BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

**Order Reserved on: 04.04.2019**

**Date of Decision : 09.09.2019**

**Appeal No. 6 of 2018**

1. Price Waterhouse & Co. now known as Price Waterhouse & Co. Bangalore LLP, a partnership firm registered with the Institute of Chartered Accountants of India bearing Registration No. 007567S/S200012
   5th Floor, Tower D, The Millennia,
   #1 & 2 Murphy Road, Ulsoor,
   Bangalore - 560008.

2. Price Waterhouse & Co. now known as Price Waterhouse & Co. Chartered Accountants LLP, a partnership firm registered with the Institute of Chartered Accountants of India bearing Registration No. 304026E/E300009.
   Plot No. Y-14, Block EP, Sector V, Salt Lake, Electronics Complex, Bidhan Nagar,
   Kolkata - 700091.

3. M/s. Lovelock & Lewes, a partnership firm registered with the Institute of Chartered Accountants of India bearing Registration No. 301056E
   Plot No. Y-14, Block EP, Sector V, Salt Lake, Electronics Complex, Bidhan Nagar,
   Kolkata - 700091.

4. M/s. Lovelock & Lewes now known as Lovelock & Lewes LLP, a partnership firm registered with the Institute of Chartered Accountants of India bearing Registration No. 116150W/W100032.
   252, Veer Savarkar Marg, Shivaji Park, Dadar (West), Mumbai - 400 028.

5. Price Waterhouse, a partnership firm registered with the Institute of Chartered Accountants of India bearing Registration No. 301112E.
Plot No. Y-14, Block EP, Sector V, Salt Lake, Electronics Complex, Bidhan Nagar, Kolkata - 700091.

6. Price Waterhouse now known as Price Waterhouse Chartered Accountants LLP, a partnership firm registered with the Institute of Chartered Accountants of India bearing Registration No. 12754N/N500016.
Sucheta Bhawan, 11A Vishnu Digambar Marg, New Delhi - 110002.

7. Price Waterhouse & Co., a partnership firm registered with the Institute of Chartered Accountants of India bearing Registration No. 50032S.
8th Floor, Prestige Palladium Bayan, 129-140, Greams Road, Chennai, Tamil Nadu 600006.

8. Price Waterhouse & Co. now known as Price Waterhouse & Co. LLP, a partnership firm registered with the Institute of Chartered Accountants of India bearing Registration No. 016844N/N500015.
Sucheta Bhavan, 1st Floor, 11-A, Vishnu Digambar Marg, New Delhi - 110002.

9. M/s. Dalal & Shah now known as Dalal & Shah LLP, a partnership firm registered with the Institute of Chartered Accountants of India bearing Registration No. 102020W/W100040.
1701, 17th Floor, Shapath V, Opp. Karnavati Club, S. G. Highway, Ahmedabad 380051, Gujarat.

10. M/s. Dalal & Shah now known as Dalal & Shah Chartered Accountants LLP, a partnership firm registered with the Institute of Chartered Accountants of India bearing Registration No. 102021W/W100110.
252, Veer Savarkar Marg, Shivaji Park,
Dadar (West), Mumbai - 400028. …Appellants

Versus

Securities and Exchange Board of India
SEBI Bhavan, Plot No. C-4A, G Block,
Bandra Kurla Complex, Bandra (East),
Mumbai - 400 051. …Respondent

Mr. Mukul Rohatgi, Senior Advocate with Mr. Janak Dwarkadas, Senior Advocate, Mr. Somasekhar Sundaresan, Mr. Zerick Dastur, Ms. Archana Uppuluri, Mr. Kunal Kothary, Ms. Palak Agrawal, Mr. Khushil Shah, Ms. Ruby Singh Ahuja and Mr. Anupam Prakash, Advocates i/b Zerick Dastur Advocates & Solicitors for the Appellants.

Mr. Ravi Kadam, Senior Advocate with Mr. Kevic Setalvad, Senior Advocate, Mr. Jayesh Ashar, Mr. Mihir Mody, Ms. Shreya Parikh, Mr. Sushant Yadav and Mr. Tabish Mooman, Advocates i/b K. Ashar & Co. for the Respondent.

**WITH**
**Appeal No. 7 of 2018**

Price Waterhouse, Bangalore,
a partnership firm registered with the Institute of Chartered Accountants of India bearing Registration No. 007568S.
5th Floor, Tower D, The Millennia,
1 & 2 Murphy Road, Ulsoor,
Bangalore - 560008. …Appellant

Versus

Securities and Exchange Board of India
SEBI Bhavan, Plot No. C-4A, G Block,
Bandra Kurla Complex, Bandra (East),
Mumbai - 400 051. …Respondent

Mr. Shyam Mehta, Senior Advocate with Mr. Zerick Dastur, Ms. Archana Uppuluri, Mr. Kunal Kothary, Ms. Palak Agrawal and Mr. Khushil Shah, Advocates i/b Zerick Dastur Advocates & Solicitors for the Appellant.

Mr. Ravi Kadam, Senior Advocate with Mr. Kevic Setalvad, Senior Advocate, Mr. Jayesh Ashar, Mr. Mihir Mody, Ms. Shreya Parikh, Mr. Sushant Yadav and Mr. Tabish Mooman, Advocates i/b K. Ashar & Co. for the Respondent.

**WITH**
**Appeal No. 190 of 2018**

S. Gopalakrishnan
LH5, 1404, Lanco Hills,
Manikonda, Rajendra Nagar,
Hyderabad - 500 089. …Appellant

Versus

Securities and Exchange Board of India
SEBI Bhavan, Plot No. C-4A, G Block,
Bandra Kurla Complex, Bandra (East),
Mumbai - 400 051. …Respondent

Mr. Gaurav Joshi, Senior Advocate with Mr. R. Sudhinder, Ms. Prerana Amitabh and Ms. Vatsala Pant, Advocates i/b Argus Partners for the Appellant.

Mr. Ravi Kadam, Senior Advocate with Mr. Kevic Setalvad, Senior Advocate, Mr. Jayesh Ashar, Mr. Mihir Mody, Ms. Shreya Parikh, Mr. Sushant Yadav and Mr. Tabish Mooman, Advocates i/b K. Ashar & Co. for the Respondent.

**AND**
**Appeal No. 191 of 2018**

Srinivas Talluri
Flat No. 4B, Macherla Apartments,
6-3-1218/6, Umanagar, Begumpet,
Hyderabad - 500 016. …Appellant

Versus

Securities and Exchange Board of India
SEBI Bhavan, Plot No. C-4A, G Block,
Bandra Kurla Complex, Bandra (East),
Mumbai - 400 051. …Respondent

Mr. Mustafa Doctor, Senior Advocate with Mr. R. Sudhinder, Ms. Prerana Amitabh and Ms. Vatsala Pant, Advocates i/b Argus Partners for the Appellant.

Mr. Ravi Kadam, Senior Advocate with Mr. Kevic Setalvad, Senior Advocate, Mr. Jayesh Ashar, Mr. Mihir Mody, Ms. Shreya Parikh, Mr. Sushant Yadav and Mr. Tabish Mooman, Advocates i/b K. Ashar & Co. for the Respondent.

CORAM : Justice Tarun Agarwala, Presiding Officer
Dr. C. K. G. Nair, Member

Per : Justice Tarun Agarwala, Presiding Officer

1. In this group of appeals, the appellants have questioned the legality and veracity of the impugned order passed by the Whole Time Member (hereinafter referred to as, 'WTM') of Securities and Exchange Board of India (hereinafter referred to as, 'SEBI') under Sections 11 and 11B of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as, 'SEBI Act') which empowers

SEBI to issue directions in the nature of remedies in the interest of the securities market and investors in securities.

2. The WTM held that:-

(i) Entities / firms practicing as Chartered Accountant (CA) in India under the brand and banner of Price Waterhouse (PW) shall not directly or indirectly issue any certificate of audit of listed companies, compliance of obligations of listed companies and intermediaries registered with SEBI under the applicable laws for a period of two years.

(ii) Individual auditors, namely, S. Gopalakrishanan and Srinivas Talluri, shall not issue an audit certificate or any certificate of compliance with respect to a listed company for a period of three years.

(iii) Gopalakrishanan, Talluri and M/s. Price Waterhouse Bangalore shall jointly and severally disgorge the wrongful gains of Rs. 13,09,01,664/- alongwith interest @ 12% p.a. from January 7, 2009 till the date of payment.

(iv) Listed companies and intermediaries registered with SEBI shall not engage any audit firm forming part of Price Waterhouse network for issuing any certificate with respect to compliance of statutory obligations which SEBI

is competent to administer and enforce, under various laws for a period of two years.

3. Even though, separate appeals have been filed against a common order we have clubbed all these appeals and are being decided together by a common order.

4. Appeal No. 6 of 2018 has been filed by Price Waterhouse & Co. alongwith nine other Chartered Accountant (CA) firms under the banner "Price Waterhouse" (PW). Appeal No. 7 of 2018 has been filed by Price Waterhouse, Bangalore. Appeal No. 190 of 2018 has been filed by S. Gopalakrishnan and Appeal No. 191 of 2018 has been filed by Srinivas Talluri.

5. The facts leading to the filing of the aforesaid appeals are that PW Bangalore was given the audit for auditing the books of accounts of Satyam Computers Services Limited (hereinafter referred to as "SCSL"). The engagement partner for the audit of SCSL for the period 2000-07 was S. Gopalakrishnan and for the financial year 2007-08 which was extended till September 2008, the engagement partner was Srinivas Talluri.

6. SCSL was regarded as one of the top IT outsourcing firms in the world. The Company had won numerous awards and accolades

including in the areas of its internal audit and corporate governance. SCSL was admired as one of India's multinational companies. SCSL was also listed in the New York Stock Exchange in 2001 after necessary due diligence carried out by renowned merchant bankers including Merrill Lynch. It is claimed that SCSL had been clocking a good growth in line with peer companies and adding a number of top customers each year. SCSL had eminent board members with experience and qualifications in diverse fields as Independent Directors. SCSL was very much in the limelight on account of media and Analysts and there were no signs of adverse comments or suspicious remark on its performances or the management came to light. More also PCAOB conducted an oversight inspection on SCSL as a US listed Company in 2006-07 and the inspection team did not find any negative in the performance of SCSL as a whole.

7. In the year 2009, SEBI received an email dated January 7, 2009 from Shri B. Ramalinga Raju, the then Chairman of SCSL stating that the statements of accounts of SCSL were not true and fair. The e-mail basically revealed that there was large scale financial manipulation in the books of accounts of SCSL, namely, that the balance sheet of SCSL as of September 30, 2008 carried inflated / non-existent cash and bank balances.

8. On the basis of this information, SEBI carried out an investigation into the affairs of SCSL. The investigations revealed that the statutory auditor of SCSL was Price Waterhouse Chartered Accountant w.e.f. April 1, 2000. The investigations found that certain directors and employees of SCSL had connived and collaborated in the overstatement, fabrication, falsification and misrepresentation in the books of account and financial statements of SCSL. The published books of accounts of SCSL contained false and inflated current account bank balances, fixed deposit balances, fictitious interest income revenue from sales and debtors' figures. The investigation also noted that the statutory auditors of SCSL had connived with the directors and employees of SCSL in falsifying the financial statements of SCSL.

9. On the basis of the investigation, a Show Cause Notice (SCN) dated February 14, 2009 was issued to Price Waterhouse Bangalore, Price Waterhouse's Company Bangalore, Price Waterhouse & Company Kolkata, Lovelock & Lewes Hyderabad, S. Gopalakrishnan and Srinivas Talluri directing them to show cause as to why directions under Section 11, 11(4) and 11B of the SEBI Act should not be issued for violation of Sections 12A(a), 12A(b) and 12A(c) of the SEBI Act read with Regulations 3(c), 3(d), 4(1), 4(2)(a), 4(2)(e), 4(2)(f), 4(2)(k) and 4(2)(r) of the Securities and

Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 (hereinafter referred to as, "PFUTP Regulations). Subsequently, a supplementary show cause notice dated February 19, 2010 was issued to the above persons/entities alongwith Lovelock & Lewis Mumbai, Price Waterhouse Kolkata, Price Waterhouse New Delhi, Price Waterhouse & Co. Chennai. Another show cause notice dated February 19, 2010 was issued to Dalal & Shah Ahmadabad, and Dalal & Shah Mumbai.

10. The show cause notice is a voluminous document. In a nutshell, the respondent directed the appellants to show cause for :

(i) successive failure to exercise even a minimum level of diligence in verifying the accounting systems and internal controls of SCSL, though accounting manipulations were going on "quarter after quarter" over the course of eight years;

(ii) gross negligence and recklessness in conducting an audit in accordance with the accounting standards and repeatedly deviating from the mandated course of audit especially in relation to items of significant materiality;

(iii) abject failure of the audit function in terms of professionalism, diligence and requisite application of mind which had consequently led to dissemination of spurious and false data in the market albeit certified as true, which distorted the decision of millions of investors and induced them to trade in the securities of SCSL;

(iv) these act of omission and commission, singly or jointly, in the discharge of their duties and "regardless of whether any criminal intent preceded such omissions or commissions clearly contained the key ingredients of the definition of fraud as laid down in SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Markets) Regulations, 2003 ('PFUTP Regulations, 2003' for short).

