arisen in the course of hearing submissions addressed on behalf of the petitioners was of the Audit Quality Review Report [AQRR] and the ultimate initiation of disciplinary proceedings being regulated and controlled by the same authority.
>
> 2. Our attention was drawn to the provisions of Section 132 of the Companies Act, 2013 [the Act] as well as the National Financial Reporting Authority Rules 2018 ["2018 Rules"] and which allude to Divisions of the Authority carrying out investigation, inquiry and disciplinary proceedings. In order to obtain clarity on the factual position as it existed at the time when the impugned Show Cause Notices had been issued, we had invited Mr. Hossain, learned counsel to obtain instructions.
>
> 3. Mr. Hossain, on instructions, apprises us today that as contemplated under Section 132 of the Act, all functions relating to auditors falling under the purview of the National Financial Reporting Authority ["the Authority"] and which include monitoring, enforcement, investigation, disciplinary action are carried out by or on behalf of the Authority by the Executive Body. Mr. Hossain further submitted that it would be the contention of the Authority that the Executive Body stands duly empowered to take appropriate measures as contemplated under Section 132(4) of the Act.
>
> 4. In fact, and according to Mr. Hossain, the Executive Body would in itself constitute a Division as defined and contemplated under the Act and the 2018 Rules. It was further contended that neither Section 132 nor the 2018 Rules contemplates a strict "separation of powers" or a bifurcation of functions relating to investigation, inquiry and conduct of disciplinary proceedings.
>
> 5. On facts, it was stated that the body which drew up the AQRR is the one which initiated proceedings under Section 132(4) of the Act.
>
> 6. Mr. Hossain, in light of the submissions aforenoted, is accorded liberty to file an additional affidavit placing on the record the details with respect to proceedings drawn and initiated by the Authority and drawn against the petitioners here. That affidavit shall place on the record complete details of the personnel who penned the AQRR in each particular case as well as the

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complement of persons who initiated action under Section 132(4) and ultimately passed the orders impugned.

7. Mr. Kathpalia, learned senior counsel is continuing with his submissions. Let the matter be called again on 09.10.2023 as part heard in the category of "End of Board" matters.

SI No.	Question	Answer
1	By whom AQR was prepared	The AQR report was prepared by the Executive Body (EB) NFRA. A team of Staff in NFRA, consisting of the Secretary, one Executive Director, and three Chartered Accountants (Professionals) assisted the EB in scrutiny of the Audit file, however EB has examined all the relevant documents contained in the audit file and after consideration of all relevant legal conditions, prepared and signed the AQRR, which was finally, with the approval of EB, issued by the Secretary, NFRA. The chronology of preparing the AQRR is as follows: a) NFRA letter dated 25.02.2019 was sent to the Engagement Partner (EP) requesting for the Audit file of IL&FS Financial Services Ltd for the Financial Year 2017-18. b) EP submitted the Audit File on 11.03.2019. c) NFRA's letter dated 25.04.2019 was sent to the Engagement Partner seeking a list of related parties and Audit/Non-Audit revenue m stipulated format on Affidavit. d) NFRA's letter dated 02.05.2019, containing a Questionnaire on matters observed in the Audit File, was sent via email on 02.05.2019 to the Engagement Partner seeking replies to the same. e) Reply of the Engagement Partner dated 08.05.2019 to NFRA letter dated 25.04.2019 was received on

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Signing Date:07.02.2025
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		affidavit and also received via email from CA Shrenik Baid, Partner DHS. f) Reply by the Engagement Partner to NFRA's Letter dated 02.05.2019 received on 13.05.2019. g) NFRA issued a letter dated 28.06.2019 to the Engagement Partner conveying its prima facie observations/comments/conclusions (PFC) on the various issues in the Questionnaire. Also, NFRA requested that the Engagement Partner, Sh. Udayan Sen, and the EQCR Partner, Sh. Rukshad Daruvala, or their respective authorised representative from the Engagement Team and the EQCR Team respectively, be present in person in the NFRA office to explain replies to PFC. h) Auditor requested NFRA through his letter dated 02.07.2019 to grant time till 30.07.2019 to provide comprehensive responses, after which to provide a date for an in-person meeting at which they may assist with any further clarifications if required. i) NFRA issued a letter dated 05.07.2019 granting time up to 5.8.2019 and the opportunity to explain the issues in person. j) Through letter dated 02.08.2019, Engagement Partner replied to NFRA's prima facie observations in its letter dated 28.06.2019. k) Draft AQRR Note was initiated by Secretary-NFRA on 25.09.2019 and put up for approval of EB. l) The EB NFRA granted approval vta notes dated 25.09.2019 for Draft AQRR and approval of providing an opportunity to the Engagement

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Signing Date:07.02.2025
18:46:26

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		Partner to appear in person before the Authority. m) Draft AQR Report (DAQRR) of NFRA dated 25.9.2019 sent to the Engagement Partner via email dated 25.9.19. n) NFRA issued letter dated 17.10.2019 to DHS seeking clarification regarding Audit documentation and IT ISSUEs. o) NFRA's letter dated 21.10.2019 containing additional Questionnaire, sent via email on 21.10.2019 to CA Udayan Sen seeking replies to the same. p) On 23.10.2019 DHS requested for extension of time up to 4.11.2020 for submission of response of NFRA's Letter dated 21.10.2019. q) NFRA emailed on 24.10.2019 granting extension of time up to 4.11.2020 as requested by DHS. r) In person Presentation to NFRA was made by the Engagement Team members from DHS on 30.10.19. s) Written replies were furnished by the Engagement Partner vide letter dated 4.11.19 to NFRA's observations in the DAQRR. t) On 15.11.2019 DHS provided its Reply to NFRA letter dated 17.10.2019 and 21.10.2019 w.r.t Audit Documentation/ IT issues and additional questionnaire. u) AQR Note was initiated by Secretary-NFRA on 11.12.2019 and put up for approval of EB. v) It was then approved by the EB for the issue vide note dated 11.12.2019. w) AQR Report, approved by the EB, was issued by

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Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

		the Secretary NFRA on 12.12.2019. x) On 23.01.2020, NFRA issued a letter to DHS for scheduling a meeting on 27.01.2020 regarding the IT application used for maintaining Audit Files. y) Presentation was given by the DHS team on 28.01.2020 regarding the IT application used for maintaining Audit Files at NFRA office and email sent by DHS regarding points to be clarified by DHS on IT related issues. z) NFRA Team with IT consultants visited office of Deloitte Haskins & Sells LLP (Auditor) at Gurugram on 29.01.2020 for further detailed understanding of their IT platform used for audit documentation. aa)Email of NFRA dated 07.02.2020 was sent to CA Udayan Sen seeking reply to additional requirements/ queries. The same were related to IT aspects of audit documentation. Reply was sought by 11.2.2020. bb)DHS emailed NFRA on 10.02.2020 seeking time to reply NFRA's letter dated 7.2.2020 by 21.2.2020. cc) Reply on the additional requirements from DHS received via letter dated 21.02.2020. dd)Draft Supplementary Audit Quality Review Report (DSAQRR) was issued to DHS on 01.05.2020. ee) On 23.05.2020, DHS requested NFRA to permit the filing of an interim reply to the DSAQRR by 25th June, 2020 and a supplemental reply to the DSAQRR within a reasonably practicable time from the date the lockdown is lifted in

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Signing Date:07.02.2025
18:46:26

		Mumbai. ff) NFRA's letter dated 2.06.2020 was issued to DHS for filing of Final Reply to Draft Supplementary Audit Quality Review Report (DSAQRR) by 25.06.2020. gg)On 23.06.2020, DHS requested NFRA to file comprehensive reply to DSAQRR by 25.07.2020. DHS also offered to alternatively, file their responses to the DSAQRR in a fragmented manner dealing with the issues covered therein in several parts and to file the first of such responses on 25th June, 2020 and the final one no later than 25th July, 2020. hh)On 26.06.2020, Part Reply was furnished by DHS in respect of the DSAQRR. ii) NFRA emailed on 27.06.2020 for granting extension of time upto 25.07.2020 to DHS for submission of consolidated response to the DSAQRR. jj) In respect of DSAQRR, Final Reply was furnished by DHS on 25.07.2020. kk)On 01.09.2020, NFRA sent a letter to DHS for oral hearing on 09.09.2020 regarding DSAQRR. ll.) On 03.09.2020, DHS sent a letter requesting for the date of hearing for any time after 2.10.2020. mm) On 05.10.2020, NFRA granted the request for extension of time. nn) On 28.10.2020 – Oral hearing was conducted on DSAQRR. oo)On 20.11.2020, DHS provided written clarifications after Oral hearing on DSAQRR. pp)On 07.12.2020, EB approved for issue of Supplementary AQRR

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Signing Date:07.02.2025
18:46:26

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		covering IT related control deficiencies in audit documentation by DHS and this was issued by the Secretary NFRA.
2	Who has conducted the investigation?	As decided by the EB, the SCN followed the detailed AQR process as detailed above. The chronology is as follows: - After the issuing the AQRR, EB with the assistance of a team under a Chief General Manager, NFRA ("CGM"), who was not part of the AQR team, examined the observations in the AQRR and prepared draft SCN to the Audit Firm and Partners. The SCNs were approved for issue by the EB. a) On 02.01.2021, CGM initiated a note for EB's approval for issue of SCN to DHS. b) On 03.01.2021, EB approved to issue the SCN. c) On 06.01.2021, SCN issued to DHS. d) After that the DHS approached the court and matter is pending before the Hon'ble Delhi High Court.
3	Which authority/official has authorized the initiation of action?	The AQR of the ILPS groups was started suo-motu as decided by the EB. Later, a reference from the central Government was also received by NFRA on the same matter.
4	Who had heard and conducted the proceedings?	SCN was issued to DHS on 06.01.2021. After that the DHS approached the Court and matter is pending before the Hon’ble Delhi High Court. Hence, further proceedings are at hold.

2. WP(C) No. 1524 of2020 (Udayan Sen),

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Signing Date:07.02.2025
18:46:26

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3. WP(C) No. 1522 of 2020 (Rukshad Daruvala),
4. WP(C) No. 1525 of 2020 (Shrenik Baid)

SI No.	Question	Answer
1	By whom AQR was prepared	The AQR report was prepared by the Executive Body (EB) NFRA. A team of Staff in NFRA, consisting of the Secretary, one Executive Director, and three Chartered Accountants (Professionals) assisted EB in scrutiny of Audit file however EB examined all the relevant documents contained in the audit file and after consideration of all relevant legal conditions, prepared and signed the AQRR, which was finally, with the approval of EB, issued by Secretary NFRA. The chronology of preparing the AQRR is as follows: a) NFRA letter dated 25.02.2019 was sent to the Engagement Partner (EP) requesting for the Audit file of IL&FS Financial Services Ltd for the Financial Year 2017-18. b) EP submitted the Audit File on 11.03.2019. c) NFRA's letter dated 25.04.2019 was sent to the Engagement Partner seeking a list of related parties and Audit/Non-Audit revenue in stipulated format on Affidavit. d) NFRA's letter dated 02.05.2019, containing a Questionnaire on matters observed in the Audit File, was sent via email on 02.05.2019 to the Engagement Partner seeking replies to the same. e) Reply of the Engagement Partner dated 08.05.2019 to NFRA letter dated 25.04.2019 was received on affidavit and also received via email from CA Shrenik Baid, Partner DHS. f) Reply by the Engagement Partner

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Signing Date:07.02.2025
18:46:26

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		to NFRA's Letter dated 02.05.2019 received on 13.05.2019. g) NFRA issued a letter dated 28.06.2019 to the Engagement Partner conveying its prima facie observations/comments/conclusions (PFC) on the various issues in the Questionnaire. Also, NFRA requested that the Engagement Partner, Sh. Udayan Sen, and the EQCR Partner, Sh. Rukshad Daruvala, or their respective authorised representative from the Engagement Team and the EQCR Team respectively, be present in person in the NFRA office to explain replies toPFC. h) Auditor requested NFRA through his letter dated 02.07.2019 to grant time till 30.07.2019 to provide comprehensive responses, after which to provide a date for an in-person meeting at which they may assist with any further clarifications if required. i) NFRA issued a letter dated 05.07.2019 granting time up to 5.8.2019 and the opportunity to explain the issues in person. j) Through letter dated 02.08.2019, Engagement Partner replied to NFRA's prima facie observations in its letter dated 28.06.2019. k) Draft AQRR Note was initiated by Secretary-NFRA on 25.09.2019 and put up for approval ofEB. 1) The EB NFRA granted approval via notes dated 25.09.2019 for Draft AQRR and approval of providing an opportunity to the Engagement Partner to appear in person before the Authority. m) Draft AQR Report (DAQRR) of

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Signing Date:07.02.2025
18:46:26

		NFRA dated 25.9.2019 sent to the Engagement Partner via email dated 25.9.19. n) NFRA issued letter dated 17.10.2019 to DHS seeking clarification regarding Audit documentation and IT issues. o) NFRA's letter dated 21.10.2019 containing additional Questionnaire, was sent via email on 21.10.2019 to CA Udayan Sen seeking replies to the same. p) On 23.10.2019 DHS requested for extension of time up to 4.11.2020 for submission of response of NFRA's Letter dated 21.10.2019. q) NFRA emailed on 24.10.2019 granting extension of time up to 4.11.2020 as requested by DHS. r) In person Presentation to NFRA was made by the Engagement Team members from DHS on 30.10.19. s) Written replies were furnished by the Engagement Partner vide letter dated 4.11.19 to NFRA's observations in the DAQRR. t) AQR Note was initiated by secretary-NFRA on 11.12.2019 and put up for approval of EB. u) It was then approved by the EB for the issue vide note dated 11.12.2019. v) AQR Report, approved by the EB, was issued by the Secretary NFRA on 12.12.2019.
2.	Who has conducted the investigation?	As decided by the EB, the SCN followed the detailed AQR process as detailed above. The chronology is as follows: - After the issuing the AQRR, EB with the assistance of a team under a CGM, who was not part of the AQR team, examined the observations in the AQRR and prepared draft SCN to the Audit

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Signing Date:07.02.2025
18:46:26

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		Firm and Partners. The SCNs were approved for issue by the EB. a) On 28-01-20, NFRA issued the Show cause Notice (SCN) to Rukshad Daruwala, wherein the last date for replying to the SCN was mentioned as 29-02-2020. b) On 07-02-20, a Writ Petition was filed by Rukshad Daruvala in Delhi High Court. c) On 14-02-20, a Letter was sent by R Daruvala informing NFRA that he will not be filing the reply to SCN, owing to the WP filed. d) On18-03-20, NFRA issued a letter to Rukshad Daruvala regarding filing of reply to SCN as there is no stay on NFRA proceeding by the Court. e) On 20-03-20, Reply from R Daruvala was received by NFRA that he shall not be filing a reply to the SCN due to the pendency of proceeding in Delhi High Court. f) On 29-04-20, NFRA sent a letter to R Daruvala, giving him time up to 1Oth May 2020 to file the reply. g) On 13-05-20, NFRA wrote a letter to R Daruvala, granting him additional time upto 20-05-2020 and also offering an opportunity of personal hearing. h) On 17-05-20, R Daruvala requested NFRA that he will file interim reply by 10-06-20. i) On 18-05-20, NFRA rejected R Daruvala's request for extension of time as a considerable time had already passed and there was no stay granted by the Delhi High Court. j) On 21-05-20, Delhi High Court granted R Daruvala time upto 10-06-

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Signing Date:07.02.2025
18:46:26

		20 to file reply to the SCN. k) On 27-05-20, NFRA sent a letter for rescheduling oral hearing on 11-06-20. 1) On 10-06-20, R Daruvala submitted Interim Reply to the SCN. m) On 11-06-20, Oral hearing was conducted before EB. n) On 13-06-20, R Daruvala provided his written submissions post oral hearing. o) On 20-07-20, R Daruvala submitted supplemental reply to the SCN. p) On 23-07-20, EB signed the order and approved for issue of same under the signature of Secretary NFRA. ***Identical process for AQRR and Investigation (SCN) was followed for Shrenik Baid and Udayan Sen as well.**
3	Which authority/official has authorized the initiation of action?	The AQR of the ILFS group was started suo-motu as decided by the EB. Later, a reference from the central government was also received by NFRA on the same matter.
4	Who had heard and conducted the proceedings?	The oral hearing was before the EB (the Chairperson and Full-time Member). Thereafter, the EB signed the orders and approved for issue of same under the signature of Secretary NFRA and the Secretary issued the orders.

5. W.P.(C) 11737/2021- SRBC Vs. UNION OF INDIA & ANR,
6. W.P.(C) 11738/2021- Vinayak Pujare Vs. UNION OF INDIA & ANR.
7. W.P.(C) 11739/2021- Ravi Bansal Vs. UNION OF INDIA & ANR

SI NO.	Question	Answer

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18:46:26

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1	By whom AQR was protected	The AQR report was prepared by the Executive Body (EB) was prepared NFRA. A team of Staff in NFRA, consisting of the Secretary, one Executive Director, one CGM and three Chartered Accountants (Professionals) assisted EB in scrutiny of Audit file, however EB examined all the relevant documents contained in the audit file and after consideration of all relevant legal conditions, prepared and signed the AQRR, which was finally, with the approval of EB, issued by Secretary NFRA. The chronology of preparing the AQRR is as follows: a) On 22.02.2019, NFRA sent an email to the Audit firm requesting for the Audit file of ILF &S Transportation Networks Limited (ITNL) for the Financial Year 2017-18. b) On 22.03.2019, the Audit firm submitted Audit Files of ITNL vide letter dated 22 March 20 19. c) On 17.05.2019, NFRA sent an email to SRBC seeking details of: 1. List of Related Parties of ITNL; 2. List of Related Parties of M/s SRBC & Co LLP; 3. Details of audit and non-audit fee received from the auditee. d) On 14.06.2019, SRBC sent a letter to NFRA providing details sought by NFRA vide its email dated 17.05.2019. e) On 03.07.2019, NFRA sent its pt Questionnaire to SRBC. f) On 17.07.2019, NFRA sent an email seeking Affidavit w.r.t the information received by NFRA on14.06.2019.

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Signing Date:07.02.2025
18:46:26

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		g) On 19.07.2019, NFRA sent its 2nd Questionnaire to SRBC. h) On 22.07.2019, SRBC provided its response to NFRA's 1st Questionnaire. i) On 23.07.2019, SRBC submitted Affidavit dated 23.07.2019 in support of information sent on 14.6.2019. j) On 29.07.2019, SRBC provided its response to NFRA's 2nd Questionnaire. k) On 09.08.2019, NFRA sent an email to SRBC, seeking audit file references and page numbers for hard files. l) On 19.09.2019, SRBC sent a letter, providing details as sought by NFRA in its email dated 09.08.2019 alongwith SQC-1 Policy, 3 Limited Review Files. m) On 17.10.2019, NFRA sent a letter to SRBC for verifying dates of audit files and procedures pertaining to integrity of dating. n) On 23.12.2019, NFRA sent a letter seeking engagement letters for audit and non-audit services to ITNL for the FYs 2014-15 to 2018-19. o) On 10.01.2020, SRBC sent a letter providing the details sought by NFRA on 23.12.2019. p) On 22.01.2020, NFRA requested the Audit firm for submission of Memorandum, analysis, presentations, and other material incorporating the impact of transition from IGAAP to lnd AS. q) On 29.01.2020, SRBC submitted details as requested by NFRA on 22.01.2020.

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Signing Date:07.02.2025
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		r) On 24.03.2020, NFRA issued its Prima-Facie Conclusions (PFC) on AQR of Statutory audit of ITNL. s) On 17.04.2020, NFRA issued Supplementary PFC (SPFC) on Integrity of audit file and Audit Firm's IT Controls Review. t) On 03.07.2020, SRBC submitted its response to PFC and SPFC. u) On 28.12.2020, NFRA asked the Audit Firm for additional documents - copy of audit committee and Board Meeting minutes for appointment of SRBC & Co LLP for FY 2016-17, Audit Engagement Acceptance Letter 20 16-17, Minutes of Audit committee 29 May 2018, Underlying agreement 2012-13. v) On 02.01.2021, SRBC provided its response to information sought by NFRA on 28.12.2020 with five annexures. w) On 08.03.2021, NFRA issued the Draft Audit Quality Review Report (DAQRR). x) On 10.07.2021, Written replies were furnished by SRBC, w.r.t NFRA's observations in the DAQRR. y) On 08.09.2021, Engagement team members of SRBC made a presentation to NFRA. z) On 23.09.2021, the EB approved the issue of AQR. aa) On 23.09.2021, as authorised by EB, the Secretary NFRA issued AQR Report for ITNL's audit done by SRBC for the Financial Year 2017-18.
2	Who had conducted the investigation?	As decided by the EB, the SCN followed the detailed AQR process as detailed above: After the issuing the AQRR, EB with

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Signing Date:07.02.2025
18:46:26

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		the assistance of a team under a CGM, examined the observations in the AQRR and prepared draft SCN to the Audit Firm and Partners. The SCNs were approved for issue by the EB. The chronology is as follows: a) On 27.09.2021, EB approved the issue of SCN to CA Vinayak Pujare ,EQCR. b) On 28.09.2021, As approved by the EB, the Secretary NFRA issued the SCN to CA Vinayak Pujare. c) On 28.09.2021, EB approved the issue of SCN to CA Ravi Bansal, EP and SRBC & Co. LLP, Audit Firm. d) On 28.09.2021, As approved by the EB, the SecretaryNFRA issued the SCN to EP and Audit Firm. e) On 18.11.2021, Ravi Bansal and Vinayak Pujare submitted their reply to the SCN issued by NFRA. f) On 19.11.2021, SRBC submitted its reply to SCN issued by NFRA. g) On 17.08.2023, Oral hearing for SRBC, Ravi Bansal and Vinayak Pujare was conducted before EB. h) Orders are yet to be issued.
3	Which authority/official the initiation of action?	The AQR of the ILFS group was started suo-motu as decided by the EB. Later, a reference from the Central Government was also received by NFRA on the same matter.
4	Who had heard and conducted the proceedings?	The oral hearing was before the EB (the Chairperson and Full-time Member). Orders are yet to be issued.

8. W.P.(C) 11987/2022 Jayesh Gandhi Vs. UNION OF INDIA & ANR

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18:46:26

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SI. NO	Question	Answer
1	By whom AQR was prepared	The AQR report was prepared by the Executive Body (EB) NFRA. A team of Staff in NFRA, consisting of the Secretary, one Executive Director, one CGM and four Chartered Accountants (Professionals) assisted EB in scrutiny of Audit file, however EB examined all the relevant documents contained in the audit file and after consideration of all relevant legal conditions, prepared and signed the AQRR, which was finally, with the approval of EB, issued by Secretary NFRA. The chronology of preparing the AQRR is as follows: a) On 12.02.2019, NFRA sent an email to Auditors of ILF &S Limited requesting for the Audit file of ILF&S Limited for the Financial Year 2017-18. b) On 25.03.2019, Auditors of IL&FS Limited submitted the Audit File. c) On 1.10.2019, NFRA requested SRBC to submit separate laptop for audit file of FY 17-18. d) On 1.10.2019 and 6.10.2019, NFRA requested IL&FS Limited to submit documents. e) On 7.10.2019, IL&FS Limited submitted the requested documents to NFRA. f) On 11.10.2019, NFRA requested SRBC to submit an Affidavit regarding list of related parties, audit & non-audit fees, peer review report, hours logged for FY 17-18latest by 25th Oct 2019. g) On 17.10.2019, NFRA requested SRBC to verify the dates of the audit file and procedures/IT safeguards

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

		pertaining to the integrity of dates. h) On 26.10.2019, NFRA received the response from SRBC for its email dated 11.10.2019. i) On 31.10.2019, NFRA requested IL&FS Limited to submit certain Investigation reports, RBI Inspection reports, Forensic audit reports. j) On 2.11.2019, NFRA received the RBI Inspection Reports from IL&FS Limited. k) On 5.10.2019, NFRA received a response for email dated 17.10.2019 regarding the date of the audit file and procedures/IT safeguards pertaining to the integrity of dates. 1) On 19.11.2019, NFRA issued a Questionnaire to SRBC. m) On 30.12.2019, SRBC provided its response to Questionnaire issued on 19.11.2019 by NFRA. n) On 26.08.2020, NFRA issued a Supplementary questionnaire. o) On 6.9.2020, NFRA received a response to the supplementary questionnaire issued by it on 26.8.2020. p) On 16.10.2020, NFRA requested IL&FS Limited to confirm whether SRBC was appointed as concurrent auditor of the company? q) On 19.10.2020, NFRA received a response from IL&FS Limited to its communication dated 16.10.2020. r) On 2.12.2020, NFRA requested clarification from SRBC regarding General Contingency Provision (GCP). s) On 2.12.2020, NFRA requested IL&FS Limited for certain information w.r.t.- Board Meeting

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Signing Date:07.02.2025
18:46:26

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		for FY17, FY18, FY19 and Audit Committee Meeting for FY19. t) On 10.12.2020, NFRA received information from IL&FS Limited regarding BM and ACM as requested on 2.12.2020. u) On 12.12.2020, NFRA received a response from SRBC w.r.t. clarification on GCP sought by NFRA on 2.12.2020. v) On 21.12.2020, NFRA issued its Prima Facie Conclusions/Observations (PFC). w) 14.4.2021, NFRA received SRBC's response to the PFC x) On 23.07.2021, NFRA issued its Draft AQRR. y) On 27.9.2021, NFRA received SRBC's reply to the DAQRR. z) On 17.5.2022, NFRA conducted an Oral hearing for SRBC Team to present Its submissions w.r.t DAQRR. aa) On 22.6.2022, as authorised by EB, the Secretary NFRA issued AQR Report for the Financial Year 2017-18.
2	Who has conducted the investigation?	As decided by the EB, the SCN followed the detailed AQR process as detailed above. After the issuing the AQRR, EB with the assistance of a team under a CGM, examined the observation in the AQRR and prepared draft SCN to the Partners. The SCNs were approved for issue by the EB. The chronology is as follows: - a) On 27.6.2022, as approved by the EB, the Secretary-NFRA issued the SCN to EP, CA Jayesh Gandhi.

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Signing Date:07.02.2025
18:46:26

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		b) On 20.9.2022, the EP submitted his Reply to SCN issued by NFRA. c) On 5.7.2023, an Oral hearing, before EB, was conducted w.r.t SCN dated 27.06.22, attended by the legal counsels and the EP. d) On 10.07.2023, the EP submitted his written summary of submissions after the oral hearing. e) Final order by EB, yet to be issued.
3	Which authority/official has authorized the initiation of action?	The AQR of the ILFS group was started suo-motu as decided by the EB. Later, a reference from the central Government was also received by NFRA on the same matter.
4	Who had heard and conducted the proceedings?	The oral hearing was before the EB (the Chairperson and Two Full-Time Members). Final Orders are yet to be issued.

9. W.P.(C) 5842/2023 SNEHAL N MUZOOMDAR Vs. UNION OF INDIA&ANR

SI. NO	Question	Answer
1	By whom AQR was prepared	No AQRR is this case.
2	Who has conducted the investigation?	At the time of carrying out an Audit Quality Review (AQR) of the statutory audit of Dewan Housing Finance Corporation Limited (DHFL) for FY 2017-18 conducted by Chaturvedi & Shah LLP (C&S) , a Mumbai based Audit Firm, the EB noticed that 33 Engagement Partners (EPs) or branch auditors had signed the "Independent Branch Auditors' Report" for nearly 250 branches, without a valid appointment. The Statutory Auditor of the Company viz. M/s Chaturvedi and Shah LLP

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Signing Date:07.02.2025
18:46:26

		had referred to these so called Branch Audit reports in its Independent Audit report of DHFL. The EB examined the work of these 33 EPs, including Snehal Muzoomdar, under section 132 (4) of the Companies Act, 2013 and observed non compliances in the acceptance of Audit engagement by the Branch Auditors and non-compliance of Standards on Auditing (SAs) in conducting the audit by them. Thereafter, the SCNs were approved for issue by the EB. a) On 10.08.2022, EB approved for initiation of action under Section 13 2(4) of the Companies Act, 2013. b) On 10.08.2022, as approved by the EB, the Secretary-NFRA sent letters and emails to Snehal Muzoomdar ,EP for submission of audit file. c) On 25.08.2022, EP submitted the audit file and EB examined the audit file. d) On 16.11.2022, EB approved for the issue of the SCN to CA Snehal Muzoomdar ,EP. e) On 21.11.2022, as approved by the EB, the secretary-NFRA issued the SCN.
3	Which authority/official has authorized the initiation of action?	The action against the EP was initiated suo-motu by the EB. a) On 21.11.2022, as approved by the EB, the secretary-NFRA issued the SCN giving 30 days time for reply. b) On 19.12.2022, EP requested for extension of time for submitting reply to the SCN. c) On 26.12.2022, on behalf of EB, the Chairperson approved the extension of time.

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

		d) On 27.12.2022, email was sent to EP granting extension of time. e) On 18.01.2023, EP submitted his reply to the SCN dated 21.11.2022. f) On 10.02.2023, a letter was sent to EP conveying the date and time for oral hearing on 17.02.2023 but this date was rescheduled by EB for 07.03.2023. g) On 06.03.2023, EP requested for reschedule of the oral hearing due to his mother's demise. h) The EB rescheduled the hearing on 27.03.2023. i) EB again, on EP's request, rescheduled the hearing on 10.04.2023. j) On 10.04.2023, first oral hearing ofEP was held. k) On 14.04.2023, EP submitted additional written submissions subsequent to the 1st oral hearing. 1) On 19.05.2023, email was sent to EP for intimating his willingness to avail the additional oral hearing along with his legal counsel. m) On 23.05.2023, EP confirmed his willingness for additional hearing. n) The hearing was scheduled on 02.06.2023. o) On 29.05.2023, EP requested for rescheduling of personal hearing due to his hearing in Supreme Court. p) On 31.05.2023, EB approved for rescheduling the personal hearing. q) On 06.06.2023, the oral hearing was adjourned after its commencement since the EP was not accompanied by a legal counsel. r) On 12.06.2023, personal hearing, before EB, was held along with his legal

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

		representative. s) On 15.06.2023, EP submitted additional written submissions subsequent to the hearing. t) On 29.09.2023, EB signed the Order and authorised Secretary NFRA to issue the same. The Secretary NFRA issued the Order.
4	Who had heard and conducted the proceedings?	The oral hearing was before the EB (the Chairperson and Two Full-time Members).

10. W.P. (C) No. 1650 of 2023 Natrajan Ram Krishna v/s UOI & NFRA

SI. NO	Question	Answer
1	By whom AQR was prepared	The AQR report was prepared by the Executive Body was prepared (EB) NFRA. A team of Staff in NFRA, consisting of the Secretary, one Executive Director, one CGM and four Chartered Accountants (Professionals) assisted EB in scrutiny of Audit file, however EB examined all the relevant documents contained in the audit file and after consideration of all relevant legal conditions, prepared and signed the AQRR, which was finally, with the approval of EB, issued by Secretary NFRA. The chronology of preparing the AQRR is as follows: a) On 12.02.2019, NFRA sent an email to Auditors of ILF &S Limited requesting for the Audit file of ILF &S Limited for the Financial Year 2017-18.) On 25.03.2019, Auditors of IL&FS Limited submitted the Audit File. b) On 25.03.2019, Auditors of IL&FS Limited submitted the Audit File.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

		c) On 1.10.2019 and 6.10.2019, NFRA requested IL&FS Limited to submit documents. e) On 7.10.2019, IL&FS Limited submitted the requested documents to NFRA. f) On 11.10.2019, NFRA requested SRBC to submit an Affidavit regarding list of related parties, audit & non-audit fees, peer review report, hours logged for FY 17-18latest by 25th Oct 2019. g) On 17.10.2019, NFRA requested SRBC to verity the dates of the audit file and procedures/IT safeguards pertaining to the integrity of dates. h) On 26.10.2019, NFRA received the response from SRBC for its email dated 11.10.2019. i) On 31.10.2019, NFRA requested IL&FS Limited to submit certain Investigation reports, RBI Inspection reports, Forensic audit reports. j) On 2.11.2019, NFRA received the RBI Inspection Reports from IL&FS Limited. k) On 5.10.20 19, NFRA received a response for email dated 17.10.20 19 regarding the date of the audit file and procedures/IT safeguards pertaining to the integrity of dates. 1) On 19.11.2019, NFRA issued a Questionnaire to SRBC. m) On 30.12.2019, SRBC provided its response to Questionnaire issued on 19.11.20 19 by NFRA. n) On 26.8.2020, NFRA issued a Supplementary questionnaire. o) On 6.9 .2020, NFRA received a response to the supplementary questionnaire issued by it on

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

		26.8.2020. p) On 16.10.2020, NFRA requested IL&FS Limited to confirm whether SRBC was appointed as concurrent auditor of the company? q) On 19.10.2020, NFRA received a response from IL&FS Limited to its communication dated 16.10.2020. r) On 2.12.2020, NFRA requested clarification from SRBC regarding General Contingency Provision (GCP). s) On 2.12.2020, NFRA requested IL&FS Limited for certain information w.r.t.- Borad Meeting for FY17, FY18, FY19 and Audit Committee Meeting for FY19. t) On 10.12.2020, NFRA received information from IL&FS Limited regarding BM and ACM as requested on 2.12.2020. u) On 12.12.2020, NFRA received a response from SRBC w.r.t. clarification on GCP sought by NFRA on 2.12.2020. v) On 21.12.2020, NFRA issued its Prima Facie Conclusions/Observations (PFC). w)14.4.2021, NFRA received SRBC's response to the PFC. x) On 23.07.2021, NFRA issued its Draft AQRR.) y)On 27.9.2021, NFRA received SRBC's reply to the DAQRR. On 22.6.2022, as authorised by EB, the Secretary NFRA issued AQR Report for the Financial Year 2017-18.
2	Who has conducted the investigation?	As decided by the EB, the SCN followed the detailed AQR process

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

		as detailed above: After the issuing the AQRR, EB with the assistance of a team under a CGM, examined the observations in the AQRR and prepared draft SCN to the Partners. The SCN s were approved for issue by the EB. The chronology is as follows: - a) On 27.6.2022, as approved by the EB, the Secretary-NFRA issued the SCN to CA Natrajan Ramkrishna, EQCR, giving him 30 days' time to reply. b) He did not respond to the SCN in-time, so, on 25.08.2022, NFRA requested CA Natrajan Ramkrishna to submit his reply to the SCN on or before 11.09.2022. c) On 12.09.2022, CA Natrajan Ramkrishna stated that he had retired from SRBC & Co. LLP three years ago and does not have any access to the audit file - as such, he is unable to submit his reply to the SCN. He also requested NFRA to make available him the audit file to submit his reply to the SCN. d) On 15.09.2022, NFRA allowed CA Natrajan Ramkrishna to visit the office of NFRA to collect the audit file. e) On 24.09.2022, CA Natrajan Ramkrishna stated that he is not in position to visit the office of NFRA due to bad health and requested NFRA to allow his authorized representative to visit on his behalf to collect all the relevant files and documents in relation to the SCN. f) On 12.10.2022, NFRA allowed CA Natrajan Ramkrishna to send his authorised representative to office of NFRA any day between 17th

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

		October, 2022 to 201h October, 2022, with prior intimation to NFRA, to collect the copy of the documents relating to SCN. g) On 19.10.2022, one person claiming to be the authorised representative of CA Natrajan Ramkrishna came to NFRA asking for the copy of the documents. However, that person came without any prior intimation and valid authorisation and affidavit from CA Natrajan Ramkrishna, requirement of which was specifically mentioned by NFRA in email dated 12.10.2022. In the absence of proper authorisation and identity, relevant documents could not be provided. h) On 3.11.2022, NFRA sent a reminder to CA Natrajan Ramkrishna to submit his response to the SCN on or before 18.11.2022. In response to the said email, CA Natrajan Ramkrishna attached a copy of signed affidavit and letter of authorisation in his email to allow his representative Ms. Saumya Kaul to visit the office of NFRA to collect files and documents in relation to the SCN. i) On 21.11.2022, Ms. Saumya Kaul, the authorised representative of CA Natrajan Ramkrishna visited the office of NFRA and she was provided with the following documents: 1. Audit File pertaining to Statutory Audit of IL&FS Limited for FY18 2. Questionnaire 3. Response of SRBC to the Questionnaire 4.PFC

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

		5. Response of SRBC to the PFC 6. DAQRR 7. Response of SRBC to the DAQRR j) On 13.12.2022, CA Natrajan Ramkrishna requested NFRA to share Appendix to the response of SRBC to PFC. k) On 27.12.2022, NFRA shared the said Appendix with CA Natrajan Ramkrishna and extended the time to submit the response to SCN by 11.01.2023. 1) On 11.01.2023, CA Natrajan Ramkrishna submitted his reply to SCN. m) On 21-09-2023, CAN Ramakrishna requested for rescheduling the hearing due to the inconvenience of his legal counsel. n) On 25-09-2023, the EB rescheduled the oral hearing to 11-10-2023 as requested by CA N Ramakrishna.
3	Which authority/official has authorized the initiation of action?	The AQR of the ILFS group was started suo-motu as decided by the EB. Later, a reference from the central government was also received by NFRA on the same the initiation of matter.
4	Who had heard and conducted the proceedings?	The oral hearing, before EB ((The Chairperson & 02 Full-Time Members) is scheduled on 11.10.2023.

11. W.P. (C) No. 10303 of2023- CA Vinay Aggarwal

SI NO.	Question	Reply
1	By whom the Audit Quality Review Report	No Audit Quality Review Report was prepared in this case.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

	was prepared?	
2	Who had conducted the investigation?	a) On 30.05.2022, NFRA received SEBI's letter dated 19.05.2022 regarding report on examination/ analysis of Annual Reports of Magnum Ventures Ltd (Magnum). b) On 02.06.2022, the Secretary NFRA submitted this matter to EB through Chairperson NFRA and on 03.06.2022, EB initiated the examination in this case. For scrutiny of the documents, the EB was assisted by an Executive Director & his team. c) On 16.06.2022, the Executive Director submitted the file to EB through Chairperson with a proposal to call audit files and other records from the Auditor and Magnum for investigation u/s 132(4) of the Companies Act 2013 (Act). d) On 20.06.2022, EB through Chairperson approved the proposal and Auditor was advised to submit audit files within 30 days. e) On 14.07.2022 Auditor sought extension of time till 30.09.2022. f) On 26.07.2022, NFRA allowed extension of 15 days' time i.e., till 05.08.2022. g) On 02.08.2022, Auditor sought extension of time till 31.10.2022. NFRA allowed extension of 15 days' time i.e., till 20.08.2022. h) On 19.08.2022, Auditor submitted audit files after 60 days. i) Thereafter, the EB, with the assistance of an Executive Director & his team examined the financial statements of Magnum ventures Ltd and audit files of M/s Aggarwal and Rampal for the relevant period.

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Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

		Based on such examination, sufficient cause existed to initiate action u/s 132(4) of the Companies Act, 2013 against CA Vinay Aggarwal, engagement partner of M/s Aggarwal and Rampal.
3	Which authority/official had authorized the initiation of action?	a) The EB through the Chairperson, NFRA authorized initiation of action on 20.06.2022 (for calling audit files) under section 132(4) of the Companies Act the initiation of b) The Executive Body (Chairperson and two full time action? members) of NFRA authorised issue of two Show Cause Notices to CA Vinay Aggarwal on 15.06.2023 with the advice to submit reply within 30 days' time. c) On 10.07.2023, Auditor sought extension of time till 05.08.2023 for submission of reply to SCN. NFRA allowed time till 25.07.2023. d) On 20.07.2023, Auditor sought extension of time till 05.08.2023 for submission of reply to SCN, which was allowed. e) On 05.08.2023, Auditor submitted reply to one SCN and sought 10 days' time for submission of reply to second SCN. Reply to 2nd SCN has also been submitted by him.
4	Who had heard and conducted the proceedings?	CA Vinay Aggarwal has submitted reply to one SCN and requested for Personal Hearing. Reply to second SCN has also been received. The Executive Body (EB) of NFRA will hear CA Vinay Aggarwal and advocate, if any, and conduct the proceedings.

12. W.P. (C) No. 2194 of2023: CA Adarsh Ranka

Sr No	Question	Reply

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Digitally Signed
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Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

1	By whom the Audit Quality Review Report was prepared?	No Audit Quality Review Report was prepared in this case.
2	Who had conducted the investigation?	a) A letter dated 11.05.2021 from SEBI was received by NFRA regarding the irregularities in the financial statements of Sobha Limited. b) On 31.05.2021, matter was submitted to the EB through Chairperson. c) On 04.06.2021, the Executive Body (EB), through chairperson, approved for calling of Audit File. In this case, the EB is assisted by an ED & him team. d) On 09.08.2021, Auditor was asked to submit the audit file. e) On 23.08.2021, Auditor sought 06 weeks extension of time till 05.10.2021. f) Extension as sought was granted by NFRA. g) On 04.10.2021, Auditor submitted audit files after 57 days of initial notice to submit the audit file (Whereas SAs mandates freezing of audit file within 60 days of signing of the audit report) h) On 10.02.2022, NFRA sought comments on the SEBI observations from the auditor and requested to submit the reply within 15 days. i) On 21.02.2022, Auditor sought extension for additional 01 month to submit his comments. j) Extension as sought was again granted by NFRA. k) On 24.03.2022, Auditor submitted his comments.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

		I) Comments of the auditor was considered by the EB and on completion of the examination by the EB, there were reasons to believe that sufficient cause existed to initiate action u/s 132(4) of the Companies Act, 2013 against CA Adarsh Ranka, Engagement Partner (EP) of S. R. Batliboi & Associates LLP.
3	Which authority/official had authorized the initiation of action?	f) On 04.06.2021, the Executive Body (EB) NFRA, through its Chairperson, authorised calling audit files and on 09.08.2021, under Section 132 of the Companies Act, 20 13 read with NFRA Rules asked the auditor to submit the audit file. g) On 05.01.2023, EB (Chairperson and two full time members), after due application of mind, approved for issue of a Show Cause Notice (SCN) to CA Adarsh Ranka, asking him to submit reply to the SCN within 30 days' time and he was also offered to avail opportunity of personal hearing. h) On 07.02.2023, Auditor submitted reply to SCN i.e., after 33 days of issue of SCN.
4	Who had heard and conducted the proceedings?	a) On 07.02.2023, CA Adarsh Ranka submitted reply to SCN and requested for Personal Hearing. b) NFRA considered his request for personal hearing and c) On 02.06.202, NFRA issued a communication to the auditor intimating the date of personal hearing scheduled to be held on 26.06.2023. Initially 24 days' time was granted, in addition to the time granted to reply the SCN, to the auditor for preparation of personal hearing.

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

		d) On 12.06.2023, Auditor sought 3 weeks extension from the date of this communication. e) On 22.06.2023, NFRA granted 18 days extension rescheduling the hearing on 14.07.2023. So, total42 days were granted to the auditor for the preparation of / Personal Hearing. f) On 14.07.2023, Personal Hearing was held before the EB. g) Final order is yet to be issued.

AUDITING INDUSTRY : EXECUTIVE DELIBERATIONS

73. Before we proceed further to chronicle and record the erudite submissions which were addressed by learned senior counsels appearing for respective sides, it would be appropriate to briefly pause and take note of the salient and significant events which appear to have led to Section 132 of the Companies Act being introduced in the statute book.

74. As was noticed in the preceding parts of this decision, the provision itself came to be introduced in the Act by virtue of Act No. 18 of 2013. The provision, however, came to be energized only on 01 October 2018. The proposed structure of Section 132 also formed the subject matter of consideration of the Standing Committee on Finance and stands noted in its Thirty Seventh report. The subject of regulation of audit firms and networks also formed part of deliberations of prior Standing Committees and some of which have been noticed in the former parts of this judgment. While the imperative need to regulate auditing firms and to align auditing norms with global standards formed

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Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

subject matter of discussion of constituents of the Union Government at different points of time, concrete steps in that direction appear to have been prompted by the direction issued by the Supreme Court on 23 February 2018 in *S. Sukumar.*

75. The direction which the Supreme Court framed on that occasion read thus:-

> "The Union of India may constitute a three member Committee of experts to look into the question whether and to what extent the statutory framework to enforce the letter and spirit of Sections 25 and 29 of the CA Act and the statutory Code of Conduct for the CAs requires revisit so as to appropriately discipline and regulate MAFs. The Committee may also consider the need for an appropriate legislation on the pattern of Sarbanes Oxley Act, 2002 and Dodd Frank Wall Street Reform and Consumer Protection Act, 2010 in US or any other appropriate mechanism for oversight of profession of the auditors. Question whether on account of conflict of interest of auditors with consultants, the auditors profession may need an exclusive oversight body may be examined. The Committee may examine the Study Group and the Expert Group Reports referred to above, apart from any other material. It may also consider steps for effective enforcement of the provisions of the FDI policy and the FEMA Regulations referred to above. It may identify the remedial measures which may then be considered by appropriate authorities. The Committee may call for suggestions from all concerned. Such Committee may be constituted within two months. Report of the Committee may be submitted within three months thereafter. The UOI may take further action after due consideration of such report."

76. Pursuant to the aforesaid directive, a three-member expert committee came to be constituted. The remit of that committee can be gathered from the terms of reference which is extracted below:-

"No. 1/4/2018- PI
GOVERNMENT OF INDIA
MINISTRY OF CORPORATE AFFAIRS

5TH Floor, 'A' Wing, Shastri Bhawan
Dr. Rajendra Prasad Road,

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Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

New Delhi-110001

Dated: 20-04-2018

OFFICE MEMORANDUM

Sub: Constitution of three (3) member Committee of Experts as per directions of Hon'ble Supreme Court of India vide order dated 23.02.2018 in Civil Appeal No. 2422 of 2018 (Arising out of Special Leave Petition)(Civil) no. 1808 of 2016 to look into the regulatory and other issues related to Multi-National Accounting Firms (MAF)

The Hon'ble Supreme Court in Civil Appeal No. 2422 of 2018 has vide Order dated 23.02.2018 in Civil Appeal No. 2422 of 2018 (Arising out of Special Leave Petition)(Civil) no. 1808 of 2016 has directed Union of India to constitute a three member Committee of Experts to look into the regulatory and other issues related to Multi-National Accounting Firms (MAFs). Accordingly, three member Committee of Experts consisting of the following members is hereby constituted:-

(i) Shri Anurag Agarwal,
Chairperson
Joint Secretary,
Ministry of Corporate Affairs

(ii) Shri Sudhanshu Pandey,
Member
Joint Secretary,
Department of Commerce

(iii) Shri Ravinder,
Member
Joint Secretary,
Department of Industry

2 The terms of reference of the Committee of Experts are as follows:

(i) The Committee of Experts will look into the question whether and to what extent the statutory framework to enforce the letter and spirit of Sections 25 and 29 of the CA Act and the statutory Code of Conduct for the CAs requires revisit so as to appropriately discipline and regulate MAFs.

(ii) The Committee may also consider the need for an appropriate legislation on the pattern of Sarbanes Oxley Act, 2002 and Dodd Frank Wall Street Reform and Consumer Protection Act, 2010 in US or any other appropriate mechanism for oversight of profession of the auditors

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Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(iii) The issue regarding conflict of interest of auditors with consultants, the auditors' profession may need an exclusive oversight body may be examined.

(iv) The Committee may examine the Study Group and the Expert Group Reports referred to in the order 23.2.2018 of Hon'ble Supreme Court apart from any other material.

(v) The Committee may also consider the steps for effective enforcement of the provisions of the FDI policy and the FEMA Regulations.

(vi) The Committee of Experts may identify the remedial measures which may then be considered by appropriate authorities. The Committee may call for suggestions from all concerned.

(vii) Any other matter to be considered the Committee of Experts.

3. The Committee of Experts shall complete its work and submit its report within three months of its constitution.

4. This issues with the approval of Competent Authority.

(G. Vaidheeswaran)
Deputy Secretary to the Govt, of India"

77. By the time the COE came to be constituted, markets as well as regulatory authorities across the globe had come to adequately acknowledge the necessity of financial information being accurate and trustworthy. In fact, as the COE itself recognized the availability of trustworthy financial information on the performance of companies had come to be accepted as a necessary requirement of the efficiency of the securities markets itself. By this time, markets as well as regulatory authorities across the globe had come to accept the imperatives of financial information being accurate, trustworthy and for a more effective and robust regulatory regime being created. This was essentially prompted by major financial scams which had occurred in various parts of the world including India and which had seen corporate behemoths imploding overnight wiping away the savings and

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Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

investments of billions. In fact, as the COE itself acknowledged the availability of trustworthy financial information on the performance of companies had come to be accepted as a necessary requirement of the efficiency of the securities markets itself.

78. We would be justified in acknowledging the fact that by this time markets as well as regulatory authorities had come to accept that corporate entities no longer remained the fiefdom of individual groups of private investors. Companies in today's time, undisputedly, survive and prosper also on the basis of investments made by members of the general public. Private equity investment has thus come to constitute an important component of the capital which drives modern corporate entities and enables them to thrive. They have thus become vehicles which carry the savings and dreams of billions. It is these amongst various other imperatives which appears to have driven the need for the creation of a more robust audit regulatory framework.

79. As the COE records, the earliest of the regulatory measures relating to the field of financial reports was prompted by the stock market crash of 1929 in the **United States of America**[24] and the Great Depression which followed in its wake. The USA thereafter constituted specialized bodies such as the Stock Exchange Commission, the Financial Accounting Standards Board and the Commission on Accounting Procedures thereafter. This system held the field till the self-regulatory model itself came to be doubted after the Enron scandal which broke out in the early 2000s. It was this and the felt need to rebuild investor confidence which led to the US Congress enacting the

[24] USA

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

Sarbanes-Oxley Act in 2002. This significant legislation marked the first transition from self- regulation to the creation of an independent body which would exercise oversight over the auditing profession. The **Public Company Accounting Oversight Board**[25] owes its genesis to this seminal legislation.

80. While we shall have an occasion to contrast the powers vested and exercisable by the PCAOB alongside those conferred on the NFRA in the subsequent segments of our decision, suffice it to note that the said regulatory body is placed under a statutory obligation to assess degree of compliance by each auditing firm with applicable laws and professional standards. It is also enabled by that legislation to inspect auditing firms and the reports of its inspection being placed in the public domain in case deficiencies are not addressed within 12 months. The PCAOB also stands empowered to inspect registered public accounting firms located in foreign jurisdictions.

81. The Sarbanes-Oxley legislation was followed by the Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010 and which in turn armed the PCAOB with powers which expanded its regulatory control and oversight over brokers and dealers registered with the SEC.

82. The tremors of Enron were not confined to the American continent alone. Taking a cue from the steps which were taken in the United States, in 2002 the Government of the **United Kingdom**[26] also undertook a detailed review of its regulatory regime. This saw the setting up of the Financial Regulatory Commission in April 2004 and

[25] PCAOB
[26] UK

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

which was conferred the status of an independent regulator in respect of corporate reporting and governance. As the COE records, the UK today follows a two-tier structure, comprising of an independent audit regulator assisted by multiple front line self regulatory organizations. Insofar as regulation of auditors is concerned, the same stands vested in the **Financial Reporting Council**[27] principally, whilst some tasks stand delegated to multiple recognized supervisory and qualification bodies. While a **Recognised Supervisory Body**[28] supervises certain aspects of auditors, the **Recognised Qualification Body**[29] formulates appropriate audit qualifications.

83. The Companies Act, 2006 as prevalent in the UK, the COE report records, prohibits a person from acting as an auditor unless it satisfies the independence requirements statutorily put in place. In terms of Section 125 of that statute, violation of independence requirements also exposes an auditor to criminal sanction. The COE significantly takes note of the legal position with respect to civil liability of an auditor as being one which is well established and accepted in English law. A similar exercise to revamp the regulatory mechanism pertaining to auditing firms also appears to have been undertaken by the People's Republic of China and which is noticed in paragraph 3.3 of the report of the COE.

84. Insofar as developments closer to home are concerned, the need and compulsion to review our own regulatory scheme appears to have been prompted by the Satyam Scam which shocked the nation in 2009.

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[27] FRC
[28] RSB
[29] RQB

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

It was around this time that the Union Government constituted a high-level committee on corporate audit and governance and which is more popularly known as the Naresh Chandra Committee. It is this Committee which undertook a comprehensive evaluation of all aspects pertaining to corporate governance. The Council itself appears to have woken up to the new challenges pursuant to the recommendations made by a study group constituted by it and which had submitted a report in 2005. It was the recommendations made by the Naresh Chandra Committee which also prompted the insertion of Section 28A in the CA Act and which for the first time mandated the establishment of a **Quality Review Board**[30].

85. While Section 210A had existed in the erstwhile company law statute and provided for the constitution of the NACAS, the Standing Committee on Finance reviewing the Companies Bill, 2009 for the first time in its 21st report recommended that NACAS should act as a quasi regulator to monitor the quality of audits undertaken. It was these developments which set the stage for the various amendments which came to be introduced in the Companies Act between 2013 to 2018.

86. However, and as was noted in the previous sections of this decision, the apprehensions of a perceived conflict between the CA Act and the role envisaged to be discharged by the NFRA arose for discussion on more than one occasion. Dealing with these aspects, the COE observed: -

> **"4.1. Whether India has an appropriate mechanism for oversight of the audit profession?**

[30] QRB

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

1.The COE is of the view that establishment of NFRA creates no inconsistency between the provisions of the Companies Act, 2013 and the Chartered Accountants Act, 1949.

2.The COE observes that with the recent move towards establishment of NFRA, India has adopted the current global best practice in this regard which can address the problems experienced with self-regulation of the audit profession.

3.The COE observes that NFRA has been structured on the lines of international best practices followed by other independent audit regulators in advanced jurisdictions.

4.The COE recommends that NFRA could be further strengthened and therefore, the rules which are presently being formulated, must provide powers to NFRA to publish audit inspection results, subject to necessary checks and balances. This will strengthen NFRA further and will provide an effective tool of deterrence for better compliance by the auditors of public companies with the applicable laws and professional standards.

5.The COE observed that there are benefits of having multiple competing SROs under one independent regulator like in UK as well as in the new insolvency profession in India. The COE is of the view that a similar model may be considered for the Indian audit profession.

The COE observed that traditionally, professions have been self-regulated. In a self-regulatory model, members of the profession undertake to be a guarantor for competence and conduct of its members. For instance, professions like auditing have been self-regulated where its members established and monitored professional standards, set entry and ongoing education standards and conducted disciplinary actions. Under the self-regulatory model, rules are drafted by the market practitioners/participants using their expert knowledge. Further, the administrative costs of regulation are borne by the professional members which reduces the regulatory overheads like inspection and enforcement of the government.

However, the global trend indicates decline in self-regulatory model and shift towards independent regulatory oversight model in the auditing profession. For instance, independent audit oversight regulation exists in countries representing approximately 80% of global stock market capitalisation. As discussed in Chapter 3, both U.S. and U.K. have moved towards independent regulatory model. For instance, in U.K., FRC is an independent body that regulates auditors of public companies, and has delegated certain tasks related to auditors of private entities to SROs. These powers can be revoked by FRC. FRC can also impose penalty on SROs, if they

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

fail to meet their duties. U.S. follows a model where SEC along with PCAOB regulates auditor of public companies, whereas professional bodies continue to regulate auditors of the private entities. Under this model, a regulatory body comprising of appointed members (independent of the practitioners) regulate the profession. In other words, unlike in SROs, members are not appointed from the profession through an electoral process. As shown in box 3, this feature of independent regulatory oversight of audit regulators has been internationally recognised.

There are numerous reasons behind this shift towards independent oversight like, financial frauds, trust deficit arising out of auditor's failure to act as gate-keepers and lack of accountability. For instance, after the Enron and WorldCom frauds in U.S., several jurisdictions gradually shifted towards an independent regulator for auditors. Further, the globalisation of economy fuelled demand for standardisation of financial reporting to protect the interest of global investors."

87. Speaking on the subject of consistency between legislations, the report of the COE observed: -

"The COE has noted that creation of independent regulatory oversight through NFRA is in addition to the existing tier of SRO and does not contradict the Chartered Accountants Act, 1949. From the information available in the public domain, the COE noted that under the framework of Companies Act, 2013, NFRA would regulate auditors of only listed companies, and public companies beyond a certain threshold. On the other hand, ICAI as SRO under the Chartered Accountants Act, 1949 would continue to regulate the auditors of public companies below a certain threshold and private companies. Further, the Companies Act, 2013 regulates the auditors of a company appointed for the limited purpose of statutory audit, on the other hand, the Chartered Accountants Act, 1949 is a legislation which governs the overall chartered accountancy profession. Also, the powers vested with NFRA under the Companies Act, 2013 would not exclude the jurisdiction of ICAI under the Chartered Accountants Act, 1949, unless when NFRA initiates an investigation into matters of professional misconduct of auditors of only listed companies and public companies beyond a certain threshold. The COE also considered the findings of Standing Committee on Finance 21st Report on The Companies Bill, 2009 which strongly recommended the need for an independent body to monitor the quality of audit undertaken across the corporate sector.

The COE also noted other sectoral developments in the domain of

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

regulating auditors which have been discussed in Chapter 3. For instance, the RBI has issued an enforcement action framework for actions to be taken by RBI against the statutory auditors of banks for lapses observed in conducting a banks statutory audit. Similarly, SEBI is considering amendments to several regulations to include CAs as well as statutory auditor within the scope of fiduciary to initiate necessary actions against them for breaching the securities laws.19 This growing inclination of other regulators to initiate action against auditors in the event of lapses, could be an indication of challenges in the current SRO structure of ICAI.

Further, the COE studied the international experience which suggests that, regulators like PCAOB and FRC already follow the two-tier structure which consists of both independent audit regulator and SRO. For instance, in U.S., the SEC and PCAOB regulates auditors of public companies registered with SEC, whereas AICPAs is a SRO for the accounting profession. Similarly, in U.K., the FRC is the independent regulator for the audit profession and there are four RSBs under it, which function as SROs. Further, the global literature also states that in this model, the threat of enforcement by the independent audit regulator may lead to more enforcement by the SRO and thereby improve its regulatory efforts.

For the reasons discussed above, the COE is of the view that establishment of NFRA is an insightful regulatory development and it creates no inconsistency between the provisions of the Companies Act, 2013 and Chartered Accountants Act, 1949. The COE believes that creation of NFRA would have dual benefits. First, NFRA would align the Indian regulatory architecture in the auditing landscape with the global trend; and second, it is expected to address the problems associated with the current SRO mechanism under ICAI"

88. The COE in unambiguous terms recommended that there was sufficient justification for strengthening the NFRA. This becomes apparent from a reading of the following passages of its report:-

"The COE observed that globally there has been a growing acceptance of independent audit regulators, because they are expected to restore investor's confidence and bring more transparency and accountability in the auditing profession. In light of this, creation of NFRA is a positive development. While NFRA as an audit regulator has been vested with necessary powers, drawing inferences from global best practices may help in creating a more robust regulator.

The COE noted that independent audit regulators in other

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

jurisdictions have been empowered to publish the results of audit inspection. For instance, the Sarbanes Oxley Act, 2002 authorises PCAOB to inspect registered firms and publish the results. Further, if such inspection reveals any deficiency or defect which are not remedied within 12 months by the audit firm to the satisfaction of PCAOB, it can publish that portion of the inspection report which deals with criticism and defects. The public copy is redacted accordingly to protect the confidential and proprietary information of the inspected firms. Other audit regulators like FRC in UK also publishes individual reports of their audit quality inspections of each major audit firms. Such publication is subject to necessary confidentiality obligations.

Empowering NFRA on similar lines can have dual benefits. First, reputation is a critical capital for audit firms to generate business. Fear of loss of reputation can be an effective deterrence for firms to build better internal checks and balances. Second, investors in the capital market can be expected to make more informed choices if they are supplied better quality of information about the performance of auditors of listed entities. Section 132 of the Companies Act, 2013 already vests NFRA with the powers to monitor/inspect the quality of services provided by auditors to ensure compliance with the standards. Therefore, the NFRA rules which are being drafted must include the power to publish inspection results."

89. The COE also appears to have deliberated upon the issue of a conflict of interest when viewed in light of non-audit services that may be undertaken by auditing firms. It proceeded to formulate the following recommendations in this respect:-

"The COE recommends the following measures to address the problem of conflict of interest in providing non-audit services to an auditee company or its holding company or subsidiary company:

1.If the auditor is a part/member of an international network, the non-audit fees earned by such network from a listed auditee company or its holding company or subsidiary companies in a financial year shall be maximum 50% of the statutory audit fee earned by that network from that auditee company or its holding company or subsidiary companies in a financial year.

2.Such auditor must separately disclose to NFRA the audit as well as non-audit fees earned by its network from each of its listed auditee company or its holding or subsidiary companies. The auditor shall also _le a declaration with NFRA stating that revenue earned from

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

non-audit services is not in excess of 50% of the statutory audit fee earned by its network from that listed auditee company or its holding company or subsidiary companies in a financial year.

3.The prohibited list of non-audit services under section 144 of the Companies Act, 2013 must include all kinds of taxation, valuation and restructuring services provided to the auditee company or its holding company or subsidiary companies. For this, the appropriate rules should be made.

4.Details of approval given by audit committee or the board of directors to auditors for providing non-audit services should be separately disclosed in the board report of the auditee company or its holding company or subsidiary companies. The board report should also contain a description of the necessary safe-guards in place to protect the independence and objectivity of such auditors providing non-audit services to the auditee company or its holding company or subsidiary companies. This will require necessary rules under section 134 of the Companies Act, 2013.

Explanation: Entities in the network should include:

- Entities covered in Explanation (i) and (ii) of section 144 of the Companies Act, 2013 depending on whether the auditor is an individual or firm.

- Entities covered within the meaning of `network' under the Revised Guidelines of Network, 2011 whether registered with ICAI or not.

- Affiliates which, regardless of its legal form, are connected to a network firm by means of common ownership, control or management.

Explanation: NFRA would regulate auditors of all listed companies, and unlisted public companies beyond a certain threshold, as prescribed by the government.

Since the collapse of Enron and the demise of Arthur Andersen, there has been public concern about the extent to which audit firms are providing non-audit services to their audit clients. Such non-audit services could range from system design to compliance related services like taxation and accounting. The concerns regarding such non-audit services are two-fold: first, auditors may not stand up the management of the auditee company because the auditors wish to retain the additional income from non-audit services to the company; second, providing a range of services to the management may lead to the auditor identifying too closely with the management's interests and lose their professional scepticism. For instance, in the Enron case, it has been widely reported that Andersen received $25 million in audit fees and $27 million for non-audit services. These

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

developments fuelled concerns that provision of non-audit services compromise auditor independence and nudged the legislative changes.

Policymakers globally have responded by prohibiting auditors from performing some specific non-audit functions. For instance, Sarbanes Oxley Act, 2002 in U.S. prohibited auditors from providing eight specific categories of non-audit services to their auditee companies. A similar list was also introduced in 2016 in the European Union for auditors of public listed companies. This prohibits eleven category of services comprising of further sub-categories. Auditors were prohibited from providing non-audit services like tax, consultancy, and advisory services to the audited entity; services that involve playing any part in the management or decision-making of the audited entity; services linked to the financing, capital structure and allocation, and investment strategy of the audited entity. Similar position has been adopted in jurisdictions like U.K. and Australia.

Policymakers globally have also intensely debated the need to impose a cap on the non-audit fees of audit firms. For instance, the SEC has long been concerned about the potential impact of audit and non-audit fees on auditor independence. It has repeatedly asserted that auditors must be independent in fact and in appearance. Independence-in-fact is defined by SEC as the auditor's mental state lacking any bias, while independence-in-appearance is a public perception that the auditor is objective and unaffected by a financial interest in the client. However, a recent study has argued that auditors' independence-in-appearance is related to client importance (total fees from a client as a percentage of the total revenues of the audit firm) rather than non-audit fee ratio (non-audit to total fees from a client).

The Indian debate on conflict of interest related to non-audit services was triggered immediately after the Enron scandal. In 2002, the committee headed by Naresh Chandra deliberated over the issue of non-audit services and recommended the position adopted in U.S. under the Sarbanes Oxley Act, 2002. Consequently, India adopted a similar approach by prohibiting auditors from performing specific non-audit services in the new Companies Act, 2013 (see, table 4.1). If the auditor is a firm, this prohibition is applicable to its associated entity or any entity whatsoever in which the firm has significant influence or control or whose brand name is used by such audit firm or its partners.

Companies Act, 2013	Sarbanes Oxley, 2002

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

Book-keeping	Book-keeping
Internal Audit	Internal Audit
Financial information systems	Financial information systems
Actuarial services	Actuarial services
Investment and banking Advisory	Investment and banking Advisory
Outsourced financial services	Appraisal or valuation services, fairness opinion
Management function	Management or human resource Function
Any other services	Legal/expert services unrelated to audit

Table 4.1.: ***Comparison of prohibited non-audit services***

While section 144 of the Companies Act, 2013 provides an exhaustive list of prohibited non-audit services, it also authorises the government to prescribe any other kind of services in this list. The COE has noted that there could be a case of self-review risk if certain services are allowed to be provided by the auditor. Therefore, there is a need to revisit the list keeping in view the various kinds of services rendered by auditors which can possibly result in conflict of interest. The international practice (EU, Australia, U.K.) shows prohibition on non-audit services like taxation, restructuring and valuation since they are likely to influence the objectivity and independence of auditors. Presently, these services are permitted in India. Therefore, the COE is of the view that the list prescribed under section 144 of the Companies Act, 2013 needs to be expanded.

Presently, there is a cap which requires that non-audit services fee earned by statutory auditor along with its associate concern or corporate bodies must not exceed the aggregate statutory audit fee. However, this cap was set in 2002 by ICAI and since then the market of non-audit services has evolved. Therefore, the COE is of the view that this cap on non-audit services needs to be reviewed. Taking into

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

account, the international position, especially in European Union and U.K., the COE recommends a cap on fee earned from non-audit services which shall not be more than 50% of the audit fee paid to the auditor by the listed auditee company or its holding or subsidiary company.

Further, there is no provision in the Companies Act, 2013 which mandates disclosure of non-audit fee earned by the auditor in the financial statements of the auditee company. Recently in 2018, SEBI amended regulations which would now require a listed company to disclose total fees for all services paid by the listed entity and its subsidiaries, on a consolidated basis, to the statutory auditor and all entities in the network firm/network entity of which the statutory auditor is a part. However, this disclosure obligation is on the listed entity. The COE recommends that a statutory auditor must separately disclose to NFRA the audit as well as non-audit fees earned from each of its auditee company or its holding or subsidiary companies. From the information available in the public domain, the COE noted that under the current Indian framework, NFRA would regulate auditors of all listed companies, and public companies beyond a certain threshold, as prescribed by the government.

The COE noted that under the Companies Act, 2013, an auditor has to obtain prior approval of the audit committee or board of the directors for providing non-audit services. Similar approvals are required in other jurisdictions also. For instance, in U.S. under the Sarbanes Oxley Act, 2002, audit committee approves the types of non-audit services which can be provided to the auditee company. Further, such approval has to be disclosed by the auditee company to investors in periodic reports. Similar practice is also followed in U.K. where The UK Corporate Governance Code, 2016 requires audit committee to develop and implement the policy on engagement of external auditor to supply non-audit services. Further, the annual report must contain a separate section describing how the audit committee has safeguarded the objectivity and independence of auditors providing non-audit services. Therefore, keeping in view the best international practices, the COE recommends that the approval of audit committee or board of directors given to auditors to provide non-audit services should be separately disclosed in the annual report of the auditee company along with a description of the necessary safeguards in place to protect the independence and objectivity of the auditors.

The Enron scandal lead to Sarbanes Oxley Act, 2002 which reduced the scope of non-audit services to address the issue of conflict of interest. This nudged several international audit firms to sell off their consultancy venture. However, over the years, they have re-established their presence in this domain. These consulting entities

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

are members of the global network. The COE after examining inputs from various stakeholders observed that there is a likelihood that substantial amount of non-audit services are provided to an auditee company by network entities belonging to the same network of which the auditor is also a member/part. The COE is of the view that such a likelihood of serious conflict of interest within a network compromises the independence - in-fact as well as in-appearance - of auditors/audit firms within that network.

Further, the government may consider placing a cap on the maximum number of statutory audit of public companies by an audit firm."

90. While speaking on the adequacy of the regulatory mechanism in respect of liability of auditors in audit firms, the COE observed:-

"1. The COE concludes that the current Indian legal regime on liability of individual auditors and audit firms is adequate.

2. The COE on the issue of network liability recommends that NFRA should be explicitly empowered by law to impose civil liability in the form of monetary penalties on the international network/entity with whom/which the Indian audit firm has entered into networking/membership, if any audit failure or fraud is found to have been caused due to any faulty methodology being followed by that particular network.

Explanation: The amount of penalty to be imposed on such international network/entity shall be upto five (5) times the amount of penalty imposed on the audit firm.

3. To enable NFRA to perform this function, every auditor and audit firm, which is operating in India as a part/member of an international network, must submit an Annual Transparency Report to NFRA, disclosing the following:

- A description of the network, its legal and structural arrangements, including payment of any fees, costs, grants, etc between the Indian audit firm and its network entities, directly or indirectly;
- Details of ownership and management structure of the out-side entity or entities constituting the network;
- The name and registered office, central administration or principal place of business, of each network member operating in India as a sole practitioner or audit firm;
- The name and registered office, central administration or

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

principal place of business, of each affiliate of the network operating in India;

- The total turnover achieved by network members operating as sole practitioners and audit firms as well as network affiliates operating in India; and

- The internal standard audit methodology followed by all the network firms globally and in India.

For these disclosure requirements, the COE recommends necessary provision in the NFRA rules which are presently under consideration.

Explanation I: NFRA would regulate auditors of all listed companies, and public companies beyond a certain threshold, as noticed by the government.

Explanation II: 'Affiliate' means any entity, regardless of its legal form, which is connected to a firm by means of common ownership, control or management.

Legal liability on auditors for an audit failure or fraud is necessary mainly for three reasons. *First*, legal liability on auditors is necessary to deter any intentional breach of duties or fraudulent behaviour. *Second*, legal liability is necessary to disgorge any unlawful gains made by an auditor. However, it not enough to merely restore the auditor back to the position it was before committing a breach or fraud. *Third*, it is important to ensure that direct victims of an audit failure or fraud are also compensated by the auditor. Such compensation by the auditor for audit failure or fraud represents a form of implicit insurance to outside investors. Such an insurance provided by the auditor enables the entrepreneur to raise capital from such investors at lower cost.

However, excessive imposition of liability on auditors could be counterproductive. First, excessive legal liability could drive auditors out of the market, making it more concentrated with fewer auditors. Second, a higher risk of legal liability on auditors could drive up their audit fees, making mandatory audit costly for all companies. Third, auditors may refuse to audit riskier companies, making it difficult for such companies to raise capital. Recent research shows that the relationship between the strength of the legal liability regime and the client rejection rate is U-shaped. In other words, clients are less likely to be rejected in environments with moderate legal regime, as compared to environments with relatively strong or relatively weak legal regime.

Taking into account the pros and cons of legal liability on auditors, the COE is of the view that it is important that the Indian legal regime on auditors' liability should take a balanced approach. From

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

this perspective, the COE analysed the current Indian legal regime on auditors' liability to identify the nature of sanctions that could be imposed against individual auditors as well as audit firms in case of a fraud. The COE reviewed the relevant provision under Chartered Accountants Act, 1949 as shown in Table 4.3 and those under Companies Act, 2013 as shown in Table 4.4.

