

NATIONAL COMPANY LAW APPELLATE TRIBUNAL
PRINCIPAL BENCH, NEW DELHI

Comp. App. (AT) No. 200 of 2022 & I.A. No. 931 of 2024

(Arising out of the Order dated 12.09.2022 passed by the National Financial Reporting Authority bearing no. NF-23/46/2021, Under Section 132(4) of Companies Act, 2013.

IN THE MATTER OF:

CA Som Prakash Aggarwal
ICAI Membership No. 74813

At:

4-A-6, Jawahar Nagar,
Sri Ganga Nagar-335001
Rajasthan

Mail: somprakashaggarwal@yahoo.com

...Appellant

Versus

National Financial Reporting Authority
(NFRA)

Office At:-

7th – 8th Floor, Hindustan Times House,
18-20, Kasturba Gandhi Marg, New Delhi-
110001

Mail: review@nfra.gov.in

...Respondent

With

Comp. App. (AT) No. 177 of 2024 & I.A. No. 4179 of 2024

(Arising out of the Order dated 23.04.2024 passed by the National Financial Reporting Authority bearing no. 009 /2024, Under Section 132(4) of Companies Act, 2013,

IN THE MATTER OF:

M/s S. Prakash Aggarwal & Co
Registration No. 06105C

At:

4-A-6, Jawahar Nagar,

Sri Ganga Nagar-335001

Rajasthan

Mail: somprakashaggarwal@yahoo.com

...Appellant

Versus

**National Financial Reporting Authority
(NFRA)**

Office At:-

7th – 8th Floor, Hindustan Times House,
18-20, Kasturba Gandhi Marg, New Delhi-
110001

Mail: review@nfra.gov.in

...Respondent

Present

For Appellant: Mr. CV Sajan & Mr. Dhanesh M. Nair, Adv.

For Respondents: Mr. Zoheb Hossain & Mr. Satyam, Adv.

J U D G E M E N T

(13.07. 2026)

NARESH SALECHA, MEMBER (TECHNICAL)

1. The present Company Appeal (AT) No. 200 of 2022 and Company Appeal (AT) No. 177 of 2024 have been filed by the Appellants i.e. CA Som Prakash Aggarwal and M/s S. Prakash Aggarwal & Co. Chartered Accountants, through its authorized partner CA Som Prakash Aggarwal, respectively, under Section 132(5) of the Companies Act, 2013 (“**the Act**”), challenging the Impugned Order no. NF-23/46/2021 in Company Appeal (AT) No. 200 of 2022 dated 12.09.2022 and Impugned Order no. 009/2024 in Company Appeal (AT) No. 177 of 2024 dated 23.04.2024, passed by the National Financial Reporting Authority, New Delhi (NFRA).

2. National Financial Reporting Authority (“**NFRA**”) is the Respondent herein.

Appeal in Company Appeal (AT) No. 200 of 2022

3. The Appellant, CA Som Prakash, submitted that by way of the impugned order, the Respondent has proceeded to hold the Appellant guilty of professional misconduct and has imposed severe civil and professional consequences upon him, namely, (i) imposition of a monetary penalty of Rs. 3,00,000/-, (ii) debarment for a period of three years from being appointed as an auditor or internal auditor or undertaking audit assignments in relation to financial statements or internal audit of any company or body corporate, and (iii) direction to undergo training on Standards on Auditing and Indian Accounting Standards and submit proof thereof within 180 days from the order becoming effective.

4. The Appellant submitted that he is a practicing Chartered Accountant of long standing and is a partner in the firm M/s S. Prakash Aggarwal & Co., which renders professional services in accordance with the framework prescribed under the Companies Act, 2013, Chartered Accountants Act, 1949, Standards on Auditing (SAs) and other regulatory requirements. The Appellant submitted that M/s S. Prakash Aggarwal & Co. acted as the statutory auditor of Vikas WSP Limited (“**VWL Company**”) for the Financial Year 2019–2020, and the Appellant acted as the Engagement Partner (“**EP**”) for the audit assignment. The Appellant was responsible for planning, supervision and conclusion of the audit

engagement and conducted the audit in accordance with the information and records made available by the Company and in compliance with professional practices recognized by the Institute of Chartered Accountants of India (ICAI).

5. The Appellant submitted that the statutory audit was conducted on the basis of books of accounts, records, explanations, representations, financial data and supporting materials supplied by the management and key personnel of VWL. The audit process was carried out by adopting procedures considered appropriate in the facts and circumstances of the engagement and in accordance with the Standards on Auditing as applicable. The Appellant submitted that auditing standards are intended to provide objectives, guiding principles and procedures to enable an auditor to obtain reasonable assurance and do not eliminate professional judgment in evaluating facts and accounting positions.

6. The Appellant submitted that during Financial Year 2019–20, VWL did not provide for interest expense in respect of borrowings which had already been classified by Bank of India and Union Bank of India as Non-Performing Advances (NPAs) on 31.12.2015 and 31.03.2016 respectively. The Appellant submitted that this accounting treatment subsequently became the sole substantive issue forming the basis of regulatory scrutiny against him by the Respondent.

7. The Appellant submitted that there was no concealment or omission regarding such accounting treatment. The fact of non-provisioning of interest and the relevant background were expressly disclosed in the audited financial

statements under Notes to Accounts, Paragraph 33(a)(i). it is the case of the Appellant that, all stakeholders examining the financial statements, including regulators, lenders and investors, had access to the relevant disclosures and no material information was withheld.

8. The Appellant submitted that nonrecognition of interest was not a matter of non-compliance of Ind AS 109 to fall with section 129(1) of the Companies Act, 2013 nor noncompliance to be treated as aberration under Section 129(5) of the Companies Act, 2013. This being a very technical matter, was within the decision-making ability of the company management, and hence was not a significant matter that required any discussion with the management and recording as per Para 10 of SA 230, particularly because the company had duly disclosed the facts of non-recognition of interest Note 33(i)(a) of the Annual Financial Statement of 2019-20.

9. The Appellant submitted that the Annual Financial Statements of VWL were thereafter examined by SEBI, and clarification was sought from the Appellant regarding non-provisioning of interest. The Appellant, by communication dated 13.07.2021, furnished detailed explanations clarifying that the Company had not removed or extinguished the underlying borrowing obligations and that the accounting treatment adopted did not violate Para 3.3.1 of Ind AS 109.

10. The Appellant submitted that the explanation furnished before SEBI was founded upon professional understanding of the principles governing measurement of financial liabilities and expected future cash flows under Ind AS 109. The Appellant maintained that the accounting treatment adopted was not an exercise of concealment but involved professional assessment of measurement principles in circumstances where borrowings had already been classified as NPAs.

11. The Appellant submitted that subsequently, based upon information forwarded by SEBI dated 25.08.2021, proceedings came to be initiated by NFRA. However, the notice dated 11.11.2021 issued under **Section 132(2) of Company Act, 2013 read with Rules 3, 4, 7 and 8 of the NFRA Rules, 2019** called upon the Appellant to submit audit records and SQC policy without disclosing the complete factual foundation and material forming the basis of initiation. The Appellant submitted that despite such circumstances, complete cooperation was extended at every stage and complete audit records along with affidavit were submitted by 19.04.2022.

12. The Appellant submitted that the Respondent was therefore placed in possession of extensive records, explanations and clarifications. At no stage did the Appellant evade inquiry, suppress information or refuse compliance. The conduct of the Appellant throughout remained transparent and cooperative. The Appellant submitted that notwithstanding full cooperation, the Respondent issued a Show Cause Notice dated 29.06.2022 alleging professional misconduct. The

Appellant filed a detailed written reply on 27.07.2022, dealing comprehensively with allegations concerning Ind AS 109, audit documentation, Standards on Auditing and audit procedures, and further requested an opportunity of hearing through an Authorized Representative.

13. The Appellant submitted that although hearing was ultimately conducted through video conferencing on 25.08.2022, the explanations furnished by the Appellant were not examined in their proper context. Material submissions explaining accounting principles, professional judgment and audit procedures were either selectively reproduced or incorrectly interpreted in the impugned order. The Appellant submitted that the **first charge under Clause (5), Part I of the Second Schedule to the CA Act, 1949, namely failure to disclose material facts in financial statements**, is fundamentally unsustainable. The Respondent has failed to identify any specific material fact which was required to be disclosed but remained omitted. The Appellant submitted that if the allegation concerns non-provisioning of interest on borrowings classified as NPAs, the same already stood disclosed in Notes to Accounts. In fact, the Show Cause Notice itself drew information and figures from the audited financial statements and cross-referenced disclosures already available therein. Therefore, the allegation of non-disclosure becomes self-contradictory and unsupported.

14. The Appellant submits that the **second charge under Clause (6) of Part I alleging failure to report material misstatements** proceeds entirely upon NFRA's disagreement with the accounting interpretation adopted by the

Appellant and not upon identification of any false entry, fabricated disclosure or concealed financial fact. The Appellant submitted that his understanding of Ind AS 109 was that where borrowers are unlikely to settle liabilities strictly in accordance with original contractual terms due to financial distress, expected future cash flows may require evaluation in accordance with actual settlement expectations and measurement principles. Whether such interpretation is accepted or rejected is ultimately a matter of accounting judgment and cannot automatically attract disciplinary consequences. The Appellant submitted that NFRA, while rejecting the Appellant's position, introduced considerations relating to legal liability of borrowers to repay debt, whereas accounting recognition principles under Ind AS 109 and enforceability of debt obligations are distinct concepts operating in separate fields.

15. The Appellant submitted that the **third charge under Clause (7) alleging absence of due diligence** is equally unsupported. The Respondent has not identified any specific audit procedure required under any Standard on Auditing which was omitted by the Appellant or any mandatory requirement which remained unperformed.

16. As regard nonrecognition of interest on bank loans by Vikas WSP Ltd during FY 2019-20 of approximately Rs 14 Crores by the Appellant justified based on the principles at para 2.16 of the Conceptual Framework for Financial Reporting under Ind-AS which requires application of Neutrality when prudence is exercised. "The exercise of prudence does not allow for the understatement of

assets or income or the overstatement of liabilities or expenses. Such misstatements can lead to the overstatement or understatement of income or expenses in future periods". The Appellant elaborated that where the company was not in any position to meet any further interest liability due to financial crisis, non-providing interest liability of FY 19-20 did not amount to understatement of liability and as its consequence there was no overstatement of profits either.

17. The Appellant also refuted Respondent's contention that the liability exists and must be measured using the **Effective Interest Method (EIM)** which according to the Appellant is contrary to the provisions regarding EIM defined in Appendix A to Ind AS 109 for which the criterion is estimated future cash outflows, and not the existence of the financial liability. The Appellant stated that Para 3.3.1 and Para B 3.3.1 of Ind AS 109 have no relevance in the accounting of interest liabilities as apparent from the definition of EIM. There was no derecognition or removal of liability in terms of Para 3.3.1 and Para B 3.3.1 of Ind AS 109 in the instant case, as the liability that was in the books in the previous year, reduced by the payments towards interest and loans made during the year, was continuing in the books of accounts of the company and in the financial statements. The Appellant also stated that a proposed One- Time Settlement (OTS) was relevant for determination of interest is not the provisions regarding extinguishment of liability as wrongly perceived by NFRA and on the contrary the interest is to be recognized based on the estimated future cashflows towards

interest in the circumstances of the case of OTS in the anvil, for which the company had remitted Rs 2.15 Crores to the Banks.

18. The Appellant submitted that reliance upon alleged **deficiency in audit documentation** cannot substitute proof of deficient audit performance. Audit working papers are evidentiary instruments supporting audit conclusions and are not themselves the sole measure of audit quality. The Appellant submitted that the Standards on Auditing do not require every professional discussion, judgment, clarification, reconciliation or evaluation to be separately documented in exhaustive detail. Matters resolved through professional engagement and reflected in final audit outputs cannot be treated as absent merely because every deliberative step was not independently preserved.

19. The Appellant submitted that the observations in the impugned order appear to equate professional explanations with disregard of auditing standards. The Appellant never disputed **applicability of Standards on Auditing** and consistently maintained compliance with applicable standards in both letter and spirit. The Appellant submitted that the **fourth and fifth charges under Clauses (8) and (9) of Second Schedule to the CA Act, 1949** are merely repetitive extensions of earlier allegations and do not independently establish absence of sufficient information or departure from accepted audit procedures. No specific information allegedly omitted nor any specific audit procedure allegedly violated has been identified.

20. The Appellant submitted that the Respondent has failed to point out any evidence from the audit file demonstrating fraud, concealment, gross negligence, recklessness, intentional omission, lack of independence or deliberate disregard of professional obligations. The Appellant submitted that disagreement with an auditor's professional judgment cannot, by itself, become a basis for disciplinary sanctions unless accompanied by demonstrable misconduct supported by cogent evidence. Professional regulation cannot convert every accounting disagreement into punitive action.