(v) for selectively obtaining direct confirmations in cases of certain bank accounts of SCSL which had nil or negligible balances while failing to obtain the same with respect to the account of Bank of Baroda, New York (BOB, NY) which showed the largest account balance (i.e. approximately 75% of all current account balances of SCSL) going upto Rs. 1731.88 crore in the quarter ending 30th September 2008.

(vi) failure to consider the direct confirmations received from banks with respect to the figures of fixed deposits while blindly relying on the indirect confirmations received from SCSL which showed higher balances. Failure to make further examination or enquiry with respect to the glaring discrepancies between the two sets of confirmations and / or exercise ordinary prudence or care in cross checking the relevant figures, thereby permitting the overstatement by Rs. 3,308.41 crores (Rupees Three Thousand Three Hundred Eight crores) as on 30th September 2008 in the financials of SCSL.

(vii) failure to detect the fictitious invoices and inflated revenues, debtors' position, etc.

(viii) complicity and/or acquiescence in the fraud and aiding and/or abetting the same.

11. It was also mentioned in the SCN that PWC International Ltd. had approved 11 partnership firms consisting of Chartered Accountants as their partners to use the name "Price Waterhouse" in India. The auditor's report, balance sheets, Profit & Loss accounts of SCSL were signed by S. Gopalakrishnan, Chartered Accountant for the period from April 2000 to March 2007. S. Gopalakrishnan was a

partner in Price Waterhouse Bangalore as well as in Lovelock & Lewes Kolkata. Srinivas Talluri was the Chartered Accountant who signed the auditor's report, etc. of SCSL for the period from April 2007 to March 2008. He was a partner in Price Waterhouse Bangalore and Lovelock & Lewes Kolkata as well as in Price Waterhouse & Co. Kolkata.

12. It was further alleged in the SCN that the 11 firms have common branch offices located in New Delhi, Mumbai, Kolkata, Chennai, Bangalore, Hyderabad, Pune, Gurgaon, Bhuvneshwar & Ahmedabad and there were several common partners in these firms. These firms share resources, manpower, offices, revenues, etc. amongst themselves and, for this purpose, the 11 firms have entered into an agreement in 2000 for resource sharing. It was further stated that the members of the "engagement team" which worked on the audit of SCSL was on the pay roll of Price Waterhouse Kolkata and Lovelock & Lewes Kolkata.

13. Two Writ Petitions were filed in July 2010 before the Bombay High Court for the quashing of the SCNs on the ground that SEBI lacked jurisdiction as it was encroaching upon the jurisdiction of Institute of Chartered Accountants of India (ICAI). Writ Petition No. 5249 of 2010 was filed by Price Waterhouse Bangalore and Writ Petition No. 5256 of 2010 was filed by 10 CA firms along with their

partners who were using the brand name "Price Waterhouse" in India. By judgment dated August 13, 2010, the Bombay High Court dismissed the Writ Petition holding that it cannot be said that SEBI at that stage, had no jurisdiction to issue a SCN simply because the appellants are professional Chartered Accountants. The Bombay High Court, however, set out the scope and extent of SEBI's power under Section 11 and 11B of SEBI Act read with Regulation 11 of the PFUTP Regulations to act against Chartered Accountants and the circumstances under which SEBI could issue direction to Chartered Accountants acting in their professional capacity. The Bombay High Court emphatically held that the jurisdiction of SEBI in the present case would depend upon the evidence which is available during the investigation and that if there was only some omission without any *mens rea* or connivance with anyone, in any manner, then SEBI could not issue any further direction.

14. The judgment of the Bombay High Court has become final inter se between the parties, as it was not challenged before a higher forum. All the parties thus, acquiesced to the observations / findings / directions given by the Bombay High Court. Much will depend upon the scope and extent of SEBI's power against CAs as provided by the Bombay High Court and therefore it would be necessary to

extract the relevant directions / observations of the Bombay High Court.

15. The two Writ Petitions were principally directed against the initiation of proceedings by SEBI against the CA's under the SEBI Act. It was contended that SEBI lacked inherent jurisdiction to enquire into the conduct of the appellants who were professionals. It was asserted that the appellants are not required to submit to the jurisdiction of SEBI unless SEBI was vested with such jurisdiction. It was contended that it was not open to SEBI to encroach upon the rights and powers of the ICAI provided under the Chartered Accountants Act, 1949 (hereinafter referred to as 'CA Act'). It was submitted that under the provisions of the SEBI Act and the Regulations framed thereunder, directions can be issued by SEBI for regulating the securities market, but beyond that, it had no power to issue any such directions. It was contended that the powers of SEBI cannot be construed to cover anybody under its umbrella on the ground of regulating the securities market. The petitioners in Writ Petition No. 5256 of 2010 submitted that the said petitioners had not taken part in any manner in the matter of audit of accounts of the Company and therefore the show cause notice could not be issued against them. It was asserted that the show cause notice could not be issued simply because the petitioners were associated with Price

Waterhouse & Company. It was contended that if there was any occasion or request on the part of any Chartered Accountants in the matter of discharging their professional duties, it is only the ICAI which had the power to regulate the profession of the Chartered Accountant (CA) under the CA Act.

16. The contention of SEBI before the High Court was that by issuing notices to CA's and to the audit firms, SEBI was not regulating the profession of CAs but was safeguarding the interest of the investors as well as the securities market. It was asserted that if by the acts and misdeeds of the CAs and its firms it was found that the books of accounts and balance sheets had been manipulated, it was open to SEBI to take remedial measures by keeping such persons and entities at a distance. It was asserted that the show cause notices were issued on the basis of the material available with SEBI and ultimately if it was found that the books of accounts of the Company were manipulated with knowledge and intent, then such manipulation would have a direct bearing on the securities market for which appropriate action could be taken. It was further asserted that if during the enquiry any evidence is brought to the effect that the auditors had connived and were in collusion with B. Ramalinga Raju and had fabricated the accounts then SEBI could proceed against the CAs and the audit firms. It was asserted that if the CAs had violated

the norms and standards of accounting prescribed by the CA Act, SEBI had powers to take regulatory measures for protecting the investor's interest by taking appropriate steps against the CAs by preventing the CA from auditing the books of accounts of such listed Companies. It was thus contended that on the basis of prima facie evidence of fudging the books of accounts SEBI had the power and jurisdiction to issue notices and enquire into the matter.

17. The question whether SEBI as a market regulator could be said to have jurisdiction to pass any of the directions as contained in the SCN was considered by the Bombay High Court. Despite the fact that the CA Act conferred exclusive jurisdiction upon the ICAI to adopt disciplinary misconduct, the Bombay High Court held that in a given case SEBI can pass orders directing CA to keep away from the securities market from auditing listed Companies. However, such directions came with a caveat, namely, that unless and until the evidence on record established the "jurisdictional fact", SEBI could not exercise any jurisdiction under the SEBI Act against a CA.

18. In ***Arun Kumar and Others vs. Union of India and Others [(2007) 1 SCC 732]*** the Supreme Court held:

> *"A "jurisdictional fact" is a fact which must exist before a Court, Tribunal or an Authority assumes jurisdiction over a particular matter. A jurisdictional fact is one on existence or non-existence of which depends*

> *jurisdiction of a court, a tribunal or an authority. It is the fact upon which an administrative agency's power to act depends. If the jurisdictional fact does not exist, the court, authority or officer cannot act. If a Court or authority wrongly assumes the existence of such fact, the order can be questioned by a writ of certiorari. The underlying principle is that by erroneously assuming existence of such jurisdictional fact, no authority can confer upon itself jurisdiction which it otherwise does not possess."*

19. On the question of jurisdiction, the Bombay High Court held that it was not open to SEBI to encroach upon the powers vested with the ICAI under the CA Act. The powers available to SEBI under SEBI Act are to be exercised in the interest of investors and interest of securities market. Further, in order to safeguard the interest of investors or interest of securities market, SEBI was entitled to take all ancillary steps and measures to ensure that the interest of the investors were protected.

20. The Bombay High Court held that the jurisdiction of SEBI would depend upon the evidence which is available during such enquiry and if any material was found against a CA to the effect that he was instrumental in preparing false and fabricated accounts, then SEBI had the power to take any remedial measures or preventive measures in such a case. The Bombay High Court further held that on conclusion of enquiry, if no evidence was available regarding fabrication and falsification of accounts etc. then SEBI could not

give any direction in any manner. The Bombay High Court further held that whether any particular firm of CA had any role to play in any manner and if it was found that there was only some omission without any means rea or connivance with anyone in any manner, then on such evidence, SEBI could not give any further directions. The Bombay High Court was quite specific in holding that the jurisdictional fact would clearly depend upon the evidence that was unearthed during the enquiry.

21. The Bombay High Court held:-

> *"It is true, as argued by the learned counsel for the petitioners, that while exercising powers under the Act, it is not open to the SEBI to encroach upon the powers vested with the Institute under the CA Act. However, it is required to be examined as to whether in substance by initiating the proceedings under the SEBI Act, the SEBI is trying to overreach or encroach upon the powers conferred under the CA Act.*

and further held:-

> *"In order to safeguard the interest of investors or interest of securities market, SEBI is entitled to take all ancillary steps and measures to see that the interest of the investors is protected. Looking to the provisions of the SEBI Act and the Regulations framed thereunder, in our view, it cannot be said that in a given case if there is material against any Chartered Accountant to the effect that he was instrumental in preparing false and fabricated accounts, the SEBI has absolutely no power to take any remedial or preventive measures in such a case. It cannot be said that the SEBI cannot give appropriate directions in safeguarding the interest of the investors of a listed Company. Whether such directions and orders are required to be issued or not is*

> *a matter of inquiry. In our view, the jurisdiction of SEBI would also depend upon the evidence which is available during such inquiry. It is true, as argued by the learned counsel for the petitioners, that the SEBI cannot regulate the profession of Chartered Accountants. This proposition cannot be disputed in any manner. It is required to be noted that by taking remedial and preventive measures in the interest of investors and for regulating the securities market, if any steps are taken by the SEBI, it can never be said that it is regulating the profession of the Chartered Accountants. So far as listed Companies are concerned, the SEBI has all the powers under the Act and the Regulations to take all remedial and protective measures to safeguard the interest of investors and securities market."*

and further held:-

> *"Normally, an investor invests his money by considering the financial health of the Company and in order to find out the same, one will naturally would bank upon the accounts and balance-sheets of the Company. If it is unearthed during inquiry before SEBI that a particular Chartered Accountant in connivance and in collusion with the Officers/Directors of the Company has concocted false accounts, in our view, there is no reason as to why to protect the interests of investors and regulate the securities market, such a person cannot be prevented from dealing with the auditing of such a public listed Company. In our view, the SEBI has got inherent powers to take all ancillary steps to safeguard the interest of investors and securities market. The powers conferred under various provisions of the Act are wide enough to cover such an eventuality and it cannot be given any restrictive meaning as suggested by the learned counsel for the petitioners. It is the statutory duty of the SEBI to see that the interests of the investors are protected and remedial and preventive measures are required to be taken in this behalf."*

22. The Bombay High Court held that the role of auditors is very important under the Companies Act and owe a duty to the

shareholders and are required to give a correct picture of the financial affairs of the Company. The Bombay High Court observed:-

> *"An investor is likely to be guided by the audited balance-sheet of the Company and would presume that the facts incorporated in the balance-sheet are true and correct. Considering the said aspect, even though the petitioners may not have direct association in the share market activities, yet the statutory duty regarding auditing the accounts of the Company and preparation of balance-sheets may have a direct bearing in connection with the interest of the investors and the stability of the securities market. In our view, the petitioners in their capacity as auditors of the Company Satyam, which was at one point of time considered to be a blue chip company who had a defining influence on the securities market, can be said to be persons associated with the securities market within the meaning of the provisions of the said Act."*

23. On the question whether SEBI can regulate the profession of a CA, the Bombay High Court held:-

> *"As regards the contention of Mr. Dwarkadas that except the Institute, no other body has any power to regulate the profession, it is required to be noted that SEBI's powers are restricted only in connection with taking care of the interest of the investors and safeguarding the interest of the investors and also to regulate the share market. SEBI has, therefore, all the powers to give appropriate directions in the aforesaid field. By initiating the proceedings, it cannot be said that the SEBI is encroaching upon the rights of the Institute or prohibiting a Chartered Accountant from practicing as a Chartered Accountant. It is natural that SEBI has no power to pass an order prohibiting a particular Chartered Accountant from practicing as a Chartered Accountant or cannot debar a Chartered Accountant from practicing as Chartered Accountant but SEBI can definitely take regulatory measures under*