Sections	Application	Criminal Sanction	Civil sanction
21A	CA found guilty of professional or other misconduct under Schedule I	NA	Board of Discipline can reprimand the CA, remove the name of the CA from the register up to a period of 3 months, and/or impose fine up to Rs. 1 lakh
21B	CA found guilty of professional or other misconduct under Schedule II or both Schedules I and II	NA	Disciplinary Committee can reprimand the CA, remove the name of the CA from the register permanently or temporarily, and/or impose fine up to Rs. 5 lakhs

Table 4.3.: *Chartered Accountants Act 1949*

As is evident from these tables there are various criminal sanctions that could be imposed on individual auditors as well as audit firms involved in any audit failure or fraud. It is important to note that the amount levied in the form of `fine' goes to the consolidated fund of India and not to the investors of the company. Therefore, these criminal sanctions can only have a deterrence function and do not serve any indemnification function.

In contrast, there are three provisions on civil sanctions that provide for indemnification to users of the faulty audited financial statements. These are section 132(4)(c), section 147(3)(ii) and section 245(1)(g)(ii) under the Companies Act, 2013 as shown in Table 4.4. The COE noted that section 132(4)(c) empowers NFRA to

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

impose monetary penalty on auditors as well as audit firms including debarment. Under section 147(3)(ii) an auditor or audit firm which is convicted under section 147(2), is liable to pay damages to the potential users of its audited financial statements. Finally, section 245(1) could be used by NCLT to award damages or compensation against auditor including audit firms for improper or misleading statements made in audit report or for any fraudulent, unlawful or wrongful act or conduct.

On review of the above provisions, the COE is of the view that the current Indian regime on auditor liability provides for all three functions - deterrence, disgorgement as well as indemnification. Accordingly, the COE concludes that the current Indian legal regime on liability of individual auditors and audit firms is adequate.

The COE noted that an audit failure or fraud could happen because of two reasons. First, it could be due to lapses on the part of the auditor or audit firm because of which proper audit methodology is not followed or observed. As discussed earlier, there are various provisions in the law to hold the auditor or audit firm liable for such a lapse being a fault on the part of the auditor or the audit firm. Second, an audit failure or fraud could also happen because the audit method followed by auditor or audit firm as part of a network is itself awed. Since this is a fault of the method being followed by the network itself, in such cases, it is important that NFRA has the power to extend the liability on the network. Therefore, the COE recommends that NFRA should be explicitly empowered by law to impose civil liability in the form of monetary penalties on the international network/entity with who/which the Indian audit firm has entered into networking/membership agreement, if any audit failure or fraud is found to have been caused due to any faulty methodology being followed by that particular network.

The COE observed that European Union has imposed a higher liability on auditors of listed companies. To achieve this, *the Regulation (EU) No 537/2014 Of the European Parliament and of the Council* has imposed legal obligations on auditors and audit firms to disclose financial information at the level of the network to which such auditors belong. The COE is of the opinion that a similar disclosure obligation has to be placed on all members of a network operating in India to enable NFRA to impose monetary penalty on such members in the event of a process failure at the network level leading to an audit failure or fraud.

The COE recommends that every auditor and audit firm, which is operating in India as a member/part of an international network, must submit *an Annual Transparency Report* to NFRA, disclosing the following:

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Signing Date:07.02.2025
18:46:26

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- A description of the network, its legal and structural arrangements, including payment of any fees, costs, grants, etc between the Indian audit firm and its network firms and affiliates, directly or indirectly;

- Details of ownership and management structure of the outside entity or entities constituting the network;

- The name and registered office, central administration or principal place of business, of each network member operating in India as a sole practitioner or audit firm;

- The name and registered office, central administration or principal place of business, of each affiliate of the network operating in India;

- The total turnover achieved by network members operating as sole practitioners and audit firms as well as network affiliates operating in India; and

- The internal standard audit methodology followed by all the network firms globally and in India.

Explanation II: `Affiliate' means any entity, regardless of its legal form, which is connected to a firm by means of common ownership, control or management.

This information available from the *Annual Transparency Report* will help NFRA keep track of the auditors and audit firms operating in India as part of the same network so that in case any legal liability needs to be imposed on that particular network for an audit failure or fraud."

91. It is the aforesaid considerations which appear to have weighed upon Parliament while structuring Section 132 of the Companies Act and the Union Government proceeding to frame supportive rules to enable the NFRA to discharge its statutory obligations. Having set out the essential matrix of facts, the legislative history and the broad ranged debate and discussion which acted as the precursor to the insertion of Section 132 in the Companies as well as the relevant statutory provisions in the context of which the present challenge has come to be laid before us, the stage is thus set to commence consideration of the legal submissions which were addressed before us.

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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THE VICARIOUS LIABILITY ARGUMENT

92. Appearing from the side of the writ petitioners, arguments were led by Mr. Kapil Sibal, Mr. Jayant Mehta and Mr. Girish Kathpalia, learned senior counsels. Assailing the action initiated by the NFRA and the validity of Section 132 of the Companies Act itself, it was firstly contended that the provision is liable to be invalidated since it amounts to the creation of a vicarious liability on audit firms as well and its constituent partners who may have in no manner been connected with the audit itself. The petitioners contended that Section 132 proceeds to impose a liability upon **Limited Liability Partnerships**[31] and which could themselves comprise of numerous partners and employees.

93. For instance, Mr. Sibal pointed out that DHS has approximately 139 partners and more than 3,900 employees across India. According to learned senior counsels, holding a LLP liable for consequences flowing from Section 132 would have the effect of imposing a liability upon each partner of the firm irrespective of whether that partner was involved in the concerned audit or had performed an audit function. According to the petitioners, such partners would thus face liabilities even though they may have had no participative role in the alleged fraud, negligence or misconduct. It was thus argued that the affirmation of such a liability not only amounts to the placement of an unreasonable restriction on the fundamental right of the LLP and its partners to practice their profession and which stands guaranteed and protected under Article 19(1)(g) of the Constitution it would also amount to the imposition of a disproportionate penalty which would clearly be

[31] LLPs

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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violative of Article 14.

94. It was argued that the principle of vicarious liability does not permit an act of fraud to be attributed to either the partner of a partnership firm or an LLP as the case may be, who are in no manner involved in or had participated in the fraud which is alleged. Reliance in this respect was also placed on Sections 27, 28 and 30 of the **Limited Liability Partnership Act, 2008**[32] and which are extracted hereinbelow: -

> "**27. Extent of liability of limited liability partnership**.—(1) A limited liability partnership is not bound by anything done by a partner in dealing with a person if—
>
> (a) the partner in fact has no authority to act for the limited liability partnership in doing a particular act; and
>
> (b) the person knows that he has no authority or does not know or believe him to be a partner of the limited liability partnership.
>
> (2) The limited liability partnership is liable if a partner of a limited liability partnership is liable to any person as a result of a wrongful act or omission on his part in the course of the business of the limited liability partnership or with its authority.
>
> (3) An obligation of the limited liability partnership whether arising in contract or otherwise, shall be solely the obligation of the limited liability partnership.
>
> (4) The liabilities of the limited liability partnership shall be met out of the property of the limited liability partnership.
>
> **28. Extent of liability of partner**.—(1) A partner is not personally liable, directly or indirectly for an obligation referred to in sub-section (3) of Section 27 solely by reason of being a partner of the limited liability partnership.

[32] LLP Act

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Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(2) The provisions of sub-section (3) of Section 27 and sub-section (1) of this section shall not affect the personal liability of a partner for his own wrongful act or omission, but a partner shall not be personally liable for the wrongful act or omission of any other partner of the limited liability partnership.

xxxx xxxx xxxx

30. Unlimited liability in case of fraud.—(1) In the event of an act carried out by a limited liability partnership, or any of its partners, with intent to defraud creditors of the limited liability partnership or any other person, or for any fraudulent purpose, the liability of the limited liability partnership and partners who acted with intent to defraud creditors or for any fraudulent purpose shall be unlimited for all or any of the debts or other liabilities of the limited liability partnership:

Provided that in case any such act is carried out by a partner, the limited liability partnership is liable to the same extent as the partner unless it is established by the limited liability partnership that such act was without the knowledge or the authority of the limited liability partnership.

(2) Where any business is carried on with such intent or for such purpose as mentioned in sub-section (1), every person who was knowingly a party to the carrying on of the business in the manner aforesaid shall be punishable with imprisonment for a term which may extend to 29[five years] and with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees.

(3) Where a limited liability partnership or any partner or designated partner or employee of such limited liability partnership has conducted the affairs of the limited liability partnership in a fraudulent manner, then without prejudice to any criminal proceedings which may arise under any law for the time being in force, the limited liability partnership and any such partner or designated partner or employee shall be liable to pay compensation to any person who has suffered any loss or damage by reason of such conduct:

Provided that such limited liability partnership shall not be liable if any such partner or designated partner or employee has acted fraudulently without knowledge of the limited liability partnership."

95. On the basis of the statutory provisions contained in the LLP Act, the petitioners argued that no vicarious liability can possibly be

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

fastened on the other partners of an LLP in case fraudulent acts are committed by an individual member of that firm. According to learned senior counsels, the imposition of such a penalty, in fact, clearly runs contrary to the protection which stands accorded in terms of the LLP Act and which clearly insulates non-participating partners from being imposed with any liability.

96. Turning then to the provisions of the Companies Act itself, it was submitted that Section 132 came to be enacted in 2013 and by which time, the LLP Act had already come to be promulgated. It was argued that Section 132 as framed cannot be read or construed as an essay of Parliament seeking to take away, destroy, diminish or for that matter altering or modifying the rights and protections conferred upon an LLP or its partners by the former.

97. The manifest arbitrariness of the provision was further sought to be underscored on the ground of Section 132 requiring no distinct proof of involvement or even knowledge of either the firm or its other partners. Leaned senior counsels in unison submitted that the debarment of a practicing CA would virtually amount to the imposition of a "death penalty" and deprive those professionals of their right of livelihood quite apart from the constitutional right to pursue a profession.

98. The petitioners also sought to sustain the challenge based on the principle of vicarious liability by relying upon various decisions rendered by the US Supreme Court and those judgments having deprecated the principle of *"guilt by association"*. Our attention was invited to the decision of the US Supreme Court in **Elfbrandt vs. R**

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

Russell[33] and where the following principles came to be enunciated: -

> "**5.** We recognized in Scales v. United States, 367 U.S. 203, 229, 81 S.Ct. 1469, 1486, 6 L.Ed.2d 782, that 'quasi-political parties or other groups * * * may embrace both legal and illegal aims.' We noted that a 'blanket prohibition of association with a group having both legal and illegal aims' would pose 'a real danger that legitimate political expression or association would be impaired.' The statute with which we dealt in Scales the so-called 'membership clause' of the Smith Act (18 U.S.C. § 2385), was found not to suffer from this constitutional infirmity because, as the Court construed it, the statute reached only 'active' membership (id., at 222, 81 S.Ct. at 1482) with the 'specific intent' of assisting in achieving the unlawful ends of the organization (id., at 229—230, 81 S.Ct. at 1522). The importance of this limiting construction from a constitutional stand-point was emphasized in Noto v. United States, 367 U.S. 290, 299—300, 81 S.Ct. 1517, 6 L.Ed.2d 836, decided the same day:
>
> > '(It should also be said that this element of the membership crime (the defendant's 'personal criminal purpose to bring about the overthrow of the Government by force and violence'), like its others, must be judged strictissimi juris, for otherwise there is a danger that one in sympathy with the legitimate aims of such an organization, but not specifically intending to accomplish them by resort to violence, might be punished for his adherence to lawful and constitutionally protected purposes, because of other and unprotected purposes which he does not necessarily share.' [Cf. Rowoldt v. Perfetto, 355 U.S. 115, 120, 78 S.Ct. 180, 183, 2 L.Ed.2d 140; Gastelum-Quinones v. Kennedy, 374 U.S. 469, 83 S.Ct. 1819, 10 L.Ed.2d 1013.]
>
> **6.** Any lingering doubt that proscription of mere knowing membership, without any showing of 'specific intent,' would run afoul of the Constitution was set at rest by our decision in Aptheker v. Secretary of State, 378 U.S. 500, 84 S.Ct. 1659, 12 L.Ed.2d 992. We dealt there with a statute which provided that no member of a Communist organization ordered by the Subversive Activities Control Board to register shall apply for or use a passport. We concluded that the statute would not permit a narrow reading of the sort we gave § 2385 in Scales. See 378 U.S., at 511, n. 9, 84 S.Ct. at 1666. The statute, as we read it, covered membership which was

[33] 1966 SCC OnLine US SC 66

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

not accompanied by a specific intent to further the unlawful aims of the organization, and we held it unconstitutional.

7. The oath and accompanying statutory gloss challenged here suffer from an identical constitutional infirmity. One who subscribes to this Arizona oath and who is, or thereafter becomes, a knowing member of an organization which has as 'one of its purposes' the violent overthrow of the government, is subject to immediate discharge and criminal penalties. Nothing in the oath, the statutory gloss, or the construction of the oath and statutes given by the Arizona Supreme Court, purports to exclude association by one who does not subscribe to the organization's unlawful ends. Here as in Baggett v. Bullitt, supra, the 'hazard of being prosecuted for knowing but guiltless behavior' (id., 377 U.S. at 373, 84 S.Ct. at 1323) is a reality. People often label as 'communist' ideas which they oppose; and they often make up our juries. '(P)rosecutors too are human.' Cramp v. Board of Public Instruction, 368 U.S. 278, 287, 82 S.Ct. 275, 281, 7 L.Ed.2d 285. Would a teacher be safe and secure in going to a Pugwash Conference? [The Pugwash Conferences, A Staff Analysis, Subcommittee to Investigate the Administration of the Internal Security Act, Senate Committee on the Judiciary, Committee Print, 87th Cong., 1st Sess. (1961); Rabinowitch, Pugwash—History and Outlook, 13 Bull. Atomic Sci. 243 (1957); Topchiev, Comments on Pugwash: From the East, 14 Bull. Atomic Sci. 118 (1958); Thirring, Comments on Pugwash: From the West, id., at 121; Rabinowitch, The Stowe Conferences, 17 Bull. Atomic Sci. 382 (1961); Statement of International Pugwash Continuing Committee: Pugwash XIII, Bull. Atomic Sci. 43—45 (December 1964); Documents of Second Pugwash Conference of Nuclear Scientists (March 31—April 11, 1958).] Would it be legal to join a seminar group predominantly Communist and therefore subject to control by those who are said to believe in the overthrow of the Government by force and violence? Juries might convict though the teacher did not subscribe to the wrongful aims of the organization. And there is apparently no machinery provided for getting clearance in advance. [Petitioner would, of course, have a hearing at a perjury trial, after the event. And one member of the Arizona Supreme Court felt that petitioner, having tenure, would be entitled to a hearing before she was discharged from her teaching position. See Elfbrandt v. Russell, 94 Ariz. 1, 17—18, 381 P.2d 554, 565 (Bernstein, C.J., concurring). But even that is not authoritatively decided by the court; indeed, another opinion states this to be a minority view, 94 Ariz., at 18, 381 P.2d at 566 (separate opinion of Jennings, J.).]

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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> **8.** Those who join an organization but do not share its unlawful purposes and who do not participate in its unlawful activities surely pose no threat, either as citizens or as public employees. Laws such as this which are not restricted in scope to those who join with the 'specific intent' to further illegal action impose, in effect, a conclusive presumption that the member shares the unlawful aims of the organization. See Aptheker v. Secretary of State, supra, 378 U.S. at 511, 84 S.Ct. at 1666. The unconstitutionality of this Act follows a fortiori from Speiser v. Randall, 357 U.S. 513, 78 S.Ct. 1332, 2 L.Ed.2d 1460, where we held that a State may not even place on an applicant for a tax exemption the burden of proving that he has not engaged in criminal advocacy."

99. Mr. Sibal then referred to the judgment of our Supreme Court in **Indra Das vs. State of Assam**[34] which had cited the decision in *Elfbrandt* as well as certain other judgments of the US Supreme Court to hold that mere membership of an organization would not expose an individual to penal consequences. Our attention was specifically drawn to the following passages as appearing in *Indra Das*:-

> "**5.** In *Arup Bhuyan case* [(2011) 3 SCC 377] we have stated that mere membership of a banned organisation cannot incriminate a person unless he is proved to have resorted to acts of violence or incited people to imminent violence, or does an act intended to create disorder or disturbance of public peace by resort to imminent violence. In the present case, even assuming that the appellant was a member of ULFA which is a banned organisation, there is no evidence to show that he did acts of the nature abovementioned. Thus, even if he was a member of ULFA it has not been proved that he was an active member and not merely a passive member. Hence the decision in *Arup Bhuyan case* [(2011) 3 SCC 377] squarely applies in this case.
>
> **6.** In our judgment in *State of Kerala* v. *Raneef* [(2011) 1 SCC 784 : (2011) 1 SCC (Cri) 409] we had referred to the judgment of the US Supreme Court in *Elfbrandt* v. *Russell* [16 L Ed 2d 321 : 384 US 11 (1965)] which rejected the doctrine of "guilt by association".
>
> **xxxx xxxx xxxx**

[34] (2011) 3 SCC 380

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18:46:26

8. In *Scales case* [6 L Ed 2d 782 : 367 US 203 (1960)] Mr Harlan, J. of the US Supreme Court observed: (L Ed pp. 801-02)

> "The clause [in the McCarran Act, 1950] does not make criminal all association with an organisation which has been shown to engage in illegal advocacy. *There must be clear proof that a defendant 'specifically intend[s] to accomplish [the aims of the organisation] by resort to violence'*. … a person may be foolish, deluded, or perhaps merely optimistic, but he is not by this statute made a criminal."
>
> (emphasis supplied)

9. *Elfbrandt case* [16 L Ed 2d 321 : 384 US 11 (1965)] also relied on the US Supreme Court decisions in *Aptheker* v. *Secy. of State* [12 L Ed 2d 992 : 378 US 500 (1963)] , *Baggett* v. *Bullitt* [12 L Ed 2d 377 : 377 US 360 (1963)] , *Cramp* v. *Board of Public Instruction* [7 L Ed 2d 285 : 368 US 278 (1961)] , *Gibson* v. *Florida Investigation Committee* [9 L Ed 2d 929 : 372 US 539 (1962)] , etc.

10. In *Noto* v. *United States* [6 L Ed 2d 836 : 367 US 290 (1960)] , US at pp. 297-98 Mr Harlan, J. of the US Supreme Court observed: (L Ed p. 841)

> "… the mere abstract teaching of Communist theory, including the teaching of the moral propriety or even moral necessity for a resort to force and violence, is not the same as preparing a group for violent action and steeling it to such action. There must be some substantial direct or circumstantial evidence of a call to violence now or in the future which is both sufficiently strong and sufficiently pervasive to lend colour to the otherwise ambiguous theoretical material regarding Communist Party teaching…."

11. In *Noto case* [6 L Ed 2d 836: 367 US 290 (1960)] Mr Hugo Black, J. in a concurring judgment wrote: (L Ed p. 843)

> "In 1799, the English Parliament passed a law outlawing certain named societies on the ground that they were engaged in 'a traitorous conspiracy … in conjunction with the persons from time to time exercising the powers of Government in France….' One of the many strong arguments made by those who opposed the enactment of this law was stated by a member of that body, Mr Tierney:

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Signing Date:07.02.2025
18:46:26

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> ‘The remedy proposed goes to the putting an end to all these societies together. I object to the system, of which this is only a branch; for the right Hon'ble gentleman has told us he intends to propose laws from time to time upon this subject, as cases may arise to require them. I say these attempts lead to consequences of the most horrible kind. I see that Governments are acting thus. Those whom *they cannot prove to be guilty, they will punish for their suspicion. To support this system, we must have a swarm of spies and informers. They are the very pillars of such a system of Government*.’
>
> The decision in this case, in my judgment, dramatically illustrates the continuing vitality of this observation.
>
> The conviction of the petitioner here is being reversed because the Government has failed to produce evidence the Court believes sufficient to prove that the Communist Party *presently advocates the overthrow of the Government by force*.”
>
> (emphasis supplied)
>
> **xxxx xxxx xxxx**
>
> **27.** Similarly, we are of the opinion that the provisions in various statutes i.e. Section 3(5) of TADA or Section 10 of the Unlawful Activities (Prevention) Act which on their plain language make mere membership of a banned organisation criminal have to be read down and we have to depart from the literal rule of interpretation in such cases, otherwise these provisions will become unconstitutional as violative of Articles 19 and 21 of the Constitution. It is true that ordinarily we should follow the literal rule of interpretation while construing a statutory provision, but if the literal interpretation makes the provision unconstitutional we can depart from it so that the provision becomes constitutional.”

100. Controverting those submissions, Mr. Hossain appearing for the NFRA, firstly invited our attention to some of the relevant provisions contained in the Companies Act to submit that the said statute itself contemplates an auditor to be either an individual or a firm. According to Mr. Hossain, a partner of a firm which has been appointed as an

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

auditor acts as a representative and agent of such an entity. Mr. Hossain, firstly cited Section 139 of the Companies Act and which provision reads as under:-

> "**139. Appointment of auditors**.—(1) Subject to the provisions of this Chapter, every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting and the manner and procedure of selection of auditors by the members of the company at such meeting shall be such as may be prescribed:
> [* * *]
>
> Provided further that before such appointment is made, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor:
>
> Provided also that the certificate shall also indicate whether the auditor satisfies the criteria provided in Section 141:
>
> Provided also that the company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within fifteen days of the meeting in which the auditor is appointed.
>
> *Explanation*.—For the purposes of this Chapter, "appointment" includes reappointment.
>
> (2) No listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint or reappoint—
> (*a*) an individual as auditor for more than one term of five consecutive years; and
>
> (*b*) an audit firm as auditor for more than two terms of five consecutive years:
>
> Provided that—
>
> (*i*) an individual auditor who has completed his term under clause (*a*) shall not be eligible for reappointment as auditor in the same company for five years from the completion of his term;
>
> (*ii*) an audit firm which has completed its term under clause (*b*), shall not be eligible for reappointment as auditor in the same company for five years from the completion of such term:

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

Provided further that as on the date of appointment no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years:

[Provided also that every company, existing on or before the commencement of this Act which is required to comply with the provisions of this sub-section, shall comply with requirements of this sub-section within a period which shall not be later than the date of the first annual general meeting of the company held, within the period specified under sub-section (1) of Section 96, after three years from the date of commencement of this Act:]

Provided also that, nothing contained in this sub-section shall prejudice the right of the company to remove an auditor or the right of the auditor to resign from such office of the company.

(3) Subject to the provisions of this Act, members of a company may resolve to provide that—

(*a*) in the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or

(*b*) the audit shall be conducted by more than one auditor.

(4) The Central Government may, by rules, prescribe the manner in which the companies shall rotate their auditors in pursuance of sub-section (2).

Explanation.—For the purposes of this Chapter, the word "firm" shall include a limited liability partnership incorporated under the Limited Liability Partnership Act, 2008 (6 of 2009).

(5) Notwithstanding anything contained in sub-section (1), in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the Comptroller and Auditor-General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of one hundred and eighty days from the commencement of the financial year, who shall hold office till the conclusion of the annual general meeting.

(6) Notwithstanding anything contained in sub-section (1), the first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within thirty days from the date of registration of the company and in the case of failure of the Board to appoint such auditor, it shall inform the members of the company, who shall within ninety days at an extraordinary general

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

meeting appoint such auditor and such auditor shall hold office till the conclusion of the first annual general meeting.

(7) Notwithstanding anything contained in sub-section (1) or sub-section (5), in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the Comptroller and Auditor-General of India within sixty days from the date of registration of the company and in case the Comptroller and Auditor-General of India does not appoint such auditor within the said period, the Board of Directors of the company shall appoint such auditor within the next thirty days; and in the case of failure of the Board to appoint such auditor within the next thirty days, it shall inform the members of the company who shall appoint such auditor within the sixty days at an extraordinary general meeting, who shall hold office till the conclusion of the first annual general meeting.

(8) Any casual vacancy in the office of an auditor shall—

(*i*) in the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within thirty days, but if such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting;

(*ii*) in the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Comptroller and Auditor-General of India within thirty days:

Provided that in case the Comptroller and Auditor-General of India does not fill the vacancy within the said period, the Board of Directors shall fill the vacancy within next thirty days.

(9) Subject to the provisions of sub-section (1) and the rules made thereunder, a retiring auditor may be reappointed at an annual general meeting, if—

(*a*) he is not disqualified for reappointment;

(*b*) he has not given the company a notice in writing of his unwillingness to be reappointed; and

(*c*) a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be reappointed.

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> (10) Where at any annual general meeting, no auditor is appointed or reappointed, the existing auditor shall continue to be the auditor of the company.
>
> (11) Where a company is required to constitute an Audit Committee under Section 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee."

101. Mr. Hossain also took us through the various **Accounting Standards**[35] in order to underscore his submission that a partner of an audit firm appointed in terms of Section 139, owes his engagement and involvement in the audit to the appointment of the firm itself. It was submitted that the SAs' require the appointed auditor to exercise, control and oversight in respect of the functions discharged by its individual partners in the course of an audit.

102. Mr. Hossain submitted that the auditor is required to exercise quality control during the entire audit process in order to ensure that its participating members discharge their functions and duties in accordance with the statutory obligations which apply. Learned counsel firstly referred us to SA 230 and which mandates the auditor to ensure that the audit exercise is conducted in accordance with the stipulations contained in SQC 1. Proceeding further, learned counsel placed for our consideration SA 220 and where the following provisions stand incorporated:-

> "**Scope of this SA**
>
> 1. This Standard on Auditing (SA) deals with the specific responsibilities of the auditor regarding quality control procedures for an audit of financial statements. It also addresses, where applicable, the responsibilities of the engagement quality control

[35] SAs

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

reviewer. This SA is to be read in conjunction with relevant ethical requirements.

System of Quality Control and Role of Engagement Teams

2. Quality control systems, policies and procedures are the responsibility of the audit firm. Under SQC 1, the firm has an obligation to establish and maintain a system of quality control to provide it with reasonable assurance that:

(a) The firm and its personnel comply with professional standards and regulatory and legal requirements; and

(b) The reports issued by the firm or engagement partners are appropriate in the circumstances.
This SA is premised on the basis that the firm is subject to SQC 1. (Ref: Para.A1)

3. Within the context of the firm's system of quality control, engagement teams have a responsibility to implement quality control procedures that are applicable to the audit engagement and provide the firm with relevant information to enable the functioning of that part of the firm's system of quality control relating to independence.

4. Engagement teams are entitled to rely on the firm's system of quality control, unless information provided by the firm or other parties suggests otherwise. (Ref: Para. A2)

xxxx xxxx xxxx

Monitoring

23. An effective system of quality control includes a monitoring process designed to provide the firm with reasonable assurance that its policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. The engagement partner shall consider the results of the firm's monitoring process as evidenced in the latest information circulated by the firm and, if applicable, other network firms and whether deficiencies noted in that information may affect the audit engagement. (Ref: Para A32-A34)"

103. The obligation of the auditing firm to lay in place a system of quality control so that it is reasonably assured that its members assigned

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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to undertake the audit comply with professional standards as well as regulatory requirements, Mr. Hossain pointed out, is a prescription which also stands mirrored in SQC 1 and more particularly paragraphs 3, 4 and 5 thereof:-

> "3. The firm should establish a system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements, and that reports issued by the firm3 or engagement partner(s) are appropriate in the circumstances.
>
> 4. A system of quality control consists of policies designed to achieve the objectives set out in paragraph 3 and the procedures necessary to implement and monitor compliance with those policies.
>
> 5. This SQC applies to all firms. The nature of the policies and procedures developed by individual firms to comply with this SQC will depend on various factors such as the size and operating characteristics of the firm, and whether it is part of a network"

104. We also deem it apposite to extract the following additional Paragraphs from SQC 1:-

> "7. The firm's system of quality control should include policies and procedures addressing each of the following elements:
>
> (a) Leadership responsibilities for quality within the firm.
>
> (b) Ethical requirements.
>
> (c) Acceptance and continuance of client relationships and specific engagements.
>
> (d) Human resources.
>
> (e) Engagement performance.
>
> (f) Monitoring.
>
> **xxxx xxxx xxxx**
>
> 9. The firm should establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements. Such policies and procedures should require the firm's chief executive officer (or equivalent) or, if appropriate, the firm's managing partners (or equivalent), to

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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assume ultimate responsibility for the firm's system of quality control.

10. The firm's leadership and the examples it sets significantly influence the internal culture of the firm. The promotion of a quality-oriented internal culture depends on clear, consistent and frequent actions and messages from all levels of the firm's management emphasizing the firm's quality control policies and procedures, and the requirement to:

(a) Perform work that complies with professional standards and regulatory and legal requirements; and

(b) Issue reports that are appropriate in the circumstances. Such actions and messages encourage a culture that recognizes and rewards high quality work. They may be communicated by training seminars, meetings, formal or informal dialogue, mission statements, newsletters, or briefing memoranda. They are incorporated in the firm's internal documentation and training materials, and in partner and staff appraisal procedures such that they will support and reinforce the firm's view on the importance of quality and how, practically, it is to be achieved.

xxxx xxxx xxxx

14. The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements.

xxxx xxxx xxxx

23. At least annually, the firm should obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent in terms of the requirements of the Code."

105. In view of the above, it was contended by Mr. Hossain that the work of a constituent of an auditing firm is inextricably linked with the policies laid in place by that firm pertaining to compliance with auditing standards and standards of quality control. On a compendious reading of the various SAs', Mr. Hossain submitted, it would be apparent that the discharge of functions by a member of an auditing firm is not liable to be viewed as distinct or removed from the engagement and appointment of the firm as an auditor itself.

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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106. Mr. Hossain then took us through the provisions contained in Section 147 of the Companies Act and which contemplates the imposition of punishment upon a firm as well as its member. The relevant parts of Section 147 are extracted hereinbelow:-

> "**147. Punishment for contravention**.—(1) If any of the provisions of Sections 139 to 146 (both inclusive) is contravened, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable 233[* * *] with fine which shall not be less than ten thousand rupees but which may extend to 234[one lakh rupees].
>
> (2) If an auditor of a company contravenes any of the provisions of Section 139, 235[* * *], Section 144 or Section 145, the auditor shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees 236[or four times the remuneration of the auditor, whichever is less]:
>
> Provided that if an auditor has contravened such provisions knowingly or wilfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year 237[and with fine which shall not be less than fifty thousand rupees but which may extend to twenty-five lakh rupees or eight times the remuneration of the auditor, whichever is less].
>
> (3) Where an auditor has been convicted under sub-section (2), he shall be liable to—
>
> (i) refund the remuneration received by him to the company; and
>
> (ii) pay for damages to the company, statutory bodies or authorities 238[or to members or creditors of the company] for loss arising out of incorrect or misleading statements of particulars made in his audit report.
>
> (4) The Central Government shall, by notification, specify any statutory body or authority or an officer for ensuring prompt payment of damages to the company or the persons under clause (ii) of sub-section (3) and such body, authority or officer shall after payment of damages to such company or persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the said notification.

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> (5) Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil or criminal as provided in this Act or in any other law for the time being in force, for such act shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally.
>
> [Provided that in case of criminal liability of an audit firm, in respect of liability other than fine, the concerned partner or partners, who acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud shall only be liable.]"

107. In view of the aforesaid, learned counsel submitted that it would be wholly incorrect for the petitioners to assert that the introduction of a provision pertaining to disciplinary proceedings against a firm would amount to the introduction of a liability which did not exist or could be described to be vicarious in character.

108. More importantly, according to Mr. Hossain, one must also bear in consideration the indisputable position of partnership firms not being liable to be viewed as separate juristic entities. Although this position is by now fairly well settled, in order to buttress his submissions, Mr. Hossain firstly relied upon the following passages as appearing in **Commissioner of Income Tax vs. R.M. Chidambaram Pillai** [36]:-

> "**15.** Is the firm a person or a mere shorthand name for a collection of persons, commercially convenient but not legally recognised? Under Section 3 of the Partnership Act it is not a person, but a relationship among persons. *Lindley on Partnership* [12th Edn., p. 28, Sweet & Maxwell] , has this:
>
> > "The firm is not recognised by English lawyers as distinct from the members composing it. In taking partnership accounts and in administering partnership assets, courts have to some extent adopted the mercantile view, and actions may now, speaking generally, be brought by or

[36] (1977) 1 SCC 431

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

> against partners in the name of their firm, but, speaking generally, the firm as such has no legal recognition. The law, ignoring the firm, looks to the partners composing it; any change amongst them destroys the identity of the firm; what is called the property of the firm is their property, and what are called the debts and liabilities of the firm are their debts and their liabilities. In point of law, a partner may be the debtor or the creditor of his co-partners, but he cannot be either debtor or creditor of the firm of which he is himself a member, nor can he be employed by his firm, for a man cannot be his own employer."

16. The Indian law of partnership is substantially the same and the reference in counsel's submissions to the Scottish view of a firm being a legal entity is neither here nor there. Primarily our study must zero on the Indian Partnership Act and not borrow courage from foreign systems. In *Bhagwanji Morarji Gokuldas* [AIR 1948 PC 100 : (1948) 18 Comp Cas 205, 209] the Privy Council ruled that the Indian Partnership Act went beyond the English Partnership Act, 1890, the law in India attributing personality to a partnership being more in accordance with the law of Scotland. Even so, Sir John Beaumont, in that case, pointed out that the Indian Act did not make a firm a corporate body. Moreover, we are not persuaded by that ruling of the Privy Council, particularly since a pronouncement of this Court in *Dulichand* [*Dulichand Laksminarayan* v. *CIT*, AIR 1956 SC 354 : 1956 SCR 154 : (1956) 2 ITR 535] strikes a contrary note. We quote:

> "In some systems of law this separate personality of a firm apart from its members has received full and formal recognition as, for instance, in Scotland. That is, however, not the English common law conception of a firm. English lawyers do not recognise a firm as an entity distinct from the members composing it. Our partnership law is based on English law and we have also adopted the notions of English lawyers as regards a partnership firm."

The life of the Indian law of partnership depends on its own terms although habitually courts, as a hangover of the past, have been referring to the English law on the point. The matter is concluded by the further observations of this Court:

> "It is clear from the foregoing discussion that the law, English as well as Indian, has, for some specific purposes, some of which are referred to above, relaxed its rigid notions and extended a limited personality to a firm. Nevertheless, the general concept of a partnership, firmly established in both systems of law, still is that a firm is not an entity or 'person' in law but is merely an

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

> association of individuals and a firm name is only a collective name of those individuals who constitute the firm. In other words, a firm name is merely an expression, only a compendious mode of designating the persons who have agreed to carry on business in partnership. According to the principles of English jurisprudence, which we have adopted, for the purposes of determining legal rights 'there is no such thing as a firm known to the law as was said by James, L.J., in *Ex parte Corbett* : *In re Shand* [(1880) 14 Ch D 122, 126 : 42 LT 164 : 28 WR 569] . In these circumstances to import the definition of the word 'person' occurring in Section 3(42) of the General Clauses Act, 1897, into Section 4 of the Indian Partnership Act will, according to lawyers, English or Indian, be totally repugnant to the subject of partnership law as they know and understand it to be."

In *Narayanappa* [*Addanki Narayanappa* v. *Bhaskara Krishtappa*, AIR 1966 SC 1300, 1303 : (1966) 3 SCR 400] the view taken by this Court accords with the position above stated.

17. The necessary inference from the premise that a partnership is only a collective of separate persons and not a legal person in itself leads to the further conclusion that the salary stipulated to be paid to a partner from the firm is in reality a mode of division of the firm's profits, no person being his own servant in law since a contract of service postulates two different persons.

18. Counsel for the respondent cited the "*Australian Income Tax Law and Practice* by F.C. Bock and F.F. Mannix [1968 Edn, Vol. 3, p. 3092] in Support of the proposition that a partner's salary is but a portion of the profits:

> "It follows that where the partnership income consists of income from property, the salary is also income from property."

19. In an early Madras case *CIT* v. *B.S. Mines* [(1922) 1 ITC 176, 177 (FB)(Mad)] the Madras High Court had held, with reference to the 1918 Income Tax Act:

> "We have no hesitation in answering that the drawings of the partners, by whatever name they are described, are part of the profits and therefore taxable, the question raised being one with reference to the character of salaries paid to partners."

20. Other cases from Other High Courts have been brought to our notice but strong reliance was placed on *Ramniklal Kothari* [*CIT* v. *Ramniklal Kothari*, (1969) 1 SCC 757 : (1969) 74

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

ITR 57] of this Court for reaching the conclusion that the business of a firm was business of the partners, that the profits of the firm were profits of the partners and that the expenditure incurred by partners in earning such share was admissible for deduction in arriving at the total income under Section 10(1).

21. Contrary views are not wanting in some rulings, but a catalogue of cases on the other side may be productive of confusion and not resolution of conflict. We abstain from that enterprise and confine ourselves to the statement of the law that although, for purposes of the Income Tax Act, a firm has certain attributes simulative of personality, we have to take it that a partnership is not a person but a plurality of persons.

22. Coming to basics over again, this Court, in *Karimtharuvi Tea Estates* [*Karimtharuvi Tea Estates Ltd.* v. *State of Kerala*, 1963 Supp 1 SCR 823 : (1963) 48 ITR 83 : AIR 1963 SC 760.] and in *Anglo-American Direct Tea Trading Co.* [*Anglo American Direct Tea Trading Co Ltd.* v. *CAg IT*, AIR 1968 SC 1213 : (1968) 2 SCR 745 : (1968) 69 ITR 667, 671] has set out the nature of and manner of assessment of composite income tax derived by the sale of tea:

> "In *Karimtharuvi Tea Estates Ltd.* v. *State of Kerala* this Court held that Explanation 2 to Section 5 of the Kerala Agricultural Income Tax Act added in 1961 disallowing certain deductions in the computation of agricultural income did not apply to computation of agricultural income derived from tea plantations. The reasons for this conclusion may be summarised thus : The definition of agricultural income in the Constitution and the Indian Income Tax Act, 1922, is bound up with Rule 24 of the Income Tax Rules, 1922. Income derived from the sale of tea grown and manufactured by the seller is to be computed under Rule 24 as if it were income derived from business in accordance with the provisions of Section 10 of the Indian Income Tax Act. The Explanation to Section 2(*a*)(2) of the Kerala Act adopts this rule of computation. Of the income so computed, 40 per cent, is treated as income liable to income tax and the other 60 per cent only is to be deemed to be agricultural income within the meaning of that expression in the Income Tax Act. The power of the State legislature to make a law in respect of taxes on agricultural income arising from tea plantations is limited to legislating with respect to agricultural income so determined. The legislature cannot add to the amount of the agricultural

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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> income so determined by disallowing any item of deductions allowable under Rule 24 read with Section 10(2)(*xv*) of the Indian Income Tax Act. Explanation 2 to Section 5 of the Kerala Act if applied to income from tea plantations would create an agricultural income which is not contemplated by the Income Tax Act and the Constitution and would be void, and it should therefore be construed not to apply to the computation of income from tea plantations."

In *Tea Estates India* [*Tea Estates India (P) Ltd* v. *CIT*, (1976) 4 SCC 446: (1976) 103 ITR 785, 795] this Court summarised the scope and implications of Rule 24:

> "Income which is realised by sale of tea by a tea company which grows tea on its land and thereafter subjects it to manufacturing process in its factory is an integrated income. Such income consists of two elements or components. One element or component consists of the agricultural income which is yielded in the form of green leaves purely by the land over which tea plants are grown. The second element or component consists of non-agricultural income which is the result of subjecting green leaves which plucked from the tea plants grown on the land to a particular manufacturing process in the factory of the tea company. Rule 24 prescribes the formula which should be adopted for apportioning the income realised as a result of the sale of tea after it is grown and subjected to the manufacturing process in the factory. Sixty per cent is taken to be agricultural income and the same consists of the first element or component, while 40 per cent represents non-agricultural income and the same comprises the second element or component."

We are fortified in the above conclusion by two decisions of this Court in the cases of *Karimtharuvi Tea Estates Ltd.* v. *State of Kerala and Anglo-American Direct Tea Trading Co. Ltd.* v. *Commissioner of Agricultural Income Tax*. In the case of Karimtharuvi Tea Estates Ltd. it was observed while dealing with the income derived from the sale of tea grown and manufactured by the seller in the context of Rule 24:

> "Of the income so computed, 40 per cent is, under Rule 24, to be treated as income liable to income tax and it would follow that the other 60 per cent only will be deemed to he 'agricultural income' within the meaning of that expression in the Income Tax Act."

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

In the case of *Anglo-American Direct Tea Trading Co. Ltd.* the Constitution Bench of this Court held that income from the sale of tea grown and manufactured by the assessee is derived partly from business and partly from agriculture. This income has to be computed as if it were income from business under the Central Income Tax Act and the Rules made thereunder. Forty per cent of the income so computed is deemed to be income derived from business and assessable to non-agricultural income tax. The balance of 60 per cent of the income so computed is agricultural income within the meaning of the Central Income Tax Act.

23. It follows that by statutory dichotomy, 60% of the tea income is agricultural in character and central income tax cannot break into its inviolability. This conceded, the flexible arrangement among partners regarding distribution of this sum may take many forms but the essential agricultural character and consequential legislative immunity cannot be lost because of tags and labels:

That which we call a rose,

By any other name would smell as sweet.

Needless to say, the position is different if the situation is of a stranger — not a partner — drawing a salary.

24. With ideological clarity, this legal position has been set forth by a learned Author whom we refer to [Law of Income Tax by AC Sampath Iyengar, 6th Edn, 1973, pp 1063-1064 (Vol II)] (by no means, rely on) compendious as his summary is:

> "Any interest, salary, bonus, commission or remuneration paid by a firm to any of its partners cannot be deducted by the firm as an expenditure in its profit-computation. The reason is this : The partners in a firm are ultimately entitled to the entire profits of the firm, according to their shares in the business. Therefore, the entirety of such profits should be brought to charge and no portion be exempted by giving the same away to a partner as his salary, bonus, commission, remuneration or interest. A partner is bound to find the necessary finances for the partnership and hence any interest on capital supplied by the partner is not deductible. A partner's rendering services to the firm stands on the same footing as his providing capital; only instead of in money, in kind. Further, no remuneration is permissible to a partner for his rendering services to the firm, since the carrying on of the business of the partnership is a primary duty which all the partners, or some of the partners acting for all, are required to do by the law relating to partnership.

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> The matter may be looked at another way too. In law, a partner cannot be employed by his firm, for a man cannot be his own employer. A contract can only be bilateral and the same person cannot be a party on both sides, particularly in a contract of personal employment. A supposition that a partner is employed by the firm would involve that the employee must be looked upon as occupying the position of one of his own employers, which is legally impossible. Consequently, when an arrangement is made by which a partner works and receives sums as wages for services rendered, the agreement should in truth be regarded as a mode of adjusting the amount that must be taken to have been contributed to the partnership's assets by a partner who has made what is really a contribution in kind, instead of contribution in money. Hence, all the aforesaid payments are non-deductible."

The contrary view favoured by *Mathew Abraham* proceeds on the reasoning:

> "Though for purposes of computation of income his share income of the firm is clubbed along with the allowance and commission, it is obvious that the character of the receipt of the latter amounts, though related to the business, cannot be said to partake of the same character of their receipt by the firm. The assessee who is a managing partner was entitled to receive the amount not by virtue of the relationship between him and the other members of the firm as partners but by virtue of the special agreement between the partners by which his services to the partnership were agreed to be remunerated." (p. 471)

> **25.** We regard this conclusion as unsound, the source of the error being a failure to appreciate that the salary of a partner is but an alias for the return, by way of profits, for the human capital — sweat, skill and toil are, in our socialist republic, productive investment — he has brought in for common benefit. The immediate reason for payment of salary was service contract but the *causa causans* in partnership."

109. The position in law so enunciated also finds resonance in **Dulichand Laxminarayan vs. Commissioner of Income Tax**[37] and where the Supreme Court had observed:-

[37] 1956 SCC OnLine SC 73

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

"**10.** Turning, then, to the Indian Partnership Act, 1932 we come to Section 4 which defines "partnership", "partner", "firm" and "firm name" in the words following:

> "4. *Definition of* 'partnership', '*partner*', '*firm*' *and* '*firm name*'.— 'Partnership' is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.
>
> Persons who have entered into partnership with one another are called individually 'partners' and collectively 'a firm', and the name under which their business is carried on is called the 'firm name'."

This section clearly requires the presence of three elements, namely (*1*) that there must be an agreement entered into by two or more persons; (*2*) that the agreement must be to share the profits of a business; and (*3*) that the business must be carried on by all or any of those persons acting for all. According to this definition "persons" who have entered into partnership with one another are collectively called a "firm" and the name under which their business is carried on is called the "firm name". The first question that arises is as to whether a firm as such can enter into an agreement with another firm or individual. The answer to the question would depend on whether a firm can be called a "person".

11. There is no definition of the word "person" in the Partnership Act. The General Clauses Act, 1897, however, by Section 3(42) provides that "person shall include any company or association or body of individuals whether incorporated or not". The firm is not a company but is certainly an association or body of individuals. The argument is that applying that definition to the word "persons" occurring in Section 4, one can at once say that an unincorporated association or body of persons, like a firm, can enter into a partnership just as by the application of that definition to Section 4 of the Indian Partnership Act a company can become a partner in a firm. The definitions given in Section 3 of the General Clauses Act, 1897, however, apply when there is nothing repugnant in the subject or context. It is difficult to say that there is anything repugnant in the context of Section 4 itself which will exclude the application of that definition to the word "persons" occurring in Section 4. Is there, however, anything repugnant in the subject of partnership law, which will exclude the application of that definition to Section 4?

12. As pointed out in *Lindley on Partnership*, 11th Edn, at p. 153, merchants and lawyers have different notions respecting the nature of a firm. Commercial men and accountants are apt to look upon a

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

firm in the light in which lawyers look upon a corporation i.e. as a body distinct from the members composing it. In other words merchants are used to regard a firm, for purposes of business, as having a separate and independent existence apart from its partners. In some systems of law this separate personality of a firm apart from its members has received full and formal recognition, as, for instance, in Scotland. That is, however, not the English Common Law conception of a firm. English lawyers do not recognize a firm as an entity distinct from the members composing it. Our partnership law is based on English law and we have also adopted the notions of English lawyers as regards a partnership firm.

13. Some of the mercantile usages relating to a firm have, however, found their way into the law of partnership. Thus in keeping accounts, merchants habitually show a firm as a debtor to each partner for what he brings into the common stock and each partner is shown as a debtor to the firm for all that he takes out of that stock. But under the English Common Law, a firm, not being a legal entity, could not sue or be sued in the firm name or sue or be sued by its own partner, for one cannot sue oneself. Later on this rigid law of procedure, however, gave way to considerations of commercial convenience and permitted a firm to sue or be sued in the firm name, as if it were a corporate body (see Code of Civil Procedure, Order 30 corresponding to rules of the English Supreme Court Order 48-A). The law of procedure has gone to the length of allowing a firm to sue or be sued by another firm having some common partners or even to sue or be sued by one or more of its own partners (see Order 30, Rule 9 of the Code of Civil Procedure), as if the firm is an entity distinct from its partners. Again in taking partnership accounts and in administering partnership assets, the law has, to some extent, adopted the mercantile view and the liabilities of the firm are regarded as the liabilities of the partners only in case they cannot be met and discharged by the firm out of its assets. The creditors of the firm are, in the first place, paid out of the partnership assets and if there is any surplus then the share of each partner in such surplus is applied in payment of his separate debts, if any, or paid to him. Conversely, separate property of a partner is applied first in the payment of his separate debts and the surplus, if any is utilised in meeting the debts of the firm (see Section 49 of the Indian Partnership Act, 1932). In the Indian Income Tax Act itself a firm is, by Section 3, which is the charging section, made a unit of assessment.

14. It is clear from the foregoing discussion that the law, English as well as Indian, has, for some specific purposes, some of which are referred to above, relaxed its rigid notions and extended a limited personality to a firm. Nevertheless, the general concept of

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

partnership, firmly established in both systems of law, still is that a firm is not an entity or "person" in law but is merely an association of individuals and a firm name is only a collective name of those individuals who constitute the firm. In other words, a firm name is merely an expression, only a compendious mode of designating the persons who have agreed to carry on business in partnership. According to the principles of English jurisprudence, which we have adopted, for the purposes of determining legal rights "there is no such thing as a firm known to the law" as was said by James L.J. in *Ex parte Corbett, In re Shand* [(1880) LR 14 Ch 122, 126] . In these circumstances to import the definition of the word "person" occurring in Section 3(42) of the General Clauses Act, 1897 into Section 4 of the Indian Partnership Act will, according to lawyers, English or Indian, be totally repugnant to the subject of partnership law as they know and understand it to be. It is in this view of the matter that it has been consistently held in this country that a firm as such is not entitled to enter into partnership with another firm or individuals. It is not necessary to refer in detail to those decisions many of which will be found cited in *Jabalpur Ice Manufacturing Association* v. *CIT, Madhya Pradesh* [(1955) 27 ITR 88] to which a reference has already been made. We need only refer to the case of *Bhagwanji Morarji Goculdas* v. *Alembic Chemical Works Co. Ltd.* [AIR 1948 PC 100] where it has been laid down by the Privy Council that Indian Law has not given legal personality to a firm apart from the partners. This view finds support from and is implicit in the observations made by this Court in the *CIT* v. *A.V. Figgies & Co.* [(1954) SCR 171 : 1953 ITR 405]

15. In *Jai Dayal Madan Gopal* [(1933) ITR 186] Sulaiman, C.J. followed the Calcutta decisions and was not prepared to dissent from the view that the word "person" in Section 239 of the Indian Contract Act, 1872 should not be interpreted so as to include a firm. The learned Chief Justice, however, expressed the view that it was difficult to say that there was anything in Section 239 itself which made the application to that section of the definition of "person" as given in General Clauses Act in any way repugnant. The learned Chief Justice, however, does not appear to have considered whether there was anything repugnant in the subject of partnership law, as it prevails in this country, which operates to exclude the application of that definition to the word "person" occurring in Section 239 of the Indian Contract Act. In our opinion, the word "persons" in Section 4 of the Indian Partnership Act, which has replaced Section 239 of the Indian Contract Act, contemplates only natural or artificial i.e. legal persons and for the reasons stated above, a firm is not a "person" and as such is not entitled to enter into a partnership with another firm or Hindu undivided family or individual. In this view of the matter there can

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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arise no question of registration of a partnership purporting to be one between three firms, a Hindu undivided family business and an individual as a firm under Section 26-A of the Act.

16. The learned Advocate for the appellant then urges that, at any rate, the partnership was not illegal, for there was no legal impediment in the way of all the members of all the three constituent firms and the karta of the Hindu undivided family and the individual entering into an agreement and that, therefore, a valid partnership was constituted by the deed of partnership under consideration. Assuming that this contention is possible in view of the language which has been used in this deed for describing the parties, the position of the appellant will not improve, for in order to be entitled to the benefit of registration under the Act, it will have to be shown that the shares of all individual partners are specified in the deed and that all the partners have personally signed the application for registration as required by Section 26-A of the Act read with Rule 2. The deed specifies that each of the five constituent parties is entitled to an equal i.e. 1/5 share but it does not specify the individual shares of each of the partners of each of the three smaller constituent firms. Further all the members of those three firms have not signed the application for registration personally. It is said that each of the three persons who executed the deed for the three smaller firms must be regarded as having the authority of their co-partners in their respective firms to sign the application for registration just as they had their authority to execute the deed itself for them. Even if they had such authority — as to which there is no evidence at all on the record — the section and Rule 2 require that each partner (not being minors) must sign personally. That admittedly has not been done, and, therefore, the application was not in proper form. In our judgment the answer given by the High Court to the question is correct. This appeal must, therefore, be dismissed with costs."

110. Mr. Hossain also relied upon the provisions introduced by virtue of Sections 25 and 26 of the Indian Partnership Act, 1932 and in terms of which every partner is held liable jointly with all other partners as also severally for all acts of the firm and the firm in turn being held liable to the same extent as the partner. According to learned counsel, the aforenoted provisions in clear and unambiguous terms provide for the partner as well as the firm being equally liable for the wrongful acts

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

or omission of either. According to Mr. Hossain, any doubt that could have possibly been harboured stands laid to rest by Section 27(2) of the LLP Act and which expressly holds an LLP to be liable in respect of any wrongful act or omission of a partner. According to learned counsel, the phrase "liable to any person" as appearing in Section 27(2) would necessarily include the legal liability which comes to be incurred under the LLP Act towards investor shareholders and other stakeholders and thus the legal consequence of such liability being liable to be suffered. In view of the aforesaid, Mr. Hossain submitted that the argument of vicarious liability is clearly misconceived.

111. Having noticed the rival submissions which were addressed on this score, we firstly turn our gaze on the principal provisions which are contained in the Companies Act and deal with the appointment and engagement of an auditor. As is manifest from a reading of Section 139 of the Companies Act, every company is entitled to appoint either an individual or a firm as its auditor. By virtue of Section 141 of the said enactment, the statute proceeds to prescribe conditions in respect of eligibility and the qualifications which must be held by an auditor appointed by a company. In terms of Section 141(1), a person would be eligible to be appointed as an auditor of a company, if he be a CA. The Proviso to Section 141(1) proceeds further to hold that a firm whose majority of partners are also qualified for appointment, may be appointed as an auditor in its own name. Similar prescriptions appear in Section 141 (2) and which prescribes the condition subject to which an LLP may be appointed as an auditor.

112. Section 141 is extracted hereunder:-

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

"**141. Eligibility, qualifications and disqualifications of auditors**.—(1) A person shall be eligible for appointment as an auditor of a company only if he is a chartered accountant:

Provided that a firm whereof majority of partners practising in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company.

(2) Where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.

(3) The following persons shall not be eligible for appointment as an auditor of a company, namely—

(*a*) a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008 (6 of 2009);

(*b*) an officer or employee of the company;

(*c*) a person who is a partner, or who is in the employment, of an officer or employee of the company;

(*d*) a person who, or his relative or partner—

(*i*) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company:

Provided that the relative may hold security or interest in the company of face value not exceeding one thousand rupees or such sum as may be prescribed;

(*ii*) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of such amount as may be prescribed; or

(*iii*) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, for such amount as may be prescribed;

(*e*) a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed;

(*f*) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel;

(*g*) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;

(*h*) a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;

[(*i*) a person who, directly or indirectly, renders any service referred to in Section 144 to the company or its holding company or its subsidiary company.

Explanation.—For the purposes of this clause, the term "directly or indirectly" shall have the meaning assigned to it in the Explanation to Section 144.]

(4) Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor."

113. It is thus evident that an individual, a partnership firm or an LLP can be appointed as an auditor of a company. The appointment, prescriptions and the nature of services which could be rendered by it are further prescribed and regulated by Section 144 of the Companies Act. The Explanation to Section 144 proceeds to explain and provide a definition to the expression *"directly or indirectly"* as appearing therein. Section 144 reads as follows:-

"**144. Auditor not to render certain services**.—An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company, namely:—

(*a*) accounting and book keeping services;

(*b*) internal audit;

(*c*) design and implementation of any financial information system;

(*d*) actuarial services;

(*e*) investment advisory services;

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

(*f*) investment banking services;

(*g*) rendering of outsourced financial services;

(*h*) management services; and

(*i*) any other kind of services as may be prescribed:

Provided that an auditor or audit firm who or which has been performing any non-audit services on or before the commencement of this Act shall comply with the provisions of this section before the closure of the first financial year after the date of such commencement.

Explanation.—For the purposes of this sub-section, the term "directly or indirectly" shall include rendering of services by the auditor,—

(*i*) in case of auditor being an individual, either himself or through his relative or any other person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control, or whose name or trade mark or brand is used by such individual;

(*ii*) in case of auditor being a firm, either itself or through any of its partners or through its parent, subsidiary or associate entity or through any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or whose name or trade mark or brand is used by the firm or any of its partners."

114. As is manifest from the Explanation appended to that provision, the statute makes appropriate provisions providing for both contingencies, namely, where the auditor be an individual or a firm. A firm when appointed as an auditor, cannot possibly be expected to act otherwise than through its members and partners. It is perhaps conscious of this facet concerning the engagement of a partnership firm or an LLP which guides the provisions made in Section 147(2). Sub-Section (2) firstly uses the word "auditor" and which must necessarily be conferred a compendious meaning bearing in mind the indisputable position of an auditor of a company being either an individual, a partnership firm or an LLP. The Proviso thereto proceeds further to

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

prescribe the punishments which could be imposed upon an auditor if it were found to have contravened the law or knowingly or wilfully to have acted with an intent to deceive the company or its shareholders. Similar provisions are thereafter engrafted in sub-section (5) and which in unambiguous terms stipulates that even in the case of an audit having been undertaken by an audit firm, if it is proved that its partner or partners had acted in a fraudulent manner, it would result in the imposition of a civil or criminal liability upon such partner or partners including the firm. The dual liability which would come to be attached is further amplified when sub-section (5) employs the phrase *"and of the firm jointly and severally"*. Of equal significance is the Proviso to sub-section (5) and which declares that in case of criminal liability of an audit firm and which be one other than that of a monetary fine, it would be the concerned partner or partners who had acted in a fraudulent manner or abetted in the commission of that crime, who alone would be liable.

115. It is thus manifest that the Companies Act makes provisions in terms of which both the firm as well as its engagement partners are held liable and could face the spectre of incarceration as well as the imposition of monetary fines. Section 147 existed on the statute book even before the NFRA came to be operationalized. The validity of that provision is not questioned before us. The said provision gets attracted the moment the provisions of Sections 139 to 146 are found to have been contravened. It is thus evident that the Act does not make any distinction insofar as the issue of liability is concerned. A liability in terms of the Companies Act could accrue or come to be suffered by

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

both the firm as well as its partners.

116. It would thus be wholly incorrect to hold that Section 132 creates a liability which is foreign to or uncontemplated by the various other provisions forming part of that statute. The Companies Act clearly contemplates a firm suffering a liability as a consequence of the action of its Engagement Partners and constituents who may be involved in the conduct of the audit. Thus, both the audit firm as well as its individual partners would be exposed to a statutory liability if Sections 139 to 146 were found to have been violated.

117. Therefore, and in our considered opinion the liability which is suffered by an audit firm by virtue of the actions of its partners engaged in an audit can neither be said to be abhorrent to the constitutional scheme or violative of Article 14. It would be wholly impermissible for an audit firm to disavow or seek to distance itself from the actions of its members. This we hold bearing in mind the indubitable fact that members come to be engaged in the conduct of the audit solely on account of the firm being appointed as an auditor of a company. The appointment of those members is not an independent engagement for it is the firm, be it a partnership or an LLP, which comes to be designated as the auditor. The individual members of those firms discharge functions and carry out duties in accordance with the directives issued by the audit firm.

118. This reasoning aligns closely with the principles of the organic theory which views the firm and its members as a single, inseparable unit for the purposes of legal and professional obligations. This indivisibility reflects the theory's premise that the firm and its members

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

are one and their roles are interdependent and unified. Thus, the appointment of the firm as an auditor naturally encompasses the actions of its members. The engagement of members in the conduct of an audit is not an independent or isolated act but is inherently derivative of the firm's appointment as the auditor. The firm acts as the central organ, and its members function as its limbs, carrying out its obligations and responsibilities. The firm's designation as the auditor inherently extends to its members, who act on its behalf.

119. Since the overarching liability and indivisible accountability vests upon the audit firm, the SAs' place it under an obligation to continually monitor, regulate and control the quality of the audit itself. It would therefore be wholly untenable in law to hold that the firm could shrug off the liability which would come to be attached consequent to the acts of omission or commission of its individual partners.

120. The fact that the audit firm is to act through its individual members becomes further evident from the following provisions which are made in the SAs:-

> "**SQC 1**
>
> 1. The purpose of this Standard on Quality Control (SQC) is to establish standards and provide guidance regarding a firm's responsibilities for its system of quality control for audits and reviews of historical financial information, and for other assurance and related services engagements. This SQC is to be read in conjunction with the requirements of the Chartered Accountants Act, 1949, the Code of Ethics and other relevant pronouncements of the Institute (hereinafter referred to as "the Code").
>
> **xxxx xxxx xxxx**
>
> 3. The firm should establish a system of quality control designed to provide it with reasonable assurance that the firm and its personnel

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

comply with professional standards and regulatory and legal requirements, and that reports issued by the firm3 or engagement partner(s) are appropriate in the circumstances.

xxxx xxxx xxxx

5. This SQC applies to all firms. The nature of the policies and procedures developed by individual firms to comply with this SQC will depend on various factors such as the size and operating characteristics of the firm, and whether it is part of a network

6. In this SQC, the following terms have the meanings attributed below:

(b) Engagement partner – 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.

(f) Firm – a sole practitioner/proprietor, partnership, or any such entity of professional accountants, as may be permitted by law.

(l) Partner – any individual with authority to bind the firm with respect to the performance of a professional services engagement.

7. The firm's system of quality control should include policies and procedures addressing each of the following elements:

(a) Leadership responsibilities for quality within the firm.

(b) Ethical requirements

(c) Acceptance and continuance of client relationships and specific engagements.

(d) Human resources.

(e) Engagement performance.

(f) Monitoring.

xxxx xxxx xxxx

14. The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements.

15. Ethical requirements relating to audits and reviews of historical financial information, and other assurance and related services engagements are contained in the Code. The Code establishes the fundamental principles of professional ethics, which include:

(a) Integrity;

(b) Objectivity;

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(c) Professional competence and due care;

(d) Confidentiality; and

(e) Professional behavior

xxxx xxxx xxxx

Independence

18. The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements (including experts contracted by the firm and network firm personnel), 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.

19. Such policies and procedures should require:

(a) Engagement partners to provide the firm with relevant information about client engagements, including the scope of services, to enable the firm to evaluate the overall impact, if any, on independence requirements;

(b) Personnel to promptly notify the firm of circumstances and relationships that create a threat to independence so that appropriate action can be taken; and

(c) The accumulation and communication of relevant information to appropriate personnel so that:

(i) The firm and its personnel can readily determine whether they satisfy independence requirements;

(ii) The firm can maintain and update its records relating to independence; and

(iii) The firm can take appropriate action regarding identified threats to independence

20. The firm should establish policies and procedures designed to provide it with reasonable assurance that it is notified of breaches of independence requirements, and to enable it to take appropriate actions to resolve such situations. The policies and procedures should include requirements for:

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

(a) All who are subject to independence requirements to promptly notify the firm of independence breaches of which they become aware;

(b) The firm to promptly communicate identified breaches of these policies and procedures to:

(i) The engagement partner who, with the firm, needs to address the breach; and

(ii) Other relevant personnel in the firm and those subject to the independence requirements who need to take appropriate action; and

(c) Prompt communication to the firm, if necessary, by the engagement partner and the other individuals referred to in subparagraph (b)(ii) of the actions taken to resolve the matter, so that the firm can determine whether it should take further action.

23. At least annually, the firm should obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent in terms of the requirements of the Code.

xxxx xxxx xxxx

28. 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:

(a) Has considered the integrity of the client and does not have information that would lead it to conclude that the client lacks integrity;

(b) Is competent to perform the engagement and has the capabilities, time and resources to do so; and

(c) Can comply with the ethical requirements.

The firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Where issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, it should document how the issues were resolved.

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Assignment of Engagement Teams

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

42. The firm should 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.

xxxx xxxx xxxx

44. The firm should also assign appropriate staff with the necessary capabilities, competence and time to perform engagements in accordance with professional standards and regulatory and legal requirements, and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances.

xxxx xxxx xxxx

Engagement Performance

46. The firm should establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards and regulatory and legal requirements, and that the firm or the engagement partner issues reports that are appropriate in the circumstances.

xxxx xxxx xxxx

Engagement Quality Control Review

60. The firm should establish policies and procedures requiring, for appropriate engagements, an engagement quality control review that provides an objective evaluation of the significant judgments made by the engagement team and the conclusions reached in formulating the report.

Such policies and procedures should:

(a) Require an engagement quality control review for all audits of financial statements of listed entities;

(b) Set out criteria against which all other audits and reviews of historical financial information, and other assurance and related services engagements should be evaluated to determine whether an engagement quality control review should be performed; and

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(c) Require an engagement quality control review for all engagements meeting the criteria established in compliance with subparagraph (b).

xxxx xxxx xxxx

Criteria for the Eligibility of Engagement Quality Control Reviewers

68. The firm's policies and procedures should address the appointment of engagement quality control reviewers and establish their eligibility through:

(a) The technical qualifications required to perform the role, including the necessary experience and authority; and

(b) The degree to which an engagement quality control reviewer can be consulted on the engagement without compromising the reviewer's objectivity.

xxxx xxxx xxxx

Completion of the Assembly of Final Engagement Files

74. The firm should establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been finalized.

xxxx xxxx xxxx

Confidentiality, Safe Custody, Integrity, Accessibility and Retrievability of Engagement Documentation

77. The firm should establish policies and procedures designed to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation

xxxx xxxx xxxx

Retention of Engagement Documentation

82. The firm should establish policies and procedures for the retention of engagement documentation for a period sufficient to meet the needs of the firm or as required by law or regulation.

83. The needs of the firm for retention of engagement documentation, and the period of such retention, will vary with the nature of the engagement and the firm's circumstances, for example, whether the engagement documentation is needed to provide a record of matters of continuing significance to future engagements. The retention period may also depend on other factors, such as whether local law or regulation prescribes specific retention periods for certain types of engagements, or whether there are generally accepted retention periods in the jurisdiction in the

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

absence of specific legal or regulatory requirements. In the specific case of audit engagements, the retention period ordinarily is no shorter than seven years8 from the date of the auditor's report, or, if later, the date of the group auditor's report.

84. Procedures that the firm adopts for retention of engagement documentation include those that:

Enable the retrieval of, and access to, the engagement documentation during the retention period, particularly in the case of electronic documentation since the underlying technology may be upgraded or changed over time.

Provide, where necessary, a record of changes made to engagement documentation after the engagement files have been completed.

Enable authorized external parties to access and review specific engagement documentation for quality control or other purposes.

Ownership of Engagement Documentation

85. Unless otherwise specified by law or regulation, engagement documentation is the property of the firm. The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the firm or its personnel.

Monitoring

86. The firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements.

xxxx xxxx xxxx

Complaints and Allegations

101. The firm should establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with:

(a) Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements; and

(b) Allegations of non-compliance with the firm's system of quality control.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

102. Complaints and allegations (which do not include those that are clearly frivolous) may originate from within or outside the firm. They may be made by firm personnel, clients or other third parties. They may be received by engagement team members or other firm personnel.

103. As part of this process, the firm establishes clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals.

104. The firm investigates such complaints and allegations in accordance with established policies and procedures. The investigation is supervised by a partner with sufficient and appropriate experience and authority within the firm but who is not otherwise involved in the engagement, and includes involving legal counsel as necessary. Small firms and sole practitioners may use the services of a suitably qualified external person or another firm to carry out the investigation. Complaints, allegations and the responses to them are documented.

105. Where the results of the investigations indicate deficiencies in the design or operation of the firm's quality control policies and procedures, or non-compliance with the firm's system of quality control by an individual or individuals, the firm takes appropriate action as discussed in paragraph 95.

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

13(d) Auditor – "Auditor" is used to refer to the person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable, the firm. Where an SA expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term "engagement partner" rather than "auditor" is used. "Engagement partner" and "firm" are to be read as referring to their public sector equivalents where relevant.

SA 220 - Quality Control for an Audit of Financial Statements

2. Quality control systems, policies and procedures are the responsibility of the audit firm. Under SQC 1, the firm has an obligation to establish and maintain a system of quality control to provide it with reasonable assurance that:

(a) The firm and its personnel comply with professional standards and regulatory and legal requirements; and

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

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

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

Differences of Opinion

22. If differences of opinion arise within the engagement team, with those consulted or, where applicable, between the engagement partner and the engagement quality control reviewer, the engagement team shall follow the firm's policies and procedures for dealing with and resolving differences of opinion.

Acceptance and Continuance of Client Relationships and Audit Engagements (Ref: Para. 12)

A8. SQC 1 requires the firm to obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client6. Information such as the following assists the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate:

• The integrity of the principal owners, key management and those charged with governance of the entity;

• Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources;

• Whether the firm and the engagement team can comply with relevant ethical requirements; and

• Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

Monitoring (Ref: Para. 23)

A32. SQC 1 requires the firm to establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control is relevant, adequate and operating effectively.

A33. In considering deficiencies that may affect the audit engagement, the engagement partner may have regard to measures the firm took to rectify the situation that the engagement partner considers are sufficient in the context of that audit.

A34. A deficiency in the firm's system of quality control does not necessarily indicate that a particular audit engagement was not performed in accordance with professional standards and regulatory and legal requirements, or that the auditor's report was not appropriate.

SA 230 – Audit Documentation

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> A23. SQC 1 requires firms to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report"

121. Having noticed the relevant provisions of the Companies Act and which contemplate an auditor to be either a partnership firm, LLP or an individual, it becomes apparent that the statutory enactments do not seek to create a distance between the auditing firm and its members or partners who may undertake the actual audit. There is no separation or disengagement between the two and the statutes duly acknowledge the position of the audit firm acting through its members and constituents.

122. To propose an arrangement where distinct spheres of liability operate independently for acts performed by a firm and for those same acts attracting liability on its partners is inherently flawed. Such a proposition assumes the existence of a framework in which the firm functions autonomously, separate from its members or constituents, while delivering auditing services. However, this assumption disregards the very essence and the nature of auditing work, where such disengagement is not only impractical but also fundamentally incompatible with the professional obligations involved.

123. Auditing, by its very nature, requires an unbroken chain of diligence, monitoring, and oversight. The service itself is deeply collaborative, demanding seamless integration of expertise and accountability between the firm and its partners. It necessitates meticulous scrutiny of financial data, adherence to regulatory frameworks and the exercise of professional judgment at every stage. These elements inherently bind the firm and its members inextricably

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

together. To suggest otherwise would ignore the operational realities of such engagements, where the quality and integrity of the work are not divisible between the firm and the individuals performing the task.

124. Moreover, rendering auditing services inherently imposes a duty of care and an expectation of the highest standards of integrity and control. The very nature of this work, with its reliance on human expertise and active involvement of professionals, compels us to outrightly reject the notion of the firm acting independent of its partners. The firm's identity and its ability to render services derives entirely from the collective actions, expertise, and oversight of its members. To argue that liability can be apportioned separately undermines the reality that the firm and its partners operate as a single cohesive entity when executing their professional obligations.

125. This interdependence must also be viewed in the context of the operational structure of professional firms. When acts are performed in the ordinary course of business—such as auditing financial statements or ensuring compliance with statutory regulations—these acts inherently reflect the firm's will and purpose executed through its partners. It is this unity of operation and accountability that ensures the trustworthiness and reliability of auditing services. Any attempt to artificially separate liability between the firm and its members creates a false dichotomy and erodes the principles of collective accountability and diligence that underpin the profession.

126. In essence, the relationship between a firm and its members while delivering auditing services is one of complete integration, where roles and responsibilities overlap to ensure the highest levels of

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

professional service. The nature of such services does not permit a firm to distance itself from the actions of its partners, especially when those actions are performed in furtherance of the firm's obligations. Therefore, liability, whether incurred by the firm or its members, cannot operate in silos but is instead a shared and unified responsibility that reflects the cohesive nature of their engagement. Such an arrangement is neither supported by the provisions contemplated within the LLP Act as well as the Companies Act.