21. The Appellant submitted that regardless of the mandatory applicability of SAs and Accounting Standards (ASs) there is room for choices, alternative procedures and adaptations based on professional judgment of the auditor. This position of the Appellant as far as Accounting Standards are concerned, was based on the provisions of **(a) Section 129(5) of the Companies Act, 2013** and based on the flexibility provided in **Ind AS 1**-Para 15,18 and 19. Similarly for Auditing Standards **SA 200**-Para 7 provides that " the SAs contain objectives, requirements and application and other explanatory material that are designed to support the auditor in obtaining reasonable assurance". **SA 200**-Para 18 also provides that "the auditor shall comply with all SAs relevant to the audit. A SA is relevant to the audit when the SA is in effect and the circumstances addressed by the SA exist". The Appellant further elaborated that **SA 500**- Para 6 stipulates that "The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit

evidence" and SA 500-Para A2 state that "Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, reperformance and analytical procedures, often in some combination, in addition to inquiry". The Appellant also explained that SA 500- Para A 6 mention "Whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion, is a matter of professional judgment". In view of these, the Appellant emphasized that despite the mandatory applicability of SAs, application of all SAs and all provisions cannot be mandatory in every audit, and the judgment of an auditor plays a vital role.

22. The Appellant submitted that the only issue relevant here is whether not recognizing interest in the circumstances of the case was compliance of **Ind AS 109** or not, which was a technical matter that was not to be addressed or to be discussed with the management, or not to be recorded as in a "minute" because it was a technical interpretation of the EIM in terms of Ind AS 109. The Appellant elaborated that there was no mandatory requirement of obtaining confirmations from banks, nor any case of consequence was made by the Respondent. There is no regulatory provision that make non-documenting of a technical interpretation on Ind AS 109 by the auditor or instance of not to seek confirmation from bank, as breaches of SA 230 or SA500.

23. The Appellant reasoned that **Engagement Quality Control Review (EQCR)** is integral part of audit procedure but the same can't be considered as an absolute condition, instead it is subject to the provisions of Para 19 of **SA 220**, meaning thereby EQCR applies to audits of all listed entities and to those other entities falling within the category of audits for which EQCR is made mandatory according to the Quality Control Policy established by the respective audit firms. The Appellant conceded that the essentiality of carrying out Engagement Quality Control Review in the instant case is not disputed. The Appellant acknowledged that not engaging an EQCR was a lapse on the part of the Appellant, however, every lapse of an audit procedure cannot qualify as professional misconduct, for which applicability of the relevant clause i.e. **Clause (9) of Part I of the Second Schedule viz, material departure from generally accepted audit procedures.**

24. The Appellant submitted that the Respondent has not made out any concrete case of material noncompliance of Auditing Standard or other professional Standards against the Appellant. The Appellant explained that the standard of proof applicable to quasi criminal charges was not tested and the charges of **Clauses (5), (6), (7), (8), (9) of Schedule II of the Chartered Accountant, 1949** and were arbitrarily invoked by the Respondent without respecting the relevant law on standard of proof in Para 4(i), (ii) and (iii) of the judicial decisions of the Hon'ble Supreme Court in **An Advocate Vs Bar Council of India [1989 Supp (2) Supreme Court Cases 25]** and that in para 26, 27 and 31 of the judicial decision of the Hon'ble Delhi High Court in **Shadilal Batra, in re,**

[1967 SCC OnLine DEL 44]. Standard of proof on the question of gross negligence of an audit professional, as covered in the Hon High Court of Hyderabad in the *ICAI Vs Mukesh Gang, Chartered Accountant* [2016 SCC Online Hyd 327] was also not tested by the Respondent. The Appellant castigated the Respondent who has held the Appellant guilty of **professional misconduct without sufficient reason or proof** of the listed offences and without testing whether these were grave enough to be treated as professional misconduct, and hence the punishments were travesty of justice.

25. The Appellant further submitted that the impugned order contains observations which appear to interpret candid professional defence as resistance to regulatory authority. Such approach has resulted in conclusions unsupported by objective assessment of audit work undertaken. The Appellant submitted that the sanctions imposed are manifestly excessive and disproportionate. The combined effect of Rs. 3,00,000/- monetary penalty, three-year debarment, and mandatory retraining substantially affects the Appellant's professional standing, livelihood and right to continue practice.

26. The Appellant submitted that findings carrying such severe professional and reputational consequences shall have been supported by clear evidence, reasoned analysis and strict demonstration of statutory misconduct by the NFRA. In the absence of such findings, the impugned order fails to satisfy settled standards of fairness, proportionality and regulatory adjudication.

27. Concluding the arguments, the Appellant requested this Appellate Tribunal to allow his appeal in Company Appeal (AT) No. 200 of 2022 and set aside the Impugned Order 12.09.2022 against the Appellant CA Som Prakash.

Appeal in Company Appeal (AT) No. 177 of 2024

28. The Appellant submitted that it is a chartered accountancy firm, under name M/s S. Prakash Aggarwal Co., and that it had served as the statutory auditor of VWL for the financial year 2019–20. The Appellant stated that CA Som Prakash Aggarwal, being the engagement partner, conducted the audit on the basis of the information, documents, and explanations provided by the management and other key personnel of the company, in accordance with the audit procedures prescribed by ICAI.

29. The Appellant submitted that it responded to NFRA’s notices by furnishing part of the audit file, the **SQC-1** policy, further portions of the audit file, responses to questionnaires, and an affidavit stating that the complete audit file had been submitted. The Appellant contended that despite full cooperation, NFRA issued a show cause notice on 29 June 2022, treated the matter as one of professional misconduct, and ultimately passed an order on 12 September 2022 against the engagement partner, debarring him from undertaking corporate audits for three years and imposing a monetary penalty.

30. The Appellant contended that the same allegations were thereafter revived against the Appellant firm through a fresh show cause notice dated 4 December

2023, even though those very issues had already been examined in the earlier proceeding against the EP. The Appellant submitted that this amounted to repetition of the same charges and that too after lapse of period and an abuse of process by NFRA.

31. The Appellant submitted that the impugned order dated 23 April 2024 wrongly interpreted **SA 220 and SQC 1** by fastening audit responsibility on the firm as if the firm itself were directly accountable for the performance of the audit in the same manner as the EP. The Appellant contended that the firm's role under SQC 1 was only to establish a system of quality control, whereas the actual implementation responsibilities, according to the firm's own policy, rested with the EP.

32. The Appellant explained the provisions in Para 59 of SQC 1 which provides that that a firm "establishes procedures to resolve" differences of opinion where "firm using a suitably qualified external person(s) to conduct an engagement quality control review" is about establishing policy and procedure by the firm in this respect, as apparent from the other relevant paragraphs No 57-58 of SQC 1 and it does not cast any responsibility on the firm to appoint EQCR. Similarly, Para 71 of SQC 1 also is for addressing a policy matter that a "firm's policies provide for the replacement of the engagement quality control reviewer where the ability to perform an objective review may be impaired to address situations where maintaining objectivity by EQCR gets affected. Provisions in Para 92 of SQC 1 that small firms and sole practitioners may wish to use a suitably

qualified external person to carry out Engagement Quality Control Review, is also a matter of policy.

33. The Appellant further contended that the NFRA misread the reference to SQC 1 and auditing standards such as **SA 200, SA 220, SA 230, SA 260, SA 620, and SA 700** as though those references created direct substantive liability on the firm for audit performance. The Appellant submitted that, under SA 200, responsibility for the engagement and its performance lies with the engagement partner, and the footnote in SQC 1 concerning signatures on reports did not alter the allocation of responsibility.

34. The Appellant submitted that the impugned order wrongly held that the firm could not dissociate itself from audit responsibilities and could not absolve itself of non-compliances in the audit of VWL. The Appellant contended that the firm's quality control policy placed the responsibility for implementation on the engagement partner, and therefore the firm could not be made liable for alleged audit lapses committed in the course of audit execution.

35. The Appellant contended that the findings in paragraphs 19 to 22 of the impugned order were also unsustainable because they related to alleged **deficiencies in audit documentation, non-recognition of interest on non-performing bank limits, and non-appointment of EQCR**, all of which had already formed the basis of proceedings against the EP in the earlier order dated 12 September 2022 in CA (AT) No. 200 of 2022. The Appellant submitted that these charges were repeated and could not legally be used again against the firm,

as the firm was not the directly responsible for those audit acts of the EP i.e. CA Som Prakash.

36. The Appellant submitted that the charges under **Clauses 5, 6, 7, 8, and 9 of Part I of the Second Schedule to the Chartered Accountants Act, 1949** were not legally sustainable against an audit firm and could only be directed against the concerned chartered accountant or engagement partner.

37. The Appellant contended that there are no relevant provisions in **Section 22 of the Chartered Accountants Act, 1949** that convert the alleged audit lapses into professional misconduct against the firm under **Section 132(4)** of the Companies Act, 2013. The Appellant further submitted that the fresh proceedings against the firm were contrary to **Rule 11(1) of the NFRA Rules, 2018**, since identical allegations had already been proceeded with earlier against the EP. The Appellant submitted that the proceedings were arbitrary, amounted to double jeopardy in substance, and reflected misuse of NFRA's powers by reopening a concluded or already-subjected-to-appeal matter.

38. The Appellant submitted that the impugned order suffers from errors of law and fact, proceeds on a misreading of SQC 1 and the auditing standards, improperly fastens liability on the firm for acts attributable to the engagement partner, and repeats charges already raised in earlier proceedings against the EP. The Appellant contended that, for these reasons, the impugned order deserves to be quashed.

39. Concluding arguments, the Appellant requested this Appellate Tribunal to allow the appeal and set aside the impugned order dated 23.04.2024 against the firm.

40. On the other hand, the Respondent, NFRA, denied the averments of the Appellants, in both appeals as misleading and baseless.

Company Appeal (AT) No. 200 of 2022

41. The Respondent submitted that M/s S. Prakash Aggarwal & Co. acted as the statutory auditor of VWL, a listed company having and the Appellant CA Som Prakash Aggarwal acted as the EP for the audit assignment. Since VWL was listed on both BSE and NSE, preparation and presentation of its annual financial statements were mandatorily governed by **Rule 4 of the Companies (Indian Accounting Standards) Rules, 2015** requiring compliance with notified Indian Accounting Standards including **Ind AS 109** relating to Financial Instruments. Consequently, the Appellant was under heightened statutory and professional obligations while conducting the audit and expressing audit opinion.

42. The Respondent, NFRA, further submitted that information dated 25.08.2021 was received from SEBI indicating serious concerns in the financial reporting practices adopted by VWL for FY 2019–2020. It was specifically observed that the Company had not recognised interest expenses on borrowings from banks in its Statement of Profit and Loss despite continuing financial obligations, resulting in distortion of the financial position and overstatement of

profits. Considering the seriousness of the allegations and their implications upon investor protection, financial reporting integrity and public confidence, the Respondent NFRA initiated examination under powers conferred under Section 132 of the Companies Act, 2013.

43. The Respondent submitted that, in furtherance of such examination, a notice dated 11.11.2021 was issued requiring the Appellant, CA Som Prakash in CA (AT) No. 200 of 2022 to produce the Audit File and SQC 1 Policy of the Firm. However, despite repeated opportunities, the Appellant CA Som Prakash failed to submit a complete and coherent audit record within the prescribed timeline. Initially, on 08.12.2021, only partial audit documentation and broad references to SQC practices were submitted. Subsequently, on 21.12.2021, a reminder was issued by the Respondent requiring complete production of audit records and quality control documentation by the Appellant. Although extension till 20.01.2022 was granted upon request, even thereafter the Appellant CA Som Prakash furnished only portions of the audit file and indicated that several audit documents were unavailable in proper digital form.

44. The Respondent submitted that in order to ensure procedural fairness and complete understanding of the audit approach adopted by the Appellant, a detailed questionnaire dated 04.02.2022 was issued seeking clarifications relating to statutory audit procedures undertaken for VWL. The Appellant submitted replies on 23.02.2022, however, deficiencies persisted and therefore another communication dated 29.03.2022 was issued requiring submission of complete

audit records supported by affidavit. Eventually, on 19.04.2022, the Appellant submitted additional material and affirmed that the audit file stood completed. However, upon examination, the documents were found fragmented, incomplete and incapable of establishing compliance with mandatory auditing requirements.

45. The Respondent submitted that after detailed scrutiny of the audit file, correspondence, explanations and underlying financial statements, an apparent case of professional misconduct emerged against the Appellant CA Som Prakash and accordingly Show cause Notice dated 29.06.2022 was issued under Rule 11(1) of the NFRA Rules, 2018. Sufficient opportunities were granted to the Appellant to respond and participate in proceedings. The Appellant submitted written responses dated 27.07.2022 and sought personal hearing. Such request was accepted and hearing was initially scheduled through Video Conferencing and thereafter rescheduled upon the Appellant's own request. The hearing was ultimately conducted on 25.08.2022 wherein the Appellant reiterated his written submissions. Thus, principles of natural justice were fully complied with and no procedural prejudice whatsoever was caused.