> *the SEBI Act in the matter of safeguarding the interest of the investors and securities market and in order to achieve the same, it can take appropriate remedial steps which may include keeping a person including a Chartered Accountant at a safe distance from the securities market. SEBI can always take preventive as well as remedial measures in this behalf. Exercising such powers, therefore, cannot be said to be in any way in conflict with the powers of the Institute under the CA Act. If ultimately any decision is taken by debarring any particular person from auditing the books of a listed company, such direction can always be said to be within the powers of SEBI and that is in the aid of regulating the affairs in connection with the investors interests and the interest of the securities market. By exercising such powers, it cannot be said that the SEBI is trying to regulate the profession of Chartered Accountants in any manner and in that view of the matter, in our view, it can never be said that it is in conflict with Section 24 of the CA Act."*

The Bombay High Court further held:-

> *"it is not advisable and safe to have any particular person to be an Auditor of a listed Company, if he is found that he has committed any misdeeds or fraud qua the interest of investors or the securities market, it can always regulate its affairs by preventing such person from carrying on such work for a particular period"*

24. The Bombay High Court held that it is open to SEBI to take into consideration the accounting standards prescribed under the CA Act to see if the CA has violated any audit norms then whether such CA should be allowed to function as an auditor of a listed Company if by construing such auditor of a listed Company it may hamper the interest of the investors of such a listed Company. The Bombay High Court however held that it is only the ICAI which is the regulating

body to consider the professional norms, but in a given case if there is evidence to show that a CA has fabricated the books of accounts etc., then SEBI can issue directions not to utilize the services of such a CA in the matter of audit of a listed Company. The Bombay High Court further went on to hold:-

> *"However, on conclusion of inquiry, if no evidence is available regarding fabrication and falsification of accounts, etc., then naturally SEBI cannot give any direction in any manner and ultimately its jurisdiction will depend upon the evidence which may be available in the inquiry and SEBI has to decide as to whether any directions can be given on the basis of available evidence on record."*

25. The Bombay High Court after considering the scheme of the SEBI Act held that in the instant case, on the basis of a show cause notice, SEBI had the jurisdiction to enquire and investigate the matter in connection with manipulation and fabricating the books of accounts and balance sheet of the Company. The Bombay High Court further held that the power of SEBI are independent and does not encroach upon the powers of the ICAI under the CA Act. The Court further held that whether any of the CA and the CA firms had, with intention and knowledge, tried to fabricate and fudge the books of accounts was a matter of investigation and enquiry by SEBI and, if ultimately if any evidence came on record to

this effect, in that event, SEBI could take appropriate steps. The Bombay High Court thus held:-

> *"Whether any of the petitioners with an intention and knowledge tried to fabricate and fudge the books of accounts is a matter of investigation and inquiry by the SEBI. Ultimately if any evidence in this behalf is brought on record before the SEBI during the inquiry, appropriate steps can be taken in this behalf as provided for by the SEBI Act."*

26. Insofar as the petitioner's of Writ Petition No. 5256 of 2010 were concerned, the Bombay High Court held that SEBI would adjudicate whether a petitioner firm of CA had any role to play and if in a given case, ultimately it was found that there was only omission without any *mens rea* or connivance with anyone, then on such evidence, SEBI could not issue any further directions. The Bombay High Court, in this regard, held:-

> *"SEBI being a quasi-judicial authority, while adjudicating the matter, will look into this aspect and will consider as to whether any particular firm of Chartered Accountants has any role to play or for that reason any of the petitioners had played any role in any manner they may bring the matter to the notice of the SEBI. In a given case, if ultimately it is found that there was only some omission without any mens rea or connivance with anyone in any manner, naturally on the basis of such evidence the SEBI cannot give any further directions."*

27. The findings of the Bombay High Court setting out the scope and extent of SEBI's power to act against CAs and the circumstances

under which SEBI could issue directions to CA acting in their professional capacity can thus be culled out as under:-

(i) On the basis of the allegation in the show cause notice, SEBI can investigate and enquire into the conduct of the CA and the CA firms in order to find out whether the books of accounts and balance sheet have been manipulated and/or fabricated.

(ii) The manipulation of the books of accounts and balance sheet by the CA and the CA firms was done with their knowledge and intent.

(iii) If during investigation and enquiry, if any evidence is brought on record to show that the auditors had connived and were in collusion with B. Ramalinga Raju and had fabricated the books of accounts of balance sheet, then SEBI can proceed in the matter and take appropriate steps against CA by preventing the CA from auditing the books of accounts of such listed Companies.

(iv) SEBI can take into consideration the accounting standards provided under the CA Act to see whether a CA has violated any norms but upon conclusion of enquiry, if no evidence is available regarding fabrication, fabrication or

fudging the books of accounts etc. then SEBI cannot issue any direction.

(v) SEBI would adjudicate whether other Price Waterhouse firms had any role to play and if it is found that there was some omission on their part without any *mens rea* or connivance with anyone, then on such evidence SEBI cannot issue any further direction.

28. We have heard Mr. Mukul Rohatgi, Senior Advocate along with Mr. Janak Dwarkadas, Senior Advocate and assisted by Mr. Somasekhar Sundaresan, Mr. Zerick Dastur, Ms. Archana Uppuluri, Mr. Kunal Kothary, Ms. Palak Agrawal, Mr. Khushil Shah, Ms. Ruby Singh Ahuja and Mr. Anupam Prakash, Advocates for the appellants in Appeal No. 6 of 2018; Mr. Shyam Mehta, Senior Advocate along with Mr. Zerick Dastur, Ms. Archana Uppuluri, Mr. Kunal Kothary, Ms. Palak Agrawal and Mr. Khushil Shah, Advocates for the appellant in Appeal No. 7 of 2018; Mr. Gaurav Joshi, Senior Advocate along with Mr. R. Sudhinder, Ms. Prerana Amitabh and Ms. Vatsala Pant, Advocates for the appellant in Appeal No. 190 of 2018; Mr. Mustafa Doctor, Senior Advocate along with Mr. R. Sudhinder, Ms. Prerana Amitabh and Ms. Vatsala Pant, Advocates for the appellant in Appeal No. 191 of 2018 and

Mr. Ravi Kadam, Senior Advocate along with Mr. Kevic Setalvad, Senior Advocate, Mr. Jayesh Ashar, Mr. Mihir Mody, Ms. Shreya Parikh, Mr. Sushant Yadav and Mr. Tabish Mooman, Advocates for the respondent in all the appeals.

29. As per the directions of the Bombay High Court, the scope of enquiry was restricted only to the charge of conspiracy and involvement in the fraud and not to any charge of professional negligence. The charge of conspiracy and involvement in the fraud was required to be established on the basis of material available on the basis of investigation. The Bombay High Court had narrowed the scope of enquiry under the SEBI Act as it was aware that the appellants are Chartered Accountant / Chartered Accountant firms and were not dealing directly in the securities. The Bombay High Court, thus, held that there must be evidence to show that the engagement partners / audit firms had indulged in or were instrumental in the fabrication of the books of account of SCSL and that there was an intention or knowledge in connivance or collusion with the management of the SCSL in fudging the books of account. The Bombay High Court further held that if there was some omission but without any *mens rea* then no further direction would be issued otherwise it would encroach upon the jurisdiction of ICAI. Thus, the

scope of enquiry was limited to the conspiracy and involvement in the fraud and not on professional negligence.

30. In this regard the term / words used consistently by the Bombay High Court in its judgment becomes important and provides an insight to the scope of enquiry. The Bombay High Court in its judgment has consistently used the words “false”, “fabricated”, “fabrication”, “falsification”, “concocted” and “fudge” in relation to the books of account of SCSL. The Bombay High Court has also used the words “indulged”, “instrumental”, “intention”, “knowledge”, “connived”, “collusion”, “manipulation”, “fraud” and “*mens rea*” in the fabrication or falsification of the books of account. These words speak volumes of the intent, scope and extent of the enquiry to be conducted under the SEBI laws.

31. Black’s Law Dictionary 8th Edition, defines “false” as untrue, deceitful, lying, not genuine. What is false can be so by intent. The term “fabricate” means to invent, forge or devise falsely. To fabricate a story is to create a plausible version of events that is advantageous to the person relating those events. The term is softer than a lie (Black’s Law Dictionary 7th Edition). “Falsification” means to counterfeit or forge; to make something false; to give a false appearance to anything. To make false by mutilation, alteration, or

addition; to tamper with, as to falsify a record or document (Black's Law Dictionary 7th Edition). The word "falsify" may be used to convey two distinct meanings- either that of being intentionally or knowingly untrue, made with intent to defraud or mistakenly and accidentally untrue (Black's Law Dictionary 8th Edition). Chambers Dictionary 2004 Edition defines "concoct" as to fabricate, to plan, devise, to make up or put together, to prepare. The same dictionary defines "fudge" as the act of distortion, to cheat, to dodge, to cover up and "indulge" as to yield to the wishes of, to favour, to gratify, to gratify one's appetite freely. "Instrumental" has been defined as acting as an instrument or means, serving to promote an object. "Intended" means planned, with design. Black's Law Dictionary 8th Edition defines "knowledge" as an awareness or understanding of a fact or circumstance. Black's Law Dictionary 6th Edition defines "collusion" as an agreement between two or more persons to defraud a person of his rights by the forms of law, or to obtain an object forbidden by law. It implies the existence of fraud of some kind, the employment of fraudulent means, or of lawful means for the accomplishment of an unlawful purpose. "Connivance" means the secret or indirect consent or permission of one person to the commission of an unlawful or criminal act by another (Black's Law Dictionary 6th Edition). Black's Law Dictionary 8th Edition defines "connivance" to mean the act of indulging or ignoring another's

wrongdoing. Advanced Law Lexicon 5th Edition defines "connivance" as voluntary blindness to some present act or conduct. "Fraudulent" means based of fraud; proceeding from or characterized by fraud, tainted by fraud; done, made, or effected; tainted by fraud; done, made or effected with a purpose or design to carry out a fraud. A statement, or claim, or a document, is "fraudulent" if it was falsely made, or cause to be made with the intent to deceive. To act with "intent to fraud" means to act willfully, and with the specific intent to deceive or cheat; ordinarily for the purpose of either causing some financial loss to another, or bringing about some financial gain to oneself (Black's Law Dictionary 7th Edition). "Fraud" means a knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment (Black's Law Dictionary, 7th edition). "Misrepresentation" means any manifestation by words or other conduct by one person to another that, under the circumstances, amounts to assertion not in accordance with the facts; an untrue statement of fact; an incorrect or false representation that which, if accepted, leads the mind to an apprehension of a condition other and different from that which exists. Colloquially, it is understood to mean a statement made to deceive or mislead (Black's Law Dictionary, 6th edition). "Negligence" means the omission to do something which a reasonable man, guided by those ordinary considerationsns which

ordinarily regulate human affairs, would do, or the doing of something which a reasonable and prudent man would not do. Negligence is the failure to use such care as a reasonably prudent and careful person would use under similar circumstances; it is the doing of some act which a person of ordinary prudence would not have done under similar circumstances or failure to do of a person of ordinary prudence would have done under similar circumstances (Black's Law Dictionary, 6th edition). "Omission" means the neglect to perform what the law requires. The intentional or unintentional failure to act which may or may not impose criminal liability depending upon the existence, *vel non*, of a duty to act under the circumstances (Black's Law Dictionary, 6th edition). In Chambers Law Dictionary the word "manipulate" means to work with the hands, to turn to one's own purpose or advantage and "manipulation" means the act of manipulating by hands.

32. From the aforesaid, it becomes apparently clear that what the Bombay High Court meant was that there must be evidence to show that there was fabrication, falsification and fudging of the books of account of SCSL by the appellants and that the said fabrication, etc. was done with intent, knowledge, connivance and collusion with the management in order to play a fraud on the shareholders / investors. The evidence must be apparent and glaring and not on the basis of

preponderance of probabilities. There must be direct evidence of falsification and fabrication of the books of account of SCSL.

33. This leads us to go into the question as to how WTM has arrived at a finding that the appellants were guilty of misconduct and were responsible for the fabrication of the books of account of SCSL. The findings are as follows:-

(i) the balance in the current account of SCSL with Bank of Baroda, New York Branch was overstated by Rs. 1731.88 crore as on 30.09.2008. The confirmation did not match with balances as per bank reconciliation statement.

(ii) the auditors relied on the bank confirmation purportedly received from Bank of Baroda, New York through SCSL for confirmation of the balances in the current account with Bank of Baroda New York.

(iii) the firm failed to seek direct confirmation of bank balance from Bank of Baroda, New York and only sought balance confirmation from other banks having nil or negligible balance.

(iv) fixed deposit account of SCSL held in 5 banks were overstated by Rs. 3308.41 crore as on September 30,

2008. These fixed deposits were fabricated documents which the auditors failed to detect. The letters of confirmation addressed to the auditors were received from the Company by the auditors and which were relied upon were also fabricated.