127. This would constitute an appropriate juncture to also notice the position which would emerge upon a consideration of the Limited Liability Partnership Act 2008[38]. It must at the outset be noted that by virtue of Section 67, the Union Government stands statutorily empowered to direct that the provisions of the LLP Act as specified would also apply to any LLP. The said provision further enables the Union Government to apply such provisions of the Companies Act to a LLP, subject to such exceptions, modifications or adaptations as may be specified. This becomes evident from a reading of Section 67 which is reproduced hereunder:-

> "**67. Application of the provisions of the Companies Act.-**
>
> (1) The Central Government may, by notification in the Official Gazette, direct that any of the provisions of the Companies Act, 2013 (1 of 1956) specified in the notification-
>
> (a) shall apply to any limited liability partnership; or
>
> (b) shall apply to any limited liability partnership with such exception, modification and adaptation, as may be specified, in the notification.
>
> (2) A copy of every notification proposed to be issued under sub-section (1) shall be laid in draft before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and

[38] LLP Act.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in disapproving the issue of the notification or both Houses agree in making any modification in the notification, the notification shall not be issued or, as the case may be, shall be issued only in such modified form as may be agreed upon by both the Houses. "

Of equal significance is Section 71 of the LLP Act and which reads as follows:-

> "**71. Application of other laws not barred.-**
>
> The provisions of this Act shall be in addition to, and not in derogation of, the provisions of any other law for the time being in force. "

128. As is manifest from the above, the provisions contained in the LLP Act are ordained to be in addition to as opposed to being in derogation of the provisions contained in any other law for the time being in force. They are thus not intended to override or supersede the provisions of the Companies Act. Thus, both the provisions contained under the Companies Act as well as the LLP statute, would have to be harmoniously construed.

129. It is in the aforesaid backdrop that we then proceed to evaluate the submission which was addressed, bearing in mind the provisions contained in Section 27. That provision stands engrafted in the statute in the following terms:-

> "**27. Extent of liability of limited liability partnership .-**
>
> (1) A limited liability partnership is not bound by anything done by a partner in dealing with a person if-
>
> (a) the partner in fact has no authority to act for the limited liability partnership in doing a particular act; and
>
> (b) the person knows that he has no authority or does not know or believe him to be a partner of the limited liability partnership.
>
> (2) The limited liability partnership is liable if a partner of a limited liability partnership is liable to any person as a result of a wrongful act

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> or omission on his part in the course of the business of the limited liability partnership or with its authority.
>
> (3) An obligation of the limited liability partnership whether arising in contract or otherwise, shall be solely the obligation of the limited liability partnership.
>
> (4) The liabilities of the limited liability partnership shall be met out of the property of the limited liability partnership. "

130. As was noticed in the preceding parts of this decision, Section 27(1) essentially adopts the well-known precept of ultra vires. It thus seeks to insulate the LLP from the acts of its partners if it were to be established that they had not been authorized to do a particular act by that entity. This is subject to the added qualification of the third party being cognizant of the partner of the LLP having been conferred no such authority or being aware of that partner not being associated with the LLP.

131. However, of significance is sub-section (2), when it provides that the LLP would be liable if its partner becomes liable to a person as a result of a wrongful act or omission in the course of the business of the LLP or with its authority. There could have been no starker acknowledgement of an LLP in law being liable for the acts of its partners or members. Section 27(2) thus stretches to an act of omission or commission of a member of the LLP acting within the scope of its authority and "*in the course of the business*" of the LLP. An audit conducted by a firm or a LLP would undoubtedly be "*in the course of the business*" of that entity.

132. We thus find ourselves unable to construe Section 132 of the Companies Act creating a vicarious liability which is otherwise not envisaged in cognate statutes and which are neither assailed nor

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

asserted to be invalid. This quite apart from the audit firm being enabled to act through its designated members, engagement partners to undertake the actual audit. We thus find ourselves unable to comprehend how that audit firm could disavow, disclaim or disown their acts.

133. In terms of Section 27(2) of the LLP Act, the statute postulates that an LLP would be liable to another person only if its partner be guilty of a wrongful act or omission committed on its part in the course of business. This provision thus is a reiteration of the LLP becoming liable for acts of its partners. Section 28 of the LLP Act proceeds further to then deal with contingencies where a partner may, if at all, become liable. It prescribes that a partner would, on a fundamental plane, not be viewed as being personally liable solely on account of being a partner of the LLP. Sub-section (2) of Section 28, however, provides that Section 27(3) which broadly stipulates that the obligations arising out of contract or otherwise would be solely that of the LLP, would not apply where personal liability comes to be attached upon a partner by virtue of a wrongful act or omission. It proceeds further to significantly provide that a partner would in turn not become personally liable for the wrongful act or omission of any other partner of the LLP. Section 28(2), however, would have to be construed, bearing in mind the admitted position of the audit firm itself having been appointed as the auditor of the corporate entity and the engagement and involvement of its partners and members being indelibly and inextricably connected with the discharge of that function.

134. While Section 28(2) insulates a partner from being held

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

personally liable for the wrongful act or omission of any other partner, the protection so accorded would clearly not apply in case the wrongful act or omission were viewed as being that of the audit firm itself. As was explained by us in the preceding paragraphs of this judgment, the issue of accrual of liability arises in the context of the engagement of a firm or an LLP as an auditor. Surely such an entity cannot discharge and perform its obligations concerned with audit unless it were acting through its members and partners. It is this ineffaceable connection which cannot possibly be erased or ignored while examining the challenge raised in the context of vicarious liability.

135. We also find ourselves unable to countenance the submission of persons disconnected with the actual audit coming to be impacted as a consequence of the audit firm suffering disciplinary action. This submission again firstly proceeds on the premise of a member having a standing distinct from that of the firm and which we have already negated in the preceding parts of this decision. Secondly, such a contingency is neither unknown nor unique. It cannot possibly be viewed as a fallout peculiar to Section 132 alone. A penal action against a corporate entity would invariably have a repercussion upon an individual in that firm's employment or engagement.

136. However, that disqualification or adverse consequence could occur even in a situation where a firm were to be debarred under any other law. Such a consequence could, for instance, occur if an entity were to be blacklisted. What thus must be borne in mind is that a person disconnected with the actual audit suffers the consequences of punishment imposed upon its employer only as long as the individual

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

remains associated with that entity and proposes to practise the profession under its aegis only. A punishment that may come to be imposed upon a firm by virtue of Section 132(4), therefore, cannot possibly be said to be violative of Article 19 of the Constitution.

137. We thus find no merit in the contention that Section 132 of the Companies Act is liable to be held as unconstitutional basis the audit firm or its individual partners and members becoming vicariously liable. In light of the above, the challenge to the constitutionality of Section 132 on the grounds of vicarious liability is without merit. The provision aligns with the fundamental principles of accountability and collective responsibility that governs the auditing profession. The firm's role as an auditor, coupled with its reliance on its partners and members to execute its obligations, makes it inevitable that liability whether arising from negligence, misconduct, or breach of statutory duties must extend to both the entity and the individuals involved. This structure not only ensures accountability but also upholds the integrity and trust essential to the auditing profession.

138. We also hold that Section 132 is neither an overreach nor can it be said to be arbitrary; it is a necessary mechanism to enforce professional accountability. The firm's designation as an auditor inherently includes the collective responsibilities of its members, making the imposition of a vicarious liability a logical and justified extension of its statutory obligations. Therefore, the contention that the provision is unconstitutional lacks merit and proceeds in ignorance of the operational and legal realities of an audit firm's engagement.

139. Since the full spectrum of auditing services would be carried out

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

under the aegis of a firm when it is engaged as an "auditor," it would be wholly untenable to abruptly sever the alignment between the firm and its members. The proposition to the contrary disregards the very essence of the firm's operational structure and undermines the objective sought to be achieved by Section 132. The essence of auditing lies in the collective responsibility of the firm and its members who work in unison to ensure compliance with accounting standards and deliver services of the highest professional integrity. Any attempt to isolate the liability of the firm from the actions of its members would result in a fragmentation of accountability, contrary to the statutory intent and purpose of ensuring public trust in financial reporting.

140. The liability in question pertains exclusively to the firm's adherence to accounting standards and its performance of auditing services, which are fundamental to maintaining the credibility and transparency of financial statements. These obligations are not abstract; they are explicitly tied to the professional judgment and diligence exercised by the firm's members in executing their duties. Thus, it cannot be construed that holding the firm and its members liable in this context would infringe upon their constitutional rights flowing Article 19. The assertion that such a liability violates the fundamental rights overlooks the reasonable restrictions imposed by statutory mandates designed to uphold public interest and ensure accountability in financial practices.

141. Moreover, statutory liability in this context is not an arbitrary imposition but a necessary mechanism to enforce adherence to regulatory standards and professional ethics. The NFRA, as the

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

governing authority, has been established to regulate and ensure the accountability of auditors and auditing firms in order to safeguard public interest. The statutory framework does not infringe upon the right to practice a profession. It merely regulates the profession in a manner that ensures its integrity and aligns with larger public interest concerns. The argument that liability under the NFRA framework falls foul of Article 19 must, therefore, be unequivocally rejected.

142. By virtue of the firm being appointed as an auditor, the firm and its members willingly undertake responsibilities that come with a clear expectation of compliance with accounting standards and the assurance of professional diligence. The alignment between the firm and its members, particularly in the discharge of auditing services, is integral and inseparable. Liability arising from statutory breaches, including those regulated by the NFRA, is both reasonable and necessary to ensure the firm's adherence to professional obligations.

143. The argument of vicarious liability equally fails when tested on the anvil of the 2007 Misconduct Rules. As is manifest from a reading of Rule 8 if a complaint comes to be lodged before the Council against a firm, the statute envisages that firm being called upon to disclose the name or names of its "member/ members concerned" as well as for it being apprised of the particulars of the alleged acts of omission or commission. Rule 8 further prescribes that upon a requisite disclosure being made by the firm, it would be the member or members concerned who would become responsible for answering the complaint. Similarly, the Explanation to Rule 8 stipulates that a notice to the firm would be deemed to be a notice to all members who are partners or employees of

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

that firm as on the date of registration of the complaint.

144. It is this statutory position which then stands mirrored in the Proviso to Rule 11 of the NFRA Rules and which reads as follows:

> "**11. Disciplinary proceedings**.—(1) Based on the reference received from the Central Government or findings of its monitoring or enforcement or oversight activities, or on the basis of material otherwise available on record, if the Authority believes that sufficient cause exists to take actions permissible under sub-section (4) of Section 132, it shall refer the matter to the concerned division, which shall cause a show-cause notice to be issued to the auditor.
>
> (2) The show-cause notice shall be in writing, and shall, inter alia, state—
>
> (*a*) the provisions of the Act or rules under which it has been issued;
>
> (*b*) the details of the alleged facts;
>
> (*c*) the details of the evidence in support of the alleged facts;
>
> (*d*) the provisions of the Act, rules or the accounting standards or auditing standards thereunder allegedly violated, or the manner in which the public interest is allegedly affected;
>
> (*e*) the actions that the Authority proposes to take or the directions it proposes to issue if the allegations are established;
>
> (*f*) the time limit and the manner in which the auditor is required to respond to the show-cause notice;
>
> (*g*) the consequences of failure to respond to the show-cause notice; and
>
> (*h*) the procedure to be followed for disposal of the show-cause notice.
>
> (3) The show-cause notice shall enclose copies of documents relied upon and extracts of relevant portions from the report of investigation or other records.
>
> (4) The show-cause notice shall be served on the auditor in the following manner, namely—
>
> (*a*) by sending it to the auditor at the address provided by him or provided by the Institute of Chartered Accountants of India (if required by the Authority) by registered post with acknowledgement due; or
>
> (*b*) by an appropriate electronic means to the email address

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

of the auditor provided by him or it or provided by the the Institute of Chartered Accountants of India (if required by the Authority):

Provided that where the auditor is a firm—

(*a*) a notice to a firm shall be deemed to be a notice to all the partners or employees of that firm as on the date of service of notice;

(*b*) the notice shall call upon the firm to disclose the name or names of the partner or partners concerned who shall be responsible for answering the allegations;

(*c*) the partner whose name is disclosed by the firm shall be responsible for answering the notice against the firm, and if no partner, whether erstwhile or present, of the firm owns responsibility for the allegations made against the firm, then the firm as a whole shall be responsible for answering the allegations, and all the partners and employees of that firm as on the date of occurrence of alleged misconduct, shall be responsible for answering the allegations.

(5) The Division shall dispose of the show-cause notice within a period of ninety days of the assignment through a summary procedure as may be specified by the Authority, by a reasoned order in adherence to the principles of natural justice including where necessary or appropriate an opportunity of being heard in person, and after considering the submissions, if any, made by the auditor, the relevant facts and circumstances, and the material on record;

[Provided that where the disposal does not take place within the said period, the Division shall record the reasons for not disposing off the show-cause notice within the said period, and the chairperson, may, after taking into account the reasons so recorded, extend the aforesaid period by such additional period not exceeding ninety days as he may consider necessary:

Provided further that the chairperson may, if he thinks fit, grant the said extension of period more than once.]

(6) The order disposing of a show-cause notice may provide for—

(*a*) no action;

(*b*) caution;

(*c*) action for imposing penalty against auditor under sub-clause (A) of clause (*c*) of sub-section (4) of Section 132 or for debarring the auditor from engaging as such under sub-clause (B) of clause (*c*) of sub-section (4) of Section 132 or both.

(7) The order passed under sub-rule (6) shall not become effective

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

until thirty days have elapsed from the date of issue of the order unless the Division states otherwise in the order along with the reason for the same.

(8) The order passed under sub-rule (6) shall be served on the auditor in the manner specified in sub-rule (3) and a copy of the same shall be sent—

(*i*) in all cases to (*a*) the Central Government; and (*b*) the Institute of Chartered Accountants of India;

(*ii*) in the case of a company referred to in sub-section (5) of Section 139 to the Comptroller and Auditor General of India;

(*iii*) in the case of a listed company to the Securities and Exchange Board of India; (*iv*) in the case of a bank or a non-banking finance company to the Reserve Bank of India;

(*iv*) in the case of a bank or a non-banking finance company to the Reserve Bank of India;

(*v*) in the case of an insurance company to the Insurance Regulatory and Development Authority of India;

(*vi*) in case the auditor is resident outside India to concerned regulator of such country;

and the same shall be published on the website of the Authority."

145. Rule 11 thus makes provisions identical to those contained in Rule 8 of the 2007 Misconduct Rules. A conjoint reading of the aforesaid statutory provisions leads us to the inevitable conclusion that it would be wholly incorrect to either assume or countenance the statutory scheme seeking to draw a distinction between the auditing firm and its constituent members. The members of the auditing firm act as its arms and sinews since an incorporated body can only act through its constituents and integral components.

146. As was noticed by us hereinabove, members or employees of an auditing firm do not come to be named or engaged in the work of audit in their individual capacity. Such a member becomes involved in the

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

audit of a corporate entity by virtue of being an employee of the auditing firm and having been designated for the purposes of discharging the obligations of audit that are proposed to be undertaken by that firm. This position clearly emerges also from the various SAs' which were noticed hereinbefore.

147. We also find the submission resting on the view expressed by the US Supreme Court flowing from *Elfbrandt* to be wholly unmerited. While it is true that some of the observations rendered by the US Supreme Court found adoption and resonance in the decision of the Supreme Court in **Arup Bhuyan vs. State of Assam and Anr.**[39] and which was reiterated in *Indra Das*, we take note of the judgment rendered by three learned Judges of the Supreme Court in **Arup Bhuyan vs. State of Assam and Anr. [Arup Bhuyan-2]**[40] and where the Supreme Court ultimately came to hold that the decisions of the US Supreme Court would be inapplicable bearing in mind the principles enshrined in Article 19 of the Constitution and the principle of reasonable restriction adopted by our Constitution as moderating that right. As is manifest from a reading of Para 8 of the report in *Arup Bhuyan-2*, the principal issue which had arisen for consideration was whether active membership is required to be proven over and above the membership of a banned organization. The second important question which stood posited in *Arup Bhuyan-2* was with respect to the correctness of the view expressed in the earlier judgments of the Supreme Court and which had proceeded to interpret the ambit of Article 19 on the basis of the principles enunciated by the US Supreme

[39] (2011) 3 SCC 377
[40] (2023) 8 SCC 745

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

Court.

148. In *Arup Bhuyan-2,* the Supreme Court noticed the distinction which is liable to be acknowledged to exist between Article 19 of our Constitution and the position which prevails in the US. Dealing with this aspect, it was pertinently observed as follows: -

> "**74.** Applying the law laid down by this Court in the aforesaid decisions to the facts of the case on hand and considering the different position of laws in US and in our country more particularly faced with Articles 19(1)(*c*) and 19(4) of the Constitution of India under which the right to freedom of speech is subject to reasonable restrictions and is not an absolute right and the Constitution permits Parliament to frame the laws taking into consideration the public order and/or the sovereignty of India, without noticing the differences in American laws and the Indian laws, this Court in *Arup Bhuyan* [*Arup Bhuyan* v. *State of Assam*, (2011) 3 SCC 377 : (2011) 1 SCC (Cri) 855] and *Raneef* [*State of Kerala* v. *Raneef*, (2011) 1 SCC 784 : (2011) 1 SCC (Cri) 409] has erred in straightway and directly following the US Supreme Court decisions and that too without adverting to the differences and the position of laws in India.
>
> **75.** In the aforesaid two decisions without noticing the differences of the US Supreme Court (referred to in the said decisions) this Court has just followed the American decisions to which we are not agreeable. This Court ought to have considered the differences in the American laws and the Indian laws more particularly the provisions in the Indian Constitution. By the aforesaid we do not say for a moment that in a given case the US Supreme Court decisions may not be taken into consideration and/or may not be a guidance. Before following the American decisions, the Indian courts are required to consider the difference in the nature of the laws applicable in the respective countries.
>
> **76.** As observed and held by this Court in *Joseph Kuruvilla Vellukunnel* [*Joseph Kuruvilla Vellukunnel* v. *RBI*, 1962 SCC OnLine SC 3 : 1962 Supp (3) SCR 632 : AIR 1962 SC 1371] , the aid of American concepts, laws and precedents in the interpretation to which laws is not always without its dangers and they have therefore to be relied upon with some caution if not with hesitation because of the difference in the nature of those laws and the institutions to which they apply."

149. This distinction stood further highlighted in paragraphs 118 to

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

120 as well as 125 of the aforenoted decision and which are extracted hereinbelow:-

> "***Distinction between the Indian and American Constitutions***
>
> **118.** In view of the above discussion, one now proceeds to consider the First Amendment of the American Constitution which is extracted as under:
>
> > "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances."
>
> **119.** The contradistinction between the rights created by the First Amendment of the American Constitution and Article 19 of the Indian Constitution is the power given to the State to make laws reasonably restricting such freedoms in India. Conversely, in the United States of America, restrictions have been imposed by the judiciary in instances, as relied upon in *Arup Bhuyan* [*Arup Bhuyan* v. *State of Assam*, (2011) 3 SCC 377 : (2011) 1 SCC (Cri) 855] and *Indra Das* [*Indra Das* v. *State of Assam*, (2011) 3 SCC 380 : (2011) 1 SCC (Cri) 1150] , however no such explicit power is available with the legislature.
>
> **120.** This distinction has been enunciated by this Court as well. In *Babulal Parate* v. *State of Maharashtra*[*Babulal Parate* v. *State of Maharashtra*, 1961 SCC OnLine SC 48 : (1961) 3 SCR 423 : AIR 1961 SC 884] , as submitted by the Union of India, a Constitution Bench of this Court (five-Judge Bench) while upholding the constitutional validity of Section 144CrPC has held that whatever may be the position in the United States, the anticipatory action under Section 144CrPC is permissible under clauses (2) and (3) of Article 19, which allow the legislature to make laws placing reasonable restrictions on the rights conferred by these clauses of Article 19. Importantly, this Court further observed that there is nothing in the American Constitution corresponding to clauses (2) to (6) of Article 19 of the Indian Constitution. It was further observed that the framework of the Indian Constitution is different from the American Constitution.
>
> **125.** In *Shreya Singhal* [*Shreya Singhal* v. *Union of India*, (2015) 5 SCC 1 : (2015) 2 SCC (Cri) 449] , this Court speaking through R.F. Nariman, J. highlighted on the differences between the US First Amendment and freedom of speech and expression under Article 19(1)(*a*) read with Article 19(2) in the following words : (SCC pp. 131-32, paras 15 & 17-18)
>
> "*15*. It is significant to notice first the differences between

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

the US First Amendment and Article 19(1)(*a*) read with Article 19(2). The first important difference is the absoluteness of the US First Amendment—Congress shall make [**Ed.** : The words between two asterisks have been emphasised in original.] *no law*[**Ed.** : The words between two asterisks have been emphasised in original.] which abridges the freedom of speech. Second, whereas the US First Amendment speaks of freedom of speech and of the press, without any reference to "expression", Article 19(1)(*a*) speaks of freedom of speech and expression without any reference to "the press". Third, under the US Constitution, speech may be abridged, whereas under our Constitution, reasonable restrictions may be imposed. Fourth, under our Constitution such restrictions have to be in the interest of eight designated subject-matters—that is, any law seeking to impose a restriction on the freedom of speech can only pass muster if it is proximately related to any of the eight subject-matters set out in Article 19(2).

***

17. So far as the second apparent difference is concerned, the American Supreme Court has included "expression" as part of freedom of speech and this Court has included "the press" as being covered under Article 19(1)(*a*), so that, as a matter of judicial interpretation, both the US and India protect the freedom of speech and expression as well as press freedom. *Insofar as abridgement and reasonable restrictions are concerned, both the US Supreme Court and this Court have held that a restriction in order to be reasonable must be narrowly tailored or narrowly interpreted so as to abridge or restrict only what is absolutely necessary*. It is only when it comes to the eight subject-matters that there is a vast difference. In the US, if there is a compelling necessity to achieve an important governmental or societal goal, a law abridging freedom of speech may pass muster. But in India, such law cannot pass muster if it is in the interest of the general public. Such law has to be covered by one of the eight subject-matters set out under Article 19(2). If it does not, and is outside the pale of Article 19(2), Indian courts will strike down such law.

18. … American judgments have great persuasive value on the content of freedom of speech and expression and the tests laid down for its infringement. It is only when it comes to subserving the general public interest that there is a world of difference."

(emphasis supplied) "

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

In view of the aforesaid, we find no merit in the arguments which were canvassed on the basis of *Elfbrandt*, *Arup Bhuyan and Indra Das.*

150. As we had found above, the SQC defines an Engagement Partner to mean one who is a member of the Institute of Chartered Accountants of India and is in full time practice as such. Similarly, an Engagement Quality Control Reviewer too is envisaged to be a partner or other person in the firm suitably qualified to discharge the functions expected of it in the course of audit. The expression "engagement team" is defined by the SQC to mean all persons contracted and engaged by the firm in connection with that engagement. The argument of Section 132 thus creating a vicarious liability which is otherwise not contemplated or envisaged is thoroughly misconceived.

151. In our considered opinion, Mr. Hossain was correct in highlighting the essential attributes of a partnership as envisaged in law and which recognizes it to be distinct and distinguishable from an incorporated entity. As was succinctly explained by the Supreme Court in **Commissioner of Income Tax, Madras vs. R. M. Chidambaram Pillai and Others**[41], a firm is essentially a collection of persons described compendiously with the aid of its name and the said principles having been so adopted only for the purposes of "commercial convenience". The Supreme Court in *Chidambaram Pillai* had significantly observed that a firm is not a legal person even though the statute may attribute some aspects of personality to it. It was held that the firm in that sense is merely a collective noun used to designate an

[41] (1977) 1 SCC 431

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18:46:26

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entity and not a person. Similar is the position which emerges when we examine the underlying scheme informing the establishment and functioning of LLPs.

152. These features of a partnership firm were reiterated in *Dulichand* and where S.R. Das CJ speaking for the Bench had pertinently observed that a firm though granted a limited personality by statute remains an association of individuals and the name of the firm being only a collective name to describe that body of individuals. The challenge on the aforesaid grounds as urged by the writ petitioners is thus negated.

SECTION 132 AND ITS RETROACTIVE OPERATION

153. Taking the discussion forward we propose to now evaluate the challenge raised by the writ petitioners on the ground of Section 132 operating retrospectively and thus impacting valuable vested rights. The petitioners had urged that although sub-sections (2) and (4) of Section 132 came to be enforced with effect from 24 October 2018 and the NFRA Rules on 13 November 2018, the NFRA seeks to apply those provisions retrospectively to audits concluded and completed prior to the dates aforenoted. The petitioners submitted that we must bear in mind the well settled precept that statutes ordinarily and as a general proposition are assumed to operate prospectively unless retrospectivity is expressly or impliedly provided for. It was their contention that the provisions as introduced by Section 132 not only ushers in a new procedure for purposes of trial of allegations of professional misconduct, it also creates new disabilities apart from imposing new obligations on transactions already accomplished. Viewed in that light it was their submission that the provision can only be applied

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

prospectively.

154. It was contended that prior to the introduction of Section 132 there was no provision under the CA Act in terms of which an LLP or a firm could have been held guilty of acts of professional or other misconduct purportedly committed by any of its partners. Taking us through those provisions, the petitioners sought to highlight the fact that any action consequent to a determination of guilt connected to professional or other misconduct could have only exposed a partner to punishments under the CA Act. It is in the aforesaid backdrop that they contend that it was Section 132 which for the first time proceeded to create a liability and contemplates penal action against an LLP and a firm. It was submitted that the CA Act read alongside the Misconduct Rules, 2007 had never provisioned for the debarment of a firm. In view of the above, it was submitted that the provisions of Section 132 cannot be invoked in respect of audits that had been undertaken or completed prior to the dates from which the new regime came into force.

155. Learned senior counsels appearing for the writ petitioners then took us through some of the provisions made in the Companies Act including Section 139 and which according to them contemplates either an individual or a firm being appointed as an auditor. Insofar as an individual auditor is concerned, it was pointed out that the maximum monetary penalty prescribed for professional misconduct under the CA Act [prior to the amendments made therein in 2022] for Schedule I offences was stipulated to be INR 1 lakh while the penalties that could be imposed for Schedule II offences was INR 5 lakhs. It was submitted that Section 132(4)(c), however, now prescribes a penalty in the case of

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

individuals to be not less than INR 1 lakh and which could extend to five times the fee received. Similarly, in the case of firms the monetary penalty is prescribed to be not less than INR 5 lakhs and which could extend to 10 times the fee received. These monetary penalties, according to the writ petitioners, are in stark contrast to what prevailed under the CA Act. They would thus contend that since the monetary penalties are far greater than those that were provided for under the CA Act, Section 132 cannot validly be enforced retrospectively.

156. The writ petitioners also questioned the stand taken by NFRA and which had alluded to the scheme underlying Section 132 as merely contemplating a change of forum and procedure. It was submitted that while the section undoubtedly introduces procedural changes, it also affects vested rights which had come to be perfected and this too would necessarily warrant the Court rendering a declaration that Section 132 can only have prospective application.

157. Arguments were then addressed in great detail on behalf of the writ petitioners with learned senior counsels referring to the various procedural safeguards which formed part of the CA Act including provisions for leading of evidence, cross-examination of witnesses and all of which have been completely done away with and the NFRA being empowered by statute to adopt such summary procedure as it may deem fit. A retroactive application of Section 132 was also assailed on the basis of Article 20(1) of the Constitution.

158. The petitioners also questioned the correctness of the stand taken by NFRA and which had urged us to recognize the Proviso to Section 132(4) as being the embodiment of a legislative intent of those

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

provisions applying even to past misdemeanors. It was submitted that the Proviso to Section 132(4) stands confined to the initiation or continuance of an investigation in the event NFRA were to take cognizance of the same. It was thus submitted that were NFRA not to initiate any investigation in relation to the audit of a company, the Council or any other authority enabled by the CA Act would continue to retain the right to initiate or continue an investigation. It was thus submitted that the word *"continue"* as appearing in the Proviso to Section 132(4) is to be read in that light and cannot possibly be construed as being indicative of an express or implied intent of the Legislature to confer retroactivity upon Section 132.

159. Reference was also made to the stand as taken by the NFRA in its affidavit filed in these proceedings and where it had sought to explain the ambit of the Proviso to Section 132(4) as being solely for the purposes of interdicting parallel investigations. This admission, according to the writ petitioners, supports their contention that the Section would not operate retrospectively.

160. For purposes of explaining the well settled precepts of substantive law operating prospectively unless a contrary intention is manifest or could be inferred from the language of the statute, the writ petitioners drew our attention to the following passages from the decision of the Supreme Court in **Hukum Chand vs. Union of India and Ors.**[42]:-

> "**9.** The learned Solicitor-General has not been able to refer to anything in Section 40 from which power of the Central Government to make retrospective rules may be inferred. In the absence of any

[42] (1972) 2 SCC 601

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

such power, the Central Government, in our view, acted in excess of its power insofar as it gave retrospective effect to the Explanation to Rule 49. The Explanation, in our opinion, could not operate retrospectively and would be effective for the future from the date it was added in February, 1960.

10. In the case of *Cannanore Spinning and Weaving Mills Ltd.* v. *Collector of Customs and Central Excise*[(1969) 3 SCC 112 : (1970) 2 SCR 830] this Court dealt with an explanation which had been added by the Central Government in purported exercise of the power vested under the Central Excise and Salt Act, 1944. Question arose whether the explanation had a retrospective effect. The Court referred in the context to the rule making power of the Central Government under the aforesaid Act and observed:

> "Dr Seiyed Muhammad, learned Counsel for the department, did not support the impugned demand on the basis of the retrospective effect purported to have been given to the explanation referred to earlier by the notification, dated February 16, 1963, (Exh. P-12) for obvious reasons. The rule making authority had not been vested with the power under the Central Excise and Salt Act to make rules with retrospective effect. Therefore the retrospective effect purported to be given under Exh. P-12 was beyond the powers of the rule-making authority."

11. In the case of *ITO* v. *M.C. Ponnoose* [(1969) 2 SCC 351 : (1970) 1 SCR 678] this Court dealt with a notification, dated August 14, 1963, which empowered the revenue officials, including the Tehsildar, to exercise the powers of a tax recovery officer under the Income Tax Act, 1961 in respect of arrears. The notification was given retrospective effect. Question which arose for determination was whether the State Government could invest the Tehsildar with such powers retrospectively. Answering this question in the negative, this Court observed:

> "The Parliament can delegate its legislative power within the recognised limits. Where any rule or regulation is made by any person or authority to whom such powers have been delegated by the Legislature it may or may not be possible to make the same so as to give retrospective operation. It will depend on the language employed in the statutory provision which may in express terms or by necessary implication empower the authority concerned to make a rule or regulation with retrospective effect. But where no such language is to be found it has been held by the courts that the persons or authority exercising subordinate legislative

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> functions cannot make a rule, regulation or bye-law which can operate with retrospective effect."

Reference was made in the above cited case to an earlier decision of this Court in *B.S. Vadera, etc.* v. *Union of India* [AIR 1969 SC 118 : (1968) 3 SCR 575 : 17 FLR 411] wherein it had been observed with reference to rules framed under the proviso to Article 309 of the Constitution that those rules could be made with retrospective operation. *Vadera case* was distinguished on the ground that the view expressed therein was based upon the language employed in the proviso to Article 309 that any rules so made shall have effect subject to the provisions of any such Act. It was also observed:

> "As the Legislature can legislate prospectively as well as retrospectively there can be hardly any justification for saying that the President or the Governor should not be able to make rules in the same manner so as to give them prospective as well as retrospective operation. For these reasons the ambit and content of the rule-making power under Article 309 can furnish no analogy or parallel to the present case."

12. We are, therefore, of the opinion that the Explanation added to Rule 49 in the present case cannot be given retrospective operation."

161. The judgment of the Orissa High Court in **Krushna Chandra vs. Commr. of Endowments and Ors.**[43] was also cited in this respect and where the legal position was summarized in the following words: -

> "**28.** The first question, arising out of these rival contentions. which, if decided in favour of the plaintiff-appellant, would negative the plea of limitation is whether Section 39 of the Act is retrospective or prospective in operation. The section opens in present tense, "When the hereditary trustee of a math nominates his successor he shall give intimation in writing". Ordinarily the word "nominates" would not comprise the connotation 'has nominated'. It is a fundamental rule of construction that no statute shall be construed to have a retrospective operation unless such a construction appears very clear in the terms of the Act or arises by necessary and distinct implication. An offshoot of this rule is that if the enactment is expressed in the language which is fairly capable of either interpretation, it ought to be construed as prospective only and that there is a presumption against a retrospective operation if, when so operated, it would prejudicially affect the vested rights or the

[43] 1975 SCC OnLine Ori 70

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> legality of past transactions. Section 39 imposes an obligation to intimate the nomination within three months thereof. The effect of giving it a retrospective operation would be to divest a nominated trustee of his vested right of succession, even where Section 39 would be impossible of compliance by reason of three months having elapsed since nomination and before enactment of Section 39 of the Act. Further it would result in altering the pre-existing situation of parties and interfering with the antecedent rights of the trustees in depriving them of their trusteeship and placing the institution under the direct control of the Commissioner. Adoption of a Chela or nomination of a successor being past transactions would be nullified, even through the obligation of intimation provided in Section 39, as indicated above, was impossible of performance. Having regard to these far-reaching consequences of exproprietory nature and of extinguishment of vested rights flowing from retrospective operation of Section 39, and in absence of any clear, strong and imperative words in that section intending that effect, the conclusion is that the legislature never intended it to operate retrospectively"

162. As was noticed hereinabove, the petitioners had laid great emphasis on the presumption of statutes having prospective application and the same being construed as intended to operate retrospectively only if the legislative body were to consciously couch that provision in a manner which could be countenanced as demonstrative of an express intent or intended implication. In order to buttress the aforesaid contention, the petitioners cited the decision of the Supreme Court in **State of Punjab and Ors. vs. Bhajan Kaur and Ors.**[44], relevant extracts whereof are reproduced hereinbelow: -

> "**9.** A statute is presumed to be prospective unless held to be retrospective, either expressly or by necessary implication. A substantive law is presumed to be prospective. It is one of the facets of the rule of law.
>
> **10.** Section 92-A of the 1939 Act created a right and a liability on the owner of the vehicle. It is a statutory liability. Per se it is not a tortuous (*sic* tortious) liability. Where a right is created by an

[44] (2008) 12 SCC 112

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

enactment, in the absence of a clear provision in the statute, it is not to be applied retrospectively.

11. Ms Arora, however, has drawn our attention to a decision of the Kerala High Court in *United India Insurance Co. Ltd.* v. *Padmavathy* [1990 ACJ 751 (Ker)] . The Kerala High Court referred to a decision of this Court in *M.K. Kunhimohammed* v. *P.A. Ahmedkutty* [(1987) 4 SCC 284 : 1987 SCC (Cri) 703 : AIR 1987 SC 2158] wherein the following observations were made : (SCC p. 295, para 14)

> "*14.* … Having regard to the inflationary pressures and the consequent loss of purchasing power of the rupee we feel that the amount of Rs 15,000 and the amount of Rs 7500 in the above provisions appear to have become unrealistic. We, therefore, suggest that the limits of compensation in respect of death and in respect of permanent disablement, payable in the event of there being no proof of fault, should be raised adequately to meet the current situation."

12. In *Padmavathy* [1990 ACJ 751 (Ker)] the Kerala High Court held : (ACJ p. 756, paras 11-12)

> "*11.* The said suggestion of the Supreme Court was given due respect by the law-making machinery when the Bill was finally introduced in Parliament. This fact can be discerned from the Statement of Objects and Reasons prefaced in the new Act. Therefore, in effect Parliament has only retained the same right which was conferred on the victims through Chapter VII-A of the repealed Act. The difference in the quantum of compensation is only intended to make the right realistic and on a par with the amount fixed earlier. Hence Section 6 of the General Clauses Act would not impede the enforcement of Section 140 of the new Act in relation to an accident which occurred prior to the coming into force of the new Act.
>
> *12.* For yet another reason, we can support the said conclusion. Section 6 of the General Clauses Act permits switching over to the repealed Act only if a different intention does not appear in the new statute. Such a different intention can be discerned from the new Act. It is in Chapter X of the new Act that provisions regarding 'no fault liability' have been included. The Chapter starts with Section 140 and ends with Section 144. The last section reads as follows:'The provisions of this Chapter shall have effect notwithstanding anything contained in any other

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> provision of this Act or of any other law for the time being in force.' The different intention manifested in the new Act is that the provisions in Chapter X should get predominance over all other laws. The provisions contained in that Chapter must be given effect to notwithstanding any contrary provision in any other law including Section 6 of the General Clauses Act. All other provisions, therefore, must yield to the provisions contained in Chapter X of the new Act. This is the legislative intention manifested through Section 144 of the new Act."

In the decision of the Punjab and Haryana High Court in *Mosmi* [1992 ACJ 192 (P&H)] , reliance has been placed upon the judgment of the Kerala High Court. With the greatest of respect to the learned Judges of the Kerala and Punjab and Haryana High Courts, we could not persuade ourselves to agree with the said view.

13. No reason has been assigned as to why the 1988 Act should be held to be retrospective in character. The rights and liabilities of the parties are determined when cause of action for filing the claim petition arises. As indicated hereinbefore, the liability under the Act is a statutory liability. The liability could, thus, be made retrospective only by reason of a statute or statutory rules. It was required to be so stated expressly by Parliament. Applying the principles of interpretation of statute, the 1988 Act cannot be given retrospective effect, more particularly, when it came into force on or about 1-7-1989.

xxxx xxxx xxxx

16. It is now well-settled that a change in the substantive law, as opposed to adjective law, would not affect the pending litigation unless the legislature has enacted otherwise, either expressly or by necessary implication.

17. In *Garikapati Veeraya* v. *N. Subbiah Choudhry* [AIR 1957 SC 540] the law is stated thus : (AIR p. 553, para 25)

> "*25.* … The golden rule of construction is that, in the absence of anything in the enactment to show that it is to have retrospective operation, it cannot be so construed as to have the effect of altering the law applicable to a claim in litigation at the time when the Act was passed."

18. The question was considered by this Court in *Gajraj Singh* v. *STAT* [(1997) 1 SCC 650] and the law was stated in the following terms : (SCC pp. 664-66, paras 22-24)

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

"*22*. Whenever an Act is repealed it must be considered, except as to transactions past and closed, as if it had never existed. The effect thereof is to obliterate the Act completely from the record of Parliament as if it had never been passed; it never existed except for the purpose of those actions which were commenced, prosecuted and concluded while it was an existing law. Legal fiction is one which is not an actual reality and which the law recognises and the court accepts as a reality. Therefore, in case of legal fiction the court believes something to exist which in reality does not exist. It is nothing but a presumption of the existence of the state of affairs which in actuality is non-existent. The effect of such a legal fiction is that a position which otherwise would not obtain is deemed to obtain under the circumstances. Therefore, when Section 217(1) of the Act repealed Act 4 of 1939 w.e.f. 1-7-1989, the law in Act 4 of 1939 in effect came to be non-existent except as regards the transactions, past and closed or saved.

23. In Crawford's *Interpretation of Law* (1989) at p. 626, it is stated that:

> '… An express repeal will operate to abrogate an existing law, unless there is some indication to the contrary, such as a saving clause. Even existing rights and pending litigation may be affected, both civil and criminal, although it is not an uncommon practice to use the saving clause in order to preserve existing rights and to exempt pending litigation.'

At p. 627, it is stated that:

> '… Moreover, where a repealing clause expressly refers to a portion of a prior Act, the remainder of such Act will not usually be repealed, as a presumption is raised that no further repeal is necessary, unless there is irreconcilable inconsistency between them. In like manner, if the repealing clause is by its terms confined to a particular Act, quoted by title, it will not be extended to an Act upon a different subject.'

Section 6 of the GC Act enumerates, inter alia, that where the Act repeals any enactment, unless a different intention appears, the repeal shall not (*a*) revive anything not in force or existing at the time at which the repeal takes effect; or (*b*) affect the previous operation of any enactment so repealed or anything duly done or suffered thereunder; or (*c*) affect any right, privilege, obligation or liability acquired, accrued

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Signing Date:07.02.2025
18:46:26

or incurred under any enactment so repealed, and any such investigation, legal proceeding or remedy may be instituted, continued or enforced. In *India Tobacco Co. Ltd.* v. *CTO* [(1975) 3 SCC 512 : 1975 SCC (Tax) 49] (SCC at p. 517 in paras 6 and 11), a Bench of three Judges had held that repeal connotes abrogation and obliteration of one statute by another from the statute book as completely as if it had never been passed. When an Act is repealed, it must be considered, except as to transactions past and closed, as if it had never existed. Repeal is not a matter of mere form but is of substance, depending on the intention of the legislature. If the intention indicated either expressly or by necessary implication in the subsequent statute was to abrogate or wipe off the former enactment wholly or in part, then it would be a case of total or *pro tanto* repeal.

24. When there is a repeal and simultaneous re-enactment, Section 6 of the GC Act would apply to such a case unless contrary intention can be gathered from the repealing Act. Section 6 would be applicable in such cases unless the new legislation manifests intention inconsistent with or contrary to the application of the section. Such incompatibility would have to be ascertained from all relevant provisions of the new Act. Therefore, when the repeal is followed by a fresh legislation on the same subject, the Court would undoubtedly have to look to the provisions of the new Act only for the purpose of determining whether the new Act indicates different intention. The object of repeal and re-enactment is to obliterate the repealed Act and to get rid of certain obsolete matters."

19. In *Ramesh Singh* v. *Cinta Devi* [(1996) 3 SCC 142 : 1996 SCC (Cri) 467] it has clearly been held that Section 217 of the 1988 Act does not expressly or by necessary implication make the relevant provision retrospective in operation.

20. In *Zile Singh* v. *State of Haryana* [(2004) 8 SCC 1] a three-Judge Bench of this Court stated the law thus : (SCC p. 10, para 17)

"*17*. Maxwell states in his work on *Interpretation of Statutes* (12th Edn.) that the rule against retrospective operation is a presumption only, and as such it 'may be overcome, not only by express words in the Act but also by circumstances sufficiently strong to displace it' (p. 225). If the dominant intention of the legislature can be clearly and doubtlessly spelt out, the inhibition contained in the rule against perpetuity becomes of doubtful applicability as the

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

> ‘inhibition of the rule’ is a matter of degree which would ‘*vary secundum materiam*’ (p. 226). Sometimes, where the sense of the statute demands it or where there has been an obvious mistake in drafting, a court will be prepared to substitute another word or phrase for that which actually appears in the text of the Act (p. 231).”

21. In *Lohia Machines Ltd.* v. *Union of India* [(1985) 2 SCC 197 : 1985 SCC (Tax) 245 : (1985) 2 SCR 686] this Court held : (SCC p. 276, para 79)

> “*79.* On the other hand it is quite clear that if the relief granted is to be withdrawn with retrospective operation from 1972 the assessees who have enjoyed the relief for all those years will have to face a very grave situation. The effect of the withdrawal of the relief with retrospective operation will be to impose on the assessee a huge accumulated financial burden for no fault of the assessee and this is bound to create a serious financial problem for the assessee. Apart from the heavy financial burden which is likely to upset the economy of the undertaking, the assessee will have to face other serious problems. On the basis that the relief was legitimately and legally available to the assessee, the assessee had proceeded to act and to arrange its affairs. If the relief granted is now permitted to be withdrawn with retrospective operation, the assessee may be found guilty of violation of provisions of other statutes and may be visited with penal consequences.”

22. In *Indian Metals and Ferro Alloys Ltd.* v. *State of Orissa* [(1987) 3 SCC 189] it was opined : (SCC p. 204, para 25)

> “*25.* … we hold that the High Court was not right in observing that the orders under Section 22-B of the Act imposing restrictions on consumption of power could not legally and validly be passed by the Government ‘with retrospective effect’ in the middle of a water year. But the position regarding disallowance of clubbing stands on an entirely different footing. If a consumer had been allowed the benefit of clubbing previously, that benefit cannot be taken away with retrospective effect thereby saddling him with heavy financial burden in respect of the past period where he had drawn and consumed power on the faith of the orders extending to him the benefit of clubbing.”

23. In *Madishetti Bala Ramul* v. *Land Acquisition Officer* [(2007) 9 SCC 650 : (2007) 8 Scale 184] this Court observed : (SCC p. 656, para 19)

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

> "*19.* In *Land Acquisition Officer-cum-DSWO* v. *B.V. Reddy and Sons* [(2002) 3 SCC 463] this Court opined that Section 25 being not a procedural provision will have no retrospective effect, holding : (SCC p. 471, para 6)
>
> > '*6.* Coming to the second question, it is a well-settled principle of construction that a substantive provision cannot be retrospective in nature unless the provision itself indicates the same. The amended provision of Section 25 nowhere indicates that the same would have any retrospective effect. Consequently, therefore, it would apply to all acquisitions made subsequent to 24-9-1984, the date on which Act 68 of 1984 came into force. The Land Acquisition (Amendment) Bill of 1982 was introduced in Parliament on 30-4-1982 and came into operation with effect from 24-9-1984.' "
>
> **24.** In *Ashok Lanka* v. *Rishi Dixit* [(2005) 5 SCC 598] this Court held : (SCC p. 623, para 62)
>
> > "*62.* A statute must be read reasonably. A statute should not read in such a manner which results in absurdity. A statute, on its plain language, although postulates a prospective operation, it cannot be held to be retrospective only because it would apply for the excise year for which applications were invited despite the fact that the selection process made thereunder is over."

163. Similar principles appear in **Purbanchal Cables & Conductors (P) Ltd. v. Assam SEB**[45], which was yet another decision cited on behalf of the writ petitioners and where the following pertinent observations appear:-

> "**32.** The fundamental rule of construction is the same for all statutes whether fiscal or otherwise. The underlying principle is that the meaning and intention of a statute must be collected from the plain and unambiguous expression used therein rather from any notion. To arrive at the real meaning, it is always necessary to get an exact conception, scope and object of the whole Act.
>
> **33.** In *Zile Singh* v. *State of Haryana* [(2004) 8 SCC 1] this Court observed that there were four relevant factors which needed to be

[45] (2012) 7 SCC 462

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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considered while considering whether a statute applied prospectively or retrospectively: (SCC p. 9, para 15)

> "*15*. … Four factors are suggested as relevant: (*i*) general scope and purview of the statute; (*ii*) the remedy sought to be applied; (*iii*) the former state of the law; and (*iv*) what it was the legislature contemplated."

34. The general scope of the Act has been discussed above. The remedy sought to be applied by the Act is made clear in the Statement of Objects and Reasons, in which, it is stated that due to the delayed payments by buyers to the small-scale industries, their working capital was being affected, causing great harm to the small-scale industries in general. This Act was passed by Parliament to impose a heavy interest on the buyers who delayed the payments of the small-scale industries, in order to deter the buyers from delaying the payments after accepting the supplies made by the suppliers.

35. The policy statement of the Ministry of Micro, Small and Medium Enterprises dated 6-8-1991, reads:

> "3. (3.4) A beginning has been made towards solving the problem of delayed payments to small industries by setting up of 'factoring' services through Small Industries Development Bank of India (Sidbi). Network of such services would be set up throughout the country and operated through commercial banks. A suitable legislation will be introduced to ensure prompt payment of small industries' bills."

36. Keeping in view the above object, the Act was enacted by Parliament. Before such enactment, it is required to examine rights of the supplier qua the buyer prior to the commencement of the Act. In case of delayed payment, the supplier, prior to the commencement of the Act, was required to file a suit for the payment of the principal amount, and could claim interest along with the principal amount. The supplier could avail of the same under Section 34 of the Code of Civil Procedure, 1908 (hereinafter referred to as "CPC"), Section 61 of the Sale of Goods Act, 1930 and Section 3 of the Interest Act, 1978.

37. In other words, the supplier whose payment was delayed by the buyer prior to the commencement of the Act, could file a suit for payment of the principal amount along with the interest. The supplier, thus, had the vested right to claim the principal amount along with interest thereon in case of a delay in payment by the buyer and it was the discretion of the court to award this interest.

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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38. The court has the discretion to award interest along with the principal amount and the same is clear from the use of the word "may" in all the three provisions cited above. Section 34 CPC is the main provision under which interest could be awarded by the court and Section 61 of the Sale of Goods Act, 1930 is an offshoot of Section 34 CPC. Section 3 of the Interest Act, 1978 also makes the Interest Act subject to the provision of Section 34 CPC. Hence, we can safely deduce that the interest awarded is a discretion exercised by the court, on the principal amount claimed, in case of a suit for recovery of payment by the supplier if such payment is delayed by the buyer.

39. With the commencement of the Act, a new vested right exists with the supplier, that being, if there is delay in payment after the acceptance of the goods by the buyer, the supplier can file a suit for claiming interest at a higher rate, as prescribed by the Act. This position has been approved by this Court in *Modern Industries* [(2010) 5 SCC 44 : (2010) 2 SCC (Civ) 280] . If a suit for interest simpliciter is maintainable as held by this Court in *Modern Industries* [(2010) 5 SCC 44 : (2010) 2 SCC (Civ) 280] , then a new liability qua the buyer is created with the commencement of the Act giving a vested right to the supplier in case of delayed payment. In other words, if there is a delayed payment by the buyer, then a right to claim a higher rate of interest as prescribed by the Act accrues to the supplier.

40. The phrase "vested right" has been defined by this Court in *Bibi Sayeeda* v. *State of Bihar* [(1996) 9 SCC 516] as: (SCC p. 527, para 17)

> "*17.* The word 'vested' is defined in *Black's Law Dictionary* (6th Edn.) at p. 1563 as:
> 'Vested; fixed; accrued; settled; absolute; complete. Having the character or given the rights of absolute ownership; not contingent; not subject to be defeated by a condition precedent.'
> Rights are 'vested' when right to enjoyment, present or prospective, has become property of some particular person or persons as present interest; mere expectancy of future benefits, or contingent interest in property founded on anticipated continuance of existing laws, does not constitute vested rights. In *Webster's Comprehensive Dictionary* (International Edn.) at p. 1397 'vested' is defined as:
> '[L]aw held by a tenure subject to no contingency; complete; established by law as a permanent right; vested interests.'"

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18:46:26

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41. A statute creating vested rights is a substantive statute. This Court, in *Dhenkanal Minor Irrigation Division* v. *N.C. Budharaj* [(2001) 2 SCC 721] , opined: (SCC p. 742, para 23)

> "*23.* … 'Substantive law', is that part of the law which creates, defines and regulates rights in contrast to what is called adjective or remedial law which provides the method of enforcing rights. Decisions, including the one in *Jena case* [*Deptt. of Irrigation* v. *Abhaduta Jena*, (1988) 1 SCC 418] while adverting to the question of substantive law has chosen to indicate by way of illustration laws such as Sale of Goods Act, 1930 [Section 61(2)], Negotiable Instruments Act, 1881 (Section 80), etc. The provisions of the Interest Act, 1839, which prescribe the general law of interest and become applicable in the absence of any contractual or other statutory provisions specially dealing with the subject, would also answer the description of substantive law."

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42. In *Thirumalai Chemicals Ltd.* v. *Union of India* [(2011) 6 SCC 739 : (2011) 3 SCC (Civ) 458] this Court comparing substantial law with procedural law, stated: (SCC pp. 748-49, paras 23-24)

> "*23.* Substantive law refers to a body of rules that creates, defines and regulates rights and liabilities. Right conferred on a party to prefer an appeal against an order is a substantive right conferred by a statute which remains unaffected by subsequent changes in law, unless modified expressly or by necessary implication. Procedural law establishes a mechanism for determining those rights and liabilities and a machinery for enforcing them. Right of

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Signing Date:07.02.2025
18:46:26

appeal being a substantive right always acts prospectively. It is trite law that every statute is prospective unless it is expressly or by necessary implication made to have retrospective operation.

24. Right of appeal may be a substantive right but the procedure for filing the appeal including the period of limitation cannot be called a substantive right, and an aggrieved person cannot claim any vested right claiming that he should be governed by the old provision pertaining to period of limitation. Procedural law is retrospective meaning thereby that it will apply even to acts or transactions under the repealed Act."

43. In *Shyam Sunder* v. *Ram Kumar* [(2001) 8 SCC 24] , a Constitution Bench of this Court discussing the scope and ambit of a declaratory law has observed: (SCC p. 49, para 39)

"*39*. Lastly, it was contended on behalf of the appellants that the amending Act whereby new Section 15 of the Act has been substituted is declaratory and, therefore, has retroactive operation. Ordinarily when an enactment declares the previous law, it requires to be given retroactive effect. The function of a declaratory statute is to supply an omission or to explain a previous statute and when such an Act is passed, it comes into effect when the previous enactment was passed. The legislative power to enact law includes the power to declare what was the previous law and when such a declaratory Act is passed, invariably it has been held to be retrospective. Mere absence of use of the word 'declaration' in an Act explaining what was the law before may not appear to be a declaratory Act but if the court finds an Act as declaratory or explanatory, it has to be construed as retrospective. Conversely where a statute uses the word 'declaratory', the words so used may not be sufficient to hold that the statute is a declaratory Act as words may be used in order to bring into effect new law."

44. In *Katikara Chintamani Dora* v. *Guntreddi Annamanaidu* [(1974) 1 SCC 567] this Court held: (SCC p. 582, para 50)

"*50*. It is well settled that ordinarily, when the substantive law is altered during the pendency of an action, rights of the parties are decided according to law, as it existed when the action was begun unless the new statute shows a clear intention to vary such rights (*Maxwell on Interpretation of Statutes*, 12th Edn. 220). That is to say, 'in the absence of anything in the Act, to say that it is to have retrospective

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Signing Date:07.02.2025
18:46:26

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operation, it cannot be so construed as to have the effect of altering the law applicable to a claim in litigation at the time when the Act is passed'."

45. In *Govind Das* v. *ITO* [(1976) 1 SCC 906 : 1976 SCC (Tax) 133] this Court speaking through P.N. Bhagwati, J. (as he then was) held: (SCC p. 914, para 11)

"*11*. Now it is a well-settled rule of interpretation hallowed by time and sanctified by judicial decisions that, unless the terms of a statute expressly so provide or necessarily require it, retrospective operation should not be given to a statute so as to take away or impair an existing right or create a new obligation or impose a new liability otherwise than as regards matters of procedure. The general rule as stated by Halsbury in Vol. 36 of the *Laws of England* (3rd Edn.) and reiterated in several decisions of this Court as well as English courts is that all statutes other than those which are merely declaratory or which relate only to matters of procedure or of evidence are prima facie prospective and retrospective operation should not be given to a statute so as to affect, alter or destroy an existing right or create a new liability or obligation unless that effect cannot be avoided without doing violence to the language of the enactment. If the enactment is expressed in language which is fairly capable of either interpretation, it ought to be construed as prospective only."

46. In *Jose Da Costa* v. *Bascora Sadasiva Sinai Narcornim* [(1976) 2 SCC 917] this Court held: (SCC p. 925, para 31)

"*31*. Before ascertaining the effect of the enactments aforesaid passed by the Central Legislature on pending suits or appeals, it would be appropriate to bear in mind two well-established principles. The first is that '… while provisions of a statute dealing merely with matters of procedure may properly, unless that construction be textually inadmissible, have retrospective effect attributed to them, provisions which touch a right in existence at the passing of the statute are not to be applied retrospectively in the absence of express enactment or necessary intendment.' (See *Delhi Cloth and General Mills Co. Ltd.* v. *CIT*[(1926-27) 54 IA 421] , IA p. 425.)

The second is that a right of appeal being a substantive right the institution of a suit carries with it the implication that all successive appeals available under the law then in force would be preserved to the parties to the suit throughout the rest of the career of the suit. There are two exceptions to the

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Signing Date:07.02.2025
18:46:26

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application of this rule viz. (*1*) when by competent enactment such right of appeal is taken away expressly or impliedly with retrospective effect and (*2*) when the court to which appeal lay at the commencement of the suit stands abolished (see *Garikapati Veeraya* v. *N. Subbiah Choudhry* [AIR 1957 SC 540] and *Colonial Sugar Refining Co. Ltd.* v. *Irving*[1905 AC 369 : (1904-07) All ER Rep Ext 1620 (PC)]).”

47. In *K. Kapen Chako* v. *Provident Investment Co. (P) Ltd.* [(1977) 1 SCC 593] this Court discussing the dicta of the English courts on the aspect of retrospectivity observed: (SCC pp. 602-03, paras 37-39)

“*37.* A statute has to be looked into for the general scope and purview of the statute and at the remedy sought to be applied. In that connection the former state of the law is to be considered and also the legislative changes contemplated by the statute. Words not requiring retrospective operation so as to affect an existing statutory provision prejudicially ought not be so construed. It is a well-recognised rule that statute should be interpreted if possible so as to respect vested rights. Where the effect would be to alter a transaction already entered into, where it would be to make that valid which was previously invalid, to make an instrument which had no effect at all, and from which the party was at liberty to depart as long as he pleased, binding, the prima facie construction of the Act is that it is not to be retrospective. (See *Gardner* v. *Lucas* [(1878) 3 AC 582 (HL)] .)

38. In *Moon* v. *Durden* [(1848) 2 Ex 22 : 154 ER 389] a question arose as to whether Section 18 of the Gaming Act, 1845 which came into effect in August 1845 was retrospective so as to defeat an action which had been commenced in June 1845. The relevant section provided that no suit shall be brought or maintained for recovering any such sum of money alleged to have been won upon a wager. It was held that it was not retrospective. Parke, B. said: (ER p. 398)

‘It seems a strong thing to hold, that the legislature could have meant that a party, who, under a contract made prior to the Act, had as perfect a title to recover a sum of money, as he had to any of his personal property, should be totally deprived of it without compensation.’

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Signing Date:07.02.2025
18:46:26

39. Again in *Smithies* v. *National Assn. of Operative Plasterers* [(1909) 1 KB 310 : (1908-10) All ER Rep 455 (CA)] Section 4 of the Trade Disputes Act, 1906 which enacted that an action for tort against a trade union shall not be entertained by any court was held not to prevent the courts from hearing and giving judgment in actions of that kind begun before the passing of the Act. It is a general rule that when the legislature alters the rights of parties by taking away or conferring any right of action, its enactments, unless in express terms they apply to pending actions, do not affect them. But there is an exception to this rule, namely, where enactments merely affect procedure and do not extend to rights of action. See *Suche (Joseph) & Co. Ltd., In re* [(1875) 1 Ch D 48] . If the legislature forms a new procedure alterations in the form of procedure are retrospective unless there is some good reason or other why they should not be. In other words, if a statute deals merely with the procedure in an action, and does not affect the rights of the parties it will be held to apply prima facie to all actions, pending as well as future."

48. In *Dahiben* v. *Vasanji Kevalbhai* [1995 Supp (2) SCC 295] this Court held: (SCC pp. 299-300, para 12)

"*12.* As the amendment in question is not to a procedural law, it may be stated that the settled principle of interpretation, where substantive law is amended, is that the same does not operate retrospectively unless it is either expressly provided or the same follows by necessary implication. Lest it be thought that a vested right cannot be taken away at all by retrospective legislation, reference may be made to *Rafiquennessa* v. *Lal Bahadur Chetri* [AIR 1964 SC 1511] where it was stated that even where vested rights are affected, legislature is competent to take away the same by means of retrospective legislation; and retrospectivity can be inferred even by necessary implication."

49. In *Zile Singh* v. *State of Haryana* [(2004) 8 SCC 1] this Court examined the various authorities on statutory interpretation and concluded: (SCC pp. 8-9, paras 13-14)

"*13.* It is a cardinal principle of construction that every statute is prima facie prospective unless it is expressly or by necessary implication made to have a retrospective operation. But the rule in general is applicable where the object of the statute is to affect vested rights or to impose

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

new burdens or to impair existing obligations. Unless there are words in the statute sufficient to show the intention of the legislature to affect existing rights, it is deemed to be prospective only—'*nova constitutio futuris formam imponere debet non praeteritis*'—a new law ought to regulate what is to follow, not the past. (See *Principles of Statutory Interpretation* by Justice G.P. Singh, 9th Edn., 2004 at p. 438.) It is not necessary that an express provision be made to make a statute retrospective and the presumption against retrospectivity may be rebutted by necessary implication especially in a case where the new law is made to cure an acknowledged evil for the benefit of the community as a whole (*ibid.*, p. 440).

14. The presumption against retrospective operation is not applicable to declaratory statutes…. In determining, therefore, the nature of the Act, regard must be had to the substance rather than to the form. If a new Act is 'to explain' an earlier Act, it would be without object unless construed retrospectively. An explanatory Act is generally passed to supply an obvious omission or to clear up doubts as to the meaning of the previous Act. It is well settled that if a statute is curative or merely declaratory of the previous law retrospective operation is generally intended…. An amending Act may be purely declaratory to clear a meaning of a provision of the principal Act which was already implicit. A clarificatory amendment of this nature will have retrospective effect (*ibid.*, pp. 468-69)."

50. In *State of Punjab* v. *Bhajan Kaur* [(2008) 12 SCC 112 : (2009) 1 SCC (Cri) 328] this Court held: (SCC p. 116, para 9)

"*9*. A statute is presumed to be prospective unless held to be retrospective, either expressly or by necessary implication. A substantive law is presumed to be prospective. It is one of the facets of the rule of law."

51. There is no doubt about the fact that the Act is a substantive law as vested rights of entitlement to a higher rate of interest in case of delayed payment accrues in favour of the supplier and a corresponding liability is imposed on the buyer. This Court, time and again, has observed that any substantive law shall operate prospectively unless retrospective operation is clearly made out in the language of the statute. Only a procedural or declaratory law operates retrospectively as there is no vested right in procedure.

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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> **52.** In the absence of any express legislative intendment of the retrospective application of the Act, and by virtue of the fact that the Act creates a new liability of a high rate of interest against the buyer, the Act cannot be construed to have retrospective effect. Since the Act envisages that the supplier has an accrued right to claim a higher rate of interest in terms of the Act, the same can only be said to accrue for sale agreements after the date of commencement of the Act i.e. 23-9-1992 and not any time prior."

164. It would, however, be relevant to note that *Purbanchal Cables* came to be subsequently overruled by the Supreme Court in **Shanti Conductors (P) Ltd. vs. Assam SEB**[46] as would be evident from a reading of paras 60, 61 and 62 of the report and which are extracted hereunder:-

> "**60.** The judgment of this Court in *Purbanchal Cables & Conductors (P) Ltd.* [*Purbanchal Cables & Conductors (P) Ltd.* v. *Assam SEB*, (2012) 7 SCC 462 : (2012) 4 SCC (Civ) 245] relying on *Assam Small Scale Industries* [*Assam Small Scale Industries Development Corpn. Ltd.* v. *J.D. Pharmaceuticals*, (2005) 13 SCC 19] and *Shakti Tubes* [*Shakti Tubes Ltd.* v. *State of Bihar*, (2009) 7 SCC 673 : (2009) 3 SCC (Civ) 258] had laid down that the 1993 Act cannot be made applicable with regard to sale agreements which were entered into prior to the enforcement of the Act and the Act can be invoked only for the sale agreements which were entered after the enforcement of the Act. Although attempt was made in *Purbanchal Cables* [*Purbanchal Cables & Conductors (P) Ltd.* v. *Assam SEB*, (2012) 7 SCC 462 : (2012) 4 SCC (Civ) 245] to get the judgment in *Assam Small Scale Industries* [*Assam Small Scale Industries Development Corpn. Ltd.* v. *J.D. Pharmaceuticals*, (2005) 13 SCC 19] and *Shakti Tubes* [*Shakti Tubes Ltd.* v. *State of Bihar*, (2009) 7 SCC 673 : (2009) 3 SCC (Civ) 258] reconsidered but the coordinate Bench in *Purbanchal Cables* [*Purbanchal Cables & Conductors (P) Ltd.* v. *Assam SEB*, (2012) 7 SCC 462 : (2012) 4 SCC (Civ) 245] has refused to permit any such reconsideration. The matter now having been referred to this three-Judge Bench we have to consider and answer as to whether the above interpretation of the 1993 Act as given is in consonance with the statutory scheme.
>
> **61.** We have noticed above that the *incidence of applicability* of the liability under the Act is *supply of goods*or *rendering of service*. In event the supply of goods and rendering of services is subsequent to

[46] (2019) 19 SCC 529

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Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

the Act, can liability to pay interest on delayed payment be denied on the ground that agreement in pursuance of which supplies were made were entered prior to enforcement of the Act? Entering into an agreement being not expressly or impliedly referred to in the statutory scheme as an incident for fastening of the liability, making the date of agreement as date for imposition of liability does not conform to the statutory scheme. This can be illustrated by taking an example. There are two small scale industries which received orders for supply of materials. 'A' received such orders prior to the enforcement of the Act and 'B' received the order after the enforcement of the Act. Both supplied the goods subsequent to enforcement of the Act and became entitled to receive payment after the supply, on or before the day agreed upon between the supplier and buyer or before the appointed day. Payments were not made both to 'A' and 'B' as required by Section 3. Can the buyer who has received supplies from supplier 'A' escape from his statutory liability to make payment of interest under Section 3 read with Section 4? The answer has to be *No*. Two suppliers who supply goods after the enforcement of the Act, become entitled to receive payment after the enforcement of the Act one supplier cannot be denied the benefit of the statutory protection on the pretext that the agreement in his case was entered prior to enforcement of the Act. When the date of agreement is not referred as material or incidence for fastening the liability, by no judicial interpretation the said date can be treated as a date for fastening of the liability. The 1993 Act being beneficial legislation enacted to protect small scale industries and statutorily ensure by mandatory provision for payment of interest on the outstanding money, accepting the interpretation as put by the learned counsel for the Board that the day of agreement has to be subsequent to the enforcement of the Act, the entire beneficial protection of the Act shall be defeated. The existence of statutory liability depends on the statutory factors as enumerated in Section 3 and Section 4 of the 1993 Act. Factor for liability to make payment under Section 3 being the supplier supplies any goods or renders services to the buyer, the liability of buyer cannot be denied on the ground that the agreement entered into between the parties for supply was prior to the 1993 Act. To hold that liability of buyer for payment shall arise only when agreement for supply was entered into subsequent to enforcement of the Act, it shall be adding words to Section 3 which is not permissible under the principles of statutory construction.

62. We, thus, are of the view that the judgments in *Purbanchal Cables & Conductors* [*Purbanchal Cables & Conductors (P) Ltd.* v. *Assam SEB*, (2012) 7 SCC 462 : (2012) 4 SCC (Civ) 245] , *Assam Small Scale Industries* [*Assam Small Scale Industries*

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Digitally Signed
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Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

Development Corpn. Ltd. v. *J.D. Pharmaceuticals*, (2005) 13 SCC 19] and *Shakti Tubes* [*Shakti Tubes Ltd.* v. *State of Bihar*, (2009) 7 SCC 673 : (2009) 3 SCC (Civ) 258] which held that the 1993 Act shall be applicable only when the agreement to sale/contract was entered into prior/subsequent to the enforcement of the Act, does not lay down the correct law. We accept the submission of the learned counsel for the appellants that even if agreement of sale is entered into prior to enforcement of the Act, liability to make payment under Section 3 and liability to make payment of interest under Section 4 shall arise if supplies are made subsequent to the enforcement of the Act."

165. Of equal significance are the following passages forming part of *Shanti Conductors* and where the aspect of retroactive application was explained in the following words:-

"**65.** The two-Judge Bench of this Court in *State Bank's Staff Union (Madras Circle)* v. *Union of India* [*State Bank's Staff Union (Madras Circle)* v. *Union of India*, (2005) 7 SCC 584 : 2005 SCC (L&S) 994] , had occasion to examine the concept of retroactive and retrospective. In paras 20 and 21 of the judgment the following has been laid down: (SCC p. 593)

"*20*. *Judicial Dictionary* (13th Edn.) by K.J. Aiyar, Butterworth, p. 857, states that the word "retrospective" when used with reference to an enactment may mean (*i*) affecting an existing contract; or (*ii*) reopening up of past, closed and completed transaction; or (*iii*) affecting accrued rights and remedies; or (*iv*) affecting procedure. *Words and Phrases*, Permanent Edn., Vol. 37-A, pp. 224-25, defines a "retrospective or retroactive law" as one which takes away or impairs vested or accrued rights acquired under existing laws. A retroactive law takes away or impairs vested rights acquired under existing laws, or creates a new obligation, imposes a new duty, or attaches a new disability, in respect to transactions or considerations already past.

21. In *Advanced Law Lexicon* by P. Ramanatha Aiyar (3rd Edn., 2005) the expressions "retroactive" and "retrospective" have been defined as follows at p. 4124, Vol. 4:

'*Retroactive*.—Acting backward; affecting what is past.

(Of a statute, ruling, etc.) extending in scope or effect to matters that have occurred in the past. —Also termed retrospective. (*Black's Law Dictionary*, 7th Edn., 1999)

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Signing Date:07.02.2025
18:46:26

> "Retroactivity" is a term often used by lawyers but rarely defined. On analysis it soon becomes apparent, moreover, that it is used to cover at least two distinct concepts. The first, which may be called "true retroactivity", consists in the application of a new rule of law to an act or transaction which was completed before the rule was promulgated. The second concept, which will be referred to as "quasi-retroactivity", occurs when a new rule of law is applied to an act or transaction in the process of completion … The foundation of these concepts is the distinction between completed and pending transactions … [T.C. Hartley, *The Foundations of European Community Law*, p. 129 (1981)].
>
> ***
>
> *Retrospective*.—Looking back; contemplating what is past.
>
> Having operation from a past time.
>
> "Retrospective" is somewhat ambiguous and that good deal of confusion has been caused by the fact that it is used in more senses than one. In general, however, the courts regard as retrospective any statute which operates on cases or facts coming into existence before its commencement in the sense that it affects, even if for the future only, the character or consequences of transactions previously entered into or of other past conduct. Thus, a statute is not retrospective merely because it affects existing rights; nor is it retrospective merely because a part of the requisite for its action is drawn from a time antecedent to its passing.' (Vol. 44, *Halsbury's Laws of England*, 4th Edn., p. 570, para 921.)"

66. Further in *Jay Mahakali Rolling Mills* v. *Union of India* [*Jay Mahakali Rolling Mills* v. *Union of India*, (2007) 12 SCC 198] , explaining retroactive and retrospective the following has been laid down: (SCC p. 200, para 8)

> "*8*. "Retrospective" means looking backward, contemplating what is past, having reference to a statute or things existing before the statute in question. Retrospective law means a law which looks backward or contemplates the past; one, which is made to affect acts or facts occurring, or rights occurring, before it comes into force. Retroactive statute means a statute, which creates a new obligation on transactions or considerations or destroys or impairs vested rights."

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> **67.** Retroactivity in the context of the statute consists of application of new rule of law to an act or transaction which has been completed before the rule was promulgated.
>
> **68.** In the present case, the liability of buyer to make payment and day from which payment and interest become payable under Sections 3 and 4 does not relate to any event which took place prior to the 1993 Act, it is not even necessary for us to say that the 1993 Act is retroactive in operation. The 1993 Act is clearly prospective in operation and it is not necessary to term it as retroactive in operation. We, thus, do not subscribe to the opinion dated 31-8-2016 [*Shanti Conductors (P) Ltd.* v. *Assam SEB*, (2016) 15 SCC 13] of one of the Hon'ble Judges holding that the 1993 Act is retroactive."