46. The Respondent NFRA submitted that upon comprehensive consideration of all records including audit files, written explanations, oral submissions and applicable legal framework, serious violations were established against the Appellant. The Respondent found that the Appellant failed to report understatement of Interest Costs pertaining to borrowings classified as NPA by lender banks, failed to report understatement of Current Liabilities, failed to

detect and disclose overstatement of Profit Before Tax, accepted inadequate and unsupported disclosures in the financial statements and failed to maintain audit documentation and audit evidence as required under Standards on Auditing. These lapses were not isolated procedural irregularities but directly affected the reliability of audited financial statements.

47. The Respondent submitted that the principal issue related to non-recognition of interest expenses by VWL despite continuing obligations under outstanding borrowings. The Company had borrowings amounting to approximately Rs.135.65 crore as on 31.03.2020 as against Rs.155.29 crore as on 31.03.2019. While the Company recognised interest cost of approximately Rs.21.08 crore in FY 2018–2019, but only Rs.4.16 crore was recognised in FY 2019–2020. Upon examination of Note 33(a)(i) of the financial statement of VWL and related financial disclosures, it was observed that complete interest liability had not been recognised in the financial statements. The Respondent submitted that such accounting treatment materially impacted profit reporting and financial presentation.

48. The Respondent specifically contended that the Appellant attempted to justify such non-recognition of interest expenses by relying upon anticipated OTS discussions and Management Representation Letter (MRL) dated 24.06.2020. However, the audit record contained no contemporaneous evidence of any concluded settlement arrangement, lender approval, audit verification or independent corroboration. The Management Representation Letter itself

suffered from multiple inconsistencies, including absence of proper identification of signatory authority, absence of company letterhead and internal inconsistencies in dates and factual references. The Respondent submitted that anticipated future concessions by lenders cannot extinguish an existing financial liability unless legally crystallised and recognised under applicable accounting standards. Therefore, the assumption adopted by the Appellant that future waiver possibilities justified non-recognition of interest costs was fundamentally inconsistent with Ind AS 109 and contrary to accepted accounting principles.

49. The Respondent further submitted that the Appellant's interpretation of the principles governing measurement of financial liabilities under Ind AS 109 was fundamentally erroneous and contrary to the statutory accounting framework applicable to listed entities. It is submitted that Ind AS 109 requires financial liabilities to continue to be recognised and measured until extinguishment in accordance with the prescribed standards and does not permit assumptions of reduced future cash outflows merely because negotiations for waiver or settlement may have commenced. The Respondent contended that the **Effective Interest Method ("EIM") under Appendix A of Ind AS 109** expressly requires estimation of expected cash flows by considering contractual terms of the financial instrument while excluding assumptions based upon expected credit losses or speculative waivers. Therefore, unless and until the liability stood legally modified, discharged or extinguished, interest obligations continued to subsist and were required to be recognised in the financial statements.

50. The Respondent submitted that the accounting treatment accepted by the Appellant resulted in a material misstatement in the audited financial statements of VWL. Even assuming that interest cost for FY 2019–2020 ought to have remained broadly aligned with the interest cost recognised in FY 2018–2019, namely approximately Rs.21.07 crore, the recognition of only Rs.4.16 crore led to understatement of interest cost and current liabilities by at least Rs.16.91 crore. The Respondent contended that such understatement had a direct and substantial impact upon profitability. The Company reported Profit Before Tax of approximately Rs.19.20 crore and the understatement of expenditure by Rs.16.91 crore constituted nearly 88% of the reported PBT, thereby making the misstatement manifestly material, significant and capable of misleading users of financial statements.

51. The Respondent submitted that the Appellant, as EP and statutory auditor, was under an independent professional obligation to critically evaluate management assumptions, obtain sufficient appropriate audit evidence and modify the audit opinion wherever material departures from accounting standards were noticed. Instead of exercising **professional scepticism**, the Appellant accepted the Company's treatment of interest costs without adequate corroboration and issued an unmodified audit opinion. The Respondent contended that statutory audit is not a mechanical endorsement of management representations but an independent assurance function governed by legal standards and professional judgment supported by evidence.

52. The Respondent submitted that the deficiencies identified were not limited to accounting treatment alone but extended to serious failures in audit execution and documentation. The audit file examined by NFRA did not contain contemporaneous documentation demonstrating examination of interest computations, challenge to management assumptions, communication with lender banks, evaluation of settlement proposals or rationale for accepting departure from ordinary accounting treatment. There was no evidence showing that the Appellant had independently assessed the impact of non-recognition of interest costs upon financial statements before certifying them.

53. The Respondent contended that the Appellant's defence based upon oral discussions, professional understanding and undocumented deliberations was legally untenable and contrary to Standards on Auditing, particularly **SA 230**. Audit documentation is not a procedural formality but constitutes the foundational evidence of work performed, conclusions reached and professional judgments exercised during the audit process. Paragraph 7 of SA 230 mandates timely preparation of audit documentation and Paragraph 8 specifically requires documentation of significant matters, conclusions reached and significant professional judgments made during audit. The Respondent submitted that these requirements acquire greater importance in matters involving listed entities and material accounting assumptions.

54. The Respondent submitted that the Appellant's position that oral explanations or internal discussions could substitute formal audit documentation

stands expressly contradicted by the Standards on Auditing. SA 230 recognises that oral explanations may only supplement documentation already existing in audit records and cannot independently establish performance of audit procedures. Audit files must speak for themselves and permit an experienced auditor, without prior involvement in the engagement, to understand the procedures performed, evidence obtained and basis of conclusions. In the present case, such standard was not satisfied and the audit record was found materially deficient.

55. The Respondent further submitted that the audit documentation lacked several categories of essential evidence ordinarily expected in a statutory audit of this nature. There was absence of direct confirmations from lender banks regarding outstanding liabilities; absence of loan agreements and corresponding communications; absence of evidence supporting the alleged OTS discussions; absence of records establishing identification and communication with Those Charged with Governance (TCWG); absence of documentation explaining acceptance of management assumptions; and absence of documented challenge to material accounting treatment adopted by management. Such deficiencies collectively demonstrated failure to obtain sufficient and appropriate audit evidence.

56. The Respondent submitted that the Appellant also failed to comply with mandatory quality control requirements applicable to listed company audits. In particular, the Respondent found that no Engagement Quality Control Reviewer

(“EQCR”) had been appointed despite the clear requirement under Paragraph 19(a) of SA 220 applicable to audits of listed entities. The Appellant’s position that appointment of EQCR was not mandatory demonstrated a serious misunderstanding of applicable auditing standards. The Respondent submitted that compliance with engagement quality control is not discretionary and forms an integral component of audit reliability, especially in listed company audits involving public interest considerations.

57. The Respondent therefore contended that the conduct of the Appellant attracted multiple categories of professional misconduct under the applicable statutory framework. The Appellant failed to disclose material facts necessary for understanding the financial statements; failed to report material misstatements known to him; failed to exercise due diligence in discharge of professional duties; failed to obtain sufficient information necessary for expression of audit opinion; and failed to invite attention to departures from accepted audit procedures. Such conduct attracted **Section 132(4) of the Companies Act, 2013 read with Section 22 and Clauses (5), (6), (7), (8) and (9) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.**

58. The Respondent submitted that each charge recorded in the impugned order was independently examined and supported by findings derived from audit files, financial records, responses furnished by the Appellant and applicable statutory standards. The conclusions reached by NFRA were neither presumptive nor punitive in nature but flowed from objective evaluation of evidence and legal

obligations cast upon auditors of public interest entities. The Respondent contended that the Appellant's attempt to portray the proceedings as mere disagreement over professional interpretation is misconceived since the findings arose from demonstrable failures in accounting evaluation, audit execution, documentation, quality control and regulatory compliance, all of which directly impacted the truthfulness and fairness of audited financial statements.

59. The Respondent further submitted that the Appellant's challenge to the findings under **Clause (5) of Part I of the Second Schedule to the Chartered Accountants Act, 1949** is wholly unsustainable. The Respondent contended that the Appellant was under a clear professional **obligation to disclose all material facts necessary for proper understanding of the financial statements** where he was associated in a professional capacity. In the present case, the financial statements did not adequately disclose the basis, rationale, assumptions and accounting consequences arising from the non-recognition of interest costs on borrowings classified as NPAs.

60. The Respondent submitted that the Appellant's challenge to findings under **Clause (6) of Schedule to of ICAI Act, 1949 relating to failure to report material misstatements** is equally devoid of merit. It was contended that the materiality threshold stood clearly crossed in the present case, considering the substantial impact upon reported profitability and liabilities. The understatement of interest expenditure and corresponding overstatement of profits was not trivial or technical in nature but materially altered the financial presentation of VWL.

The Respondent submitted that once such material departure existed and remained unreported despite knowledge and audit involvement of the Appellant, the ingredients constituting professional misconduct stood fully established.

61. The Respondent submitted that the Appellant's contention that standards on auditing merely lay down broad principles and permit unrestricted auditor discretion is legally incorrect and contrary to the statutory scheme. Standards on Auditing prescribed under Section 143(10) of the Companies Act, 2013 carry mandatory force and establish minimum requirements that must be demonstrably complied with. While professional judgment remains part of audit execution, such judgment must be capable of verification through contemporaneous records and documented evidence. The Respondent contended that audit standards are intended precisely to eliminate subjective and retrospective justification unsupported by audit records.

62. The Respondent further submitted that the **Appellant's argument that quality of audit ought to be judged only through financial outputs and not through** working papers is fundamentally misconceived. Audit documentation constitutes the legal evidence of audit performance and forms the basis upon which regulators, peer reviewers and courts assess whether statutory duties were discharged. The absence of adequate working papers, especially in matters involving material accounting estimates and departures from ordinary accounting treatment, directly undermines the credibility of audit conclusions. The Respondent therefore submitted that deficiencies in audit documentation cannot

be dismissed as administrative imperfections but constitute substantive violations affecting the audit process itself.

63. The Respondent submitted that the challenge to the findings under **Clause (7) Schedule to of ICAI Act, 1949, namely lack of due diligence and gross negligence**, deserves rejection. The Appellant relied substantially upon management assertions and alleged settlement expectations without independent verification from lending institutions and without preserving documentary evidence supporting such reliance. The Respondent contended that professional diligence requires active verification, corroboration and challenge, particularly where financial liabilities materially affect profitability and solvency indicators. The Appellant's conduct revealed absence of professional scepticism expected of an independent statutory auditor.

64. The Respondent further submitted that findings under **Clause (8) Schedule to of ICAI Act, 1949, namely failure to obtain sufficient information necessary for expression of audit opinion**, are fully supported by the record. It is submitted that the Appellant did not obtain adequate evidence regarding borrowings, interest obligations, correspondence with banks, settlement arrangements, governance communications and accounting rationale adopted by management. The absence of such evidence could not be cured through subsequent explanations furnished during disciplinary proceedings. The Respondent contended that sufficiency and appropriateness of audit evidence

must exist at the time of issuance of audit report and cannot be reconstructed after commencement of regulatory scrutiny.

65. The Respondent submitted that the findings under **Clause (9) Schedule to of ICAI Act, 1949 concerning failure to invite attention to departures from accepted audit procedures**, are also justified and supported by statutory provisions. Despite serious deficiencies in accounting treatment and absence of supporting audit evidence, the Appellant issued an audit report representing compliance with Standards on Auditing. The Respondent submitted that such representation created an impression of regulatory and professional compliance which was not borne out from the audit records. Therefore, the Appellant's conduct amounted to failure to report material departures and constituted actionable professional misconduct.

66. The Respondent reiterated that in view of the foregoing facts, statutory provisions, accounting standards, auditing requirements and evidence available on record, the impugned order dated 12.09.2022 has been passed after due application of mind, proper appreciation of facts and strict adherence to law. The findings of professional misconduct recorded against the Appellant CA Som Prakash under Section 132(4) of the Companies Act, 2013 read with the relevant provisions of the Chartered Accountants Act, 1949 are fully justified and supported by evidence. The sanctions imposed, namely monetary penalty of Rs.3,00,000/-, debarment for three years from undertaking audit assignments and requirement to complete prescribed professional training within 180 days from

the order becoming effective, are **proportionate** to the seriousness of misconduct established.

Company Appeal (AT) No. 177 of 2024

67. The Respondent stated that upon detailed examination of the audit file and other materials available on record, while deciding against the EP in CA (AT) 200 of 2022, NFRA came to know that a prima facie case of professional misconduct also existed against the Appellant Firm. Accordingly, a Show Cause Notice (SCN) dated 04.12.2023 was issued to the Firm under Rule 11(1) of the NFRA Rules, 2018, granting it reasonable opportunity to respond. The Firm sought multiple extensions of time and was granted sufficient opportunities, and the Appellant eventually submitted on 14.02.2024.

68. The Respondent contended that after careful perusal of the entire record, including the audit file, the Firm's reply to the SCN, and all supporting documents, it was established that the Appellant Firm failed to discharge its statutory responsibilities. The Firm, being primarily responsible for establishing and maintaining a robust system of quality control, failed to ensure that the firm and its personnel complied with professional standards, regulatory and legal requirements, and that the audit reports issued were not appropriate in the circumstances. This failure constitutes professional misconduct on the part of the Firm.