(v) internal audit did not conduct verification of bank balances and therefore it was left to the statutory auditors to conduct such verification which they failed to do so and they relied upon the balance confirmation letters received through SCSL which were found to be fabricated.

(vi) the manner in carrying out the verification of the bank balance and fixed deposits was not in accordance with Auditing and Assurance Standards (AAS) issued by ICAI which was a mandatory requirement.

(a) as per AAS 13, the auditors had a duty to obtain direct bank confirmation as a preliminary validation procedure which the appellants failed to do so.

(b) as per AAS 30, the responsibility of sending the letters seeking external confirmation was upon the

auditor which the firm failed to adhere to the said audit process.

(c) as per AAS 30, the auditors were mandated to verify the source of contents of confirmation letters by additional audit procedures viz. telephonic calls, email, etc. which the appellants failed to do so.

(vii) having failed to comply with the audit procedures as mandated under AAS, the appellants failed to fulfill these basic professional duties of an auditor.

(viii) the auditors have relied upon the monthly bank statement of Bank of Baroda which turned out to be forged and manipulated.

(ix) bank statement was obtained from SCSL instead of obtaining it directly from the bank.

(x) by not seeking external confirmation of the current account balance of SCSL with Bank of Baroda, New York, the auditors had failed to exercise care and prudence and adhere to the standards and procedures prescribed under AAS 30.

(xi) complete reliance on the bank statements provided by SCSL without taking recourse to external confirmation on the ground that SCSL enjoyed a good reputation for corporate governance does not behove an auditor with an attitude of professional skepticism as mandated under para 18 of AAS 4.

(xii) even though the fake invoices were not distinguishable with the genuine invoices to a naked eye, it was the duty of the auditor to transcends beyond what is visible to the naked eye by requiring the auditors to apply an attitude of professional skepticism.

(xiii) the auditors during the audit process had acted in total disregard to the auditing standards under the AAS mandate pertaining to materiality of information (bank balances and FDs), reliability of audit evidence, external confirmation and having an attitude of professional skepticism.

(xiv) the auditors failed to detect the fabrication of the Invoicing Management System (IMS) of SCSL which were exported manually from the IMS into the Oracle Financials which was the accounting software used by

SCSL which resulted in the inflation of the revenues of SCSL. This failure to detect the fake invoices occurred as auditors failed to carry out any reconciliation between invoices in Oracle Financials (OF) and IMS. Failure to detect the fake invoices indicated the quality of audit and thus did not conduct the audit with bonafide intentions.

(xv) the 'alternate procedure' as per para 39 of the AAS 30 adopted by the auditors was prone to potential fraud risk and, in any case, did not relieve the auditor from this obligation of conducting a satisfactory confirmation of debtors.

(xvi) passive acceptance at face value of information provided by SCSL does not benefit the stature of audit and amounts to gross negligence.

(xvii) the carefully laid out scheme of fraud and fabrication of accounts in SCSL by the top management of SCSL was not possible without the knowledge and involvement of the statutory auditors.

(xviii) there were gaping holes in the auditing process since they did not follow scrupulously the AAS and Guidance Note, which points the needle of suspicion from negligence to

one of acquiescence and complicity on the part of the auditors which in turns draws an inference of malafide and involvement on their part.

(xix) the accumulated omission on the part of the auditors over eight years is an act of gross negligence and amount to an act of commission of fraud for the purposes of SEBI Act and SEBI PFUTUP Regulations.

(xx) *mens rea* in the criminal sense is not relevant and is not required to be established in a violation alleged under PFUTP Regulations read with the SEBI Act in view of the Supreme Court decision in the case of ***Securities and Exchange Board of India vs. Shri Kanaiyalal Baldevbhai Patel & Others, (2017) 15 SCC 1***. Thus reliance on the judgment of the Bombay High Court by the appellants was unnecessary and misplaced.

34. In a nutshell, the WTM held that failure to seek external confirmation of the bank balances, fixed deposits, failure to detect fake invoices without adopting the rigorous procedure mandated by AAS draws an inference of gross negligence and inference of involvement in the fudging of the accounts. This gross negligence amounts to an act of commission of a fraud for the purposes of SEBI

Act and SEBI PFUTP Regulations for which *mens rea* is not required to be proved beyond a reasonable doubt but could be based on a preponderance of probability.

35. Reliance has been made on a decision of the Supreme Court in ***Securities and Exchange Board of India vs. Shri Kanaiyalal Baldevbhai Patel, (2017) 15 SCC 1*** wherein the Supreme Court held that *mens rea* is not indispensable in PFUTP violations. The Supreme Court held:-

> *"To attract the rigor of Regulations 3 and 4 of the 2003 Regulations, mens rea is not an indispensable requirement and the correct test is one of preponderance of probabilities. Merely because the operation of the aforesaid two provisions of the 2003 Regulations invite penal consequences on the defaulters, proof beyond reasonable doubt as held by this Court in Securities and Exchange Board of India v. Kishore R. Ajmera (supra) is not an indispensable requirement. The inferential conclusion from the proved and admitted facts, so long the same are reasonable and can be legitimately arrived at on a consideration of the totality of the materials, would be permissible and legally justified. …."* .

36. Before we deal with the findings given by the WTM and the submission made by the parties it would be appropriate to extract the provisions of Section 12A of the SEBI Act as well as Regulation 2(1)(b), 2(1) (c), 3 & 4 of the PFUTP Regulations which reads as follows:-

***SEBI Act***

***Prohibition of manipulative and deceptive devices, insider trading and substantial acquisition of securities or control.***

*12A. No person shall directly or indirectly—*

*(a) use or employ, in connection with the issue, purchase or sale of any securities listed or proposed to be listed on a recognized stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of this Act or the rules or the regulations made thereunder;*

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

*(c) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person, in connection with the issue, dealing in securities which are listed or proposed to be listed on a recognised stock exchange, in contravention of the provisions of this Act or the rules or the regulations made thereunder;*

*(d) engage in insider trading;*

*(e) deal in securities while in possession of material or non-public information or communicate such material or non-public information to any other person, in a manner which is in contravention of the provisions of this Act or the rules or the regulations made thereunder;*

*(f) acquire control of any company or securities more than the percentage of equity share capital of a company whose securities are listed or proposed to be listed on a recognised stock exchange in contravention of the regulations made under this Act."*

***"PFUTP Regulations***

***"Definitions***

***2.****(1) In these regulations, unless the context otherwise requires,-*

……..

*(b) "dealing in securities" includes an act of buying, selling or subscribing pursuant to any issue of any security or agreeing to buy, sell or subscribe to any issue of any security or otherwise transacting in any way in any security by any person as principal, agent or intermediary referred to in section 12 of the Act.*

*(c) "fraud" includes any act, expression, omission or concealment committed whether in a deceitful manner or not by a person or by any other person with his connivance or by his agent while dealing in securities in order to induce another person or his agent to deal in securities, whether or not there is any wrongful gain or avoidance of any loss, and shall also include—*

*(1) a knowing misrepresentation of the truth or concealment of material fact in order that another person may act to his detriment;*

*(2) a suggestion as to a fact which is not true by one who does not believe it to be true;*

*(3) an active concealment of a fact by a person having knowledge or belief of the fact;*

*(4) a promise made without any intention of performing it;*

*(5) a representation made in a reckless and careless manner whether it be true or false;*

*(6) any such act or omission as any other law specifically declares to be fraudulent;*

*(7) deceptive behavior by a person depriving another of informed consent or full participation;*

*(8) a false statement made without reasonable ground for believing it to be true;*

*(9) the act of an issuer of securities giving out misinformation that affects the market price of the security, resulting in investors being effectively misled even though they did not rely on the statement itself or anything derived from it other than the market price.*

*And "fraudulent" shall be construed accordingly;*

*Nothing contained in this clause shall apply to any general comments made in good faith in regard to—*

*(a) the economic policy of the Government;*
*(b) the economic situation of the country;*
*(c) trends in the securities market;*
*(d) any other matter of a like nature;*

*whether such comments are made in public or in private;*

***Prohibition of certain dealings in securities***

***3. No person shall directly or indirectly—***

*(a) ……*

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

*(d) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person in connection with any dealing in or issue of securities which are listed or proposed to be listed on a recognized stock exchange in contravention*

*of the provisions of the Act or the rules and the regulations made there under.*

***4. Prohibition of manipulative, fraudulent and unfair trade practices***

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

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

*(a) indulging in an act which creates false or misleading appearance of trading in the securities market;*

*……..*

*(e) any act or omission amounting to manipulation of the price of a security;*

*(f) publishing or causing to publish or reporting or causing to report by a person dealing in securities any information which is not true or which he does not believe to be true prior to or in the course of dealing in securities;"*

*……*

*(k) an advertisement that is misleading or that contains information in a distorted manner and which may influence the decision of the investors;*

*…….*

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

37. In ***Securities and Exchange Board of India vs. Pan Asia Advisors Limited and Another, (2015) 14 SCC 71*** the Supreme Court has set out the scope of Section 12A of the SEBI Act. The Supreme Court held:-

> *"78. Section 12-A of the SEBI Act, 1992 creates a clear prohibition of manipulating and deceptive devices, insider trading and acquisition of securities. Sections 12-A(a), (b) and (c) are relevant, wherein, it is stipulated that no person should directly or indirectly indulge in such manipulative and deceptive devices either directly or indirectly in connection with the issue, purchase or sale of any securities, listed or proposed to be listed wherein manipulative or deceptive device or contravention of the Act, Rules or Regulations are made or employ any device or scheme or artifice to defraud in connection with any issue or dealing in securities or engage in any act, practice or course of business which would operate as fraud or deceit on any person in connection with any issue dealing with security which are prohibited. By virtue of such clear cut prohibition set out in Section 12-A of the Act, in exercise of powers under Section 11 referred to above, as well as Section 11-B of the SEBI Act, it must be stated that the Board is fully empowered to pass appropriate orders to protect the interest of investors in securities and securities market and such orders can be passed by means of interim measure or final order as against all those specified in the abovereferred to provisions, as well as against any person. The purport of the statutory provision is protection of interests of the investors in the securities and the securities market.*
>
> *79. Along with Section 12-A, when we read Regulation 2(1)(c) of the 2003 Regulations, the act of fraud has been elaborately defined to include any kind of activity which would work against the interest of the investors in securities. Further, such interest of the investors can be better ascertained by making reference to Section 2(h)(iii) of the SCR Act, 1956 which defines*

*"security" to mean the right or interest in securities. A conspectus reference to Sections 12-A(a), (b) and (c) read along with Regulations 2(1)(b) and (c), as well as Section 2(h)(iii) of the SCR Act, 1956 sufficiently disclose that it would cover any act which will have relevance in protecting the interest of the investors in securities and security market with any person however remotely the same are connected with such securities, in the event of such an act working against the interest of investors in securities and securities market by way of fraud which has been elaborately defined under Regulation 2(i)(c) of the 2003 Regulations.*

*90. Under Section 12-A, it is specifically provided to prohibit any manipulative and deceptive devices, insider trading and substantial acquisition of securities or control by ANY PERSON either directly or indirectly. If SEBI's allegation listed out earlier as well as all the other allegations fall under Sections 12-A(a), (b) and (c), there will be no escape for the respondents from satisfactorily explaining before the Tribunal as to how these allegations would not result in fully establishing the guilt as prescribed under sub-clauses (a), (b) and (c) of Section 12-A. Similar will be the situation for answering the definition under Regulations 2(1)(b), (c), 3, 4(1), (2)(a), (b), (c), (d), (e), (f), (k) and (r) of the 2003 Regulations, apart from taking required penal action against those who are involved in any fraud being played in the creation of securities."*

38. In ***N. Narayanan vs Securities and Exchange Board of India, (2013) 12 SCC 152*** the Supreme Court held:-

*"33. Prevention of market abuse and preservation of market integrity is the hallmark of securities law. Section 12-A read with Regulations 3 and 4 of the 2003 Regulations essentially intended to preserve "market integrity" and to prevent "market abuse". The object of the SEBI Act is to protect the interest of investors in securities and to promote the development and to regulate the securities market, so as to promote orderly, healthy growth of securities market and to promote investors' protection. Securities market is based on free*

> *and open access to information, the integrity of the market is predicated on the quality and the manner on which it is made available to market. "Market abuse" impairs economic growth and erodes investor's confidence. Market abuse refers to the use of manipulative and deceptive devices, giving out incorrect or misleading information, so as to encourage investors to jump into conclusions, on wrong premises, which is known to be wrong to the abusers. The statutory provisions mentioned earlier deal with the situations where a person, who deals in securities, takes advantage of the impact of an action, may be manipulative, on the anticipated impact on the market resulting in the "creation of artificiality"."*

39. Thus, Section 12A of the SEBI Act creates a clear prohibition of manipulative and deceptive devices, insider trading and acquisition of securities. Section 12A(a),(b) & (c) stipulates that no person should directly or indirectly indulge in such manipulative and deceptive devices in connection with the issue, purchase and sale of any securities or use any device or engage in any act which would operate as fraud or deceit on any person while dealing in securities. The emphasis is on the word(s) "securities" and "dealing in securities". The manipulative and deceptive devices which would operate as a fraud or deceit is directly linked to "securities" and "dealing in securities". If a person is not dealing in securities either directly or indirectly then Section 12A would not be applicable. In this regard "securities" have been defined under Section 2(h) of the Securities Contracts (Regulation) Act, 1956 ('SCRA Act' for short) which is extracted hereunder:-

*"(h) "securities" include—*

*(i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;*

*(ia) derivative;*

*(ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;*

*(ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;*

*(id) units or any other such instrument issued to the investors under any mutual fund scheme;*

*(ii) Government securities;*

*(iia) such other instruments as may be declared by the Central Government to be securities; and*

*(iii) rights or interest in securities;"*

40. "Dealing in securities" have been defined under Regulation 2(1)(b) of PFUTP Regulations, 2003 which has already been extracted above, includes an act of buying and selling of any security or otherwise transacting in any way in any security. The term security has been defined under Section 2(h) of the SCR Act to include shares, scrips, stocks, bonds, etc. Thus, Section 12A becomes

applicable only when a person deals in securities either directly or indirectly and indulges in manipulative and deceptive devices, etc.

