

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

CORAM: S K MOHANTY, WHOLE TIME MEMBER

FINAL ORDER

**Under Sections 11, 11(4) and 11B (1) of the Securities and Exchange Board of India
Act, 1992**

In respect of:

S. No.	Name of the Noticee	Registration No. / PAN
1.	M/s Doshi Chatterjee Bagri & Co. LLP	325197ELE30002
2.	Shri R K Bagri	ADAPB9341A

**In the matter of falsification/ misstatement in financial statements of Arvind
Remedies Limited**

(The aforesaid entities are hereinafter individually referred to by their respective names/Noticee nos. and collectively as "Noticees", unless the context specifies otherwise)

Background:

1. Securities and Exchange Board of India (hereinafter referred to as "SEBI") received a reference from Punjab National Bank (hereinafter referred to as "PNB" or "the Bank") wherein PNB provided a copy of the forensic audit report prepared by M/s Maharaj N R Suresh & Co. dated May 23, 2015 (hereinafter referred to as the "**Forensic Audit Report**"), highlighting therein various irregularities in financial statements apparently showing profits through inflated sales and non-existent purchases and sales by Arvind Remedies Limited (hereinafter referred to as "**ARL**" or "**Company**").
2. Subsequent to the receipt of the aforementioned document, a preliminary examination was undertaken by SEBI to ascertain as to whether the books of accounts

of ARL were manipulated during the Financial Years (FYs) 2011 to 2015. Following were, *inter alia*, the observations of the preliminary examination conducted by SEBI.

- a) ARL showed purchases and sales with Controlled / Connected Entities. The funds for the purchase and sell transactions with Controlled / Connected Entities have been noticed to be routed through circuitous transactions without actual movement of goods and; on most occasions the funds movement of many layers were happening on the same day indicating that ARL inflated its sales and profits.
- b) ARL prepared different sets of financial statements for FYs ending March 31, 2011, March 31, 2012 and March 31, 2013 and thereby projected untrue financial statements to various stakeholders which portrayed its intention to deceive its stakeholders.
- c) In the Annual Reports, ARL posted inflated figures of sales and purchases of goods. As observed from the *Forensic Audit Report*, goods shown as being purchased were, actually not purchased by ARL. Further, sales shown to have been made by ARL were without actual delivery of goods.
- d) The sales/purchases of goods were disclosed by ARL as having been made with the Controlled / Connected Entities. All these Controlled / Connected Entities, were incorporated during the FYs 2010-11 and 2011-12, the bank accounts were opened only for the purpose of showing fictitious transactions with ARL and not for any actual business purpose. Further, significant cash withdrawals were observed in the said bank accounts.
- e) The transactions were quite in large numbers over the years and substantial part of these transactions were engaged with the Controlled / Connected Entities, however, Statutory Auditors failed to detect the aforesaid multiple Reversal/Circular transactions;
- f) The *Company* had disclosed to its shareholders the financial results, which were not true but were containing false and fabricated numbers and nothing abnormal was noticed by the Statutory Auditors, as a consequence, the

shareholders were not provided with true and corrects financials of the Company.

g) ARL's Statutory Auditor i.e. M/s Doshi, Chatterjee, Bagri & Co. LLP (for convenience "**DCB / Noticee no. 1**") was negligent in certifying accounts of ARL and failed to maintain professional standards in Audit. The Statutory Auditor therefore, enabled ARL and its Director to perpetrate manipulation/fraud on genuine investors in the securities market.

3. After preliminary examination and on the basis of the *prima facie* findings, SEBI passed an *ad interim ex parte* order dated February 16, 2017 (hereinafter referred to as the "**interim order**") against the Company and its Managing Director viz. Arvind Kumar Shah observing the acts to be in violation of securities laws. Since, DCB was the statutory auditor of the Company during the FYs 2011 to 2014 and Shri R K Bagri (for convenience "**Noticee no. 2**") had signed the financial statements From FY2010-11 to FY 2013-14 on behalf of DCB, the *interim order* was passed advising the Noticees to show cause as to why suitable directions/prohibitions under Sections 11(1), 11(4) and 11B of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as the "**SEBI Act, 1992**") including the following, should not be taken/imposed against them as extracted from the said order hereunder :-

"Directing them to restrain from, directly or indirectly, issuing any certificate required under securities laws i.e. SEBI Act; Securities Contract (Regulations) Act, 1956; Depositories Act, 1996; Rules, Regulations, Guidelines made thereunder; Listing Agreement along with the applicable provision of the Companies Act, 2013; Rules, Regulations, Guidelines made thereunder, which are administered by SEBI, with respect to-

- *Listed entities;*
- *Intermediaries and*
- *Initial Public Offer(s)".*

4. Simultaneously, a detailed investigation into the trading activities was also conducted pertaining to the scrip of ARL as well as with reference to manipulations of financial statements and insider trading by promoters of the Company, while off-

loading the shares of the *Company* during the period of April 01, 2010 to June 13, 2016 (for convenience “**Investigation Period**”) for possible violation, if any, of the provisions of *SEBI Act, 1992* and rules and regulations made thereunder.

Findings of Investigation

5. In the course of investigation conducted by SEBI, while analyzing the price and trade movement in the scrip of *ARL*, following facts, *inter alia*, came to light:

A. Manipulations of financial statements of *ARL*

- a) It is noticed that *ARL* had inflated both purchases and sales by entering into transactions with connected entities and making entries in bank statements which were either reversed or routed in a circular manner without movement of goods. As a result of the same, the books of account of *ARL* were not reflecting true and fair view of the financial statement for the year ending March 31, 2012, March 31, 2013, March 31, 2014 and March 31, 2015.
- b) The *Noticees*, being the statutory auditor of the *Company*, had knowingly not adhered to the basic procedure of sending confirmation letters to the debtors, which if were done, would have revealed that those entities having transacted with *ARL* existed only on paper.
- c) It was also revealed that *ARL* prepared different sets of financial statements for financial years ending March 31, 2011, March 31, 2012 and March 31, 2013 and projected untrue financial statements to various stakeholders which demonstrated its intention to deceive its shareholders. Both the sets of financial statements were signed by the *Noticee no. 2* on behalf of *Noticee no. 1*.
- d) The findings on the role of *Noticees* as statutory auditors of *ARL* in respect of the relevant Auditing and Assurance Standards (**AAS**) issued by the Institute of Chartered Accountants of India (**ICAI**) which are mandated on the statutory auditor are summarized as follows:

- (i) There were frequent circular transactions of ARL with Controlled / Connected Entities. In this regard, as per para 9 of AAS 13, exceptionally high number of transactions made the degree of materiality self-evident and thereby created a bounden duty on the *Notices* to question the nature and motive of such transactions, which the *Notices* had failed to do;
 - (ii) Paras 7 and 15 of AAS 5 unambiguously state that the quality of external evidence is superior to that of internal evidence and when such external evidence is procured directly by the auditor, it becomes more reliable. The mandated procedure as per para 32 of AAS 30 strictly places the responsibility of sending letters out to various transacting parties seeking external confirmation, on the auditor, however, the *Notices* auditors in this case had appeared to be consciously not followed the same by verifying the debtors;
 - (iii) Under the AAS, the auditor shares the primary responsibility for the prevention and detection of fraud and error with those actually in charge of the governance and management of the entity;
 - (iv) The importance of AAS 4 cannot be overlooked where it states, '*When obtaining reasonable assurance, the auditor is responsible for maintaining an attitude of Professional Scepticism throughout the audit.*' The several red flags listed above, which were all too noticeable for any reasonable professional auditor to miss, failed to engender the necessary professional scepticism in the auditors associated with the audit of ARL.
- e) It was unearthed that the *Notices* being the statutory auditors of ARL have aided /facilitated ARL in projecting untrue financial statements for financial years ending March 31, 2011, March 31, 2012 and March 31, 2013 to various stakeholders which portrayed its collusive intention in facilitating the ARL and its management to deceive its stakeholders. *Notices* have knowingly failed to

perform their duties in compliances with the rules prescribed for the auditors and thereby abetted *ARL* in preparation and presenting of false and fabricated books of account containing potential ingredients to induce investors to trade in the scrip of *ARL* as well as to keep shareholders and investors in dark about the true financial position of the *Company*. In view of the aforesaid, the *Noticees* have been alleged to have violated provisions of Sections 12A (a), (b) and (c) of *SEBI Act, 1992* and regulation 3 (b), (c), (d), 4(1) and 4(2)(f), (k) and (r) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 (hereinafter referred to as the “*PFUTP Regulations, 2003*”) for aiding and abetting *ARL* and its directors in falsification / misstatement of financial statements.

Show Cause Notice, Hearing and Replies

6. The above findings of the investigation conducted by SEBI pertaining to the Statutory Auditors led to the issuance of a common Show Cause Notice dated June 23, 2020 (for convenience “*SCN*”) to both the *Noticees*, asking them to show cause as to why appropriate directions under Sections 11B (1) and 11(4) read with Section 11(1) of the *SEBI Act, 1992* including directions for imposing penalty under Sections 11(4A) and 11B(2) r/w Section 15HA of *SEBI Act, 1992* read with the SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995 should not be issued against them.

7. I note from the available records that the aforesaid *SCN* was duly served on both the *Noticees*. I also note that both the *Noticees* have filed replies to the *SCN*. Subsequently, in compliance with the principle of natural justice, an opportunity of personal hearing was accorded to the *Noticees* intimating them the scheduled date of hearing as fixed on 15.07.2021. In this regard, vide email dated 02.07.2021, *Noticee no. 1* sought adjournment from personal hearing on account of pendency of settlement application filed with SEBI and on account of lockdown due to Covid in the state of West Bengal. Similarly, vide email dated 07.07.2021, *Noticee no. 2* requested adjournment from personal hearing on ground of Covid restrictions. The aforesaid

request of the *Notices* was considered and next date of hearing was fixed at 12.07.2022. *Noticee no. 1* vide email dated 14.06.2022 requested for adjournment of personal hearing due to his other commitments. Accordingly, another opportunity of personal hearing was provided to both the *Notices* on 26.07.2022, however on the said date again, the *Notices* requested SEBI to provide inspection of various documents including the Investigation Report hence, the hearing could not be conducted successfully. After noting that the inspection of the documents sought by the *Noticee no.1* has been duly provided by SEBI on 18.10.2022, a final opportunity of personal hearing was accorded to both the *Notices* on 23.11.2022, which was attended by *Noticee no. 2* who advanced various arguments in his defense on the lines of the replies filed by him with SEBI. I also note that the Authorized Representative (AR) of *Noticee no. 1*, before appearing for the personal hearing, requested for another adjournment on the ground that a Writ Petition Application (WPA) no. 25410 of 2022 has been filed by *Noticee no. 1* before the Hon'ble High Court of Calcutta. However, considering the facts that there was no stay on the present proceedings by the Hon'ble High Court of Calcutta and also the fact that already various adjournments have been provided to the *Noticee no. 1* in the past, it was informed to the *Noticee no. 1* to ensure its presence and argue the case on merit to complete the hearing and that no further opportunity of hearing will be provided in the matter. Subsequently, the AR appeared on behalf of *Noticee no. 1* on 23.11.2022 and argued on the lines of the reply already filed with SEBI, contending that SEBI lacks jurisdiction to proceed against *Noticee no. 1* and again sought adjournment from hearing on the ground that the above mentioned Writ Petition has been filed assailing the issuance of SCN in the matter. *Noticee no. 2* on the other hand has made submissions on merit arguing vehemently that the SCN does not contain sufficient material that can bring home the allegations and therefore, the proceedings should be disposed of by exonerating him. After hearing both the *Notices*, I take the hearing in the matter as concluded qua both the *Notices*. I find that adequate opportunities have been provided to the *Notices* to present their case and while *Noticee no. 2* availed the opportunity to put forth his case

on merit during the personal hearing, for the reason best known to the *Noticee no. 1*, despite having provided with sufficient opportunities to present its case on merit, it has chosen a recalcitrant approach and kept on resisting the SCN on frivolous technical reasons which are not acceptable. Therefore, the matter can now be adjudicated qua both the *Noticees* on merit based on facts & evidences on record.

8. After completion of their personal hearing, *Noticee no. 2* has also submitted his post hearing written submissions. Details of the replies filed by the *Noticees* are tabulated below:

Table no. 1

<i>Noticee</i>	Date of replies
<i>Noticee no. 1</i>	18.08.2017, 15.07.2020, 05.05.2022
<i>Noticee no. 2</i>	16.03.2017, 31.08.2020, 07.12.2022

9. After perusing the written replies filed by the *Noticees* in response to the allegations made in the SCN, arguments made before me during the personal hearing as well as by way of their post hearing submissions (as indicated in the preceding table), I summarize their replies hereunder:

Submissions by *Noticee no. 1*

- a) Vide *interim order*, *Noticee* was asked to show cause as to why action should not be initiated against it under *SEBI Act, 1992*. After a lapse of three years from of passing the *interim order*, on the basis of same set of allegations, SCN has been issued by SEBI. It may not be legally tenable to issue two show cause notices for the same set of allegations.
- b) Subsequent to issuance of *interim order*, reply vide letter dated 15.07.2020 was filed by *Noticee*, however, no communication was issued by SEBI during the period between *interim order* and SCN. Because of intervening delay, which spans over three years, the instant proceedings stand vitiated

by the principles of delay and SEBI is estopped from raking up a five-year-old matter.

- c) As a statutory auditor, *DCB*, upon coming to know of some issues / fraud in *ARL*, had qualified the quarterly report of *ARL* for the quarter ending 31-12-2014. This fact was submitted while responding to the *interim order*, however, it appears that the same has not been considered while issuing the SCN in the matter.
- d) The seal of *DCB* and signature of *Noticee no. 2* on the multiple financial statements of *ARL* as referred to in the SCN are forged and don't pertain to the *Noticee*.
- e) The references made to various AAS in the SCN have been withdrawn / substituted with different standards. Therefore, the allegations of non-compliance of such AASs are not only baseless but also without application of mind.

