$~1-3 (Spl. Bench)

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

\+ W.P.(C) 5840/2024

VISHAL DHIREN SHAH ..... Petitioner

Through: Mr. Shri Venkatesh, Mr. Shryesth Ramesh Sharma, Mr. Vineet Kumar and Mr. Vedant Choudhary, Advs.

versus

UNION OF INDIA, THROUGH MINISTRY OF CORPORATE AFFAIRS & ANR. ..... Respondents

Through: Mr. Aakash Meena, G.P. for UOI.

Mr. Zoheb Hossain, Mr. Vivek Gurnani, Mr. Kartik Sabharwal, Ms. Abhipriya Rai, Ms. Radhika Puri and Mr. Vivek Gaurav, Advs. for Resp./ NFRA**.**

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\+ W.P.(C) 5841/2024

PARIMAL KUMAR JHA ..... Petitioner

Through: Mr. Kapil Sibal and Mr. Arun Kathpalia, Sr. Advs. with Mr. Shri Venkatesh, Mr. Shri Venkatesh, Mr. Shryesth Ramesh Sharma, Mr. Vineet Kumar, Mr. Vedant Choudhary, Ms. Manisha Singh, Mr. Aditya Dhupar and Ms. Bani, Advs.

versus

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

Through: Mr. Ripu Daman Bhardwaj, CGSC along with Mr. Kushagra

Kumar and Mr. Abhinav Bhardwaj, G.P.

Mr. Zoheb Hossain, Mr. Vivek Gurnani, Mr. Kartik Sabharwal, Ms. Abhipriya Rai, Ms. Radhika Puri and Mr. Vivek Gaurav, Advs. for Resp./ NFRA**.**

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\+ W.P.(C) 5842/2024

M S PATHAK H D AND ASSOCIATES LLP..... Petitioner

Through: Mr. Shri Venkatesh, Mr. Shryesth Ramesh Sharma, Mr. Vineet Kumar and Mr. Vedant Choudhary, Advs.

versus

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

Through: Mr. Zoheb Hossain, Mr. Vivek Gurnani, Mr. Kartik Sabharwal, Ms. Abhipriya Rai, Ms. Radhika Puri and Mr. Vivek Gaurav, Advs. for Resp./ NFRA**.**

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

O R D E R

% 09.05.2024

CM APPL. 24158/2024 (Ex.) in W.P.(C) 5840/2024
CM APPL. 24160/2024 (Ex.) in W.P.(C) 5841/2024
CM APPL. 24162/2024 (Ex.) in W.P.(C) 5842/2024

Allowed, subject to all just exceptions.

Applications stand disposed of.

W.P.(C) 5840/2024 , W.P.(C) 5841/2024 & W.P.(C) 5842/2024

1. Notice. Since the respondents are represented by Mr. Hossain,

let a reply be filed within a period of three weeks' from today. The petitioner may file a rejoinder on or before the next date fixed.

2. The instant writ petitions have been preferred by M/s Pathak HD & Associates ['**PHD**'], the Audit Firm, CA Parimal Kumar Jha, who was the Engagement Partner ['**EP**'] and CA Vishal D Shah, the Engagement Quality Control Review ['**EQCR**'] Partner, all of whom were concerned with the statutory audit of Reliance Capital Limited ['**RCL**'], for Financial Year ['**FY**'] 2018-19.

3. The Petitioners are aggrieved by the order dated 12 April 2024 whereby the National Financial Reporting Authority ['**NFRA**'] has debarred CA Parimal Kumar Jha and CA Vishal D Shah for 10 years and 5 years respectively from being appointed as an auditor or internal auditor or from undertaking any audit in respect of financial statements or internal audit of the functions and activities of any company or body corporate. NFRA has also imposed penalty of INR 3 crores on PHD and penalties of INR 1 crore and INR 50 lakhs on CA Parimal Kumar Jha and CA Vishal D Shah respectively. The Petitioners also assail the constitutional validity to Section 132(4) of the Companies Act, 2013 and Rules 10, 11 and 12(4) of the NFRA Rules, 2018.

4. We take note of the following facts which emerge from the record. RCL was jointly audited by M/s Price Waterhouse & Co LLP ['**PW**'] and PHD for FY 2018-19. PW resigned from the audit, without issuing an audit report. Subsequently on 11 June 2019, PW filed a report to the Ministry of Corporate Affairs, alleging suspected fraud in RCL. However, on examination of the matter, it was noted that the audit report issued by PHD on 14 August 2019 reported no irregularities.

5. Undisputedly, before its resignation, PW had issued a letter dated 24 April 2019 to RCL, as well as the Audit Committee and PHD, regarding its observations concerning loans disbursed, investments, and disposal of Compulsory Convertible Debentures of group companies having a cumulative carrying value of approximately INR 12,571 crore. On the basis of the aforenoted, a suo moto examination of the Audit file of PHD was undertaken by NFRA which ultimately led to the issuance of a Show Cause Notice [**'SCN'**] dated 25 July 2023 to the Petitioners.