166. The judgment in **Katta Sujatha Reddy and Anr. vs. Siddamsetty Infra Projects Private Limited and Ors.**[47] had dealt with the question of whether some of the amendments introduced in the **Specific Relief Act, 1963**[48], in 2018 could be said to have retrospective application. The Supreme Court in *Katta Sujatha Reddy* held that Section 10 of the SRA could not be viewed as being merely procedural since it also affected substantive principles underlying contracts in general. The issue was thus answered as under: -

> "**47.** The High Court, in the impugned order, has taken a different approach in categorising the Specific Relief Act, 1963 as procedural and holding that the 2018 Amendment is also a procedural provision which requires to be given retrospective effect. The High Court places reliance on an old case of *Radheshyam Kamila*v. *Kiran Bala Dasi* [*Radheshyam Kamila* v. *Kiran Bala Dasi*, 1971 SCC OnLine Cal 15 : AIR 1971 Cal 341] , wherein the High Court, while relying upon the commentary of *Pollock & Mulla on Indian Contract Act and Specific Relief Act* (4th Edn.) specifically observed that "specific relief, as a form of judicial process, belongs to the law of procedure". In this context, the Court came to a conclusion that such procedural amendment ought to be given retrospective effect.

[47] (2023) 1 SCC 355
[48] SRA

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

48. We do not subscribe to the aforesaid reasoning provided by the High Court for the simple reason that after the 2018 Amendment, specific performance, which stood as a discretionary remedy, is not (*sic* now) codified as an enforceable right which is not dependent anymore on equitable principles expounded by Judges, rather it is founded on satisfaction of the requisite ingredients as provided under the Specific Relief Act. For determination of whether a substituted law is procedural or substantive, reference to the nature of the parent enactment may not be material. Instead, it is the nature of the amendments which determine whether they are in the realm of procedural or substantive law.

xxxx xxxx xxxx

51. In any case, the amendment carried out in 2018 was enacted to further bolster adherence to the sanctity of contracts. This approach was radical and created new rights and obligations which did not exist prior to such an amendment. Section 10, after amendment, reads as under:

> "**10.** ***Specific performance in respect of contracts***.—The specific performance of a contract shall be enforced by the court subject to the provisions contained in sub-section (2) of Section 11, Section 14 and Section 16."

52. This provision, which remained in the realm of the courts' discretion, was converted into a mandatory provision, prescribing a power the courts had to exercise when the ingredients were fulfilled. This was a significant step in the growth of commercial law as the sanctity of contracts was reinforced with parties having to comply with contracts and thereby reducing efficient breaches.

53. Under the pre-amended Specific Relief Act, one of the major considerations for grant of specific performance was the adequacy of damages under Section 14(1)(*a*). However, this consideration has now been completely done away with, in order to provide better compensation to the aggrieved party in the form of specific performance.

54. Having come to the conclusion that the 2018 Amendment was not a mere procedural enactment, rather it had substantive principles built into its working, this Court cannot hold that such amendments would apply retrospectively.

55. In *Shyam Sunder* v. *Ram Kumar* [*Shyam Sunder* v. *Ram Kumar*, (2001) 8 SCC 24] , this Court held as under : (SCC pp. 42-43, para 28)

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Signing Date:07.02.2025
18:46:26

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"*28*. From the aforesaid decisions the legal position that emerges is that when a repeal of an enactment is followed by a fresh legislation, such legislation does not affect the substantive rights of the parties on the date of the suit or adjudication of the suit unless such a legislation is retrospective and a court of appeal cannot take into consideration a new law brought into existence after the judgment appealed from has been rendered because the rights of the parties in an appeal are determined under the law in force on the date of the suit. However, the position in law would be different in the matters which relate to procedural law but so far as substantive rights of parties are concerned, they remain unaffected by the amendment in the enactment. We are, therefore, of the view that where a repeal of provisions of an enactment is followed by fresh legislation by an amending Act, such legislation is prospective in operation and does not affect substantive or vested rights of the parties unless made retrospective either expressly or by necessary intendment. We are further of the view that there is a presumption against the retrospective operation of a statute and further a statute is not to be construed to have a greater retrospective operation than its language renders necessary, but an amending Act which affects the procedure is presumed to be retrospective, unless the amending Act provides otherwise. We have carefully looked into the new substituted Section 15 brought in the parent Act by the Amendment Act, 1995 but do not find it either expressly or by necessary implication retrospective in operation which may affect the rights of the parties on the date of adjudication of the suit and the same is required to be taken into consideration by the appellate court. In *Shanti Devi* v. *Hukum Chand* [*Shanti Devi* v. *Hukum Chand*, (1996) 5 SCC 768] this Court had occasion to interpret the substituted Section 15 with which we are concerned and held that on a plain reading of Section 15, it is clear that it has been introduced prospectively and there is no question of such section affecting in any manner the judgment and decree passed in the suit for pre-emption affirmed by the High Court in the second appeal. We are respectfully in agreement with the view expressed in the said decision and hold that the substituted Section 15 in the absence of anything in it to show that it is retrospective, does not affect the right of the parties which accrued to them on the date of the suit or on the date of passing of the decree by the court of first instance. We are also of the view that the present appeals are unaffected by change in law insofar it related to

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Signing Date:07.02.2025
18:46:26

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> determination of the substantive rights of the parties and the same are required to be decided in the light of the law of pre-emption as it existed on the date of passing of the decree."
>
> **56.** From the aforesaid decision in *Shyam Sunder case* [*Shyam Sunder* v. *Ram Kumar*, (2001) 8 SCC 24] , it is clear that when a substantive law is brought about by amendment, there is no assumption that the same ought to be given retrospective effect. Rather, there is a requirement for the legislature to expressly clarify whether the aforesaid amendments ought to be retrospective or not.
>
> **57.** In the light of the aforesaid discussion, it is clear that ordinarily, the effect of amendment by substitution would be that the earlier provisions would be repealed, and amended provisions would be enacted in place of the earlier provisions from the date of inception of that enactment. However, if the substituted provisions contain any substantive provisions which create new rights, obligations, or take away any vested rights, then such substitution cannot automatically be assumed to have come into force retrospectively. In such cases, the legislature has to expressly provide as to whether such substitution is to be construed retrospectively or not.
>
> **58.** In the case at hand, the Amendment Act contemplates that the said substituted provisions would come into force on such date as the Central Government may appoint, by notification in the Official Gazette, or different dates may be appointed for different provisions of the Act. It may be noted that 1-10-2018 was the appointed date on which the amended provisions would come into effect.
>
> **59.** In view of the above discussion, we do not have any hesitation in holding that the 2018 Amendment to the Specific Relief Act is prospective and cannot apply to those transactions that took place prior to its coming into force."

167. The petitioners while questioning the extent to which the Proviso to Section 132(4) could be stretched, also bid us to bear in consideration that a Proviso is in a sense an exception and cannot be interpreted so as to expand the meaning of the principal provision. This well settled legal proposition was lucidly explained by the Supreme

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

Court in **Ishverlal Thakorelal Almaula vs. Motibhai Nagjibhai**[49] a decision cited on behalf of the petitioners in this respect and relevant passages whereof are extracted hereunder: -

> "**8.** The proper function of a proviso is to except or qualify something enacted in the substantive clause, which but for the proviso would be within that clause. It may ordinarily be presumed in construing a proviso that it was intended that the enacting part of the section would have included the subject-matter of the proviso. But the question is one of interpretation of the proviso : and there is no Rule that the proviso must always be restricted to the ambit of the main enactment. Occasionally in a statute a proviso is unrelated to the subject-matter of the preceding section, or contains matters extraneous to that section, and it may have then to be interpreted as a substantive provision, dealing independently with the matter specified therein, and not as qualifying the main or the preceding section.
>
> **9.** By the substantive clause of Section 43-C the tenants do not acquire in respect of lands described therein rights conferred by Sections 32 to 32-R : that part of Section 43-C is therefore in the nature of a qualification or an exception, and functions as a proviso to Sections 32 to 32-R. The proviso to Section 43-C goes on, not to carve out an exception or to impose a qualification to the exclusion prescribed by the main enactment, but deals with a matter which is unrelated thereto. In terms it seeks to protect rights acquired or arising not under Sections 32 to 32-R (which were added by Act 13 of 1956) but under the principal Act 67 of 1948 on or after December 28, 1948, and those rights are protected not from the operation of the substantive part of Section 43-C, but from the operation of Act 33 of 1952, or of "the Amending Act of 1955". It may be recalled that by Act 33 of 1952, the Act ceased to apply to land within the municipal boroughs, but the intention disclosed by the proviso to Section 43-C was to declare that all rights acquired by persons as tenants under the principal Act were to continue to remain available to them in respect of lands within the Municipal Boroughs as if Act 33 of 1952 were never enacted. The "Amending Act of 1955" is no other than Act 13 of 1956 [see the definition of "permanent tenant" in Section 2(10-A) added to the Principal Act and Section 1(1) of Act 13 of 1956]. The legislature has by referring to the Amending Act of 1955 sought also to protect, save as expressly provided in Section 43-D, the rights acquired under Act 67 of 1948, notwithstanding the amendments made by Act 13 of 1956.

[49] 1965 SCC OnLine SC 102

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> By Section 48 of Act 13 of 1956, the scheme of exemption from the operation of the Act of certain provisions thereof was extensively amended in respect of different classes of land. Section 88 of Act 67 of 1948 as originally enacted substituted by Sections 88, 88-A, 88-B, 88-C & 88-D. But this modified scheme of exemption and other provisions of the Act were by virtue of the proviso to Section 43-C not to affect the rights of tenants acquired on or after December 28, 1948 under Act 67 of 1948, save as expressly provided by Section 43-D."

168. The petitioners then drew our attention to the judgment in **S. Sundaram Pillai vs. V.R. Pattabiramanb**[50], and where the purpose of a proviso was explained more elaborately as would become apparent from a reading of the following passages: -

> "**27.** The next question that arises for consideration is as to what is the scope of a proviso and what is the ambit of an Explanation either to a proviso or to any other statutory provision. We shall first take up the question of the nature, scope and extent of a proviso. The well established rule of interpretation of a proviso is that a proviso may have three separate functions. Normally, a proviso is meant to be an exception to something within the main enactment or to qualify something enacted therein which but for the proviso would be within the purview of the enactment. In other words, a proviso cannot be torn apart from the main enactment nor can it be used to nullify or set at naught the real object of the main enactment.
>
> **28.** Craies in his book *Statute Law* (7th Edn.) while explaining the purpose and import of a proviso states at p. 218 thus:
>
> > "The effect of an exception or qualifying proviso, according to the ordinary rules of construction, is to except out of the preceding portion of the enactment, or to qualify something enacted therein, which but for the proviso would be within it.... The natural presumption is that, but for the proviso, the enacting part of the section would have included the subject-matter of the proviso."
>
> **29.** Odgers in *Construction of Deeds and Statutes* (5th Edn.) while referring to the scope of a proviso mentioned the following ingredients:

[50] (1985) 1 SCC 591

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> "p. 317. *Provisos* —These are clauses of exception or qualification in an Act, excepting something out of, or qualifying something in, the enactment which, but for the proviso, would be within it.
>
> p. 318. Though framed as a proviso, such a clause may exceptionally have the effect of a substantive enactment."

30. Sarathi in *Interpretation of Statutes* at pages 294-295 has collected the following principles in regard to a proviso:

> (*a*)When one finds a proviso to a section the natural presumption is that, but for the proviso, the enacting part of the section would have included the subject-matter of the proviso.
>
> (*b*)A proviso must be construed with reference to the preceding parts of the clause to which it is appended.
>
> (*c*)Where the proviso is directly repugnant to a section, the proviso shall stand and be held a repeal of the section as the proviso speaks the latter intention of the makers.
>
> (*d*)Where the section is doubtful, a proviso may be used as a guide to its interpretation: but when it is clear, a proviso cannot imply the existence of words of which there is no trace in the section.
>
> (*e*)The proviso is subordinate to the main section.
>
> (*f*)A proviso does not enlarge an enactment except for compelling reasons.
>
> (*g*)Sometimes an unnecessary proviso is inserted by way of abundant caution.
>
> (*h*)A construction placed upon a proviso which brings it into general harmony with the terms of section should prevail.
>
> (*i*)When a proviso is repugnant to the enacting part, the proviso will not prevail over the absolute terms of a later Act directed to be read as supplemental to the earlier one.
>
> (*j*)A proviso may sometimes contain a substantive provision.

31. In the case of *Local Government Board* v. *South Stoneham Union* [1909 AC 57 : 99 LT 896 (HL)] Lord Macnaghten made the following observation:

> "I think the proviso is a qualification of the preceding enactment which is expressed in terms too general to be quite accurate."

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

32. In *Ishverlal Thakorelal Almaula* v. *Motibhai Nagjibhai* [(1966) 1 SCR 367 : AIR 1966 SC 459 : (1967) 1 SCJ 41] it was held that the main object of a proviso is merely to qualify the main enactment. In *Madras and Southern Mahrata Railway Co. Ltd.* v. *Bezwada Municipality* [AIR 1944 PC 71 : 71 IA 113 : 218 IC 333] Lord Macmillan observed thus:

> "The proper function of a proviso is to except and deal with a case which would otherwise fall within the general language of the main enactment, and its effect is confined to that case."

33. The above case was approved by this Court in *CIT* v. *Indo Mercantile Bank Ltd.* [1959 Supp (2) SCR 256 : AIR 1959 SC 713] where Kapur, J. held that the proper function of a proviso was merely to qualify the generality of the main enactment by providing an exception and taking out, as it were, from the main enactment a portion which, but for the proviso, would fall within the main enactment. In *Shah Bhojraj Kuverji Oil Mills and Ginning Factory* v. *Subbash Chandra Yograj Sinha* [(1962) 2 SCR 159 : AIR 1961 SC 1596 : (1962) 1 SCJ 377] Hidayatullah, J., as he then was, very aptly and succinctly indicated the parameters of a proviso thus:

> "As a general rule, a proviso is added to an enactment to qualify or create an exception to what is in the enactment, and ordinarily, a proviso is not interpreted as stating a general rule."

34. In *West Derby Union* v. *Metropolitan Life Assurance Society* [1897 AC 647 : 66 LJ Ch 726 : 77 LT 284 (HL)] while guarding against the danger of interpretation of a proviso, Lord Watson observed thus:

> "a very dangerous and certainly unusual course to import legislation from a proviso wholesale into the body of the statute."

35. A very apt description and extent of a proviso was given by Lord Oreburn in *Rhondda Urban District Council* v. *Taff Vale Railway Co.* [1909 AC 253 : 100 LT 713 (HL)] where it was pointed out that insertion of a proviso by the draftsman is not always strictly adhered to its legitimate use and at times a section worded as a proviso may wholly or partly be in substance a fresh enactment adding to and not merely excepting something out of or qualifying what goes before. To the same effect is a later decision of the same Court

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

in *Jennings* v. *Kelly* [1940 AC 206 : (1939) 4 All ER 464 : 162 LT 1 (HL)] where it was observed thus:

> "We must now come to the proviso, for there is, I think, no doubt that, in the construction of the section, the whole of it must be read, and a consistent meaning, if possible, given to every part of it. The words are:... 'provided that such licence shall be granted only for premises situate in the ward or district electoral division in which such increase in population has taken place...' There seems to be no doubt that the words "such increase in population" refer to the increase of not less than 25 per cent of the population mentioned in the opening words of the section."

36. While interpreting a proviso care must be taken that it is used to remove special cases from the general enactment and provide for them separately.

37. In short, generally speaking, a proviso is intended to limit the enacted provision so as to except something which would have otherwise been within it or in some measure to modify the enacting clause. Sometimes a proviso may be embedded in the main provision and becomes an integral part of it so as to amount to a substantive provision itself.

38. Apart from the authorities referred to above, this Court has in a long course of decisions explained and adumbrated the various shades, aspects and elements of a proviso. In *State of Rajasthan* v. *Leela Jain*[(1965) 1 SCR 276 : AIR 1965 SC 1296 : (1966) 1 SCJ 37] the following observations were made:

> "So far as a general principle of construction of a proviso is concerned, it has been broadly stated that the function of a proviso is to limit the main part of the section and carve out something which but for the proviso would have been within the operative part."

39. In the case of *STO, Circle-I, Jabalpur* v. *Hanuman Prasad* [(1967) 1 SCR 831 : AIR 1967 SC 565 : (1967) 19 STC 87] Bhargava, J. observed thus:

> "It is well-recognised that a proviso is added to a principal clause primarily with the object of taking out of the scope of that principal clause what is included in it and what the legislature desires should be excluded."

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

40. In *Commissioner of Commercial Taxes* v. *R.S. Jhaver* [(1968) 1 SCR 148 : AIR 1968 SC 59 : 20 STC 453] this Court made the following observations:

> "Generally speaking, it is true that the proviso is an exception to the main part of the section; but it is recognised that in exceptional cases a proviso may be a substantive provision itself."

41. In *Dwarka Prasad* v. *Dwarka Das Saraf* [(1976) 1 SCC 128 : (1976) 1 SCR 277 : AIR 1975 SC 1758] Krishna Iyer, J. speaking for the Court observed thus: (SCC pp. 136-37, paras 16, 18)

> "There is some validity in this submission but if, on a fair construction, the principal provision is clean a proviso cannot expand or limit it. Sometimes a proviso is engrafted by an apprehensive draftsman to remove possible doubts, to make matters plain, to light up ambiguous edges. Here, such is the case.
>
> * * *
>
> If the rule of construction is that prima facie a proviso should be limited in its operation to the subject-matter of the enacting clause, the stand we have taken is sound. To expand the enacting clause, inflated by the proviso, sins against the fundamental rule of construction that a proviso must be considered in relation to the principal matter to which it stands as a proviso. A proviso ordinarily is but a proviso, although the golden rule is to read the whole section, inclusive of the proviso, in such manner that they mutually throw light on each other and result in a harmonious construction."

42. In *Hiralal Rattanlal* v. *State of U.P.* [(1973) 1 SCC 216 : 1973 SCC (Tax) 307] this Court made the following observations: [SCC para 22, p. 224: SCC (Tax) p. 315]

> "Ordinarily a proviso to a section is intended to take out a part of the main section for special treatment. It is not expected to enlarge the scope of the main section. But cases have arisen in which this Court has held that despite the fact that a provision is called proviso, it is really a separate provision and the so-called proviso has substantially altered the main section."

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> **43.** We need not multiply authorities after authorities on this point because the legal position seems to be clearly and manifestly well established. To sum up, a proviso may serve four different purposes:
>
> (*1*) qualifying or excepting certain provisions from the main enactment:
>
> (*2*) it may entirely change the very concept of the intendment of the enactment by insisting on certain mandatory conditions to be fulfilled in order to make the enactment workable:
>
> (*3*) it may be so embedded in the Act itself as to become an integral part of the enactment and thus acquire the tenor and colour of the substantive enactment itself; and
>
> (*4*) it may be used merely to act as an optional addenda to the enactment with the sole object of explaining the real intendment of the statutory provision."

169. It was then contended that even if a statute were construed to be procedural if its operation were to affect vested rights adversely, it would be liable to be held to have prospective application only. In support of the aforesaid proposition the petitioners cited the decision of the Supreme Court in **Garikapati Veeraya vs. N. Subbaih Choudhry and Ors**[51] and where the legal position was summarized as follows:-

> "**23.** From the decisions cited above the following principles clearly emerge:
>
> (i) That the legal pursuit of a remedy, suit, appeal and second appeal are really but steps in a series of proceedings all connected by an intrinsic unity and are to be regarded as one legal proceeding.
>
> (ii) The right of appeal is not a mere matter of procedure but is a substantive right.
>
> (iii) The institution of the suit carries with it the implication that all rights of appeal then in force are preserved to the parties thereto till the rest of the career of the suit.
>
> (iv) The right of appeal is a vested right and such a right to enter the superior court accrues to the litigant and exists as on and from the date the lis commences and although it may be actually exercised when the adverse judgment is pronounced such right is to be governed by the law prevailing at the date of the institution of the

[51] 1957 SCC OnLine SC 28

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

suit or proceeding and not by the law that prevails at the date of its decision or at the date of the filing of the appeal.

(v) This vested right of appeal can be taken away only by a subsequent enactment, if it so provides expressly or by necessary intendment and not otherwise."

170. Further, reliance was also placed on the decision in **Hitendra Vishnu Thakur and Ors. vs. State of Maharashtra**[52], where while dealing with the Terrorist and Disruptive Activities (Prevention) Act, 1987, the Supreme Court had held:-

"**25.** We have already noticed that clause (*b*) of sub-section (4) of Section 20 was amended by the Amendment Act No. 43 of 1993 with effect from 22-5-1993. Besides reducing the maximum period during which an accused under TADA could be kept in custody pending investigation from one year to 180 days, the Amendment Act also introduced clause (*bb*) to sub-section (4) of Section 20 enabling the prosecution to seek extension of time for completion of the investigation. Does the Amendment Act No. 43 of 1993 have retrospective operation and does the amendment apply to the cases which were pending investigation on the date when the Amendment Act came into force? There may be cases where on 22-5-1993 the period of 180 days had already expired but the period of one year was not yet over. In such a case, the argument of learned counsel for the appellant is that the Act operates retrospectively and applies to pending cases and therefore the accused should be *forthwith* released on bail if he is willing to be so released and is prepared to furnish the bail bonds as directed by the court, an argument which is seriously contested by the respondents.

26. The Designated Court has held that the amendment would operate retrospectively and would apply to the pending cases in which investigation was not complete on the date on which the Amendment Act came into force and the challan had not till then been filed in the court. From the law settled by this Court in various cases the illustrative though not exhaustive principles which emerge with regard to the ambit and scope of an Amending Act and its retrospective operation may be culled out as follows:

(*i*) A statute which affects substantive rights is presumed to be prospective in operation unless made retrospective, either expressly or by necessary intendment, whereas a statute which merely affects

[52] (1994) 4 SCC 602

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> procedure, unless such a construction is textually impossible, is presumed to be retrospective in its application, should not be given an extended meaning and should be strictly confined to its clearly defined limits.
>
> (*ii*) Law relating to forum and limitation is procedural in nature, whereas law relating to right of action and right of appeal even though remedial is substantive in nature.
>
> (*iii*) Every litigant has a vested right in substantive law but no such right exists in procedural law.
>
> (*iv*) A procedural statute should not generally speaking be applied retrospectively where the result would be to create new disabilities or obligations or to impose new duties in respect of transactions already accomplished.
>
> (*v*) A statute which not only changes the procedure but also creates new rights and liabilities shall be construed to be prospective in operation, unless otherwise provided, either expressly or by necessary implication."

171. It was then lastly urged that a statute which imposes penal consequences cannot be recognized to have a retroactive application since conferment of such a construction would clearly violate Article 20(1) of the Constitution. The petitioners sought to draw sustenance in this respect from the following paragraphs of the judgment in **T. Barai vs. Henry Ah Hoe**[53]:-

> "**2.** It is common ground that the offence with which the respondents are charged is alleged to have been committed under Section 16(1)(*a*) at a time when the Act stood amended in its application to the State of West Bengal by the provisions of the West Bengal Amendment Act. If the law continued to stand as it stood on the date of the offence which was so committed, there would have been no difficulty because the maximum penalty would be imprisonment for life and fine and as such the offences would be exclusively triable by the Court of Session. But a change was brought about when Parliament enacted the Central Amendment Act which came into force on April 1, 1976 by which the scheme of Section 16 of the Act providing for various punishments was materially altered; so also the procedure for the trial of such offences. The effect of the Central Amendment Act was that the West Bengal Amendment Act stood

[53] (1983) 1 SCC 177

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

impliedly repealed with effect from April 1, 1976 and the question is whether the previous operation of the repealed West Bengal Amendment Act in respect of any liability incurred thereunder is preserved by Section 8 of the Bengal General clauses Act, 1899 which is pari materia with Section 6 of the General clauses Act, 1897 both as to procedure for trial of such offences and the nature of punishment liable to be imposed.

xxxx xxxx xxxx

17. It is strenuously argued on behalf of the appellant that Section 16-A of the Act is not retrospective in operation, and that it does not deal with procedure alone but touches a substantive right. The submission is that in view of clauses (*c*), (*d*) and (*e*) of sub-section (1) of Section 8 of the Bengal General clauses Act, 1899 which provide that if any law is repealed then unless a different intention appears, the repeal shall not affect any liability incurred under any enactment so repealed or affect any legal proceeding or remedy in respect of such liability, penalty or punishment as aforesaid. It is said that there was a liability incurred by the commission of an offence punishable under Section 16(1)(*a*) of the Act as amended by the West Bengal Amendment Act and Section 8 of the Bengal General clauses Act, 1899 preserved the continued operation of the repealed West Bengal Amendment Act for imposition of that punishment. The contention is that where rights and procedure are dealt with together by the repealing Act, then, the intention of the legislature is that the old rights are still to be determined by the old procedure. In support of the contention, reliance is placed on the decision of Sargant, J. in *Re Hale's Patent* [LR (1920) 2 Ch 377 : 90 LJ Ch 35 : 124 LT 261] . We are afraid, the contention cannot prevail. Just as a person accused of the commission of an offence has no right to trial by a particular court or to a particular procedure, the prosecutor equally has no right to insist upon that the accused be subjected to an enhanced punishment under the repealed Act. The dictum of Sargant, J. in *Re Hale's Patent* [LR (1920) 2 Ch 377 : 90 LJ Ch 35 : 124 LT 261] is therefore not applicable.

18. Whenever there is a repeal of an enactment, the consequences laid down in Section 6 of the General clauses Act though it has been specifically mentioned in the repealing Act or not, will follow, unless, as the section itself says, a different intention appears. In *State of Punjab* v. *Mohar Singh* [AIR 1955 SC 84: (1955) 1 SCR 893: 1955 SCJ 25 : 1955 Cri LJ 254] , this Court has elaborately dealt with the effect of repeal. In the case of a simple repeal, there is scarcely any room for expression of a contrary opinion. But when the repeal is followed by fresh legislation on the same subject, the court would undoubtedly have to look to the provisions of the new

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

Act, but only for the purpose of determining whether they indicate a different intention. “The line of inquiry would be, not whether the new Act expressly keeps alive old rights and liabilities”, in the words of Mukherjea, J., “but whether it manifests an intention to destroy them.” The Court held that it cannot subscribe to the broad proposition that Section 6 of the General clauses Act is ruled out when there is repeal of an enactment followed by fresh legislation. Section 6 would be applicable in such cases also unless the new legislation manifests an intention incompatible with or contrary to the provisions of the section. Such incompatibility would have to be ascertained from a consideration of all the relevant provisions of the new Act and the mere absence of a saving clause is not by itself material. The Court therefore held that the provisions of Section 6 of the General clauses Act will apply to a case of repeal even if there is simultaneous enactment unless a contrary intention can be gathered from the new enactment. Of course, the consequences laid down in Section 6 of the General clauses Act will apply only when a statute or regulation having the force of a statute is actually repealed. It has no application when a statute which is of a temporary nature automatically expires by efflux of time. The principles laid down by the Court in *Mohar Singh case* [AIR 1955 SC 84: (1955) 1 SCR 893: 1955 SCJ 25 : 1955 Cri LJ 254] , have consistently been followed in subsequent cases. The old doctrine of extinguishing or effacing the repealed law for all purposes and intents except for the acts past and closed has now given way to the principles enunciated by the Court in *Mohar Singh case* [AIR 1955 SC 84: (1955) 1 SCR 893: 1955 SCJ 25 : 1955 Cri LJ 254] .

xxxx xxxx xxxx

21. Lastly, the learned Judge refers to the new offences created by the Central Amendment Act, one of them being that under Section 16(1)(*b*) of the Act with regard to manufacturing for sale, or storing, or selling, or distributing any adulterant which was not in the Act at any time before. Accordingly, he holds that it is not possible to give retrospective effect to the other parts of the Act and observes that it could never have been the intention of the legislature nor was it possible to give retrospective effect to the Act. <u>According to him, Article 20(1) of the Constitution stands in the way of giving retrospective effect to Section 16(1)(*b*) of the Act and thus renders the act which was otherwise innocent at the time when it was done to be an offence by later enactment. We are not concerned with new offences created by the Central Amendment Act or with offences for which an enhanced punishment is provided for and therefore there is no question of Article 20(1) of the Constitution being attracted. We are here concerned with the same offence, namely, an offence</u>

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

punishable under Section 16(1)(*a*) of the Act for which a reduced punishment is provided for.

22. It is only retroactive criminal legislation that is prohibited under Article 20(1). The prohibition contained in Article 20(1) is that no person shall be convicted of any offence except for violation of a law in force at the time of the commission of the act charged as an offence prohibits nor shall he be subjected to a penalty greater than that which might have been inflicted under the law in force at the time of the commission of the offence. It is quite clear that insofar as the Central Amendment Act creates new offences or enhances punishment for a particular type of offence no person can be convicted by such ex post facto law nor can the enhanced punishment prescribed by the amendment be applicable. But insofar as the Central Amendment Act reduces the punishment for an offence punishable under Section 16(1)(*a*) of the Act, there is no reason why the accused should not have the benefit of such reduced punishment. The rule of beneficial construction requires that even ex post facto law of such a type should be applied to mitigate the rigour of the law. The principle is based both on sound reason and common sense. This finds support in the following passage from *Craies on Statute Law*, 7th Edn., at pp. 388-89:

> "A retrospective statute is different from an ex post facto statute. "Every ex post facto law…" said Chase, J., in the American case of *Calder* v. *Bull* [3 US (3 Dall) 386: 1 L Ed 648 (1798)] "must necessarily be retrospective, but every retrospective law is not an ex post facto law. Every law that takes away or impairs rights vested agreeably to existing laws is retrospective, and is generally unjust and may be oppressive; it is a good general rule that a law should have no retrospect, but in cases in which the laws may justly and for the benefit of the community and also of individuals relate to a time antecedent to their commencement: as statutes of oblivion or of pardon. They are certainly retrospective, and literally both concerning and after the facts committed. But *I do not consider any law ex post facto within the prohibition that mollifies the rigour of the criminal law, but only those that create or aggravate the crime, or increase the punishment or change the rules of evidence for the purpose of conviction....* There is a great and apparent difference between making an unlawful act lawful and the making an innocent action criminal and punishing it as a crime."

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Signing Date:07.02.2025
18:46:26

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23. To illustrate, if Parliament were to reenact Section 302 of the Penal Code, 1860 and provide that the punishment for an offence of murder shall be sentence for imprisonment for life instead of the present sentence of death or imprisonment for life, then it cannot be that the courts would still award a sentence of death even in pending cases.

24. In *Rattan Lal* v. *State of Punjab* [AIR 1965 SC 444: (1964) 7 SCR 676: (1965) 1 SCJ 779: (1965) 1 Cri LJ 360] , the question that fell for consideration was whether an appellate court can extend the benefit of Probation of Offenders Act, 1958 which had come into force after the accused had been convicted of a criminal offence. The Court by majority of 2: 1 answered the question in the affirmative. Subba Rao, J. who delivered a majority opinion, concluded that in considering the question, the rule of beneficial construction required that even ex post facto law of the type involved in that case should be applied to reduce the punishment.

25. It is settled both on authority and principle that when a later statute again describes an offence created by an earlier statute and imposes a different punishment, or varies the procedure, the earlier statute is repealed by implication. In *Michell* v. *Brown* [(1958) 120 ER 909, 912: 32 LTOS 146 : 7 WR 80] Lord Campbell put the matter thus:

> "It is well settled rule of construction that, if a later statute again describes an offence created by a former statute and affixes a different punishment, varying the procedure, the earlier statute is repealed by the later statute; see also *Smith* v. *Benabo* [(1937) 1 All ER 523: (1937) 1 KB 518: 156 LT 194] .
>
> In *Regina* v. *Youle* [(1861) 158 ER 311, 315-16: 4 LT 299: 9 WR 637] , Martin, B. said in the oft-quoted passage:
>
> "If a statute deals with a particular class of offences, and a subsequent Act is passed which deals with precisely the same offences, and a different punishment is imposed by the later Act, I think that, in effect, the legislature has declared that the new Act shall be substituted for the earlier Act."

The rule is however subject to the limitation contained in Article 20(1) against ex post facto law providing for a greater punishment and has also no application where the offence described in the later Act is not the same as in the earlier Act i.e. when the essential ingredients of the two offences are different.

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> **26.** In the premises, the Central Amendment Act having dealt with the same offence as the one punishable under Section 16(1)(*a*) and provided for a reduced punishment, the accused must have the benefit of the reduced punishment. We wish to make it clear that anything that we have said shall not be construed as giving to the Central Amendment Act a retrospective operation insofar as it creates new offences or provides for an enhanced punishment."

172. In support of the aforesaid proposition, the petitioner also additionally drew our attention to the following paragraphs forming part of the judgment of the Bombay High Court in **Balu Shankar Patil vs. State of Maharashtra**[54]:-

> **"10.** Mr. Murtaza Najmi the learned counsel for the applicant contended that it is ex-post facto law with retrospective operation and, therefore, it will be applicable to all the accused persons, who were undergoing life imprisonment on the date, when this amendment came into force. At the outset, it may be stated that Mr. Kumbhakoni also took the same stand. However, before coming to the conclusion, it will be necessary to refer to the law settled in different cases by the Supreme Court. In *Punjab Tin Supply Co. Ltd.* v. *Central Government*, (1984) 1 SCC 206 : AIR 1984 SC 87, Their Lordships had observed as follows in paragraph 17:
>
> > "17. All laws which affect substantive rights generally operate prospectively and there is a presumption against their retrospectivity if they affect vested rights and obligations unless the legislative intent is clear and compulsive. Such retrospective effect may be given where there are express words giving retrospective effect or where the language used necessarily implies that such retrospective operation is intended. Hence the question whether a statutory provision has retrospective effect or not depends primarily on the language in which it is couched. If the language is clear and unambiguous effect will have to be given to the provision in question in accordance with its tenor. If the language is not clear then the Court has to decide whether in the light of the surrounding circumstances retrospective effect should be given to it or not."
>
> **11.** In *State Bank's Staff Union* v. *Union of India*, (2005) 7 SCC 584, Their Lordships observed as follows in paragraph 19.

[54] [2007] (5) Mh. LJ 675

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

> "19. Every sovereign legislature possesses the right to make retrospective legislation. The power to make laws includes the power to give it retrospective effect. Craies on *Statute Law* (7th Edn.) at p. 387 defines retrospective statutes in the following words:
> "A statute is to be deemed to be retrospective, which takes away or impairs any vested right acquired under existing laws, or creates a new obligation, or imposes a new duty, or attaches a new disability in respect to transactions or considerations already past."

12. Their Lordships observed that every sovereign legislature possesses the right to make retrospective legislation and then considered what the "retrospective" means. Their Lordships observed as follows in paragraph 20 as follows:

> 20. *Judicial Dictionary* (13th Edn.) by K.J. Aiyar, Butterworth, p. 857, states that the word "retrospective" when used with reference to an enactment may mean (i) affecting an existing contract; or (ii) reopening up of past, closed and completed transaction; or (iii) affecting accrued rights and remedies; or (iv) affecting procedure. *Words and Phrases*, Permanent Edn., Vol. 37-A, pp. 224-25, defines a "retrospective or retroactive law" as one which takes away or impairs vested or accrued rights acquired under existing laws. A retroactive law takes away or impairs vested rights acquired under existing laws, or creates a new obligation, imposes a new duty, or attaches a new disability, in respect to transactions or considerations already past."

13. Their Lordships further observed in paragraph 21 as follows:

> "21. In Advanced Law Lexicon by P. Ramanath Aiyar (3rd Edn., 2005) the expressions "retroactive" and "retrospective" have been defined as follows at p. 4124, Vol. 4;
> "Retroactive. — Acting backward; affecting what is past.
> (Of a statute, ruling, etc.) extending in scope or effect to matters that have occurred in the past. — Also termed retrospective. (*Black's Law Dictionary*, 7th Edn., 1999)
> "Retroactivity" is a term often used by lawyers but rarely defined. On analysis it soon becomes apparent, moreover, that it is used to cover at least two distinct concepts. The first, which may be called "true retroactivity", consists in the application of a new rule of law to an act or transaction which was completed before the rule was promulgated. The second concept, which will be referred to as "quasi-retroactivity", occurs when a new rule of law is applied to

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> an act or transaction in the process of completion…. The foundation of these concepts is the distinction between completed and pending transactions….' T.C. Hartley, Foundations of European Community Law, p. 129 (1981).
> ***
> Retrospective. — Looking back; contemplating what is past.
> Having operation from a past time."

14. In *T. Barai* v. *Henry Ah Hoe*, (1983) 1 SCC 177 : AIR 1983 SC 150, the Supreme Court observed as follows in paragraph 22:

> "22. It is only retroactive criminal legislation that is prohibited under Article 20(1). The prohibition contained in Article 20(1) is that no person shall be convicted of any offence except for violation of a law in force at the time of the commission of the act charged as an offence prohibits nor shall he be subjected to a penalty greater than that which might have been inflicted under the law in force at the time of the commission of the offence……"

15. In view of this authority, it becomes clear that the act, which was not prohibited or not offence at the time of commission would not be made an offence by some legislation with retrospective effect and nor a penalty greater than which might have been inflicted under the law in force could be made applicable to the act committed at a particular time by making a law later on with retrospective effect. Therefore, the retrospective or retroactive law, which takes away or impairs vested or accrued rights under the existing law or which creates a new obligation or imposes a new duty or attaches a new disability or which makes an act, which was not an offence before the act, an offence under the Act, or which provides a punishment higher than that obtaining at the time of commission of the offence, is prohibited under Article 20(1) of the Constitution. However, if the law mollifies the rigour of the criminal law and thereby give certain benefits to the accused, that law is not prohibited under Article 20(1) of the Constitution of India."

173. While various other decisions were also cited in this respect and which have essentially reiterated the legal position as enunciated in the judgments aforenoted, we for the sake of completeness also deem it apposite to reproduce the following paragraphs which appear in the decision of the Supreme Court in **Virtual Soft Systems Ltd. vs.**

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Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

Commissioner of Income Tax[55]:-

> "**54.** There is nothing in the language of Section 271(1)(*c*) as amended by the Finance Act, 2002 w.e.f. 1-4-2003 to suggest that the amendment is retrospective. The amendment in sub-clause (*iii*) and simultaneously in Explanation 4(*a*) carried out enlarges the scope of penalty under Section 271(1)(*c*) to include even cases where assessment has been completed at loss. The same being in the nature of a substantive amendment would be prospective, in the absence of any indication to the contrary.
>
> **55.** Explanation 4 to Section 271(1)(*c*) as it stood prior to its amendment by the Finance Act, 2002, requires to be carefully compared with the said Explanation as amended by the Finance Act, 2002. The comparison of the Explanation as it stood before 2002 and after 2002 by itself shows clearly that it is only after the amendment made by the Finance Act, 2002 that the Explanation dealt with the situation of an assessee having returned a loss and where, even after addition of concealed income by the assessee, the end result was still an assessed loss. This situation was not dealt with at all by the Explanation to Section 271(1)(*c*) as it stood prior to its amendment by the Finance Act, 2002. Further, a plain reading of Clause (*a*) of Explanation 4 to Section 271 as it stood prior to the 2002 Amendment, shows that this clause applied to a situation where an assessee has returned a loss which by reason of the addition of the concealed income thereto by the assessing officer, is converted into a positive figure of the assessed income on which the assessee is required to pay tax. In contrast, Clause (*c*) of the said Explanation 4 applies only to a situation where the assessee has returned a positive income, which stands enhanced by reason of the concealed income added thereto by the assessing officer in the assessment order. Consequently, both under Clause (*a*) and Clause (*c*) of the said Explanation 4, the assessee can be penalised only if he has a positive assessed income on which tax is payable. The only difference between Clause (*a*) and Clause (*c*) is that Clause (*a*) applied to an assessee who had filed a loss return, and Clause (*c*) to an assessee who has filed a positive return. However, the end result in both the cases was the same i.e. a positive assessed income on which the assessee was required to pay tax. It is this basic condition precedent for the imposition of the penalty i.e. existence of liability to pay tax which existed prior to 2002, which has been done away with for the first time by the Finance Act, 2002.

[55] (2007) 9 SCC 665

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

56. There is nothing in the language of Section 271(1)(*c*) as amended by the Finance Act, 2002 w.e.f. 1-4-2003 to suggest that the amendment is retrospective. The amendment in sub-clause (*iii*) and simultaneously in Explanation 4(*a*) carried out enlarges the scope of penalty under Section 271(1)(*c*) to include even cases where assessment has been completed at loss. The same being in the nature of a substantive amendment would be prospective, in the absence of any indication to the contrary. The Finance Bill/Finance Act, 2002 brought about many amendments in the statute, some of which had retrospective operation. The amendment in Section 271(1)(*c*) was consciously made applicable w.e.f. 1-4-2003 and not with retrospective date.

57. Next proposition is with reference to the amended provision of law made by the Finance Act, 2002, where the expression used in Explanation 4 "the amount of tax sought to be evaded" has been deliberately amended providing specifically for cases where the filing of return and the assessment had the effect of reducing the loss declared in the return or converting that loss into income. Taking support from this amendment brought about in the statute with effect from 1-4-2003, it is contended that the legislature has now deliberately enacted such provision to fill in the lacuna in law and also to put an end to the controversy which existed between the High Courts in interpreting the laws after 1-4-1976. The amended provision of law is not available prior to 1-4-2003, as the same is not enacted with retrospective effect. That this amendment is declaratory and applies to all pending cases, as held by the Bombay High Court in *CIT* v. *Chemiequip Ltd.* [(2004) 265 ITR 265 (Bom)] is untenable for the following reasons:

> (*a*) There is nothing in the statute to suggest to that effect. The interpretation that it is clarificatory as per the Notes on Clauses do not advance the Revenue's case, because of its specific omission to that effect. It is purely a case of amendment to the statute.
>
> (*b*) Amendment is not retrospective and there is no assumption as to its retrospectivity. Retrospectivity has to be enacted specifically in the fiscal statute and it is more so in the case of penal provisions, otherwise it would be contradictory or derogatory to Article 20(1) of the Constitution. This Court has held in *Brij Mohan* v. *CIT* [(1979) 4 SCC 118 : 1979 SCC (Tax) 294 : (1979) 120 ITR 1] that the law to be applied is the one in force on the first day of accounting period. To this effect are the other decisions of this Court as *CIT* v. *Patel Bros. & Co. Ltd.* [(1995) 4 SCC 485 : (1995) 215 ITR 165] The Allahabad High Court has also taken the same view in *Zam*

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> *Zam Tanners* [(2005) 279 ITR 197 (All)] . Notes on Clauses on the amendment introduced by the Finance Act, 2002 makes specific mention inter alia of the amendment to be effective from 1-4-2003 of which the Bombay High Court has failed to take notice in its judgment in *CIT* v. *Chemiequip Ltd.* [(2004) 265 ITR 265 (Bom)]"

174. Mr. Hossain, learned counsel appearing for the respondents, however, questioned the soundness of the arguments on retrospectivity and addressed the following submissions. Learned counsel firstly reminded us of the debate and deliberations which had ensued both at the level of the executive arm of the Union as well as the legislative bodies and all of which had found an imperative necessity to revamp the regulatory regime with respect to auditing firms. According to Mr. Hossain, since a peer review was found to be clearly flawed and unresponsive, Parliament had deliberately intervened by introducing Section 132 in the statute book so as to remedy the mischief of errant companies and auditing firms having failed to adequately regulate their activities.

175. According to Mr. Hossain, no CA or auditing firm can claim to have a vested right to commit professional or other misconduct and not be tried. It was pointed out that misconduct already stood defined in the CA Act and made such conduct unlawful right from the time of the commencement of that statute in 1949. It was thus submitted that since professional or other misconduct was always triable under the CA Act, the petitioners are clearly incorrect when they argue that a vested right had been taken away by Section 132(4) of the Act.

176. Mr. Hossain laid great emphasis on the fact that Section 132(4) does not create a new category of misconduct since it merely

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

incorporates the definition of professional or other misconduct as appearing in Section 22 of the CA Act. It was thus submitted that a misdemeanor which would fall within the meaning of professional or other misconduct had remained unaltered with Section 132(4) merely providing that the expression "*professional or other misconduct*" would have the same meaning as assigned to that phrase by the CA Act.

177. It was further submitted that the obligation to comply with SAs too was one which existed even prior to the introduction of Section 132 as would be manifest from a reading of Section 143(9) of the Companies Act alongside Section 147(2) thereof. It was argued that by virtue of the aforenoted two statutory provisions, non-compliance with SAs was a criminal offence which existed and stood recognized by law even prior to 2018 when Section 132 came to be introduced. It was thus submitted by Mr. Hossain that it would be wholly incorrect to suggest that either a vested right had come to be infringed or that the provisions of Section 132 violated rights and the protection flowing from Article 20(1) of the Constitution.

178. Mr. Hossain then vehemently argued that Article 20(1) can clearly have no application since the expression penalty as appearing therein is used in a narrow sense and stands confined to a criminal prosecution. It was thus argued that the said provision is clearly inapplicable to a civil penalty arising out of disciplinary proceedings. According to Mr. Hossain while this proposition is well settled, since the petitioners have repeatedly alluded to an infraction of Article 20(1), it would be apposite to refer to the following enunciation of the legal position as it appears in **Shiv Dutt Rai Fateh Chand vs. Union of**

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

India[56]**:-**

"**25.** The contention of the petitioners is that any act or omission which is considered to be a default under the Act for which penalty is leviable is an offence, that such act or omission was not an offence and no penalty was payable under the law in force at the time when it was committed and hence they cannot be punished by the levy of penalty under a law which is given retrospective effect. They principally rely on Article 20(1) in support of their case. Article 20(1) is modelled on the basis of Section 9(3) of Article 1 of the Constitution of the United States of America which reads: "No bill of attainder or ex post facto law shall be passed." This clause has been understood in the United States of America as being applicable only to legislation concerning crimes (see *Calder* v. *Bull* [3 Dall 386 : 1 L Ed 648 (1798)]). The expression "offence" is not defined in the Constitution. Article 367 of the Constitution says that unless the context otherwise provides for words which are not defined in the Constitution, the meaning assigned in the General' Clauses Act, 1897 may be given. Section 3(38) of the General Clauses Act defines "offence" as any act or omission made punishable by any law for the time being in force. The marginal note of our Article 20 is "protection in respect of conviction for offences". The presence of the words "conviction and "offences", in the marginal note "convicted of an offence", "the act charged as an offence" and "commission of offence" in clause (1) of Article 20, 'prosecuted and punished' in clause (2) of Article 20 and 'accused of an offence' and 'compelled to be a witness against himself' in clause (3) of Article 20 clearly suggests that Article 20 relates to the constitutional protection given to persons who are charged with a crime before a criminal court [see H.M. Seervai: *Constitutional Law of India* (3rd Edn.), Vol. 1, p. 759]. The word "penalty" is a word of wide significance. Sometimes it means recovery of an amount as a penal measure even in a civil proceeding. An exaction which is not of compensatory character is also termed as a penalty even though it is not being recovered pursuant to an order finding the person concerned guilty of a crime. In Article 20(1) the expression "penalty" is used in the narrow sense as meaning a payment which has to be made or a deprivation of liberty which has to be suffered as a consequence of a finding that the person accused of a crime is guilty of the charge.

xxxx xxxx xxxx

31. After giving an anxious consideration to the points urged before us, we feel that the word 'penalty' used in Article 20(1) cannot be construed as including a 'penalty' levied under the sales tax laws by

[56] (1983) 3 SCC 529

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> the departmental authorities for violation of statutory provisions. A penalty imposed by the Sales Tax Authorities is only a civil liability, though penal in character. It may be relevant to notice that sub-section (2-A) of Section 9 of the Act specifically refers to certain acts and omissions which are offences for which a criminal prosecution would lie and the provisions relating to offences have not been given retrospective effect by Section 9 of the Amending Act. The argument based on Article 20(1) of the Constitution is, therefore, rejected."

179. Proceeding along these lines, Mr. Hossain submitted that Section 132 neither introduces a new or novel concept of misconduct nor does NFRA seek to levy a penalty greater than the quantum of penalty envisaged under the CA Act and which is a fine which may extend to INR 5 lakhs for all cases pertaining to the period prior to 2018. It was his submission that even the penalty of debarment is lesser when compared to the specter of permanent removal from the register by the Council as was envisioned under the CA Act. The challenge according to Mr. Hossain based on Article 20(1) of the Constitution is thus wholly misconceived.

180. It was further submitted that the essence of Section 132(4) of the Companies Act is essentially a change in the regulatory mechanism pertaining to audits and auditing standards driven by the legislative policy of bringing a certain class of auditors engaged in the audit of financial statements to be overseen by an expert body in public interest. It was his contention that Section 132 now envisages those cases being examined by an independent regulatory body in line with global practices and thus following the trend of the self- regulatory model which had earlier prevailed having been jettisoned the world over. Mr. Hossain submitted that Section 132(4) thus merely represents a change

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

in forum. Mr. Hossain submitted that the legislative amendments represented by Section 132 are also in sync with the observations of the Supreme Court and which had held that accounting firms can no longer be left to self-regulate and had underscored the need for the creation of an adequate oversight mechanism.

181. Mr. Hossain also referred to the following chart and with the aid of which he sought to illustrate and lend clarity to the aforenoted submissions. The chart which seeks to highlight the similarity between Section 21B of the CA Act and Section 132(4)(c) is reproduced below:-

"

S. 21(B) **Chartered Accountants Act, 1949**	**S. 132(4)(c)** **Companies Act, 2013**
(3) Where the Disciplinary Committee is of the opinion that a member is guilty of a professional or other misconduct mentioned in the Second Schedule or both the First Schedule* and the Second Schedule**, it shall afford to the member an opportunity of being heard before making any order against him and may thereafter take any one or more of the following actions, namely:– (a) reprimand the member; **(b) remove the name of the member from the Register permanently or for such period, as it thinks fit;** **(c) impose such fine as it may think fit, which may extend to rupees five lakhs.**	**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**

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

	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.]** Explanation. —For the purposes of this sub section, the expression "professional or other misconduct" shall have the same meaning assigned to it under section 22 of the Chartered Accountants Act, 1949 (38 of 1949).

”

182. Mr. Hossain argued that while interpreting a statutory provision, Courts as is well-settled, are obliged to bear in mind the nature of the remedy and the mischief which a Legislature seeks to address. Learned counsel thus urged us to interpret Section 132(4) in a manner which suppresses the mischief and furthers the cure. He referred to the celebrated Heydon's principle which came to be expounded in **Heydon's Case**[57] and submitted that since the system of a peer review had been found to be inadequate, Parliament was compelled to step in and formulate a new regulatory mechanism which would be more robust and responsive. The statutory procedure now embodied in Section 132(4), according to learned counsel, was intended to overcome the various shortcomings which beset the earlier statutory regime and to learn from the bitter experiences of the past. Learned counsel thus submitted that there exists no justification for the Court to strike down Section 132(4) on grounds as suggested by the petitioners.

[57] (1584) 76 ER 637

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

183. Mr. Hossain then contended that a statutory audit of a company was undoubtedly liable to be conducted in accordance with law and in compliance with the SAs which are binding on auditors by virtue of Section 143(9) of the Companies Act. These, according to learned counsel, were obligations which applied to auditors in general even prior to the introduction of Section 132(4). It was in the aforesaid light that Mr. Hossain submitted that the creation of the NFRA does not alter the liability of a statutory auditor. NFRA, according to Mr. Hossain, is merely envisaged to be an authority which would monitor and enforce compliance with existing SAs and which had themselves been formulated in accordance with law and were binding on statutory auditors. It was thus submitted that it would be wholly incorrect for the petitioners to argue that a new obligation stands created. This more so since NFRA would be obliged to examine allegations of misconduct on the anvil of SAs which already existed and which were liable to be adhered to by all statutory auditors in any case.

184. It was further argued that no person can claim to have a vested right in a particular forum. This principle, Mr. Hossain submitted, stands succinctly explained by the Supreme Court in **New India Insurance Co. Ltd. vs. Shanti Misra**[58] as would be evident from the following extracts of that judgment:-

> "**5.** On the plain language of Sections 110-A and 110-F there should be no difficulty in taking the view that the change in law was merely a change of forum i.e. a change of adjectival or procedural law and not of substantive law. It is a well-established proposition that such a change of law operates retrospectively and the person has to go to the new forum even if his cause of action or right of action accrued prior to the change of forum. He will have a vested right of action but not a

[58] (1975) 2 SCC 840

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Signing Date:07.02.2025
18:46:26

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vested right of forum. If by express words the new forum is made available only to causes of action arising after the creation of the forum, then the retrospective operation of the law is taken away. Otherwise the general rule is to make it retrospective. The expressions "arising out of an accident" occurring in sub-section (1) and "over the area in which the accident occurred", mentioned in sub-section (2) clearly show that the change of forum was meant to be operative retrospectively irrespective of the fact as to when the accident occurred. To that extent there was no difficulty in giving the answer in a simple way. But the provision of limitation of 60 days contained in sub-section (3) created an obstacle in the straight application of the well-established principle of law. If the accident had occurred within 60 days prior to the constitution of the tribunal then the bar of limitation provided in sub-section (3) was not an impediment. An application to the tribunal could be said to be the only remedy. If such an application, due to one reason or the other, could not be made within 60 days then the tribunal had the power to condone the delay under the proviso. But if the accident occurred more than 60 days before the constitution of the tribunal then the bar of limitation provided in sub-section (3) of Section 110-A on its face was attracted. This difficulty of limitation led most of the High Courts to fall back upon the proviso and say that such a case will be a fit one where the tribunal would be able to condone the delay under the proviso to sub-section (3), and led others to say that the tribunal will have no jurisdiction to entertain such an application and the remedy of going to the civil court in such a situation was not barred under Section 110-F of the Act. While taking the latter view the High Court failed to notice that primarily the law engrafted in Sections 110-A and 110-F was a law relating to the change of forum."

185. Yet another decision which was cited for our consideration in this respect was that of **Securities and Exchange Board of India vs. Classic Credit Ltd.**[59] and to Paras 49 and 50 of the report which are reproduced hereinbelow:-

"**49.** We will now deal with the legality of the propositions canvassed at the hands of learned counsel for the rival parties. In our considered view, the legal position expounded by this Court in a large number of judgments including *New India Insurance Co. Ltd.* v. *Shanti Misra* [*New India Insurance Co. Ltd.* v. *Shanti Misra*, (1975) 2 SCC 840] ; *SEBI* v. *Ajay Agarwal* [*SEBI* v. *Ajay Agarwal*, (2010) 3 SCC 765 : (2010) 2 SCC (Cri) 491] and *Ramesh Kumar Soni* v. *State of*

[59] (2018) 13 SCC 1

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Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> *M.P.* [*Ramesh Kumar Soni* v. *State of M.P.*, (2013) 14 SCC 696 : (2014) 4 SCC (Cri) 340] , is clear and unambiguous, namely, that procedural amendments are presumed to be retrospective in nature, unless the amending statute expressly or impliedly provides otherwise. And also, that generally change of "forum" of trial is procedural, and normally following the above proposition, it is presumed to be retrospective in nature unless the amending statute provides otherwise. This determination emerges from the decision of this Court in *Hitendra Vishnu Thakur* v. *State of Maharashtra* [*Hitendra Vishnu Thakur* v. *State of Maharashtra*, (1994) 4 SCC 602 : 1994 SCC (Cri) 1087] ; *Ranbir Yadav* v. *State of Bihar* [*Ranbir Yadav* v. *State of Bihar*, (1995) 4 SCC 392 : 1995 SCC (Cri) 728] and *Kamlesh Kumar* v. *State of Jharkhand* [*Kamlesh Kumar* v. *State of Jharkhand*, (2013) 15 SCC 460 : (2014) 6 SCC (Cri) 489] , as well as, a number of further judgments noted above.
>
> **50.** We have also no doubt, that alteration of "forum" has been considered to be procedural, and that, we have no hesitation in accepting the contention advanced on behalf of the SEBI, that change of "forum" being procedural, the amendment of the "forum" would operate retrospectively, irrespective of whether the offence allegedly committed by the accused was committed prior to the amendment."

186. Proceeding then to the Proviso to Section 132(4) itself, it was Mr. Hossain's contention that a plain reading of the Proviso would establish that the legislative intendment clearly was to debar any authority other than the NFRA from initiating an investigation even in respect of matters relating to professional or other misconduct committed prior to Section 132(4) coming into force. According to learned counsel the expression "*such matters of misconduct*" would clearly mean misconduct which may have been committed prior to 24 October 2018, the date when Section 132(4) came into force. According to learned counsel, the language of the proviso leaves no room for doubt of the legislative intent being that allegations of professional misconduct arising out of audits falling within a specified class being examined exclusively by the NFRA. The fact that Parliament clearly intended for the NFRA to exclusively try such cases,

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

according to learned counsel, is further fortified by that provision in unambiguous terms also interdicting pending investigations and enquiries. The bar with respect to initiation as well as continuation of enquiries as created by that provision would, according to Mr. Hossain, lead one to the irrefutable conclusion of the statute intended to operate retroactively.

187. Mr. Hossain also commended for our consideration the concept of a continuing offense to submit that a misconduct even if committed in the past does not get effaced by mere passage of time. According to learned counsel, a misconduct is not governed by a statute of limitation on the basis of which the petitioners could have legitimately urged that a misdemeanor committed prior to 2018 cannot be enquired into. Learned counsel referred to the following definitions of the word "continue/continuing" as explained in the Black's Law Dictionary: -

> "1. uninterrupted: persisting <a continuing offense>.
> 2. Not requiring renewal; enduring <continuing stockholders > <continuing jurisdiction>".

188. Proceeding ahead to deal with the argument of retrospectivity, Mr. Hossain submitted that the fundamental principles which would govern the operation of statutes were lucidly enunciated by the Supreme Court in **Zile Singh vs. State of Haryana**[60] in the following terms: -

> "**13.** It is a cardinal principle of construction that every statute is prima facie prospective unless it is expressly or by necessary implication made to have a retrospective operation. But the rule in general is applicable where the object of the statute is to affect vested rights or to impose new burdens or to impair existing obligations. Unless there are words in the statute sufficient to show

[60] (2004) 8 SCC 1

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

the intention of the legislature to affect existing rights, it is deemed to be prospective only — "*nova constitutio futuris formam imponere debet non praeteritis*" — a new law ought to regulate what is to follow, not the past. (See *Principles of Statutory Interpretation* by Justice G.P. Singh, 9th Edn., 2004 at p. 438.) It is not necessary that an express provision be made to make a statute retrospective and the presumption against retrospectivity may be rebutted by necessary implication especially in a case where the new law is made to cure an acknowledged evil for the benefit of the community as a whole (*ibid*., p. 440).

14. The presumption against retrospective operation is not applicable to declaratory statutes…. In determining, therefore, the nature of the Act, regard must be had to the substance rather than to the form. If a new Act is "to explain" an earlier Act, it would be without object unless construed retrospectively. An explanatory Act is generally passed to supply an obvious omission or to clear up doubts as to the meaning of the previous Act. It is well settled that if a statute is curative or merely declaratory of the previous law retrospective operation is generally intended…. An amending Act may be purely declaratory to clear a meaning of a provision of the principal Act which was already implicit. A clarificatory amendment of this nature will have retrospective effect (*ibid*., pp. 468-69).

15. Though retrospectivity is not to be presumed and rather there is presumption against retrospectivity, according to Craies (*Statute Law*, 7th Edn.), it is open for the legislature to enact laws having retrospective operation. This can be achieved by express enactment or by necessary implication from the language employed. If it is a necessary implication from the language employed that the legislature intended a particular section to have a retrospective operation, the courts will give it such an operation. In the absence of a retrospective operation having been expressly given, the courts may be called upon to construe the provisions and answer the question whether the legislature had sufficiently expressed that intention giving the statute retrospectivity. Four factors are suggested as relevant: (*i*) general scope and purview of the statute; (*ii*) the remedy sought to be applied; (*iii*) the former state of the law; and (*iv*) what it was the legislature contemplated. (p. 388) The rule against retrospectivity does not extend to protect from the effect of a repeal, a privilege which did not amount to accrued right. (p. 392)

16. Where a statute is passed for the purpose of supplying an obvious omission in a former statute or to "explain" a former statute, the subsequent statute has relation back to the time when the prior

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

Act was passed. The rule against retrospectivity is inapplicable to such legislations as are explanatory and declaratory in nature. A classic illustration is the case of *Attorney General* v. *Pougett* [(1816) 2 Price 381 : 146 ER 130] (Price at p. 392). By a Customs Act of 1873 (53 Geo. 3, c. 33) a duty was imposed upon hides of 9s 4d, but the Act omitted to state that it was to be 9s 4d per cwt., and to remedy this omission another Customs Act (53 Geo. 3, c. 105) was passed later in the same year. Between the passing of these two Acts some hides were exported, and it was contended that they were not liable to pay the duty of 9s 4d per cwt., but Thomson, C.B., in giving judgment for the Attorney General, said: (ER p. 134)

> "The duty in this instance was, in fact, imposed by the first Act; but the gross mistake of the omission of the weight, for which the sum expressed was to have been payable, occasioned the amendment made by the subsequent Act: but that had reference to the former statute as soon as it passed, and they must be taken together as if they were one and the same Act;" (Price at p. 392)

17. Maxwell states in his work on *Interpretation of Statutes* (12th Edn.) that the rule against retrospective operation is a presumption only, and as such it "may be overcome, not only by express words in the Act but also by circumstances sufficiently strong to displace it" (p. 225). If the dominant intention of the legislature can be clearly and doubtlessly spelt out, the inhibition contained in the rule against perpetuity becomes of doubtful applicability as the "inhibition of the rule" is a matter of degree which would "*vary secundum materiam*" (p. 226). Sometimes, where the sense of the statute demands it or where there has been an obvious mistake in drafting, a court will be prepared to substitute another word or phrase for that which actually appears in the text of the Act (p. 231).

18. In a recent decision of this Court in *National Agricultural Coop. Marketing Federation of India Ltd.* v. *Union of India* [(2003) 5 SCC 23] it has been held that there is no fixed formula for the expression of legislative intent to give retrospectivity to an enactment. Every legislation whether prospective or retrospective has to be subjected to the question of legislative competence. The retrospectivity is liable to be decided on a few touchstones such as: (*i*) the words used must expressly provide or clearly imply retrospective operation; (*ii*) the retrospectivity must be reasonable and not excessive or harsh, otherwise it runs the risk of being struck down as unconstitutional; (*iii*) where the legislation is introduced to overcome a judicial decision, the power cannot be used to subvert the decision without removing the statutory basis of the decision. There is no fixed

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

formula for the expression of legislative intent to give retrospectivity to an enactment. A validating clause coupled with a substantive statutory change is only one of the methods to leave actions unsustainable under the unamended statute, undisturbed. Consequently, the absence of a validating clause would not by itself affect the retrospective operation of the statutory provision, if such retrospectivity is otherwise apparent.

19. The Constitution Bench in *Shyam Sunder* v. *Ram Kumar* [(2001) 8 SCC 24] has held: (SCC p. 49, para 39)

> "Ordinarily when an enactment declares the previous law, it requires to be given retroactive effect. The function of a declaratory statute is to supply an omission or to explain a previous statute and when such an Act is passed, it comes into effect when the previous enactment was passed. The legislative power to enact law includes the power to declare what was the previous law and when such a declaratory Act is passed, invariably it has been held to be retrospective. Mere absence of use of the word 'declaration' in an Act explaining what was the law before may not appear to be a declaratory Act but if the court finds an Act as declaratory or explanatory, it has to be construed as retrospective." (p. 2487).

20. In *Bengal Immunity Co. Ltd.* v. *State of Bihar* [(1955) 2 SCR 603 : AIR 1955 SC 661] , *Heydon case* [(1584) 3 Co Rep 7a : 76 ER 637] was cited with approval. Their Lordships have said: (SCR pp. 632-33)

> "It is a sound rule of construction of a statute firmly established in England as far back as 1584 when *Heydon case* [(1584) 3 Co Rep 7a : 76 ER 637] was decided that—
>
> '… for the sure and true interpretation of all statutes in general (be they penal or beneficial, restrictive or enlarging of the common law) four things are to be discerned and considered—
>
> *1st*. What was the common law before the making of the Act.
>
> *2nd*. What was the mischief and defect for which the common law did not provide.
>
> *3rd*. What remedy Parliament hath resolved and appointed to cure the disease of the Commonwealth, and
>
> *4th*. The true reason of the remedy; and then the office of all the judges is always to make such construction as shall suppress the mischief, and advance the remedy, and to suppress subtle inventions and evasions for continuance of

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> the mischief, and *pro privato commodo*, and to add force and life to the cure and remedy, according to the true intent of the makers of the Act, *pro bono publico*.' "

> **21.** In *Allied Motors (P) Ltd.* v. *CIT* [(1997) 3 SCC 472] certain unintended consequences flowed from a provision enacted by Parliament. There was an obvious omission. In order to cure the defect, a proviso was sought to be introduced through an amendment. The Court held that literal construction was liable to be avoided if it defeated the manifest object and purpose of the Act. The rule of reasonable interpretation should apply.
>
> > "A proviso which is inserted to remedy unintended consequences and to make the provision workable, a proviso which supplies an obvious omission in the section and is required to be read into the section to give the section a reasonable interpretation, requires to be treated as retrospective in operation so that a reasonable interpretation can be given to the section as a whole." (SCC pp. 479-80, para 13)"

189. Mr. Hossain submitted that a presumption against a retrospective applicability can only arise when a vested right is impaired. According to learned counsel, the petitioners have clearly failed to prove or establish that this primordial benchmark has been violated. It was Mr. Hossain's submission that no CA can possibly claim to have a vested right not to be tried for a misconduct. According to learned counsel, it would be preposterous to accept the argument of the petitioners that they acquired a perfected right to be tried for professional misconduct only in accordance with the procedure prescribed by the CA Act.

190. This more so since professional or other misconduct in any case in light of Section 22 of the CA Act already stood prohibited and statutorily declared to be illegal. It was submitted that the said statute itself envisaged an enquiry into allegations of misconduct and the consequential possibility of a CA being exposed to disciplinary action. Mr. Hossain thus submitted that absent any vested right being infringed

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

or impacted, the argument of retrospectivity is clearly misconceived and untenable.

191. It would be appropriate to preface our evaluation of the challenge to Section 132(4) on the basis of its perceived retroactive operation as well as Article 20(1) of the Constitution by taking note of the following two significant statements which were made by Mr. Hossain. Learned counsel firstly stated that NFRA has taken the considered position that it would impose no fines which exceed INR 5 lakhs in respect of any audit conducted prior to October 2018. It was in this regard further stated that any orders if passed by NFRA violating the aforenoted statement would be duly recalled to the aforesaid extent. It becomes pertinent to note that this statement assumes significance since undisputedly the maximum penalty which the CA Act envisages is INR 5 lakhs. The statement so made thus and to an extent impacts the challenge which was mounted to the validity of Section 132(4) on the ground of it having introduced penalties which were more onerous and greater than those existing under the CA Act.

192. The second without prejudice statement, and clearly one which was of greater import and consequence, was that NFRA would not proceed against any firms in respect of an audit that may have been conducted prior to 20 October 2018. The aforesaid statement was made by Mr. Hossain notwithstanding his submission that the obligations of firms to comply with the law as well as the SAs predated the introduction of Section 132 in the Companies Act. However, and since that statement is duly taken on board and accepted, it obviates the Court ruling on the challenge raised by auditing firms to Section 132(4)

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

insofar as it was sought to be extended to audits completed prior to October 2018 and the argument of it being retroactive.

193. However, the Court would still be required to deal with the challenge to its validity insofar as individual CAs' and pre-2018 audits to which they were a party is concerned. The related facet of the common challenge raised before us which too would survive for consideration would be the validity of Section 132(4) as applicable to audits that may be undertaken post its promulgation and as voiced by the two categories of writ petitioners before us. Having broadly delineated the contours of the challenge which survives, we proceed ahead to evaluate the submissions which were advanced in the context of the perceived retrospective operation of Section 132(4).

194. There cannot possibly be a cavil of doubt with respect to the well-established precept that statutes are generally presumed to be prospective in their operation. That presumption, undoubtedly, constitutes the starting point from which a court would embark upon its analysis. Equally well-settled is the principle of that presumption being dispelled only if a court were to find from the language of an enactment or a provision that the law maker intended otherwise. The intention of the legislative body can be discerned either from the express language in which a provision is couched or if it be not explicitly stated, where it is implicitly evident that it was intended to apply to events and acts of the past.

195. As Maxwell eloquently explains in his seminal work on Interpretation of Statutes [12th Edition], the rule against retrospective operation is only a presumption and as such *"it may be overcome, not*

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

only by express words in the Act but also by circumstances sufficiently strong to displace it." The rule as expounded by Maxwell was quoted with approval by our Supreme Court in *Zile Singh* and where it was pertinently observed that *"If the dominant intention of the legislature can be clearly and doubtlessly spelt out, the inhibition contained in the rule against perpetuity becomes of doubtful applicability as the inhibition of the rule is a matter of degree……"*. What needs to be acknowledged is that the retrospective application of laws is not an aberration but a well-established and necessary tool to correct historical oversights, address legal vacuums, and ensure that legislative objectives are met in their true spirit. The determination of retrospectivity is guided by several factors, foremost among them being the intent of the Legislature, which may be discerned from the statutory language and the circumstances leading upto the law's enactment. Where the language of the provision indicates a clear or even implicit intent of being intended to have retrospective operation, Courts would give full effect to that intent, recognizing that legislative power extends not only to regulating future conduct but also to rectifying past anomalies. The necessity that may have prompted the enactment is another crucial factor. Often, laws are introduced to address pressing concerns, to correct that which has persisted for long due to outdated legal frameworks, or to fill gaps that have led to uncertainty or unfair advantage. In such cases, applying the law prospectively alone would fail to remedy the mischief the Legislature sought to address, rendering the enactment ineffective in achieving its true objective.

196. While innumerable decisions were cited by learned counsels

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

appearing for respective sides in this regard, in our considered opinion the legal position has remained unaltered and our understanding of the application and operation of statutes has over the centuries continued to be guided by the precepts culled out above.

197. A challenge to a statute on the ground of it being retrospective, however, is invariably and indelibly linked to how it impacts or infringes the rights of an individual or entity. The issue of retrospectivity thus becomes liable to be examined in the backdrop of how the enactment operates and affects the rights which inhere or may have come to be perfected prior to its promulgation. What we seek to emphasize is that the argument of retrospectivity cannot be evaluated in an abstract dimension. That submission has to be necessarily tested on what we find at the crossroads and intersection where the statute meets with the expanse of the bundle of rights which are asserted to exist.

198. The challenge to Section 132(4) and its retrospective application too would thus have to be appreciated on the assertion of certain rights, procedural or substantive, which could be said to have become absolute and fixed. The petitioners had essentially contended that the creation of penalties as well as the shifting of the adjudicatory function from the Council to the NFRA in respect of audits conducted prior to October 2018 would lead one to necessarily come to the irresistible conclusion that the statute impacts rights retrospectively.