69. The Respondent submitted that the scheme of the Companies Act, 2013, the Standards on Auditing (SAs), and the NFRA Rules, 2018 explicitly impose independent obligations upon the audit firm itself, apart from the individual auditor/Engagement Partner. The Act also provides for specific penalties upon the firm in cases of non-compliance or professional misconduct. The Respondent contended that under **Section 139** of the Companies Act, 2013, a firm can be appointed as statutory auditor. Once appointed, the firm is accountable for the duties and responsibilities under **Section 143**, including mandatory compliance with auditing standards as per **Section 143(9) and 143(10) of Companies Act, 2013**.

70. The Respondent stated **that SA 220 – “Quality Control for an Audit of Financial Statements”** categorically provides that quality control systems, policies, and procedures are the responsibility of the audit firm. Para 2 of SA 220, **read with SQC 1**, obligates the firm to establish and maintain a system of quality control to provide reasonable assurance that the firm and its personnel comply with professional standards, regulatory and legal requirements, & the reports issued by the firm or engagement partners are appropriate in the circumstances.

71. The Respondent further elaborated that **Para 3 of SQC-1 mandates the firm to establish such a system designed to provide reasonable assurance regarding compliance and quality of reports**. This responsibility is not limited to merely formulating policies but extends to ensuring their effective implementation and monitoring.

72. The Respondent submitted that while the EP is responsible for the conduct and performance of a specific audit engagement (as per SA 220), the Firm retains overarching responsibility for the quality control framework. The Firm cannot shift or abdicate its liability by merely pointing towards the EP. Both the Firm and the EP have distinct yet overlapping responsibilities, and both can be held accountable.

73. The Respondent contended that Section 132(4)(c) of the Companies Act, 2013 expressly empowers NFRA to impose monetary penalties on firms (up to ten times the fees received) and to debar them in cases of proven professional misconduct. The Appellant Firm's plea of "**double jeopardy**" is entirely misplaced and without any legal basis, as the proceedings against the EP and the Firm are independent and arise from the Firm's separate statutory obligations.

74. The Respondent contended that the Appellant firm's interpretation of SQC-1, various SAs, and Section 143(9) of the Companies Act denying any responsibility on the firm is grossly erroneous and, if accepted, would severely undermine the integrity of the auditing profession and financial reporting in the country. The Respondent submitted that the Firm, having been appointed under Section 139, is fully accountable for compliance with Section 143 of Companies Act, 2013. The argument that the Firm's role is confined only to "establishing" a system is misconceived. SA 220 read with SQC-1 requires the Firm to "reasonably assure" compliance and quality of reports, which was not done in this case.

The Respondent stated that non-compliance with mandatory auditing standards amounts to **professional misconduct under the Chartered Accountants Act, 1949, particularly Clauses 5, 7, and 9 of Part I of the Second Schedule.** The Firm, as the appointed auditor, remains **vicariously and directly responsible for misconduct committed by its partners/employees** in the course of the audit and cited judgement of Hon'ble Delhi High Court in case of *Deloitte Haskins & Sells LLP Versus Union of India and Another* [2025 SCC OnLine Del 641] establishing these principles.

75. The Respondent contended that the **Firm, the EP and the EQCR are jointly and severally liable.** The Firm has a continuing duty to maintain and enforce quality control systems. It cannot evade responsibility for deficiencies in its quality control mechanisms or failure to ensure compliance with auditing standards. The Respondent submitted that all charges levelled against the Firm are fully sustainable. The reference to the PCAOB Order against PricewaterhouseCoopers (PwC) was cited only to highlight that leading international regulators also hold audit firms accountable for systemic failures in quality control.

76. The Respondent stated that no substantial questions of law arise in this appeal, as the Appellant has not challenged the constitutional validity of the relevant statutory provisions. All grounds raised regarding double jeopardy, applicability of clauses, and procedural fairness have been thoroughly addressed in the impugned order. The Respondent further submitted that the procedure

adopted by NFRA has been upheld by this Appellate Tribunal in **Harish Kumar T.K. vs. NFRA** passed in *Company Appeal (AT) No. 68 of 2023* and confirmed by the Hon'ble Supreme Court in related appeals.

77. Concluding arguments, the Respondent prayed that the present appeal be dismissed with exemplary costs, as it is an abuse of the process of law and an attempt to evade statutory accountability.

Findings

78. Both these appeals arise from two orders passed by the NFRA under Section 132(4)(c) of the Companies Act, 2013, both arising from the statutory audit of VWL for the Financial Year 2019-20.

79. The first Impugned Order (Order No. NF-23/46/2021 dated 12.09.2022) was passed against CA Som Prakash Aggarwal, who was the Engagement Partner ('EP') for the said statutory audit, imposing a monetary penalty of Rs. 3 Lakhs and a debarment of three years from being appointed as auditor or internal auditor of any company or body corporate. He was also directed to undergo training in Standards on Auditing and Ind AS within 180 days.

80. The second impugned order no. 177 of 2024 (order dated 23rd April 2024) was passed against M/s S. Prakash Aggarwal & Co. ('the Firm'), imposing a monetary penalty of Rs. 5 Lakhs.

81. Both appeals have been heard together since they arise from a common set of facts and involve overlapping legal questions which related to VWL Financial statement of 2019-20. We also consulted both parties, who also agreed for common judgment on both appeals. After detailed consideration of the impugned orders, the grounds of appeal, the pleadings and the written submissions filed by the parties. We now proceed to pass this common judgment in following part.

Company Appeal (AT) No.200 of 2022

82. Looking to the background of the case, we are of the opinion that issues are required to be framed the issues framed for determination focus on critical accounting and auditing standards in case of CA Som Prakash in Company Appeal (AT) No. 200 of 2022 are as under: -

Issue No. I: RBI IRACP Norms vs. Borrower's obligations: Whether RBI's prudential norms (IRACP Norms) that stop banks from recognizing income on NPA accounts also extinguish the borrower's legal obligation to recognize and accrue interest expense in its own financial statements.

Issue No. II: Ind AS 109 & Interest recognition: Whether the Effective Interest Rate (EIR) method under Ind AS 109 allows a borrower to substitute expected One-Time Settlement (OTS) cash flows for contractual cash flows when computing interest expense on NPA-classified borrowings.

Issue No. III: Violation of SAs, Companies Act, 2013 and Chartered Accountant Act, 1949.

Issue No. IV : Modified V/s Unmodified Audit Report:-

(a): Whether an unaccepted and undocumented OTS proposal constitutes a sufficient basis for an auditor to accept the non-recognition of a financial liability and issue an unmodified audit report.

(b): Whether, and in what circumstances, an auditor of a PIE is required to issue a modified opinion under SA 705 (Revised) — specifically, whether the instant facts required at minimum a Qualified Opinion or an Adverse Opinion?

Issue No. V: Appointment of EQCR; Whether appointing an Engagement Quality Control Reviewer (EQCR) is mandatory for the audit of a listed entity under SA 220.

Issue No. VI: Authority of Standards on Auditing (SAs) Whether SAs issued by the ICAI are mandatory requirements binding on every statutory auditor or if they are merely "guiding principles" allowing unlimited professional discretion.

Issue No. VII Proportionate of Penalty: Whether the sanctions imposed Rs. 3,00,000/- penalty and 3-year debarment are proportionate to the gravity of the proved misconduct?

Background

83. To understand the factual matrix of the case, we note that VWL is a company listed on both the BSE and the NSE. VWL is engaged in the manufacture and export of guar gum powder and is headquartered at RIICO Industrial Area, Sri Ganganagar, Rajasthan. VWL had taken various credit facilities from a consortium of three lenders: Punjab National Bank ('PNB') as lead bank, Union Bank of India ('UBI'), and Bank of India ('BOI'), primarily comprising export credit facilities including pre-shipment packing credit, Pre-Shipment Credit in Foreign Currency ('PCFC'), Foreign Bills Purchased/Collected ('FBP/FCBP'), and related working capital facilities.

84. Being a listed company, VWL is a **Public Interest Entity ('PIE')** and is mandatorily required to comply with Indian Accounting Standards (Ind AS) as per Rule 4 of the Companies (Indian Accounting Standards) Rules, 2015. We may state that PIE refer to a category of high profile or high-risk business like publicly traded companies, banks, insurance companies, since their financial health directly impacts public at large and market stability. PIE, are subject to

stricter independence regulations including accounting (Ind AS) and Auditing Standard (SAs).

85. It is an admitted and established fact that as at the balance sheet date of 31 March 2020, all three consortium lenders had already classified the Company's accounts as Non- Performing Assets (NPA). The Company continued to hold total borrowings of approximately Rs. 135.65 crores as on 31.03.2020.

86. We further note that on 25.08.2021, the Respondent NFRA received information from the SEBI in the case of VWL, alleging that the Company had not recognised interest expense on its borrowings from banks in its Statement of Profit and Loss for FY 2019-20, resulting in overstatement of profits. This information set off the chain of disciplinary proceedings that culminated in the impugned orders against EP & the Firm in Company Appeal (AT) No. 200 of 2022 & Company Appeal (AT) No. 177 of 2024 respectively.

87. We have already noticed that the firm i.e., M/s S. Prakash Aggarwal & Co. was the statutory auditor of VWL for FY 2019-20. CA Som Prakash Aggarwal was the sole proprietor of M/s S. Prakash Aggarwal & Co. and was the Engagement Partner for this audit of VWL.

Issue Wise Discussion

88. Now, we will discuss various issues framed by us in para 82

89. Issue No. I: RBI IRACP Norms vs. Borrower's obligations: Whether RBI's prudential norms (IRACP Norms) that stop banks from recognizing income on NPA accounts also extinguish the borrower's legal obligation to recognize and accrue interest expense in its own financial statements.

Issue No. II: Ind AS 109 & Interest recognition: Whether the Effective Interest Rate (EIR) method under Ind AS 109 allows a borrower to substitute expected One-Time Settlement (OTS) cash flows for contractual cash flows when computing interest expense on NPA-classified borrowings.

90. Since both these issues are inter-connected and inter-dependent in the present appeal, we should deal both these issues together.

91. A comparison of the published financial data of VWL for FY 2019-20 vis-a-vis the previous year reveals the reduction in Finance Cost from Rs. 21.08 Crores in FY 2018-19 to only Rs. 4.16 Crores in FY 2019-20 i.e. a collapse of 80.25% which is the single most significant indicator in this case. It is worth noting that this occurred despite total borrowings remaining substantial at Rs. 135.65 crores and all three consortium banks having classified the account of VWL as NPA and no formal debt waiver having been executed by Banks. In this background, the Respondent/ NFRA treated this as interest suppression, which compromised Audit Report.

92. For our initial understanding, doing back of envelope calculation, indicates prima facie, even using the FY 2018-19 finance cost figure as a baseline, the

understatement of interest expense in FY 2019-20 of at least Rs. 16.91 crores. Against a reported PBT of Rs. 19.20 crores, this understatement represents 88% of the reported PBT. Thus, we find that had interest been properly accounted for, VWL would have reported a net loss, not a profit. It seems to have become foundational distortion of the financial statements that goes to the very core of the Company's reported performance i.e. converting what would have been a loss-making year into an apparently profitable one. One may assume and also legally argue that the investing public, banks, creditors, and regulators might have been allegedly misled. This aspect of alleged suppression of interest liability can also be view from another perspective. The ultimate confirmation of the alleged suppressed interest liability came when the Corporate Insolvency Resolution Process ('CIRP') commenced against VWL on 02.02.2022, and the Resolution Professional admitted total interest claims of Rs. 124.28 Crores including prior period interest of Rs. 87.07 Crores from the consortium banks. Prima facie it indicates that the obligation on part of VWL was never waived by Bank and always existed for VWL.

93. We would now examine this aspect from Appellant's view point who pointed out that the Company's accounting treatment rested on few assumptions.

Assumption I - Since RBI's prudential norms (IRACP Norms) required the banks to stop recognising interest as income in their books once the account was classified as NPA, the Company was similarly not required to recognise or provide for interest in its books.

94. At the outset, we will put to test validity of the arguments of the Appellant vis-à-vis finding of the NFRA in order to determine Issue No. I. The Assumption I by the Appellant (as stated above) is built on a fundamental confusion between lender- side income recognition rules and borrower-side liability recognition obligations. It is the case of Appellant that both operate in conjoint manner and in fact are two sides of the same coin. However, we observe that the two operate under entirely different legal and regulatory frameworks and serve entirely different purposes.

95. We take into consideration that the applicable RBI framework is the Master Circular on Prudential Norms on Income Recognition, Asset Classification and Provisioning Pertaining to Advances (IRACP Norms), consolidated as RBI/2015-16/101 (DBR.No.BP.BC.2/21.04.048/2015-16) dated 1st July 2015 ('RBI Master Circular') (as applicable in the case of VWL at relevant time).

“Paragraph 4.2.1 of the RBI Master Circular provides:

Banks should not charge and take to income account interest on any NPA. This will apply to Government guaranteed accounts also.