41. The scope of PFUTP Regulations, 2003 has been set out by the Supreme Court in ***Kanaiyalal's case (supra)***. The Supreme Court held:-

> *"10. The 2003 FUTP has three chapters, namely, "Preliminary", "Prohibition of fraudulent and unfair trade practices relating to securities market" and "Investigation". Regulation 1 contains the short title and commencement. Regulation 2 consists of certain definitions. Clause (b) of Regulation 2 defines "dealing in securities" which includes an act of buying, selling or subscribing pursuant to any issue of any security or agreeing to buy, sell or subscribe to any issue of any security or otherwise transacting in any way in any security by any person as principal, agent or intermediary referred to in Section 12 of the SEBI Act. Clause (c) of Regulation 2 defines "fraud".*
>
> *11. Regulation 3 prohibits certain dealings in securities, whereas Regulation 4 prohibits manipulative, fraudulent and unfair practices. Regulation 5 deals with the power of the board to order investigation. Regulation 6 elaborates on the power of the investigating authority.*
>
> *14.2. Clauses (i), (j), (l), (m), (p), (o) and (q) of sub-regulation (2) of Regulation 4 expressly make themselves applicable only to the case of intermediaries and not to individual buyers or sellers.*
>
> *23. The object and purpose of the 2003 FUTP is to curb "market manipulations". Market manipulation is normally regarded as an "unwarranted" interference in the operation of ordinary market forces of supply and demand and thus undermines the "integrity" and efficiency of the market.*

*29. On a comparative analysis of the definition of "fraud" as existing in the 1995 Regulations and the subsequent amendments in the 2003 Regulations, it can be seen that the original definition of "fraud" under the FUTP Regulations, 1995 adopts the definition of "fraud" from the Contract Act, 1872 whereas the subsequent definition in the 2003 Regulations is a variation of the same and does not adopt the strict definition of "fraud" as present under the Contract Act. It includes many situations which may not be a "fraud" under the Contract Act or the 1995 Regulations, but nevertheless amounts to a "fraud" under the 2003 Regulations.*

*30. The definition of "fraud" under clause (c) of Regulation 2 has two parts; first part may be termed as catch all provision while the second part includes specific instances which are also included as part and parcel of term "fraud". The ingredients of the first part of the definition are:*

*1. includes an act, expression, omission or concealment whether in a deceitful manner or not;*

*2. by a person or by any other person with his connivance or his agent while dealing in securities;*

*3. so that the same induces another person or his agent to deal in securities;*

*4. whether or not there is any wrongful gain or avoidance of any loss.*

*The second part of the definition includes specific instances:*

*(1) a knowing misrepresentation of the truth or concealment of material fact in order that another person may act to his detriment;*

*(2) a suggestion as to a fact which is not true by one who does not believe it to be true;*

*(3) an active concealment of a fact by a person having knowledge or belief of the fact;*

*(4) a promise made without any intention of performing it;*

*(5) a representation made in a reckless and careless manner whether it be true or false;*

*(6) any such act or omission as any other law specifically declares to be fraudulent;*

*(7) deceptive behaviour by a person depriving another of informed consent or full participation;*

*(8) a false statement made without reasonable ground for believing it to be true;*

*(9) the act of an issuer of securities giving out misinformation that affects the market price of the security, resulting in investors being effectively misled even though they did not rely on the statement itself or anything derived from it other than the market price.*

*33. Regulation 3 prohibits a person from committing fraud while dealing in securities. A reading of the aforesaid provision describes the width of the power vested with SEBI to regulate the security market. In our view, the words employed in the aforesaid provisions are of wide amplitude and would therefore take within its sweep the inducement to bring about inequitable result which has happened in this instant case.*

*34. Regulation 4 prohibits manipulative, fraudulent and unfair trade practices. It is to be noted that Regulation 4(1) starts with the phrase "without prejudice to the provisions of Regulation 3". This phrase acquires significance as it portrays that the prohibitions covered under Regulation 3 do not bar the prosecution under Regulation 4(1). Therefore Regulation 4(1) has to be read to have its own ambit which adds to what is contained under Regulation 3.*

*39. It should be noted that the provisions of Regulations 3(a), (b), (c), (d) and 4(1) are couched in general terms to cover diverse situations and possibilities. Once a conclusion, that fraud has been committed while dealing in securities, is arrived at, all these provisions get attracted in a situation like the one under consideration. We are not inclined to agree with the submission that SEBI should have identified as to which particular provision of the 2003 FUTP Regulations has been violated. A pigeon-hole approach may not be applicable in this case instant.*

*47. Accordingly, non-intermediary front-running may be brought under the prohibition prescribed under Regulations 3 and 4(1), for being fraudulent or unfair trade practice, provided that the ingredients under those heads are satisfied as discussed above. From the above analysis, it is clear that in order to establish charges against tippee, under Regulations 3(a), (b), (c) and (d) and 4(1) of the 2003 FUTP, one needs to prove that a person who had provided the tip was under a duty to keep the non-public information under confidence, further such breach of duty was known to the tippee and he still trades thereby defrauding the person, whose orders were front-runned, by inducing him to deal at the price he did.*

*54. The definition of "fraud", which is an inclusive definition and, therefore, has to be understood to be broad and expansive, contemplates even an action or omission, as may be committed, even without any deceit if such act or omission has the effect of inducing another person to deal in securities. Certainly, the definition expands beyond what can be normally understood to be a "fraudulent act" or a conduct amounting to "fraud". The emphasis is on the act of inducement and the scrutiny must, therefore, be on the meaning that must be attributed to the word "induce".*

*55. The dictionary meaning of the word "induced" may now be taken note of:*

> *Black's Law Dictionary, 8th Edn., defines "inducement" as "The act or process of enticing or persuading another person to take a certain course of action".*
>
> * * *
>
> *Merriam-Webster Dictionary defines "inducement" as "a motive or consideration that leads one to action or to additional or more effective actions".*

*56. A person can be said to have induced another person to act in a particular way or not to act in a particular way if on the basis of facts and statements made by the first person the second person commits an*

> *act or omits to perform any particular act. The test to determine whether the second person had been induced to act in the manner he did or not to act in the manner that he proposed, is whether but for the representation of the facts made by the first person, the latter would not have acted in the manner he did. This is also how the word "inducement" is understood in Criminal law. The difference between inducement in Criminal law and the wider meaning thereof as in the present case, is that to make inducement an offence the intention behind the representation or misrepresentation of facts must be dishonest whereas in the latter category of cases like the present the element of dishonesty need not be present or proved and established to be present. In the latter category of cases, a mere inference, rather than proof, that the person induced would not have acted in the manner that he did but for the inducement is sufficient. No element of dishonesty or bad faith in the making of the inducement would be required."*

42. In the light of the above and on the totality of the facts in the given case, we are of the opinion that while interpreting a statute, an effort must be made to give effect to each and every word used by the legislature. The Courts should presume that the legislature inserted every part for a purpose and the legislative intention is that every part of the statute should have effect. While interpreting a provision, the effort must always be made to find out the true intention behind the law.

43. From the aforesaid decisions and on a reading of the provisions of Section 12A of the SEBI Act and Regulation 3 & 4 of PFUTP Regulations, it is apparently clear that the object of Section 12A &

PFUTP Regulations is to curb “market manipulations”. The manipulative and deceptive devices must be in relation to “securities” and must be by a person “dealing in securities”. The Supreme Court in ***Kanaiyalal (supra)*** has expanded the term ‘person’ to include a non-intermediary culpable under the PFUTP Regulations as the front runner was found to be dealing with the securities. Further, the charge against the “tippee” was required to be proved under Regulation 3(a),(b),(c),(d) & 4(1) of the PFUTP Regulations. Further, the use of manipulative device was intended to deceive another person. The Supreme Court thus enlarged the scope of “fraud” under the PFUTP Regulations to cover an action or omission even without deceit if such act or omission had the effect of inducing another person to deal in securities. Thus, more than “reckless or careless”, “inducement” becomes more significant where ‘fraud’ is required to be proved. The Supreme Court held that *mens rea* is not an indispensible requirement and fraud can be inferred on a preponderance of probabilities. However, the inferential conclusion must be arrived at from proven and admitted facts.

44. From the aforesaid, it becomes apparently clear that Regulation 3 and 4 of PFUTP Regulations applies only on persons dealing in securities. The applicability can be extended to persons who are associated with the securities directly or indirectly. Admittedly, the

appellants are not dealing in the securities either directly or indirectly. They are auditors of listed companies. In order to bring them culpable within the four corners of Section 12A and Regulation 3 and 4 of PFUTP Regulations, fraud has to be proved on the basis of evidence. The Supreme Court in ***Kanaiyalal's*** case (supra) extended the applicability of the provisions of Regulation 3 and 4 of PFUTP Regulation on a "tippee" only when a charge against him was proved. In the instant case, there is no shred of evidence to show that the auditor / audit firm had fabricated or falsified or fudged the books of account of SCSL in collusion with the top management of the SCSL. Further, fraud cannot be proved only on alleged gross negligence, carelessness or recklessness as amounting to collusion and connivance on a preponderance of probabilities. The Supreme Court in ***Kanaiyalal's case (supra)*** has categorically held that the element of "inducement" must exist and should be proved before holding that a person is guilty of fraud. In the instance case, there is no finding that the appellants had induced someone and thereby played a fraud in the securities market. Assuming without admitting that the concept of preponderance of probabilities would also apply in the case of the appellants, still, it must be proved by cogent evidence that the appellants are guilty of "inducement". In the absence, of any evidence, the charge of fraud is not proved, nor the provisions of Regulation 3 and 4 of PFUTP Regulations applicable.

If there was gross negligence, recklessness in adhering to the AAS in the course of auditing the accounts of SCSL, it can and can only point out to professional negligence which would amount to a misconduct to be taken up only by ICAI.

45. The evidence that has been brought on record indicates that certain directors and employees had connived in the fabrication, falsification and misrepresentation in the books of account and financial statements of SCSL. The books of account contained false and inflated current account bank balances, fixed deposit balances, fictitious interest from sales. We find that there is no direct evidence to show that the engagement partners / audit firms / other PW firms were directly involved in the fabrication of the books of account of SCSL. In fact, the Chairman of SCSL has gone on record in so many words that the statutory auditors were kept in the dark and that they had no role to play in the fudging of the books of account.

46. The fraud at SCSL involved deception by way of manipulation, fabrication, alteration of accounting records and supporting documents from which the financial statements were prepared. Apparently, audit team's audit procedures did not reveal SCSL's alleged fraud because there was a devious systematic scheme by the SCSL's Directors, management and employees to circumvent SCSL

own corporate governance structure, internal controls and internal audit as well as the statutory audit process. The modus operandi of this complex fraud was perpetuated by the management of SCSL which deceived the naked eye of the auditors. The fake sale invoices as in the case of genuine sale invoices had a perfect document trail like purchase orders, time sheets, master software, service agreements, etc. and therefore very difficult to detect.

47. The scope of the enquiry as directed by the Bombay High Court was restricted only to the charge of conspiracy and involvement in the fraud and not to any charge of professional negligence. The charge of conspiracy or connivance was required to be established by the respondent on the basis of the material available pursuant to the investigation. The Bombay High Court while passing the order was conscious of the fact that Chartered Accountants were not amenable to SEBI Act. The order of the Bombay High Court was thus passed in the peculiar facts and circumstances of the given case wherein jurisdiction was conferred upon SEBI only if it proved that on the basis of the material the Chartered Accountant was instrumental in preparing false and fabricated accounts or had connived in the preparation and falsification of the books of accounts.

48. In our view, action against a Chartered Accountant can be taken only in terms of Chartered Accountants Act, 1949. SEBI cannot in

the garb of proving conspiracy and connivance on the part of the Chartered Accountant interpret the auditing standard on a standalone basis. The auditing standards can only be related to the professionalism of a Chartered Accountant vis-à-vis its professional misconduct which can only be considered by the ICAI.