199. We at the outset note that the presumption against retrospectivity is founded on the jurisprudential principle of rights not being impaired by statutes which may come to be promulgated after the former have accrued or become absolute. We find a detailed explanation on the

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

meaning liable to be ascribed to the word 'vested' in **MGB Gramin Bank vs. Chakrawarti Singh**[61] and which would be of relevance:-

> "**11.** The word "vested" is defined in *Black's Law Dictionary* (6th Edn.) at p. 1563, as:
>
> > "Vested.—fixed; accrued; settled; absolute; complete. Having the character or given in the rights of absolute ownership; not contingent; not subject to be defeated by a condition precedent. Rights are 'vested' when right to enjoyment, present or prospective, has become property of some particular person or persons as present interest; mere expectancy of future benefits, or contingent interest in property founded on anticipated continuance of existing laws, does not constitute 'vested rights'."
>
> **12.** In *Webster's Comprehensive Dictionary* (International Edition) at p. 1397, "vested" is defined as law held by a tenure subject to no contingency; complete; established by law as a permanent right; vested interest. (Vide *Bibi Sayeeda* v. *State of Bihar* [(1996) 9 SCC 516 : AIR 1996 SC 1936] and *J.S. Yadav* v. *State of U.P.* [(2011) 6 SCC 570 : (2011) 2 SCC (L&S) 140])
>
> **13.** Thus, vested right is a right independent of any contingency and it cannot be taken away without consent of the person concerned. Vested right can arise from contract, statute or by operation of law. Unless an accrued or vested right has been derived by a party, the policy decision/scheme could be changed. [Vide *Kuldeep Singh* v. *Govt. (NCT of Delhi).* [(2006) 5 SCC 702 : AIR 2006 SC 2652]]"

As is evident from the aforesaid passages, the word "vested" was defined and explained by the Supreme Court as pertaining to rights which could be said to have become fixed, absolute and complete. Those rights would fall in the category of assertions and protections which could be claimed and not being contingent or subject to be defeated by a condition precedent. It was, however, also pertinently observed that mere expectancy of future benefits and interests which may be contingent, or an anticipated continuance of existing laws

[61] (2014) 13 SCC 583

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

would not constitute vested rights. The word "vested" was thus explained to mean a right which is not dependent on any contingency and which in that sense had accrued and was entitled to be derived by a party irrespective of any subsequent change in the legal position. Vested rights were thus explained to mean those which would remain unimpacted by any future change in the legal position. Regard must be had to the fact that if the right hinges on an unsecured or contingent foundation, susceptible to modification by a change in the legislative scheme, then such a right was never truly vested, as it lacked the essential characteristics of being absolute, fixed, or immune to future alteration.

200. In **Howrah Municipal Corporation. vs. Ganges Rope Co. Ltd**[62], the Supreme Court was called upon to consider the correctness of a submission that an application for obtaining sanction to undertake construction would be governed by the law as it existed on the date when that application was made. Negating that contention, the Supreme Court held that it would be the law as prevalent on the date when the application arises for consideration which would apply. It was observed in *Howrah Municipal Corporation* that a person could not claim a "settled expectation" of an application for sanction being decided within a particular time. It proceeded further to hold that even such a settled expectation would not constitute a vested right. We deem it apposite to extract para 37 of that decision hereunder:-

> "**37.** The argument advanced on the basis of so-called creation of *vested right* for obtaining sanction on the basis of the Building Rules (unamended) as they were on the date of submission of the

[62] (2004) 1 SCC 663

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

application and the order of the High Court fixing a period for decision of the same, is misconceived. The word "vest" is normally used where an immediate fixed right in present or future enjoyment in respect of a property is created. With the long usage the said word "vest" has also acquired a meaning as "an absolute or indefeasible right" [see *K.J. Aiyer's Judicial Dictionary (A Complete Law Lexicon)*, 13th Edn.]. The context in which the respondent Company claims a vested right for sanction and which has been accepted by the Division Bench of the High Court, is not a right in relation to "ownership or possession of any property" for which the expression "vest" is generally used. What we can understand from the claim of a "vested right" set up by the respondent Company is that on the basis of the Building Rules, as applicable to their case on the date of making an application for sanction and the fixed period allotted by the Court for its consideration, it had a "legitimate" or "settled expectation" to obtain the sanction. In our considered opinion, such "settled expectation", if any, did not create any vested right to obtain sanction. True it is, that the respondent Company which can have no control over the manner of processing of application for sanction by the Corporation cannot be blamed for delay but during pendency of its application for sanction, if the State Government, in exercise of its rule-making power, amended the Building Rules and imposed restrictions on the heights of buildings on G.T. Road and other wards, such "settled expectation" has been rendered impossible of fulfilment due to change in law. The claim based on the alleged "vested right" or "settled expectation" cannot be set up against statutory provisions which were brought into force by the State Government by amending the Building Rules and not by the Corporation against whom such "vested right" or "settled expectation" is being sought to be enforced. The "vested right" or "settled expectation" has been nullified not only by the Corporation but also by the State by amending the Building Rules. Besides this, such a "settled expectation" or the so-called "vested right" cannot be countenanced against public interest and convenience which are sought to be served by amendment of the Building Rules and the resolution of the Corporation issued thereupon."

201. This would constitute an appropriate juncture to view the celebrated enunciation of the principle of retrospectivity which is found in Halsbury's Laws of England and which has been repeatedly quoted with approval in various judgments handed down by the Supreme Court. The Halsbury's Law of England while defining the expression

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

"retrospective" had stated that a statute would not be construed as retrospective merely because a part of the requisites for its action is drawn from a time antecedent to its passing. The aforesaid proposition as mooted in that authoritative work was cited with approval by the Supreme Court in **Darshan Singh vs. Ram Pal Singh**[63] and where the following observations appear:-

> "**35.** Mr Sachar relies on *Thakur Gokulchand* v. *Parvin Kumari* [(1952) 1 SCC 713 : AIR 1952 SC 231 : 1952 SCR 825] , *Garikapatti Veeraya* v. *N. Subbiah Choudhury* [1957 SCR 488 : AIR 1957 SC 540] , *Jose Da Costa* v. *Bascora Sadasiva Sinai Narcornim* [(1976) 2 SCC 917] , *Govind Das* v. *ITO* [(1976) 1 SCC 906 : 1976 SCC (Tax) 133] , *Henshall* v. *Porter* [(1923) 2 KBD : 193 : 39 TLR 409] , *United Provinces* v. *Mst. Atiga Begum* [1940 FCR 110 : AIR 1941 FC 16] , in support of his submission that the Amendment Act was not made retrospective by the legislature either expressly or by necessary implication as the Act itself expressly provided that it shall be deemed to have come into force on January 23, 1973; and therefore there would be no justification to giving it retrospective operation. The vested right to contest which was created on the alienation having taken place and which had been litigated in the court, argues Mr Sachar, could not be taken away. In other words, the vested right to contest in appeal was not affected by the Amendment Act. However, to appreciate this argument we have to analyse and distinguish between the two rights involved, namely, the right to contest and the right to appeal against lower court's decision. Of these two rights, while the right to contest is a customary right, the right to appeal is always a creature of statute. The change of the forum for appeal by enactment may not affect the right of appeal itself. In the instant case we are concerned with the right to contest and not with the right to appeal as such. There is also no dispute as to the propositions of law regarding vested rights being not taken away by an enactment which is ex facie or by implication not retrospective. But merely because an Act envisages a past act or event in the sweep of its operation, it may not necessarily be said to be retrospective. Retrospective, according to Black's *Law Dictionary*, means looking backward; contemplating what is past; having reference to a statute or things existing before the Act in question. Retrospective law, according to the same dictionary, means a law which looks backward or contemplates the past; one

[63] 1992 Supp (1) SCC 191

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

which is made to affect acts or facts occurring, or rights occurring, before it came into force. Every statute which takes away or impairs vested rights acquired under existing laws, or creates a new obligation, imposes a new duty, or attaches a new disability in respect to transactions or considerations already past. Retroactive statute means a statute which creates a new obligation on transactions or considerations already past or destroys or impairs vested rights.

36. In *Halsbury's Laws of England* (4th edn., Vol. 44, at paragraph 921) we find:

> "921. *Meaning of 'retrospective'*.— It has been said that 'retrospective' is somewhat ambiguous and that a good deal of confusion has been caused by the fact that it is used in more senses than one. In general, however, the courts regard as retrospective any statute which operates on cases or facts coming into existence before its commencement in the sense that it affects, even if for the future only, the character or consequences of transactions previously entered into or of other past conduct. Thus a statute is not retrospective merely because it affects existing rights; or is it retrospective merely because a part of the requisites for its action is drawn from a time antecedent to its passing."

37. We are inclined to take the view that in the instant case legislature looked back to January 23, 1973 and not beyond to put an end to the custom and merely because on that cut off date some contests were brought to abrupt end would not make the Amendment Act retrospective. In other words, it would not be retrospective merely because a part of the requisites for its action was drawn from a time antecedent to the Amendment Act coming into force. We are also of the view that while providing that "no person shall contest any alienation of immovable property whether ancestral or non-ancestral or any appointment of an heir to such property", without preserving any right to contest such alienations or appointments as were made after the coming into force of the Principal Act and before the coming into force of the Amendment Act, the intention of the legislature was to cut off even the vested right; and that it was so by implication as well. There is no dispute as to the proposition that retrospective effect is not to be given to an Act unless, the legislature made it so by express words or necessary implication. But in the instant case it appears that this was the intention of the legislature. Similarly courts will construe a provision as conferring power to act retroactively when clear words are used. We find both the intention and language of the Amendment Act clear in these respects.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

38. Craies on *Statute Law* (7th edn., page 389) has stated as under:

> "It is obviously competent for the legislature, in its wisdom, to make the provisions of an Act of Parliament retrospective, and no one denies the competency of the legislature to pass retrospective statutes if they think fit, and many times they have done so. Before giving such a construction to an Act of Parliament one would require that it should either appear very clearly in the terms of the Act or arise by necessary and distinct interpretation, and perhaps no rule of construction is more firmly established than this — that a retrospective operation is not to be given to a statute so as to impair an existing right or obligation otherwise than as regards matter of procedure, unless that effect cannot be avoided without doing violence to the language of the enactment."
>
> We agree with the above statement of law. However, applying the Amending Act of 1973 to alienations prior to January 23, 1973 does not necessarily mean its retrospective operation."

202. As is apparent from the aforesaid discussion, while delving on the subject of retrospectivity of a legislation the Supreme Court had pertinently observed that while it is true that an enactment would not be construed as having retrospective operation unless such be the position which could be countenanced either on account of an express provision or by implication, merely because the statute takes into consideration a past act or event, that would not necessarily lead one to conclude that it be said to operates retrospectively. The Supreme Court in *Darshan Singh*, went even further to observe that a statute would be deemed to be retroactive only if it created a new obligation on transactions or considerations already past or where its application would result in the destruction or impairment of vested rights.

203. The rules so enunciated also find resonance in the following passages of the judgment of the Supreme Court in **Securities and**

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

Exchange Board of India vs. Rajkumar Nagpal and Ors.[64]:-

"**98.** Mr N. Venkataraman, learned Senior Counsel and Additional Solicitor General has argued that the SEBI Circular is retroactive in nature as it does not take away or impair any vested rights. It operates in the future, based on events that arose prior to its issuance. Mr Darius Khambata, learned Senior Counsel appearing for RCFL argued that the effect of applying the SEBI Circular to the present case will render it retrospective and not retroactive. According to him, Clauses 22 and 23 of the Fifth Schedule to the Debenture Trust Deed(s) vested debenture-holders with the right to authorise debenture trustees "to sanction any compromise or arrangement proposed to be made between the company and the beneficial owner(s)/debenture-holder(s)". This sanction could be authorised by a majority of "not less than three-fourths of the persons voting … or if a poll is demanded … not less than three-fourths in value of the votes cast on such poll". The SEBI Circular, it has been urged, changed the nature of the special majority required to sanction a compromise by introducing the requirement of a majority of 60% of ISIN level votes.

99. We are of the opinion that the SEBI Circular has retroactive application. In *Principles of Statutory Interpretation* by Justice G.P. Singh (14th Edn., 2016 at p. 583), it is stated that:

> "The *rule against retrospective construction is not applicable to a statute merely because "a part of the requisites for its action is drawn from a time antecedent to its passing*". If that were not so, every statute will be presumed to apply only to persons born and things which come into existence after its operation and the rule may well result in virtual nullification of most of the statutes."
>
> (emphasis supplied)

100. In *Vineeta Sharma* v. *Rakesh Sharma* [*Vineeta Sharma* v. *Rakesh Sharma*, (2020) 9 SCC 1 : (2021) 1 SCC (Civ) 119] this Court described the nature of prospective, retrospective, and retroactive laws : (SCC p. 53, para 61)

> "*61*. The prospective statute operates from the date of its enactment conferring new rights. The retrospective statute operates backwards and takes away or impairs vested rights acquired under existing laws. A retroactive statute is the one that does not operate retrospectively. It operates in futuro.

[64] (2023) 8 SCC 274

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> However, its operation is based upon the character or status that arose earlier. Characteristic or event which happened in the past or requisites which had been drawn from antecedent events."

101. The terms "retrospective" and "retroactive" are often used interchangeably. However, their meanings are distinct. This Court succinctly appreciated the difference between these concepts in *State Bank's Staff Union (Madras Circle)* v. *Union of India* [*State Bank's Staff Union (Madras Circle)* v. *Union of India*, (2005) 7 SCC 584 : 2005 SCC (L&S) 994] :

> " "Retroactivity" is a term often used by lawyers but rarely defined. On analysis it soon becomes apparent, moreover, that it is used to cover at least two distinct concepts. The first, which may be called "true retroactivity", consists in the application of a new rule of law to an act or transaction which was completed before the rule was promulgated. The second concept, which will be referred to as "quasi-retroactivity", occurs when a new rule of law is applied to an act or transaction in the process of completion….The foundation of these concepts is the distinction between completed and pending transactions…." [T.C. Hartley, *The Foundations of European Community Law* 129 (1981).]

102. Many decisions of this Court define "retroactivity" to mean laws which destroy or impair vested rights. In real terms, this is the definition of "retrospectivity" or "true retroactivity". "Quasi-retroactivity" or simply "retroactivity" on the other hand is a law which is applicable to an act or transaction that is still underway. Such an act or transaction has not been completed and is in the process of completion. Retroactive laws also apply where the status or character of a thing or situation arose prior to the passage of the law. Merely because a law operates on certain circumstances which are antecedent to its passing does not mean that it is retrospective."

204. Hereto, the Supreme Court apart from revisiting the succinct exposition of the legal principle as propounded in Halsbury's Laws of England, it, and in addition, quoted with approval the view penned by the celebrated author G.P. Singh in 'Principles of Statutory Interpretation' and who had opined that if a statute were to be

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

acknowledged as being retrospective merely because it were found to draw from actions taken or completed prior to its passing, every statute would necessarily have to be presumed to apply only to persons born and things which had come into existence after its promulgation. The essential characteristics of a retroactive statute were further explained with the Supreme Court holding that although such an enactment would operate *in futuro*, its operation itself could be based upon a character or status that had arisen earlier.

205. Tested on the aforesaid principles, we find ourselves unable to sustain the argument that Section 132 is liable to be struck down on the ground that it operates retrospectively and impacts rights which may have been perfected or completed. It becomes relevant to note that the Explanation to Section 132(4) in unambiguous and explicit terms provides that the expression "*professional or other misconduct*" would have the same meaning as assigned to that phrase by Section 22 of the CA Act. Section 132 therefore, does not create a new species of misconduct nor does it create a liability which was otherwise not contemplated under a pre-existing legislation. "*Professional or other misconduc*t" already stood defined by Section 22 of the CA Act and thus all actions of CAs and auditors were liable to be tested on the basis thereof. It would thus be wholly incorrect to contend that Section 132 creates a new liability with respect to a misconduct or misdemeanor committed prior to October 2018.

206. The principal issue which weighs upon us and compels us to hold that the argument of retrospectivity is unmerited is the facet of professional misconduct having remained unaltered and only the

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

manner and ambit of the inquiry having been amended for a particular class of audits. As noted hereinabove, the argument of retrospectivity is liable to be rejected also because it does not introduce new categories of misconduct or liabilities. Instead, it relies on the pre-existing definition of "professional or other misconduct" under Section 22 of the CA Act. Since the legal characterization of misconduct remains unchanged, the only discernible difference is the manner and scope of the inquiry under Section 132.

207. Suffice it to note that no auditor can possibly claim or assert a vested right having come to be created in respect of professional misconduct that may have been committed prior to Section 132 coming into force. We find ourselves unable to comprehend any right, leave alone a vested right, that could have been claimed to have come into existence in respect of professional conduct which would have fallen within the scope of Section 22 of the CA Act prior to the introduction of Section 132. Vested rights, as was observed in the preceding parts of this decision, would be those which had come to accrue, settle or had become absolute.

208. Vested rights are those which come to be perfected and would remain unimpacted by any contingency. Surely an auditor cannot possibly assert that it had acquired a settled expectation to not be tried in respect of professional or other misconduct merely because that act had come to be completed prior to Section 132 coming into force. Acceptance of the contention as broadly canvassed on behalf of the writ petitioners would essentially mean that professional or other misconduct if committed prior to October 2018 would stand insulated

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

and not be liable to be tried or inquired into under Section 132. We find ourselves unable to countenance that submission since a CA or an auditor cannot justifiably in law argue or assert that it is not liable to be tried for an act of misconduct. We do so observe conscious of the separate contention of the petitioners pertaining to the procedural safeguards which Section 132 allegedly does away with and which is an aspect that we propose to deal with in a subsequent segment of this decision.

209. We are thus of the firm opinion, that no right, let alone a vested right, accrued in favour of the writ petitioners and which could be said to be entitled to be insulated from the reach of Section 132(4). As was pertinently observed by the Supreme Court, a statute is not liable to be viewed as having retroactive operation merely because it draws upon an event or act which preceded its promulgation. Acts of misconduct committed prior to October 2018 were neither accorded nor conferred a shield of immunity. Section 132 does not create a new disqualification or create a novel set or category of misdemeanors to constitute professional or other misconduct. The conduct of an audit, an individual or a firm remains liable to be enquired into based on the obligations and duties which held the field even prior to the introduction of Section 132. The conduct of an audit would continue to be examined and evaluated based on those legal obligations and set of rules which existed earlier.

210. The scrutiny, test and rigor of conduct in the rendering of services as a professional or auditor is a well-understood, rooted and an accepted reality. To raise objections to the new and evolved rigors

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

under Section 132 on the ground that it exposes them to an unprecedented level of scrutiny and that they were previously protected from such rigors would be to incorrectly assume the existence of an immunity prior to Section 132. Therefore, any contention that Section 132 unfairly introduces a novel and retrospective burden on auditors fails to acknowledge that the foundational principles of professional accountability have always remained intact. The only change is in the manner and extent of enforcement and not in the fundamental obligation of auditors to uphold professional and ethical standards.

211. Regard must also be had to the fact that the CA Act incorporated no provision for a firm being held liable for an audit that may have been conducted. The only contingency in which a firm could have been penalised were those envisaged in Sections 21A and 21B and which in turn stood confined to repeat offenses committed by the partner or member. Thus, even though the firm may have been appointed as an auditor, it was the individual partners who alone could have been proceeded against and punished. We have while dealing with the argument of vicarious liability already held that a firm cannot in law disavow or disassociate itself from the actions of its partners and members. They after all act in discharge of the principal obligation which stands placed upon the firm to undertake the audit. This was a serious lacuna and shortcoming in the CA Act.

212. Parliament as well as the expert groups which were formed had after undertaking an exhaustive review of global practices and norms ultimately come to the firm conclusion that peer review and self-corrective or in-house models had neither been found to be effective

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

nor efficacious. Section 132, viewed in that light, therefore borrows, learns and seeks to build upon regulatory regimes prevalent in other parts of the world and thus sync our regulatory practices with global norms. With the spread of international commerce and upon India becoming part of the globalized world order, Parliament appears to have acted in acknowledgement of the imperative need to review the regulatory scheme relating to audits as prevalent in different jurisdictions.

213. Parliament appears to have borne in consideration the indubitable necessity of financial statements being compliant with standards and best practices accepted as the benchmark in different jurisdictions. The system of audit and review in India had to necessarily keep abreast with the winds of change. The amendments embodied in Section 132 are thus a reflection of this change in policy and in that sense clearly remedial. We consequently find ourselves unable to accept the submissions of the writ petitioners addressed on this score.

214. On a consideration of the legislative history preceding the introduction of Section 132 clearly suggests a pre-existing regulatory deficiency or gap was sought to be addressed through the introduction of Section 132 aligning with the broader objective of strengthening oversight mechanisms and enhancing the quality of professional services rendered by audit firms. This measure was implemented not to create new liabilities but to bridge an existing gap in enforcement, ensuring that standards of professional conduct and accountability evolve in tandem with global best practices.

215. The enactment of Section 132 thus represents a progressive

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

regulatory shift, aimed at reinforcing compliance, raising the bar for audit quality, and ensuring that no aspect of professional misconduct or deficiency in service remains unchecked or unsupervised. By instituting a more structured and stringent framework, Section 132 ensures that audit firms and professionals adhere to internationally recognized standards, thereby fostering greater transparency, accountability, and confidence in financial reporting.

216. This regulatory evolution does not operate retrospectively in a punitive sense but rather brings India's auditing and financial oversight framework in line with global standards, ensuring that all professional conduct meets the highest levels of scrutiny and quality assurance. The underlying objective is to create a more robust and reliable regulatory ecosystem, where professional standards are continuously refined to prevent any compromise in audit quality or integrity

217. Of equal import is the Proviso to Section 132 (4) (a) and which prohibits any other institute or body to initiate or continue an investigation once the same has been taken over by the NFRA. The Proviso thus clearly seeks to operate both in respect of proceedings which may be either pending or under contemplation. In our considered opinion, the provision is a clear essay of the intent of Parliament to vest exclusive authority in the NFRA to investigate allegations of misconduct and to bring even pending proceedings within the scope of its investigation.

218. Regard may additionally be had to the fact that the power which is conferred upon the NFRA is available to be exercised only in respect of a particular class of bodies corporate or persons. Those are bodies

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

which are specified in Rule 3 of the NFRA Rules. The statute thus insofar as entities falling within the ambit of Rule 3 are concerned clearly removes such cases from the remit of any other council or body which could have under a pre-existing law investigated or initiated disciplinary action. One also cannot possibly ignore the non obstante clause which introduces sub-section (4) into the statute book and by virtue of which its provisions are ordained to apply notwithstanding any other law which may have been in force.

219. There is thus ample clarity with respect to the legislative intent which informs Section 132(4) and the NFRA having been conferred with an overriding power to initiate and take over enquiries and investigations. It is in this respect that the decision of the Supreme Court in *New India Assurance* assumes importance and which was an authority cited by Mr. Hossain in aid of his submission that Section 132(4) amounted to a mere change of forum. We find that Section 132(4) is fundamentally intended to confer an overarching authority upon the NFRA to investigate and enquire into matters relating to a particular class of bodies corporate and persons. Cases which are thus taken over by the NFRA would then be liable to be investigated by it exclusively. Such category of cases shall be liable to be tried only by that statutory authority.

220. However, and as was observed earlier, NFRA does not assume authority for the purposes of enquiring into a newly created specie of misconduct. Misconduct continues to be an act as defined by Section 22 of the CA Act. It is only the enquiry which would now be undertaken by the NFRA and which represents the new forum for the aforesaid

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

purpose. In *New India Assurance* the Supreme Court had observed that amendments of procedure which may compel one to institute an action before a newly minted forum would not be unconstitutional. Their Lordships had pertinently observed that what vests in an individual is *"a right of action but not a vested right of forum"*. Of course, whether the procedure prescribed under the amended regime is fair, reasonable and does not cause prejudice is a separate issue altogether and the challenge mounted on that score by the writ petitioners is presently kept aside and shall be dealt with in the latter parts of this judgment.

221. However, the aforesaid discussion is liable to be appreciated subject to the following caveat. Our understanding of the imperatives underlying the introduction of Section 132(4) and which stands elucidated in the immediately preceding paragraphs was in the context of the broad challenge to the validity of that section which was addressed before us. This we state since NFRA has taken a principled stand that it does not propose to subject any firm or LLP to an action referrable to Section 132(4) for an audit undertaken prior to October 2018. Our observations rendered hereinabove are thus liable to be appreciated solely from the perspective of the foundational validity of that provision and which could extend to firms and LLPs' for audits undertaken after the date when the section came into being.

222. That then takes us to the argument based on Article 20(1) of the Constitution and in terms of which it was sought to be contended that Section 132(4) is an ex post facto law and creates a punishment for an act or omission which had occurred prior to its enforcement. Controverting the submissions that were advanced by the petitioners,

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

Mr. Hossain had cited for our consideration the decision of the Supreme Court in *Shiv Dutt***.** The decision assumes significance in view of how the Supreme Court construed offences and punishment in the context of Article 20. In *Shiv Dutt* it was held that a penalty imposed under a Sales Tax legislation is only a civil liability albeit having the attributes of being penal. However, the Supreme Court held that such penalties would not fall within the ken of Article 20(1) and which would have to be narrowly interpreted as relating to a payment made in the context of deprivation of liberty or as a consequence of a finding of guilt coming to be returned against a person accused of a crime.

223. The principle that a civil liability would not fall within the meaning of the word offense as it appears in Article 20(1) of the Constitution came to be reiterated by a Constitution Bench of the Supreme Court in **Hathising Manufacturing Co. Ltd. vs. Union of India**[65], with Shah J. observing as under:-

> **27.** For reasons already set out, payment of compensation and wages in lieu of notice under the impugned section are not made conditions precedent to effective termination of employment. The section only creates a right in the employees : it does not enjoin the employers to do anything before closure. Section 31(2) of the Act which imposes penal liability for contravention of the provisions of the Act can therefore have no application to failure to make payment of compensation and wages for the period of notice under Section 25-FFF(1). The amending Act was, it is true, passed in June 1957, and liability to pay compensation arises in respect of all undertakings closed on or after November 28, 1956. But, if liability to pay compensation is not a condition precedent to closure, by failing to discharge the liability to pay compensation and wages in lieu of notice, the employer does not contravene Section 25-FFF(1). A statute may prohibit or command an act and in either case, disobedience thereof will amount to contravention of the statute. If the statute fixes criminal liability for contravention of the prohibition or the command which is made applicable to transactions which have taken place before the date of

[65] AIR 1960 SC 923

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> its enactment the protection of Article 20(1) may be attracted. But Section 25-FFF(1) imposes neither a prohibition nor a command. Under Section 25-F, there is a distinct prohibition against an employer against retrenching employees without fulfilling certain conditions. Similar prohibitions are found in Sections 22 and 23 of the Act. If this prohibition is infringed, evidently, criminal liability may arise. But there being no prohibition against closure of business without payment of compensation, Section 31(2) does not apply. By Section 33(*c*) liability to pay compensation may be enforced by coercive process, but that again does not amount to infringement of Article 20(1) of the Constitution. Undoubtedly for failure to discharge liability to pay compensation, a person may be imprisoned, under the statute providing for recovery of the amount e.g., the Bombay Land Revenue Code, but failure to discharge a civil liability is not, unless the statute expressly so provides, an offence. The protection of Article 20(1) avails only against punishment for an act which is treated as an offence, which when done was not an offence."

224. This position came to be reaffirmed by the Supreme Court in **Securities and Exchange Board of India vs. Ajay Agarwal**[66] and which again held that a penalty imposed in the context of adjudicatory proceedings would not fall within the ambit of Article 20(1) of the Constitution. While reiterating the legal position which had been enunciated in **Rao Shiv Bahadur Singh vs. State of Vindhya Pradesh**[67], the Supreme Court held that even if penalty had come to be imposed in the context of adjudicatory proceedings, Article 20(1) would have no application since the person foisted with the penalty cannot be called an accused. We deem it apposite to extract the following paragraphs from the decision in *Ajay Agarwal*:

> "**24.** The right of a person of not being convicted of any offence except for violation of a law in force at the time of the commission of the act charged as an offence and not to be subjected to a penalty greater than that which might have been inflicted under the law in force at the time of the commission of the offence, is a fundamental right guaranteed under our Constitution only in a case where a

[66] (2010) 3 SCC 765
[67] (1953) 2 SCC 111

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

person is charged of having committed an "offence" and is subjected to a "penalty".

xxxx xxxx xxxx

26. The word "offence" under Article 20, sub-clause (1) of the Constitution has not been defined under the Constitution. But Article 367 of the Constitution states that unless the context otherwise requires, the General Clauses Act, 1897 shall apply for the interpretation of the Constitution as it does for the interpretation of an Act.

27. If we look at the definition of "offence" under the General Clauses Act, 1897 it shall mean any act or an omission made punishable by any law for the time being in force. Therefore, the order of restrain for a specified period cannot be equated with punishment for an offence as has been defined under the General Clauses Act.

28. Under the Criminal Procedure Code, "offence" has been defined under Section 2(*n*) as follows:

> "2. (*n*) 'offence' means any act or omission made punishable by any law for the time being in force and includes any act in respect of which a complaint may be made under Section 20 of the Cattle-Trespass Act, 1871 (1 of 1871);"

29. On a comparison of the aforesaid two definitions we find that there are common links between the two. An offence would always mean an act of omission or commission which would be punishable by any law for the time being in force.

30. Article 20(1) was interpreted by the Court in *Rao Shiv Bahadur Singh* v. *State of Vindhya Pradesh* [(1953) 2 SCC 111 : AIR 1953 SC 394 : 1953 Cri LJ 1480] . Jagannadha Das, J. speaking for the Constitution Bench, on a comparison of similar provisions in English law and the American Constitution, opined that the language used in Article 20 is in much wider terms. This Court held that: (AIR p. 398, para 8)

> "*8*. … what is prohibited is the conviction of a person or his subjection to a penalty under 'ex post facto' laws. The prohibition under the article is not confined to the passing or the validity of the law, but extends to the conviction or the sentence and is based on its character as an 'ex post facto' law."

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

The ratio of this judgment has again been affirmed in *State of W.B.* v. *S.K. Ghosh* [AIR 1963 SC 255 : (1963) 1 Cri LJ 252] , wherein another Constitution Bench of this Court speaking through Wanchoo, J., as His Lordship then was, held that a forfeiture by a District Judge under Section 13(3) of the Criminal Laws Amendment Ordinance of 1944 cannot be equated to a forfeiture under Section 53 IPC inasmuch as forfeiture under Section 13(3) of the Ordinance involved embezzlement of government money or property and the same is not a punishment or penalty within the meaning of Article 20(1) of the Constitution (see paras 14 and 15 of the judgment).

31. Even if penalty is imposed after an adjudicatory proceeding, persons on whom such penalty is imposed cannot be called an accused. It has been held that proceedings under Section 23(1-A) of the Foreign Exchange Regulation Act, 1947 are adjudicatory in character and not criminal proceedings [see *Director of Enforcement* v. *MCTM Corpn. (P) Ltd.* [(1996) 2 SCC 471 : 1996 SCC (Cri) 344]]. Persons who are subjected to such penalties are also not entitled to the protection under Article 20(1) of the Constitution.

32. Following the aforesaid ratio, this Court cannot hold that protection under Article 20(1) of the Constitution in respect of ex post facto laws is available to the respondent in this case.

33. If we look at the legislative intent for enacting the said Act, it transpires that the same was enacted to achieve the twin purposes of promoting orderly and healthy growth of securities market and for protecting the interest of the investors. The requirement of such an enactment was felt in view of substantial growth in the capital market by increasing the participation of the investors. In fact such enactment was necessary in order to ensure the confidence of the investors in the capital market by giving them some protection.

34. The said Act is pre-eminently a social welfare legislation seeking to protect the interests of common men who are small investors. It is a well-known canon of construction that when the court is called upon to interpret provisions of a social welfare legislation the paramount duty of the court is to adopt such an interpretation as to further the purposes of law and if possible eschew the one which frustrates it. Keeping this principle in mind if we analyse some of the provisions of the Act it appears that the Board has been established under Section 3 as a body corporate and the powers and

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

functions of the Board have been clearly stated in Chapter IV and under Section 11 of the said Act."

225. In **Yogendra Kumar Jaiswal vs. State of Bihar**[68], the Supreme Court was faced with a similar challenge contained in a statute promulgated by the Legislature of the State of Orissa and which had contemplated confiscation of properties. Following the line of precedents rendered in the context of Article 20(1), the Supreme Court held that confiscation was clearly not a punishment which would attract Article 20(1). We extract the following passages from that decision hereinbelow:

> **"147.** The next facet of the said submission pertains to retrospective applicability. The submission has been put forth on the ground that by transfer of cases to the Special Courts under the Orissa Act in respect of the accused persons who are arrayed as accused under the 1988 Act, have been compelled to face harsher punishment which is constitutionally not permissible. It is contended that there was no interim confiscation under the 1988 Act but under the Orissa Act they have to face confiscation. We have already opined that confiscation is not a punishment and, therefore, Article 20(1) is not attracted. Thus, the real grievance pertains to going through the process of confiscation and suffering the same after the ultimate adjudication of the said proceeding which is subject to appeal. In this context we are required to see the earlier provision. The 1988 Act provides for applicability of the Criminal Law (Amendment) Ordinance, 1944. Section 2 refers to "interpretation" and in sub-section (1) it is stipulated that "schedule offence" in the Ordinance means an offence specified in the Schedule to the Ordinance; Section 3 deals with the application for attachment of property; Section 4 provides for ad interim attachment; Section 5 deals with investigation of objections to attachment; Section 6 provides for attachment of property of mala fide transferees; Section 7 stipulates how execution of orders of attachment shall take place; Section 8 provides for security in lieu of attachment and Section 9 deals with administration of attached property. Section 10 deals with duration of attachment and Section 11 provides for appeals. Section 13 deals with disposal of attached property upon termination of criminal proceedings. Section 13(3) reads as follows:

[68] (2016) 3 SCC 183

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

> "13. (3) Where the final judgment or order of the criminal courts is one of conviction, the District Judge shall order that from the property of the convicted person attached under this Ordinance or out of the security given in lieu of such attachment, there shall be forfeited to the Government such amount or value as is found in the final judgment or order of the criminal courts in pursuance of Section 12 to have been procured by the convicted person by means of the offence, together with the costs of attachment as determined by the District Judge and where the final judgment or order of the criminal courts has imposed or upheld a sentence of fine on the said person (whether alone or in conjunction with any other punishment), the District Judge may order, without prejudice to any other mode of recovery, that the said fine shall be recovered from the residue of the said attached property or of the security given in lieu of attachment."

148. The learned counsel for the appellants would submit that under the 1988 Act the accused were liable to face attachment during trial and forfeiture after conviction but by virtue of the Orissa Act they are compelled to face confiscation as a consequence of which they are deprived of the possession and the property goes to the State Government. The learned counsel for the State would submit that the forfeiture is provided after the conviction as the property has to be forfeited and embezzled amount requires to be realised but it does not debar the legislature to provide confiscation of property as an interim measure by providing an adequate adjudicatory process. It is also submitted that the offence under Section 13(1)(*e*) has its gravity and, therefore, the stringent interim measure is the requisite. Alternatively, it is argued that when forfeiture was prescribed, and attachment of property was provided as an interim measure, different arrangement, may be a stringent one, can always be provided by the legislature.

149. We have already held that confiscation is not a punishment and hence, Article 20(1) is not violated. The learned counsel for the State would lay stress on the decision in *State of A.P.* v. *Gandhi* [*State of A.P.* v. *Gandhi*, (2013) 5 SCC 111 : (2013) 2 SCC (Cri) 884] . In that case, the issue that arose for consideration was : when the disciplinary proceeding was initiated one type of punishment was imposable and when the punishment was imposed due to amendment of rule, a different punishment, which was a greater one, was imposed. The High Court opined that the punishment imposed under the amended rule amounted to imposition of two major penalties which was not there in the old rule. Dealing with the issue

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

the Court referred to the rule that dealt with major penalties and the rule-making power. Reference was made to the decision in *Pyare Lal Sharma* v. *J&K Industries Ltd.* [*Pyare Lal Sharma* v. *J&K Industries Ltd.*, (1989) 3 SCC 448 : 1989 SCC (L&S) 484] wherein it has been stated that no one can be penalised on the ground of a conduct which was not penal on the date it was committed. Thereafter, the two-Judge Bench referred to the authority in *K. Satwant Singh* v. *State of Punjab* [*K. Satwant Singh* v. *State of Punjab*, AIR 1960 SC 266 : 1960 Cri LJ 410] wherein it has been held thus : (*Gandhi case* [*State of A.P.* v. *Gandhi*, (2013) 5 SCC 111 : (2013) 2 SCC (Cri) 884] , SCC pp. 133-34, para 46)

> *"46.* … '*28.* … In the present case a sentence of imprisonment was, in fact, imposed and the total of fines imposed, whether described as 'ordinary' or 'compulsory', was not less than the amount of money procured by the appellant by means of his offence. Under Section 420 of the Penal Code an unlimited amount of fine could be imposed. Article 20(1) of the Constitution is in two parts. The first part prohibits a conviction of any person for any offence except for violation of law in force at the time of the commission of the act charged as an offence. The latter part of the article prohibited the imposing of a penalty greater than that which might have been inflicted under the law in force at the time of the commission of the offence. The offence with which the appellant had been charged was cheating punishable under Section 420 of the Penal Code which was certainly a law in force at the time of the commission of the offence. The sentence of imprisonment which was imposed upon the appellant was certainly not greater than that permitted by Section 420. The sentence of fine also was not greater than that which might have been inflicted under the law which had been in force at the time of the commission of the offence, as a fine unlimited in extent could be imposed under the section.'" (*K. Satwant Singh case* [*K. Satwant Singh* v. *State of Punjab*, AIR 1960 SC 266 : 1960 Cri LJ 410] , AIR p. 275, para 28)

150. Thereafter, the Court referred to *Maya Rani Punj* v. *CIT* [*Maya Rani Punj* v. *CIT*, (1986) 1 SCC 445 : 1986 SCC (Tax) 220] , *K. Satwant Singh* [*K. Satwant Singh* v. *State of Punjab*, AIR 1960 SC 266 : 1960 Cri LJ 410] and *Tiwari Kanhaiyalal* v. *CIT* [*Tiwari Kanhaiyalal* v. *CIT*, (1975) 4 SCC 101 : 1975 SCC (Cri) 312 : 1975 SCC (Tax) 214] and eventually held : (*Gandhi case* [*State of A.P.* v. *Gandhi*, (2013) 5 SCC 111 : (2013) 2 SCC (Cri) 884] , SCC p. 135, para 51)

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> "*51*. … The order of compulsory retirement is a lesser punishment than dismissal or removal as the pension of a compulsorily retired employee, if eligible to get pension under the Pension Rules, is not affected. Rule 9(*vii*) was only dealing with reduction or reversion but issuance of any other direction was not a part of it. It has come by way of amendment. The same being a lesser punishment than the maximum, in our considered opinion, is imposable and the disciplinary authority has not committed any error by imposing the said punishment, regard being had to the nature of charges. It can be looked from another angle. The rule-making authority has split Rule 9(*vii*) into two parts—one is harsher than the other, but, both are less severe than the other punishments, namely, compulsory retirement, removal from service or dismissal. The reason behind it, as we perceive, is not to let off one with simple reduction but to give a direction about the condition of pay on restoration and also not to impose a harsher punishment which may not be proportionate. In our view, the same really does not affect any vested or accrued right. It also does not violate any constitutional protection."

151. We are absolutely conscious that the said judgment was delivered in a different context. What is prohibited under Article 20(1) is imposition of greater punishment that might have been imposed and prohibition of a conviction of any person for violation of law at the time of commission of the act. We repeat at the cost of repetition that confiscation being not a punishment does not come in either of the categories. Thus viewed, the property of an accused facing trial under the 1988 Act could be attached and there can be administration by third party of the said property and eventual forfeiture after conviction. The term "attachment" has been understood by this Court in *Kerala State Financial Enterprises Ltd.* v. *Official Liquidator* [*Kerala State Financial Enterprises Ltd.* v. *Official Liquidator*, (2006) 10 SCC 709] in the following manner : (SCC p. 713, para 11)

> "*11*. The word 'attachment' would only mean 'taking into the custody of the law the person or property of one already before the court, or of one whom it is sought to bring before it'. It is used for two purposes : (*i*) to compel the appearance of a defendant; and (*ii*) to seize and hold his property for the payment of the debt. It may also mean prohibition of transfer, conversion, disposition or movement of property by an order issued by the court."

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> **152.** The legislature has thought it proper to change the nature and character of the interim measure. The property obtained by ill-gotten gains, if prima facie found to be such by the authorised officer, is to be confiscated. An accused has no vested right as regards the interim measure. He is not protected by any constitutional right to advance the plea that he cannot be made liable to face confiscation proceedings of the property which has been accumulated by illegal means. That being the litmus test, the filament of reasoning has to rest in favour of confiscation and not against it. Therefore, we are of the considered view that the provision does not violate any constitutional assurance."

226. The precedents thus rendered in the context of Article 20(1) clearly appear to exclude civil liabilities or penalties that may come to be imposed from the ambit of that constitutional prohibition. The scope of Article 20(1) has thus been consistently explained to be confined to crimes and punishments as generally understood. In any event, an act of professional misconduct was liable to be penalised and punishment meted out even earlier and had existed as such decades prior to the insertion of Section 132 in the Companies Act. Section 132, as noticed hereinabove, merely adopts the meaning assigned to misconduct by the CA Act for the purposes of proceedings that may be initiated thereunder. The argument based on Article 20(1) is thus liable to be rejected on this score alone.

227. We thus come to the conclusion that the present case does not fall within the ambit of Article 20(1) as it neither involves the creation of a new offence nor the imposition of a criminal penalty with retrospective effect. The disciplinary consequences for professional misconduct had always existed under the CA Act and Section 132 merely reinforces and formalizes the enforcement framework without altering the substantive nature of misconduct. Since Article 20(1)

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

applies exclusively to criminal offences and punishments, and the present case pertains to civil and regulatory disciplinary proceedings, its invocation is clearly misconceived. Moreover, professional misconduct was always subject to scrutiny and Section 132 does not introduce an unprecedented liability but only refines the mechanism for inquiry and enforcement. Thus, the challenge based on Article 20(1) is without merit.

228. While it is true that the monetary penalties that are imposed by Section 132(4) could exceed those which were prescribed under the CA Act, the challenge so raised in any case remains of little significance in light of the statement made by Mr. Hossain and who had submitted that no monetary penalties exceeding INR 5 Lakhs would be imposed in respect of any audit conducted prior to 2018.

229. Regard must also be had to the fact that the debarment which may come to be imposed upon a member or the firm could run for a minimum period of six months or such higher period not exceeding ten years as may be determined by the NFRA. This may be contrasted with the position which prevails under the CA Act and contemplates the name of a CA or an auditor being removed permanently from the register of members. The removal from the register thus had the potential of depriving a CA from practicing the profession for all times to come. The punishment thus which has now come to be introduced clearly cannot be said to be greater than that which could have been imposed under the CA Act.

NFRA RULES : LACK OF PROCEDURAL SAFEGUARDS

230. The validity of Section 132(4) as well as the procedure adopted

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

by the NFRA was then assailed on the ground of the latter having deprived the petitioners of various significant rights and procedural safeguards which were otherwise provisioned for under the CA Act and the subordinate rules governing the conduct of disciplinary proceedings. It was submitted that the Act as well as the NFRA Rules merely provide for that authority evolving such procedure as may be considered expedient in the facts of a particular case. The statute, the petitioners argued, neither lays in place a codified procedure for the conduct of disciplinary proceedings nor do its provisions provide any guidance to the NFRA to adhere to a procedure which would be commensurate with the constitutional imperatives of fairness and natural justice. Our attention was also drawn to Rule 11(5) with the petitioners highlighting the fact that the said rule merely enjoins a division of the NFRA to dispose of the SCN proceedings through a summary procedure albeit while adhering to the principles of natural justice.

231. The note submitted by DHS enclosed a chart which sought to highlight the substantive differences between the disciplinary procedure as existing under the CA Act with how proceedings would unfold under the NFRA Rules. That chart is reproduced hereinbelow:-

"**COMPARATIVE CHART – ICAI AND NFRA**

Sr. No.	**Board of Discipline of ICAI ("Board")**	**Disciplinary Committee of ICAI ("Committee")**	**NFRA**
1.	Receipt of the *prima facie* opinion formed by the Director upon receipt and examination of a	Receipt of *prima facie* opinion formed by the Director upon receipt and examination of a	Receipt of matter by the Investigation Division upon receiving any reference from and the central

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

	complaint under Rule 9. **[Rule 14(1)]**	complaint under Rule 9. **[Rule 18(1)]**	government, or on the basis of NFRA's oversight activities or *suo motu* investigation and issue show-cause notice. **[Rule 10(1) and Rule (11)1]**
2.	Written Statement to be submitted by the person against whom the complaint is made. **[Rule 14(3)]**	Written Statement to be submitted by the person against whom the complaint is made **[Rule 18(3)]**	
3.	Provision for additional time to submit the written statement. **[Rule 14(4)]**	Provision for additional time to submit the written statement **[Rule 18(3)]**	
4.	4. Rejoinder to the Written Statement. **[Rule 14(5)]**	Rejoinder to the Complaint **[Rule 18(5)]**	
5.	Hearing (including the right to be represented by an advocate, or any Authorized representative who may be a CA, Cost Accountant or Company Secretary) **[Rule 14(6)]**	Hearing (including the right to be represented by an advocate, or any Authorized representative who may be a CA, Cost Accountant or Company Secretary) **[Rule 18(6)]**	Discretion to grant an opportunity for being heard in person. **[Rule 11(5)]** NFRA has by its letter dated 10th June, 2020 interpreted the term 'in person' hearing to mean a hearing where only the person himself/herself can appear and make submissions and has accordingly expressly denied the right to

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

			being represented by an authorized representative.
6.	-	Framing of charges and response by the respondent to charges framed. **[Rule 18(7)]**	-
7.	-	Recording of the plea of the respondent. **[Rule 18(8)]**	-
8.	-	Fixing of date for examination of witnesses and production of documents **[Rule 18(9)]**	-
9.	-	Power to issue notice to any witnesses along with directions to attend or produce any documents or material evidence (on an application from the Director) **[Rule 18(10)]**	-
10.	-	Evidence to be given by the Director. (Discretion to permit cross-examination of any witnesses or re-call of any witness for further cross-examination.) **[Rule 18(11)]**	-
11.	-	Opportunity to the complainant to present evidence **[Rule 18(12)]**	-
12.	-	Evidence to be given by the Respondent. **[Rule 18(13)]**	-

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

13.	-	Power to issue notice to any witnesses along with directions to attend or produce any documents or material evidence (on an application from the Respondent) **[Rule 18(14)]**	-
14.	-	After presentation of Evidence, arguments to be made before the Committee by the Director, Respondent and the Complainant. **[Rule 18(16)]**	-
15.	Discretion to serve of fresh notice, in case the person against whom the complaint is made does not appear for the hearing. **[Rule 14(7)]**		-
16.	Power to adjourn the proceedings at any stage. **[Rule 14(8)]**	Power to adjourn the proceedings at any stage **[Rule 18(18)]**	-
17.	Further, if the Board arrives at a finding that the respondent is guilty of professional or other misconduct a further opportunity is given to the respondent to be heard before such an order is passed. **[Rule 15]**	Further, if the Committee arrives at a finding that the respondent is guilty of professional or other misconduct a further opportunity is given to the respondent to be heard before such an order is passed. **[Rule 19]**	-

"

232. DHS also sought to underscore the salient and salutary

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

procedural safeguards which guided the Council as well as other similar regulatory bodies including the PCAOB and FRC. The chart which was placed for our consideration in this regard is extracted below:-

"**Procedure followed in disciplinary proceedings against Chartered Accountants prior to imposing sanctions**

Procedure	ICAI		PCAOB	FRC
	Board of Discipline of ICAI ("Board")[69]	**Disciplinary Committee of ICAI ("Committee")**[70]		
Initiation of proceedings	If the Board agrees with the *prima facie* opinion of the Director that the member of firm is guilty of misconduct under 1st Schedule of CA Act it may proceed with disciplinary proceedings. **[Rule 9 (2) (b) of ICAI Rules]** If the Board disagrees with the *prima facie* opinion of the Director that the member or the firm is not	If the Committee agrees with the *prima facie* opinion of the Director that the member of firm is guilty of misconduct under 1st and 2nd Schedule or 2nd Schedule of CA Act it may proceed with disciplinary proceedings. **[Rule 9 (2) (b) of ICAI Rules]** If the Board disagrees with the *prima facie* opinion of the Director that the member or the firm is not guilty of any is conduct then it	Board may initiate Disciplinary proceedings as a result of investigation or otherwise. **[Rule 5200 (a) of PCAOB Rules]**	If the Enforcement Committee finds the Respondent liable for Enforcement action it shall issue a Decision Notice. If the respondent does not agree with the Decision Notice the matter is referred for hearing before a Tribunal **[Rule 26 of FRC Audit Enforcement Procedure]**

[69] Conducts disciplinary proceedings in relation to offences under Schedule 1 of the Chartered Accountants Act, 1949.
[70] Conducts proceeding in relation to offences under Schedule 2 of the Chartered Accountants Act, 1949.

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

	guilty of any misconduct then it may proceed with disciplinary proceedings. **[Rule 9 (3) (b) of ICAI Rules]**	may proceed with disciplinary proceedings. **[Rule 9 (3) (b) of ICAI Rules]**		
Notice	The Board shall Expeditiously cause to deliver to the respondent and the complainant a copy of the following: (a) *Prima facie* opinion of the Director; and (b) Particulars of forming documents relied upon by the Director, if any, for forming p*rima facie* opinion. **[Rule 14 (2) of ICAI Rules]**	The Committee shall cause to deliver to the response and the complainant a copy of the following: (a) *Prima facie* opinion of the Director; and (b) Particulars of documents relied upon by the Director, if any, for forming *prima facie* opinion. **[Rule 18 (2) of ICAI Rules]**	A copy of the Order instituting proceedings shall be issued by the Board which shall include a which statement of matters of fact and law to be considered and determined with respect to each person charged including the conduct alleged to have violated the Act and the rule, statute or standard violated. **[Rule 5201 (a) and (b) of PCAOB Rules]**	Where the Tribunal is to hold a hearing, the notice of hearing shall state: (a) Date, time and venue; (b) Allegation s; (c) Warning that the Tribunal may proceed with the hearing in the absence of any party. **[Rule 34 of FRC Audit Enforcement Procedure]**
Reply	The respondent	The respondent shall file a	A party may be required	

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

	shall file a written statement within such time as may be specified by the Board. **[Rule 14 (3) of ICAI Rules]**	written statement within such time as the Committee may specify. **[Rule 18 (3) of ICAI Rules]**	by the Board *vide* the order instituting proceedings or a party may elect to file an answer to each of the allegations levelled in the order instituting proceedings. The reply shall be filed within 20 days after service of the order instituting proceedings unless additional time has been granted. **[Rule 5421 (a) and (b) of PCAOB Rules]**	
Rejoinder	The complainant or the Director may, after receipt of the written statement, submit a rejoinder to the Board with a copy to the respondent	The complainant or the Director may, after receipt of the written statement, submit a rejoinder to the Committee with a copy to the respondent	N.A.	N.A.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

	along with supporting documents, if any. **[Rule 14 (5) of ICAI Rules]**	along with supporting documents, if any. **[Rule 18 (5) of ICAI Rules]**		
Representation	The Director, respondent and complainant shall appear before the Board themselves or through an advocate or authorized representative who may be a CA, Cost Accountant or Company Secretary. **[Rule 14 (6) read With Explanation thereto of ICAI Rules]**	The Director, respondent and complainant shall appear before the Committee themselves or through an advocate or authorized representative who may be a CA, Cost Accountant or Company Secretary. **[Rule 18 (6) read with Explanation thereto of ICAI Rules]**	Person may represent oneself before the Board or a Hearing Officer or be represented by counsel. **[Rule 5401 (a) and (b) of PCAOB Rules]**	The respondent may represent themselves or be represented by a Solicitor or Counsel or another person at the discretion of the Chair or Tribunal provided the person is not a witness in the case, a member or employee of FRC. **[Rule 53 of FRC Audit Enforcement Procedure]**
Hearing	The Presiding Officer of the Board shall fix a date, hour and place of hearing, not later than 45 days from date of receipt of *prima facie* opinion. **[Rule 14 (6) of ICAI Rules]**	The Presiding Officer of the Committee shall fix a date, hour and place of hearing, not later than 45 days from date of receipt of *prima facie* opinion. **[Rule 18 (6) of ICAI Rules]**	In an informal inquiry the Director of Enforcement and Investigations may request documents, testimony, information or an interview with any	The Tribunal shall consider any preliminary legal arguments; the respondent shall indicate whether any admissions are made; Executive Council shall open the case and call

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

			person. **[Rule 5100 (b) of PCAOB Rules]**	evidence in support; the respondent may open his case and call evidence in support; subject to Rule 54, the Tribunal shall announce its decision **[Rule 53 of FRC Audit Enforcement Procedure]**
Evidence	Summary procedure and therefore no provision for leading evidence. The Board shall consider the written Representations including written statements, rejoinder and supporting documents and oral submissions and arrive at its finding on whether the respondent is guilty or not of professional or other misconduct.	If at the first hearing the respondent does not plead guilty, the Committee shall fix a date for examination of witnesses and production of documents. On the date so fixed the Committee shall proceed to take evidence produced by the Director including oral examination of witnesses and production of documents. The Committee may permit cross examination of witnesses. After presenting of	A party may present its case or defence by oral or Documentary evidence, submit rebuttal evidence, and conduct such cross-examination as determined by the Board or the Hearing Officer. **[Rule 5444 of PCOAB Rules]**	The Tribunal has discretion to allow a party to adduce Written evidence or call a witness at a hearing which has not been disclosed in accordance with the Rules or at the Case Management Direction. Witnesses shall first be examined by the party calling them; may be cross examined and re-examined; may be questioned

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

	[**Rule 14 (1) read with Rule 14 (9) of ICAI Rules]**	evidence by the Director, the complainant shall be given an opportunity to present any additional evidence. Thereafter the respondent shall be called upon to enter his defence and produced his evidence. **[Rule 18 (9) to (13) of ICAI Rules]**		by the Tribunal. **[Rules 37 and 41 of FRC Audit Enforcement Procedure]**
Oral arguments	Oral arguments permitted at the hearing before the Board which shall be fixed within 45 days of the *prima facie* opinion. **[Rule 14 (6) of ICAI Rules]**	After the evidences have been presented the Director and respondent shall present their arguments before the Committee. **[Rule 18 (16) of ICAI Rules]**	Oral arguments permitted before the Board **[Rule 5463 of PCAOB Rules]**	Oral arguments permitted before the Tribunal **[Rule 53 of FRC Audit Enforcement Procedure]**
Post hearing submission	N.A.	N.A.	At the end of the hearing the Hearing Officer shall, after consulting the parties, prescribe a period within which post hearing briefs or other	N.A.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

			submissions are to be filed. **[Rule 5445 of PCAOB Rules]**	
Hearing prior to passing order imposing sanctions	N.A.	If the Committee finds the respondent guilty of professional or other misconduct the Committee shall, before passing any order, give the respondent an opportunity of being heard. **[Rule 19 (1) of ICAI Rules]**	N.A.	In the event of an adverse finding the Tribunal may receive evidence and submissions in respect of sanction. **[Rule 54 (b) of FRC Audit Rules of Procedure]**

"

Although a similar comparative table was placed for our consideration by SRBC, we do not propose to burden this judgment by reproducing that table here since the distinctions which are sought to be highlighted are identical to those which were pointed out by DHS.

233. The petitioners also laid emphasis on the provisions which existed under the CA Act and which enabled them to undertake cross - examination of witnesses, lead evidence, evidence in defense as well as the elaborate procedure of hearing which the Disciplinary Directorate, as well as the Board of Discipline were obliged to follow. All of this, according to the petitioners, has been completely done away with and replaced by a summary procedure and where a person or entity charged

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

with professional misconduct is restricted to construct a defense based solely on the audit record.

234. It was argued that the insistence of NFRA to restrict responses to the audit file clearly deprives the petitioners of the right to effectively respond to allegations of professional misconduct and causes immense prejudice. It was in this respect submitted that SA 230 and more particularly Para A7 thereof itself acknowledges the fact that it would neither be practicable nor is it necessary for an auditor to document every matter considered or professional judgment made. It was thus argued that since the SA itself takes note of the impracticality of every document being included and made part of the audit file, the restriction so placed by the NFRA is wholly arbitrary and illegal. It was then contended that the restriction of the disciplinary proceedings to the audit file is violative of Rule 11(5) itself and which speaks of the procedure being in consonance with the principles of natural justice, the respondents being obliged to provide an opportunity of hearing and on consideration of the submissions made by the auditor as well as all relevant facts and circumstances.

235. SRBC had additionally argued that the limitation of evidence to the audit file is an artificial restriction created by NFRA and cannot be sustained in light of Section 132(4)(b) read along with Rule 8(3) itself.

236. In order to appreciate the submissions so addressed, we deem it apposite to extract clauses (i), (iii) and (iv) of Section 132(4)(b) which read as follows:-

> "(i) discovery and production of books of account and other documents

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

xxxx xxxx xxxx

(iii) inspection of any books, registers and other documents of any person referred to in clause (b) at any place

(iv) issuing commissions for examination of witnesses or documents"

237. It becomes pertinent to note that Rule 8 though cited in this regard is principally concerned with the power of the NFRA to monitor and enforce compliance with auditing standards. Although not directly connected with disciplinary proceedings since the same was referred to, we only note that the argument essentially was that since the authority stands empowered to review working papers including audit plans, other audit documents and communications related to audit coupled with the power conferred upon the authority by Rule 8(3) enabling NFRA to call for and seek additional information or explanation in connection with the conduct of an audit, there exists no plausible justification for the defense of the auditor being confined to the audit file alone.

238. Resisting the aforesaid arguments, Mr. Hossain contended that the challenge based on the inquiry being restricted to the audit file documentation is thoroughly misconceived since the said limitation binds and operates upon the NFRA also. Quite apart from the above, Mr. Hossain submitted that not only Section 143(9) but the specific SAs themselves lay emphasis on the audit record being comprehensive and including all material forming part of the audit exercise itself. Reference in this respect was specifically made to the provisions contained in SA 230, SA 500 and SQC1. It was Mr. Hossain's submission that the essential purpose of all records pertaining to the

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

audit being preserved and maintained is to enable external inspection and review. It was submitted that the completeness of the audit file is an aspect which is duly highlighted and underscored by SA 230.

239. It was further submitted that in fact Para A5 of SA 230 itself provides that oral explanations that may be proffered by an auditor would not be liable to be taken into consideration nor would they "represent adequate support for the work auditor performed or conclusions the auditor reached". Oral explanations, Mr. Hossain submitted in terms of Para A5 can only be used to explain or clarify information contained in the audit documentation. It was thus submitted that the NFRA is clearly justified in restricting the enquiry proceedings to the audit file and excluding the introduction of additional evidence.

240. Mr. Hossain then contended that merely because the statute speaks of a summary procedure, the same cannot lead to a presumption being drawn that the proceedings would inevitably be in violation of the fundamental precepts of fair play or for that matter the principles of natural justice. Mr. Hossain submitted that such a course is adopted even by the PCAOB as would be evident from a reading of Rule 5427(d) which makes the following provisions:-

> "Rule 5427. Motion for Summary Disposition
>
> **xxxx xxxx xxxx**
>
> (d)Decision on Motion
>
> The hearing officer shall promptly grant a motion for summary disposition if the pleadings, depositions, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a disposition as a matter of law. A summary disposition, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to a sanction. A hearing officer's decision

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> to deny a motion for summary disposition is not subject to interlocutory appeal"

241. It was thus argued that since the only proof accepted is the audit file, a summary procedure can neither be said to be arbitrary nor violative of the basic principles of fair play which must imbue all actions of an administrative authority. Learned counsel in this context also relied upon the decision of the Hyderabad High Court in **Institute of Chartered Accountants of India vs. Mukesh Gang**[71] which while speaking of the procedure liable to be followed under the CA Act which respect to disciplinary proceedings had held as follows:-

> "43. One of the contentions urged by Sri Ashok Anand Kumar, learned counsel for the respondent, is that no evidence was recorded following the rules of evidence but, based on admission of the respondent, a finding was recorded. Undoubtedly, there is no specific procedure prescribed to be followed by the Disciplinary Committee to record its finding. The strict rules of evidence, under the Indian Evidence Act, and the elaborate procedure prescribed under the Code of Civil Procedure or the Criminal Procedure Code, are not applicable to proceedings before the Disciplinary Committee of the Institute except for a few provisions of the Code of Civil Procedure as stipulated under Section 21(8) of the Act. There is nothing in the Act, or in the Regulations, which disables the Committee from evolving its own procedure in conducting an enquiry into the misconduct alleged to have been committed by a member of the Institute. A questionnaire was sent, during the enquiry, eliciting answers from the respondent on 29.11.2008 at 10.10 a.m. in the office of the Institute at Chennai, and an opportunity was given to the respondent to explain the circumstances in which the certificate was issued by him. During questioning, the President of the Committee put a specific question What do you want to say in your defence? then the respondent gave the following answer:
>
> > I gave a certificate on 9th June, 1995 and on that date the cheques were deposited and because the cheques could not cleared on that day and subsequently I appeared before the SEBI they told me that you should have subsequently

[71] 2016 SCC OnLine Hyd 327

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> withdrawn the certificate if you had come to know that the cheques are not cleared. I told them that that is the work of Merchant Bank and they are monitoring the day to day movement of the funds. I cannot go and monitor the day to day movement of the funds in their Company and based on their track record whatever cheques they have earlier deposited got cleared that is only one time that Rs. 37 lacs cheques not cleared. That was the only plea which I took before the SEBI and I also taking before the Disciplinary Committee."

242. The aforesaid principles as enunciated in *Mukesh Gang*, according to Mr. Hossain, would, a fortiori, apply to disciplinary proceedings under the NFRA Rules. Mr. Hossain submitted that the degree of proof or evidence which is required in disciplinary proceedings that may be initiated by the NFRA, is not expected to meet the test of guilt being proven beyond reasonable doubt and which is the fundamental test governing criminal trials. Disciplinary proceedings, learned counsel submitted are concerned solely with preponderance of probabilities. It was submitted that other regulatory bodies including the PCAOB and the FRC also follow a similar criterion of deciding charges of professional misconduct based on persuasive evidence. Our attention in this respect was invited to Rule 5204 which guides the PCAOB in the conduct of disciplinary proceedings and is extracted hereunder:-

> "**Rule 5204. Determinations in Disciplinary Proceedings**
>
> **(a) Burden of Proof**
>
> In any disciplinary proceeding instituted pursuant to Rule 5200(a)(1), Rule 5200(a)(2), or Rule 5200(a)(3), the interested division shall bear the burden of proving an alleged violation or failure to supervise by a preponderance of the evidence. A respondent raising an affirmative defense shall bear the burden of proving that affirmative defense by a preponderance of the evidence.
>
> **(b) Initial Decision of a Hearing Officer**

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

Unless the Board directs otherwise, a hearing officer shall prepare an initial decision in any proceeding in which the Board directs a hearing officer to preside at a hearing. An initial decision shall include findings and conclusions, including sanctions, if appropriate, and the reasons or basis therefor, as to all the material issues of fact, law or discretion presented on the record and such other information as the Board may require.

Note: Unless the Board has directed otherwise, the Board expects hearing officers in proceedings instituted pursuant to Rule 5200(a)(1) or Rule 5200(a)(2) to prepare initial decisions within 60 days after the deadline for filing post-hearing briefs or other submissions; the Board expects hearing officers in proceedings instituted solely pursuant to Rule 5200(a)(3) to prepare initial decisions within 30 days after the deadline for filing post-hearing briefs; and the Board expects hearing officers in proceedings pursuant to Rule 5500 to prepare initial decisions within 45 days after the deadline for filing post-hearing briefs or other submissions.

(c) Filing, Service and Publication

The hearing officer shall file the initial decision with the Secretary. The Secretary shall promptly serve the initial decision upon the parties. In a public proceeding, the Secretary shall as soon as practicable thereafter publish the initial decision, unless the Board otherwise directs.

(d) When Final

(1) An initial decision as to a party shall become the final decision of the Board as to that party upon issuance of a notice of finality by the Secretary.

(2) Subject to subparagraph (3) of this paragraph, the Secretary shall issue a notice of finality no later than 20 days after the lapsing of the time period for filing a petition for review of the initial decision.

(3) The Secretary shall not issue a notice of finality as to any party

(i) who has filed a timely petition for review; or

(ii) with respect to whom the Board has ordered review of the initial decision pursuant to Rule 5460(b).”

243. It was then contended that it would be wholly incorrect to seek similarity in the procedure that was prescribed under the CA Act with the Rules which regulate the conduct of disciplinary proceedings by the

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

NFRA. It was submitted that the Council under the CA Act is also enjoined to try complaints that may be made against members. NFRA proceedings on the other hand, it was explained, are merely concerned with monitoring the quality of service related to the audit. Those proceedings, Mr. Hossain submitted, can be initiated either suo moto or upon a reference being received by the NFRA from an appropriate authority. Viewed in that light, it was his contention, that it would be wholly incorrect to view the disciplinary proceedings as being adversarial and consequently obliging the NFRA to factor in an opportunity of cross-examination or recordal of evidence.

244. It was lastly urged that a statute is not rendered unconstitutional merely if it fails to stipulate a procedure or prescribe a code for the conduct of disciplinary proceedings. The submission was that as long as an authority adheres to a procedure which is reasonable and compliant with the principles enshrined in Article 14 of the Constitution, the statute itself would not be liable to be struck down. Reliance in this respect was placed upon a decision handed down by a Division of the Court in **Reckitt Benckiser India Private Limited vs. Union of India Through: Its Secretary & Ors**[72] where the Court had observed as under:-

> "125. It is also well-established that where a power exists to prescribe a procedure and such power has not been exercised, the implementing authorities are at liberty to determine and adopt such procedure as they may deem fit subject to the same being fair and reasonable. In *Dhanjibhai Ramjibhai* v. *State of Gujarat*[(1985) 2 SCC 5.] , the Supreme Court has held, "… Merely because procedural rules have not been framed does not imply a negation of the power. In the absence of such rules, it is sufficient that the power

[72] 2024 SCC OnLine Del 3649

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

is exercised fairly and reasonably, having regard to the context in which the power has been granted….". In *Chairman and MD, BPL Ltd.* v. *S.P. Gururaja* [(2003) 8 SCC 567.] , the Supreme Court has held, "…Under the Act or the Regulations framed thereunder, no procedure for holding such consultations had been laid down. In that situation it was open to the competent authorities to evolve their own procedure. Such a procedure of taking a decision upon deliberations does not fall foul of article 14 of the Constitution of India.

126. Consequently, rule 126 of the Rules, 2017 to the extent it grants flexibility to NAA to determine the methodology and procedure to decide whether reduction in rate of tax or benefit of input-tax credit has been passed on or not to the recipient is reasonable and legal. Moreover, as per rule 126 NAA "may determine" the methodology and not "prescribe" it. The substantive provision, i.e., section 171 of the Act, 2017 itself provides sufficient guidance to NAA to determine the methodology on a case by case basis depending upon peculiar facts of each case and the nature of the industry and its peculiarities. Consequently, so long as the methodology determined by NAA is fair and reasonable, the petitioners cannot raise the objection that the specifics of the methodology adopted are not prescribed."

245. This would constitute an appropriate juncture to additionally notice some of the decisions that were cited for our consideration by respective sides. From the side of the writ petitioners reliance was firstly placed on an **Advocate vs. Bar Council of India**[73] and where the Supreme Court while examining Section 35 of the Advocates Act had held as follows:-

"4. At this juncture, it is appropriate to articulate some basic principles which must inform the disciplinary proceedings against members of the legal profession in proceedings under Section 35 of the Advocates Act, read with the relevant Rules:

"(*i*) essentially the proceedings are quasi-criminal in character inasmuch as a member of the profession can be visited with penal consequences which affect his right to practise the profession as also his honour; under Section 35(3)(*d*) of the Act, the name of the advocate found guilty of professional or other misconduct can be removed from the State Roll of Advocates. This extreme penalty is

[73] 1989 Supp (2) SCC 25

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

equivalent of death penalty which is in vogue in criminal jurisprudence. The advocate on whom the penalty of his name being removed from the roll of advocates is imposed would be deprived of practising the profession of his choice, would be robbed of his means of livelihood, would be stripped of the name and honour earned by him in the past and is liable to become a social apartheid. A disciplinary proceeding by a statutory body of the members of the profession which is statutorily empowered to impose a punishment including a punishment of such immense proportions is quasi-criminal in character;

(*ii*) as a logical corollary it follows that the Disciplinary Committee empowered to conduct the enquiry and to inflict the punishment on behalf of the body, in forming an opinion must be guided by the doctrine of benefit of doubt and is under an obligation to record a finding of guilt only upon being satisfied beyond reasonable doubt. It would be impermissible to reach a conclusion on the basis of preponderance of evidence or on the basis of surmise, conjecture or suspicion. It will also be essential to consider the dimension regarding mens rea."

This proposition is hardly open to doubt or debate particularly having regard to the view taken by this Court in *L.D. Jaisinghani* v. *Naraindas N. Punjabi* [(1976) 1 SCC 354] wherein Ray, C.J., speaking for the Court has observed: (SCC p. 358, para 9)

> "In any case, we are left in doubt whether the complainant's version, with which he had come forward with considerable delay was really truthful. *We think that in a case of this nature, involving possible disbarring of the advocate concerned, the evidence should be of a character which should leave no reasonable doubt about guilt.* The Disciplinary Committee had not only found the appellant guilty but had disbarred him permanently."

(emphasis added)

(*iii*) in the event of a charge of negligence being levelled against an advocate, the question will have to be decided whether negligence simpliciter would constitute misconduct. It would also have to be considered whether the standard expected from an advocate would have to answer the test of a reasonably equipped prudent practitioner carrying reasonable workload. A line will have to be drawn between tolerable negligence and culpable negligence in the sense of negligence which can be treated as professional misconduct exposing a member of the profession to punishment in the course of disciplinary proceedings. In forming the opinion on this question the standards of professional conduct and etiquette spelt out in Chapter 2 of Part VI of the Rules governing advocates, framed under Section

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

60(3) and Section 49(1)(*g*) of the Act, which form a part of the Bar Council of India Rules may be consulted. As indicated, in the preamble of the Rules, an advocate shall, at all times compose himself in a manner befitting his status as an officer of the court, a privileged member of the community and a gentleman bearing in mind what may be lawful and moral for one who is not a member of the Bar may still be improper for an advocate and that his conduct is required to conform to the rules relating to the duty to the court, the duty to the client, to the opponent, and the duty to the colleagues, not only in letter but also in spirit.

It is in the light of these principles the Disciplinary Committee would be required to approach the question as regards the guilt or otherwise of an advocate in the context of professional misconduct levelled against him. In doing so apart from conforming to such procedure as may have been outlined in the Act or the Rules, the Disciplinary Authority would be expected to exercise the power with full consciousness and awareness of the paramount consideration regarding principles of natural justice and fair play."

246. The petitioners then pressed into aid the judgment of the Supreme Court in **L.D Jaisinghani vs. Naraindas Punjabi**[74] which too was in respect of disciplinary action taken against an advocate. In that decision, the Supreme Court had observed:-

"**9.** It is true that the advocate had not fared well under cross-examination. He had tried to conceal similar complaints against him in the past. It is, however, equally true that the complainant was no greenhorn. At any rate he was not so gullible as he tried to make himself out to be. After going through the relevant evidence, we doubt whether both sides have come out with full and true facts. It is more likely that there was some dispute over the payment of Rs 350 which the advocate appellant claimed as his fee for work done, but, the complainant seems to have considered himself entitled to demand the payment back. It is possible that there may have been other reasons too for friction between the two so as to lead to a disruption between the complainant and the Counsel whom he had been frequently engaging in addition to others. In any case, we are left in doubt whether the complainant's version, with which he had come forward with considerable delay, was really truthful. We think that, in a case of this nature, involving possible disbarring of the advocate concerned, the evidence should be of a character which

[74] (1976) 1 SCC 354

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

should leave no reasonable doubt about guilt. The Disciplinary Committee had not only found the appellant guilty but had disbarred him permanently.