The RBI Master Circular, at Paragraph 4.2.3, goes further and explicitly provides:

In case of NPAs, as a prudential norm, there is no use in debiting the said account by interest accrued in subsequent months and taking this accrued interest amount as income of

*the bank as the said interest is not being received. **It is simultaneously desirable to show such accrued interest separately or park in a separate account so that interest receivable on such NPA account is computed and shown as such, though not accounted as income of the bank.***”

(Emphasis Supplied)

96. We find this provision is of cardinal importance. The RBI not only permits but directs banks to maintain a memorandum record of accrued interest on NPA accounts precisely because the RBI itself recognises that the borrower's contractual obligation subsists. The memorandum record is the bank's internal evidence of what the borrower owes. If the RBI considered the interest to be non-existent upon NPA classification, there would be no need to track it at all. The direction to track it is the RBI's own affirmation that the liability continues.

97. It is very significant for us to take into consideration that the RBI Master Circular is a regulation under the Banking Regulation Act, 1949. It operates exclusively within the domain of banking regulation. It creates rights and obligations only between the bank (as a regulated entity) and the Reserve Bank of India (as its regulator). It creates no rights, obligations, or exemptions for the bank's borrowers. A borrower is not a regulated entity under the Banking Regulation Act, 1949, in respect of these norms.

98. The borrower's obligations are governed by the loan/facility agreement executed between the parties, the applicable Accounting Standards and the

Companies Act, 2013. We hold that none of these are affected by the RBI's IRACP norms.

99. During pleading, it was brought to our notice that the Respondent NFRA issued Circular dated 20.10.2022, in the wake of this very case, for bringing clarity to others. This reads as under :-

“It has come to the attention of the NFRA during a disciplinary action under Section 132(4) of the Act for professional misconduct of the statutory auditor of a listed company (Vikas WSP Limited), that the company in the Financial Statements of 2019-20, had discontinued accrual/recognition of interest expense on its bank borrowings, which had been reportedly classified as Non-Performing Asset (NPA) by the lender banks and for which the company was negotiating One Time Settlement with the banks. This accounting treatment was in contravention of the provisions of applicable accounting standard, as these borrowings as well the interest payable thereon continued to be the financial liabilities of the company and were required to be accounted for as amortised cost in accordance with the requirements of Indian Accounting Standard (Ind AS) 109, Financial Instruments.

100. On this issue, it is the case of the Appellants that since this was not existing earlier, their audit was in order and Impugned Orders are perverse. On the other hand, the Respondent NFRA Argued that it was only way of clarification as these principles always existed. We also find that NFRA had

not stipulated any new requirement and only reiterated the then existing correct interpretation.

101. In view of above, we do not agree with first assumption of the Appellant. We hold that the RBI Prudential Norms argument of the Appellant is legally untenable, factually misconceived, and is rejected in its entirety.

102. Assumption II - Since the Company was negotiating One Time Settlement ('OTS') with the banks and expected that interest would be waived, there was no obligation to provide for same.

103. The assumption of the Appellant on the issue of non-disclosure of interest is that since the Company was negotiating OTS and anticipated that the banks would waive the interest, there was no need to provide for it. We find that this argument and assumption fail on multiple grounds, which we are elaborating now, as detailed under:-

(i) A proposal is not a contract. An OTS negotiation is an opening of discussions, not a concluded agreement. As at 26.06.2020 i.e. the date the audit report was signed no legally binding OTS had been concluded. None of the three banks had issued any formal sanction letter, waiver deed, or legally enforceable commitment to waive interest. The same fact was confirmed by the Appellant also during the pleadings before us.

(ii) Under Section 37 and 62 of the Indian Contract Act, 1872, a contractual obligation subsists until it is performed or it is specifically waived in writing by the obligee; or the contract is novated or rescinded by mutual agreement.

A unilateral expectation of waiver by the obligor does not constitute extinguishment of the obligation.

(iii) Under Ind AS 109, Paragraph 3.3.1, a financial liability is derecognised when, and only when, 'it is extinguished i.e., when the obligation specified in the contract is discharged or cancelled or expires.' A proposal or expectation of OTS is none of these.

(iv) Under Ind AS 8 (Accounting Policies, Changes in Accounting Estimates and Errors) and Ind AS 10 (Events after the Reporting Period), only events occurring after the balance sheet date that provide evidence of conditions existing at the balance sheet date may be reflected in the financial statements. An alleged OTS concluded after 31.03.2020 cannot be used to extinguish a liability that undeniably existed on 31.03.2020.

(v) The Respondent NFRA found, and we also noticed that the EP himself admitted during the personal hearing that while he had seen the OTS proposal, he had never documented it. We are of the firm view that OTS proposal that was never documented, never sanctioned by the bank's and never legally executed cannot serve as the basis for de-recognising a financial liability of interest.

(vi) The CIRP proceedings proved this argument wrong in the most conclusive manner possible. The banks filed claims for the interest in CIRP before the IRP. If the interest had been waived even indirectly, the banks would not have filed claims. The admission of claims of Rs. 124.28 Crores

by the Resolution Professional is the final and definitive rebuttal of the OTS expectation argument.

Thus, assumption of the Appellant's also stands rejected by us in view of above detailed reasoning.

104. We note that the Indian Accounting Standard 109 — Financial Instruments ('Ind AS 109') corresponds to International Financial Reporting Standard 9 ('IFRS 9'). It is the comprehensive standard governing the recognition, classification, measurement, impairment, and derecognition of financial instruments. It became mandatorily applicable to listed companies from FY 2016- 17 onwards.

105. In this background, it is reiterated that the borrowings of VWL from its consortium banks are 'financial liabilities' within the meaning of Ind AS 32 (Financial Instruments: Presentation) — specifically, they are contractual obligations to deliver cash (repayment of principal and interest) to the lending banks. There is no dispute on this classification. Under Ind AS 109, Paragraph 4.2.1, the default and mandatory classification for financial liabilities measurement at amortised cost using the Effective Interest Method ('EIM') has been stipulated. We find that this is not optional as it applies to all unless the liability falls within specific exempted categories Fair Value through Profit or Loss (FVTPL) designation, derivatives, financial guarantees, contracts etc. (in all five clauses 4.2.1 (a) to (e) in Ind AS 109), none of which apply to VWL's term borrowings and working capital facilities as reflected in Auditing Financial

Statement for FY 2019-20 of VWL. Accordingly, measurement at amortised cost using EIM was not discretionary rather it was the only permissible accounting treatment.

106. At this stage, we will also look into the concept of ‘**Amortised cost**’, which is defined in Appendix A of Ind AS 109 as:

“The amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance.”

(Emphasis Supplied)

In other words, we can say that the amortised cost of a borrowing at any point in time equals: the initial loan amount, minus repayments made, plus accrued interest calculated at the EIR that has not yet been paid. Thus, we find that in present case the accrued interest component is precisely what VWL failed to recognise in FY 2019-20 and was overlooked or ignored by the Appellants during audit.

107. Similarly, the **Effective Interest Rate ('EIR')** is defined in Appendix A of Ind AS 109 as:

“The rate that exactly discounts estimated future cash”

payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortised cost of a financial liability. When calculating the effective interest rate, an entity shall estimate the expected cash flows by considering all the contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but shall not consider the expected credit losses....”

(Emphasis Supplied)

108. The above definition r/w other points of Ind AS 109 clarify that the EIR is calculated considering the contractual terms of the financial instrument and not the expectations of the borrower about future settlements. **The definition explicitly states that 'expected credit losses' shall NOT be considered when calculating the EIR.** This is critical as the risk that a borrower may not repay is irrelevant to the EIR calculation. The EIR is determined by contract, not by credit risk especially expected credit losses. We also need to appreciate that the EIR is fixed at the time of initial recognition. It does not change because the borrower's financial condition deteriorates or because the bank classifies the loan as NPA.

109. Thus, we hold that the arguments of the Appellant for non-reporting of interest liability, on the basis of expected credit losses is not sustainable and therefore, we are not in a position to support the Appellant on this issue.

110. We will also take efforts to understand and elaborate the Effective Interest

Method and try to see how it works and what impact it, would have made in present appeals before us. The **Effective Interest Method ('EIM')** has been discussed in Ind AS 109, Paragraph B5.4.1. The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. Under EIM, interest expense is recognised period by period by applying the EIR to the carrying amount (amortised cost) of the liability at the beginning of each period. This interest expense accrues by operation of the mathematical formula it does not require any action by the lender. We may also try to understand by simulating, in present case by way of simple illustration, that supposing, if VWL has a borrowing of Rs. 100 crores at a contractual rate of 12% per annum, the EIR would be approximately 12%. Each quarter, Rs. 3 crores of interest expense accrue as a financial liability in VWL's books by operation of Ind AS 109 regardless of whether the bank has sent a statement, regardless of whether the account is NPA, and regardless of whether VWL intends to pay it.

111. Thus, in accordance with Ind AS 109, the VWL was required to provide for full accrued interest liability and was not given choice for non-providing simply by providing Note No. 33(a)(i) in Audited Financial Statement for 2019-20. At this stage, we take into account exact wording of Note No. 33(a)(i), which reads as under:-

“The Company has been availing various export credit facilities amounting Rs.12,151.28 lacs (previous year

Rs.14128.18 lars) for Export from Punjab National Bank, Union Bank of India and Bank of India under consortium. The aforementioned credit facilities of the Company were classified as Non-Performing Assets (NPA) in June 2016. However, during the current year, The Company has repaid loan Rs. 19.76 lacs to Punjab National Bank.

In accordance with the prudential norms for banks by the Reserve Bank of India, the lender banks have not charged interest on aforementioned export credit facilities extended to the Company upon the classification of the export credit facilities of the Company as NPA. Accordingly, the Company is not making provision for interest on bank borrowings.”

(Emphasis Supplied)

112. Based on our earlier discussion, we find above Note No. 33(a)(i) does not allow the company to avoid reporting accrued interest. Similarly, the Appellants were also required to emphasise same in Audit report rather than only depending on Note No. 33(a)(i). Thus, we reject the arguments of the Appellant on these aspects.

113. It has been case of the Appellant that when a borrower like VWL is unlikely to settle his loan obligations at contractual terms, because of financial problems, expected future cash flows associated with the loan will not be according to contractual terms, but should be based on the amount at which it will be settled. The Appellant also gave reference to alleged OTS proposal of VWL to Banks. We are not inclined to accept these pleadings of the Appellant as it reveals

a fundamental and disqualifying misreading of Ind AS 109 for reasons. The EP conflates the EIR calculation methodology with the ECL (Expected Credit Loss) impairment methodology. These are two entirely separate frameworks within Ind AS 109. The EIR governs interest expense recognition. ECL governs impairment of financial assets (in the lender's books) and it has no application whatsoever to the borrower's recognition of interest expense. Further, Ind AS 109, Appendix A explicitly states that when calculating EIR, an entity 'shall not consider the expected credit losses.' The Appellant's argument that future expected settlement amounts should be substituted for contractual cash flows in EIR calculation is directly contradicted by the text of the standard. We also find that the Appellants argue that since VWL was unlikely to settle at contractual terms, the EIR were recalculated based on expected settlement amounts (OTS values). However, we hold that this is not a principle recognised anywhere in Ind AS 109. The standard provides for modification accounting only when a legal modification of the terms of the liability has been agreed and not when a borrower unilaterally expects modification or consensus by the bank.

114. We will capture relevant portion of Ind AS 109 for present issue. Under Ind AS 109, Paragraph 3.3.2, a substantial modification of an existing liability is treated as extinguishment of the old liability and recognition of a new one. For this to apply, there must be: (a) a legally concluded agreement; (b) between the debtor and creditor; (c) substantially modifying the terms. A unilateral OTS

proposal meets none of these criteria.

The exact wording of Para “3.3, 3.3.1 and 3.3.2 of Ind AS 109 reads as under :-

“3.3. Derecognition of financial liabilities

3.3.1 An entity shall remove a financial liability (or a part of a financial liability) from its balance sheet when, and only when, it is extinguished—i.e. when the obligation specified in the contract is discharged or cancelled or expires.

3.3.2 An exchange between an existing borrower and lender of debt instruments with substantially different terms shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. Similarly, a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.”

(Emphasis Supplied)

115. We will also refer to Appendix B, Para 3.3.1 of Ind AS 109 which further clarifies that a financial liability is extinguished when the debtor either discharges the liability by paying the creditor, normally with cash, other financial assets, goods or services; or is legally released from primary responsibility for the liability either by process of law or by the creditor.

116. Thus, it is crystal clear that only when legal liability of company is extinguished then only financial liability can be decognised, which is not the case. hence, we do not accept the logic of the Appellant on this issue also.

117. The Respondent's response to the argument was unequivocal and correct, and the NFRA correctly held that the Assumption of no future cash outflow on account of interest costs on the Borrowings classified as NPAs merely on the basis of a proposal for One Time Settlement is a flawed assumption. If such a rationale is accepted, then by analogy, the companies will resort to de-recognizing liabilities at will, which would lead to a systemic failure of accrual-based accounting.

This Appellate Tribunal endorses the views of the Respondent NFRA. To accept the Appellants interpretation would be to introduce a back door through which any financially distressed company could eliminate its liabilities from its balance sheet simply by proposing OTS negotiations — without ever concluding them. This would render the entire framework of financial reporting meaningless.