Submissions by *Noticee no. 2*

- f) *Noticee* was the first entity to highlight certain irregularities in the *Company* and raised obvious red flags on irregularities / unusual transactions, by way of disclosure and qualifications in the limited review report for the quarter ended 31-12-2014. The afore said limited review report was heavily qualified with qualifications on stock, debtors and fixed assets etc. Their report was the first report in public domain regarding irregularities in *ARL*. Therefore, the allegation that the *Noticee* has missed the red flags is not correct.
- g) Had the *Notices* been negligent in any manner, professionally or otherwise, he would not have qualified the review report heavily while conducting the limited review, where the scope is much lesser compared to year-end statutory audit.

- h) Considering the heavily qualified report, the *Noticee* was not comfortable in continuing with the *Company* and resigned without doing audit for the year ended 31.03.2015. In fact, in the Form ADT 3 filed with the Registrar of Companies, the same was cited as a reason for the resignation.
- i) SEBI has not considered the difference between the scope and methodology followed by Statutory Auditors and Forensic Auditors. The Forensic Auditor acts with the scope of unearthing the fraud, unlike what a statutory auditor is supposed to do. These two audits can never be equated and expected to deliver same result. A forensic audit is specifically designed for detection of frauds, whereas a statutory audit is only meant to express opinion as to 'true and fair' presentation of the accounts based on information provided by the management of the company. A statutory audit is normally not conducted with the objective of detecting fraud.
- j) An audit may reduce the risk of misstatements, but that risk can never be eliminated, and in fact that assurance is never even provided by the statutory auditor. More so in cases, where internal controls are over ridden by the management and those in charge of governance, and the abuse of proper systems to perpetuate frauds are planned and executed by the management in connivance with those in charge of governance, the detection of such frauds is very difficult under normal auditing practice. Under such circumstances, the allegation of professional misconduct for reasons of gross negligence can't be fixed against the statutory auditor. In fact, the *Forensic Audit Report* has time and again pointed out involvement of management of *ARL* in fraudulent practices.
- k) *Noticee* has not signed multiple sets of financial statements with varying figures. Despite his submissions, no action has been taken to use the services of a handwriting expert to find out the genuineness of signatures and initials on the alleged forged documents. Merely because multiple financial

statements with varying figures have been unearthed by Forensic auditors, it is not right to conclude that all the sets with varying figures have been signed by the *Noticee no. 2* unless and until the signatures are verified by hand writing experts. He has signed only one set of financial statements for the financial year or limited review reports for various quarters on behalf of the firm, which was submitted by the management to NSE / BSE.

l) *DCB* was subjected to Peer review conducted by the ICAI and the file of *ARL* was reviewed by ICAI and the reviewer reported no exception of any nature.

m) *Noticee* has referred to following judicial decisions in support his submission that no action should be taken against the *Noticees* as auditors until connivance is found with the management of the *Company*:

- Hon'ble Bombay High Court in matter of *Tri-Sure India Ltd. vs A.F. Ferguson and Co. and Others* [1985 SCC OnLine Bom 342 : (1987) 61 Comp Cas 548];
- SEBI order in the matter of *Mr. Rashim Tandon (Partner, Deloitte Haskins & Sells LLP)* dated August 26, 2021 (Order No.- Order/GR/KG/2021-22/13092)
- In *Kingston Cotton Mill Co.*, Lord Justice Lindley made it clear that the auditors should not be suspicious but only reasonably careful;
- In *London & General Bank*, it was decided that an auditor is not bound to be a detective, or, as was said, to approach his work with suspicion or with a foregone conclusion that there is something wrong. He is a watch-dog, but not a bloodhound. He is justified in believing tried servants of the company in whom confidence is placed by the company."

n) For each of the FYs relating to which this SCN has been issued, all the referred AASs were not in effect. The AASs have been replaced by Standards of Auditing (SAs) effective from 01.04.2009 / 01.04.2010. Based on this simple assertion, these allegations are redundant.

Consideration of Issues and Findings

10. Considering the findings of Investigation, the allegations levelled against the *Noticees* in the SCN based on such findings and the explanations offered by the *Noticees* through their written replies to the SCN and during the course of personal hearing before me, I find that the following question / issue requires consideration:

Whether the Noticees have violated the provisions of Section 12A (a), (b), (c) of the SEBI Act, 1992 and regulation 3, (b), (c), (d) and regulation 4 (1) and 4 (2) (f), (k) and (r) of PFUTP Regulations, 2003?

11. I note that the SCN has alleged that certain actions / inactions on the part of the *Noticees* were observed to be in violations of various provisions of *SEBI Act, 1992* and *PFUTP Regulations 2003*. Before, moving forward to examine as to whether the acts of the above *Noticees* were in violation of the alleged provisions of law, it would be proper to visit the afore-stated regulatory provisions which are produced hereunder for ready the reference:

SEBI Act, 1992

12A. No person shall directly or indirectly –

- (a) use or employ, in connection with the issue, purchase or sale of any securities listed or proposed to be listed on a recognized stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of this Act or the rules or the regulations made thereunder;
- (b) employ any device, scheme or artifice to defraud in connection with issue or dealing in securities which are listed or proposed to be listed on a recognised stock exchange;
- (c) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person, in connection with the issue, dealing in securities which are listed or proposed to be listed on a recognised stock exchange, in contravention of the provisions of this Act or the rules or the regulations made thereunder;

PFUTP Regulations, 2003

3. Prohibition of certain dealings in securities

No person shall directly or indirectly –

(b) use or employ, in connection with issue, purchase or sale of any security listed or proposed to be listed in a recognized stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of the Act or the rules or the regulations made there under;

(c) employ any device, scheme or artifice to defraud in connection with dealing in or issue of securities which are listed or proposed to be listed on a recognized stock exchange;

(d) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person in connection with any dealing in or issue of securities which are listed or proposed to be listed on a recognized stock exchange in contravention of the provisions of the Act or the rules and the regulations made there under.

4. Prohibition of manipulative, fraudulent and unfair trade practices

(1) Without prejudice to the provisions of regulation 3, no person shall indulge in a fraudulent or an unfair trade practice in securities.

(2) Dealing in securities shall be deemed to be a fraudulent or an unfair trade practice if it involves fraud and may include all or any of the following, namely:-

(f) publishing or causing to publish or reporting or causing to report by a person dealing in securities any information 13[relating to securities, including financial results, financial statements, mergers and acquisitions, regulatory approvals,] which is not true or which he does not believe to be true prior to or in the course of dealing in securities;

(k) disseminating information or advice through any media, whether physical or digital, which the disseminator knows to be false or misleading and which is designed or likely to influence the decision of investors dealing in securities;

(r) planting false or misleading news which may induce sale or purchase of securities.