49. The respondent on the basis of the material was required to prove that the audit firm or the engagement partners had willfully with intent and knowledge connived with the management of SCSL in the fabrication and falsification of the accounts and induced the investors in taking a wrong decision. No such finding has been arrived at by the WTM in the impugned order.

50. The WTM has dwelt at great length in considering the auditing standards prescribed under the Chartered Accountants Act in coming to a conclusion that the auditors acted in reckless or careless manner and thus committed a “fraud” as defined under Section 2(c) of the PFUTP Regulations. The approach adopted by the respondents is patently misconceived and based on surmises and conjectures. In the peculiar facts and circumstances of the case, a finding of guilt cannot be imposed upon the appellants on the basis of preponderance of probabilities. There has to be a specific finding that there was an intention on the part of the engagement partners and/or of the audit firm that they had deliberately with intention and knowledge

fabricated the books of accounts of SCSL in connivance with the top management of SCSL. In the instant case, there is overwhelming evidence to show that the fabrication and falsification of books of accounts was done only by the top management of SCSL and that the engagement partners as well as the audit firm had no clue nor had any hand in this fraud. Thus, pinning down the engagement partners and the audit firms on a preponderance of probabilities that they had committed a big fraud in a reckless and careless manner cannot in our view lead to a conclusion that there was any intention or *mens rea* on their part. The High Court was very clear and categorical that SEBI could only proceed under the SEBI laws only if there was a specific finding of mens rea against the engagement partners and / or the audit firm.

51. The contention that the term "*mens rea*" should be broadly construed and recklessness should be equated to be a part of the term "*mens rea"* is erroneous. On this issue, reliance by the respondents in the case of ***Naresh Giri vs. State of M.P. (2008) 1 SCC 791*** is misplaced as it was dealing with Sec. 304A of the Indian Penal Code where it was observed that a person is reckless if he carried out a deliberate act knowing that there is some risk of damage resulting from that act but nevertheless continues in the performance of that act. It was also stated that there are only two states of mind which

contributes *mens rea*, namely, "intention" and "recklessness". In the instant case, both elements are missing. No such finding to this extent has been given by the WTM. The said decision is thus not applicable. Contention that proof of intention is not required and that standard of proof can be based on preponderance of probabilities is also misplaced Reliance on this issue in ***Securities and Exchange Board of India vs. Rakhi Trading P. Ltd. 2018(13) SCC 753*** is wholly erroneous. In the case of ***Rakhi Trading (supra)*** the standard of proof was based on preponderance of probability in synchronized trading under the PFUTP Regulations. That principle is applicable to persons dealing in the securities market and is not applicable in the instant case. In the instant case, *mens rea* was not proved. There is no finding that the auditors or the audit firms had knowledge or had intention to connive or collude with the management in the fabrication of the books of account of the company.

52. On the issue of fraud reliance by SEBI on the decision of the Supreme Court in ***Securities and Exchange Board of India vs. Shri Kanaiyalal Baldevbhai Patel, (2017) 15 SCC 1*** is misconceived. The contention of SEBI that it can exercise its jurisdiction on a Chartered Accountant as the definition of fraud under Section 2(c) of PFUTP Regulations includes any representation made in a reckless or careless manner cannot be applied in the facts of the present case.

The decision of the Supreme Court in ***Kanaiyalal matter (supra)*** was passed where the person was dealing directly in securities. In the present case directions have been issued in a matter where a Chartered Accountant has certified the books of accounts. Such act of Chartered Accountant by no stretch of imagination could be treated as dealing directly or indirectly in securities. It is in this light that the Bombay High Court clearly held that *mens rea* is required to be proved and that there must be an intention and knowledge that an engagement partner / audit firm connived or colluded with the management in the falsification and fabrication of the books of account. The High Court clearly recorded:-

> *"It is further submitted that during inquiry if any evidence is brought to the effect that the Auditors with the connivance and in collusion with Mr. Ramalinga Raju had fabricated the accounts, then naturally SEBI can proceed against the petitioners."*

In furtherance to the aforesaid, the Bombay High Court further held:-

> *"In a given case, if ultimately it is found that there was only some omission without any mens rea or connivance with anyone in any manner, naturally on the basis of such evidence the SEBI cannot give any further directions."*

53. Thus, in order to issue any directions under the SEBI Act, SEBI was required to establish with evidence regarding "connivance" and

"collusion" by the auditors with the management of SCSL in the falsification of the books of accounts. In the present case there is no shred of evidence of any connivance or collusion nor there is any finding of actual collusion or connivance by the engagement partners and / or by the audit firm with the management of SCSL.

54. In this regard Section 11(4)(b) of the SEBI Act provides that the Board may by an order for reasons to be recorded in writing, in the interest of investors or securities market, take measures to restrain persons from accessing the securities market and prohibit any person associated with the securities market to buy, sell or deal in securities. Taking this provision into consideration, the Bombay High Court accordingly laid down the parameters by which SEBI could issue a direction against a Chartered Accountant while certifying the books of accounts of SCSL. The provisions of the SEBI Act cannot be construed to take into its sweep any professional who is remotely connected with the securities market by way of certifying the books of accounts. Such inclusion would necessarily expand the scope and ambit of the SEBI Act and simultaneously encroach upon the powers of the ICAI under the Chartered Accountants Act.

55. The impugned order deals at length with the non-adherence to the auditing standards issued by ICAI. These auditing standards

cannot be utilized to prove conspiracy or connivance on the part of a Chartered Accountant in the absence of any material evidence. Reliance on the auditing standards would only, at best, lead to a finding of a lapse in the professional work of Chartered Accountant which can become a ground for professional misconduct to be taken up strictly by the ICAI but such lapse under no circumstances could lead to a conclusion that the engagement partner / the audit firm had with intent manipulated the books of accounts in a reckless or careless manner.

56. Let us now consider what is the role of an auditor. Under Section 224 of the Companies Act, 1956, a Company is required to appoint an auditor. Under Section 226 of the Companies Act, an auditor must be a Chartered Accountant within the meaning of the CA Act. Section 227 provides powers and duties of an auditor. Under Section 229, an auditor is required to sign the auditor's report. Under Section 230, the auditor is required to read the auditor's report before the Company in general meeting. Failure to comply with the provisions of the Companies Act entails penalty upon the auditor under Section 233 of the Companies Act.

57. Auditing and Assurance Standards (AAS) has been framed by ICAI relating to the role and responsibility of an auditor. Under AAS2, the objective of an audit of financial statements, prepared

within a framework of recognized accounting policies and practices and relevant statutory requirements, if any, is to enable an auditor to express an opinion on such financial statements. The auditor's opinion helps determination of the true and fair view of the financial position and operating results of an enterprise. The user, however, should not assume that the auditor's opinion is an assurance as to the future viability of the enterprise or the efficiency or effectiveness with which management has conducted the affairs of the enterprise. The auditor's work involves exercise of judgement, for example, in deciding the extent of audit procedures and in assessing the reasonableness of the judgements and estimates made by management in preparing the financial statements. Furthermore, much of the evidence available to the auditor can enable him to draw only reasonable conclusions therefrom. Because of these factors, absolute certainty in auditing is rarely attainable. In forming his opinion on the financial statements, the auditor follows procedures designed to satisfy himself that the financial statements reflect a true and fair view of the financial position and operating results of the enterprise. The auditor recognizes that because of the test nature and other inherent limitations of an audit, together with the inherent limitations of any system of internal control, there is an unavoidable risk that some material misstatement may remain undiscovered. While in many situations the discovery of a material misstatement by

management may often arise during the conduct of the audit, such discovery is not the main objective of audit nor is the auditor's programme of work specifically designed for such discovery. The audit cannot, therefore, be relied upon to ensure the discovery of all frauds or errors but where the auditor has any indication that some fraud or error may have occurred which could result in material misstatement, the auditor should extend his procedures to confirm or dispel his suspicion.

58. Under AAS 4, the primary responsibility for the prevention and detection of fraud and error rests with both those charged with the governance and the management of an entity. The respective responsibilities of those charged with governance and management may vary from entity to entity. Management, with the oversight of those charged with governance, needs to set the proper tone, create and maintain a culture of honesty and high ethics, and establish appropriate controls to prevent and detect fraud and errors within the entity. An auditor cannot obtain absolute assurance that material misstatements in the financial statements will be detected. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements will not be detected, even though the audit is properly planned and performed in accordance with the auditing standards generally accepted in India.

An audit does not guarantee that all material misstatements will be detected because of such factors as the use of judgment, the use of testing, the inherent limitations of internal control and the fact that much of the evidence available to the audit is persuasive rather than conclusive in nature. For these reasons, the auditor is able to obtain only a reasonable assurance that material misstatements in the financial statements will be detected. The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting a material misstatement resulting from error because fraud, generally, involves sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the auditor to believe that evidence is persuasive when it is, in fact, false. The auditor's ability to detect a fraud depends on factors such as the skillfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those involved. Audit procedures that are effective for detecting an error may be ineffective for detecting fraud. Furthermore, the risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because those charged with

governance and management are often in a position that assumes their integrity and enables them to override the formally established control procedures. Certain levels of management may be in a position to override control procedures designed to prevent similar frauds by other employees, for example, by directing subordinates to record transactions incorrectly or to conceal them. Given its position of authority within an entity, management has the ability to either direct employees to do something or solicit their help to assist management in carrying out a fraud, with or without the employees' knowledge. The auditor's opinion on the financial statements is based on the concept of obtaining reasonable assurance; hence, in an audit, the auditor does not guarantee that material misstatements, whether from fraud or error, will be detected. Therefore, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not, in itself, indicate:

(a) failure to obtain reasonable assurance,

(b) inadequate planning, performance or judgment,

(c) absence of professional competence and due care, or,

(d) failure to comply with auditing standards generally accepted in India.

This is particularly the case for certain kinds of intentional misstatements, since auditing procedures may be ineffective for

detecting an intentional misstatement that is concealed through collusion between or amongst one or more individuals in the management. Whether the auditor has performed an audit or not in accordance with auditing standards generally accepted in India is determined by the adequacy of the audit procedures performed in the circumstances and the suitability of the auditor's report based on the result of these procedures. However, unless the audit reveals evidence to the contrary, the auditor is entitled to accept records and documents as genuine. Accordingly, an audit performed in accordance with auditing standards generally accepted in India rarely contemplate authentication of documentation, nor are auditors trained as, or expected to be, experts in such authentication.

59. Under AAS 30, the auditor should determine whether the use of external confirmations is necessary to obtain sufficient appropriate audit evidence to support certain financial statement assertions. In making this determination, the auditor should consider materiality, the assessed level of inherent and control risk, and how the evidence from other planned audit procedures would reduce audit risk to an acceptably low level for the applicable financial statement assertions. The auditor should employ external confirmation procedures in consultation with the management. In deciding the extent to use external confirmations, the auditor is required to consider the

characteristics of the environment in which the entity being audited operates and the practice of potential respondents in dealing with requests for direct confirmation. When obtaining evidence for assertions not adequately addressed by confirmations, the auditor considers other audit procedures to complement confirmation procedures or to be used instead of confirmation procedures.

60. Under AAS 28, the report should include a statement that the financial statements are the responsibility of the entity's management and a statement that the responsibility of the auditor is to express an opinion on the financial statements based on the audit. Financial statements are the representations of management. The preparation of such statements requires management to make significant accounting estimates and judgments, as well as to determine the appropriate accounting principles and methods used in preparation of the financial statements. This determination will be made in the context of the financial reporting framework that management chooses, or is required to use. In contrast, the auditor's responsibility is to audit these financial statements in order to express an opinion thereon. The auditor's report should describe the audit as including:

(a) examining, on a test basis, evidence to support the amounts and disclosures in financial statements;.....

The report should include a statement by the auditor that the audit provides a reasonable basis for his opinion.