118. We must understand categorically that “legally released” requires an actual legal release i.e., a formally executed agreement, court order, or statutory operation. An ongoing OTS negotiation is none of these. The Appellants arguments that anticipated future OTS justifies non-recognition of current interest is, therefore, not only factually unsupported but legally impermissible under the standards of auditing.

Conclusion on Issue No. I

119. RBI's prudential norms (IRACP Norms) that stop banks from recognizing income on NPA accounts does not extinguish the borrower's legal obligation to recognize and accrue interest expense in its own financial statements.

Conclusion on Issue No. II

120. The Effective Interest Rate (EIR) method under Ind AS 109 does not allow a borrower to substitute expected One-Time Settlement (OTS) cash flows for contractual cash flows when computing interest expense on NPA-classified borrowings.

121. Issue No. III : Violation of SAs, Companies Act, 2013 and Chartered Accountant Act, 1949

122. At the outset, it is noted that SA 200 (Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing) establishes the foundational framework of every audit. Paragraph 15 of SA 200 requires the auditor to adopt a fundamental principle called “**Professional Scepticism**” which reads as under :-

“The auditor shall plan and perform an audit with professional scepticism recognising that circumstances may exist that cause the financial statements to be materially misstated.”

(Emphasis Supplied)

123. The 80.25% collapse in Finance Cost year on year was precisely the kind

of anomaly that should have triggered the highest level of professional scepticism on the part of the Appellant's. Any auditor using basic scepticism in financial analysis during audit would have identified this variance as a major red flag and demanded satisfactory explanation supported by documentation. The EP CA Som Prakash did not do so in case of audit of VWL.

124. Another bone of contentions between parties is regarding Audit Documentations. We observe that SA 230 (Audit Documentation) governs the auditor's responsibility to prepare audit documentation that provides a sufficient and appropriate record of the basis for the auditor's report. Paragraph 8 of SA 230 requires the auditor to prepare documentation that enables 'an experienced auditor, having no previous connection with the audit, to understand: (a) The nature, timing, and extent of the audit procedures performed; (b) The results of the audit procedures performed, and the audit evidence obtained; (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.' Similarly, Paragraph 10 of SA 230 requires the auditor to 'document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place.'

125. The audit file submitted by the EP CA Som Prakash was found to be devoid of: (a) any documentation of the NPA interest issue; (b) any challenge to

management's accounting treatment; (c) any record of discussions with management about the OTS; (d) any revised loan agreements; (e) any bank confirmation letters; for reducing and waiving interest liability and (f) any minutes of meetings of OTS discussion.

126. In this background of the case, we find that the EP's defence that 'audit documentation is one of the means to the process of audit' and that the 'job of an auditor must be judged on the basis of outputs, not on the basis of quality of his noting' is a complete inversion of the purpose of audit documentation. Audit documentation is not a mere formality but it is the foundation of accountability, reviewability, and reproducibility of audit conclusions. Without documentation, there is no audit and at best there is only assertion.

127. The EP also argued that his analogy between an auditor and a civil servant or judge entitled to immunity. At the outset, it is wrong to assume by the Appellant that civil servants having complete immunity. In fact civil servants are always governed by large set of rules and subject to disciplinary action and vigilance scrutiny, in any case of violations. We find the logic of the Appellant for immunity to be completely flawed and misplaced. Auditors of PIEs (already discussed earlier) owe a duty of the highest order of the investing public. Auditors are professional service providers who have accepted a responsibility to verify and certify financial information for public reliance.

128. Now, we will also issue of risk of material Misstatement as stipulate in SA 315 (Identifying and Assessing the Risks of **Material Misstatement** through

Understanding the Entity and Its Environment) which requires the auditor to identify and assess the risks of material misstatement at the financial statement level and the assertion level. The key assertions relevant to Finance Cost in VWL's financial statements are: Completeness i.e., all finance costs that should have been recognised have been recognised; and Accuracy i.e., finance costs have been correctly calculated and further that Occurrence recording finance costs actually occurred. The 80% year-on-year collapse in Finance Cost directly implicated all three assertions. An auditor having Scepticism (discussed earlier while discussing SA 200) while assessing risks under SA 315 would have identified Finance Cost as a 'significant risk' defined in SA 315, as a risk of material misstatement that, in the auditor's judgment, requires special audit consideration. The EP CA Som Prakash either, did not assess this risk at all, or assessed it and then failed to respond to it. We find both of which constitute professional misconduct.

129. We also examine SA 500 (Audit Evidence) which requires the auditor to design and perform audit procedures to obtain **sufficient appropriate audit evidence** on which to base the auditor's opinion. 'Sufficiency' is the measure of the quantity of audit evidence. 'Appropriateness' is the measure of quality. For the specific assertion of completeness of finance costs in a situation where the auditor knows the borrower has outstanding NPA classified loans, the minimum audit procedures would include inter-alia, bank confirmation letters from all three consortium banks confirming outstanding principal, accrued interest, and

interest charged; along with review of loan agreements specifying interest rates. Further, independent calculation of interest using the contractual rate/EIR (discussed earlier), with review of bank statements and review of NPA communication letters from banks would have expected from the Auditors. None of these basic procedures were documented in the audit file. The only 'evidence' the EP relied upon was an alleged Management Representation Letter 24.06.2020 from the very management who had a direct financial interest in suppressing the interest expense to show a profit.

130. It is the case of the Appellant that the EIR calculation is an accounting estimate. The decision about whether and how much interest to accrue is an accounting estimate. The assessment of whether the OTS expectation justifies non-recognition is a critical area of management judgment and the Appellant has given due respect while auditor of VWL. However, we find that the EP did not document any of these procedures. The unilateral change from recognising Rs. 21.08 crores in interest (FY 2018-19) to recognising only Rs. 4.16 crores (FY 2019-20) should have triggered an intensive SA 540 review, none was performed.

131. We have examined other SAs as discussed by the Appellant and the Respondent before us and find that these are also proved sufficiently.

132. Thus, we find that the Appellant to have violated various SAs as discussed above in addition to going through pleadings of both the Appellant and the Respondent earlier.

Companies Act, 2013

133. We will also devote some time to provisions of the Companies Act. Section 129(1) provides that Financial statements shall give a true and fair view of the state of affairs of the company, comply with accounting standards notified under section 133, and shall be in the form(s) provided in Schedule III. VWL's FY 2019-20 financial statements violated this provision by failing to present a true and fair view due to the suppression of interest liability. Section 133 stipulates that the Central Government shall prescribe the accounting standards or any addendum thereto as recommended by the ICAI in consultation with NFRA. The Indian Accounting Standards (Ind AS) are prescribed under this section via the Companies (Indian Accounting Standards) Rules, 2015. Compliance with Ind AS is accordingly statutory compliance not mere professional best practice. Similarly, Section 143(3)(e) stipulate that the auditor's report shall state whether the financial statements comply with accounting standards under Section 133. The EP's report stated compliance when there was none. Section 143(9) stipulated that every auditor shall comply with the auditing standards. This statutory obligation was violated across multiple standards as detailed above. Section 132(4)(c) mention that where professional or other misconduct is proved, NFRA shall have the power to make an order imposing monetary penalty and/or debarring the member from being appointed as an auditor or internal auditor. This is the provision under which both impugned orders were passed.

Chartered Accountant Act, 1949

134. We will take into consideration the Schedule II of Chartered Accountants Act, 1949 which describe Professional Misconduct of the Chartered Accountant with respect to present appeal. The relevant clause reads as under: -

135. Clause (5) fails to disclose a material fact: A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary to make the financial statement not misleading. The non-disclosure of the NPA interest liability was precisely such a material fact.

Clause (6) fails to report a material misstatement: A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity. The EP knew of the interest non-provision and knew it was a material misstatement.

Clause (7) does not exercise due diligence, or is grossly negligent in the conduct of his professional duties; A Chartered Accountant shall be guilty of misconduct if he fails to exercise due diligence, and is grossly negligent in the conduct of professional duties. The comprehensive failure across SA 200, SA 220, SA 230, SA 315, SA 500, SA 540, SA 570, SA 580, SA 700, SA 701, and SA 705 constitutes gross negligence in the most fundamental sense.

Clause (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;

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

Both above clauses 8 and 9 also stand proved in view of our detailed discussion on non provision of interest by failing to take sufficient information and not bringing out this material departure.

Conclusion on Issue No. III

136. Based on preceding discussion, we concur with NFRA that the Appellant have violated SAs falling under ambit of Professional Misconduct as per Schedule II of Chartered Accounts Act, 1949 as well as provision of the Companies Act, 2013.

137. Issue No. IV : Modified V/s Unmodified Audit Report :-

(a): Whether an unaccepted and undocumented OTS proposal constitutes a sufficient basis for an auditor to accept the non-recognition of a financial liability and issue an unmodified audit report.

(b): Whether, and in what circumstances, an auditor of a PIE is required to issue a modified opinion under SA 705 (Revised) — specifically, whether the

instant facts required at minimum a Qualified Opinion or an Adverse Opinion?

138. As per SAs, Audit Report can be issued by Auditors in various classification.

TYPE 1-UNQUALIFIED (CLEAN) OPINION

SA 700 (Revised) (Forming an Opinion and Reporting on Financial Statements) requires the auditor to form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework, and to express an unmodified opinion only when so satisfied.

It means the auditor found the financial statements to be true and fair in all material respects, with no significant issues, are financial statement clean with no concerns. Everything is properly stated.

TYPE 2-QUALIFIED OPINION

As per para 7(a) of SA 705 (Revised), the auditor shall express a qualified opinion when: (a) the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or (b) the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial

statements of undetected misstatements, if any, could be material but not pervasive. In other words, the accounts are broadly fine, but there are specific areas where there are problems. That problems are significant but limited in scope and assent report to be read with that caveat mind.

TYPE 3- ADVERSE OPINION

As per SA 705 (Revised), Paragraph 8, the auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements. '**Pervasive**' effects are effects that, in the auditor's judgment are not confined to specific elements, accounts, or items of the financial statements; and if so confined, represent or could represent a substantial proportion of the financial statements; or in relation to disclosures, are fundamental to users' understanding of the financial statements.

An adverse opinion is an opinion by the auditor that the financial reports contain gross misstatements and these can have material impact on the financials of the company. This indicates that these accounts do not show a true and fair picture and the problems are so widespread and fundamental that the auditor cannot simply flag one area as the entire set of financial statements is unreliable.

TYPE 4- DISCLAIMER OF OPINION

In terms of Para 9 of SA 705 (Revised), the auditor shall disclaim an opinion when the possible effect of inability to obtain sufficient appropriate audit

evidence is so material and pervasive that the auditor is unable to obtain sufficient appropriate audit evidence and accordingly is unable to express an opinion on the financial statements. A disclaimer of opinion should be expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor is unable to obtain sufficient appropriate audit evidence and is hence unable to express an opinion on the financial statements. It indicates that the Auditor cannot form any opinion at all. The management has not given adequate information, or the situation is so uncertain, that the Auditor unable to say anything useful about the financial statements.

TYPE 5- EMPHASIS OF MATTER PARAGRAPH (EOM)

The SA 706 (Revised) gives flexibility to the auditor to add supplementary paragraphs within an otherwise unmodified (clean) report, used to draw the reader's attention to something already disclosed in the financial statements that fundamental to understanding them. The inclusion of an Emphasis of Matter paragraph in the auditor's report does not affect the auditor's opinion. An Emphasis of Matter paragraph is not a substitute for: (a) a modified opinion in accordance with SA 705 (Revised) when required by the circumstances; (b) disclosures in the financial statements that the applicable financial reporting framework requires management to make; or (c) reporting in accordance with SA 570 (Revised) when a material uncertainty exists relating to events or

conditions that may cast significant doubt on an entity's ability to continue as a going concern.

139. It is the case of the NFRA that EP should have given modified opinion. We have noted the Appellant's reliance on Management Representation Letter dated 24.06.2020. We note that SA 580 (Written Representations) requires written representations from management as part of the audit evidence. Paragraph 6 requires such representations to be in the form of a representation letter addressed to the auditor. We find the Management Representation Letter ('MRL') dated 24.06.2020 relied upon by the EP was found to be fatally defective: (a) it was not on the letterhead of VWL; (b) the name and designation of the signing authority were not mentioned; (c) it contained a provision referring to inventory records as on 30.09.2020 — three months after the date of the MRL. This chronological impossibility means the MRL was either back-dated after 30.09.2020 or was prepared in haste and contained errors. Either way, it is unreliable. The EP's complete silence on the MRL anomaly in his reply to the SCN was treated by NFRA correctly.

Looking from other perspective, it can be said that a defective, unreliable, and chronologically impossible MRL is worse than no MRL at all — it actively misleads the auditor into a false sense of security. An auditor who relies on such an MRL as the primary basis for not qualifying a material misstatement has fundamentally failed in his professional duty.