10. The complainant has no doubt produced Tendolkar and D.D. Nalvade to show what enquiries were made relating to Suit No. 1040 of 1964 by the respondent complainant. It is, however, not disputed that the respondent did make those enquiries. The case of the appellant was that these enquiries were made in an attempt to bolster up a weak case. These enquiries merely prove a much too belated conduct of the complainant. They could be the result of an attempt to give a semblance of truth to a coloured and exaggerated version. It is also true that the appellant had been most unwise in not sending a registered letter in reply to the registered notice received by him on January 8, 1971 by the complainant. His version that he spoke to the complainant on the telephone and sent a letter in reply on January 15, 1971, of which- a copy was Ex. R-1, had been rejected by the committee on the ground that the advocate's conduct did not appear to be above board. We cannot help thinking that the committee had been unduly swayed by the unsavoury background of the appellant so that it could not see its way to giving the appellant even the benefit of doubt in the instant case."

247. The petitioners had also sought to invoke the principle of manifest arbitrariness in the context of Rule 11(5) failing to incorporate appropriate safeguards and defining the content of the summary procedure that the NFRA is obliged to adopt. In order to explain the precept of manifest arbitrariness and which has now become an indelible part of our jurisprudence insofar as constitutional validity of statutes is concerned, the petitioners relied upon the following passages from the celebrated decision of the Supreme Court in **Shreya Singal vs. Union of India**[75]:-

"**57.** In *Burstyn* v. *Wilson* [96 L Ed 1098: 343 US 495 (1952)] , sacrilegious writings and utterances were outlawed. Here again, the US Supreme Court stepped in to strike down the offending section stating : (L Ed p. 1121)

[75] (2015) 5 SCR 963

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

> "… It is not a sufficient answer to say that 'sacrilegious' is definite, because all subjects that in any way might be interpreted as offending the religious beliefs of any one of the 300 sects of the United States are banned in New York. To allow such vague, undefinable powers of censorship to be exercised is bound to have stultifying consequences on the creative process of literature and art—for the films are derived largely from literature. History does not encourage reliance on the wisdom and moderation of the censor as a safeguard in the exercise of such drastic power over the minds of men. We not only do not know but cannot know what is condemnable by 'sacrilegious'. And if we cannot tell, how are those to be governed by the statute to tell?"

xxxx xxxx xxxx

97. The argument of the learned Additional Solicitor General on this score is reproduced by us verbatim from one of his written submissions:

> "Furthermore it is respectfully submitted that in the event of Hon'ble Court not being satisfied about the constitutional validity of either any expression or a part of the provision, the Doctrine of Severability as enshrined under Article 13 may be resorted to."

98. The submission is vague : the learned Additional Solicitor General does not indicate which part or parts of Section 66-A can possibly be saved. This Court in *Romesh Thappar* v. *State of Madras* [*Romesh Thappar*v. *State of Madras*, 1950 SCR 594 : 1950 SCC 436 : AIR 1950 SC 124 : (1950) 51 Cri LJ 1514] repelled a contention of severability when it came to the courts enforcing the fundamental right under Article 19(1)(*a*) in the following terms : (SCR p. 603 : AIR p. 129, para 13)

> "… It was, however, argued that Section 9(1-A) could not be considered wholly void, as, under Article 13(1), an existing law inconsistent with a fundamental right is void only to the extent of the inconsistency and no more. Insofar as the securing of the public safety or the maintenance of public order would include the security of the State, the impugned provision, as applied to the latter purpose, was covered by clause (2) of Article 19 and must, it was said, be held to be valid. We are unable to accede to this contention. Where a law purports to authorise the imposition of restrictions on a fundamental right in language wide enough to cover restrictions both within and without the limits of constitutionally permissible legislative action affecting such right, it is not possible to uphold it even so far as it may be

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> applied within the constitutional limits, as it is not severable. So long as the possibility of its being applied for purposes not sanctioned by the Constitution cannot be ruled out, it must be held to be wholly unconstitutional and void. In other words, clause (2) of Article 19 having allowed the imposition of restrictions on the freedom of speech and expression only in cases where danger to the State is involved, an enactment, which is capable of being applied to cases where no such danger could arise, cannot be held to be constitutional and valid to any extent."

248. With respect to the aspect of vagueness of a statute the petitioners sought to draw sustenance from the following observations appearing in **K.A. Abbas vs. Union of India**[76]:-

> "**44.** This brings us to the manner of the exercise of control and restriction by the directions. Here the argument is that most of the regulations are vague and further that they leave no scope for the exercise of creative genius in the field of art. This poses the first question before us whether the "void for vagueness" doctrine is applicable. Reliance in this connection is placed on *Municipal Committee, Amritsar* v. *State of Rajasthan*[AIR 1960 SC 1100] . In that case a Division Bench of this Court lays down that an Indian Act cannot be declared invalid on the ground that it violates the due process clause or that it is vague. Shah, J., speaking for the Division Bench, observes:
>
> > "... the rule that an Act of a competent Legislature maybe 'struck down' by the courts on the ground of vagueness is alien to our constitutional system. The Legislature of the State of Punjab was competent to enact legislation in respect of 'fairs', vide Entry 28 of List II of the VII Schedule to the Constitution. A law may be declared invalid by the superior courts in India if the Legislature has no power to enact the law or that the law violates any of the fundamental rights guaranteed in Part III of the Constitution or is inconsistent with any constitutional provision, but not on the ground that it is vague".
>
> The learned Judge refers to the practice of the Supreme Court of the United States in *Claude C. Caually* v. *General Construction Co.* [(1926) 70 L Ed 332] where it was observed:

[76] (1970) 2 SCC 780

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

> "A statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application violates the first essential of due process of law."

The learned Judge observes in relation to this as follows:

> "But the rule enunciated by the American Courts has no application under our constitutional set-up. This rule is regarded as an essential of the 'due process clause' incorporated in the American Constitution by the 5th and 14th Amendments. The Courts in India have no authority to declare a statute invalid on the ground that it violates 'the due process of law'. Under our Constitution, the test of due process of law cannot be applied to the statutes enacted by the Parliament or the State Legislature."

Relying on the observations of Kania, C.J., in *A.K. Gopalan* v. *State of Madras* [1950 SCC 228 : (1950) SCR 88] to the effect that a law cannot be declared void because it is opposed to the spirit supposed to pervade the Constitution but not expressed in words, the conclusion above set out is reiterated. The learned Judge, however, adds that the words "cattle fair" in act there considered, are sufficiently clear and there is no vagueness.

45. These observations which are clearly obiter are apt to be too generally applied and need to be explained. While it is true that the principles evolved by the Supreme Court of the United States of America in the application of the Fourteenth Amendment were eschewed in our Constitution and instead the limits of restrictions on each fundamental right were indicated in the clauses that follow the first clause of the nineteenth article, it cannot be said as an absolute principle that no law will be considered bad for sheer vagueness. There is ample authority for the proposition that a law affecting fundamental rights may be so considered. A very pertinent example is to be found in *State of Madhya Pradesh and Another* v. *Baldeo Prasad* [(1961) 1 SCR 970 at 979] where the Central Provinces and Berar Goondas Act, 1946 was declared void for uncertainty. The condition for the application of Sections 4 and 4-A was that the person sought to be proceeded against must be a Goonda but the definition of Goonda in the Act indicated no tests for deciding which person fell within the definition. The provisions were therefore held to be uncertain and vague.

46. The real rule is that if a law is vague or appears to be so, the court must try to construe it, as far as may be, and language permitting, the construction sought to be placed on it, must be in accordance with the intention of the Legislature. Thus if the law is

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> open to diverse construction, that construction which accords best with the intention of the Legislature and advances the purpose of legislation, is to be preferred. Where however the law admits of no such construction and the persons applying it are in a boundless sea of uncertainty and the law prima facie takes away a guaranteed freedom, the law must be held to offend the Constitution as was done in the case of the Goonda Act. This is not application of the doctrine of due process. The invalidity arises from the probability of the misuse of the law to the detriment of the individual. If possible, the Court instead of striking down the law may itself draw the line of demarcation where possible but this effort should be sparingly made and only in the clearest of cases."

249. Another argument that was addressed by the writ petitioners was of Section 132(4) suffering from the vice of invidious discrimination. It was argued that while auditors generally are guaranteed salutary rights under the CA Act when faced with allegations of professional misconduct, auditors and firms falling within Rule 3 would face the specter of a trial in accordance with a summary procedure and thus deprived of the right to lead evidence, cross-examination and the various other procedural safeguards which otherwise imbue enquiries conducted under the CA Act. This according to the writ petitioners results in hostile discrimination amongst members otherwise forming part of a homogenous class. The petitioners also assailed the validity of the procedure followed by the NFRA arguing that the denial of legal assistance which could otherwise be availed of under the CA Act has been done away with and which renders the impugned provisions wholly arbitrary and liable to be struck down.

250. Controverting the aforenoted submissions, Mr. Hossain submitted that a right of cross examination cannot be elevated to the status of an inviolable facet of natural justice. Learned counsel in this respect cited for our consideration the decision of the Supreme Court in

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

M/s Kanugo & Company vs. Collector of Customs[77] and where the following observations appear:-

> "**12.** We may first deal with the question of breach of natural justice. On the material on record, in our opinion, there has been no such breach. In the show-cause notice issued on August 21, 1961, all the material on which the Customs Authorities have relied was set out and it was then for the appellant to give a suitable explanation. The complaint of the appellant now is that all the persons from whom enquiries were alleged to have been made by the authorities should have been produced to enable it to cross-examine them. In our opinion, the principles of natural justice do not require that in matters like this the persons who have given information should be examined in the presence of the appellant or should be allowed to be cross-examined by them on the statements made before the Customs Authorities. Accordingly we hold that there is no force in the third contention of the appellant."

251. Mr. Hossain then argued that the principles of natural justice, as is well settled, are not mantras or incantations but a set of fundamental rules of fair play which we have recognised as being applicable to a varied nature of proceedings. However, it was submitted that their application would depend upon the character of the proceedings. It was his contention that since the proceedings envisaged under Section 132(4) do not entail the NFRA relying upon any oral evidence, the right of cross examination as claimed is thoroughly misconceived. Learned counsel also questioned the challenge to the provisions on the ground of NFRA refusing lawyers to represent auditors and submitted that legal assistance in such enquiries has never been recognised to be a fundamental right. It was his submission that the writ petitioners, in any case, were not pitted against legal experts but members of the NFRA having domain knowledge in finance and accounting. It was thus argued that no prejudice had been caused to the petitioners in this

[77] (1973) 2 SCC 438

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

respect.

252. It was further submitted that NFRA had subsequent to the commencement of the proceedings impugned before us decided to permit auditors to be represented by lawyers before it. Notwithstanding the above, for the purposes of lending support to his submission with respect to a right to legal representation, Mr. Hossain relied upon the judgment of the Supreme Court in **Hyderabad Vanaspati Limited vs. A.P State Electricity Board**[78] and to the following observations rendered therein:-

> "**42.** In *Patel Parshottamadas Vanmalidas* v. *Gujarat Electricity Board* [AIR 1987 Guj 188 : (1987) 1 Guj LR 637 : (1987) 2 Guj LH 64] a Division Bench of the Gujarat High Court considered similar conditions and upheld their validity. The Bench said:
>
> > "Thus, it is clear that the Board has formulated such a condition in order to safeguard its interest. Such a condition is there for the purpose of checking, apart from other things, the theft of electricity. It is not a case of any defective meter, but it is a case of theft of electricity by the consumer concerned. As a matter of fact, in this case it is alleged that the petitioner, by inserting a plastic strip, was able to stop the running of the meter and thereby, committed theft of electricity. The condition clearly states as to the procedure that has to be adopted for the purpose of questioning the departmental action in levying penal charges. It has also been made clear in the condition as to the limit to which the Department can go for the purpose of assessing the theft of electricity. In no case the Department can go beyond a period of six months, according to this condition. In Condition No. 34, we are able to see that manner of assessment also has been specified. If all these steps are taken by the Department, the condition itself states that the consumer has a remedy by filing an appeal to the appropriate authority within a specified time. Thus, a conjoint reading of this condition and the purpose for which it is intended, clearly makes out that such a condition is not arbitrary or unreasonable, but within the powers of the Board and, in our opinion, it does not offend

[78] (1988) 4 SCC 470

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Signing Date:07.02.2025
18:46:26

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> any of the articles of the Constitution. The argument as if the imposition of penal assessment before filing an appeal is harsh and makes the appeal illusory cannot be appreciated. The penal assessment, as we have stated already, is restricted to a limited period. Such an assessment was made after the Department itself was satisfied with regard to the theft of electricity committed by the consumer concerned. Hence, it cannot be said that the appeal provided under Condition No. 34 is an illusory one."
>
> We agree with the above opinion.
>
> **43.** The principle "*nemo judex in causa sua*" will not apply in this case as the officers have no personal lis with the consumers. As pointed out by learned Senior Counsel for the Board, they are similar to income tax or sales tax officials. There is nothing wrong in their adjudicating the matter especially when the consumers may be represented by an advocate and the formula for making provisional assessment is fixed in the clause itself. An argument has been advanced that the Board has recently deleted the provision enabling the consumer to be represented by a power-of-attorney agent. It is contended that the consumer is thereby deprived of the assistance of an expert which may be required in technical matters. We do not agree. When the consumer is represented by a lawyer, he can certainly get such assistance as may be needed from a technical expert. It is stated by the Board's learned counsel that the provision was deleted as there was frequent misuse of the same. Whatever may be the reason for deleting the provision, the existing part of the clause enables the consumer to be represented by an advocate. That is sufficient safeguard for the consumer."

253. From the recordal of submissions addressed by respective sides, it becomes apparent that the primary challenge under this head was of the NFRA not being bound to follow a fair and just procedure while conducting an enquiry. That submission rested on the perceived lack of due process contemplated in Rule 11 of the NFRA Rules when contrasted with the procedure which was liable to be adhered to in the case of an inquiry under the CA Act read along with the Misconduct Rules, 2007. It was this perceived and asserted distinction in the procedure prescribed which was sought to be highlighted by both the

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

DHS and SRBC with the aid of the charts which have been referred to hereinabove. The petitioners had essentially referred to the provisions contained in Rules 14, 18 and 19 of the Misconduct Rules, 2007 to highlight the nature of rights which according to them CAs' and firms stand deprived of in the course of proceedings that may unfold before the NFRA.

254. In order to evaluate the soundness of that submission, it would be appropriate to advert to the Misconduct Rules, 2007. As is evident from Rule 7, the proceedings that may come to be initiated could have commenced upon the receipt of any written information containing allegations against a member or a firm. On receipt of such an application, the Director in terms of Rule 9 was obliged to examine the complaint, the written statements submitted by the CA or the firm as well as other additional particulars or documents in order to come to a prima facie conclusion of guilt in respect of the member or the firm. It was that prima facie opinion of the Director which would, in terms of the procedure prescribed, be thereafter transmitted to the Board of Discipline or the Disciplinary Committee.

255. It becomes pertinent to note that in terms of Rule 14(1), the Board of Discipline was statutorily enjoined to follow a summary disposal procedure while dealing with cases laid before it. It was required, by virtue of Rule 14(2), to supply a copy of the prima facie opinion formed by the Director as well as particulars and documents relied upon by that authority for the purposes of formation of that opinion to the arrayed respondent as well as the complainant. Since the complainant was envisaged to be a party to those proceedings, it was

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

also entitled to respond to any written statement that would have been submitted by a respondent in terms of Rule 14(5). The Board of Discipline was enjoined to consider the written representations, written statements, documents as well as oral submissions, if any made by the complainant as well as the respondent while arriving at a finding on whether the charge of professional or other misconduct was made out.

256. Similarly, and in terms of Rule 18, the Disciplinary Committee was cautioned to ensure that all proceedings undertaken by it were in accord with the principles of natural justice. This statutory command stands embodied in Rule 18(1). By virtue of Rule 18(2), the Disciplinary Committee is enjoined to provide a copy of the prima facie opinion of the Director together with documents relied upon by that authority to both the complainant and the respondent. The respondent as well as the complainant were thereafter entitled to submit their written statements and replies for the consideration of the Disciplinary Committee. Rule 18(9) then dealt with a contingency where the respondent was to deny the allegations of professional misconduct and on such a stand being struck, the Disciplinary Committee being obliged to fix a date for the examination of witnesses and for the production of documents. In terms of Rule 18(11), the Disciplinary Committee could take evidence as led before it as well as the statement of witnesses that may have been recorded in the course of such oral examination. The Proviso to Rule 18(11) gives an indication of the Disciplinary Committee also being obliged to permit cross-examination of witnesses whose testimony may have come to be recorded in the course of those proceedings.

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

257. According to the writ petitioners, it is some of these facets or the procedure which the Board of Discipline and the Disciplinary Committee were enjoined to follow which have been completely done away with in proceedings that may unfold before the NFRA.

258. As we view Rule 11 of the NFRA Rules, it becomes apparent that the statute clearly commands that authority to ensure that the disciplinary proceedings are undertaken in accordance with the principles of natural justice including where deemed necessary and appropriate by providing an opportunity of hearing to the charged entity in person. By virtue of Rule 11(5), the division of the NFRA is obliged to pass an order after considering all submissions made and taking into account the material on record as well as all other relevant facts and circumstances. The NFRA Rules, however, do not speak of or appear to envisage oral testimony being recorded in the course of proceedings that may ensue.

259. The reason for this is clearly not far to discern since the proceedings themselves would have been commenced based either on a *suo motu* decision taken by the NFRA or on receipt of a reference made to it either by the Union Government or any other competent authority. The NFRA thus commences proceedings not on the basis of a written complaint or at the behest of a complainant and which was a possibility envisaged under the CA Act and the Misconduct Rules, 2007. Even though the Union Government itself is enabled to make a reference to the NFRA to undertake an investigation, the said entity merely stands in the shoes of an informant or a body which provides material for the NFRA to investigate. The proceedings thus are clearly not adversarial

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

and which was a possible scenario under the Misconduct Rules 2007.

260. We further note that the NFRA itself initiates and undertakes the inquiry on the basis of the audit file and record which may have been gathered in the course of an audit quality review. Those proceedings are thus not triggered or based upon the oral testimony of a complainant or person. As is thus manifest from a reading of Rule 10, the investigative process would commence either with the NFRA receiving a reference or where it decides itself to undertake an investigation into any matter based on its review of audit and oversight functions. In terms of Rule 10(1)(c), it could also initiate an investigation *suo motu* if it were for reasons recorded come to form a preliminary opinion that a matter pertaining to professional or other misconduct which comes to light merits an inquiry. Thus, the commencement of an inquiry by the NFRA is premised entirely on either a reference that may be made to it by the Union Government or where the said body were to initiate an investigation *suo motu* or in light of facts that may be gathered in the course of its supervisory role envisaged in Rules 7, 8 and 9.

261. In the absence of those proceedings being based on the version of an individual complaint or testimony, we fail to appreciate the submission that the denial of a right of cross-examination is liable to be viewed as a factor which renders the procedure prescribed under the NFRA Rules to be arbitrary. A right to cross examine could have been claimed provided the NFRA were to rely upon the oral testimony of an individual or such a statement constituting material that it took into consideration for the purposes of formation of an opinion to commence proceedings referrable to Section 132(4) of the Act. However, and on

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

facts, we find that none of the impugned SCNs' are based on a complaint of an individual or a statement made by a person. At least the petitioners have woefully failed to establish that such was the case.

262. The position which thus emerges from the record is of the SCNs' being prompted by the prima facie conclusions which were recorded and the AQRRs'. It is that material alone which constituted the basis for initiation of the action impugned before us. It was not the case of the petitioners that the disciplinary action was prompted by a complaint submitted by a person or based upon a statement that may have been recorded. In fact, the only testimony which appears to have been borne in consideration was the responses submitted by the writ petitioners as well as the statements of representatives, members and partners made and recorded. We thus find ourselves unable to appreciate the assertion of a right of cross examination which was vehemently canvassed before us.

263. We also bear in mind the undisputed fact of both Rules 14 and 18 of the Misconduct Rules, 2007 themselves envisaging a summary procedure of disposal being adopted by the Board of Discipline and the Disciplinary Committee. Both those rules only placed those authorities under the over-arching obligation of ensuring that proceedings were undertaken in consonance with the principles of natural justice. It was in terms of Rule 18(9) alone that oral examination and recordal of testimony were contemplated. The aforesaid provision clearly appears to have been engrafted since the Disciplinary Committee would be considering a complaint made by an individual against a CA or a firm. Since the complainant could have introduced oral testimony in such

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

proceedings, the rules proceeded to incorporate a right of cross-examination. However, and undisputedly the NFRA rules do not contemplate oral testimony or evidence for the purposes of the investigation or inquiry that may be undertaken.

264. Regard must also be had to the well-settled precept of the principles of natural justice being essentially concerned with adherence to a fair procedure and the provision of an adequate opportunity to the charged person to contest the allegations leveled. Rules of natural justice, as has been repeatedly held, cannot be applied or viewed as operating as a straight jacketed formula. They are neither rigid nor are they liable to be viewed as inviolable conditions etched in stone. Way back in the decision of **K.L. Tripathi vs. State Bank of India**[79], the Supreme Court had pertinently held that a right of cross-examination would inevitably arise if the version or the statement of a person who has tendered testimony is sought to be disputed or challenged. However, their Lordships pertinently observed that absent such a situation, the right of cross-examination cannot be acknowledged to be a necessary ingredient of the principles of natural justice. We deem it apposite to extract the following passages from that decision:-

> "**29.** We are of the opinion that Mr Garg is right that the rules of natural justice as we have set out hereinbefore implied an opportunity to the delinquent officer to give evidence in respect of the charges or to deny the charges against him. Secondly, he submitted that even if the rules had no statutory force and even if the party had bound himself by the contract, as he had accepted the Staff Rule, there cannot be any contract with a Statutory Corporation which is violative of the principles of natural justice in matters of domestic enquiry involving termination of service of an employee. We are in agreement with the basic submission of Mr Garg in this

[79] (1984) 1 SCC 43

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

respect, but we find that the relevant rules which we have set out hereinbefore have been complied with even if the rules are read that requirements of natural justice were implied in the said rules or even if such basic principles of natural justice were implied, there has been no violation of the principles of natural justice in respect of the order passed in this case. In respect of an order involving adverse or penal consequences against an officer or an employee of Statutory Corporations like the State Bank of India, there must be an investigation into the charges consistent with the requirements of the situation in accordance with the principles of natural justice as far as these were applicable to a particular situation. So whether a particular principle of natural justice has been violated or not has to be judged in the background of the nature of charges, the nature of the investigation conducted in the background of any statutory or relevant rules governing such enquiries. Here the infraction of the natural justice complained of was that he was not given an opportunity to rebut the materials gathered in his absence. As has been observed in *On Justice* by J.R. Lucas, the principles of natural justice basically, if we may say so, emanate from the actual phrase "*audi alteram partem*" which was first formulated by St. Augustine (*De Duabus Animabus*, XIV, 22 J.P. Migne, PL. 42, 110).

30. In dealing with particular situation we must formulate the actual principles to be applied in a particular situation. Hence it may be illustrated as J.R. Lucas — *On Justice* (p. 86) has done it, thus:

> "Hence, when we are judging deeds, and may find that a man did wrong, there is a requirement of logic that we should allow the putative agent to correct misinterpretations or disavow the intention imputed to him or otherwise disown the action. God needed to ask Adam 'Hast thou eaten of the tree whereof I commanded thee that thou shouldest not eat?' Because it was essential that Adam should not be blamed or punished unless he had done exactly that deed. If the serpent had planted the evidence, or if he had beguiled Adam into eating it under the misapprehension that it came from another, non-forbidden tree, then Adam had not sinned and should not have been expelled from Eden. Only if the accused admits the charge, or, faced with the accusation, cannot explain his behaviour convincingly in any other way, are we logically entitled to conclude that he did indeed do it."

31. Wade in his *Administrative Law*, 5th Edn. at pp. 472-475 has observed that it is not possible to lay down rigid rules as to when the principles of natural justice are to apply: nor as to their scope and extent. Everything depends on the subject-matter, the application of principles of natural justice, resting as it does upon statutory implication, must always be in conformity with the scheme of the

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

Act and with the subject-matter of the case. In the application of the concept of fair play there must be real flexibility. There must also have been some real prejudice to the complainant; there is no such thing as a merely technical infringement of natural justice. The requirements of natural justice must depend on the facts and the circumstances of the case, the nature of the inquiry, the rules under which the tribunal is acting, the subject-matter to be dealt with, and so forth.

32. The basic concept is fair play in action administrative, judicial or quasi-judicial. The concept of fair play in action must depend upon the particular lis, if there be any, between the parties. If the credibility of a person who has testified or given some information is in doubt, or if the version or the statement of the person who has testified, is, in dispute, right of cross-examination must inevitablly form part of fair play in action but where there is no lis regarding the facts but certain explanation of the circumstances there is no requirement of cross-examination to be fulfilled to justify fair play in action. When on the question of facts there was no dispute, no real prejudice has been caused to a party aggrieved by an order, by absence of any formal opportunity of cross-examination per se does not invalidate or vitiate the decision arrived at fairly. This is more so when the party against whom an order has been passed does not dispute the facts and does not demand to test the veracity of the version or the credibility of the statement.

33. The party who does not want to controvert the veracity of the evidence from record or testimony gathered behind his back cannot expect to succeed in any subsequent demand that there was no opportunity of cross-examination specially when it was not asked for and there was no dispute about the veracity of the statements. Where there is no dispute as to the facts, or the weight to be attached on disputed facts but only an explanation of the acts, absence of opportunity to cross-examination does not create any prejudice in such cases.

34. The principles of natural justice will, therefore, depend upon the facts and circumstances of each particular case. We have set out hereinbefore the actual facts and circumstances of the case. The appellant was associated with the preliminary investigation that was conducted against him. He does not deny or dispute that. Information and materials undoubtedly were gathered not in his presence but whatever information was there and gathered namely, the versions of the persons, the particular entries which required examination were shown to him. He was conveyed the information given and his explanation was asked for. He participated in that investigation. He gave his explanation but he did not dispute any of the facts nor did he ask for any opportunity to call any evidence to

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

rebut these facts. He did ask for a personal hearing, as we have mentioned hereinbefore and he was given such opportunity of personal hearing. His explanations were duly recorded. He does not allege that his version has been improperly recorded nor did he question the veracity of the witnesses or the entries or the letters or documents shown to him upon which the charges were framed and upon which he was found guilty. Indeed it may be mentioned that he was really consulted at every stage of preliminary investigation upon which the charges were based and upon which proposed action against him has been taken. In that view of the matter, we are of the opinion, that it cannot be said that in conducting the enquiry or framing of the charges or arriving at the decision, the authorities concerned have acted in violation of the principles of natural justice merely because the evidence was not recorded in his presence or that the materials, the gist of which was communicated to him, were not gathered in his presence. As we have set out hereinbefore, indeed he had accepted the factual basis of the allegations. We have set out hereinbefore in extenso the portions where he had actually admitted the factual basis of these allegations against him, where he has not questioned the veracity of the witness of the facts or credibility of the witnesses or credibility of the entries on records. Indeed he has given explanation namely, he was overworked, he had consulted his superiors and sought their guidance, his conduct has not actually, according to him caused any financial risk or damage to the bank concerned. Therefore, in our opinion, in the manner in which the investigation was carried out as a result of which action has been taken against him cannot be condemned as bad being in violation of the principles of natural justice. Had he, however, denied any of the facts or had questioned the credibility of the persons who had given information against him, then different considerations would have applied and in those circumstances, refusal to give an opportunity to cross-examine the persons giving information against him or to lead evidence on his own part to rebut the facts would have been necessary and denial of such opportunity would have been fatal. But such is not the case here as we have mentioned hereinbefore."

265. In **Transmission Corporation. of A.P. Ltd. vs. Sri Rama Krishna Rice Mill**[80]**,** a question arose as to whether the statement of officers that may come to form the basis for action that the Board may initiate was liable to be tested by providing a right of cross-examination to the consumer. Negating the assertion of such a right, the Supreme

[80] (2006) 3 SCC 74

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

Court held:-

"**5.** In response, learned counsel for the respondent submitted that clause 39.9.2 provides for grant of a "reasonable opportunity" to the consumer. If the statements of the officers are to be relied upon without being tested by cross-examination, the consumer will be highly prejudiced and, therefore, the right to cross-examine them is inbuilt *in* clause 39.9.2 of the Terms and Conditions of Supply. Clause 39.9.2 deals with final assessment. Sub-clauses (1) to (3) thereof are extracted below for ready reference:

39.9.1. After the provisional assessment, notice is served upon the consumer as mentioned in clause 39.3 thereof. The officer authorised in this behalf by the Board (see statement referred to in clause 39.4 above) shall issue a show-cause notice in the forms prescribed therefor advising the consumer to file his representation, if any, within 30 days from the receipt of the notice.

39.9.2. The said officer of the Board shall, after the expiry of the aforesaid notice period, enquire into the matter and after giving reasonable opportunity to the consumer and taking into account all relevant facts and circumstances shall decide whether the consumer has committed malpractice or pilferage of energy and if so satisfied proceed to assess to the best of his judgment, the loss sustained by the Board on account of such malpractice or pilferage of energy by the consumer. The consumer may be represented by an advocate or any other person at the time of personal hearing provided the consumer files proper vakalatnama or power of attorney as the case may be.

39.9.3. The final assessing authority shall then pass an order setting out his conclusions and the reasons thereof and communicate a copy of the order to the consumer and demand the amount, if any, due from the consumer on the basis of such order after giving credit to the amounts paid by him.

6. At this juncture, it is to be noted that in para 39 of *Hyderabad Vanaspathi case* [(1998) 4 SCC 470] what was observed by this Court was in relation to disconnection and for that purpose reliance was placed on an earlier decision of this Court in *M.P. Electricity Board* v. *Harsh Wood Products* [(1996) 4 SCC 522] . At the stage of issuing notice of disconnection there is no question of granting any opportunity to the consumer. On the basis of prima facie view of the officer concerned, notice of disconnection is issued. In that context it was held both in *M.P. Electricity Board* [(1996) 4 SCC 522] and *Hyderabad Vanaspathi cases* [(1998) 4 SCC 470] that the procedure laid down was not in violation of the principles of natural justice. So far as para 43 of *Hyderabad Vanaspathi case* [(1998) 4

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

SCC 470] is concerned, that related to the absence of personal lis or interest of the adjudicator. In that background it was held that merely because the departmental authority was adjudicating there was no prejudice involved. Those principles are not of any assistance in the present case. In the case at hand without even granting of an opportunity to the respondent, the final order of assessment was passed. Merely taking note of the objection filed cannot be said to be compliance with the provisions contained in clause 39.9.2. Therefore, the respondent had made a prayer before the Appellate Authority. The parameters of the principles of natural justice cannot be covered by any straitjacket formula. It would vary depending upon the circumstances involved. It is true that the Terms and Conditions of Supply did not contemplate anything like recording oral or documentary evidence in the way as is normally done in the courts of law. But clause 39.9.2 itself provides for a reasonable opportunity being granted. What would be a reasonable opportunity would also depend upon the fact situation. In *Advanced Law Lexicon* by P. Ramanatha Aiyar (3rd Edn., Vol. 4, pp. 3959 and 3968) the word "reasonable" has been described as follows:

(*i*) "[What is] fair, proper, or moderate under the circumstances…."

(*ii*) "The expression 'reasonable' is not susceptible of a clear and precise definition. A thing which is reasonable in one case may not be reasonable in another. Reasonable does not mean the best, it means most suitable in a given set of circumstances."

(*iii*) "There is no point on which a greater amount of decision is to be found in courts of law and equity than as to what is reasonable : It is impossible *a priori* to state what is reasonable as such in all cases. You must have the particular facts of each case established before you can ascertain what is meant by reasonable under the circumstances—Lord Romilly, M.R., *Labouchere* v. *Dawson* [(1872) LR 13 Eq 322 : 25 LT 894] ."

7. In *Khem Chand* v. *Union of India* [1958 SCR 1080 : AIR 1958 SC 300] a Constitution Bench of this Court explained the meaning of "reasonable opportunity" thus in the context of Article 311(2) of the Constitution of 1950 (in short "the Constitution") : (SCR pp. 1096-97)

"(*a*) an opportunity to deny his guilt and establish his innocence….

(*b*) an opportunity to defend himself by cross-examining the witnesses produced against him and by examining himself or any other witnesses in support of his defence; and finally

(*c*) an opportunity to make his representation as to why the proposed punishment should not be inflicted on him…."

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

8. The nature of adjudication under clause 39.9.2 of the Terms and Conditions of Supply is somewhat different from an enquiry under Article 311(2) of the Constitution. It cannot be laid down as a rule of universal application that whenever the statement of the departmental officer is pressed into service for the purpose of adjudication, a right of cross-examination is inbuilt. On the other hand, what was said in *Bakshi case* [1966 Supp SCR 401 : AIR 1967 SC 122] has also really no relevance because that was a case where no penal consequences were involved and the Commission was only a fact-finding Commission and, therefore, is clearly distinguishable of facts.

9. In order to establish that the cross-examination is necessary, the consumer has to make out a case for the same. Merely stating that the statement of an officer is being utilised for the purpose of adjudication would not be sufficient in all cases. If an application is made requesting for grant of an opportunity to cross-examine any official, the same has to be considered by the adjudicating authority who shall have to either grant the request or pass a reasoned order if he chooses to reject the application. In that event an adjudication being concluded, it shall be certainly open to the consumer to establish before the Appellate Authority as to how he has been prejudiced by the refusal to grant an opportunity to cross-examine any official. As has been rightly noted by the High Court in the impugned judgment where the reliance is only on accounts prepared by a person, cross-examination is not necessary. But where it is based on reports alleging tampering or pilferage, the fact situation may be different. Before asking for cross-examination the consumer may be granted an opportunity to look into the documents on which the adjudication is proposed. In that event, he will be in a position to know as to the author of which statement is necessary to be cross-examined. The applications for cross-examination are not to be filed in a routine manner and equally also not to be disposed of by an adjudicator in casual or routine manner. There has to be application of mind by him. Similarly, as noted above, the consumer has to show as to why cross-examination is necessary."

Of significance is the observation rendered in *Transmission Commission* when their Lordships held that a right of cross-examination cannot be elevated to the status of a rule of universal application whenever the statement of a departmental officer is made the basis of an adjudication. It further held that even if a consumer were

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

denied the opportunity to cross-examine an official, it would still be incumbent upon it to prove and establish the prejudice that may have been caused.

266. Reverting then to the varied situations in which an investigation or an inquiry may be commenced by the NFRA, we fail to discern any possibility of oral testimony being made the basis for disciplinary action. In fact, it was the categorical and unequivocal stand of that body that any proceedings that it may initiate would stand confined to the audit record only. We thus fail to find any merit in the submission that the denial of a right to cross examine would result in the violation of the principles of natural justice. That right would in any event be liable to be claimed provided the action were based on the testimony and statement of an individual. The petitioners have failed to dislodge the stand of the NFRA that its action was founded solely on the audit record and the inferences and findings that formed part of the AQRR. The statements and material that it appears to have taken into consideration were only the responses submitted by the writ petitioners and the statements attributed to their members. The arguments addressed on this score are thus wholly unmerited.

267. We also bear in consideration the following succinct observations entered in *Kanugo and Co*. and where too the Supreme Court had negated a contention of a right of cross-examination being an inviolable principle of natural justice. The relevant extracts from *Kanugo* are reproduced hereinbelow:-

> "**11.** The learned counsel for the appellant contended that the burden on the Customs Authorities has not been discharged. He urged that there was no evidence that the watches had not been brought into

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

India lawfully. He urged, secondly, that the impugned order wrongly placed the burden on the appellant, thirdly, that the impugned order was made in contravention of natural justice; and fourthly, that there was no evidence that watches had been improted in contravention of law.

12. We may first deal with the question of breach of natural justice. On the material on record, in our opinion, there has been no such breach. In the show-cause notice issued on August 21, 1961, all the material on which the Customs Authorities have relied was set out and it was then for the appellant to give a suitable explanation. The complaint of the appellant now is that all the persons from whom enquiries were alleged to have been made by the authorities should have been produced to enable it to cross-examine them. It our opinion, the principles of natural justice do not require that in matters like this the persons who have given information should be examined in the presence of the appellant or should be allowed to be cross-examined by them on the statements made before the Customs Authorities. Accordingly, we hold that there is no force in the third contention of the appellant."

268. In *Hyderabad Vanaspati* the Supreme Court was called upon to consider the submission of a right of cross-examination in the context of energy theft. Negating that submission, the Supreme Court observed as follows:-

"43. The principle "*nemo judex in causa sua*" will not apply in this case as the officers have no personal lis with the consumers. As pointed out by learned Senior Counsel for the Board, they are similar to income tax or sales tax officials. There is nothing wrong in their adjudicating the matter especially when the consumers may be represented by an advocate and the formula for making provisional assessment is fixed in the clause itself. An argument has been advanced that the Board has recently deleted the provision enabling the consumer to be represented by a power-of-attorney agent. It is contended that the consumer is thereby deprived of the assistance of an expert which may be required in technical matters. We do not agree. When the consumer is represented by a lawyer, he can certainly get such assistance as may be needed from a technical expert. It is stated by the Board's learned counsel that the provision was deleted as there was frequent misuse of the same. Whatever may be the reason for deleting the provision, the existing part of the

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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> clause enables the consumer to be represented by an advocate. That is sufficient safeguard for the consumer."

The aforenoted observations are clearly apt and relevant in the context of the character of proceedings that may be undertaken by virtue of Section 132(4) and which are neither adversarial nor one which could be said to entail a resolution of *a lis.*

269. It is also pertinent to note that the mere usage of the word 'summary' cannot lead one to presume that the procedure that the NFRA may ultimately adhere to, would be violative of the principles of natural justice. When Rule 11(5) uses the expression 'summary procedure' all that the rule-making authority perhaps intended to convey was that disciplinary proceedings would not be liable to be conducted in accordance with a procedure or rules of evidence which a court of law may be obliged to follow while trying *a lis*. In fact, that rule itself enjoins the authority to ensure adherence to the principles of natural justice. It also places it under the duty to provide an opportunity of hearing to a person in cases where circumstances may so warrant. The statute thus provides enough guidance for the authority to ensure that the disciplinary proceedings are conducted in a manner which is fair, transparent and in consonance with the broad, basic and fundamental principles of natural justice.

270. The proceedings in terms of Rule 11 are envisaged to commence with the issuance of a SCN and which as per Rule 11(2) must necessarily make available to the charged CA or firm a detail of the allegations that are laid together with the evidence in support thereof as well as an appropriate disclosure with respect to the provisions of the

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

Act, Rules or the SAs which are found to have been allegedly violated. Rule 11(2) further enjoins the SCN to broadly indicate the action that the NFRA proposes to take or the directions that it may be constrained to frame if the allegations were to be ultimately established. By virtue of Rule 11(3) the authority is also statutorily obliged to enclose all copies of documents relied upon as well as to make available the extracts of reports of investigation or other records which are proposed to be used for proving the allegation levelled. In terms of Rule 11(4) the SCN must be served upon the auditor as well as the firm dependent upon the action which the authority proposes to initiate. The statute thus adopts and incorporates appropriate measures and safeguards to ensure that the procedure that it adopts is in accord with the principles of fair play and natural justice.

271. We are also of the firm opinion that the proceedings which the NFRA would undertake are not liable to conform to the requirement of guilt being proved beyond reasonable doubt and which is a test which primarily applies to criminal trials. The proceedings under Section 132(4) are essentially disciplinary proceedings and which are governed and guided by the well-accepted principle of the charge being liable to be proved on the basis of preponderance of probabilities. While dealing with the nature of the inquiry, which Section 21 of the CA Act envisaged, the Supreme Court in *Mukesh Gang* had upon an exhaustive review of the scheme of that statute observed as follows:-

> "**23.** On a reference made by the Institute, this Court can exercise the power conferred under Section 21(6) of the Act. In such a reference, the jurisdiction and powers of the High Court, while dealing with cases under sub-sections (2), (3) and (4) of Section 21 of the Act, are limited. The Calcutta High Court took the view that, even if a wider

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

construction is put on the material words used in Sections 21 and 22, they would not be justified in passing any orders against the respondent in the proceedings because the finding which had been referred to the High Court was only one, and that was that the respondent was guilty of professional misconduct in the narrow sense of the term. In other words, the High Court was of the view that if a wider construction is placed on the material words of the Section, it would be making out a new case on the reference, and the Court would not be justified in adopting such a course. The Apex Court, in *Council of the Institute of Chartered Accountants* v. *B. Mukherjea* (referred supra), held that the view of the Calcutta High Court was not well-founded. Section 21(2) lays down the procedure to be followed by the High Court when a finding, made by the Council, is referred to it under Section 21(1). Notice, of the day fixed for the hearing of the reference, should be given to the parties specified in Section 21(1), and an opportunity of being heard has to be afforded to them. Section 21(3) then lays down that the High Court may either pass such final orders on the case as it thinks fit or refer it back for further inquiry by the Council, upon receipt of the finding after such inquiry, to deal with the case in the manner provided in sub-section (2), and to pass final orders thereon. It is clear that, in hearing a reference made under Section 21(5), the High Court can examine the correctness of the findings recorded by the statutory bodies in that behalf. The High Court can even refer the matter back for further inquiry by the Council, and record a fresh finding. It is not as if the High Court is bound in every case to consider the merits of the finding as it has been recorded, and to either accept or reject the said finding. If, in a given case, it appears to the High Court that, on the facts alleged and proved, an alternative finding may be recorded, the High Court can as well send the case back to the Council with appropriate directions in this regard. The powers of the High Court, under Section 21(3), are undoubtedly wide enough to enable it to adopt any course which, in its opinion, will enable it to render justice to the parties.

24. In *Institute of Chartered Accountants of India* v. *L.K. Ratna* (referred supra) the Apex Court discussed the scope of an enquiry in a reference under Section 21(5) of the Act, and held that it was apparent that, in the scheme incorporated in Section 21 of the Act, there were separate functionaries, the Disciplinary Committee, the Council and, in certain cases, the High Court. The controlling authority was the Council, which was only logical for the Council is the governing body of the Institute. When the Council receives information or a complaint alleging that a member of the Institute is guilty of misconduct, and it is prima facie of the opinion that there is substance in the allegations it refers the case to the Disciplinary Committee. The Disciplinary Committee plays a subordinate role. It conducts an inquiry into the allegations. Since the inquiry is into the

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

allegations of misconduct by the member, it possesses the character of a quasi-judicial proceeding. The Disciplinary Committee, thereafter, submits a report of the result of the inquiry to the Council. The Disciplinary Committee is merely a Committee of the Institute, with its functions specifically limited by the provisions of the Act. As a subordinate body, it reports to the Council, the governing body. The report will contain a statement of the allegations, the defence entered by the member, a record of evidence and the conclusions upon that material. The conclusions are the conclusions of the Committee. They are only tentative. They cannot be regarded as 'findings'. The Disciplinary Committee is not vested by the Act with power to render any findings. It is the Council which is empowered to find whether the member is guilty of misconduct. Both Section 21(2) and Section 21(3) are clear as to that. If, on receipt of the report, the Council finds that the member is not guilty of misconduct, Section 21(2) requires it to record its finding accordingly, and to direct that the proceedings shall be filed or the complaint shall be dismissed. If, on the other hand, the Council finds that the member is guilty of misconduct, Section 21(3) requires it to record a finding accordingly, and thereafter to proceed in the manner laid down in the succeeding sub-sections. The finding by the Council is the determinative decision as to the guilt of the member, and because it is determinative, the Act requires it to be recorded. A responsibility as grave as the determination that a member is guilty of misconduct, and recording of that finding, has been specifically assigned by the Act to the governing body, the Council. It is also apparent that it is only upon a finding being recorded by the Council that the Act moves forward to the final stage of penalisation. The recording of the finding by the Council is the jurisdictional springboard for the penalty proceeding which follows.

25. At this point, it is necessary to advert to the nature of the power conferred on the Council. The Council is empowered to find a member guilty of misconduct. The penalty which follows is so harsh that it may result in the removal of a members name from the Register for several years which would deprive him of the right to a certificate of practice. As is clear from Section 6(1) of the Act, he cannot practice without such a certificate. In the circumstances there is every reason to presume in favour of an opportunity being given to the member of being heard by the Council before it proceeds to pronounce upon his guilt. As seen, the finding by the Council operates with finality in the proceeding, and it constitutes the foundation for the penalty imposed by the Council on him. The power to find and record whether a member is guilty of misconduct has been specifically entrusted by the Act to the entire Council itself and not to a few of its members who constitute the Disciplinary Committee. It is the character and complexion of the proceeding, considered in conjunction with the structure of power constituted by the Act, which

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

leads to the conclusion that the member is entitled to a hearing by the Council before it can find him guilty.

26. In *Institute of Chartered Accountants of India* v. *Price Waterhouse* (referred supra) the Apex Court held that a combined reading of the relevant provisions in Section 21 and Regulation 16 did indicate that recording of a finding of guilt or non-guilt by the Council was mandatory to take further action or to dismiss the complaint or for further process. The Council was required to consider independently the explanation submitted by the member and the evidence adduced in the enquiry before the Disciplinary Committee, and the report of the Disciplinary Committee. It provided an in-built mechanism under which the Council itself was required to examine the case of the professional or other misconduct of a member of the Institute or associate member, taking the aid of the report submitted by the Disciplinary Committee, the evidence adduced before the Committee, and the explanation offered by the delinquent member. The entire material constitutes the record of the proceeding before the Council to reach a finding whether or not the delinquent member had committed professional or other misconduct. Otherwise, the primacy accorded to the report of the Disciplinary Committee would attain finality, denuding the Council of the power of discipline over the members of the Institute, and that would have a deleterious effect on the maintenance of discipline among the members or associate members of the Institute.

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48. The phrase Quasi-criminal mean a lawsuit or equity proceeding that has some, but not all, of the qualities of a criminal prosecution. It may appear either in a Common law or a Civil law jurisdiction. It refers to a courts right to punish for actions or omissions as if they were criminal. The origins of the phrase comes from the Latin word, quasi, meaning somewhat, sort-of, alike or akin to criminal law, as in Quasi-contract. The word Quasi is used to indicate that one subject resembles another, with which it is compared, in certain characteristics, but there are intrinsic and material differences between them. During a civil or equity trial, a court may act as if it were a criminal case to punish a person for contempt of court. In some cases, a court may impose asset forfeiture or another penalty. For example, a court has the right to punish actions or omissions of a party in a child support case as if they were a criminal, penalizing the parent with a sentence of jail term. Quasi-criminal proceedings include a wide variety of matters, including prosecution for a violation of the law or ordinance, psychiatric matters, motor vehicle law, status offences, family court actions, and equity proceedings such as a Writ.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

49. In criminal cases, generally, Courts try cases following the prescribed procedure, and impose punishment either of a sentence or a fine or both, but in disciplinary proceedings, more particularly under the Act, the punishment which may be imposed is not a jail term or fine like any other criminal proceeding. The punishment which may be imposed under Section 21 of the Act, if the respondent is found guilty of misconduct, cannot be equated to a sentence or a fine imposed on a person being found guilty in a criminal prosecution. The standard of proof required in criminal cases and civil cases also vary.

50. In *S.A.L. Narayan Row* v. *Ishwarlal Bhagwandas* the Supreme Court held that, generally speaking, a proceeding is a civil proceeding only if it relates to a civil right whether resting on common law or created by statute. The nature of the proceeding depends not upon the nature of the tribunal which is invested with the authority to grant relief, but upon the nature of the right violated, and the appropriate relief which may be claimed. A civil proceeding is, therefore, one in which a person seeks to enforce, by appropriate relief, the alleged infringement of his civil rights against another person or the State, and which if the claim is proved would result in the declaration, express or implied, of the right claimed and relief such as payment of debt, damages, compensation, delivery of specific property, enforcement of personal rights, determination of status etc. There is thus a marked difference between Civil Proceeding and Criminal Proceeding.

51. If the principles laid down in *S.A.L. Narayan Row* v. *Ishwarlal Bhagwandas*(referred supra) is applied to the facts of the present case, the proceedings before this Court, before the Council and Committee are not criminal proceedings, and the rules of evidence applicable to criminal cases cannot be applied to the disciplinary proceedings initiated against the respondent.

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60. It is apparent from the above definitions that the Indian Evidence Act applies the same standard of proof in all civil cases. It makes no difference between cases in which charges of fraudulent or criminal character are made and cases in which such charges are not made. But this is not to say that the Court will not, while striking the balance of probability, keep in mind the presumption of honesty or innocence or the nature of the crime or fraud charged. In our opinion, Woodroffe, J., was wrong in insisting that such charges must be proved clearly and beyond reasonable doubt.

61. In view of the law laid down by the Constitution Bench of the Apex Court, in *Gulabchand* v. *Kudilal* (referred supra), and the Judgment of the Privy Council in *A, a pleader* v. *The Judges of the High Court of Madras* (referred supra), it must be held that the standard of proof required to establish a charge, in a disciplinary

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

proceedings, is on a preponderance of probabilities, and cannot be equated with the standard of proof in a criminal prosecution, wherein a charge is required to be proved beyond reasonable doubt. Accordingly, this point is decided.

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114. The Chartered Accountant is a professional whose expertise in accountancy is acknowledged. He is a member of an expert body and of a premier institute in India. The certificate issued by an Auditor has its own impact on the public at large, as it is largely on the basis of this certificate that the general public subscribe to the shares of the company. Reckless certification by an Auditor, which has resulted in the public being misled into subscribing to the shares of the company in the public issue, would undoubtedly amount to gross negligence. Large sections of society rely on the certification by the Chartered Accountants for taking many vital decisions. It is imperative that utmost care and caution is exercised in issuing such certificates, and the objectivity, integrity, reliability and credibility of the information therein is ensured. Of late, several instances have come to light where, due to the erroneous/ambiguous advice tendered by Chartered Accountants, borrowal accounts have had to face quick mortality resulting in huge losses for banks and financial institutions. To ensure public faith and protect gullible small investors from being cheated of their life savings, the Institute should ensure that its members possess competence of a high order, their character is above board, and their integrity beyond reproach. Chartered Accountants are responsible to the public for their actions, as heavy reliance is placed on their credibility by the general public consisting of investors, banks, financial institutions, governments etc. The Chartered Accountants duty is not merely to his client, but extends to various segments of society, more particularly in the commercial field, on whose expertise, integrity and impartiality they rely on in taking various decisions.

115. Larger public interest would be served only if Chartered Accountants maintain high ethical standards apart from her standards of expertise in accountancy and related fields. In the rare instances where Auditors are found to lack integrity, objectivity, professional competence, and to have failed to exercise due care and caution in issuing certificates, larger public interest would be served only if they are sternly dealt with. The certificate issued by the auditor is, in this case, the basis for the general public subscribing to the shares of the company. The present case best illustrates how a false and misleading certification by the Auditors, has resulted in the general public being cheated into believing that the promoters of the company had invested Rs. 2.25 crores in its capital, before the public at large were invited to invest in the share capital of the company.

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

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125. As seen from Clause (7) of Part I of Schedule II read with Section 21(5) and 22 of the Act, mere negligence by itself would not constitute misconduct, as the word negligence is prefixed with the word gross. What is gross negligence is a question required to be decided by us.

126. The Act does not define gross negligence, but it is defined in Black Law Dictionary as follows:

Gross Negligence:

1. A lack of slight diligence or care. 2. A conscious, voluntary act or omission in reckless disregard of a legal duty and of the consequences to another party, who may typically recover exemplary damages. Also termed reckless negligence; wanton negligence; willful negligence; willful and wanton negligence; hazardous negligence, magna neglegentia. 3. See criminal negligence.

127. Negligence is gross if the precautions to be taken against harm are very simple, such as persons who are but poorly endowed with physical and mental capacities can easily take. H.L.A. Hart, Negligence, Mens Rea and Criminal Responsibility, in Punishment and Responsibility 136, 149 (1968).

128. Gross Negligence. As it originally appeared, this was very great negligence, or the want of even slight or scant care. It has been described as a failure to exercise even that care which a careless person would use. Several courts, however, dissatisfied with a term so nebulous. have construed gross negligence as requiring willful, wanton, or reckless misconduct, or such utter lack of all care as will be evidence thereof. But it is still true that most courts consider that gross negligence falls short of a reckless disregard of the consequences, and differs from ordinary negligence only in degree, and not in kind.

129. Similarly, in Law Lexicon by P. Ramanatha Aiyar the word gross negligence is defined as follows:

130. Gross negligence, sometimes called wilful blindness is the same thing as negligence, with the additional of a vituperative epithet.

131. The term gross neglect means and involves a failure on the part of a person to take such reasonable precautions against the risk of an innocent person being deceived in the circumstances of the particular case.

132. Gross negligence means some culpable default, not arising merely from want of foresight or mistake of judgment.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

133. Negligence marked by total or nearly total disregard for the rights of others and by total or nearly total indifference to the consequences of an act.

134. For an act of negligence to constitute gross negligence, it must be in reckless disregard of a legal duty and of the consequences to another party, or wilful or voluntary or wanton omission. Negligence is the failure to take reasonable care as an ordinary prudent man, depending upon the circumstances of the case, would take.

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155. The Supreme Court also held that the Auditor holds a position of trust and it is his bounden duty to honour that trust by being candid with the shareholders, and telling them frankly and fully everything with regard to the affairs of the company which has come to his knowledge and which it is material for the shareholders to know; if an Auditor does not do what it is his duty to do, it is no defence for him to say in a disciplinary proceeding, started under the Chartered Accountants Act, that he had told the shareholders that he had not done it. The lapse is constituted by his failure to perform a duty without which an audit is meaningless and it is not excused by giving information of the omission to the share-holders. The reason is that the object of the Act is to ensure in public interest that those who practise the profession of Auditors shall perform, in their actual practice, at least the essential duties of an audit and shall bring to bear on their work attention to matters to which their duty requires them to pay attention, and the examination of accounts involves thorough and exhaustive testing of every account in the general ledger. If such negligence would cause no damage to anyone, such negligence cannot be termed as gross negligence within the definition of Section 22 of the Act.

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178. The professional misconduct attributed to the respondent is grave and serious in nature which affects public confidence, and their faith in the integrity and impartiality of the Chartered Accountants and the Institute of which they are members. A false certification by the respondent has enabled the promoters of the company to squander public money, on inducing the general public to subscribe to the share capital of the company. Taking a lenient view, or exonerating such professionals, would encourage others to indulge in similar acts, and completely erode the faith of the general public in the impartiality and integrity of the members of the Institute, and bring the Institute itself into disrepute.

179. The Council of the Institute has recommended removal of the name of the respondent from the Register of the Institute for a period

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> of three (3) years i.e. suspending him from practicing as a Chartered Accountant for a period of three (3) years. The recommendation of the Institute, regarding the nature of the punishment, is not binding on this Court and, in exercise of the wide powers conferred on it by the Act, this Court can impose a different punishment. In a similar situation, the Division Bench of this Court, in *Council of the Institute of Chartered Accountants of India* v. *V.I. Oommen* (referred supra), imposed a higher punishment than the one recommended by the Institute.
>
> **180.** In the light of the above discussion, after anxious consideration of the matter, we find it appropriate that the respondent herein should be suspended from practising as a Chartered Accountant for a period of three years from 01.11.2016 to 31.10.2019."
>
> **181.** Accordingly, the referred case is disposed of directing the respondent's membership with the Institute of Chartered Accountants of India shall stand suspended from 01.11.2016 to 31.10.2019, and, consequently, during that period he shall not practice or function as a Chartered Accountant. There shall be no order for costs."

272. As is evident from a reading of the conclusions rendered in *Mukesh Gang* the Supreme Court had in unequivocal terms found that the rules of evidence which otherwise inform criminal trials cannot be imputed to or held to govern proceedings initiated under the CA Act. It was held that the standard of proof required to establish a charge in those proceedings cannot be equated to that which applies to a criminal prosecution. It would thus be wholly incorrect for the proceedings in question being held to necessarily be in conformity with proof of evidence and the standard of beyond reasonable doubt and which are principles concerned with criminal trials alone.

273. That then takes us to the assertion of the petitioners being deprived of an opportunity to effectively meet the charges levelled in light of the proceedings being restricted to the audit file. We in the preceding parts of this judgment had an occasion to notice some of the provisions contained in the SAs and which had repeatedly laid

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

emphasis on the audit file and record being comprehensive and incorporating all material which may have constituted the basis for the conclusions appearing in the audit report. Suffice it to state that the charge of professional misconduct which may come to be laid against a CA or a firm would have to be necessarily proved and established on the basis of that audit record alone. The restriction of the proceedings to the audit record thus binds not only the person charged with misconduct but the NFRA itself.

274. Of course that is not to state, that an auditor or a firm is precluded from referring to material or standards that may be sought to be referred to in order to lend credence or support to the conclusions contained in the audit report. However, since the charge is to be proved solely on the basis of the audit record and the reports of investigation and other records, we find no merit in the challenge to the procedure prescribed under the NFRA Rules when they restrict the inquiry to the audit file.

275. Yet another submission which was advanced in challenge to the procedure contemplated under the NFRA Rules was on the basis of a procedure distinct from the Misconduct Rules, 2007 being made applicable only to a particular class of auditors and firms. The submission was that since an investigation or inquiry by the NFRA would only be in respect of a class of companies, which are spoken of in Rule 3, the same would lead to a situation where only auditors of such companies would be subjected to disciplinary proceedings undertaken in accordance with the NFRA Rules. All other auditors and firms, according to the writ petitioners, would continue to be governed

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

by the CA Act and the Rules framed thereunder.

276. The aforenoted submission is clearly misconceived since it proceeds on the premise that the NFRA Rules are far more stringent and onerous when compared to the Misconduct Rules, 2007. However, we have already in the preceding parts of this judgment found that the aforesaid contention is clearly untenable. Both the Misconduct Rules, 2007, as well as Rule 11(5) enjoin disciplinary proceedings to be conducted in accordance with the principles of natural justice and to follow a summary procedure of disposal. The Misconduct Rules, 2007 speak of oral examination and testimony only since proceedings under those rules could commence on the basis of information supplied or submitted by a complainant or an individual against an auditor or a firm. It is only to cater to such contingencies that those rules incorporate provisions of oral testimony and cross-examination. However, and as was noted hereinabove, disciplinary proceedings commenced on the basis of Section 132(4) are not concerned with individual complaints or the testimony of persons. Those proceedings commence either upon a reference by the Union Government or on information that may be available with the NFRA or the opinion formed by it in the course of discharge of its various statutory functional obligations contemplated under Rules 8, 9 and 10 of the NFRA Rules.

277. As was noted in the prefatory parts of this decision, Section 132(4) and the consequential rules framed to enable NFRA to discharge its functions, represent a policy decision taken by Parliament to bring the regulation of audits in tune with global practices. The statute thus

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

seeks to borrow from and adopt some of the best practices which inform the functioning of other regulatory bodies including the PCAOB and the FRC. The PCAOB is guided by the following Rules in the conduct of investigations:-

"**Rule 5100. Informal Inquiries**

(a) Commencement of an Informal Inquiry

The Director of Enforcement and Investigations may undertake an informal inquiry where it appears that, or to determine whether, an act or practice, or omission to act, by a registered public accounting firm, any associated person of that firm, or both, may violate -

(1) any provision of the Act;

(2) the Rules of the Board;

(3) the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under the Act; or

(4) professional standards.

(b) Informal Inquiry Activities

In an informal inquiry, the Director of Enforcement and Investigations may request documents, information or testimony from, or an interview with, any person.

Rule 5101. Commencement and Closure of Investigations

(a) Commencement of Investigations

(1) Order of Formal Investigation

Upon the recommendation of the Director of Enforcement and Investigations or the Director of Registration and Inspections, or upon the Board's own initiative, or otherwise, the Board may issue an order of formal investigation when it appears that an act or practice, or omission to act, by a registered public accounting firm or any person associated with a registered public accounting firm may violate any provision of the Act, the Rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

accountants with respect thereto, including the rules of the Commission issued under the Act, or professional standards.

(2) Designation of Staff

In an order of formal investigation, the Board may designate members, or groups of members, of the Board's staff to issue accounting board demands to, and otherwise require or request cooperation of, any person pursuant to Section 105(b)(2) of the Act, and the Board's Rules thereunder, to the extent the information sought is relevant to the matters described in the Board's order of investigation.

(b) Closure of Investigations

Upon the recommendation of the Director of Enforcement and Investigations, or on its own initiative, the Board may issue an order terminating or suspending, for a specified period of time, a formal investigation.

Rule 5102. Testimony of Registered Public Accounting Firms and Associated Persons in Investigations

(a) General

The Board, and the staff of the Board designated in an order of formal investigation, may require the testimony of any registered public accounting firm or any person associated with a registered public accounting firm, with respect to any matter that the Board considers relevant or material to an investigation.

(b) Accounting Board Demand for Testimony

The Board, and the staff of the Board designated in an order of formal investigation, shall require testimony by serving an accounting board demand that -

(1) gives reasonable notice of the time and place for the taking of testimony;

(2) states the method or methods by which the testimony shall be recorded, which may be by sound or sound-and-visual, but shall include by stenographic means; and

(3) if the person to be examined is a registered public accounting firm, a description with reasonable particularity of the matters on which examination is requested.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(c) Conduct of Examination

(1) Oath or Affirmation

Before testifying, every witness shall be required to declare that the witness will testify truthfully, by oath or affirmation administered in a form calculated to awaken the witness's conscience and impress the witness's mind with the duty to do so.

(2) General

Examinations shall be conducted before a reporter designated by the Board's staff.

(3) Persons Permitted to be Present

Persons permitted to be present at an examination pursuant to this Rule are limited to -

(i) the person being examined and his or her counsel, subject to Rule 5109(b);

(ii) any Board member or member of the staff of the Board;

(iii) the reporter; and

(iv) such other persons as the Board, or the staff of the Board designated in the order of formal investigation, determine are appropriate to permit to be present; provided, however, that in no event shall a person other than the witness who has been or is reasonably likely to be examined in the investigation be present.

(4) Examinations of Registered Public Accounting Firms

A registered public accounting firm subject to an accounting board demand shall designate one or more individuals who consent to testify on its behalf, and shall set forth, for each individual designated, the matters on which the individual will testify. The individuals so designated shall testify as to matters known or reasonably available to the registered public accounting firm.

(d) Transcript

A witness shall have 15 days, or such longer period as the Director of Enforcement and Investigations may allow, after being notified by the reporter that the transcript, or, where applicable, video or other recording, is available in which to review the transcript or other recording and, if there are changes in form or

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

substance, to sign a statement reciting such changes and the reasons given by the witness for making them. The reporter shall make a certificate in writing to accompany the transcript, which shall indicate -

(1) that the witness was duly sworn by the officer and that the transcript is a true record of the testimony given by the witness; and

(2) whether the witness requested to review the transcript and, if so, that the reporter has appended any changes made by the witness during the period allowed.

Rule 5105. Requests for Testimony or Production of Documents from Persons Not Associated With Registered Public Accounting Firms

(a) Testimony

The Board, and the staff of the Board designated in an order of formal investigation, may issue an accounting board request for the testimony of any person, including any client of a registered public accounting firm, that the Board considers relevant or material to an investigation.

(1) Requests for Testimony

An accounting board request for testimony pursuant to subparagraph (a) of this Rule shall -

(i) give appropriate notice, subject to the needs of the investigation of the time and place for the taking of testimony;

(ii) state the method or methods by which the testimony shall be recorded, which may be by sound or sound-and-visual, but shall include by stenographic means; and

(iii) if the person to be examined is an issuer, broker, dealer, partnership, association, governmental agency, or other organized entity, provide a description with reasonable particularity of the matters on which examination is requested.

(2) Conduct of Examination and Transcript

An examination requested pursuant to this Rule shall be conducted consistent with Rules 5102(c) and a transcript shall be prepared consistent with Rule 5102(d). If the person to be examined is an issuer, broker, dealer, partnership, association, or governmental agency, the person to be examined shall designate one or more individuals who consent to testify on its behalf and shall set forth, for each individual designated, the matters on which the individual will testify. The individuals so designated shall testify as to matters known or reasonably available to the organization.

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(b) Documents

The Board, and the staff of the Board designated in an order of formal investigation, may issue an accounting board request to any person, including any issuer, broker, or dealer for the production of any document that is relevant or material to an investigation, with appropriate notice, subject to the needs of the investigation. A request issued pursuant to this Rule shall set forth a reasonable time and place for production, subject to the needs of the investigation.

Note: Failure to comply with an accounting board request pursuant to Rule 5105 may result in a Board request for the issuance of a Commission subpoena, pursuant to Rule 5111.

Rule 5200. Commencement of Disciplinary Proceedings

(a) Grounds for Commencement of Disciplinary Proceedings

The Board may commence a disciplinary proceeding when –

(1) it appears to the Board, as the result of an investigation or otherwise, that a hearing is warranted to determine whether a registered public accounting firm, or an associated person of such a firm, has engaged in any act or practice, or omitted to act, in violation of the Act, the Rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under the Act, or professional standards;

(2) it appears to the Board, as the result of an investigation or otherwise, that a hearing is warranted to determine whether a registered public accounting firm, or any person who is, or at the time of the alleged failure reasonably to supervise was, a supervisory person of such firm, has failed reasonably to supervise an associated person, either as required by the Rules of the Board relating to auditing or quality control standards, or otherwise, with a view to preventing violations of this Act, the Rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission under the Act, or professional standards, and that such associated person has committed a violation of the Act, or of any such rules, laws, or standards;

(3) it appears to the Board that a hearing is warranted pursuant to Rule 5110.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

[Effective pursuant to SEC Release No. 34-49704, File No. PCAOB-2003-07 (May 14, 2004); and SEC Release No. 34-72087, File No. PCAOB-2013-03 (May 2, 2014)]

(b) Presiding Official

All proceedings shall be presided over by the Board or, if the Board orders, by a hearing officer.

(c) Assignment of a Hearing Officer

Subject to Rule 5200(b), as soon as practicable after the Board has issued an order instituting proceedings, or after a registration applicant has requested a hearing pursuant to Rule 5500(b), the Secretary shall assign a hearing officer to preside over the proceeding and shall serve the parties with notice of the hearing officer's assignment. Subject to Rules 5402 and 5403, the hearing officer shall have the authority to do all things necessary and appropriate to discharge his or her duties. The powers of the hearing officer include, but are not limited to, the following –

(1) obtaining a court reporter to administer oaths and affirmations;

(2) issuing accounting board demands pursuant to Rule 5424;

(3) receiving relevant evidence and ruling upon the admission of evidence and offers of proof;

(4) regulating the course of a proceeding and the conduct of the parties and their counsel;

(5) holding prehearing and other conferences and requiring the attendance at any such conference of at least one representative of each party who has authority to negotiate concerning the resolution of issues in controversy;

(6) recusing himself or herself upon motion made by a party or upon his or her own motion;

(7) ordering, in his or her discretion, in a proceeding involving more than one respondent, that the interested division indicate, on the record, at least one day prior to the presentation of any evidence, each respondent against whom that evidence will be offered;

(8) subject to any limitations set forth elsewhere in these Rules, considering and ruling upon all procedural and other motions;

(9) preparing an initial decision as provided in Rule 5204;

(10) upon notice to all parties, reopening any hearing prior to the filing of an initial decision therein, or, if no initial decision is

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

to be filed, prior to the time fixed for the filing of final briefs with the Board;

(11) informing the parties as to the availability of one or more alternative means of dispute resolution, and encouraging the use of such methods; and

(12) scheduling hearing dates, except that a hearing officer may not, absent the approval of the Board, change a hearing date set by Board order.

(d) Separation of Functions

The staff of the Division of Enforcement and Investigations may not participate or advise in the decision, or in Board review of the decision, in any proceeding in which the Division of Enforcement and Investigations is the interested division, except as a witness or counsel in the proceeding. Any other employee or agent of the Board engaged in the performance of investigative or prosecutorial functions for the Board in a proceeding may not, in that proceeding or one that is factually related, participate or advise in the decision, or in Board review of the decision, except as a witness or counsel in the proceeding. A hearing officer may not be responsible to or subject to the supervision or direction of an employee or agent engaged in the performance of investigative or prosecuting functions for the Board.

(e) Consolidation of Proceedings

By order of the Board or a hearing officer, proceedings involving a common question of law or fact may be consolidated for hearing of any or all the matters at issue in such proceedings. The Board or the hearing officer may make such orders concerning the conduct of such proceedings as it deems appropriate to avoid unnecessary cost or delay. Consolidation shall not prejudice any rights under these Rules and shall not affect the right of any party to raise issues that could have been raised if consolidation had not occurred. For purposes of this Rule, no distinction is made between joinder and consolidation of proceedings."

A consideration of the above would establish that the NFRA Rules are broadly in consonance with the above. The departure occurs only on account of oral testimony being excluded.

DIVISIONS : SEPARATION OF FUNCTIONS

278. That takes us to the next segment of our decision and which

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

pertains to the contention that the NFRA failed to follow the statutory scheme itself and with a common complement of people authoring the AQRR which contained damning findings of guilt and the same body thereafter taking a decision to commence disciplinary proceedings. Our attention was firstly drawn to Section 132(1)(a) and which prescribes that the NFRA would perform its functions through such divisions as may be prescribed. The petitioners also invited our attention to Section 132(3)(a) and which stipulates that each division of the NFRA would be presided over by its Chairperson or a full time member authorized by the former. The petitioners lay stress on the clear and distinct role which is assigned to the Executive Body on the other hand and whose composition is spelt out in Section 132(3)(b).

279. Proceeding then to the Rules, the petitioners alluded to Rule 2(g) and which defines that word to mean a division including one headed by a Chairperson or a full time member established for the purpose of organizing and carrying out its functions and duties. It was submitted that the broad division of functions amongst separate units of the NFRA is clearly evident from the statutory scheme underlying the NFRA Rules and which at more than one place speak of the *"concerned division"*.

280. For instance, they referred to Rule 7(4) and which postulates that if the NFRA has reason to believe that any accounting standard has been violated, it may take a decision on the further course of investigation or action liable to be undertaken *"through its concerned division"*. The petitioners underscore the fact that the dichotomy of functions which are envisaged to be performed by different divisions of

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

the NFRA stands replicated in Rule 8(8). The said Rule too enjoins the authority to chart a future course of investigation or enforcement *"through its concerned division"*. Similar provisions are found in Rule 10 and which entails the NFRA forwarding a particular case for investigation or a reference received by the Union Government or even where it were to suo moto decided to commence an investigation to a division dealing with enforcement. The aforesaid position again stands reiterated in Rule 11 and which in unequivocal terms provides that based on the findings of the NFRA in the course of discharge of its monitoring, enforcement or oversight functions, if sufficient cause were found to exist warranting action being taken under Section 132(4), the matter would be referred to the concerned division which shall thereafter dispose of the SCN proceedings. This is a position which also emerges from a reading of sub-rule (5) of Rule 11.