61. Further, considering the auditing practices adopted by the ICAI, the Bombay High Court in ***Tri-Sure India Ltd. vs A.F. Ferguson and Co. and Others 1985 SCC OnLine Bom 342 : (1987) 61 Comp Cas 548***, held:-

> *"In "Statement on Auditing Practices" published by the Institute of Chartered Accountants of India in the year 1968, it is pointed out that it is the directors of a company who are primarily responsible for the preparation of the annual accounts and for the information contained in it. The duty of safeguarding the assets of a company is primarily that of the management and the auditor is entitled to rely upon the safeguards and internal controls instituted by the management, although he will, of course, take into account any deficiencies he may note therein while drafting the audit programme. The auditor does not conduct the audit with the objective of discovering all frauds, because in the first place it would take a considerable amount of time and it would not be possible to complete the audit within the time-limit prescribed by law for the presentation of accounts to the shareholders. Further, such an audit would have to involve a detailed and minute examination of all the books, records and other documents of the company, and the cost of doing so would be prohibitive and disproportionate to the benefits which may be derived by the shareholders. Finally, even if such examinations were to be conducted, there will be no assurance that all types of frauds, omissions and forgery, etc., would be discovered. The auditor, while conducting the audit, bears in mind the possibility of existence of fraud and irregularities in the accounts of the company."*

and further held-

> *"The duties of auditors must not be rendered too onerous. Their work is responsible and laborious, and the remuneration moderate..... auditors must not be made liable for not tracking out ingenious and carefully laid schemes of fraud when there is nothing to arouse their suspicion, and when those frauds are perpetrated by tried servants of the company and are undetected for years by the directors. So to hold would make the position of an auditor intolerable."*

The Court further held-

> *On consideration of the authorities cited at the Bar, the principles which can be carved out are as follows:*
>
> *The auditor is required to employ reasonable skill and care, but he is not required to begin with suspicion and to proceed in the manner of trying to detect a fraud or a lie, unless some information has reached which excites suspicion or ought to excite suspicion in a professional man of reasonable competence. An auditor's duty is to see what the state of the company's affairs actually is, and whether it is reflected truly in the accounts of the company, upon which the balance-sheet and the profit and loss accounts are based, but he is not required to perform the functions o: a detective. What is reasonable care and skill must depend upon the circumstances of each case.*

62. In ***Re Kingston Cotton Mill Company, 1896 2 Ch 279 the Court of Appeals*** examined the role of auditors and held that an auditor is not an insuror and that in the discharge of his duty, he is only bound to exercise a reasonable amount of care and skill depending on the circumstances of that case. The notion that the

auditor is bound to be suspicious as distinguished from reasonably careful would lead to a serious error.

63. In Institute of ***Chartered Accountants of India vs P.K. Mukherjee, AIR 1968 SC 1104***, the Supreme Court held:-

> *"In other words, the auditing was intended for protection of the beneficiaries and the auditor was expected to examine the account maintained by the trustee with a view to inform the beneficiaries of the true financial position. The auditor is, in such as case, under a clear duty towards the beneficiaries "to probe into the transactions" and to report on their true character."*

64. In ***Deputy Secretary to the Government of India, Ministry of Finance Vs S.N. Das Gupta , AIR 1956 Cal 414***, the Calcutta High Court while examining whether a Chartered Accountant was guilty of negligence in the discharge of his duties as auditor held:-

> *"the scope of the enquiry to be made by him and the nature of the facts which he has to certify have been held to be indicated. He has to ascertain and report not merely whether the balance-sheet exhibits, the true state of the company's affairs as shown in the books of the company, but also whether the books of the company themselves exhibit the true state of the company's affairs."*
>
> *"Next as to the method the Auditor must follow. He must of course examine the books of the company to see what they contain, but he must also ask for further information and for explanations when such are required. In performing that function, he is required on the one hand to employ reasonable skill and care, but on the other hand, he is not required to*

> *do more. He is not required to begin with suspicion and to proceed in the manner of trying to detect a fraud or a lie, unless some information has reached him which excites suspicion or ought to excite suspicion in a professional man of reasonable competence. An Auditor's duty is to see what the state of the company's affairs actually is and whether it is reflected truly in the accounts of the company upon which the balance-sheet and the profit and loss account are based, but he is not required to perform the functions of a detective. As has been said, he is a watch-dog but not a blood-hound and, as the same thing has been said without the aid of a metaphor, his duty is verification and not detection, although in performing the duty of verification, he must employ reasonable care and skill. What is reasonable care and skill must depend on the circumstances of each ease."*

65. In the light of the aforesaid, picking one para of an AAS and thus holding the appellants to be guilty of gross negligence and recklessness in conducting the audit is misplaced. Merely because the auditors failed to seek direct confirmation from the Bank relating to bank balances and fixed deposit does not amount to gross negligence or recklessness. AAS should be read as a whole. No doubt, under AAS-30 there is a responsibility of sending letters seeking external confirmation and, by not seeking external confirmation, the auditors failed to exercise care and prudence. However, it does not mean that there was gross negligence or carelessness or that the auditors had any intention to defraud the shareholders of the investors especially when alternate procedure as per para 39 of AAS-30 was adopted and no fault was found in

following such procedure. It may be noted here that SCSL enjoyed a good reputation for corporate governance and thus there was nothing wrong in accepting the bank statements and fixed deposits provided by SCSL. The same were on the letterhead of the Bank and there was no reason to suspect that the bank statement or the fixed deposits were not genuine. Merely saying that the norms laid down in AAS were not followed leads to an inference of gross negligence is misplaced. The auditor is required to employ reasonable skill and care and is not required to proceed in the manner of trying to detect a fraud. When the bank statements were presented by SCSL, the auditor was entitled to accept the document as genuine. Subsequent discovery of a material misstatement does not in our opinion amounts to gross negligence or recklessness amounting to fraud or complete failure to comply with the auditing standards. At best, it amounts to a lapse. The audit could have been conducted with more care and prudence.

66. The contention that the auditor should proceed with the attitude of professional skepticism as mandated under AAS-4 is misplaced. Picking a para somewhere from an AAS does not mean that the auditor only has to sniff like a bloodhound and proceed with an attitude of professional skepticism. The entire AAS is required to be considered as a whole to see what are the duties of an auditor and

what professional standards are required to be mentioned. Reliance by the respondents of a decision of the U.S. Court of Appeals in ***Kyle Pippins vs. KPMG LLP, MANU/FESC/0889/2014*** has no application to the present controversy. The Court was faced with the question whether the plaintiffs were entitled to receive overtime compensation. It was found that the plaintiffs received substantial specialised education as accountants and held that they were employed in a professional capacity and thus were not entitled to receive overtime compensation. While considering the kind of specialization, the Court observed that professional skepticism includes having a questioning mind and not doing something mindlessly, but with perpetual diligence founded in specialized knowledge and with consistent exercise of discretion and judgment. None of the above has been found in the impugned order except that the auditor should proceed with an attitude of professional skepticism. The WTM lost fact that there are other accounting standards apart from AAS-4.

67. Reliance on the decision in ***United States vs Benjamin 328 F. 2D 854 (1964)*** of the US Court of Appeals is misplaced. The case was concerned with a securities fraud by an accountant. The Court was examining whether there was sufficient evidence to convict the accountant. In that context, the Court held that the accountant

deliberately closed his eyes to facts he had duty to see. The accountant was convicted for conspiring willfully. It was found that the accountant had knowledge of the falsity of his reports and deliberately conspired to defraud investors. In that light the Court observed that the accountant deliberately closed his eyes. No such finding to this extent has been found in the instant case.

68. From the aforesaid decisions, the principles which can be culled out is that the auditor is required to employ reasonable skill and care but the auditor is not required to begin with suspicion or to proceed in the manner of trying to detect a fraud or a lie, unless some information has reached which creates suspicion. What is reasonable care and skill must depend upon the circumstance of each case. The auditor is not required to perform the functions of a detective. The auditor is a watchdog and not a blood hound. The duty of an auditor is verification and not detection.

69. Audit regulators around the world have identified certain themes, such as the need to exercise more professional skepticism in difficult audit areas. The circumstances may indicate a need for deeper examination of how the firms can improve audit quality so that the audit can serve as reliable and useful for shareholders and investors. There is a need to maintain a high quality audit on a consistent basis. In the Indian Courts, the audit oversight mechanism

is still evolving. The Companies Act, 2013 now mandates constitution of a separate National Financial Reporting Authority which would, inter alia, also review quality of services provided by the member of the ICAI which has already been set up in 2018. Complaints against auditors could be considered by this authority but professional skepticism in isolation cannot be considered under SEBI Laws. Under Section 28B of the CA Act, a Quality Review Board has been constituted to perform the following functions, namely-

(i) to make recommendations to the Council with regard to the quality of services provided by the members of Institute;

(ii) to review the quality of services provided by the members of the Institute including audit services; and

(iii) to guide the members of the Institute to improve the quality of services and adherence to the various statutory and other regulatory requirements.

70. Thus, in view of the aforesaid, SEBI as a regulator has no authority under SEBI laws and regulations to look into the quality of audit services performed by the auditors.

71. Detecting fraud is difficult, especially, involving material financial statement, misstatements, which occur in about 2 percent of

all financial statements (as per the study on forensic accounting and fraud detection issued by ICAI). Normally the documents supporting omitted transactions are not kept in Company files. False documentation is often created or legitimate documents are altered to support fictitious documents. While fraud detection techniques will not identify all frauds, the use forensic audit increases the likelihood that misstatements or defalcators could be detected. The job in forensic audit is to catch the perpetrators of the financial theft and fraud which could range from money laundering, tax evasion, false documentation, etc. Auditing the books of account and forensic auditing are two different and distinct areas. The procedures for financial audits are designed to detect material misstatement and not in material frauds. There is no doubt that many of the financial misstatements and frauds could be detected with the use of financial audits which can only be done by a detailed examination of the audit trail as well as the events and activities behind the documents. This procedure is problematic and involves a lot of time. On the other hand, financial audit is dependent on sample documents and reliance on the audit trail coupled with the fact that financial audit has to be completed within a stipulated period.

72. Thus, the auditor must not be made liable for not tracking the carefully laid schemes of fraud when there was nothing to arouse

their suspicion especially when the fraud is perpetuated by the top management of the Company and remain undetected for years. The auditor does conduct the audit with the objective of discovering all frauds. When an action is taken against the auditor, one has to look at the facts which have been subjected to scrutiny and explained by the auditors. The duty of the Tribunal is to endeavour and ascertain what was the problem presented to the auditor and what was the knowledge available to them at the time of audit. In our opinion it would not be fair to consider the case with hindsight and hold that the auditor was grossly negligent or reckless in the discharge of their duties. One must keep in mind the facts available at the time of the alleged negligence by the auditors and one should not be cowed down by the facts that emerged after a scrutiny was carried out by the special audit. So also the standard of care, while assessing the practice as adopted is justified in the light of knowledge available at the time of incident and not at the time of trial. The law requires that a professional man lives up in practice to the standard of the ordinary skilled man exercising and preferring to have special professional skill. He need not possess the highest expert skill; it is enough if he exercises the ordinary skill of an ordinary competent man exercising his particular art.

73. In ***Bolam vs Friern Hospital Management Committee [1957] 1 WLR 582*** it was held:-

> *"No matter what profession it may be, the common law does not impose on those who practice it any liability for damage resulting from what in the result turn out to have been errors of judgment, unless the error was such as no reasonably well-informed and competent member of that profession could have made."*

74. In ***Eckersley & Others vs. Binnie & Others, the Court of Appeal (Civ Div)*** held :-

> *"In deciding whether a professional man has fallen short of the standards observed by ordinarily skilled and competent members of his profession, it is the standards prevailing at the time of his acts or omissions which provide the relevant yardsticks. He is not, as the learned Judge in this case correctly observed (at p. 20H of his judgment) to be judged by the wisdom of hindsight. This of course means that knowledge of an event which happened later should not be applied when judging acts and omissions which took place before that event; a very relevant consideration here because knowledge of the Abbeystead catastrophe has (as the evidence shows) had a profound educational effect. It is proper and necessary to investigate very carefully the events leading up to this methane explosion to ascertain what assessment was made of the methane explosion risk, and why; but it is necessary if the defendants' conduct is to be fairly judged, that the making of this detailed retrospective assessment should not of itself have the effect of magnifying the significance of the methane risk as it appeared or should reasonably have appeared to ordinarily competent practical men with a job to do at the time."*

75. The aforesaid principle was adopted by the Supreme Court in ***Jacob Mathew vs State of Punjab and Another (2005) 6 SCC 1***. In ***Re: A Vakil, ILR (1925) 49 Mad***, it was held that negligence by itself is not a professional misconduct. It must have the element of moral delinquency. Similar view was adopted by the Supreme Court in ***Pandurang Dattatraya Khandekar vs. Bar Council of Maharashtra, Bombay and Ors. AIR 1984 SC 110***.