140. It is noted that the EP formed and expressed an unmodified opinion in the following terms in the Audit Financial Statement of VWL for FY 2019-20:-

“In our opinion and to the best of our information and according to the explanations given to us, the aforesaid standalone financial statements give the information required by the Companies Act, 2013 ('the Act') in the manner so required and give a true and fair view in conformity with the Indian Accounting Standards prescribed under section 133 of the Act read with the Companies (Indian Accounting Standards) Rules, 2015, as amended, ('Ind AS') and other accounting principles generally accepted in India, of the state of affairs of the Company as at March 31, 2020, and its profit, total comprehensive income, its cash flows and the changes in equity for the year ended on that date.”

(Emphasis Supplied)

141. In the present case, the auditor certified that the financial statements gave a 'true and fair view.' In this regard, it is reiterated that Financial statements that overstate PBT by 88% through omission of a contractually accruing financial liability cannot give a 'true and fair' certificate by any stretch of any professional standard and potential hidden misstatement could be both material and pervasive.

142. We have already examined and noted earlier that the NPA interest misstatement affected: (a) Finance Costs in the P&L — understated by at least Rs. 16.91 crores; (b) Current Liabilities in the Balance Sheet — understated by

the same amount; (c) Profit Before Tax — overstated by 88%; (d) Profit After Tax — correspondingly overstated; (e) Retained Earnings — overstated; (f) Net Worth — overstated. The misstatement was not confined to a single line item. It permeated the profit and loss account, the balance sheet, and the statement of changes in equity simultaneously.

Conclusion on Issue No. IV

143. Thus, in given circumstances, the EP could have considered modified opinion like an Adverse Opinion or a Qualified Opinion but the EP issued neither and rather issued unmodified opinion which was not correct on the part of the Appellant.

144. Issue No. V: Appointment of EQCR; Whether appointing an Engagement Quality Control Reviewer (EQCR) is mandatory for the audit of a listed entity under SA 220.

145. Now we will review aspect of EQCR as Mandatory for listed entities.

146. We note that the Appellant has submitted that EP's failure to appoint an EQCR, though noncompliance of Para 19 of SA 220, did not constitute professional misconduct, because it was not a "material departure from generally accepted audit procedures", as no case of serious omissions or quality issue on the true and fair view of the financial statements was brought up.

147. On the other hand, NFRA submitted that as per the standards on auditing, which are statutory in nature, the firm and the engagement partner were makers

of the audit report and the EQCR was the reviewer. Both the maker and the reviewer would have to be in tandem for the audit report to be finalized. NFRA further stated that the Standard on Auditing (SA) 220 paras 19 to 21 requires the EQCR to evaluate the significant judgments made by the engagement team and conduct review of the financial statements and the proposed auditor's report, thus the EQCR is involved in the audit process and without a review and green signal by the EQCR, the audit cannot be concluded/completed.

148. We note that SA 220 (Quality Control for an Audit of Financial Statements) addresses the specific responsibilities of auditors in relation to quality control procedures for audits of financial statements. Paragraph 19(a) of SA 220 clearly stipulated that for audits of financial statements of listed entities, and those other audit engagements, if any, for which the firm has determined that an engagement quality control review is required, the engagement partner shall not sign the audit report until the engagement quality control reviewer has completed the review. This provision is unambiguous. For a listed entity which VWL undeniably is an Engagement Quality Control Review ('EQCR') is mandatory before the audit report could have been signed by the EP CA Som Prakash. There is no exception, no carve-out, and no discretion.

149. We are of the view that the purpose of EQCR is precisely to prevent the kind of **failure by way of a second qualified professional reviewing the key judgments of the engagement partner** before the report is signed. In present

case we observe that if EQCR would have been there, perhaps he would likely have identified the material issue continued of NPA, interest non-recognition and required it to be addressed. The absence of EQCR removed this vital safeguard.

Conclusion on Issue No. V

150. The Appellant was required to have appointed EQCR, which is mandatory requirement for listed companies like VWL in terms of SA 220.

151. **Issue No. VI: Authority of Standards on Auditing (SAs) Whether SAs issued by the ICAI are mandatory requirements binding on every statutory auditor or if they are merely "guiding principles" allowing unlimited professional discretion.**

152. It is the case of the Respondent/ NFRA that Ind AS & SAs are binding on all companies and Auditor respectively and carry legal force in Companies Act, 2013. On the other hand, the Appellant's fairly conceded that, Ind AS & SAs are mandatory but submitted that these Ind AS & SAs also provide reasonable flexibilities for companies and Auditors to exercise their discretion in accordance with Ind AS and SA. The Appellant particularly argued that as Auditor, they have been given choice of adopt particular line in given circumstances.

153. The Appellants contend that Standards on Auditing represent a set of principles affording discretion to auditors, and that an auditor cannot be faulted for adopting alternative approaches consistent with the underlying principles.

This seems to be non-convincing as Section 143(9) of the Companies Act, 2013 provides in unambiguous terms that 'Every auditor shall comply with the auditing standards.' The word 'shall' is a term of mandate, not permission. It has been brought out during pleadings by NFRA that the present-day standard setting has undergone a paradigm shift wherein sufficient application guidance and other explanatory material is available in SAs and Ind AS apart from the principles of the standards, which are required to be mandatorily followed.

154. We note that paragraph 18 of SA 200 provides: 'The auditor shall comply with all SAs relevant to the audit.' The Appellants position that SAs are 'principles' and not 'thumb rules' was rejected by NFRA and is rejected by this Appellate Tribunal also. Section 143(9) of the Companies Act, 2013 imposes a statutory obligation in absolute terms: 'Every auditor shall comply with the auditing standards.' The word 'shall' in legal drafting signifies a mandatory requirement admitting no discretion. This was settled by us in case of **Harish Kumar TK (Supra)** which has been upheld by the Hon'ble Supreme Court in Appeal No. 2024 SCC OnLine SC 3687.

Conclusion on Issue No. VI

155. SAs are binding and mandatory and every auditor is required to follow the same.

156. Issue No. VII:-Proportionate of Penalty: Whether the sanctions imposed — Rs. 3,00,000/- penalty and 3-year debarment — are proportionate to the gravity of the proved misconduct?

157. On proportionality, we find that NFRA has the power under Section 132(4)(c) of the Companies Act, 2013 to impose penalties up to Rs. 10,00,000/- on an individual auditor and to debar for up to 10 years. The penalties actually imposed is Rs. 3,00,000/- and 3 years debarment for the individual and Rs. 5,00,000/- for the firm are at the lower end of the spectrum. They are proportionate to the gravity of misconduct and the signalling value required to deter similar conduct by other auditors of listed companies. We find the penalties imposed are at the lower-to-middle range of what NFRA could have imposed. NFRA explicitly applied the principles of deterrence, proportionality, and signalling value. We find that the sanctions are proportionate to the gravity of the misconduct i.e. issuing an unmodified opinion on statements that overstated PBT by 88% and the public interest dimension as VWL is a listed company whose investors relied on the audited financial statements. It is also a fact that this the systemic impact which made the NFRA Circular in consequence of this case has set a standard for all stakeholders and finally the need for deterrence that the auditors of listed companies must need to be more careful else professional misconduct may result in consequence of penalties. For all the

foregoing reasons, this Appellate Tribunal finds no merit in either of the appeals filed by the Appellants on the issue of quantum of penalty.

Conclusion on Issue No. VII

158. We find penalty imposed on the Appellant as reasonable and proportionate to professional misconduct.

Company Appeal (AT) No. 177 of 2024

159. Now we will deal with the Firm's Obligations for which separate impugned order was issued on 23.04.2024. We frame following issues for determination focus on critical accounting and auditing standards in case of the firm in Company Appeal (AT) No. 177 of 2024.

Issue No. I: Whether an audit firm is independently and primarily liable for quality control failures under SQC 1, separate and distinct from the EP's individual liability under Standards on Auditing?

Issue No. II: Whether having an SQC 1 policy document in place is sufficient to discharge the Firm's quality control obligations, or whether the Firm must also ensure the policy is actually implemented?

Issue No. III: Whether the Firm's contention that only the EP is accountable for audit non-compliance — and that the Firm is only responsible for formulating the SQC 1 policy — is legally correct?

Issue No. IV: Whether non-compliance with SA 220 (EQCR), SA 230 (documentation), SA 260 (TCWG communication) and SA 315 (risk assessment) by the EP attracts liability on the Firm under SQC 1?

Issue No. V: Whether proceeding against the Firm after already penalising the EP for the same underlying audit deficiencies constitutes double jeopardy prohibited under law? Whether NFRA could have issued SCN and impugned order to firm at later stage?

Issue No. VI Whether the penalty of Rs. 5,00,000/- on the Firm is proportionate and whether a higher penalty in firm than the individual EP penalty is justified?

160. Now we will deal these issues in the following discussion.

161. **Issue No. I: Whether an audit firm is independently and primarily liable for quality control failures under SQC 1, separate and distinct from the EP's individual liability under Standards on Auditing?**

Issue No. II: Whether having an SQC 1 policy document in place is sufficient to discharge the Firm's quality control obligations, or whether the Firm must also ensure the policy is actually implemented?

Issue No. III: Whether the Firm's contention that only the EP is accountable for audit non-compliance — and that the Firm is only responsible for formulating the SQC 1 policy — is legally correct?

Issue No. IV: Whether non-compliance with SA 220 (EQCR), SA 230 (documentation), SA 260 (TCWG communication) and SA 315 (risk assessment) by the EP attracts liability on the Firm under SQC 1?

162. Since all above issues are inter-linked, inter-connected and inter dependent, we shall deal all these issues in conjoint manner in the following discussions.

163. We note that Standards on Quality Control 1 (SQC 1) (Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements) establishes standards and provides guidance on a firm's responsibilities for its system of quality control for audits and reviews. Paragraphs 7 and 8 of SQC 1 require a firm to establish and maintain a system of quality control that provides reasonable assurance that the firm and its personnel comply with professional standards and applicable legal and regulatory requirements and reports issued by the firm or engagement partners are appropriate in the circumstances.

164. We find from Impugned Order that the Respondent NFRA's order against the Firm found the systemic failures like failure to ensure EQCR was conducted for a listed entity audit, a failure at the 'Engagement Performance' quality control level, failure to ensure adequate audit documentation, failure at the 'Engagement Performance' level, Failure to ensure the EP had adequate competence in Ind AS and failure to observe SAs applicable to listed entities. Failure to maintain and

implement firm-wide quality control policies that would have prevented an unmodified opinion by EP on materially misstated financial statements of a listed company, as already discussed in detail while discussion in Company Appeal (AT) No. 200 of 2022.

165. It needs to be appreciated that the audit Firm was primarily responsible for establishing and maintaining a system of quality control to ensure that the firm and its personnel comply with professional standards and regulatory and legal requirements; and the reports issued by the firm or engagement partners are appropriate in the circumstances.

166. We consciously note that the scheme of the Companies Act, 2013, SAs as well as NFRA Rules, 2018 imposes obligation upon the firm to undertake audit in compliance with the relevant statutes. It is significant to take note that Companies Act, 2013 stipulates penalty upon the firm also in case of any non-compliance/professional misconduct.

167. We note that the firm named S Prakash Aggarwal & Co., was appointed as the statutory auditor of VWL under section 139 of the Act and it is the firm which is overall accountable for EP's duties and responsibilities under section 143 of the Act, including compliance with SAs. The Appellant firms contentions that the firm's responsibility is only limited to establish a system of quality control is not correct because Para 2 of SA 220 read with Para 3 of SQC1 requires the Firm to not only have an SQC-1 policy but also to 'reasonably assure' that the firm and its personnel comply with professional standards, legal and

regulatory requirements and that the reports issued by the firm or the EP are appropriate in the circumstances.

168. The contentions of the Appellant firm that non-compliance of SAs would not constitute professional misconduct is flawed. In the instant case, it was the audit firm that was appointed as auditor of the company u/s 139 of the Companies Act, 2013. Further, Section 143(9) of the Companies Act, 2013 mandates that every auditor shall comply with auditing standards. As already noted these auditing standards provide essential guidelines and principles for conducting audits, ensuring reliability and integrity of the financial statements. Non-compliance with auditing standards undermines the fundamental principles of professional misconduct and the integrity of financial reporting. Such breaches can directly impact the quality and reliability of audit reports, potentially misleading stakeholders and damaging public trust, thereby warranting disciplinary actions. The firm, as the appointed auditor, remains responsible for any professional misconduct committed by the individuals who perform the audits on behalf of the firm.

Conclusion on Issue No. I

169. We hold that an audit firm is independently and primarily liable for quality control failures under SQC 1, separate and distinct from the EP's individual liability under Standards on Auditing.

Conclusion on Issue No. II

170. We hold that the firm having an SQC 1 policy document in place is not sufficient to discharge the Firm's quality control obligations, and the Firm must also ensure the policy is actually implemented.

Conclusion on Issue No. III

171. We find that the Firm's contention that only the EP is accountable for audit non-compliance and that the Firm is only responsible for formulating the SQC 1 policy is legally not correct and impermissible.