12. Moving on to the allegations made in the SCN regarding the aforesaid issue, I note that SCN has stated that ARL prepared two different sets of financial statements for FYs ending March 31, 2011, March 31, 2012 and March 31, 2013 and presented untrue financial statements to various stakeholders which portrayed its collusive intention to deceive its stakeholders. In this regard, it has been alleged that both sets of financial statements for the aforementioned FYs were signed by the Noticee no. 2 on behalf of DCB (Noticee no. 1). Noticees being statutory auditors had been conspiring

with the management and/or were knowingly negligent in their job so as to facilitate the *Company* in defrauding the shareholders and investors. In this regard, I note from the perusal of the two sets of financial statements (one i.e. reported in the Annual Report and another that was unearthed by the Forensic Auditors) that there are substantial differences in the figures including the sales and profit figures of *ARL* as reported in the afore mentioned two sets of financial statements. Some of the differences observed in the aforesaid two sets of financial statements pertained to *ARL* and were alleged to have been signed by *Notices* are presented in the table below:

Table no. 2

Year	Sales as reported in Annual Report (INR crores)	Sales as per another set of signed financial statements (INR crores)	Difference (%)
2010-11	362	27	93%
2011-12	437	41	91%
2012-13	664	38	94%

Table no. 3

Year	Profit after tax as reported in Annual Report (INR crores)	Profit after tax as per another set of signed financial statements (INR crores)	Difference (%)
2010-11	16.90	1.23	93%
2011-12	19.41	2.15	89%
2012-13	40.62	2.22	95%

13. From the above two tables, it can be noted that there is a huge difference in the sales and profits figures reported in the Annual reports of *ARL* vis-a-vis the financial statement unearthed during the Forensic Audit. For instance, sales reported in the Annual Report of *ARL* for the FY ended March 31, 2013 was INR 664 crores, however,

in reality as per another financial statement of ARL, the same was barely INR 38 crores i.e. 94% less than what was reported in the Annual Report. Similarly, profits disclosed in the Annual Report of ARL for the FY ended March 31, 2013 was INR 40.62 crores, however, as per another financial statement of ARL, the same was 95% less than what was reported in the Annual Report wherein the profit was shown as only INR 2.22 crores.

14. I note that both the *Noticees* have submitted that *Noticee no. 2* has not signed multiple sets of financial statements with varying figures as alleged against them and the seal used on such financial statements does not pertain to DCB (*Noticee no. 1*). They have further argued that the issue was raised by them while responding to the observations insinuated in the *interim order*, however, no steps have been taken to verify the signature either by availing the services of a handwriting expert to find out the genuineness of the signatures such on documents or by any other means like recording statements before issuing the instant SCN, thus, no such exercise was undertaken. Having perused the aforesaid arguments, I find that such arguments of accusing SEBI for not conducting forensic examination of hand writing expert, etc. thereby shifting the burden to SEBI, are not good enough to be accepted to grant exoneration from the allegations on this ground alone. It is noted that though a submission has been advanced disputing the signature on the financial statements, no independently verifiable evidence to support their contention has been placed on record, based on which it can be *prima facie* held with conviction that the signatures of the *Noticee no. 2* were forged. I also can't ignore the fact that despite the allegations having been placed on them that they had signed multiple financial statements to facilitate the management of ARL to present wrong, false and untrue disclosure of financial statements to the stakeholders, the *Noticees* have so far not demonstrated their *bonafide* by at least protesting or complaining against the *Company* or its management before appropriate authorities for impersonating the signature of *Noticee no. 2* and seal of *Noticee no. 1* on those financial statements or for misrepresenting to the public that certain audited accounts apparently were being

audited by them which, according to their assertions were not audited by them. The *Notices* ought to have filed a criminal complaint for forgery and criminal breach of trust against the management of the *Company* for forging their signatures and seal on different set of financial statements due to which, they have been served with a SCN from SEBI. However, no such action apparently has been taken by the *Notices* to protect their interest and reputation or to prove their innocence, despite the fact that the allegation of signing different sets of financial statements with varying sales / profit figures is a serious allegation of criminal misconduct. Thus, there is no tangible evidence available before me to rely on the claim of innocence made by the *Notices* in this regard. In any case, the above allegation is not completely an independent allegation but is arising out of allegation of manipulating the numbers in the financial statement of *ARL* and as per their admitted averment, the financials disclosed on the website of the stock exchange for the financial years referred to above have not been disputed. In this respect, the forensic audit conducted by PNB has shown that the financials disclosed through the annual report were not true and correct and were containing highly manipulated figures. Therefore, the aforesaid argument of the *Notices* does not hold ground for any further consideration and I can't entertain the only ground of protest made by the *Notices* about no action taken to conduct forensic examination of the signatures as sufficient enough as an argument to grant exoneration from the serious allegations of fraudulent misrepresentation of financial statements that have been leveled against the *Notices* in the SCN.

15. I note that the investigation has further observed that *ARL* had inflated both purchases and sales by entering into transactions with certain Controlled / Connected Entities. In its drive to inflate the books, it has been noticed that there were entries in bank statements which were either reversed or routed in a manner without having support of movement of goods, resultantly, the books of account of *ARL* were noticed to be not disclosing the true, correct and fair statement for financial years ending March 31, 2012, March 31, 2013, March 31, 2014 and March 31, 2015. Based on the above facts, SCN has alleged that the *Notices*, during the course of their statutory

audit of the *Company*, had knowingly did not adhere to the basic procedure of sending confirmation to the debtors, which if done properly, would have revealed that the entities who had transactions with *ARL* were existing only on paper. The *SCN* has alleged that *Notices* have knowingly and in collusion with *ARL* have actively and intentionally failed to highlight the irregularities in financial statements of *ARL*.

16. In this regard, having perused the records including the *Forensic Audit Report*, it is noted that in its Annual Reports, *ARL* had posted inflated figures of sales and purchases of goods. The investigation reveals that the sales and purchase were made with entities, which are noticed to be connected and controlled by *ARL* or its promoter. In this respect, the aforesaid sales/purchases of goods as were disclosed by *ARL* were entered into and transacted with the following entities:

- Preventive Pharmaceuticals Private Limited;
- Aroma Remedies Private Limited;
- Holy Remedies Private Limited;
- Zurich Bio Tech Pharma;
- Venus International Private Limited;
- Cosmic Remedies Private Limited;
- Avathar Pharmaceuticals Private Limited;
- Bright Medicure Private Limited;
- Maximus Wellnus Drugs Private Limited;
- Elixir Life Science Private Limited;
- Mascot Machines Private Limited;
- Matrix Device and Mechanism Private Limited;
- Zeal Hi-Tech Engineers Private Limited

For the purpose of convenience, the aforesaid entities are together referred to "*Controlled / Connected Entities*" of *ARL*.