281. Reference in this respect was also made to Rules 14 and 18 of the Misconduct Rules, 2007 and which are extracted hereinbelow: -

> " **14. Procedure to be followed by the Board of Discipline**
>
> (1) The Board of Discipline shall follow summary disposal procedure in dealing with all cases before it, as laid down in this Chapter.
>
> (2) If the Board of Discipline decides to proceed further under clause (b) of sub-rule (2) of rule 9 or under clause (b) of sub-rule (3) of rule 9, it shall expeditiously cause to deliver to the respondent and the complainant, a copy each of the following:–
>
> (a) prima facie opinion formed by the Director; and
>
> (b) particulars or documents relied upon by the Director, if any, during the course of formulation of prima facie opinion.
>
> (3) The Board of Discipline shall inform the respondent to file a written statement, within such time as may be specified:
>
> Provided that the Board of Discipline may give him additional time for submitting his written statement on application by the respondent

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

on his adducing sufficient reasons to the satisfaction of the Board of Discipline for seeking additional time:

Provided further that such additional time shall not be given more than once and if the respondent still does not submit a written statement, the Board of Discipline shall presume that he has no further submissions to make and shall proceed to decide the case on merits.

(4) The respondent shall send a copy of his written statement, along with supporting documents, to the Director and the complainant within the stipulated time.

(5) The complainant or the Director may, after receipt of the written statement, submit a rejoinder to the Board of Discipline, with a copy to the respondent, along with supporting documents, if any.

(6) The Presiding Officer of the Board of Discipline shall fix a date, hour and place of hearing, which shall not ordinarily be later than 45 days from the date of receipt of prima facie opinion and the Board of Discipline shall cause a notice to be sent of such date, hour and place to the Director, respondent and complainant and require them to appear before it in person to make oral submissions, if any.

Explanation 1. − For the purpose of this rule, the appearance includes, unless and otherwise directed, appearance by an advocate or through any authorized representative, who may be a Chartered Accountant, Cost Accountant or Company Secretary. 1

[Explanation 2 - For the purpose of this rule, the appearance also includes the appearance through video-conference, modalities for which may be as formulated by the Institute from time to time.]

(7) On the date of hearing, if the respondent, in spite of the service of notice, under sub-rule (6), does not appear either in person 1 [or through video conference in terms of the modalities formulated under these Rules] or through his authorized representative, the Board of Discipline may proceed ex-parte and pass such orders as it may think fit or direct fresh notice to be served.

(8) The Board of Discipline may, on such terms as it thinks fit, and at any stage of the proceedings, adjourn the hearing: Provided that such adjournment shall not be given more than once at any stage of the proceedings.

(9) The Board of Discipline shall consider the written representations, including the written statements, rejoinder and supporting documents, and the oral submissions, if any made by the Director, the complainant and the respondent and arrive at a finding on whether the respondent is guilty or not of any professional or other misconduct.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

xxxx xxxx xxxx

18. Procedure to be followed by the Committee

(1) The Committee shall be guided by the principles of natural justice and shall follow the procedure in dealing with all cases before it, as laid down in this Chapter.

(2) If the Committee decides to proceed further under clause (b) of sub-rule (2) of rule 9 or if it receives a reference from Board of Discipline under clause (b) of sub-rule (3) of rule 9, it shall expeditiously cause to deliver to the respondent and the complainant, a copy each of the following, −

(a) prima facie opinion formed by the Director, and (b) particulars or documents relied upon by the Director, if any, during the course of formulation of prima facie opinion.

(3) The Committee shall inform the respondent, as the case may be to file a written statement, within such time as may be specified: Provided that the Committee may give him additional time for submitting his written statement, on application by the respondent on his adducing sufficient reasons to the satisfaction of the Committee for seeking additional time:

Provided further that such additional time shall not be given more than once and if the respondent still does not submit a written statement, the Committee shall presume that he has no further submissions to make and shall proceed to decide the case on merits.

(4) The respondent shall send a copy of his written statement, along with supporting documents and a list of witnesses, to the Director and the complainant within the stipulated time.

(5) The complainant or the Director may, after receipt of the written statement, submit a rejoinder to the Committee, with a copy to the respondent, along with supporting documents, if any.

(6) The Presiding Officer of the Committee shall fix a date, hour and place of hearing, which shall not ordinarily be later than 45 days from the date of receipt of prima facie opinion and the committee shall cause a notice to be sent of such date, hour and place to the Director, respondent and complainant and require them to appear before it in person to make oral submissions, if any.

[Explanation 1. – For the purpose of this rule, the appearance includes, unless and otherwise directed, appearance by an advocate or through any authorized representative, who may be a Chartered Accountant, Cost Accountant or Company Secretary.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

[Explanation 2. - For the purpose of this rule, the appearance also includes the appearances through video-conference, modalities for which may be as formulated by the Institute from time to time.]"

282. It becomes pertinent to note that by virtue of the Act and the NFRA Rules, all matters pertaining to investigation, monitoring, enforcement and disciplinary proceedings are to be decided by the Chairperson or any one or more of the full-time members acting through "one of the divisions". According to the petitioners, while a division may be headed by either a Chairperson or a full time Member, it would be clearly untenable in law for the same body of persons donning the dual role of examining compliance with auditing standards and thereafter using the said material to form an opinion as to whether disciplinary proceedings should be initiated. The writ petitioners would contend that a conspectus of the provisions comprised in the Act as well as the NFRA Rules makes it abundantly clear that the monitoring and oversight functions, the power of the NFRA to investigate as well as the power to initiate and adjudicate disciplinary proceedings are necessarily required to be performed through separate divisions. They assert that in the facts of these cases, it becomes apparent that no separate divisions in fact existed.

283. The petitioners thereafter invited our attention to our order of 12 September 2023 passed in these proceedings. Pursuant to the directions issued by us on that date, the NFRA had filed an affidavit dated 06 October 2023 contents whereof have been extracted hereinbefore. According to the writ petitioners, from the disclosures so made, it is manifest that NFRA admits that the AQRR and SAQRR was prepared and approved by its Executive Body and it was that body which

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

decided to issue the impugned notices. It was submitted that it is thus apparent that was the Executive Body which prepared and approved the Show Cause Notices which came to be issued to the partners and it was that very body which had heard oral arguments.

284. It was submitted that the statutory provisions requiring NFRA to discharge its functions through separate divisions is based on the principles of natural justice itself and which forbids a person from being a judge in its own cause. We were referred to the well-settled precept of reasonable likelihood of bias and which ordains that bias need not be actually proved in fact. It was submitted that proceedings would be rendered a nullity even where one were able to establish from the circumstances obtaining that a reasonable apprehension of bias could arise. According to the writ petitioners, it is this reasonable apprehension and likelihood of bias which is frowned upon by courts.

285. In order to buttress the aforesaid contentions, the petitioners cited for our consideration the judgment of the Supreme Court in **Mohd. Yunus Khan vs. State of Uttar Pradesh and Ors.**[81] and where it was held that a witness in a case can neither initiate disciplinary proceedings nor pass an order of punishment. The judgment in *Mohammad Yunus Khan*, however, and in our considered opinion, is clearly distinguishable since what it essentially held was that a person cannot don the dual role of being a witness in an enquiry as well as act as the Inquiry Officer. Neither the NFRA as a body nor its Executive Body can possibly be construed as having acted as a witness in proceedings.

286. The decision cited by the writ petitioners in the matter of

[81] (2010) 10 SCC 539

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

Institute of Chartered Accountants of India vs. LK Ratna and Ors.[82], however, would be more apt since the said judgment was rendered in the context of the CA Act and the disciplinary powers which stand vested in the Council. It would thus be appropriate to refer to the following passage of that decision: -

> " **24.** There can be no dispute that the function of the Disciplinary Committee of holding an enquiry under Section 21(1) of the Act into the conduct of the member calls for a recording of evidence by the Committee. Its duty does not end there. It must consider the evidence and come to its conclusions. As Section 21(2) of the Act plainly says, it must report "the result of its enquiry" to the Council. In the absence of express or implied statutory intendment to the contrary, it appears to us that the members of such a Committee would be disqualified from participating in the deliberations of the Council when it proceeds to consider the report in order to find whether the member is guilty of misconduct. For that alone would be consistent with the fundamental principle that justice must not only be done but must also appear to be done. The nature of the function discharged by the Council in rendering its finding is quasi-judicial, and we are reminded of the observations of this Court as far back as *Manek Lal* v. *Prem Chand* [AIR 1957 SC 425 : 1957 SCR 575, 580-81] :
>
> > "It is well settled that every member of a tribunal that is called upon to try issues in judicial or quasi-judicial proceedings must be able to act judicially; and it is of the essence of judicial decisions and judicial administration that Judges should be able to act impartially, objectively and without any bias. In such cases the test is not whether in fact a bias has affected the judgment; the test always is and must be whether a litigant could reasonably apprehend that a bias attributable to a member of the Tribunal might have operated against him in the final decision of the Tribunal. It is in this sense that it is often said that justice must not only be done but must also appear to be done." "

287. SRBC while advancing submissions similar to those canvassed by DHS had urged that it is manifest from the disclosures made by the

[82] (1986) 4 SCC 537

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

respondent that all functions had been bundled into one singular body, namely the Executive Body. It was contended that since Section 132(3)(b) clearly and specifically spells out the composition of the Executive Body, it would be wholly incorrect to equate it to a division and which is separately defined under the NFRA Rules quite apart from having been spoken of in the principal provision of the Act itself. The petitioners in this respect also sought to highlight the distinction and division of functions which are factored in and placed as salutary safeguards to guide proceedings taken by similar regulatory bodies including the PCAOB as well as the FRC. We propose to deal with some of those provisions and which regulate the functioning of those authorities in the latter parts of this decision.

288. It was thus contended that the overlapping of functions coupled with the admitted fact of a body of individuals having discharged a dual role and function despite the separation which is envisaged, gives rise to a reasonable apprehension of likelihood of bias. Our attention was in this context drawn to the decision of the US Supreme Court in **Williams vs. Pennsylvania**[83] and where the following illuminating passages appear:-

> "Due process guarantees "an absence of actual bias" on the part of a judge. In re Murchison, 349 U. S. 133, 136 (1955). Bias is easy to attribute to others and difficult to discern in oneself. To establish an enforceable and workable framework, the Court's precedents apply an objective standard that, in the usual case, avoids having to determine whether actual bias is present. The Court asks not whether a judge harbors an actual, subjective bias, but instead whether, as an objective matter, "the average judge in his position is 'likely' to be neutral, or whether there is an unconstitutional 'potential for bias.'" Caperton, 556 U. S., at 881. Of particular relevance to the instant

[83] 579 U.S. ___ (2016)

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

case, the Court has determined that an unconstitutional potential for bias exists when the same person serves as both accuser and adjudicator in a case. See Murchison, 349 U. S., at 136–137. This objective risk of bias is reflected in the due process maxim that "no man can be a judge in his own case and no man is permitted to try cases where he has an interest in the outcome." Id., at 136.

The due process guarantee that "no man can be a judge in his own case" would have little substance if it did not disqualify a former prosecutor from sitting in judgment of a prosecution in which he or she had made a critical decision. This conclusion follows from the Court's analysis in In re Murchison. That case involved a "one-man judge grand jury" proceeding, conducted pursuant to state law, in which the judge called witnesses to testify about suspected crimes. Id., at 134. During the course of the examinations, the judge became convinced that two witnesses were obstructing the proceeding. He charged one witness with perjury and then, a few weeks later, tried and convicted him in open court. The judge charged the other witness with contempt and, a few days later, tried and convicted him as well. This Court overturned the convictions on the ground that the judge's dual position as accuser and decisionmaker in the contempt trials violated due process: "Having been a part of [the accusatory] process a judge cannot be, in the very nature of things, wholly disinterested in the conviction or acquittal of those accused." Id., at 137.

No attorney is more integral to the accusatory process than a prosecutor who participates in a major adversary decision. When a judge has served as an advocate for the State in the very case the court is now asked to adjudicate, a serious question arises as to whether the judge, even with the most diligent effort, could set aside any personal interest in the outcome. There is, furthermore, a risk that the judge "would be so psychologically wedded" to his or her previous position as a prosecutor that the judge "would consciously or unconsciously avoid the appearance of having erred or changed position." Withrow, 421 U. S., at 57. In addition, the judge's "own personal knowledge and impression" of the case, acquired through his or her role in the prosecution, may carry far more weight with the judge than the parties' arguments to the court. Murchison, supra, at 138; see also Caperton, supra, at 881."

289. Yet another decision which was cited in this respect was that of the Supreme Court in **Ranjit Thakur vs Union of India**[84] and which

[84] (1987) 4 SCC 611

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

had explained the concept of bias in the following words:-

> " **"16.** It is the essence of a judgment that it is made after due observance of the judicial process; that the court or tribunal passing it observes, at least the minimal requirements of natural justice; is composed of impartial persons acting fairly and without bias and in good faith. A judgment which is the result of bias or want of impartiality is a nullity and the trial "*coram non-judice*". (See *Vassiliades* v. *Vassiliades* [AIR 1945 PC 38 : 221 IC 603]
>
> **17.** As to the tests of the likelihood of bias what is relevant is the reasonableness of the apprehension in that regard in the mind of the party. The proper approach for the Judge is not to look at his own mind and ask himself, however, honestly, "Am I biased?"; but to look at the mind of the party before him.
>
> **18.** Lord Esher in *Allinson* v. *General Council of Medical Education and Registration* [(1894) 1 QB 750, 758-59] said:
>
> > "The question is not, whether in fact he was or was not biased. The court cannot inquire into that. . . . In the administration of justice, whether by a recognised legal court or by persons who, although not a legal public court, are acting in a similar capacity, public policy requires that, in order that there should be no doubt about the purity of the administration, any person who is to take part in it should not be in such a position that he might be suspected of being biased."
>
> **19.** In *Metropolitan Properties Co. (F.G.C.) Ltd.* v. *Lannon* [(1969) 1 QB 577, 599] Lord Denning M.R. observed:
>
> > ". . . in considering whether there was a real likelihood of bias, the court does not look at the mind of the justice himself or at the mind of the chairman of the tribunal, or whoever it may be, who sits in a judicial capacity. It does not look to see if there was a real likelihood that he would, or did, in fact favour one side at the expense of the other. The court looks at the impression which would be given to other people. Even if he was as impartial as could be, nevertheless if right-minded persons would think that, in the circumstances, there was a real likelihood of bias on his part, then he should not sit."
>
> **20.** Frankfurter, J. in *Public Utilities Commission of the District of Columbia* v. *Pollak* [343 US 451, 466-67 : 96 L Ed 1068, 1079] said:
>
> > "The judicial process demands that a Judge move within the framework of relevant legal rules and the covenanted modes of thought for ascertaining them. He must think

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> dispassionately and submerge private feeling on every aspect of a case. There is a good deal of shallow talk that the judicial robe does not change the man within it. It does. The fact is that on the whole Judges do lay aside private views in discharging their judicial functions. This is achieved through training, professional habits, self-discipline and that fortunate alchemy by which men are loyal to the obligation with which they are entrusted. But it is also true that reason cannot control the subsconscious influence of feelings of which it is unaware. When there is ground for believing that such unconscious feelings may operate in the ultimate judgment, or may not unfairly lead others to believe they are operating, Judges recuse themselves. They do not sit in judgment."

21. Referring to the proper test, Ackner, L.J. in *Regina* v. *Liverpool City Justices, ex parte Topping* [(1983) 1 WLR 119 : (1983) 1 All ER 490, 494] said:

> "Assuming, therefore, that the magistrates had applied the test advised by Mr Pearson: 'Do I feel prejudiced?' then they would have applied the wrong test, exercised their discretion on the wrong principle and the same result, namely, the quashing of the conviction, would follow."

22. Thus tested the conclusion becomes inescapable that, having regard to the antecedent events, the participation of Respondent 4 in the court-martial rendered the proceedings *coram non-judice.*

xxxx xxxx xxxx

25. Judicial review generally speaking, is not directed against a decision, but is directed against the "decision-making process". The question of the choice and quantum of punishment is within the jurisdiction and discretion of the court-martial. But the sentence has to suit the offence and the offender. It should not be vindictive or unduly harsh. It should not be so disproportionate to the offence as to shock the conscience and amount in itself to conclusive evidence of bias. The doctrine of proportionality, as part of the concept of judicial review, would ensure that even on an aspect which is, otherwise, within the exclusive province of the court-martial, if the decision of the court even as to sentence is an outrageous defiance of logic, then the sentence would not be immune from correction. Irrationality and perversity are recognised grounds of judicial review. In *Council of Civil Service Unions* v. *Minister for the Civil Service* [(1984) 3 WLR 1174 (HL) : (1984) 3 All ER 935, 950] Lord Diplock said:

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> "Judicial review has I think developed to a stage today when, without reiterating any analysis of the steps by which the development has come about, one can conveniently classify under three heads the grounds on which administrative action is subject to control by judicial review. The first ground I would call 'illegality', the second 'irrationality' and the third 'procedural impropriety'. That is not to say that further development on a case by case basis may not in course of time add further grounds. I have in mind particularly the possible adoption in the future of the principle of 'proportionality' which is recognised in the administrative law of several of our fellow members of the European Economic Community;. . ."

26. In *Bhagat Ram* v. *State of Himachal Pradesh* [(1983) 2 SCC 442 : 1983 SCC (L&S) 342 : AIR 1983 SC 454] this Court held: [SCC p. 453, SCC (L&S) p. 353, para 15]

> "It is equally true that the penalty imposed must be commensurate with the gravity of the misconduct, and that any penalty disproportionate to the gravity of the misconduct would be violative of Article 14 of the Constitution."

The point to note, and emphasise is that all powers have legal limits.

27. In the present case the punishment is so strikingly disproportionate as to call for and justify interference. It cannot be allowed to remain uncorrected in judicial review."

290. Insofar as the facts are concerned, SRBC had additionally asserted that the proceedings which were undertaken and the hearings conducted were fatally flawed since the full complement of the authority was not even in place on the relevant dates. They have sought to highlight this aspect by drawing our attention to the following table in order to buttress their contention that at different stages of the impugned proceedings, the NFRA had not even been constituted in accordance with the Act. The table seeks to underscore the absence of the requisite number of full-time members who could have chaired and headed the committee which drew up the prima facie conclusions, the DAQRR, the AQRR and all of which ultimately culminated in the

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

issuance of the impugned SCNs'. That chart is reproduced hereinbelow:-

*" **Tabulation of number of full-time members in NFRA at every stage of the review and disciplinary proceedings in each matter.***

S.NO.	DOCUMENT	DATE OF ISSUANCE-ITNL WPC 11737/2021, WPC 11738/2021, WPC 11739/2021	NO. OF FULL TIME MEMBERS ON DATE OF ISSUANCE	DATE OF ISSUANCE-IL & FS WPC 11987/2021, WPC 1650/2023	NO. OF FULL TIME MEMBERS ON DATE OF ISSUANCE	DATE OF ISSUANCEWPC 2194/2023	NO. OF FULL TIME MEMBERS ON DATE OF ISSUANCE
1.	**Questionnaire-1**	03.07.2019 *(Annexure P-8, pg. 122-135)*	1 (Prasenjit Mukherjee)	19.11.2019 *(Annexure P-6, pg. 123-147)*	1 (Prasenjit Mukherjee)	--	--
2.	**Questionnaire-2**	19.07.2019 *(Annexure P-10, pg. 138-141)*		26.08.2020 (Supplementary Questionnaire) *(Annexure P-8, pg. 340-348)*		--	--
3.	**PFC**	24.03.2020 *(Annexure P-25, pg. 340 – 460)*		21.12.2020 *(Annexure P-10, pg. 651-899)*		--	--
4.	**SPFC**	17.04.2020 *(Annexure P-26, pg. 461-481)*		--		--	--
5.	**DAQRR**	08.03.2021 *Annexure P-27, pg. 482 - 839)*		23.07.2021 *Annexure P- 11, pg. 900-1231)*		--	--
6.	**1st Oral Hearing**	08.09.2021		17.05.2022	2 (Smita Jhingran, Praveen Kr. Tiwari)	--	--
7.	**Publication of**	23.09.2021 *(Annexure P-*		22.06.2022 *(Annexure*		--	--

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

	AQRR	*29, pg. 841 - 1183)*		*P-15, pg. 1235-1623)*			
8.	**SCN**	29.09.2021 *(Annexure P-31, pg. 1210 - 1585)*		27.06.2022 *(Annexure P- 16 pg. 1624-2028)*		05.01.2023 *(Annexure P-15, pg. 168-202)*	2 (Smita Jhingran, Praveen Kr. Tiwari
9.	**2nd Oral Hearing**	05.07.2023 Chaired by EB: Ajay Bhushan Pandey, Smita Jhingran, Praveen Kr. Tiwari	2 (Smita Jhingran, Praveen Kr. Tiwari)	Jayesh Gandhi: 17.08.2023 N Ramkrishna: 11.10.2023 Ajay Bhushan Pandey, Smita Jhingran, Praveen Kr. Tiwari		13.07.2023 Ajay Bhushan Pandey, Smita Jhingran, Praveen Kr. Tiwari	2 (Smita Jhingran, Praveen Kr. Tiwari)

”

291. The petitioners also alleged that the affidavit submitted by NFRA pursuant to our order of 12 September 2023 is wholly vague and clearly fails to inspire confidence since there has been a deliberate omission to make a full, complete and candid disclosure. This was sought to be underscored with reference to the following concise table: -

“ A. CONTENTS OF THE AFFIDAVIT IN LIGHT OF THE DIRECTIONS IN THE ORDER DATED 12.09.2023:

SNO	DIRECTION IN ORDER (PARA 6) Affidavit to place on record:	COMPLIANCE IN AFFIDAVIT
1.	Details with respect to proceedings drawn and initiated by the Authority and drawn against the petitioners here.	**Although the Affidavit makes** submissions with respect to the body that drafted the AQRR and the SCN, there is no submission regarding which division of the NFRA drafted the PFC, SPFC, DAQRR.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

		Therefore, the details with respect to proceedings drawn and initiated by the Authority in the Affidavit are not complete.
2.	Complete details of the personnel who penned the AQRR in each particular case as well as the complement of persons who initiated action under Section 132(4) and ultimately passed the orders impugned.	The affidavit does not provide any personnel details in this regard. It only mentions the: - Executive Body, NFRA ("**EB**") - Secretary, NFRA - Chief General Manager, NFRA("**CGM**") and; - a team under the CGM There is no specific submission with respect to: - the composition of the EB; - the names of the respective EB members in each specific case; - the eligibility and qualification of such members of the EB; - the names of the respective CGM involved in each specific case *(NFRA website shows currently 2 CGMs, record of previous CGMs not available);* - the qualification of the CGM; - the composition of the team under the CGM; - the names of the respective Secretaries involved in each specific case *(NFRA website on shows the name of the present Secretary, record of past Secretaries not available)*

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

B. CONTRADICTIONS WITH THE APPLICABLE SECTIONS AND RULES

SNO	PROVISION	CONTRADICTION
1.	Section 132(3B), Companies Act: *"There shall be an executive body of the National Financial Reporting Authority consisting of the Chairperson and fulltime Members of such Authority for efficient discharge of its functions under sub-section (2) other than clause (a) and sub-section (4)"*	The Affidavit gives no details about the composition or strength of the EB during the different stages in each case and such information is also not available on the NFRA website. The order directs NFRA to Complete details of the personnel who penned the AQRR in each particular case as well as the complement of persons who initiated action under Section 132(4) and ultimately passed the orders impugned. It is not possible to ascertain whether the EB at each stage in different cases was composed in compliance with the requirements of Section 132(3B).
2.	Rule 3(1), NFRA (Manner of Appointment and other Terms and Conditions of Service of Chairperson and Members) Rules, 2018: **Composition of Authority:** (1) The Authority ***shall*** consist of the following persons to be appointed by the Central Government, namely:- (a) a chairperson; (b) three full time members; and (c) nine part time members.	*Tenure of all Full-time members of NFRA till date:* • Dr Prasenjit Mukherjee: 03.10.2018 to 01.10.2021 • Dr. Praveen Kumar Tiwari: 28.03.2022 to present • Ms. Smita Jhingran: 19.04.2022 to Present Use of the word 'shall' makes it **mandatory** for NFRA to have, **at all times, 3 full time members**. From the abovementioned tenures of full time members, it is evident that NFRA, from its establishment till date, does not have the requisite number of full-time members.
3.	Section 132(1A) of the Companies Act: *"The National Financial Reporting Authority shall perform its functions* ***through such divisions*** *as may be prescribed"*	Despite the prescribed mandate for NFRA to discharge its functions through divisions, the submissions in the affidavit make it clear that NFRA has not functioned through divisions as the EB itself has: - Scrutinized the audit file - Prepared and signed the AQR

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

		- Conducted the investigation for drafting of SCN - Prepared and approved the SCN - Conducted the oral hearing It is therefore evident that NFRA has not adhered to the mandate of functioning through divisions.
4.	Section 132(4)(a), Companies Act: "*Notwithstanding anything contained in any other law for the time being in force, the National Financial Reporting Authority shall— (a) have the power to investigate,* ***either suo motu or on a reference made to it by the Central Government,*** *for such class of bodies corporate or persons, in such manners may be prescribed into the matters of professional or other misconduct committed by any member or firm of chartered accountants, registered under the Chartered Accountants Act, 1949"*	[Page 16, Page 20, Page 29 of Affidavit] The affidavit states that "*The AQR of the ILFS group was started suo-motu as authority/official decided by the EB. Later, a reference from the central government was also received by NFRA on the same the initiation of matter.*" However, no communication in the above cases has been received by the Petitioners from NFRA stating that NFRA initiated the said proceedings in suo moto exercise of its powers. [Page 33 of affidavit] Although the SCN in this case is based on the letter dated 11.05.2021 containing SEBI's findings, NFRA has neither cited suo moto initiation nor central government reference in this para of the affidavit and there has been no investigation conducted by NFRA in this matter. Therefore, the Affidavit gives no clarity about who initiated action under Section 132(4) in this case as directed by the order. "*reasons to believe that sufficient cause existed to initiate action u/s 132(4)*" were not communicated to the Petitioner to provide a response.

"

292. Refuting the aforesaid submissions, Mr. Hossain argued that as is manifest from a reading of Section 132(3)(b), the statute requires the

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

Executive Body to be involved in the monitoring, enforcement, inquiry and disciplinary proceedings that may be undertaken. It was his submission that quite apart from there being no challenge to that provision, the law recognizes no overarching principle which may postulate that enquiry and adjudicatory functions cannot be conferred on the same body. It was submitted that criminal legislation as well as various revenue laws incorporate innumerable instances where an assessing officer acts both as an investigator as well as the adjudicator. It was submitted that the division as defined in Rule 2(g) itself includes one which would be headed by the Chairperson or a full-time member. This, according to Mr. Hossain, is itself indicative of the statute contemplating divisions to be constituted only for the purposes of internal administrative convenience.

293. It was then submitted that neither the Act nor the NFRA Rules contemplate that the person who investigates or conducts an inquiry would be different from the one who takes a final decision. According to Mr. Hossain, this is evident when one bears in mind Rule 11 and which contemplates the same division issuing the Show Cause Notice and taking a final decision in terms of sub-rule (5) thereof. It was further argued that Rule 14 is yet another indicator of the statute contemplating the involvement of the Executive Body in all matters including those pertaining to disciplinary proceedings. Mr. Hossain submitted that while Rule 7 does allude to a concerned division, the reference to that authority would be occasioned only if the NFRA were to form an opinion that accounting standards had been violated. This, in any case, according to the learned counsel, would lead to action being

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

taken either under Rule 10(2) or disciplinary proceedings under Rule 11 and thus it being evident that those Rules did not contemplate that the division which caused further investigation would be different from the one which issued the SCN.

294. Mr. Hossain also questioned the applicability of various precedents which had been cited on behalf of the writ petitioners and all of which pertained to service jurisprudence. It was submitted that unlike disciplinary authorities who may have an interest in the outcome of departmental inquiries, the Chairperson and Members of the NFRA are bound by the oath that they subscribe to in terms of Section 132(3) and are completely impartial while acting as constituents of the statutory authority. It was submitted that by virtue of the nature of the office held by the Chairperson and members, the possibility of bias is clearly ruled out. This according to learned counsel, quite apart from the fact that a review mechanism also stands put in place in the shape of an appeal being carried to a statutory tribunal which in turn is headed by a former Supreme Court Judge.

295. Reverting then to the provisions as they existed under the CA Act, it was Mr. Hossain's submission that the Board of Discipline as well as the Disciplinary Committee were not only conducting an inquiry but also imposing punishments. The Director Discipline, it was pointed out, was only obliged to examine a complaint and to form a prima facie opinion as to whether information provided was actionable or liable to be examined in greater detail. Mr. Hossain also questioned the reliance placed upon the judgment of the Supreme Court in *L.K. Ratna* and submitted that the CA Act itself came to be amended

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

thereafter and as a consequence of which an enquiry was to be conducted by the Disciplinary Committee and which in turn is empowered to pass a final order of punishment. This submission, however, has been noted mindful of the fact that neither Sections 21A nor 21B are yet to be brought into force.

296. Mr. Hossain then sought to sustain the procedure as adopted by referring to the doctrine of necessity. It was his submission that a mere overlap of investigative and adjudicative functions would not render a provision unconstitutional. In support of the aforesaid submission, Mr. Hossain firstly referred to the judgment of the Supreme Court in **Election Commission of India vs. Subramaniam**[85] and which had ultimately upheld the decision of the Election Commission by alluding to the doctrine of necessity. Yet another line of precedents which were cited by Mr. Hossain were those rendered in the context of income tax assessments and other revenue laws, including those in **Anuj Chawla vs. Commissioner of Income Tax**[86], **Om Pal Singh vs. Union of India**[87] and **Union of India vs. Vipan Kumar Jain**[88]. These set of decisions have essentially held that there is nothing inherently unconstitutional in the Assessing Officer collating or gathering information and thereafter undertaking the assessment process itself. The relevant parts of the decision of the Supreme Court in *Vipin Kumar Jain* are reproduced hereinbelow:-

> "**8.** There is nothing inherently unconstitutional in permitting the assessing officer to gather the information and to assess the value of

[85] (1996) 4 SCC 104
[86] 2017 SCC OnLine Del 7852
[87] 2006 SCC OnLine Del 290
[88] (2005) 9 SCC 579

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

the information himself. The issue as to the constitutional validity of a provision which permitted an examining board not only to hold an inquiry but also to take action against doctors was raised before the Supreme Court of the United States in *Harold Withrow* v. *Duane Larkin* [43 L Ed 2d 712 : 421 US 35 (1975)] . In negating the challenge the Court said: (US p. 47)

> "The contention that the combination of investigative and adjudicative functions necessarily creates an unconstitutional risk of bias in administrative adjudication has a much more difficult burden of persuasion to carry. It must overcome a presumption of honesty and integrity in those serving as adjudicators; and it must convince that, under a realistic appraisal of psychological tendencies and human weakness, conferring investigative and adjudicative powers on the same individual poses such a risk of actual bias or prejudgment that the practice must be forbidden if the guarantee of due process is to be adequately implemented."

9. It is true that there may be cases where the outcome of the assessment may be influenced by the fact that the raiding assessing officer had himself in the course of the raid been witness to any incriminating material against the assessee. The assessing officer's decision on the basis of such material is not the final word in the matter. The assessment order is appealable under the provisions of the statute itself and ultimately by way of judicial review.

10. Finally, the courts cannot read in limitations to the jurisdiction conferred by statutes, in the absence of a challenge to the provision itself when the language of the Act clearly allows for an ostensible violation of the principles of natural justice including the principle that a person cannot be a judge in his own cause. In *Union of India* v. *Tulsiram Patel* [(1985) 3 SCC 398 : 1985 SCC (L&S) 672] in recognition of this principle this Court held: (SCC p. 479, para 101)

> "*101*. Not only, therefore, can the principles of natural justice be modified but in exceptional cases they can even be excluded. There are well-defined exceptions to the *nemo judex in causa sua* rule as also to the audi alteram partem rule. The *nemo judex in causa sua* rule is subject to the doctrine of necessity and yields to it as pointed out by this Court in *J. Mohapatra & Co.* v. *State of Orissa* [(1984) 4 SCC 103] ."

xxxx xxxx xxxx

12. Ultimately, the question of bias will have to be decided on the facts of each case. If the assessee is able to establish that the

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> assessing officer was in fact biased in the sense that he was involved or interested in his personal capacity in the outcome of the assessment or the procedure for assessment, no doubt, it would be a good ground for setting aside the assessment order. But to hold, as the High Court has that bias is established only because the authorised officer under Section 132 and the assessing officer are the same person is, in our view, an incorrect approach."

297. We, firstly and on facts find that it appears to be the conceded case of the NFRA that proceedings both at the stage of preparation of the SQARR as well as the AQRR were all undertaken by the Executive Body of the NFRA. This becomes evident from the disclosures which were made in the affidavit of compliance filed pursuant to our order of 12 September 2023. For instance, in the matter of DHS, it is disclosed that the AQRR was prepared by the Executive Body of the NFRA assisted by a team consisting of the Secretary, an Executive Director and three Chartered Accountants. It is then disclosed that a draft AQRR note was initiated by the Secretary NFRA on 25 September 2019 and which was thereafter placed for the approval of the Executive Body. This was accorded by the Executive Body on the same date itself pursuant to which the draft DAQRR came to be issued to the engagement partner.

298. Similar was the process which appears to have been followed for the drawl of the AQRR which was approved by the Executive Body on 11 December 2019. After the issuance of the AQRR, it is the same Executive Body which with the assistance of a team headed by a Chief General Manager examined the observations appearing therein and drew up a draft SCN proposed to be issued to DHS and its partners. This draft SCN prepared by the Executive Body was thereafter

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

approved by it and issued.

299. The NFRA followed a similar procedure in the case of Udayan Sen, Rukshad Daruvala and Shrenik Baid, petitioners in WP(C) No. 1524 of 2020, WP(C) No. 1522 of 2020 and WP(C) No. 1525 of 2020 respectively. Here again starting from the circulation of a prima facie conclusion leading upto the issuance of the AQRR by the Executive Body, the proceedings ultimately culminated in the issuance of a SCN. All that is additionally disclosed insofar as these writ petitioners are concerned is that post the issuance of the AQRR, the Executive Body with the assistance of a team working under a Chief General Manager who was not a part of the AQR team, examined the observations forming part of that report and prepared a draft SCN to be issued to the audit firm and its partners. It thus becomes apparent that it was the Executive Body which not only authored the AQRR, but it was the same body, albeit assisted by a supportive team, which then proceeded to form an opinion with respect to initiation of disciplinary proceedings and which in turn culminated in the issuance of the impugned SCNs.

300. As we view Section 132 of the Companies Act, there appears to be no doubt in our mind that the provision did and always contemplated the NFRA performing and discharging its functions through such divisions as may be constituted. While it is true that Rule 2(g), while defining the word ‘division’ includes one headed by a Chairperson or a full time Member, the Executive Body cannot possibly be construed to be a division in itself. A conjoint reading of sub-sections (3)(a) and (3)(b) appearing in Section 132 alongside the NFRA Rules, leads us to the irresistible conclusion that the statute clearly contemplated the

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

discharge of functions enumerated in Rules 7 and 8 being undertaken by independent units or divisions of the NFRA. Mr. Hossain had submitted that by virtue of Section 132(3)(b), the Act clearly contemplates the Executive Body to be the pivotal authority to discharge the various functions which it has to perform. This position, according to Mr. Hossain, is further fortified by Rule 2(g) when it includes within its ambit a part, component or unit of the authority which could be headed by the Chairperson or a full-time member. Mr. Hossain submitted that the only function which the NFRA acting as a body as a whole is liable to discharge is that specified in sub-section (2)(a) of Section 132. It was the contention of the respondents that since the power to undertake disciplinary action is one which is placed in sub-section (4) and which too stands reserved in favour of the Executive Body, the dual role, if it were to be so acknowledged as having been discharged, would not invalidate the proceedings impugned before us.

301. We find ourselves unable to concur with the aforenoted contentions of Mr. Hossain since and although the Executive Body of the NFRA does stand conferred a status of pre-eminence in the overall hierarchical structure of that authority, the same would clearly not lend credence or be liable to be countenanced as sanctioning a dual role being discharged by the same body or complement of people. This we hold since it is imperative that the proceedings be not only fair in fact, but also liable to be perceived from the standpoint of a reasonable person as being fair and compliant with Article 14 of the Constitution.

302. Acceptance of the position as canvassed on behalf of the NFRA

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

would essentially mean that the very body which had come to render findings of guilt and infraction of the SAs' would be expected to independently form an opinion as to whether circumstances warranted initiation of disciplinary action. There would in such a situation hardly be a possibility of the matter being independently and dispassionately reviewed or examined. As has been repeatedly held by courts, proceedings expected to be in consonance with the principles of natural justice, must not only qualify the test of fairness in fact, but be expected to appear to be impartial and untainted by bias.

303. While various decisions were cited by the respondents in this respect, we note that the petitioners while questioning the validity of the procedure ultimately adopted by the NFRA have not alleged institutional bias. The various judgments which were cited for our consideration by Mr. Hossain are clearly of little relevance and do not appear to be germane to the challenge which stands raised before us. While courts may accept a broad or loose overlap of investigative and adjudicatory functions being exercised by a singular authority, the aforenoted general precept would clearly not withstand the test of fairness when one of those bodies is expected to form an independent opinion of whether transgressions alleged to have been committed warrant further disciplinary measures being adopted. The judgments cited by Mr. Hossain and which pertained to the exercise of powers by authorities under the Income Tax Act is also misplaced since it is well settled that proceedings under a fiscal statute are neither akin to judicial proceedings nor are they concerned with an adjudication of a lis which may be said to exist between an assessee and the officer concerned.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

Those statutes by virtue of the inherent nature of the obligation that officers are enjoined to discharge contemplate those persons performing the dual function of investigation and assessment. Although this principle is by now well recognized, we deem it appropriate to take note of the succinct enunciation of the legal position in this respect which appears in **Deepak Agro Foods vs. State of Rajasthan**[89]:-

> "18. Proceedings for assessment under a fiscal statute are not in the nature of judicial proceedings, like proceedings in a suit inasmuch as the assessing officer does not adjudicate on a lis between an assessee and the State and, therefore, the law on the issue laid down under the civil law may not stricto sensu apply to assessment proceedings. Nevertheless, in order to appreciate the distinction between a null and void order and an illegal or irregular order, it would be profitable to notice a few decisions of this Court on the point."

304. That then takes us to review the constitutional requirements which we would expect administrative proceedings to adhere to. In **Ratan Lal Sharma vs. Managing Committee**[90], the Supreme Court, while broadly explaining the fundamental facets of natural justice, had this to say with respect to the principle of *nemo debet esse judex in propria causa*: -

> "**10.** Since the rules of natural justice were not embodied rules it is not possible and practicable to precisely define the parameters of natural justice. In *Russell* v. *Duke of Norfolk* [(1949) 1 All ER 109 (CA)] Tucker, L.J. observed:
>
> > "… There are, in my view, no words which are of universal application to every kind of inquiry and the every kind of domestic tribunal. The requirements of natural justice must depend on the circumstances of the case, the nature of the

[89] (2008) 7 SCC 748
[90] (1993) 4 SCC 10

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

> inquiry, the rules under which the tribunal is acting, the subject-matter that is being dealt with, and so forth."

It has been observed by this Court in *Union of India* v. *P.K. Roy* [(1968) 2 SCR 186 : AIR 1968 SC 850 : (1970) 1 LLJ 633] :

> "The extent and application of the doctrine of natural justice cannot be imprisoned within the strait-jacket of a rigid formula. The application of the doctrine depends upon the nature of the jurisdiction conferred on the administrative authority, upon the character of the rights of the persons affected, the scheme and policy of the statute and other relevant circumstances disclosed in the particular case."

Similar view was also expressed in *A.K. Kraipak case* [(1969) 2 SCC 262 : (1970) 1 SCR 457] . This Court observed: (SCC pp. 272-73, para 20)

> "… What particular rule of natural justice should apply to a given case must depend to a great extent on the facts and circumstances of that case, the framework of the law under which the enquiry is held and the constitution of the Tribunal or body of persons appointed for that purpose. Whenever a complaint is made before a court that some principle of natural justice had been contravened, the court has to decide whether the observance of that rule was necessary for a just decision on the facts of that case."

Prof. Wade in his *Administrative Law* has succinctly summarised the principle of natural justice to the following effect:

> "It is not possible to lay down rigid rules as to when the principles of natural justice are to apply: not as to their scope and extent. Everything depends on the subject-matter, the application for principles of natural justice, resting as it does upon statutory implication, must always be in conformity with the scheme of the Act and with the subject-matter of the case. In the application of the concept of fair play there must be real flexibility. There must also have been some real prejudice to the complainant; there is no such thing as a merely technical infringement of natural justice. The requirements of natural justice depend on the facts and the circumstances of the case, the nature of the enquiry, the rules under which the tribunal is acting, the subject-matter to be dealt with, and so forth."

One of the cardinal principles of natural justice is *nemo debet esse judex in propria causa* (no man shall be a judge in his own cause). The deciding authority must be impartial and without bias. It has been held by this Court in *Secretary to*

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18:46:26

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> *Government, Transport Department* v. *Munuswamy Mudaliar* [1988 Supp SCC 651] that a predisposition to decide for or against one party without proper regard to the true merits of the dispute is bias. Personal bias is one of the three major limbs of bias namely pecuniary bias, personal bias and official bias. A classic case of personal bias was revealed in the decision of this Court in *State of U.P.* v. *Mohd. Nooh* [1958 SCR 595 : AIR 1958 SC 86] . In the said case, a departmental inquiry was held against an employee. One of the witnesses against the employee turned hostile. The officer holding the inquiry then left the inquiry, gave evidence against the employee and thereafter resumed to complete the inquiry and passed the order of dismissal. This Court quashed the order of dismissal by holding inter alia that the rules of natural justice were grievously violated."

305. The principle of no man being a judge in its own cause was explained by the Supreme Court as mandating the deciding authority being one which was impartial and without bias. It also alluded to aspects such as a predisposition to decide for or against one party or where that authority may be inclined to disregard the true merits of the dispute by virtue of bias. *Ratan Lal Sharma* was a case where the delinquent employee in the course of disciplinary proceedings had assailed the participation of an individual who not only was a member of the enquiry committee but had also appeared as a witness to prove the charges that had been laid. Deprecating such a procedure, the Supreme Court pertinently observed: -

> "**11.** In the instant case, charge No. 12 states that a particular sum on account of amalgamated fund for the month of December was given to the appellant by Shri Maru Ram who was teacher in charge of the amalgamated fund. In the inquiry committee comprising three members, the said Shri Maru Ram was taken as one of the members and he himself deposed to establish the said charge No. 12 and thereafter again joined the inquiry committee and submitted a report holding the appellant guilty of some of the charges including the said charge No. 12. Shri Maru Ram was interested in establishing the said charge. From the charge itself, it is apparent that he had a pre-disposition to decide against the

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

appellant. It is really unfortunate that although the appellant raised an objection before the inquiry committee by clearly indicating that the said Shri Maru Ram was inimical towards him and he should not be a member in the inquiry committee, such objection was rejected on a very flimsy ground, namely, that since the said Shri Maru Ram was one of the members of the Managing Committee and was the representative of the teachers in the Managing Committee it was necessary to include him in the inquiry committee. It is quite apparent that the inquiry committee could have been constituted with other members of the Managing Committee and the rules of the inquiry are not such that Shri Maru Ram being teachers' representative was required to be included in the said inquiry committee so that the doctrine of necessity may be attracted. If a person has a pecuniary interest, such interest, even if very small, disqualifies such person. For appreciating a case of personal bias or bias to the subject-matter the test is whether there was a real likelihood of a bias even though such bias has not in fact taken place. De Smith in his *Judicial Review of Administrative Action*, (1980) at page 262 has observed that a real likelihood of bias means at least substantial possibility of bias. In *R.* v. *Sunderland Justices* [(1901) 2 KB 357, 373] it has been held that the court will have to judge the matter as a reasonable man would judge of any matter in the conduct of his own business. In *R.* v. *Sussex Justices* [(1924) 1 KB 256, 259 : 1923 All ER Rep 233] it has been indicated that answer to the question whether there was a real likelihood of bias depends not upon what actually was done but upon what might appear to be done. In *Halsbury's Laws of England*, 4th Edn., Vol. 2, para 551, it has been indicated that the test of bias is whether a reasonable intelligent man, fully apprised of all the circumstances, would feel a serious apprehension of bias. The same principle has also been accepted by this Court in *Manak Lal* v. *Dr Prem Chand* [1957 SCR 575 : AIR 1957 SC 425] . This Court has laid down that the test is not whether in fact, a bias has affected the judgment; the test always is and must be whether a litigant could reasonably apprehend that a bias attributable to a member of the tribunal might have operated against him in the final decision of the tribunal. It is in this sense that it is often said that justice must not only be done but must also appear to be done.

12. In the facts of the case, there was not only a reasonable apprehension in the mind of the appellant about the bias of one of the members of the inquiry committee, namely, the said Shri Maru Ram but such apprehension became real when the said Shri Maru Ram appeared as a witness against the appellant to prove the said charge and thereafter proceeded with the inquiry proceeding as a member of the inquiry committee to uphold the correctness of his

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

deposition as a judge. The learned Single Judge considering the aforesaid facts came to the finding that the participation of Shri Maru Ram as a member of the inquiry committee has vitiated the inquiry proceeding because of flagrant violation of the principles of natural justice. Unfortunately, the Division Bench set aside such judgment of the learned Single Judge and dismissed the writ petition improperly, to say the least, on a technical ground that plea of bias of Shri Maru Ram and his acting as a judge of his own case by being a member of the inquiry committee was not specifically taken before the Deputy Commissioner and also before the appellate authority, namely, the Commissioner by the appellant and as such the said plea should not be allowed to be raised in writ proceeding, more so, when the case of prejudice on account of bias could be waived by the person suffering such prejudice. Generally, a point not raised before the tribunal or administrative authorities may not be allowed to be raised for the first time in the writ proceeding, more so when the interference in the writ jurisdiction which is equitable and discretionary is not of course a must as indicated by this Court in *A.M. Allison* v. *B.L. Sen* [AIR 1957 SC 227] particularly when the plea sought to be raised for the first time in a writ proceeding requires investigation of facts. But if the plea though not specifically raised before the subordinate tribunals or the administrative and quasi-judicial bodies, is raised before the High Court in the writ proceeding for the first time and the plea goes to the root of the question and is based on admitted and uncontroverted facts and does not require any further investigation into a question of fact, the High Court is not only justified in entertaining the plea but in the anxiety to do justice which is the paramount consideration of the court, it is only desirable that a litigant should not be shut out from raising such plea which goes to the root of the lis involved. The aforesaid view has been taken by this Court in a number of decisions and a reference may be made to the decisions in *A. St. Arunachalam Pillai* v. *Southern Roadways Ltd.* [AIR 1960 SC 1191 : (1960) 3 SCR 764] and *Cantonment Board, Ambala* v. *Pyarelal* [(1965) 3 SCR 341 : AIR 1966 SC 108 : 1966 Cri LJ 93] . In our view, the learned Single Judge has very rightly held that the Deputy Commissioner was under an obligation to consider the correctness and propriety of the decision of the Managing Committee based on the report of the inquiry committee which since made available to him, showed on the face of it that Shri Maru Ram was included and retained in the inquiry committee despite objection of the appellant and the said Shri Maru Ram became a witness against the appellant to prove one of the charges. It is really unfortunate that the Division Bench set aside the decision of the learned Single Bench by taking recourse to technicalities that the plea of bias on account of inclusion of Shri

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

Maru Ram in the inquiry committee and his giving evidence on behalf of the department had not been specifically taken by the appellant before the Deputy Commissioner and the Commissioner. The Division Bench has also proceeded on the footing that as even apart from charge No. 12, the Deputy Commissioner has also considered the other charges on consideration of which along with charge No. 12, the proposed order of dismissal was made, no prejudice has been caused to the appellant. Such view, to say the least, cannot be accepted in the facts and circumstances of the case. The learned Single Judge, in our view, has rightly held that the bias of Shri Maru Ram, one of the members of the inquiry committee had percolated throughout the inquiry proceeding thereby vitiating the principles of natural justice and the findings made by the inquiry committee was the product of a biased and prejudiced mind. The illegality committed in conducting the departmental proceedings has left an indelible stamp of infirmity on the decision of the Managing Committee since affirmed by the Deputy Commissioner and the Commissioner. The observation of S.R. Das, C.J. in *Mohd. Nooh case* [1958 SCR 595 : AIR 1958 SC 86] may be referred to in this connection:

> "… Where the error, irregularity or illegality touching jurisdiction or procedure committed by an inferior court or tribunal of first instance is so patent and loudly obtrusive that it leaves on its decision an indelible stamp of infirmity or vice which cannot be obliterated or cured on appeal or revision. If an inferior court or tribunal of first instance acts wholly without jurisdiction or patently in excess of jurisdiction or manifestly conducts the proceedings before it in a manner which is contrary to the rules of natural justice and all accepted rules of procedure and which offends the superior court's sense of fair play, the superior court may, we think, quite properly exercise its power to issue the prerogative writ of certiorari to correct the error of the court or tribunal of first instance, even if an appeal to another inferior court or tribunal was available and recourse was not had to it or if recourse was had to it, it confirmed what ex facie was a nullity for reasons aforementioned."

Some of the observations which appear in para 12 of the report assume added significance in light of the Supreme Court holding that an illegality which taints administrative proceedings and leaves an *"indelible stamp of infirmity"* would not be salvaged merely because a review or an appeal avenue may have existed.

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

306. In explaining the rule of reasonable likelihood of bias, the Supreme Court in **State of West Bengal vs. Shivananda Pathak**[91] observed :-

> "**25.** Bias may be defined as a preconceived opinion or a predisposition or predetermination to decide a case or an issue in a particular manner, so much so that such predisposition does not leave the mind open to conviction. It is, in fact, a condition of mind, which sways judgments and renders the judge unable to exercise impartiality in a particular case.
>
> **xxxx xxxx xxxx**
>
> **29.** As pointed out earlier, an essential requirement of judicial adjudication is that the judge is impartial and neutral and is in a position to apply his mind objectively to the facts of the case put up before him. If he is predisposed or suffers from prejudices or has a biased mind, he disqualifies himself from acting as a judge. But Frank, J. of the United States in *Linahan, In re* [138 F 2d 650] says:
>
> > "If, however, 'bias' and 'partiality' be defined to mean the total absence of preconceptions in the mind of the judge, then no one has ever had a fair trial and no one will. The human mind, even at infancy, is no blank piece of paper. We are born with predispositions…. Much harm is done by the myth that, merely by … taking the oath of office as a judge, a man ceases to be human and strips himself of all predilections, becomes a passionless thinking machine."
>
> [See also Griffith and Street, *Principles of Administrative Law* (1973 Edn.), p. 155; *Judicial Review of Administrative Action* by de Smith (1980 Edn.), p. 272; *II Administrative Law Treatise* by Davis (1958 Edn.), p. 130.]
>
> **30.** These remarks imply a distinction between prejudging of facts specifically relating to a party, as against preconceptions or predispositions about general questions of law, policy or discretion. The implication is that though in the former case, a judge would disqualify himself, in the latter case, he may not. But this question does not arise here and is left as it is.
>
> **31.** This Court has already, innumerable times, beginning with its classic decision in *A.K. Kraipak* v. *Union of India* [(1969) 2 SCC 262 : AIR 1970 SC 150] laid down the need of "fair play" or "fair hearing" in quasi-judicial and administrative matters. The hearing

[91] (1998) 5 SCC 513

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

has to be by a person sitting with an unbiased mind. To the same effect is the decision in *S.P. Kapoor (Dr)* v. *State of H.P.* [(1981) 4 SCC 716 : 1982 SCC (L&S) 14 : AIR 1981 SC 2181] In an earlier decision in *Mineral Development Ltd.* v. *State of Bihar* [AIR 1960 SC 468 : (1960) 2 MLJ (SC) 16] it was held that the Revenue Minister, who had cancelled the petitioner's licence or the lease of certain land, could not have taken part in the proceedings for cancellation of licence as there was political rivalry between the petitioner and the Minister, who had also filed a criminal case against the petitioner. This principle has also been applied in cases under labour laws or service laws, except where the cases were covered by the doctrine of necessity. In *Financial Commr. (Taxation), Punjab* v. *Harbhajan Singh* [(1996) 9 SCC 281] the Settlement Commissioner was held to be not competent to sit over his own earlier order passed as Settlement Officer under the Displaced Persons (Compensation & Rehabilitation) Act, 1954. The maxim *nemo debet esse judex in propria sua causa* was invoked in *Gurdip Singh* v. *State of Punjab* [(1997) 10 SCC 641 : 1997 SCC (L&S) 1742] ."

307. As is manifest from the aforesaid passages, the Supreme Court laid great emphasis on proceedings not being tainted by preconceived opinions, predisposition or predetermination and underscored the imperatives of the absence of an unbiased mind. The principles of reasonable likelihood of bias so enunciated were again explained in **Kumaon Mandar Vikas Nigam Ltd. vs. Girja Shankar Pant**[92] and where it was pertinently observed:-

"**28.** Mathew, J. in *Parthasarathi case* [(1974) 3 SCC 459 : 1973 SCC (L&S) 580] observed: (SCC pp. 465-66, para 16)

"*16.* The tests of 'real likelihood' and 'reasonable suspicion' are really inconsistent with each other. We think that the reviewing authority must make a determination on the basis of the whole evidence before it, whether a reasonable man would in the circumstances infer that there is real likelihood of bias. The court must look at the impression which other people have. This follows from the principle that justice must not only be done but seen to be done. If right-minded persons would think that there is real likelihood of bias on the

[92] (2001) 1 SCC 182

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

part of an inquiring officer, he must not conduct the inquiry; nevertheless, there must be a real likelihood of bias. Surmise or conjecture would not be enough. There must exist circumstances from which reasonable men would think it probable or likely that the inquiring officer will be prejudiced against the delinquent. The court will not inquire whether he was really prejudiced. If a reasonable man would think on the basis of the existing circumstances that he is likely to be prejudiced, that is sufficient to quash the decision [see per Lord Denning, M.R. in *Metropolitan Properties Co. (F.G.C.) Ltd.* v. *Lannon* [(1968) 3 WLR 694, 707 : (1969) 1 QB 577 : (1968) 3 All ER 304 (CA)] (WLR at p. 707]. We should not, however, be understood to deny that the court might with greater propriety apply the 'reasonable suspicion' test in criminal or in proceedings analogous to criminal proceedings."

29. Lord Thankerton however in *Franklin* v. *Minister of Town and Country Planning* [1948 AC 87 : (1947) 2 All ER 289 (HL)] had this to state:

"… I could wish that the use of the word 'bias' should be confined to its proper sphere. Its proper significance, in my opinion, is to denote a departure from the standard of even-handed justice which the law requires for those who occupy judicial office, or those who are commonly regarded as holding a quasi-judicial office, such as an arbitrator. The reason for this clearly is that, having to adjudicate as between two or more parties, he must come to his adjudication with an independent mind, without any inclination or bias towards one side or other in the dispute."

30. Recently however, the English Courts have sounded a different note, though may not be substantial but the automatic disqualification theory rule stands to some extent diluted. The affirmation of this dilution however is dependent upon the facts and circumstances of the matter in issue. The House of Lords in the case of *R.* v. *Bow Street Metropolitan Stipendiary Magistrate, ex p Pinochet Ugarte (No. 2)* [(2000) 1 AC 119] observed:

"… In civil litigation the matters in issue will normally have an economic impact; therefore a Judge is automatically disqualified if he stands to make a financial gain as a consequence of his own decision of the case. But if, as in the present case, the matter at issue does not relate to money or economic advantage but is concerned with the promotion of the cause, the rationale disqualifying a Judge applies just as much if the Judge's decision will lead to the promotion of a

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

cause in which the Judge is involved together with one of the parties."

31. Lord Brown-Wilkinson at p. 136 of the report stated:

> "It is important not to overstate what is being decided. It was suggested in argument that a decision setting aside the order of 25-11-1998 would lead to a position where Judges would be unable to sit on cases involving charities in whose work they are involved. It is suggested that, because of such involvement, a Judge would be disqualified. That is not correct. The facts of this present case are exceptional. The critical elements are (*1*) that A.I. was a party to the appeal; (*2*) that A.I. was joined in order to argue for a particular result; (*3*) the Judge was a director of a charity closely allied to A.I. and sharing, in this respect, A.I.'s objects. Only in cases where a Judge is taking an active role as trustee or director of a charity which is closely allied to and acting with a party to the litigation should a Judge normally be concerned either to recuse himself or disclose the position to the parties. However, there may well be other exceptional cases in which the Judge would be well advised to disclose a possible interest."

32. Lord Hutton also in *Pinochet case* [(2000) 1 AC 119] observed:

> "There could be cases where the interest of the Judge in the subject-matter of the proceedings arising from his strong commitment to some cause or belief or his association with a person or body involved in the proceedings could shake public confidence in the administration of justice as much as a shareholding (which might be small) in a public company involved in the litigation."

33. Incidentally in *Locabail [Locabail (U.K.) Ltd.* v. *Bayfield Properties Ltd.* [2000 QB 451] *]* the Court of Appeal upon a detail analysis of the oft-cited decision in *R.* v. *Gough* [1993 AC 646] together with the *Dimes case*[3 House of Lords Cases 759] , *Pinochet case* [(2000) 1 AC 119] , Australian High Court's decision in the case of *J.R.L., ex p C.J.L., Re* [(1986) 161 CLR 342 (Aus HC)] as also the Federal Court in *Ebner, Re* [(1999) 161 ALR 55] and on the decision of the Constitutional Court of South Africa in *President of the Republic of South Africa* v. *South African Rugby Football Union* [(1999) 4 SA 147] stated that it would be rather dangerous and futile to attempt to define or list the factors which may or may not give rise to a real danger of bias. The Court of Appeal continued to the effect that everything will depend upon facts which may include the nature of the issue to be decided. It further observed:

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

> "By contrast, a real danger of bias might well be thought to arise if there were personal friendship or animosity between the Judge and any member of the public involved in the case; or if the Judge were closely acquainted with any member of the public involved in the case, particularly if the credibility of that individual could be significant in the decision of the case; or if, in a case where the credibility of any individual were an issue to be decided by the Judge, he had in a previous case rejected the evidence of that person in such outspoken terms as to throw doubt on his ability to approach such person's evidence with an open mind on any later occasion; or if on any question at issue in the proceedings before him the Judge had expressed views, particularly in the course of the hearing, in such extreme and unbalanced terms as to throw doubt on his ability to try the issue with an objective judicial mind (see *Vakuta* v. *Kelly*[(1989) 167 CLR 568]); or if, for any other reason, there were real ground for doubting the ability of the Judge to ignore extraneous considerations, prejudices and predilections and bring an objective judgment to bear on the issues before him. The mere fact that a Judge, earlier in the same case or in a previous case, had commented adversely on a party-witness, or found the evidence of a party or witness to be unreliable, would not without more found a sustainable objection. In most cases, we think, the answer, one way or the other, will be obvious. But if in any case there is real ground for doubt, that doubt should be resolved in favour of recusal. We repeat: every application must be decided on the facts and circumstances of the individual case. The greater the passage of time between the event relied on as showing a danger of bias and the case in which the objection is raised, the weaker (other things being equal) the objection will be."

34. The Court of Appeal judgment in *Locabail* [2000 QB 451] though apparently as noticed above sounded a different note but in fact, in more occasions than one in the judgment itself, it has been clarified that conceptually the issue of bias ought to be decided on the facts and circumstances of the individual case — a slight shift undoubtedly from the original thinking pertaining to the concept of bias to the effect that a mere apprehension of bias could otherwise be sufficient.

35. The test, therefore, is as to whether a mere apprehension of bias or there being a real danger of bias and it is on this score that the surrounding circumstances must and ought to be collated and necessary conclusion drawn therefrom — in the event however the conclusion is otherwise inescapable that there is existing a real danger of bias, the administrative action cannot be sustained: If on

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

the other hand, the allegations pertaining to bias is rather fanciful and otherwise to avoid a particular court, Tribunal or authority, question of declaring them to be unsustainable would not arise. The requirement is availability of positive and cogent evidence and it is in this context that we do record our concurrence with the view expressed by the Court of Appeal in *Locabail case* [2000 QB 451] ."

308. More recently, the Constitution Bench in **Central Organization for Railway Electrification vs. ECI SPIC**[93] after a review of precedents relating to bias rendered by courts across jurisdictions had held as follows:-

"**76.** The principles of natural justice principally consist of two rules : (i) no one shall be a judge in their own cause (nemo judex in causa sua); and (ii) no decision shall be given against a party without affording a reasonable opportunity of being heard.141 Adherence to the principles of natural justice is a facet of procedural fairness. A decision made by the State to the prejudice of a person must be after following the basic rules of justice and fair play.142 The principles of natural justice are applied because administrative or quasi-judicial proceedings can abridge or take away rights.143 Application of the principles of natural justice prevents miscarriage of justice.144 Natural justice has both an intrinsic and an instrumental function. The intrinsic function values natural justice as an end in itself. It values natural justice as an essential feature of fairness. In its instrumental element, natural justice is viewed as a means to achieving just outcomes.

77. The principle of nemo judex is based on the precept that justice should not only be done but manifestly and undoubtedly be seen to be done.145 The principle of nemo judex applies to judicial, quasi-judicial, and administrative proceedings.146 An adjudicator should be disinterested and unbiased.147 A bias is a predisposition to decide for or against one party, without proper regard to the true merits of the dispute.

xxxx xxxx xxxx

124. The doctrine of bias as evolved in English and Indian law emphasizes independence and impartiality in the process of adjudication to inspire the confidence of the public in the adjudicatory processes. Although Section 12 deals with the quality of independence and impartiality inherent in the arbitrators, the

[93] 2024 SCC OnLine SC 3219

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

provision's emphasis is to ensure an independent and impartial arbitral process."

309. The attributes of equal treatment and impartiality were highlighted by Chandrachud, C.J. (whose opinion constituted the majority) in the following words:-

" **129.** Equal treatment of parties at the stage of appointment of an arbitrator ensures impartiality during the arbitral proceedings. A clause that allows one party to unilaterally appoint a sole arbitrator is exclusive and hinders equal participation of the other party in the appointment process of arbitrators. Further, arbitration is a quasi-judicial and adjudicative process where both parties ought to be treated equally and given an equal opportunity to persuade the decision-maker of the merits of the case. An arbitral process where one party or its proxy has the power to unilaterally decide who will adjudicate on a dispute is fundamentally contrary to the adjudicatory function of arbitral tribunals.

130. In comparison, a three-member arbitral tribunal usually allows each party to nominate one arbitrator of their choice, with the third arbitrator being appointed either by the two party-appointed arbitrators or by agreement of parties.240 The fact that both parties nominate their respective arbitrators gives them "a sense of investment in the arbitral tribunal."241 A three-member arbitral tribunal also enhances the quality of the adjudicative deliberations and ensures compliance with due process.242 According to Gary Born, the major advantage of a three-member tribunal is that the parties can participate in the selection of the tribunal to the maximum extent possible.

131. In a three-member tribunal, each of the parties seeks to appoint a co-arbitrator. However, the third arbitrator is usually appointed by a process which allows equal participation of both parties in the appointment process. The equal participation of parties enables the appointment of an independent and impartial third arbitrator. Hence, any perceived tilt of an arbitrator in favour of the party which nominated that arbitrator is offset by the appointment of the third arbitrator in the course of a deliberative process involving both the arbitrators or as envisaged in the agreement between parties. Perkins (supra) rightly observed that whatever advantage a party may derive by nominating an arbitrator of its choice would get counter-balanced by equal power with the other party.244 This counter-balancing will ideally apply only in situations where the arbitrators are appointed by the parties in the exercise of their genuine party autonomy. TRF

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(supra) and Perkins (supra) have been relied upon by this Court on numerous occasions, including in Glock Asia-Pacific Limited v. Union of India245 and Lombardi Engg Ltd. v. Uttarakhand Jal Vidyut Nigam Ltd.

132. In Voestalpine (supra) and CORE (supra), one of the parties curated a panel of arbitrators and mandated the other party to select their arbitrator from the panel. Since the curation of the list is exclusively undertaken by one party, the other party is effectively excluded from the process of curating the panel from which exclusively, the appointment of an arbitrator is to be made. The other party has to mandatorily select its arbitrator from a curated panel, restricting their freedom to appoint an arbitrator of their choice. This is against the principle of equal treatment contained under Section 18. In this situation, there is no effective counter-balance because both parties do not participate equally in the process of appointing arbitrators. The party curating the panel can restrict the choice of the party only to a person who is on the panel selected by the other party and to no other person.

133. Many PSUs are regularly involved in arbitration disputes and constantly need the services of arbitrators. Such institutions often maintain a pool of potential arbitrators with the sole object of having a ready pool of qualified professionals who have committed their time and consented to act as arbitrators for fixed fees. The Arbitration Act does not prohibit parties to an arbitration agreement from maintaining a curated panel of potential arbitrators. However, the problem arises when the PSUs make it mandatory for other parties to select their nominees from the curated panel of arbitrators. When a PSU exercises its discretion to curate a panel, the very factor that the PSU is choosing only a certain number of persons as potential arbitrators and not others will raise a reasonable doubt in the mind of a fair-minded person. The PSUs may conceivably have nominated a person on the panel of potential arbitrators because they have a certain predisposition in favour of the former. This doubt is reinforced when the other party is given no choice but to select its arbitrator from the curated panel."

310. As was succinctly explained by Chandrachud CJ, bias is a predisposition to decide for or against one party disregarding the true merits of the dispute. It was pertinently observed that a unilateral appointment impinges upon the right of the other party to equal participation and could give rise to serious doubts with respect to the

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

impartiality of the tribunal itself. The view so expressed by the majority and relating to equal treatment finds resonance in the part penned by Hrishikesh Roy J. who penned a concurring opinion.

311. What thus emerges from the aforesaid discussion is that a body must not only be fair and impartial, but it should also not be burdened by a predisposition or a predetermined state of mind. This aspect assumes significance insofar as we are concerned in light of a common complement of persons having rendered findings of alleged professional misconduct and thereafter sitting upon that very opinion to consider commencement of disciplinary action. A person charged by such an authority could be reasonably said to apprehend a reasonable likelihood of the opinion so formed being tainted by the proscription of a reasonable likelihood of bias. It is these principles which weighed upon the Supreme Court in *L.K. Ratna* to hold that a person who may have been a party to the preparation of the result of the enquiry would be disqualified from participating in the deliberations of the Council.

312. In **De. Smith's Judicial Review**[94], the test of bias was lucidly explained in the following words:-

> **"12- 011** Whether a decision is unlawful on the basis that a fair minded and informed observer would conclude there was a real possibility of bias is a question of law for a reviewing or appellate court to decide. Recusal is not a matter of discretion for the decision maker. If the *Porter* test is made out the decision- maker is disqualified from hearing the case. If it is not, there is no valid objection to the decision-maker sitting.
>
> **12-012** In applying the *Porter* test a court should consider the circumstances in the round. The fair-minded and informed observer would not view allegations of bias individually and conclude that if there is nothing in them individually there can be nothing in them in

[94] 9th Edition

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18:46:26

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combination, Rather, all factors alleged to indicate apparent bias are to be considered collectively.

12-013 The outcome of a decision-making process is irrelevant to the question of determining whether there was an appearance of bias. If the fair-minded and informed observer would conclude that there was a real possibility of bias, a decision is not lawful simply because it is likely that a different decision-maker would have reached the same conclusion. Correlatively, the fact that a decision-maker reached a conclusion adverse to the complaining party is not a factor pointing to apparent bias. The question is whether the fair-minded and informed observer would have been concerned before the outcome of the process was known Considerations of cost and delay are also irrelevant.

12-014 Bias has been defined as "prejudice against one party or its case for reasons unconnected with the legal or factual merits." A "real possibility" of bias does not require probability. However, "it is a test which is founded on reality and demands not only any possibility but a real possibility of bias."

313. While commenting on whether an appeal could cure such a defect, the learned authors observe thus:-

"**SUBSEQUENT FAIR HEARING OR APPEAL**

10-053 The common law and the ECHR both permit a public authority to make decisions which do not comply fully with procedural fairness requirements if the person affected has recourse to a further hearing or appeal which itself provides fairness.

Common law and subsequent hearings

10-054 There are situations where the absence of procedural fairness before a decision is made can subsequently be adequately "cured", for example on appeal. A prior hearing may be better than a subsequent hearing, but a subsequent hearing is better than no hearing at all, and in some cases the courts have held that statutory provisions for an administrative appeal or even full judicial review on the merits are sufficient to negative the existence of any implied duty to have a hearing before the original decision is made. This approach may be acceptable where the original decision does not cause significant detriment to the person affected, or where there is also a paramount need for prompt action, or where it is otherwise impracticable to afford antecedent hearings.

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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10-055 The question of whether a decision vitiated by a breach of the rules of fairness can be made good by a subsequent hearing does not admit of a single answer applicable to all situations in which the issue may arise. In general the approach will depend upon an assessment of whether, in all the circumstances of the hearing and appeal, the procedure as a whole satisfied the requirements of fairness. Of particular importance are (1) the gravity of the error committed at first instance, (2) the likelihood that the prejudicial effects of the error may also have permeated the rehearing, (3) the seriousness of the consequences for the individual, (4) the width of the powers of the appellate body, (5) whether the appellate decision is reached only on the basis of the material before the original tribunal or by way of fresh hearing, or rehearing de novo, and (6) if applicable, the purpose of the statutory scheme.

10-056 In general, the courts will not intervene on grounds of procedural unfairness where the procedurally unfair decision is subject to correction by a procedure which has proper procedural safeguards. In *Calvin v Carr,* the Privy Council doubted that there was a general rule that a failure of fairness at the initial hearing is not to be cured by procedurally correct appeal; in particular, it was suggested, a more latitudinarian attitude should be taken towards the proceedings of domestic tribunals whose authority is derived from the consensual rules of a voluntary association.

Thus, in that case, an appeal to the Committee of the Australian Jockey Club was held, for this reason, to cure a defective decision of race stewards who had disqualified the owner of a horse alleged to have been raced improperly. In Lloyd vs McMahon, the House of Lords confirmed this approach outside the context of domestic tribunals. It was held that the decision of a district auditor to surcharge councilors for failure to set a valid rate, without according them oral hearings would, had it been procedurally defective, have been cured by the statutory appeal from the auditor's decision to the High Court. It should be noted, however, with reference to the criteria set out above, that the scope of the appeal was very wide, all the evidence being susceptible of re-examination, including the merits of the decision.

10-057 Where there is an option for rapidly seeking annulment or amendment of the order made, the initial procedurally unfair proceeding will not be reviewed. Thus, where interim anti-social behaviour orders were made without notice, there was no breach of procedural fairness since the orders were subject to the safeguards of early review or discharge hearings, which were compliant with procedural fairness. Similarly, where a re-categorisation decision is being made in respect of a determinate sentence prisoner, there is no need to permit the prisoner to make representations in advance of the

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

re-categorisation decision; all that fairness requires is that the prisoner have an opportunity to appeal the re-categorisation decision. It has also been held that unfairness in the context of school exclusion decisions are capable of being cured by means of statutory appeal, provided that the independent appeal body is entrusted with the task of dealing with the merits of the case fully and de novo, and that it does so in a way that is not open to challenge on normal judicial review grounds and the appeal process is not contaminated in some real sense by the defect in the earlier decision-making process . The curative principle also applies in the immigration context and in the context of care proceedings. It is not just appeal procedures which can cure an initial defective decision and defective decisions have been cured by a minister's lawful approval and later fair and open-minded reconsideration of the decision.