6. It was noted that as per the Consolidated Financial Statements for FY 2018-19, RCL had loans from Banks of approximately INR 12,000 crore and other external borrowings which amounted to INR 32,000 crores, consisting of debentures, commercial papers and pass-through certificates. It is alleged that RCL used these loans and borrowing to extend loans and investments to other group companies. PW reported suspected fraud regarding loans and investments amounting to approximately INR 12,571 crore to some group companies which were portrayed as recoverable. NFRA asserts that despite evidence of documented irregularities as well as communications by the joint auditor PW, the Petitioners failed to take appropriate steps. It was in this backdrop that the impugned order has come to be passed observing the Petitioners have been negligent and failed to obtain sufficient appropriate audit evidence to support their opinion and failed to identify and report material misstatements in the financial statements of RCL.

7. Although Mr. Hossain had drawn our attention to an order dated 15 March 2024 in W.P.(C) 3969/2024 to submit that no writ petition in respect of final orders have been entertained and in fact in one such

matter, we had relegated parties to follow the appealed procedure before the National Company Law Tribunal [**'NCLT'**], we note from the facts recorded in W.P.(C) 3969/2024, that in the said matter the petitioners had already instituted appeals before the NCLT. It was in the aforesaid context that we had bifurcated the reliefs claimed and entertained the writ petitions only to the extent of the challenge to Section 132(4). However, that is not the position which obtains in these writ petitions.

8. Since we are already hearing a batch of matters which question the validity of Section 132(4), we entertain the instant writ petitions on our board.

9. Let these writ petitions be tagged with W.P.(C) 1065/2021 to be called on the date fixed i.e. 29.05.2024.

CM APPL. 24157/2024 (Interim Direction) in W.P.(C) 5840/2024
CM APPL. 24159/2024 (Interim Direction) in W.P.(C) 5841/2024
CM APPL. 24161/2024 (Interim Direction) in W.P.(C) 5842/2024

1. Upon going through the final order passed by the NFRA, we take note of the following disclosures which appear:-

> "**13.** PHD and PW were appointed as joint statutory auditors of RCL for a term of 5 consecutive years at the Annual General Meeting of the Company held on 27.09.2017 and 26.09.2017. As per the agreement between the joint auditors, made as per SA 299(Revised), there was no division of audit work among the joint auditors. Hence both the joint auditors were jointly and severally responsible for the entire audit work. While PHD was functioning as a joint auditor, PW brought some significant matters to PHD's notice through various communications starting from the letter dated 24.04.2019. These matters included potentially irrecoverable loans and investments amounting to approximately ₹12,571 crore made to group companies, which were portrayed as recoverable. Despite these communications, EP failed to carry out any independent procedures on these matters as mandated in Para 14, 16 and 17 of SA 299 (Revised) regarding the responsibilities of a joint auditor. Hence EP and the Audit Firm were charged with non-compliance with SA 299(Revised).

14. The EP denied all the charges and submitted that there are no violations of SAs as the records reflect their repeated and consistent efforts to engage with PW as the joint auditor and such efforts were resisted by PW. Based on the "intensive audit procedures" EP concluded that none of the concerns of PW warranted a report under Section 143(12). The Auditors also listed out the WPs to support their contentions and conclusions. On examination of the detailed replies, we observe the following in this regard.

a. In FY 2018-196 RCL had loans from Banks of around ₹12,700 crore and other external borrowings of around ₹32,400 crores, consisting of debentures, commercial papers and pass through certificates. RCL was a Core Investment Company (CIC) investing primarily in its group companies. On 11.06.2019 PW resigned without issuing an audit report and filed form ADT-4 with the MCA as per the provisions of Section 143(12) of the Act, (i.e., reporting of suspected fraud in the Company). Before the resignation, PW issued a letter dated 24.04.2019 to the Company, copied to the Audit Committee and PHD, regarding its observations concerning loans disbursed, investments, and disposal of Compulsory Convertible Debentures (CCDs) of group companies having a cumulative carrying value of approximately ₹12,571 crore. This letter formed the key basis for PW's reporting of fraud under section 143(12) of the Act. Following this communication, PW and RCL exchanged various communications culminating in the report under 143(12) by PW on 11.06.2019. PHD was copied in these communications. These Group Companies, reported by PW, had serious credit impairment. Many of these group companies used the money to invest in or lend to other group companies with similar credit impairment. The business rationale and recoverability of these loans were not explained.

b. As per the requirements of paragraph 14(c) of SA 299(Revised) PHD was required to agree or disagree with the significant observations raised by PW when they were brought to their notice. However, the Auditors failed to show any evidence in the Audit File of performing any audit procedures to examine and conclude these matters while it was functioning as a joint auditor.

c. PW's letters dated 24.04.2019 and 14.05.2019 regarding loans and investments were detailed and self-explanatory. The final observations of PW include unresolved issues regarding recoverability, end-use, valuation, unusual mode of transactions and internal control matters. As per the requirements of SA 299 (Revised), EP was required to perform audit procedures and come to an independent conclusion regarding the significant matters. EP examined the issues only after the audit committee

specifically *asked* PHD on 12.06.2019 to examine the issues, i.e. one day after PW filed form ADT-4 and resigned from the Company. From 24.04.2019, when the issue was first raised by PW, till 12.06.2019 EP did not perform any audit procedures on these matters as is evident from the Audit File. There is no evidence in the Audit File that the Auditors disagreed with these observations, as mandated by SA 299 (Revised).