17. I note from the records available before me that there were frequent bank transfers observed between *Controlled / Connected Entities* and *ARL*. I also note that there were regular bank transfers amongst these *Controlled / Connected Entities*. A few

bank transitions noted between *ARL* and *Controlled / Connected Entities* as retrieved from the respective bank accounts are tabulated below:

Table no. 4

Date	Bank Account No.	Entity name	Counter Party - Connected Entity	Debit Amount	Credit Amount
05/04/2011	841271906	Preventive Pharmaceuticals Private Limited	ARL	-	2,11,53,124.00
04/04/2012	0007-W10851-050	Aroma Remedies Private Limited	Mascot Machines	-	89,40,230.00
04/04/2012	0007-W10851-050	Aroma Remedies Private Limited	Elixir life Science	-	10,235,950.00
04/04/2012	0007-W10851-050	Aroma Remedies Private Limited	ARL	8,735,650.00	-
04/04/2014	602005118053	Holy Remedies Private Limited	ARL	10,02,400.00	-
27/04/2011	910020028351986	Zurich Bio Tech Pharma	ARL	-	54,05,259.00
09/10/2014	603106263960	M/s. Venus International Enterprises Pvt Ltd	ARL	17,58,350.00	-
27/04/2011	902940702	Cosmic Remedies Private Limited	ARL	-	51,41,024.00
27/12/2013	112109000133356	Avathar Pharmaceuticals Private Limited	ARL	-	62,81,182.00
17/12/2011	0511132788	Bright Medicure Private Limited	Cosmic Remedies Private Limited	-	510,244.00
30/12/2011	0511132788	Bright Medicure Private Limited	Matrix Device And Mechanism	6,702,500.00	-
26/12/2011	669011000320	Maximus Wellnus Drugs Private Limited	ARL	-	7,431,500.00
26/12/2011	669011000320	Maximus Wellnus Drugs Private Limited	Zurich Bio Tech Pharma	7,430,500.00	-

04/04/2012	669011000297	Zeal Hi-Tech Engineers Private Limited	ARL	-	7,292,454.00
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18. The details of sales/purchases of goods as alleged to have been undertaken by ARL with *Controlled / Connected Entities* are as under:

Table no. 5

FY	Purchases by ARL from Controlled / Connected Entities (in INR Crore)	Total Purchases (As reported in P&L Account of ARL) (in INR Crore)	%
2011-12	220.75	354.69	62
2012-13	202.96	494.75	41
2013-14	297.72	705.98	42
2014-15	113.50	712.59	16
FY	Sales by ARL to Controlled / Connected Entities (in INR Crore)	Gross Sales (As reported in P&L Account of ARL) (in INR Crore)	%
2011-12	215.73	456.02	48
2012-13	201.38	704.46	29
2013-14	297.67	967.00	31
2014-15	113.36	785.38	14

19. I note that the SCN has stated that reversal transactions were observed between the *Controlled / Connected Entities* and ARL i.e. a *Controlled / Connected Entity* received a credit from ARL on a particular day and on that same day, such entity transferred back almost the same amount to ARL. Details of a few of such transactions have been tabulated below:

Table no. 6

I - NAME OF THE CONTROLLED / CONNECTED ENTITY: ELIXIR LIFE SCIENCE PRIVATE LIMITED. ACCOUNT NO.669011000304 BANK NAME-KOTAK MAHINDRA BANK LIMITED					
DATE	CREDIT AMOUNT	RECEIVED FROM	DATE	DEBIT AMOUNT	PAID TO
25-11-2011	80,14,300	ARL	25-11-2011	79,05,150	ARL
28-11-2011	70,14,500	ARL	28-11-2011	70,59,150	ARL
01-12-2011	36,40,300	ARL	01-12-2011	36,50,100	ARL
15-12-2011	75,66,200	ARL	15-12-2011	75,50,060	ARL
19-12-2011	75,65,100	ARL	19-12-2011	75,70,600	ARL
II - NAME OF THE CONTROLLED / CONNECTED ENTITY: MASCOT MACHINES PRIVATE LIMITED. ACCOUNT NO. 669011000312 BANK NAME- KOTAK MAHINDRA BANK LIMITED					
DATE	CREDIT AMOUNT	RECEIVED FROM	DATE	DEBIT AMOUNT	PAID TO
25-11-2011	70,45,500	ARL	25-11-2011	69,25,850	ARL
28-11-2011	68,48,300	ARL	28-11-2011	68,96,250	ARL
29-11-2011	45,12,300	ARL	29-11-2011	45,05,150	ARL
01-12-2011	49,49,500	ARL	01-12-2011	4,950,600	ARL
15-12-2011	54,65,800	ARL	15-12-2011	54,50,950	ARL
21-12-2011	68,54,557	ARL	21-12-2011	68,65,850	ARL
III - NAME OF THE CONTROLLED / CONNECTED ENTITY: MATRIX DEVICE AND MECHANISM PVT. LTD ACCOUNT NO. 6311134717 BANK NAME-KOTAK MAHINDRA BANK LIMITED					
28-11-2011	65,57,500	ARL	28-11-2011	64,25,100	ARL
01-12-2011	42,12,700	ARL	01-12-2011	42,10,650	ARL
15-12-2011	64,78,600	ARL	15-12-2011	64,75,100	ARL
19-12-2011	82,45,600	ARL	19-12-2011	82,50,100	ARL

20. From the aforesaid table, it is noted that on various instances, almost similar amounts paid by ARL to its *Controlled / Connected Entities* on a particular day were returned back by such entities to ARL either on the same day or within next few days thereafter. For instance, ARL paid INR 75,65,100 /- to one of its Controlled / Connected Entity viz. Elixir Life Science Private Limited on 19.12.2011 and almost similar amount (INR 75,70,600/-) was returned by the aforesaid entity to ARL on the very same day i.e. on 19.12.2011. I further note that during the Investigation, in some of the banking transactions of ARL with the *Controlled / Connected Entities*, a peculiar pattern of circular transactions has been noticed, wherein funds were first transferred by ARL to a *Controlled / Connected Entity* (A) and then the funds in turn were transferred to another *Controlled / Connected Entity* (B) and then, the second *Controlled / Connected Entity* (B) further transferred the funds back to ARL. With the help of these circular transactions, the Company was able to inflate and manipulate both purchase and sale transactions, to fatten its books, however, in reality it has been noticed that there was actual no movement of the underlying goods for which such funds / bank transfers were transferred inter se, as narrated above, as highlighted in the *Forensic Audit Report*. Some of these transactions are illustrated as follows:

Table no. 7

<i>Transaction 1</i>		
Date	Amount (in INR)	Particulars
29-10-2012	93,41,625	ARL transferred to Elixir
29-10-2012	93,28,340	Elixir transferred to Preventive Pharmaceuticals
29-10-2012	93,18,940	Preventive Pharmaceuticals transferred to ARL
<i>Transaction 2</i>		
Date	Amount (in INR)	Particulars
25-09-2013	2,78,10,300	ARL transferred to Venus International
26-09-2013	2,72,13,610	Venus International transferred to Holy Remedies

26-09-2013	2,65,38,350	Holy Remedies transferred to <i>ARL</i>
Transaction 3		
Date	Amount (in INR)	Particulars
20-Nov-14	16,11,000	<i>ARL</i> transferred to Preventive Pharmaceuticals
	83,90,000	
22-Nov-14	1,00,00,060	Preventive Pharmaceuticals transferred to Zurich Biotech
22-Nov-14	99,76,593	Zurich Biotech transferred to <i>ARL</i>

21. From the aforesaid table, it is noted that the *Company* had entered into circular transactions with *Controlled / Connected Entities* in its bank account on various occasions. For instance, on 29.10.2012, *ARL* transferred an amount of INR 93.41 lacs to one of its *Controlled / Connected Entity* viz. Elixir and on same day i.e. on 29.10.2012, Elixir transferred an almost equivalent amount i.e. INR 93.28 lacs to another *Controlled / Connected Entity* i.e. Preventive Pharmaceuticals, which in turn transferred INR 93.18 lacs to *ARL* on the same day. Similar circular pattern of funds movements has been observed between *ARL* and its *Controlled / Connected Entities* on various occasions during the Investigation Period.