Limits

10-058 There are, however, limits to the extent to which procedural unfairness can be "cured". There may be situations in which, although the provision of a right of appeal is not required, a court will be satisfied that nothing short of compliance with the requirements of procedural fairness at both stages will afford to the individual the standards of fairness demanded in the particular context. For example, trial on indictment is not an adequate alternative to judicial review for committal on inadmissible evidence given the importance of providing a right to cross-examine at a preliminary stage. Similarly, inadequate consultation was not corrected by appeal where a budgetary decision was easier to overturn before it was firmly made; while a procedurally defective decision will not be cured by the decision-maker communicating with the aggrieved party after the decision, in defence of the decision. A right of individual petition to the ECtHR is also not a right of appeal to an appeal court capable of curing the national authorities' failure to provide a fair trial."

314. The test which was propounded by the learned authors was that of the view that could be formed by a fair minded and informed observer and whether a real possibility of bias could have been legitimately inferred. It was further pertinently observed that a decision-making process which fails to satisfy the test of real possibility of bias is not saved merely because it is likely that a different decision

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

maker may have reached the same conclusion. The learned authors also expressed a doubt as to whether a subsequent fair hearing of appeal would cure proceedings which otherwise failed to meet the test of likelihood of bias. This reminds us of what our Supreme Court observed in *Ratan Lal Sharma* when they held that when the error or irregularity is *"so patent and loudly obtrusive"* it leaves *"an indelible stamp of infirmity or vice which cannot be obliterated or cured on appeal or revision"*. The celebrated work also has the following elucidating passages on "predetermination" and which are relevant to the question which stands posed before us: -

> "**PREDERMINATION**
>
> **12-054** Closely related to the concept of bias is that of predetermination. Bias is commonly defined as a prejudice against one of the parties or their case for reasons unconnected to its merits. Predetermination occurs when a decision-maker approaches the issues with a closed mind: "it is seen in a corporate determination to adhere to a particular view, regardless of the relevant factors or how they could be weighed. Although bias and predetermination are treated as distinct they clearly overlap: a decision-maker with a strong prejudice again party is likely to approach the issues with a closed mind. It is therefore for the grounds to be considered together.
>
> **12-055** As with bias, courts are concerned both with actual predetermination appearance. A finding of actual predetermination will be made if the available evidence shows that a decision-maker in fact approached the issues without an open evidence. For example, a decision to refuse security clearance to the applicant was held to be unlawful in *R. (on the application of Kind) v Secretary of State for the Home Department*. Documentary evidence and email exchanges between officers demonstrated a "decision-making process which was designed to appear to tick the boxes" but the result of which was effectively prejudged. A finding of actual predetermination can overlap with other forms of legal error, such as a failure to undertake consultation at a formative stage.
>
> **12-056** The lawful expression of a provisional view on a case is distinct from predetermination. While the law "certainly does not

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

sanction the premature expression of factual conclusions or anything which may prematurely indicate a closed mind", disclosure by a judge or other decision-maker of their provisional thinking may positively assist the parties and may be necessary to displace a presumption or misapprehension. The provision of an incomplete draft judgment in order to assist the parties has therefore been held not give rise to apparent bias or predetermination. A judge or other decision-maker may also quite properly indicate that they find an answer impossible to believe when hearing from parties or witnesses without appearing to have predetermined the case.

The distinction between unlawful predetermination and lawful predisposition

10-057 A distinction is to be drawn between the case where a decision-maker predetermines a matter in the sense that they approach it with a closed mind, and the case where the decision-maker has a predisposition towards a particular outcome. While predetermination (both actual and apparent) is always unlawful, it may be lawful for a decision-maker to approach a case with an inclination towards a particular conclusion. Indeed, in some contexts, such as where the decision-maker holds an elected office or has been appointed on the basis of their expertise on a particular subject matter, predispositions towards particular views may be inevitable or even desirable."

315. We are in this respect also tempted to recall the theory of self-affirmation and lack of sensitivity to argument strength which is spoken of by psychologists. That theory proceeds on the premise that self-affirmation disables an individual to objectively evaluate information. It speaks of persons seeking to resist information that may conflict with an opinion harboured or a decision made. This, according to that theory, leads to a person being predisposed to affirm a view expressed or an opinion formed.

316. We are thus of the firm opinion that the bifurcation or division of functions which the statute envisaged could have neither been ignored nor disregarded. The underlying purpose of that separation of functions and roles was clearly intended to confer a real and discernible degree of

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Signing Date:07.02.2025
18:46:26

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impartiality and neutrality. The statute clearly envisaged separate and distinct branches of the NFRA discharging its functions of monitoring, oversight and adoption of disciplinary measures. But for the separation of those powers, one would be inevitably faced with the possibility of one branch discharging dual and overlapping roles. This clearly exposes the authority to the charge of a predilection to affirm, the tendency to shut out a challenge to an opinion already formed and disregard the weight of argument aimed at convincing one to review and reappreciate. It would thus be akin to what we in law term as the useless formality theory- an appeal from Caesar to Caesar's wife. This in addition to such a procedure clearly becoming susceptible to the possibility of a person reasonably and justifiably viewing the same as being unfair and violating the golden principle of justice not only being done but being visibly and perceivably served.

317. As is evident from the various disclosures which were made by the NFRA before us, it was the Executive Body which was involved and engaged at all stages of the drawl of the AQRR as well as the formation of the opinion that action in terms of Section 132(4) was liable to be initiated. The mere fact that in the course of this exercise, it was assisted by certain other officers is, in our considered opinion, wholly irrelevant, since the ultimate formation of opinion was one which was of the Executive Body as a whole. The petitioners could have thus reasonably harboured an apprehension of lack of neutrality and potential bias.

318. As in all such situations, it is not our intent to even remotely suggest that the Executive Body was in fact biased or prejudiced

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

against the writ petitioners. It ultimately boils down to the view or opinion that a reasonable person may form. While it is true that the reasonableness of apprehension cannot be based on an unfounded belief or tenuous reasoning, as long as it is an opinion which could be said to be reasonably drawn, the test of reasonable likelihood of bias would be satisfied.

319. We also find ourselves unable to sustain the argument of necessity and which was canvassed for our consideration by Mr. Hossain. The doctrine of necessity applies where it is impermissible or impossible for a modified composition of a statutory body being enabled to undertake the decision-making inquiry. In fact, and as we have found on a review of the statutory scheme, the Legislature as well as the rule making authority appears to have consciously made appropriate provisions for the monitoring of compliance of SAs, enforcement of compliance, oversight, investigation and disciplinary proceedings being undertaken by different arms of the NFRA. The division of functions which the principles of due process and fairness would demand clearly appear to inform the statutory provisions when they speak of divisions performing different functions and obligations that stand placed.

320. It is these fundamental constructs which also stand adopted by authorities such as the PCAOB and the FRC. The Byelaws which govern and regulate the functioning of the PCAOB incorporate the following significant provisions. As per those rules, disciplinary proceedings are to be undertaken by a Hearing Officer who must and necessarily be a person other than a board member or staff of the

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

interested division. This becomes apparent from the manner in which those Rules define the phrase "hearing officer" in Rule 1001(h)(i):-

> " **Hearing Officer**
>
> The term "hearing officer" means a person, other than a Board member or staff of the interested division, appointed in accordance with Article 6.3 of the Board's bylaws to preside at hearings.

321. An interested division is defined by Rule 1000(i)(iv) as follows:-

> "**Interested Division**
> The term "interested division" means a division or office of the Board assigned primary responsibility by the Board to participate in a particular proceeding. "

322. Under Section 4, the task of undertaking an inspection is entrusted to the Division of Registration. This flows from a reading of Rules 4000, 4001 and 4002 and which are extracted hereinbelow: -

> "**Section 4. Inspections**
>
> **Rule 4001. Regular Inspections**
>
> In performing a regular inspection, the staff of the Division of Registration and Inspections and any other person authorized by the Board to participate in the inspection shall take such steps, and perform such procedures, as the Board determines are necessary or appropriate. Such steps and procedures must include, but need not be limited to, those set forth in Section 104(d)(1) and (2) of the Act and such other tests of the audit, supervisory, and quality control procedures of the firm as the Director of the Division of Registration and Inspections or the Board determines.
>
> **Rule 4002. Special Inspections**
>
> In performing a special inspection, the staff of the Division of Registration and Inspections and any other person authorized by the Board to participate in the inspection shall take such steps, and perform such procedures, as are necessary or appropriate concerning the issue or issues specified by the Board in connection with its authorization of the special inspection."

323. The dichotomy of roles that may be discharged by separate

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

constituents of the PCAOB comes to the fore as we proceed to Section 5 and which is concerned with investigations and adjudications. The said Chapter speaks of a Director of Enforcement and Investigation which may undertake an informal inquiry in the first instance. It is upon the recommendation of the Director that the Board then proceeds to draw a formal order for commencement of an investigation. This becomes apparent from a reading of Rules 5000 and 5101 which are reproduced hereinbelow: -

> "**Rule 5000. General**
>
> A registered public accounting firm, and any person associated with such a firm, shall comply with all Board orders to which the firm or person is subject.
>
> [Effective pursuant to SEC Release No. 34-49704, File No. PCAOB-2003-07 (May 14, 2004)]
>
> **Part 1 - Inquiries and Investigations**
>
> **Rule 5100. Informal Inquiries**
>
> **(a) Commencement of an Informal Inquiry**
>
> The Director of Enforcement and Investigations may undertake an informal inquiry where it appears that, or to determine whether, an act or practice, or omission to act, by a registered public accounting firm, any associated person of that firm, or both, may violate -
>
> (1) any provision of the Act;
>
> (2) the Rules of the Board;
>
> (3) the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under the Act; or
>
> (4) professional standards.
>
> **(b) Informal Inquiry Activities**
>
> In an informal inquiry, the Director of Enforcement and Investigations may request documents, information or testimony from, or an interview with, any person."

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Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

324. The subject of disciplinary proceedings is spelt out in Rule 5200 and which reads as under: -

> "**Rule 5200. Commencement of Disciplinary Proceedings**
>
> **(a) Grounds for Commencement of Disciplinary Proceedings**
>
> The Board may commence a disciplinary proceeding when –
>
> (1) it appears to the Board, as the result of an investigation or otherwise, that a hearing is warranted to determine whether a registered public accounting firm, or an associated person of such a firm, has engaged in any act or practice, or omitted to act, in violation of the Act, the Rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under the Act, or professional standards;
>
> (2) it appears to the Board, as the result of an investigation or otherwise, that a hearing is warranted to determine whether a registered public accounting firm, or any person who is, or at the time of the alleged failure reasonably to supervise was, a supervisory person of such firm, has failed reasonably to supervise an associated person, either as required by the Rules of the Board relating to auditing or quality control standards, or otherwise, with a view to preventing violations of this Act, the Rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission under the Act, or professional standards, and that such associated person has committed a violation of the Act, or of any such rules, laws, or standards;
>
> (3) it appears to the Board that a hearing is warranted pursuant to Rule 5110.
>
> [Effective pursuant to SEC Release No. 34-49704, File No. PCAOB-2003-07 (May 14, 2004); and SEC Release No. 34-72087, File No. PCAOB-2013-03 (May 2, 2014)]
>
> **(b) Presiding Official**
>
> All proceedings shall be presided over by the Board or, if the Board orders, by a hearing officer.
>
> **(c) Assignment of a Hearing Officer**
>
> Subject to Rule 5200(b), as soon as practicable after the Board has issued an order instituting proceedings, or after a

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Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

registration applicant has requested a hearing pursuant to Rule 5500(b), the Secretary shall assign a hearing officer to preside over the proceeding and shall serve the parties with notice of the hearing officer's assignment. Subject to Rules 5402 and 5403, the hearing officer shall have the authority to do all things necessary and appropriate to discharge his or her duties. The powers of the hearing officer include, but are not limited to, the following –

(1) obtaining a court reporter to administer oaths and affirmations;

(2) issuing accounting board demands pursuant to Rule 5424;

(3) receiving relevant evidence and ruling upon the admission of evidence and offers of proof;

(4) regulating the course of a proceeding and the conduct of the parties and their counsel;

(5) holding prehearing and other conferences and requiring the attendance at any such conference of at least one representative of each party who has authority to negotiate concerning the resolution of issues in controversy;

(6) recusing himself or herself upon motion made by a party or upon his or her own motion;

(7) ordering, in his or her discretion, in a proceeding involving more than one respondent, that the interested division indicate, on the record, at least one day prior to the presentation of any evidence, each respondent against whom that evidence will be offered;

(8) subject to any limitations set forth elsewhere in these Rules, considering and ruling upon all procedural and other motions;

(9) preparing an initial decision as provided in Rule 5204;

(10) upon notice to all parties, reopening any hearing prior to the filing of an initial decision therein, or, if no initial decision is to be filed, prior to the time fixed for the filing of final briefs with the Board;

(11) informing the parties as to the availability of one or more alternative means of dispute resolution, and encouraging the use of such methods; and

(12) scheduling hearing dates, except that a hearing officer may not, absent the approval of the Board, change a hearing date set by Board order.

(d) Separation of Functions

The staff of the Division of Enforcement and Investigations may not participate or advise in the decision, or in Board review of the decision, in any proceeding in which the Division of

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

> Enforcement and Investigations is the interested division, except as a witness or counsel in the proceeding. Any other employee or agent of the Board engaged in the performance of investigative or prosecutorial functions for the Board in a proceeding may not, in that proceeding or one that is factually related, participate or advise in the decision, or in Board review of the decision, except as a witness or counsel in the proceeding. A hearing officer may not be responsible to or subject to the supervision or direction of an employee or agent engaged in the performance of investigative or prosecuting functions for the Board.
>
> **(e) Consolidation of Proceedings**
>
> By order of the Board or a hearing officer, proceedings involving a common question of law or fact may be consolidated for hearing of any or all the matters at issue in such proceedings. The Board or the hearing officer may make such orders concerning the conduct of such proceedings as it deems appropriate to avoid unnecessary cost or delay. Consolidation shall not prejudice any rights under these Rules and shall not affect the right of any party to raise issues that could have been raised if consolidation had not occurred. For purposes of this Rule, no distinction is made between joinder and consolidation of proceedings."

325. Of significance is the statutory injunct of the staff of the Division of Enforcement and Investigation from having any participatory role at any stage of the proceedings that may be undertaken. Similar is the restraint which operates in respect of any other employee or agent of the Board who may have been engaged in the performance of investigative or prosecutorial functions at any prior stage of the proceedings that may have involved the auditor or the auditing firm.

326. A similar structure is followed by the FRC and which discharges its functions through an Executive Committee, the Audit and Risk Committee and the Conduct Committee amongst various others. As is apparent from a reading of the **Terms of Reference**[95] framed with respect to the Audit and Risk Committee, the said body is enjoined to

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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support and advise the Board by providing oversight of a company's financial reporting process, use of public funds, adherence to corporate government principles, audit process and internal controls. The TOR of the Conduct Committee exercises oversight over inquiries, investigations and enforcement functions that may be performed. The Enforcement Committee panel is enjoined to consider report submitted by audit quality review teams deciding whether a recognized auditor is liable to be sanctioned as well as considering representations that may be submitted in response to a notice proposing sanctions. The structure so put in place by the FRC too thus follows lines similar to those adopted by the PCAOB.

327. While we do not intend to suggest that the NFRA was obliged to punctiliously follow or adopt an identical structure, what we seek to highlight is that regulatory bodies appear to have universally formulated and attempted to adhere to a procedure which would meet the test of due process, of a fair opportunity being afforded to the person charged and above all justice appearing to have been truly served. These are surely not principles foreign to our jurisprudence. They are above all the command of Article 14 itself. The proceedings impugned before us, however, clearly falter and fall when tested on the aforenoted basic postulates.

SCNs: The Scar of Pre-determination

328. As noticed above, it was the Executive Body which in the first instance came to record findings of guilt and violation of the SAs'. Those reports had come to conclude in no uncertain terms that the petitioners had violated the ethics standards required to be maintained

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

and having acted in violation of the SAs' which applied. That very body proceeded to take a decision to commence disciplinary action based not an independent review of the facts that obtained but solely on the strength of what had been found in the AQRR. The composition of the body which penned the AQRR and that which issued the SCN remained unaltered. The proceedings have thus come to be stigmatized beyond repair and cannot in law be salvaged or saved.

329. This facet of the challenge attains added significance in light of the nature of findings which we find came to be reflected in the AQRR**.** Some of those findings and observations as appearing in the AQRR of WP(C) 1065 of 2021 are extracted hereinbelow:-

> "**2.5.16** NFRA had analysed the details given in Annexure 4.5, and its conclusions were as follows:
>
> Annexure 4.5 Presumed Risk of Management Override of Control The working papers referred in this Annexure primarily cover the testing of design and implementation and the operating effectiveness of the controls related to accounting of transactions as well as serial continuity testing on the COD listing. The working papers do not contain any relevant information to enable the Audit Firm to assess the impact of management involvement in the functioning of the company in such a manner as to override the established policies and procedures.
>
> **2.5.17** The above figures clearly indicated that almost all the sanctioning of loans was done manually and that was afterwards regularized in the system. As has been highlighted in the RBI reports also, the manual overrides essentially have to do with relaxation of the norms and conditions that should normally attach to the sanctions. Apart from the possibility of ROMM due to fraud, such overrides also needed to be examined by the Audit Firm in order to do its duties as per Sec 143 of the Companies Act, 2013. The Audit Firm had been grossly negligent in considering and evaluating the effect of management override of controls on account of sanctioning of such loans and failed to evaluate the circumstances that required the company to sanction the loans manually instead of following the established policies and procedures. This preponderance of manual

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

overrides should also have alerted the Audit Firm to the possibility of fraud that needed to be reported under Sec 143(12). However, nothing was done in this regard. Also, having analysed the COD listing of manual approvals, NFRA had come across various cases of sanctioning of loans/ modification in the conditions attached to existing loans which were subsequently pointed out by the RBI in their report. The audit documentation clearly indicates that the Audit Firm in such cases has relied on the management representations completely instead of performing adequate audit procedures.

2.5.18 To summarise,

(a) The Audit Firm had clearly indulged in a deliberate misrepresentation of a material fact;

(b) There had been a complete lack of clarity, and utter confusion had prevailed, in the ROMM assessment;

(c) Important aspects of the auditee company's situation, such as its SI-NBFC status, the very disturbing RBI Inspection Reports on the company, the wide discrepancies in reporting of NPAs, etc., had not been given adequate importance in the ROMM assessment;

(d) Accordingly, the audit responses had been grossly inadequate;

(e) Such procedures as had been performed have had no link to the real ROMM;

(f) In crucial matters, the Audit Firm had relied completely on the management's representations;

(g) The Audit Firm had totally failed in communicating to TCWG/the management the key issues arising out of the audit.

xxxx xxxx xxxx

2.3.6 NFRA had further examined aspects of the engagement that were directed/supervised/reviewed by CA Udayan Sen in his capacity as EP. Contrary to the statement made at document 5/page 10 of the Audit Firm's response to the prima facie conclusions, WP No. 29702 (Manual) Closing Procedures Check list had not been initiated by CA Udayan Sen. CA Udayan Sen's initials were seen only in that part of the WP No. 29702 which is designated as the closing memorandum. This is in the form of a report sent by CA Shrenik Baid to CA Udayan Sen. This paper is a summary of the procedures adopted during the course of the audit. The very fact that CA Shrenik Baid had to send such a memorandum to CA Udayan Sen was itself proof that CA Udayan Sen had not participated in any

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Signing Date:07.02.2025
18:46:26

of the audit processes listed therein. This is for the reason that if CA Udayan Sen had indeed participated in the listed procedures etc., his presence there would have been automatically recorded and the need for such a closing procedures memorandum would not have arisen. No further evidence had been provided by the Audit Firm to counter the conclusions of the NFRA that CA Udayan Sen was not involved with almost all the important work of the audit engagement.

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2.3.18 The Audit Firm in their reply submits that IFIN classified its investment in RNEL as a long term investment, which, under AS 13, was measured at cost less any other than temporary diminution in value. The highest traded price of the shares of RNEL during FY 2017-18 was Rs.70.65, and there were many days during FY 17-18 where the closing traded price of shares of RNEL were more than the carrying value of the shares in the books of account of IFIN. Given such share prices and the general volatile nature of the RNEL share price, there certainly was no decline in value other than temporary as on 31st March, 2018. The Engagement Team documented important facts set forth in management's representation regarding the RNEL investment in WP 23150.01.05 including carrying cost and price movement, in the documentation of its testing reflected in WP 23150.01.01 "Investment In Equity and Preference Shares"- Refer Tab 'Valuation of listed shares'.

xxxx xxxx xxxx

2.4.2 The response of the Audit Firm was as follows:

(a) Discussions were had with TCWG throughout the audit period;

(b) Not all discussions are required to be documented in the form of minutes of discussions;

(c) Our written communications with the Audit Committee are as follows:

(i) Engagement letter

(ii) Presentation made at the time of the half year review; and

(iii) Presentation made at the time of audit for the year ended 31st March, 2018, jointly with the joint statutory auditors.

(d) Our discussions with the Management are embedded within each work paper as, prima facie, all information was provided by the Management and hence would not require separate documentation.

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Signing Date:07.02.2025
18:46:26

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(e) All work was performed at the client's offices, and hence communication with the Management was on a daily basis.

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2.6.4 For all the above reasons, the DAQRR concluded that it is very clear that the ET had completely failed to obtain sufficient appropriate audit evidence to satisfy itself about the credit risk associated with the fulfilment of the put option by SREPPL.

2.6.5 It is seen that the option Agreement was executed sometime in December 2015. If the argument of the Audit Firm that the option had a value of around Rs.180 crores was to be accepted, there was no reason why this was not reflected in the Balance Sheets as of 31st March, 2016, or 2017. The fact that this option contract was brought into the books as of 31st March, 2018, only served to confirm the prima facie conclusion of the NFRA that this action was only a method used by the management to inflate the profit, and that the Audit Firm did not display the required professional skepticism and challenge the evidence produced by the management

2.6.6 After considering all the above matters, NFRA concluded as follows in the DAQRR:

(a) The Audit Firm did not obtain sufficient, appropriate audit evidence to support the value of the derivative asset included in the Balance Sheet as at 31st March, 2018;

(b) The Audit Firm did not do the due diligence necessary to obtain and critically evaluate such evidence as was provided to it by the management;

(c) Accounting guidelines that are clearly inapplicable had been used to justify the treatment given;

(d) In order to offset the impact of provisioning that could not be deferred any more, on account of RBI insistence, the Audit Firm went along with the management in including a derivative asset of zero value in the Balance Sheet at over Rs 180 crores, and taking credit in the Profit and Loss Account. This resulted in a very material misstatement of the financial statements.

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2.6.9 NFRA has come to the conclusion that:

(a) The Audit Firm had failed in not insisting on fully providing for the value of TTSL shares even in the earlier years;

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Signing Date:07.02.2025
18:46:26

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(b) The Audit Firm did not obtain sufficient appropriate audit evidence to support the value of the derivative assets (put option) included in the balance sheet as of 31.03.2018;

(c) The Audit Firm did not show the due diligence necessary to obtain and critically evaluate such evidence as was provided to it by the management;

(d) Accounting treatment that is clearly inapplicable, had been used to justify the treatment given;

(e) The RBI Directions relating to restructuring were flouted; the Audit Firm did not raise this issue, nor did it take up the matter of non-disclosure of such restructured account in the financial statements;

(f) In order to offset the impact of provisioning that was long overdue, the Audit Firm went along with the management in including a derivative asset of zero value in the balance sheet at Rs.184.31 crores and taking credit for the same in the profit and loss account. This resulted in a very material misstatement in the financial statements.

xxxx xxxx xxxx

2.11.11 NFRA has considered the above contentions of the Audit Firm and its conclusion are as follows:

(a) NFRA is a body constituted under the Companies Act, 2013, to, inter alia, monitor and enforce compliance with auditing and accounting standards prescribed under the said Act. All auditors of companies that are registered under the Act will be monitored only with reference to standards in force in India. The supposed equivalence of International Standard to, or their even greater rigour in comparison with, Indian Standards is entirely irrelevant for the purposes of NFRA;

(b) Both the inadequacies of the QC policies and processes on the one hand, and the non compliance with such policies as exist on the other, have been clearly brought out in this AQRR. Specifically, NFRA wishes to draw attention to the large scale and serious violations of Independence requirements, the clear display of the lack of the required professional skepticism, the lack of insistence on obtaining sufficient appropriate audit evidence, the repeated assertions that there could be more than one EP for an engagement, the evident confusion in assessing the ROMM and its impacts on the Audit responses and evidence obtained, and the sham character of

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Signing Date:07.02.2025
18:46:26

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the EQCR, as evidence of the need to revamp the QC policies and processes of the Audit Firm;

(c) The complete breakdown of QC system evident in this case is serious enough to support the suspicion that the Audit Firm had aligned itself completely with the interests of the management of the Auditee Company;

(d) NFRA, therefore, is of the opinion that the Audit Firm would be well advised to prepare a comprehensive, concise and systematically structured policy document to conform to SQC 1, and to put in place mechanisms to rigorously enforce it and monitor compliance.

xxxx xxxx xxxx

SAQRR

2.2.3 On consideration of all the above evidence, the NFRA had concluded in the DSAQRR that:

a) The reappointment of the Audit Firm as Statutory Auditor of IFIN for the FY 201 7-18 was ab initio illegal and void for violation of Section 141(3)(e) and Section 141(3)(i) of the Act.

b) The declaration of eligibility submitted by the Audit Firm in terms of Proviso to Section 139(1) of the Act read with Rule 4 of the Companies (Audit and Auditors) Rules, 2014, was false and invalid, with full knowledge of such illegality. Hence, this clearly constituted fraudulent conduct on the part of the Audit Firm.

c) The Audit Firm's compliance with the fundamental principles of the Code of Ethics was threatened by the self-interest threat.

d) The Audit Firm, its EP, and the EQCR Partner were all guilty of professional misconduct arising out of gross violations of the law and the Code of Ethics.

2.5.16 NFRA had analysed the details given in Annexure 4.5, and its conclusions were as follows:

Annexure 4.5 Presumed Risk of Management Override of Control The working papers referred in this Annexure primarily cover the testing of design and implementation and the operating effectiveness of the controls related to accounting of transactions as well as serial continuity testing on the COD listing. The working papers do not contain any relevant information to enable the Audit Firm to assess the impact of management involvement in the functioning of the

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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company in such a manner as to override the established policies and procedures.

2.5.17 The above figures clearly indicated that almost all the sanctioning of loans was done manually and that was afterwards regularized in the system. As has been highlighted in the RBI reports also, the manual overrides essentially have to do with relaxation of the norms and conditions that should normally attach to the sanctions. Apart from the possibility of ROMM due to fraud, such overrides also needed to be examined by the Audit Firm in order to do its duties as per Sec 143 of the Companies Act, 2013. The Audit Firm had been grossly negligent in considering and evaluating the effect of management override of controls on account of sanctioning of such loans and failed to evaluate the circumstances that required the company to sanction the loans manually instead of following the established policies and procedures. This preponderance of manual overrides should also have alerted the Audit Firm to the possibility of fraud that needed to be reported under Sec 143(12). However, nothing was done in this regard. Also, having analysed the COD listing of manual approvals, NFRA had come across various cases of sanctioning of loans/ modification in the conditions attached to existing loans which were subsequently pointed out by the RBI in their report. The audit documentation clearly indicates that the Audit Firm in such cases has relied on the management representations completely instead of performing adequate audit procedures.

2.5.18 To summarise,

(a)The Audit Firm had clearly indulged in a deliberate misrepresentation of a material fact;

(b) There had been a complete lack of clarity, and utter confusion had prevailed, in the ROMM assessment;

(c) Important aspects of the auditee company's situation, such as its SI-NBFC status, the very disturbing RBI Inspection Reports on the company, the wide discrepancies in reporting of NPAs, etc., had not been given adequate importance in the ROMM assessment;

(d) Accordingly, the audit responses had been grossly inadequate;

(e) Such procedures as had been performed have had no link to the real ROMM;

(f) In crucial matters, the Audit Firm had relied completely on the management's representations;

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Signing Date:07.02.2025
18:46:26

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(g) The Audit Firm had totally failed in communicating to TCWG/the management the key issues arising out of the audit.

2.3.6 NFRA had further examined aspects of the engagement that were directed/supervised/reviewed by CA Udayan Sen in his capacity as EP. Contrary to the statement made at document 5/page 10 of the Audit Firm's response to the prima facie conclusions, WP No. 29702 (Manual) Closing Procedures Check list had not been initialed by CA Udayan Sen. CA Udayan Sen's initials were seen only in that part of the WP No. 29702 which is designated as the closing memorandum. This is in the form of a report sent by CA Shrenik Baid to CA Udayan Sen. This paper is a summary of the procedures adopted during the course of the audit. The very fact that CA Shrenik Baid had to send such a memorandum to CA Udayan Sen was itself proof that CA Udayan Sen had not participated in any of the audit processes listed therein. This is for the reason that if CA Udayan Sen had indeed participated in the listed procedures etc., his presence there would have been automatically recorded and the need for such a closing procedures memorandum would not have arisen. No further evidence had been provided by the Audit Firm to counter the conclusions of the NFRA that CA Udayan Sen was not involved with almost all the important work of the audit engagement.

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2.4.2 The response of the Audit Firm was as follows:

(a) Discussions were had with TCWG throughout the audit period;

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(i) Engagement letter

(ii) Presentation made at the time of the half year review; and

(iii) Presentation made at the time of audit for the year ended 31st March, 2018, jointly with the joint statutory auditors.

(d) Our discussions with the Management are embedded within each work paper as, prima facie, all information was provided by the Management and hence would not require separate documentation.

(e) All work was performed at the client's offices, and hence communication with the Management was on a daily basis.

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18:46:26

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2.6.4 For all the above reasons, the DAQRR concluded that it is very clear that the ET had completely failed to obtain sufficient appropriate audit evidence to satisfy itself about the credit risk associated with the fulfilment of the put option by SREPPL.

2.6.5 It is seen that the option Agreement was executed sometime in December 2015. If the argument of the Audit Firm that the option had a value of around Rs.180 crores was to be accepted, there was no reason why this was not reflected in the Balance Sheets as of 31st March, 2016, or 2017. The fact that this option contract was brought into the books as of 31st March, 2018, only served to confirm the prima facie conclusion of the NFRA that this action was only a method used by the management to inflate the profit, and that the Audit Firm did not display the required professional skepticism and challenge the evidence produced by the management.

2.6.6 After considering all the above matters, NFRA concluded as follows in the DAQRR:

(a) The Audit Firm did not obtain sufficient, appropriate audit evidence to support the value of the derivative asset included in the Balance Sheet as at 31st March, 2018;

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(d) In order to offset the impact of provisioning that could not be deferred any more, on account of RBI insistence, the Audit Firm went along with the management in including a derivative asset of zero value in the Balance Sheet at over Rs 180 crores, and taking credit in the Profit and Loss Account. This resulted in a very material misstatement of the financial statements.

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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(b) The Audit Firm did not obtain sufficient appropriate audit evidence to support the value of the derivative assets (put option) included in the balance sheet as of 31.03.2018;

(c) The Audit Firm did not show the due diligence necessary to obtain and critically evaluate such evidence as was provided to it by the management;

(d) Accounting treatment that is clearly inapplicable, had been used to justify the treatment given;

(e) The RBI Directions relating to restructuring were flouted; the Audit Firm did not raise this issue, nor did it take up the matter of non-disclosure of such restructured account in the financial statements;

(f) In order to offset the impact of provisioning that was long overdue, the Audit Firm went along with the management in including a derivative asset of zero value in the balance sheet at Rs.184.31 crores and taking credit for the same in the profit and loss account. This resulted in a very material misstatement in the financial statements.

2.11.11 NFRA has considered the above contentions of the Audit Firm and its conclusion are as follows:

(a) NFRA is a body constituted under the Companies Act, 2013, to, inter alia, monitor and enforce compliance with auditing and accounting standards prescribed under the said Act. All auditors of companies that are registered under the Act will be monitored only with reference to standards in force in India. The supposed equivalence of International Standard to, or their even greater rigour in comparison with, Indian Standards is entirely irrelevant for the purposes of NFRA;

(b) Both the inadequacies of the QC policies and processes on the one hand, and the non compliance with such policies as exist on the other, have been clearly brought out in this AQRR. Specifically, NFRA wishes to draw attention to the large scale and serious violations of Independence requirements, the clear display of the lack of the required professional skepticism, the lack of insistence on obtaining sufficient appropriate audit evidence, the repeated assertions that there could be more than one EP for an engagement, the evident confusion in assessing the ROMM and its impacts on the Audit responses and evidence obtained, and the sham character of the EQCR, as evidence of the need to revamp the QC policies and processes of the Audit Firm;

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

(c) The complete breakdown of QC system evident in this case is serious enough to support the suspicion that the Audit Firm had aligned itself completely with the interests of the management of the Auditee Company;

(d) NFRA, therefore, is of the opinion that the Audit Firm would be well advised to prepare a comprehensive, concise and systematically structured policy document to conform to SQC 1, and to put in place mechanisms to rigorously enforce it and monitor compliance.

2.3.18 The Audit Firm in their reply submits that IFIN classified its investment in RNEL as a long term investment, which, under AS 13, was measured at cost less any other than temporary diminution in value. The highest traded price of the shares of RNEL during FY 2017-18 was Rs.70.65, and there were many days during FY 17-18 where the closing traded price of shares of RNEL were more than the carrying value of the shares in the books of account of IFIN. Given such share prices and the general volatile nature of the RNEL share price, there certainly was no decline in value other than temporary as on 31st March, 2018. The Engagement Team documented important facts set forth in management's representation regarding the RNEL investment in WP 23150.01.05 including carrying cost and price movement, in the documentation of its testing reflected in WP 23150.01.01 "Investment In Equity and Preference Shares"- Refer Tab 'V1luation of listed shares'.

xxxx xxxx xxxx

2.2.3 On consideration of all the above evidence, the NFRA had concluded in the DSAQRR that:

a) The reappointment of the Audit Firm as Statutory Auditor of IFIN for the FY 201 7-18 was ab initio illegal and void for violation of Section 141(3)(e) and Section 141(3)(i) of the Act.

b) The declaration of eligibility submitted by the Audit Firm in terms of Proviso to Section 139(1) of the Act read with Rule 4 of the Companies (Audit and Auditors) Rules, 2014, was false and invalid, with full knowledge of such illegality. Hence, this clearly constituted fraudulent conduct on the part of the Audit Firm.

c) The Audit Firm's compliance with the fundamental principles of the Code of Ethics was threatened by the self-interest threat.

d) The Audit Firm, its EP, and the EQCR Partner were all guilty of professional misconduct arising out of gross violations of the law and the Code of Ethics.

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

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2.3.6 NFRA therefore reiterates its conclusions in the DSAQRR and observes that the Audit Firm has gone against its own assessment and has accepted higher valuation of the Investments. The Audit Firm has, thus, colluded with the Management, and has failed to disclose the overstatement of profit.

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2.10.2 The above observations of NFRA are reinforced by various observations of NFRA in this SAQRR, which are as follows:

a) In Para 2.3 above, it has been conclusively shown that the reappointment of the Audit Firm as Statutory Auditor of IFIN for the FY 2017-18 was ab initio illegal and void for violation of Section 141(3)(e) and Section 141(3)(i) of the Act. The declaration of eligibility submitted by the Audit Firm in terms of Proviso to Section 139(1) of the Act when read with Rule 4 of the Companies (Audit and Auditors) Rules, 2014, was false and invalid, with full knowledge of such illegality. The Audit Firm's compliance with the fundamental principles of the Code of Ethics was threatened by the self-interest threat. Thus, the EQCR Partner was guilty of professional misconduct arising out of gross violations of the law and Code of Ethics.

b) As shown in Para 2.3.3.19, the ET and EQCR failed to verify the investments of the Company and their valuation with valid, sufficient, appropriate and reliable Audit Evidences and failed to comply with the applicable Accounting Framework.

c) There is absolutely no record of any discussion held by the EQCR with the ET. For example, the reversal of Rs. l75 Crores from provision for general contingencies has not been explained in any WP. The EQCR team has neither done any independent Analysis nor questioned the ET on the same. The conclusion is, therefore, inescapable that the profits for the year were inflated by Rs.175 Crores, without any basis or justification.

d) As shown in Para 2.9.7, NFRA ~ad pointed out several discrepancies in audit documentation that raised doubts, even at a prima facie level, about the authenticity and reliability of the audit documentation. The details given in Para 2.9 shows that the deficiencies are systemic and structural in nature and arise substantially from a complete disregard for the basic principles of IT security in the software used. This renders the audit documentation completely unfit for the intended purpose. In not having cross verified that the IT systems used for Audit File documentation did not suffer from any of these serious deficiencies, the EQCR has been guilty of serious professional misconduct.

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

2.10.3 Thus NFRA reiterates its conclusions in the DSAQRR and concludes that: -

a. The EQCR has completely failed in documenting its working properly and separately from the work of the Audit team as required by SQC 1 and SA 230.

b. The EQCR has violated the provisions of SA 220 in preforming their works.

c. The conclusion, therefore, is inescapable that such EQCR as was, if at all, performed, was so perfunctory as to render it a complete sham."

330. Similar observations and findings can be found in the AQRR of WP(C) 11737 of 2021:-

"2.16. The above instances clearly prove that even SRBC identifies itself as an EY entity. All the above facts show that the audit network of SRBC is clearly EY itself, when substance over form is considered. Read together with all the above facts, and the requirements of the ethical guidelines, and how they are to be applied, as described above, it is clear that the arguments presented by the Audit Firm to try and make out that they have no "indirect" connection (as contemplated by explanation (ii) to Sec 144) with EYG entities are clearly intended only to mislead and deceive. All entities in the EY network clearly hold themselves out as EY constituents. In summary, it is crystal clear that any entity providing any non-audit services under the EY brand name is to be regarded as providing the said non-audit services indirectly, as contemplated by the explanation to Section 144 of the Act. The separate legal structure of the entities providing the non-audit services does not exclude them from being considered as services provided "indirectly" for the purposes of explanation (ii) to Sec 144.

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2.19. Therefore, NFRA concludes that SRBC, EYLLP and EYMBS are covered under directly or indirectly related entities as per explanation (ii) to Sec 144 of the Act. Read with conclusions in section above, the non-audit services provided by these entities fall within the purview of the prohibited services, including management services, covered under section 144 of the Companies Act, 2013.

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

2.46. In view of the above observations, NFRA concludes that the EP and the EQCR Partner have been grossly negligent in complying with the requirements of Para 11 and Para 21 of SA 220. Para 11 of SA 220 stipulates that the EP shall obtain relevant information from the firm and, where applicable, network firms to identify and evaluate circumstances and relationships that create threats to independence. Para 21 of SA 220 requires that for audits of financial statements of the listed entities, the EQCR Partner shall consider the ET's evaluation of firm's independence in relation to the audit engagement

2.47. Thus, subject to the above observations, NFRA reiterated its findings in the preliminary stage and concluded in the DAQRR that:

i. The appointment of the Audit Firm as Statutory Auditor of IFIN was ab initio illegal and void for violation of Section 141(3)(e) and Section 141(3)(i) of the Act, because of the provision of non-audit services, in violation of section 144 of the Act, as listed in Appendix 1, except the two services mentioned above.

Because of the two non-audit services detailed above, the Audit Firm has violated section 141(4) as well.

ii. The declaration of eligibility submitted by the Audit Firm in terms of Proviso to Section 139(1) of the Act read with Rule 4 of the Companies (Audit and Auditors) Rules, 2014, was false and invalid, with full knowledge of such illegality. Hence, this clearly constitutes fraudulent conduct on the part of the Audit Firm.

iii. The Audit Firm had grossly violated the provisions of Section 144 of the Companies Act, 2013.

iv. The Audit Firm had been in serious breach of the Code of Ethics.

v. The violations had undoubtedly fatally compromised the independence in mind and independence in appearance required of the Audit Firm. Independence in appearance stood destroyed since no unbiased person could conclude, on an objective assessment of the circumstances, that there had been no abridgement of the auditor's independence.

vi. EP and the EQCR Partner were guilty of professional misconduct arising out of gross violations of the applicable Auditing Standards.

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2.67. In view of the above, NFRA reiterates its observations in the DAQRR and concludes that:

i. The appointment of the Audit Firm as Statutory Auditor of ITNL was ab initio illegal and void for violation of Section 141(3)(e) and Section 141(3)(i) of the Act, because of the provision of prohibited

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

non-audit services, in violation of section 144 of the Act. Because of the two non-audit services detailed in para 2.45 above, the Audit Firm has violated section 141(4) as well.

ii. The declaration of eligibility submitted by the Audit Firm in terms of Proviso to Section 139(1) of the Act read with Rule 4 of the Companies (Audit and Auditors) Rules, 2014, was false and invalid, with full knowledge of such illegality. The Audit Firm had grossly violated the provisions of Section 144 of the Companies Act, 2013.

iii. The Audit Firm had been in serious breach of the Code of Ethics.

iv. The violations had undoubtedly fatally compromised the independence in mind and independence in appearance required of the Audit Firm. Independence in appearance stood destroyed since no unbiased person could conclude, on an objective assessment of the circumstances, that there had been no abridgement of the auditor's independence.

xxxx xxxx xxxx

11.3. On consideration of all the above evidence, NFRA therefore reiterates its conclusions made in the PFC that:

i. Based on the overall inadequacies in the audit done by the Engagement Team led by EP, it is apparent that the EQCR Partner has failed to bring to notice the key matters not appropriately dealt with during the audit.

ii. The EQCR partner failed to report material misstatements known to him to appear in a financial statement with which he is concerned in his professional capacity.

iii. The EQCR partner did not exercise due diligence to obtain sufficient information to objectively evaluate the significant judgments of the ET and conclusions reached by them.

iv. The exaggerated claims of the Audit Firm about involvement of EQCR Partner are clearly unsupported by evidence and the Audit Firm has failed in complying with various provisions of SQC 1, SA 220 and SA 230.

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Annexure II

1.3 Thus, SRBC did not independently exercise reasonable due diligence to ensure compliance with Section 141 (3) (i) of the Act. SRBC also did not exercise due diligence to prevent violation of Sec 144 of the Act. This resulted in compromise of the independence in mind and independence in appearance required of the auditor. This

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

failure to evaluate the independence breaches resulted in accepting an illegal appointment by the Audit Firm as a statutory auditor of ITNL for FY 2017-18 and continuing and added illegality thereafter.

1.4 SRBC is guilty of breach of independence in mind and independence in appearance as required by the Para 290.8 of Code of Ethics. SRBC is also guilty of violation of para 220.2 of Code of Ethics which stipulates "A professional accountant in public practice should evaluate the significance of any threats. Evaluation includes considering, before accepting or continuing a client relationship or specific engagement, whether the professional accountant in public practice has any business interests or relationships with the client or a third party that could give rise to threats".

1.5 Because of the above actions/omissions, SRBC has failed to comply with Para A1 of SA 210, Para 11 of SA 220, Paras 14, A14, A15, and A16 of SA 200.

1.6 Thus, SRBC is guilty of professional misconduct arising out of gross violations of the Companies Act, 2013, the Standards of Auditing and the Code of Ethics. These actions/omissions/violations of SRBC, as detailed with evidence in the AQRR, therefore, amount to professional misconduct of failure to exercise due diligence and being grossly negligent in the conduct of professional duties.

xxxx xxxx xxxx

2.6 The above actions of SRBC, as detailed with evidence in the AQRR, amount to professional misconduct of failure to:
a) disclose a material fact known to them which is not disclosed in a financial statement, but disclosure of which is necessary in making such financial statement where SRBC is concerned with that financial statement in a professional capacity,

b) report a material misstatement known to them to appear in a financial statement with which SRBC is concerned in a professional capacity,

c) exercise due diligence, and being grossly negligent in the conduct of professional duties,

d) 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) invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances. "

331. As is manifest from the above, those findings clearly appear to

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Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

transgress the boundaries of a prima facie opinion or one which could be termed as being precursive. They ex facie verge if not cross the border of the conclusive. They are clearly imbued by notes of finality. It is these findings and conclusions rendered by the Executive Body which constituted the foundational material for the formation of opinion by it as to whether circumstances warranted disciplinary action being taken against the writ petitioners. The Executive Body thereafter is stated to have reviewed that very material in order to come to the conclusion that circumstances clearly did exist which merited action being taken in terms of Rule 11. The Executive Body thus not only acted as the propounder of a prima facie finding of violation of SAs and the laws, it took its own opinion into consideration for the purposes of formation of the belief that sufficient cause existed to take action as contemplated under Section 132(4).

332. We are in this respect also reminded of the following pertinent observations which came to be rendered by the Supreme Court in **Oryx Fisheries (P) Ltd. vs Union of India**[96] and where it was held:-

> "**27.** It is no doubt true that at the stage of show cause, the person proceeded against must be told the charges against him so that he can take his defence and prove his innocence. It is obvious that at that stage the authority issuing the charge-sheet, cannot, instead of telling him the charges, confront him with definite conclusions of his alleged guilt. If that is done, as has been done in this instant case, the entire proceeding initiated by the show-cause notice gets vitiated by unfairness and bias and the subsequent proceedings become an idle ceremony.
>
> **28.** Justice is rooted in confidence and justice is the goal of a quasi-judicial proceeding also. If the functioning of a quasi-judicial authority has to inspire confidence in the minds of those subjected to its jurisdiction, such authority must act with utmost fairness. Its

[96] (2010) 13 SCC 427

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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fairness is obviously to be manifested by the language in which charges are couched and conveyed to the person proceeded against.

xxxx xxxx xxxx

31. It is of course true that the show-cause notice cannot be read hypertechnically and it is well settled that it is to be read reasonably. But one thing is clear that while reading a show-cause notice the person who is subject to it must get an impression that he will get an effective opportunity to rebut the allegations contained in the show-cause notice and prove his innocence. If on a reasonable reading of a show-cause notice a person of ordinary prudence gets the feeling that his reply to the show-cause notice will be an empty ceremony and he will merely knock his head against the impenetrable wall of prejudged opinion, such a show-cause notice does not commence a fair procedure especially when it is issued in a quasi-judicial proceeding under a statutory regulation which promises to give the person proceeded against a reasonable opportunity of defence.

32. Therefore, while issuing a show-cause notice, the authorities must take care to manifestly keep an open mind as they are to act fairly in adjudging the guilt or otherwise of the person proceeded against and specially when he has the power to take a punitive step against the person after giving him a show-cause notice.

33. The principle that justice must not only be done but it must eminently appear to be done as well is equally applicable to quasi-judicial proceeding if such a proceeding has to inspire confidence in the mind of those who are subject to it.

xxxx xxxx xxxx

35. Going by the aforesaid test any man of ordinary prudence would come to a conclusion that in the instant case the alleged guilt of the appellant has been prejudged at the stage of show-cause notice itself."

333. We are thus of the firm opinion that the Executive Body could not have discharged the dual role of rendering findings of guilt and violation of the SAs' while authoring the SQARR/AQRR and thereafter don the mantle of the division which is contemplated under Rule 11. The assessment of whether circumstances warranted a disciplinary enquiry being initiated was statutorily liable to be undertaken by a unit of the NFRA separated from the one which drew up those reports. This

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

since, the Act and the Rules clearly contemplate a separation of functions between different constituents of the NFRA. Notwithstanding what may be observed in those reports, the law would contemplate and require a decision to initiate disciplinary action being arrived at impartially and independently. The procedure which NFRA chose to follow in these cases clearly lacked attributes of neutrality and a dispassionate appraisal.

334. The doctrine of necessity has also been found to be inapplicable since it was open for the NFRA to have constituted separate units which could have discharged the functions statutorily envisaged. Since the body of persons which penned the reports and took a decision to initiate proceedings under Rule 11 was one and the same, the procedure is found to be in clear violation of the reasonable likelihood of bias test. An informed observer would be justified in alleging predisposition, predetermination and an inclination to affirm against that body. We have also borne in consideration the damning and conclusive findings of guilt and infraction which came to form part of the AQRR and essentially shut the doors on an independent and impartial evaluation of the infractions which were alleged to have been committed. We are thus convinced that these facets have ineffaceably tainted the proceedings impugned before us.

PERIPHERAL ISSUES

335. That only leaves us to examine the argument of invidious discrimination amongst members of a homogenous class and those falling within the ambit of Rule 3 being placed at a serious disadvantage in the sense of being deprived of the safeguards

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

incorporated in the CA Act and the Misconduct Rules, 2007. We find ourselves unable to accede to that submission bearing in mind the underlying policy objectives which imbue Section 132(4) and the classification of auditors on the basis of entities whose audit they may have conducted. As we view the class of entities which are placed within the scope of Rule 3, it becomes apparent that they are body corporates in which members of the general public would have a vital interest and financial exposure. The potential fallout of financial statements of such entities not being compliant with the statutory obligations which apply may have huge ramifications. It is these facets which appear to have constituted the basis of classification. It would therefore be wholly incorrect to assert that the classification is not based on a rational criteria or nexus aimed at subserving a larger public interest. We have, in any case, found that there is no fundamental difference between the procedure contemplated under the CA Act and the NFRA Rules if matter being tried be based not on a complaint but on an investigation initiated either by the authority itself or on a reference made.

336. The argument of deprivation of the right of legal representation pales into insignificance in light of the statement made on behalf of NFRA and when it was stated that it had undertaken a course correction and taken a principled decision to permit legal assistance to a charged auditor or auditing firm.

STATEMENT OF CONCLUSIONS

337. For sake of convenience and ease of reference we deem it appropriate to summarise our principal conclusions which form part of

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

this judgment as under:-

A. The Companies Act makes provisions in terms of which both the firm as well as its engagement partners are held liable and could face the spectre of incarceration as well as the imposition of monetary fines. Section 147 existed on the statute book even before the NFRA came to be operationalized. The said provision gets attracted the moment the provisions of Sections 139 to 146 are found to have been contravened. It is thus evident that the Act does not make any distinction insofar as the issue of liability is concerned. A liability in terms of the Companies Act could accrue or come to be suffered by both the firm as well as its partners. It would thus be wholly incorrect to hold that Section 132 creates a liability which is foreign to or uncontemplated by the various other provisions forming part of that statute.

B. The Companies Act clearly contemplates a firm suffering a liability as a consequence of the action of its Engagement Partners and constituents who may be involved in the conduct of the audit. Thus, both the audit firm as well as its individual partners would be exposed to a statutory liability if Sections 139 to 146 were found to have been violated. Therefore, the liability which is suffered by an audit firm by virtue of the actions of its partners engaged in an audit can neither be said to be abhorrent to the constitutional scheme nor violative of Article 14. It would be wholly impermissible for an audit firm to disavow or seek to distance itself from the actions of its members.

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By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

C. This we hold bearing in mind the indubitable fact that members come to be engaged in the conduct of the audit solely on account of the firm being appointed as an auditor of a company. The appointment of those members is not an independent engagement for it is the firm, be it a partnership or an LLP, which comes to be designated as the auditor. The individual members of those firms discharge functions and carry out duties in accordance with the directives issued by the audit firm.

D. This reasoning aligns closely with the principles of the organic theory which views the firm and its members as a single, inseparable unit for the purposes of legal and professional obligations. This indivisibility reflects the theory's premise that the firm and its members are one and their roles are interdependent and unified. Thus, the appointment of the firm as an auditor naturally encompasses the actions of its members. The engagement of members in the conduct of an audit is not an independent or isolated act but is inherently derivative of the firm's appointment as the auditor. The firm acts as the central organ, and its members function as its limbs, carrying out its obligations and responsibilities. The firm’s designation as the auditor inherently extends to its members, who act on its behalf.

E. To propose an arrangement where distinct spheres of liability operate independently for acts performed by a firm and for those same acts attracting liability on its partners is inherently flawed. Such a proposition assumes the existence of a framework in which the firm functions autonomously, separate from its

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

members or constituents, while delivering auditing services. However, this assumption disregards the very essence and the nature of auditing work, where such disengagement is not only impractical but also fundamentally incompatible with the professional obligations involved.

F. Auditing, by its very nature, requires an unbroken chain of diligence, monitoring, and oversight. The service itself is deeply collaborative, demanding seamless integration of expertise and accountability between the firm and its partners. It necessitates meticulous scrutiny of financial data, adherence to regulatory frameworks and the exercise of professional judgment at every stage. These elements inherently bind the firm and its members inextricably together. To suggest otherwise would ignore the operational realities of such engagements, where the quality and integrity of the work are not divisible between the firm and the individuals performing the task.

G. In essence, the relationship between a firm and its members while delivering auditing services is one of complete integration, where roles and responsibilities overlap to ensure the highest levels of professional service. The nature of such services does not permit a firm to distance itself from the actions of its partners, especially when those actions are performed in furtherance of the firm’s obligations. We thus find no merit in the contention that Section 132 of the Companies Act is liable to be held as unconstitutional basis the audit firm or its individual partners and members becoming vicariously liable.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

H. We also hold that Section 132 is neither an overreach nor can it be said to be arbitrary; it is a necessary mechanism to enforce professional accountability. The firm's designation as an auditor inherently includes the collective responsibilities of its members, making the imposition of a vicarious liability a logical and justified extension of its statutory obligations. Therefore, the contention that the provision is unconstitutional lacks merit and proceeds in ignorance of the operational and legal realities of an audit firm's engagement.

I. There cannot possibly be a cavil of doubt with respect to the well-established precept that statutes are generally presumed to be prospective in their operation. That presumption, undoubtedly, constitutes the starting point from which a court would embark upon its analysis. Equally well-settled is the principle of that presumption being dispelled only if a court were to find from the language of an enactment or a provision that the law maker intended otherwise.

J. The word "vested" is explained by precedents as pertaining to rights which could be said to have become fixed, absolute and complete. Those rights would fall in the category of assertions and protections which could be claimed and not being contingent or subject to be defeated by a condition precedent. However, mere expectancy of future benefits and interests which may be contingent, or an anticipated continuance of existing laws would not constitute vested rights.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

K. Vested rights are those which would remain unimpacted by any future change in the legal position. Regard must be had to the fact that if the right hinges on an unsecured or contingent foundation, susceptible to modification by a change in the legislative scheme, then such a right was never truly vested, as it lacked the essential characteristics of being absolute, fixed, or immune to future alteration.

L. A challenge to a statute on the ground of it being retrospective, however, is invariably and indelibly linked to how it impacts or infringes the rights of an individual or entity. The issue of retrospectivity thus becomes liable to be examined in the backdrop of how the enactment operates and affects the rights which inhere or may have come to be perfected prior to its promulgation. What we seek to emphasize is that the argument of retrospectivity cannot be evaluated in an abstract dimension. That submission has to be necessarily tested on what we find at the crossroads and intersection where the statute meets with the expanse of the bundle of rights which are asserted to exist.

M. Tested on the aforesaid principles, we find ourselves unable to sustain the argument that Section 132 is liable to be struck down on the ground that it operates retrospectively and impacts rights which may have been perfected or completed. It becomes relevant to note that the Explanation to Section 132(4) in unambiguous and explicit terms provides that the expression "*professional or other misconduct*" would have the same meaning as assigned to that phrase by Section 22 of the CA Act.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

Section 132 therefore, does not create a new species of misconduct nor does it create a liability which was otherwise not contemplated under a pre-existing legislation.

N. "*Professional or other misconduc*t" already stood defined by Section 22 of the CA Act and thus all actions of CAs and auditors was liable to be tested on the basis thereof. It would thus be wholly incorrect to contend that Section 132 creates a new liability with respect to a misconduct or misdemeanor committed prior to October 2018.

O. No auditor can possibly claim or assert a vested right coming to be created in respect of professional misconduct that may have been committed prior to Section 132 coming into force. We find ourselves unable to comprehend any right leave alone a vested right that could have been claimed to have come into existence in respect of professional conduct which would have fallen within the scope of Section 22 of the CA Act prior to the introduction of Section 132.

P. As was pertinently observed by the Supreme Court, a statute is not liable to be viewed as having retroactive operation merely because it draws upon an event or act which preceded its promulgation. Acts of misconduct committed prior to October 2018 were neither accorded nor conferred a shield of immunity. Section 132 does not create a new disqualification or create a novel set or category of misdemeanors to constitute professional or other misconduct. The conduct of an audit, an individual or a firm remains liable to be enquired into based on the obligations

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

and duties which held the field even prior to the introduction of Section 132. The conduct of an audit would continue to be examined and evaluated based on those legal obligations and set of rules which existed earlier.

Q. A consideration of the legislative history preceding the introduction of Section 132 clearly suggests that a pre-existing regulatory deficiency or gap was sought to be addressed through the introduction of Section 132 aligning with the broader objective of strengthening oversight mechanisms and enhancing the quality of professional services rendered by audit firms. This measure was implemented not to create new liabilities but to bridge an existing gap in enforcement, ensuring that standards of professional conduct and accountability evolve in tandem with global best practices.

R. The enactment of Section 132 thus represents a progressive regulatory shift, aimed at reinforcing compliance, raising the bar for audit quality, and ensuring that no aspect of professional misconduct or deficiency in service remains unchecked or unsupervised. By instituting a more structured and stringent framework, Section 132 ensures that audit firms and professionals adhere to internationally recognized standards, thereby fostering greater transparency, accountability, and confidence in financial reporting.

S. This regulatory evolution does not operate retrospectively in a punitive sense but rather brings India's auditing and financial oversight framework in line with global standards, ensuring that

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

all professional conduct meets the highest levels of scrutiny and quality assurance. The underlying objective is to create a more robust and reliable regulatory ecosystem, where professional standards are continuously refined to prevent any compromise in audit quality or integrity.

T. The precedents rendered in the context of Article 20(1) clearly appear to exclude civil liabilities or penalties that may come to be imposed from the ambit of that constitutional prohibition. The scope of Article 20(1) has thus been consistently explained to be confined to crimes and punishments as generally understood. An act of professional misconduct was liable to be penalised and punishment meted out as per a law which existed decades prior to the insertion of Section 132 in the Companies Act. Section 132, as noticed hereinabove, merely adopts the meaning assigned to misconduct by the CA Act for the purposes of proceedings that may be initiated thereunder. The argument based on Article 20(1) is thus liable to be rejected on this score alone.

U. As we view Rule 11 of the NFRA Rules, it becomes apparent that the statute clearly commands that authority to ensure that the disciplinary proceedings are undertaken in accordance with the principles of natural justice including where deemed necessary and appropriate providing an opportunity of hearing to the charged entity in person. The reason for not prescribing for oral testimony as a matter of rule or practice is evident from the fact that the proceedings themselves would have been commenced based either on a *suo motu* decision taken by the NFRA or on

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

receipt of a reference made to it either by the Union Government or any other competent authority.

V. The NFRA thus commences proceedings not on the basis of a written complaint or at the behest of a complainant and which was a possibility envisaged under the CA Act and the Misconduct Rules, 2007. Even though the Union Government itself is enabled to make a reference to the NFRA to undertake an investigation, the said entity stands merely in the shoes of an informant or a body which provides material for the NFRA to investigate. The proceedings are thus clearly not adversarial and which was a possible scenario under the Misconduct Rules 2007.

W. The NFRA itself initiates and undertakes the inquiry on the basis of the audit file and record which may have been gathered in the course of an audit quality review. Those proceedings are thus not triggered or based upon the oral testimony of a complainant or person. Thus, the commencement of an inquiry by the NFRA is premised entirely on either a reference that may be made to it by the Union Government or where the said body were to initiate an investigation *suo motu* or in light of facts that may be gathered in the course of its supervisory role envisaged in Rules 7, 8 and 9.

X. In the absence of those proceedings being based on the version of an individual complaint or testimony, we fail to appreciate the submission that the denial of a right of cross-examination is liable to be viewed as a factor which renders the procedure prescribed under the NFRA Rules to be arbitrary.

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

Y. The mere usage of the word 'summary' cannot lead one to presume that the procedure that the NFRA may ultimately adhere to, would be violative of the principles of natural justice. When Rule 11(5) uses the expression 'summary procedure' all that the rule-making authority perhaps intended to convey was that disciplinary proceedings would not be liable to be conducted in accordance with a procedure or rules of evidence which a court of law may be obliged to follow while trying *a lis*. In fact, that rule itself enjoins the authority to ensure adherence to the principles of natural justice. It also places it under the duty to provide an opportunity of hearing to a person in cases where circumstances may so warrant. The statute thus provides enough guidance for the authority to ensure that the disciplinary proceedings are conducted in a manner which is fair, transparent and in consonance with the broad, basic and fundamental principles of natural justice.

Z. The NFRA Rules oblige the authority to make available to the charged CA or firm a detail of the allegations that are laid together with the evidence in support thereof as well as an appropriate disclosure with respect to the provisions of the Act, Rules or the SAs which are found to have been allegedly violated. It enjoins the SCN to broadly indicate the action that NFRA proposes to take or the directions that it may be constrained to frame if the allegations were to be ultimately established. The authority is also statutorily obliged to enclose all copies of documents relied upon as well as to make available the

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

extracts of reports of investigation or other records which are proposed to used for proving the allegation levelled. The SCN must be served upon the auditor as well as the firm dependent upon the action which the authority proposes to initiate. The statute thus adopts and incorporates appropriate measures and safeguards to ensure that the procedure that it adopts is in accord with the principles of fair play and natural justice.

AA. We are also of the firm opinion that the proceedings which the NFRA would undertake are not liable to conform to the requirement of guilt being proved beyond reasonable doubt and which is a test which primarily applies to criminal trials. The proceedings under Section 132(4) are essentially disciplinary proceedings and which are governed and guided by the well-accepted principle of the charge being liable to be proved on the basis of preponderance of probabilities.

BB. The argument of the restriction of proceedings to the audit file being arbitrary is misconceived. The provisions contained in the SAs' have repeatedly laid emphasis on the audit file and record being comprehensive and incorporating all material which may have formed the basis for the conclusions appearing in the audit report. Suffice it to state that the charge of professional misconduct which may come to be laid against a CA or a firm would have to be necessarily proved and established on the basis of that audit record alone. The restriction of the proceedings to the audit record thus binds not only the person charged with misconduct but the NFRA itself.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

CC. Of course that is not to state, that an auditor or a firm is precluded from referring to material or standards that may be sought to be referred to in order to lend credence or support to the conclusions contained in the audit report. However, since the charge is to be proved solely on the basis of the audit record, the reports of investigation and other records, we find no merit in the challenge to the procedure prescribed under the NFRA Rules when they restrict the inquiry to the audit file.

DD. As we view Section 132 of the Companies Act, there appears to be no doubt in our mind that the provision did and always contemplated the NFRA performing and discharging its functions through such divisions as may be constituted. While it is true that Rule 2(g), while defining the word 'division' includes one headed by a Chairperson or a full time Member, the Executive Body cannot possibly be construed to be a division in itself. A conjoint reading of sub-sections (3)(a) and (3)(b) appearing in Section 132 alongside the NFRA Rules, leads us to the irresistible conclusion that the statute clearly contemplated the discharge of functions enumerated in Rules 7 and 8 being undertaken by independent units or divisions of the NFRA.

EE. A body must not only be fair and impartial, but it should also not be burdened by a predisposition or a predetermined state of mind. This aspect assumes significance insofar as we are concerned in light of a common complement of persons having rendered findings of alleged professional misconduct and thereafter sitting

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

upon that very opinion to consider commencement of disciplinary action.

FF. A person charged by such an authority could be reasonably said to apprehend a reasonable likelihood of the opinion so formed being tainted by the proscription of a reasonable likelihood of bias. It is these principles which weighed upon the Supreme Court in *L.K. Ratna* to hold that a person who may have been a party to the preparation of the result of the enquiry would be disqualified from participating in the deliberations of the Council.

GG. We are in such situations primarily concerned with the view that could be formed by a fair minded and informed observer and whether a real possibility of bias could have been legitimately inferred. As has been pertinently observed, a decision-making process which fails to satisfy the test of real possibility of bias is not saved merely because it is likely that a different decision maker may have reached the same conclusion.

HH. We also doubt the soundness of the proposition that a subsequent fair hearing or appeal would cure proceedings which otherwise failed to meet the test of likelihood of bias or that the said statement could be accepted as an inviolable rule. We are reminded of what our Supreme Court observed in *Ratan Lal Sharma* when they held that when the error or irregularity is *"so patent and loudly obtrusive"* it leaves *"an indelible stamp of infirmity or vice which cannot be obliterated or cured on appeal or revision"*.

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

II. We are thus of the firm opinion that the bifurcation or division of functions which the statute envisaged could have neither been ignored nor disregarded. The underlying purpose of that separation of functions and roles was clearly intended to confer a real and discernible degree of impartiality and neutrality. The statute clearly envisaged separate and distinct branches of the NFRA discharging its functions of monitoring, oversight and adoption of disciplinary measures. But for the separation of those powers, one would be inevitably faced with the possibility of one branch discharging dual and overlapping roles.

JJ. The principle of no man being a judge in its own cause was explained by the Supreme Court as mandating the deciding authority being one which was impartial and without bias. It also alluded to aspects such as a predisposition to decide for or against one party or where that authority may be inclined to disregard the true merits of the dispute by virtue of bias.

KK. This clearly exposes the authority to the charge of a predilection to affirm, the tendency to shut out a challenge to an opinion already formed and disregard the weight of argument aimed at convincing one to review and reappreciate. It would thus be akin to what we in law term as the useless formality theory- an appeal from Caesar to Caesar’s wife. This in addition to such a procedure clearly becoming susceptible to the possibility of a person reasonably and justifiably viewing the same as being unfair and violating the golden principle of justice not only being done but being visibly and perceivably served.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

LL. Our jurisprudence on the subject lays great emphasis on proceedings not being tainted by preconceived opinions, predisposition or predetermination and underscores the imperatives of the absence of an unbiased mind. What thus emerges from the aforesaid discussion is that a body must not only be fair and impartial, but it should also not be burdened by a predisposition or a predetermined state of mind.

MM. This aspect assumes significance insofar as we are concerned in light of a common complement of persons having rendered findings of alleged professional misconduct and thereafter sitting upon that very opinion to consider commencement of disciplinary action. A person charged by such an authority could be reasonably said to apprehend a reasonable likelihood of the opinion so formed being tainted by the proscription of a reasonable likelihood of bias.

NN. As we have found on a review of the statutory scheme, the Legislature as well as the rule making authority appears to have consciously made appropriate provisions for the monitoring of compliance of SAs, enforcement of compliance, oversight, investigation and disciplinary proceedings being undertaken by different arms of the NFRA. The division of functions which the principles of due process and fairness would demand clearly appear to inform the statutory provisions when they speak of divisions performing different functions and obligations that stand placed.

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

OO. As we have found in the body of this judgment, it was the Executive Body which in the first instance came to record findings of guilt and violation of the SAs'. Those reports had come to conclude in no uncertain terms that the petitioners had violated the ethics standards required to be maintained and having acted in violation of the SAs' which applied. That very body proceeded to take a decision to commence disciplinary action based not an independent review of the facts that obtained but solely on the strength of what had been found in the AQRR. The composition of the body which penned the AQRR and that which issued the SCN remained unaltered. The proceedings have thus come to be stigmatized beyond repair and cannot in law be salvaged or saved.

PP. As is manifest from the language in which the AQRR and the SCNs' proceed, they are replete with findings which clearly appear to transgress the boundaries of a prima facie opinion or one which could be termed as being precursive. They ex facie verge if not cross the border of the conclusive. They are clearly imbued by notes of finality. It is these findings and conclusions rendered by the Executive Body which constituted the foundational material for the formation of opinion by it as to whether circumstances warranted disciplinary action being taken against the writ petitioners. The Executive Body thus not only acted as the propounder of a prima facie finding of violation of SAs and the laws, it took its own opinion into consideration for

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Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

WWW.TAXSCAN.IN - Simplifying Tax Laws - 2025 TAXSCAN (HC) 226

the purposes of formation of the belief that sufficient cause existed to take action as contemplated under Section 132(4).

QQ. We are thus of the firm opinion that the Executive Body could not have discharged the dual role of rendering findings of guilt and violation of the SAs' while authoring the SQARR/AQRR and thereafter don the mantle of the division which is contemplated under Rule 11. The assessment of whether circumstances warranted a disciplinary enquiry being initiated was statutorily liable to be undertaken by a unit of the NFRA separated from the one which drew up those reports. This since, the Act and the Rules clearly contemplate a separation of functions between different constituents of the NFRA.

RR. Notwithstanding what may be observed in those reports, the law would contemplate and require a decision to initiate disciplinary action being arrived at impartially and independently. The procedure which NFRA chose to follow in these cases clearly lacked attributes of neutrality and a dispassionate appraisal.

DISPOSITION

338. On an overall conspectus of the above, we uphold the validity of Section 132 and the NFRA Rules. We find no merit in the challenge based on the arguments of vicarious liability, retroactive operation and a violation of Article 20(1) of the Constitution.

339. We also find ourselves unable to sustain the challenge to those provisions which were asserted to suffer from the vice of manifest arbitrariness and deprivation of a fair procedure. The prescription of a

Signature Not Verified
Digitally Signed
By:KAMLESH KUMAR
Signing Date:07.02.2025
18:46:26

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summary procedure for trial of disciplinary matters neither obviates nor relieves the NFRA from adhering to a procedure which is in consonance with the principles of fairness and natural justice.

340. However, the NFRA clearly acted contrary to the command of the legislation which obliged it to bear in mind the division of functions and which clearly mandates a separation of roles that the authority is called upon to discharge under the Companies Act and the NFRA Rules. The assessment of whether circumstances warranted a disciplinary enquiry being initiated was statutorily liable to be undertaken by a unit of the NFRA separated from the one which drew up those reports. The procedure which NFRA chose to follow in these cases clearly lacked attributes of neutrality and a dispassionate appraisal.

341. We would thus allow the instant writ petitions and quash the impugned SCNs' and final orders assailed in this batch as per the details which appear below:-

S.No.	Case Number	Date of SCN	Date of Final Order
1.	W.P.(C) 1065/2021	06 January 2021	-
2.	W.P.(C) 1522/2020	28 January 2020	23 July 2020
3.	W.P.(C) 1524/2020	17 January 2020	22 July 2020
4.	W.P.(C) 11737/2021	29 September 2021	-
5.	W.P.(C) 11738/2021	28 September 2021	-
6.	W.P.(C) 11739/2021	29 September 2021	-
7.	W.P.(C) 11987/2022	27 June 2022	-

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8.	W.P.(C) 1525/2020	24 January 2020	28 July 2020
9.	W.P.(C) 1650/2023	27 June 2022	-
10.	W.P.(C) 2194/2023	5 January 2023	-
11.	W.P.(C) 5842/2023	21 November 2022	29 September 2023

342. However, we leave it open to the NFRA to draw proceedings afresh if so chosen and advised from the stage of issuance of fresh notices based on the findings that have come to be recorded in the AQRRs'. The findings and conclusions appearing in the AQRRs' would be liable to viewed as merely being the expression of a prima facie opinion as opposed to definitive conclusions. Those findings and conclusions may be evaluated afresh for the purposes of formation of opinion whether disciplinary action is liable to be initiated.

343. The decision of whether disciplinary action is liable to be commenced shall be taken independently by a complement of the NFRA comprising of members who were disconnected and disassociated from the process of audit review and the drawl of the AQRRs'.

YASHWANT VARMA, J.

DHARMESH SHARMA, J.

FEBRUARY 07, 2025/Neha/DR/RW/KK

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