Conclusion on Issue No. IV

172. We are of view that non-compliance with SA 220 (EQCR), SA 230 (documentation), SA 260 (TCWG communication) and SA 315 (risk assessment) by the EP attracts liability on the Firm under SQC 1.

Issue No. V: Whether proceeding against the Firm after already penalising the EP for the same underlying audit deficiencies constitutes double jeopardy prohibited under law? Whether NFRA could have issued SCN and impugned order to firm at later stage.

173. Now we will examine the contentions of the Appellant that there is no provision in law for punishing both the EP and the Appellant as audit firm on the same allegations of professional misconduct and that it is a case of **double jeopardy**. At the outset, we hold that the firm, as a legal entity, has a continuous

obligation to establish and maintain quality control systems, as mandated by auditing standards and regulatory requirements. These quality control systems are designed to ensure that the firm and its personnel comply with professional standards and regulatory obligations. Therefore, the firm cannot evade responsibility for any deficiencies in its quality control systems or failure to enforce compliance with auditing standards. The Firm, the EP and the EQCR are jointly and severally responsible for professional misconduct observed during an audit. The scheme of Companies Act, 2013, SAs, Ind AS read with NFRA rules specifically impose obligations on individual auditors as well as the firm.

174. The obligations of the Firm which can be exercised with reference to the SAs. Prima facie for an audit assigned, both the auditor as well as the firm shall be made responsible, even though there may be an overlap. As per SA 220, the responsibility of each engagement is assigned to the EP and who carries out the audit following the relevant SAs applicable and also in line with the quality policies of the Firm. Similarly, Para A1 of SA 220, SQC 1 deals with the firm's responsibilities to establish and maintain its system of quality control for audit engagements. The system of quality control includes policies and procedures that address each of the elements like Leadership responsibilities for quality within the firm; relevant ethical requirements; Acceptance and continuance of client relationships and specific engagements; Human resources; Engagement performance; and Monitoring. Further, Standard on Quality Control (SQC) 1 delineates the responsibilities of the Firm regarding audit quality. Audit quality is

the foundation of any statutory audit. SQC - 1 lays down these core principles a Firm must adhere to ensure minimum required quality in any audits undertaken at the firm level. Further, SAs, such as SA 200, SA 220, SA 230, SA 260 (Revised), SA 610(Revised), SA 620 and SA 700(Revised) refer to SQC-1 when it comes to specific aspects of audit such as documentation, communication with those charged with governance, engagement of Auditor's expert, evaluating the adequacy of internal audit function of the Company, and general quality aspects.

Para 3 of SQC-1 reads as under:

"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 firm or engagement partner(s) are appropriate in the circumstances".

(Emphasis supplied)

175. We find the issue whether the firms are vicariously liable for the misconduct by its partners or not and whether the NFRA can penalise both the firm and its partner, is no longer res integra.

176. We would like to refer to two supportive judgements in case of Deloitte i.e. one by Hon'ble Supreme Court and one by Delhi High Court, which are relevant to present appeals. These judgements reads as under:

A.) 2025 SCC OnLine Del 641 - Deloitte Haskins & Sells LLP Versus Union of India and Another

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 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.

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 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.**

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.

B.) Union of India v. Deloitte Haskins & Sells LLP, (2023) 8 SCC 56

113. Now so far as another submission that Section 140(5) is violative of Article 14 of the Constitution of India and discriminates against the auditors unfairly in comparison to similarly placed alleged perpetrators, such as Directors, management, etc. It is required to be noted that the role of auditors cannot be equated with Directors and/or management. Auditors play very important role in the affairs of the company and therefore they have to act in the larger public interest and all other stakeholders including investors, etc. Chapter X of the Act is specifically for the "Audit and Auditors" looking to the importance of the auditors. Therefore, Section 140(5) cannot be said to be discriminatory and/or violative of Article 14 of the Constitution of India.

114. Now so far as the submission that the penalty in the form of automatic disqualification of auditors and of the entire firm including partners and that too for a period of five years to become the auditor of any other company is highly disproportionate is concerned, it is ultimately for the legislature/Parliament to provide the debarment. On the principle of joint and several liability, the auditors and the entire firm including partners shall be liable and therefore can be subjected to Section 140(5) and the consequences mentioned in Section 140(5) of the 2013 Act. So far as the

submission that the disqualification is akin to civil death and Section 140(5) impinges upon BSR and its partners' fundamental right to carry on its profession, as guaranteed under Article 19(1)(g) of the Constitution is concerned, nobody can be permitted to say that despite acting fraudulently, directly or indirectly, they had a right to continue and/or carrying on their profession. Acting in a fraudulent manner, directly or indirectly, by an auditor is a very serious misconduct and therefore the necessary consequence of indulging into such fraudulent act shall follow.

(Emphasis supplied)

177. We find above conclusions very relevant to settle the principle of vicarious liability of the EP and the firm. We are of very clear opinion and considered view that it is the firm which has to take higher responsibility and consequently higher obligations and consequences including penalties. By no stretch of imagination, the Appellant firm in present case, can separate itself from the conduct of the EP. Thus, we firmly conclude that the firm and the EP both were responsible and rightly dealt by NFRA by two different Impugned Orders, holding them guilty of professional misconduct.

178. In this connection we have taken into consideration the Appellants arguments that the Firm's liability under SQC 1 is independent of and not co-extensive with the EP's individual liability under the SAs. On the other hand, it is the case of the Respondent that the Firm is not merely vicariously liable for

the EP's failures — it bears primary, independent liability for failing to establish and implement the institutional safeguards that would have prevented those failures. The Respondent explained that penalty of Rs. 5,00,000/- against the Firm — higher than the penalty of Rs. 3,00,000/- against the individual EP — correctly reflects this principle. We also find the Firm as an institution bears a heavier responsibility for systemic quality control than the individual engagement partner for engagement-level failures.

179. The Appellant firm alleged that the show cause notice to the firm was issued after 15 months as an afterthought, by NFRA. We note that the Respondent-NFRA issued a Show Cause Notice (SCN) under Rule 11(1) of the NFRA Rules, to the Engagement Partner on 29.06.2022. We also note that post giving opportunity of hearing to the EP, on 12.09.2022 NFRA passed an order under Section 132(4) of Companies Act, 2013 imposing a penalty of Rs. 3 Lakhs and 3-year debarment against the Engagement Partner. We also take into consideration the arguments of NFRA that, nowhere in the Companies Act, 2013 or NFRA Rules, limitation period has been provided for the issuance of show cause notice. NFRA referred to observation by the Hon'ble Supreme Court in the judgement in the case of ***M/S North Eastern Chemicals Industries (P) Ltd. & Anr Vs M/S Ashok Paper Mill (Assam) Ltd. & Anr.*** Civil Appeal No. 2669 of 2013, where it was held that in cases where no limitation is given in any statute for an act to be done as such, as the present one, any such urgency may be absent

and statutory remedies if availed in a reasonable time will uphold the purport of the act. Relevant portion of the judgement is reads as under:

“27. When a statute, either general or specific in application, provides for a limitation within which to file an appeal, the parties interested in doing so are put to notice of the requirement to act with expedition. However, opposite thereto, in cases such as the present one where neither statute provides for an explicit limitation, such urgency may be absent. While it is still true that, as held in Ajaib (supra), this does not entitle parties to litigate issues decades later, however shorter delays, in such circumstances, would not attract delay and laches.”

180. NFRA further submitted that initially, the proceedings focused solely on the EP, based on his individual responsibilities under the Standards on Auditing, however, as the proceedings progressed, it became evident to NFRA that the Firm had also failed to discharge its responsibilities under SQC 1, particularly in ensuring that audits of listed companies were subject to EQCR, indicating systemic failure of the Firm’s quality control mechanisms, not just an isolated lapse by the EP. As per SQC 1, it is the responsibility of the Audit Firm to establish policies and procedures that provide reasonable assurance that both the Firm and its personnel comply with professional standards and applicable regulatory requirements.

181. To examine the issue, we take into consideration, Paragraph 70 of SQC 1 which clarifies that the EQCR is not to be selected by the EP. The appointment

of the EQCR is a responsibility the Audit Firm, as part of its obligation to maintain an independent and effective system of quality control. Paragraph 70 of SQC 1 reads as under:

“70. The firm’s policies and procedures are designed to maintain the objectivity of the engagement quality control reviewer. For example, the engagement quality control reviewer:

(a) Is not selected by the engagement partner;

(b) Does not otherwise participate in the engagement during the period of review;

(c) Does not make decisions for the engagement team; and

(d) Is not subject to other considerations that would threaten the reviewer’s objectivity”

(Emphasis supplied)

182. We note contention of NFRA that the alleged delay in issuing the SCN to the Firm did not arise from the EP’s response, nor was it a reactive measure. It was a result of the sequential and evolving evaluation of responsibilities arising during the course of the proceedings. NFRA further elaborated that at the time of issuance of the Penalty Order against the EP on 12.09.2022, the Executive Body of NFRA had not yet made a legal determination regarding the Firm’s systemic role under SQC 1. It was further the case of NFRA that it was only upon further scrutiny of the same underlying facts, it became necessary to initiate

proceedings against the Firm, albeit at a later stage. The NFRA further argued that the regulator's obligation is continuing and dynamic and submitted that during the course of proceedings, it becomes apparent that further parties including the Firm bear regulatory responsibility. The Respondent stated that it is incumbent upon NFRA to take action, even if some delay occurs in the process was failure to do so would amount to abdication of statutory responsibilities.

183. We observe that logically, NFRA should have issued SCN, both to EP and the firm, simultaneously. It does not make sense for NFRA to issue SCN and subsequently impugned order to the firm at such later stage. Having noted this, we do find merit in the contentions of NFRA that being New Regulatory Body, it is also evolving. We also find logic in NFRA's submission that the whole process is dynamic. We also take into consideration that charges against the EP and the firm are proved beyond doubt. Moreover, we do not find any prejudice caused to the Appellant firm on account of this gap of SCN and impugned order between EP and the firm. In view of this, we are not inclined to accept arguments of the Appellant firm on this account. However, we would like to advise NFRA, without prejudice, to consider that in future such gap is avoided. We rest at this stage on this issue.

Conclusion on Issue No. V

184. We hold that the proceeding against the firm after already penalising the EP for the same underlying audit deficiencies does not constitute double jeopardy and is not prohibited under law. We further hold that NFRA could have

issued SCN and Impugned Order to firm, even at later stage although it is advisable for the NFRA to avoid such gap in future.

185. Issue No. VI Whether the penalty of Rs. 5,00,000/- on the Firm is proportionate — and whether a higher penalty in firm than the individual EP penalty is justified?

186. On proportionality, we find that NFRA has the power under Section 132(4)(c) of the Companies Act, 2013 to impose penalties up to Rs. 10,00,000/- on an individual auditor and to debar for up to 10 years. The penalties actually imposed is Rs. 3,00,000/- and 3 years debarment for the individual and Rs. 5,00,000/- for the firm are at the lower end of the spectrum. They are proportionate to the gravity of misconduct and the signalling value required to deter similar conduct by other auditors of listed companies. We note that section 132(4)(c) of Companies Act empowers NFRA to decide quantum of penalties. We find the penalties imposed are at the lower-to-middle range of what NFRA could have imposed. NFRA explicitly applied the principles of deterrence, proportionality, and signalling value. We find that the sanctions are proportionate to the gravity of the misconduct i.e. issuing an unmodified opinion on statements that overstated PBT by 88% and the public interest dimension as VWL is a listed company whose investors relied on the audited financial statements. It is also a fact that this the systemic impact which made the NFRA Circular in consequence of this case has set a standard for all stakeholders and

finally the need for deterrence that the auditors of listed companies must need to be more careful else professional misconduct may result in consequence of penalties.

Conclusion on Issue No. VI

187. We hold that the penalty of Rs. 5,00,000/- on the Firm is proportionate and higher penalty on the Appellant firm than the individual EP penalty is justified.

Final Conclusions

188. For all the foregoing reasons, this Appellate Tribunal finds no merit in either of the appeals filed by the Appellants.

189. Before parting the case, we would like to emphasize that the statutory audit is not a ceremonial exercise. For a listed company with thousands of public shareholders, institutional investors, and bank creditors relying on the audited financial statements, the audit is the primary safeguard against financial misrepresentation. When that safeguard fails, as it did here, the consequences extend far the company itself as it undermine public confidence in financial markets. In this backdrop, the Engagement Partner and the Firm bear a heightened responsibility to discharge their duties with utmost diligence and integrity so as to preserve and reinforce public confidence.

190. Both appeals are accordingly dismissed. Any penalty amounts deposited

by the Appellants pursuant to the Appeals, shall be adjusted against the outstanding penalty amounts. No order as to the cost. Pending, I.A. if any, stand closed.

191. Finally, this Tribunal records its appreciation, for valuable assistance provided to us during hearing by CA CV Sajan for the Appellants and Shri Zoheb Hossain, ably assisted by Shri Satyam, for their painstakingly efforts in expanding their arguments necessary for our judgment.

[Justice Mohammad Faiz Alam Khan]
Member (Judicial)

[Mr. Naresh Salecha]
Member (Technical)

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