15. We also observe that the written communications between PW and the Company, starting from 25.04.2019, were copied to PHD. On an examination of these communications, as documented by EP, we observe that the contents of these letters are readily understandable. For instance, we note the following from the letter dated 24-04-2019 from PW, addressed to the CFO of RCL and copied to the Audit Committee and PHD.

> During our review of loan files for the financial year ended March 31, 2019, we have noted that there are various disbursements to/outstanding balances from group companies with a carrying value aggregating to approximately Rs. 12,571 Crores as at March 31, 2019. On a sample testing of such loans/ CCDs we have noted certain observations on the status/ financial strength of the borrower/ issuer of the CCDs. Such Borrowers/ issuers included in Exhibit 1 have one or more of the undermentioned characteristics;
>
> 1. Networth of borrowers/ parties is negative/ Latest available audit reports on the financial statements of the Borrower/ party carry an "Emphasis of Matter paragraph" on going concern status of borrower companies.
> 2. There is limited / no revenue and/or profits as per the last available audited financial statements
> 3. Equity capital is low in comparison to debt raised by the borrower/ parties

> In light of the above, we would like the Management of the Company to respond to our queries, which may also incorporate audit committee's point of view. These evaluations will help us to determine next steps as may be warranted under Companies Act 2013, professional standard including standards on auditing and consequential impact on our reporting responsibility on financial statements, Internal Financial Reporting over Financial Reporting and other regulatory reportings.

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24. We now examine how the above material information included in the notes to the financial statements of the Company was prepared by the Auditors and subsequently became the subject matter of their audit opinion, amounting to self-review.

xxxx xxxx xxxx

d. Thus, the sequence of events as mentioned above confirms that the Audit Committee's conclusion was based solely on EP's presentation to the Committee in which EP concluded that the PW observations did not attract the provisions of section 143(12) of the Act. The opinions of the two legal counsels did not examine the merits of the transactions. Nor did the PHD subject the points raised by PW to the rigours of audit examination commensurate with fraud risk to agree or disagree with them and arrive at its own conclusions before the "mandate" (discussed in more detail in Sections C1 and C.4). Ultimately the same conclusion appeared in the Board's Report with acknowledgement of its origin to PHD. It is also disclosed in the Financial Statements in the form of a material assertion. Finally, PHD audited the same disclosure, based on its own opinion, and provided its audit opinion, in the form of an EoM16, that there was no matter attracting section 143(12) in the PW observations. The draft note containing the above disclosure was included in the draft financial statements by the management only one day before the signing of the audit report. Thus, it is evident that the disclosure note emanated from information originally prepared by EP.

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25. Thus, in this case, PHD ruled out fraud reported by another joint auditor (PW). Also, they did so on being asked by the Audit Committee. It may be noted that the Audit Committee had not even responded to the points raised by PW within the 45 days statutory limit. The management used PHD's said work (done without adequate rigor) as a disclosure in the financial statements. These financial statements were then audited and an EoM was then included in the Auditor's report that relied on the disclosure made by the management (which itself was based on the Auditor's examination). Thus, the actions of PHD amount to self-reviewing the financial statements. Hence the charges in para 21 are established.

xxxx xxxx xxxx

48. We observe that the total balance sheet size of RISL for the FY 2017-18 was only ₹20.7 crore, without the above-said transaction. This is only 3.5% of the loan amount of ₹581 crore. Thus, the balance sheet size is negligible as compared to the loan amount. During the oral hearing, EP submitted that RISL had created a charge on the assets in favour of RCL. Neither the liability towards RCL nor the assets represented by the loan to Reliance Communications appear in the audited balance sheet of the borrower. Yet a charge was created on its assets, and the balance confirmation was provided! Moreover, RCL convinced the Auditors

by rationalising this fully illegal accounting treatment which flays the standards in this regard. No Standard of Accounting permits a loan taken from and given to separate legal entities to be 'netted off' in the balance sheet. Such a practice would lead to gross misstatements of accounts and any explanations and rationalisations for the same are indications of fraud risk factors as explained in SA 240. The replies of EP and the facts show the absence of due diligence and gross negligence. Despite the presence of a report under Section 143(12), these factors did not prompt EP to revise the risk assessment or perform additional procedures to rule out the existence of any material misstatements due to fraud or error, such as the authenticity of the confirmations or validity of the charges in all the cases. Thus, EP ignored the contradictory evidence and did not perform any further procedures to confirm the facts in accordance with the requirements of para 26 of SA 330 and failed to obtain sufficient appropriate audit evidence as required by SA 500 to support the audit opinion."

2. Bearing in mind the aforesaid facts and conclusions which the NFRA has come through record, we find no ground to grant any interim relief at this stage.

3. The applications shall consequently stand rejected.

YASHWANT VARMA, J.

DHARMESH SHARMA, J.

MAY 09, 2024/RW