22. I also note that though such circular transactions were being shown as purchase and sale transactions in the books of accounts of *ARL*, however, in effect no real sale or purchase transactions were undertaken by *ARL* with the said *Controlled / Connected Entities*, i.e. there were no actual movements of any goods. By the way of the aforesaid circular transactions, *Company* continuously inflated both purchases and sales by entering into series of transactions with *Controlled / Connected Entities* and making relevant entries in bank statements just to fake the purchases and sales figures which were either reversed or routed in a circular manner without actual movement of goods. As a result of the same, the books of account were manipulated for financial years ending March 31, 2012, March 31, 2013, March 31, 2014 and March 31, 2015. In this regard, it is pertinent to mention here that similar charge was levelled against the *Company*, its MD and Directors vide show cause notice dated June 23, 2020 for which no plausible explanation with supporting

documents was furnished by *ARL*, its MD and its Directors rebutting the allegations made in the aforesaid show cause notice, to justify that the circular transactions that *ARL* has undertaken with its *Controlled / Connected Entities* were indeed genuine business transactions. There was also no answer forthcoming from the *Noticees* before me to the book entries made showing reversal of transactions on frequent basis and there is no explanation from the *Noticees* about the circumstances and reasons necessitating those transactions and their reversals of such transactions on the same day happening between the *Controlled / Connected Entities* and *ARL* for almost same amounts. Considering the above factual observations and other material on record, SEBI vide order dated August 24, 2022, held the *Company*, its MD and other Directors guilty for manipulation of books of accounts and financial statements.

23. After having convinces myself beyond doubt that the books of accounts and financial statements of *Company* during the Investigation Period were indeed manipulated and did not show true affairs of the *Company* as evidenced by the compelling findings from the SEBI's investigation and the forensic report, I now move on to the role of statutory auditors of the *Company* in this regard. I note that the SCN has alleged that during the course of their statutory audit of the *Company*, *Noticees* have knowingly and in collusion with *ARL* have actively facilitated by intentionally failing to highlight the irregularities in the financial statements of *ARL* despite having noticed the obvious red flags about mis-statements of financial figures, and have thus enabled *ARL* and its directors in falsification/ misstatement of financial statements of *ARL*.

24. I note that SCN has referred to paragraphs 7 and 15 of AAS 5 which, *inter alia*, state that the quality of external evidence is superior to that of internal evidence and when such external evidence is procured directly by the auditor it becomes reliable. SCN has also referred to paragraph 32 of AAS 30 to highlight the point that the said provisions in AAS 30 strictly places the responsibility of sending the letters to outside parties so as to obtain external confirmations of such parties with respect to their transactions on the auditor. SCN alleges that the *Noticees* had consciously not

followed the same responsibility and did not verify with the debtors. In this regard, I note that the *Noticees* have submitted that the AASs referred to in the SCN were not applicable for the relevant FYs and had been replaced by corresponding SAs as provided in the table below:

Table no. 8

AAS	SA	Date from which the SA is effective
4	240	1/4/2009
5	500	1/4/2009
13	320	1/4/2010
30	505	1/4/2010

25. I have gone through the aforesaid submission of the *Noticees* and find that the AAS referred to in the SCN have been replaced by corresponding SAs, however, in the relevant SAs also, responsibility has been entrusted to the statutory auditors for taking confirmations. For instance, it is submitted by the *Noticees* that AAS4 which refer to *"The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements"* has been repealed and replaced with Standard on Auditing (SA 240) with effect from April 01, 2009. In this regard, I note that Professional Skepticism covered under para 12 of SA 240 read as under *"the auditor shall maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance"*. Further, I also note that para 10.4 of SCN states that *"When obtaining reasonable assurance, the auditor is responsible for maintaining an attitude of Professional Scepticism throughout the audit."*.... with the audit of ARL. Therefore, the red flags indicated in the SCN about falsification of accounts and two sets of financial statements, etc. could have been easily noticed by the *Noticees*, in case they had adopted the procedure to obtain the external evidence by

obtaining balance confirmations from the debtors/ creditors. At this juncture, it is important to mention here that M/s Vivekanandan Associates, the subsequent statutory auditors of ARL, have stated in the independent auditors' report for the year ended March 31, 2016 that they had sent request letters for account confirmations to the debtors (*Controlled / Connected Entities*), but no confirmation was received from them. From the above, it is very evident that the *Notices* have not shown Professional Skepticism while performing their duties of the statutory auditor and have certainly failed in exercising professional diligence and care as expected of the statutory auditor of a listed company like ARL.

26. *Noticee no. 2* has submitted that AAS5 which refers to "*Audit Evidence*" has been repealed and replaced with Standard on Auditing (SA 500) with effect from April 01, 2009 and hence, not applicable on the *Notices*. In this regard, I note that AAS 5 states that the quality of external evidence is superior to that of internal evidence and when such evidence is procured directly by the auditor, it becomes reliable. As per SA 500 "*An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other media.*" From a bare perusal of the aforesaid SA 500, the importance of external confirmation is clearly evident. However, in the instant case the auditors have not evidently verified the confirmation from debtors, which would have revealed the fact that the realization of the proceeds in the form of sale was nothing but part of inter se circular transactions amongst the *Controlled / Connected Entities* of ARL.

27. In view of the aforesaid findings and observations, the contentions of the *Notices* regarding repealing of AAS's by SA's is nothing but an evasive reply, thereby seeking protection under the shelter of change of auditing standard without realizing that particularly nothing has been changed in substance and in spirit of the earlier standard and even under the revised standard, the liability of a statutory auditor remained same. Therefore, mere mentioning of an old auditing standards that was substituted by a new standard is not a material ground that could be helpful to the

Notices to seek exoneration from the allegations, when the applicable revised standard also equally fastens responsibilities nothing less than what was applicable under the old standard of conducting audit. In fact, it is important to note here that it is an admitted fact that the *Noticee no. 1* had been the statutory auditor of the *Company* since the year 2002 and was having a long exposure to the accounts of the *Company* over such a long period. Therefore, no doubt, it must be very well conversant with the business model and working culture of the *Company* apart from its accounting policies and practices, in a much deeper way than M/s Vivekanandan Associates who was appointed as the statutory auditors after resignation of *Noticee no. 1*. Therefore, it is expected that the *Notices* would at least be aware about the business activities undertaken by the *Company*, details about its associated / related companies and its business performance over the years. In the backdrop of their long auditing association with the *Company*, the quantum of sales / profits as reported by the management of the *Company* for the relevant years would have easily alerted *Notices* with regard to its veracity. Hence, they ought to have verified the authenticity of such figures reported by the management of the *Company* at least by obtaining account confirmations from the debtors as a first precaution but they have conveniently omitted the same. Such a glaring act of omission and causal approach further cast serious aspersion on their professional ethics and ability and further give rise to a suspicion about their suspect collusion / connivance with the management of the *Company*, in presenting those false and misleading audited financial results for many years.

28. I further note that *Notices have* stated that DCB was subjected to Peer review conducted by the ICAI and the file of ARL was reviewed and no exception was reported by the reviewer. In this regard, it is pertinent to note that the findings in SCN regarding manipulation of books of accounts of ARL pertain to the FY 2011-12 to FY 2014-15. However, *Notices* have not specified as to which year's accounts of ARL were reviewed by the peer reviewer. Nonetheless, from the ICAI's website(https://www.icai.org/post.html?post_id=1979), I note that the primary

objective of peer review is not to find out deficiencies but to improve the quality of services rendered by members of the profession. Further, the inherent limitations of Peer Review, as mentioned in ICAI's website (https://www.icai.org/post.html?post_id=1990), is indicated below:

"The reviewer conducts the review in accordance with the Statement on Peer Review. The review would not necessarily disclose all weaknesses in compliance of technical standards and maintenance of the quality of attestation services since it would be based on selective tests. As there are inherent limitations in the effectiveness of any system of quality control which happens to be subject-matter of review, departure from the system may occur and may not be detected"

29. In view of the above, the argument that peer reviewer has not found any exceptions during the peer review of the DCB cannot be used as a defense to conclusively prove that there were no deficiencies on the part of DCB in carrying of audit of ARL particularly when the Forensic Audit has strongly observed the falsification/ misstatement of financial statements of the ARL during the relevant period. Under the circumstances, the said contention does not have a ground to stand on, hence does not require any further consideration.

30. Noticees have further contended that SEBI has not considered the difference between the scope and methodology followed by Statutory Auditors and Forensic Auditors. They have submitted that these two audits can never be equated and expected to deliver same results. For instance, a forensic audit is specifically designed for the detection of frauds, whereas a statutory audit is only meant to express opinion as to 'true and fair' presentation of the accounts based on information provided by the management of the company. A statutory audit is not expected to perform with the objective of detecting fraud. I find it important here to make a note about the role that statutory auditors have to play with respect to a listed company in the securities market. A statutory auditor is expected to be an independent entity which ought to act as the conscience keeper of the listed company. It has to act as a guard to inhibit the management or any other employee of such listed company from committing any

financial wrongdoing. Its role is one that creates a sense of trust in outsiders making them believe that an independent and competent entity has examined the financial records of the company and has found them to be in order. Investors in the securities market rely on the opinion of the statutory auditors while evaluating the financial statements of a company. Being a professionally qualified entity and being governed by elaborate auditing standards prescribed by ICAI, it is always presumed that a statutory auditor would have conducted audits of books of accounts of a company after exercising due care and diligence and would diligently point out shortcomings in the records or processes followed by the company, which the listed company is obligated by law to disclose to the shareholders and such listed company is also required to explain the steps it is taking to remedy those shortcomings. Therefore, the argument of the *Notices* that statutory audit just expresses opinion with respect to 'true and fair' presentation of the accounts based on information provided by the management of the company, is erroneous and a misleading argument that is misplaced on fact and law, hence the same is rejected in *limine*. Moreover, the instances of accounts falsifications narrated under the SCN primarily amounted to non-adherence to the basic principles and practices expected to be performed by a statutory auditor itself and not about the professionalism required to be shown by a forensic auditor for unearthing a fraud. So, the attempt of the *Notices* to highlight the differences between statutory auditors and forensic auditors is irrelevant and unwarranted.

31. I further note that the *Notices* have submitted that they had highlighted certain irregularities in the affairs of the *Company* and raised red flags on irregularities / unusual transactions, by way of qualifications on stock, debtors and fixed assets etc., in the limited review report of the *Company* for the Quarter ended 31-12-2014. In this regard, I note that, *inter alia*, following qualifications have been raised by the *Notices* in the aforementioned limited review report:

- Note no. 3 regarding provision against certain inventories likely to be non usable due to reasons mentioned therein valuing **INR 12,617.51 lacs**. We are unable to comment on the destruction since the matter is highly technical in nature. In respect of the balance inventories lying at the plant, we are unable to comment on the further losses, if any, on account of similar reasons;
- In respect of destruction of inventories as mentioned in the preceding paragraph, no intimation was given to excise and other regulatory authorities. We are unable to comment on the liability on account of excise duty since the same has not been ascertained and provided for.
- Besides the above, we are unable to comment on receivables from certain other distributors aggregating to **INR 4,958 lacs** since the confirmation is not available with the company and their payments being irregular.
- Note No 5 regarding non realisation of certain overdue receivables aggregating to **Rs. 9,525 lacs** in respect of sales to certain distributors which are considered good of recovery due to reasons mentioned therein.

32. From the submissions of the Noticees, I note that they have tried to contend that since they had issued a qualified report for limited period review for the Quarter ended 31.12.2014, they cannot be charged for the *malafide* intention and connivance with the management of the Company. In this regard, I note from the Investigation Report that ARL claimed to have destroyed raw material worth **INR 197.3 crores** and it was observed that the said raw material was destroyed without intimation to the relevant governmental agencies like the Drug Control, Pollution Control Board, Excise Department, etc. and also without the permission of banks, with whom the said raw materials were hypothecated. However, ARL submitted to SEBI a copy of letter claimed to have been written by it, to Tamil Nadu Pollution Control Board (TNPCB) in this regard and when the same was verified by SEBI from TNPCB, it denied receipt of any such intimation from the Company. I note from the submissions of the Noticees that in the limited review report of the Company for the Quarter ended

31-12-2014, they have categorically stated that "no intimation was given to excise and other regulatory authorities in respect of destruction of inventories." I also note that the Noticees in their afore-stated Qualified report have, *inter alia*, highlighted other irregularities such as "receivables from certain other distributors aggregating to INR 4,958 lacs since the confirmation is not available with the company, regarding provision against certain inventories likely to be non usable due to reasons mentioned therein valuing INR 12,617.51 lacs. We are unable to comment on the destruction since the matter is highly technical in nature, etc."

33. Noticees have also contended that, had the Noticees been negligent in any manner, professionally or otherwise, they would not have qualified the review report heavily while conducting the limited review, where the scope is much lesser compared to the statutory audit of a complete financial year. Noticees have further submitted that considering the heavily qualified report, DCB was not comfortable to continue with the Company and resigned without doing audit for the year ended 31.03.2015 and in the Form ADT 3 filed with the Registrar of Companies, the same reason was cited by Noticees for resignation.

34. From a conjoint reading of the findings of the Investigation and the aforesaid submissions of the Noticees regarding their Qualified report and the reason furnished by them to ROC while resigning as the statutory auditor of ARL, I find some force in the said submission of the Noticees who have undisputedly reported the said irregularities observed by them in the limited review report on the Company and this fact ought to be given due consideration.

35. I also note that while arguing their role as statutory auditors in ARL, Noticees have relied upon various judicial pronouncements viz. a decision of the Hon'ble Bombay High Court in the matter of *Tri-Sure India Ltd. vs A.F. Ferguson and Co. and Others (supra)* and an Order passed by SEBI in the matter of *Mr. Rashim Tandon (supra)*, etc. to contend that if it is established that an auditor had no 'mens rea' and did not connive and collude with the management of a company for falsification of financial statements, it cannot be held liable under the SEBI Act, 1992 or any Regulations

framed there under on the charges of 'fraud' pertaining to the securities market, only because it had *prima facie* failed to detect an act of misstatement in the financial statement(s) of a company by the management of the said company. It has been further submitted that even if there had been a breach of Standards of Auditing by the concerned auditor leading to a failure in detection of a fraud perpetrated by the management, in the absence of evidence establishing collusion of the auditor with the management of the said company in the commission of the fraud or any other active role played by the auditor in the perpetration of the fraud, the auditor shall not come under the disciplinary/penal jurisdiction of SEBI and for all such lack of professionalism or negligence in performing duties as an auditor of a company, it is the ICAI/ National Financial Reporting Authority (NFRA) who shall be the competent authority to adjudicate upon that. In other words, the *mens rea*, i.e. the 'intent' to commit an act knowing the same to be false, untrue or illegal, needs to be established *qua* the auditor in order to bring him/ it under the disciplinary/penal jurisdiction of SEBI under the category of 'fraud'.

36. The *Notices* have further sought to submit that since, there is no evidence to even remotely indicate about connivance of these *Notices* with the management of ARL, it would not be legally justified to exercise jurisdiction to punish the *Notices*. The *Notices* while assailing the jurisdiction of SEBI have also referred to the findings of the Hon'ble High Court of Bombay in the matter of *Price Waterhouse Co. Vs SEBI* (Writ Petition no. 5249/2010, judgment dated August 13, 2020), wherein while upholding the jurisdiction of SEBI, the Hon'ble High Court has held as under:

"25. In our view, the jurisdiction of SEBI would also depend upon the evidence which is available during such inquiry. It is true, as argued by the learned counsel for the petitioners, that the SEBI cannot regulate the profession of Chartered Accountants. This proposition cannot be disputed in any manner. It is required to be noted that by taking remedial and preventive measures in the interest of investors and for regulating the securities market,

if any steps are taken by the SEBI, it can never be said that it is regulating the profession of the Chartered Accountants.....

If it is unearthed during inquiry before SEBI that a particular Chartered Accountant in connivance and in collusion with the Officers/Directors of the Company has concocted false accounts, in our view, there is no reason as to why to protect the interests of investors and regulate the securities market, such a person cannot be prevented from dealing with the auditing of such a public listed Company. In our view, the SEBI has got inherent powers to take all ancillary steps to safeguard the interest of investors and securities market."

37. From the aforesaid observations of the Hon'ble High Court of Bombay, it is very much evident that it is wrong to content SEBI has no jurisdiction to deal with entities not registered with it and whose activities are regulated by other Regulators. However, at the same time, it is a trite law that one of the duty of the Board is to protect the interest of investors in securities and to promote the development and to regulate the securities marked by taking such measures as it thinks fit while exercising the powers under the *SEBI Act, 1992* and rules and regulations made thereunder. In a given case, if there is material evidence against the Chartered Accountant / Statutory Auditor to the effect that the Chartered Accountant / Statutory Auditor or the accounting firm was instrumental in preparing false and fabricated accounts in connivance with the management, then SEBI is entitled to pass appropriate orders under section 11(4) of the *SEBI Act, 1992* in the interest of the investors or securities market and is entitled to take measures as prescribed in the said section and such exercise of power by SEBI would not amount to encroaching upon the powers vested with the Institute under the Chartered Accountant Act, 1949 or any other Regulator created for that purpose.

38. It is further noted that *Noticees* have also relied upon various judicial decisions to contend that the scope of the enquiry by SEBI can be limited to the charge of conspiracy and involvement in the fraud, if any, so as to take consequential action in

terms of *SEBI Act, 1992* read with *PFUTP Regulations, 2003* of SEBI. However, it is not open to SEBI to enquire into any charge of professional negligence of the Auditor since the audit firm was not dealing directly in the securities. An instance of negligence or recklessness in adhering to the accounting norms in the course of auditing can only point out to the professional negligence which would amount to a misconduct that may be taken up only by ICAI.

39. Keeping the aforesaid argument of the *Noticees* in view, I note that, to take any action against a chartered accountant under SEBI Rules and Regulations, two essentials ingredients are required to be satisfied:

a. Gross negligence and dereliction of duty on the part of auditor; **and**

b. It's connivance and collusion with the company/management

40. There is no dispute to the finding that the *Noticees* were instrumental in preparing accounts of *ARL*. I find that there are strong evidences in this matter available on records to point out that there has been gross negligence and dereliction of duty on the part of *Noticees*. However, at the same time I can turned a blind eye to the fact that the *Noticees* had issued a Qualified Report highlighting certain irregularities in the financials of the *Company* that were taken up for limited review for the quarter ended 31-12-2014. The instances of being unprofessional or being negligence would be difficult to equate with committing fraud in connivance with the management, where evidences are not sufficient to demonstrate that the *Noticees* had actually manipulated the books of accounts with knowledge and fraudulent intention. In the absence of any tangible evidence, the question of fraud committed by the them would be difficult to survive and therefore in the absence of any material to establish knowledge/collusion/connivance of the *Noticees* with such fraudulent scheme, the *Noticee* cannot be brought under disciplinary/penal jurisdiction of SEBI. Further, with respect to any possible connivance or collusion by the *Noticees* with the *Company* or its management, it is acknowledged that, in such matter it is very difficult to find out either a written agreement or such agreement of minds and the

same has to be culled out from the acts of the parties. However, there has to be some evidence to support such meeting of minds before attributing to the *Notices* of actively colluding with the *Company*. In the present matter, I don't find sufficient evidence from the record to make an assertive statement that there was an agreement or understanding suggesting that the *Notices* were acting in connivance and collusion with the *Company* or its management in executing their fraudulent scheme. However, at the same time, while dealing with the submission of the *Notices* for being granted exoneration based on the observations in the peer review conducted by the ICAI, it may be stated that primary objective of peer review is not to find out deficiencies but to improve the quality of services rendered by members of the profession. Under the circumstances, while granting benefit of doubt to the *Notices* with respect to alleged commission of fraud by the *Notices*, I am of the view that it would sufficient that to meet the end of justice so as to address the gross negligence and sheer professional misconduct as displayed by the *Notices* as the Statutory Auditor of the *Company* which has been deliberated and established beyond doubt in the preceding paragraphs, the instant proceedings are disposed of with the following directions.

Directions

41. In view of the foregoing findings and observations in the preceding paragraphs, I find that the materials brought forth in the Investigation while propounding the allegation against the *Notices* herein, lack the tenacity to withstand legal scrutiny required in the matter pertaining to violation of the *PFUTP Regulations, 2003* or suchlike. Accordingly, I am constrained to dispose of the present proceedings qua the *Notices* with a cautionary advice to be careful while dealing in the securities market.

42. However, looking at the glaring misconduct and dereliction of duties and abhorrence of due diligence while conducting statutory audit as glaringly displayed

by the *Noticees*, it is directed that a certified copy of this order be forwarded to ICAI and NFRA for appropriate action, if any, as deemed fit at their end.

43. The Order shall come into force with the immediate effect.

44. Further, a copy of this order shall be served upon the *Noticees*, Stock Exchanges, Depositories and Registrar and Share Transfer Agents of all Mutual Funds for ensuring compliance with the above direction.

-Sd-

DATE: JUNE 19, 2023

S. K. MOHANTY

PLACE: MUMBAI

WHOLE TIME MEMBER

SECURITIES AND EXCHANGE BOARD OF INDIA