76. SEBI under the SEBI Act enjoys wide powers under Section 11, 11A and 11B to protect the interests of the investors in the securities market by taking such measures as it thinks fit. In ***Securities and Exchange Board of India vs Pan Asia Advisors Limited and Others (2015) 14 SCC 77***, the Supreme Court held:-

> *"75. On a reading of the above statutory provisions, we find under Section 11(1) of the SEBI Act, 1992, a duty has been cast on SEBI to protect the interest of the investors in securities and also to promote the development of the securities market as well as for regulating the same by taking such measures as it thinks fit. The paramount purpose has been shown as protection of interest of investors on the one hand and also simultaneously for promoting the development as well as orderly regulation of the security market. By way of elaboration under Sections 11(2)(a) to (e) it is stipulated that the duty of SEBI would include regulating the business in the stock exchanges and any other securities market which would include the working of stockbrokers, share transfer agents and similarly placed other functionaries associated with securities market in any manner, registering and regulating the working of the depositories, participants of securities including foreign institutional investors in*

*particular to ensure that fraudulent and unfair trade practices relating to securities markets are prohibited and also prohibiting insider trading in securities.*

*76. Under Sections 11(4)(a) and (b) apart from and without prejudice to the provisions contained in sub-sections (1), (2), (2-A) and (3) as well as Section 11-B, SEBI can by an order, for reasons to be recorded in writing, in the interest of the investors of securities market either by way of interim measure or by way of a final order after an enquiry, suspend the trading of any security in any recognised stock exchange, restrain persons from accessing the securities market and prohibiting any person associated with the securities market to buy, sell or deal in securities. On a careful reading of Section 11(4)(b), we find that the power invested with SEBI for passing such orders of restraint, the same can even be exercised against "any person".*

***77.** Under Section 11-B, SEBI has been invested with powers in the interest of the investors or orderly development of the securities market or to prevent the affairs of any intermediary or other persons referred to in Section 11 in themselves conducting in a manner detrimental to the interest of investors of securities market and also to secure proper management of any such intermediary or person. It can issue directions to any person or class of persons referred to in Section 11 or associated with securities market or to any company in respect of matters specified in Section 11-B in the interest of investors in the securities and the securities market. The paramount duty cast upon the Board, as stated earlier, is protection of interests of the investors in securities and securities market. In exercise of its powers, it can pass orders of restraint to carry out the said purpose by restraining any person."*

77. In ***Sahara India Real Estate Corporation Limited and Others vs Securities and Exchange Board of India and Another (2013) 1 SCC 1***, the Supreme Court held the SEBI Act is a special law and a

complete code in itself containing elaborate provisions with respect to protection of the interests of the investors. The SEBI Act is a special Act dealing with a specific subject which has to be read in harmony with the provisions of the Companies Act, 1956. The Companies Act and the SEBI Act will have to work in tandem in the interests of the investors. The Supreme Court held:-

> *"303.1. Sub-section (1) of Section 11 of the SEBI Act casts an obligation on SEBI to protect the interest of investors in securities, to promote the development of the securities market, and to regulate the securities market, "by such measures as it thinks fit". It is therefore apparent that the measures to be adopted by SEBI in carrying out its obligations are couched in open-ended terms having no prearranged limits. In other words, the extent of the nature and the manner of measures which can be adopted by SEBI for giving effect to the functions assigned to SEBI have been left to the discretion and wisdom of SEBI. It is necessary to record here that the aforesaid power to adopt "such measures as it thinks fit" to promote investors' interest, to promote the development of the securities market and to regulate the securities market, has not been curtailed or whittled down in any manner by any other provisions under the SEBI Act, as no provision has been given overriding effect over sub-section (1) of Section 11 of the SEBI Act."*

78. Thus, the powers conferred on SEBI under Section 11 and 11B is to protect the interests of investors in securities and to promote the development of and to regulate the securities market. Therefore, the measure to be adopted by SEBI is remedial and not punitive. In a given case a measure of debarring a person from entering the

securities market will be justified, but in our view, banning an audit firm or an auditor from auditing the books of a listed Company or from certifying any report of a listed Company cannot be justified. By no stretch of imagination, a direction debarring an auditor from auditing the books of a listed Company can be said to be remedial in nature. A remedial action is to correct a wrong, or a defect. Preventive measure can be issued in a given case of unfair trade practice or where fraud is proved. However, in the instant case, the direction to debar the auditor from auditing the books of a listed Company is neither remedial nor preventive. In fact, the direction is clearly punitive and violative of Article 19(1)(g) of the Constitution of India as it takes away the fundamental right to carry on its business. Reliance on the decision of Bank ***of Baroda vs. Securities and Exchange Board of India (2000) SCC OnLine SAT 2*** to contend that the powers under Section 11 and 11B of the SEBI Act are very wide and includes entities not within the regulatory purview of SEBI is misplaced. The decisions in Bank of Baroda, Sahara and Pan Asia deal with entities and market participants over whom SEBI has direct jurisdiction under the SEBI Act and its Regulations. Thus, the role of debarment is beyond the scope and powers under Section 11 and 11B of the SEBI Act. Direction under Section 11 and 11B of the SEBI Act can be issued to a person associated with the securities market. Such directions can only be remedial. If such person is not

dealing in securities then only remedial direction could be issued. Preventive directions cannot be issued. In our opinion, debarment is punitive. We may further point out that ICAI had initiated proceedings against the auditors under the CA Act and cancelled their license to practice as CA. Once their license has been cancelled, there was no need for SEBI to issue an order of debarment. In our opinion, it was a redundant exercise in view of Section 226 of the Companies Act which stipulates that only a CA under the CA Act could audit a Company. Once the license of an auditor to practice as a CA has been cancelled by the ICAI, the question of auditing the books of account of any company does not arise.

79. Appeal No. 6 of 2018 has been filed by ten partnership firms of CA comprising several partners having their head office at various places in India. The said ten firms are registered with the Institute of Chartered Accountants of India (ICAI) established under the CA Act. The said ten firms does not deal in securities either directly or indirectly. Further, the ten firms were never the statutory auditor of Satyam Computer Services Ltd. (SCSL).

80. The charge against the said ten firms is that they are entities / firms practicing as CA in India under the brand and banner of Price Waterhouse (PW) and are liable for the audit of SCSL on the basis of

them being a member of network of firms under the banner Price Warehouse (PW).

81. As regards the liability of the firms in the PW Network, the following facts, as revealed during the investigation, are relevant for consideration:

(i) SCSL had appointed 'PW' (branch office being in Hyderabad) as its auditors and PW Bangalore is stated to have taken up the assignment. Persons deployed for the SCSL Audits were sourced from various firms/offices of PW. The audits thus involved personnel from various firms linked to the PW Network.

(ii) The core engagement team who worked on the audit of SCSL was on the payroll of other PW firms, namely, Price Waterhouse Calcutta and Lovelock and Lewes Hyderabad and not PW Bangalore. The resources of these firms were utilized as per the resource sharing arrangement between member firms. PW Bangalore has paid the other two firms for the services rendered by them in the audit.

(iii) Srinivas Talluri, one of the partners who certified the accounts of SCSL during the period of the accounting fraud, is a partner in three Price Waterhouse firms, namely, Bangalore, Calcutta and Hyderabad and S. Gopalakrishnan, the other partner who certified the accounts of SCSL during the period of the accounting fraud, is a partner in two Price Waterhouse firms, namely, Hyderabad and Bangalore.

82. It has been alleged in the SCNs that these 11 firms have common branch offices located at New Delhi, Mumbai, Kolkata, Chennai, Bangalore, Hyderabad, Pune, Gurgaon, Bhubaneswar and Ahmedabad and there are several common partners in these firms. These firms share resources, manpower, offices, revenues etc. amongst themselves and, for this purpose, the ten firms entered into an agreement with each other. Most of the 'engagement team' members which worked on the audit of SCSL were on the payroll of Price Waterhouse, Kolkata and Lovelock and Lewes, Kolkata.

83. As per available documents, PW network firms in India are linked to each other on the following two fundamental basis:

a. the firms comprising the network are either members of or connected with the Price Waterhouse Coopers International Ltd. (PWCIL), a United Kingdom based private company; and

b. there are Resource Sharing Agreements with each other.

(i) The PW network of audit firms neither operate as a corporate multinational, nor do they act as agent of any other member firm.

(ii) Each of the ten firms-

(a) is wholly owned by Indian nationals registered as Chartered Accountants with the ICAI

(b) is a separate entity

(c) does not own stakes in one another

(d) is separately registered with ICAI

(e) maintains separate books of account

(f) accounts for profit and loss as a separate entity

(g) pays its personnel from separate budgets

(h) has their own PAN and GST Registrations

(i) files separate income tax returns

84. The WTM by the impugned order restrained the ten firms from issuing any certificate of audited listed companies under the brand

and banner PW and further directed the listed companies and intermediaries registered with SEBI not to engage any one firm forming part of the PW network for issuing any certificate with respect to compliance of statutory obligations with SEBI. The reasoning and finding of the WTM leading to the passing of the impugned order was based on the following reasons:-

(a) The webpage of PWC India indicates that PWC has offices at Ahmedabad, Bangalore, Chennai, Delhi, Hyderabad, Kolkata, Mumbai, Pune etc. and that the webpage that PWC Global describes PWC as the brand under which member firms of Price Waterhouse Coopers International Limited (PWCIL) operate and provide professional services which member firms include the ten firms in question.

(b) The settlement order of Securities and Exchange Commission, USA (SEC) has imposed remedial sanctions and a cease and desist order against five of the ten firms of PW in India in the context of fraud at SCSL, namely, Lovelock & Lewes, PW Bangalore, PW & Co. Bangalore, PW Calcutta and PW & Co. Calcutta.

(c) Similar findings were also given by Public Company Accounting Oversight Board (PCAOB), USA imposing similar sanctions.

(d) Institute of Chartered Accountants of India (ICAI) has formulated rules of network amongst the firms registered with ICAI which treats networks as being an aggregation of firms which function as a consolidated unit. The WTM perceived such network of firms as a single unit / common entity called Price Waterhouse (PW) instead of treating it as different registered partnership firms.

(e) The Price Waterhouse network allows the Indian firms to share the benefits arising out of the brand name PWC and the resources depending on the arrangements / agreements inter se the Indian firms. The brand PWC holds the ten partnership firms in a loose-knit network arrangement, enabling each firm to derive the advantages of the brand value without laying down any supervisory mechanisms to check the quality of performance of various firms under the network.

(f) The partners and the individual firms have ostensibly held out to the public to be a single consolidated network of firms under the brand PW.

(g) The engagement letter entered into by SCSL with PW is signed only as a Price Waterhouse. Neither the name of the relevant auditor nor the audit partnership firm has been recorded explicitly thereby leading the stakeholders to believe that the audit was done by the international network of PWC.

85. It was contended that the impugned order is manifestly erroneous in law and the directions given by the Bombay High Court was totally disregarded. The impugned order is stated to have been passed under Section 11 and 11B of the SEBI Act which empowers SEBI to issue directions in the nature of remedies in the interest of the securities market and investors in securities. It was urged that the action taken in the impugned order is not remedial but punitive in nature. It was contended that the alleged irregularities from 2000 to 2009 was only noticed when B. Ramalinga Raju made a statement in January 2009 with regard to financial manipulation in the books of account of the SCSL. The impugned order was passed on January 10, 2018 after nine years from the date of issuance of the SCN. It was thus urged, that no remedial action could be taken after nine years. The action had become stale and the delay caused, at the instance of SEBI, was not curable.

86. It was urged that the ban imposed is on the CA firms and not on the partners. It was contended that as on the date of the impugned order there were 98 partners in the ten firms out of which 70 are new partners who were not partners of the firms during the period 2000 to 2009 and thus banning them from doing audit work of listed Company merely because those are presently partners in PW firms is wholly arbitrary and illegal. Further, 90% of the staff engaged in the "engagement team" are different now and debarring them for no fault of theirs was thus also arbitrary and illegal.

87. It was thus contended that vicarious liability of a CA cannot be extended to the firm and other firms other than the audit firm nor the vicarious liability could be fastened upon the new partners who admittedly had no role in the audit of SCSL as they were not partners at the relevant moment of time.

88. It was contended that the WTM has failed to consider the provisions of The Partnership Act, 1932 which governs the appellant firms. The learned counsel submitted that under Section 31(2) of The Partnership Act, 1932 a partner is not liable for any act of the firm before he became a partner and thus submitted that the present partners who were not partners at the relevant moment of time could not be held liable for any act of the firm or its erstwhile partners.

89. It was contended that the ten firms were not involved in the audit of SCSL. Each of the ten firms is a separate legal entity registered with ICAI and has its own budget and is assessed separately under the Income Tax Act. The ten firms have a resource sharing agreement with each other, based on which the ten firms share resources, manpower, offices, etc. The sharing of such resources is to facilitate mobilizing of space, manpower at short notice and, does not in any way, make the ten firms as one big unit / firm.

90. Insofar as the engagement team was concerned, it was urged that the manpower were on a payroll of PW firms of Calcutta and Lovelock & Lewes Calcutta and their services were paid by PW Bangalore who undertook the audit of SCSL.

91. It was contended that banning the ten firms on the strength that they are part of the PW network was wholly illegal. Sharing of resources, offices, manpower was permissible by ICAI which governs the profession of CAs and thus holding that such networking under the brand name PW was responsible for the fraud in SCSL was totally farfetched which cannot be sustained under any provision of law. It was contended that each of the ten firms is a separate entity

registered separately with the ICAI and is assessed separately under the Income Tax Act.

92. It was urged that the ban order was wholly illegal and in violation of Article 14 & 19(1)(g) of the Constitution of India.

93. The stand of SEBI before us is the same. The learned senior counsel submitted that the findings given by the WTM does not suffer from any error of law. It was contended that under the SEBI Act, especially under Section 11 & 11B of the Act, SEBI enjoys wide and extensive power to issue any measures in the interest of investors and to promote the development of, and regulate the securities market. It was urged that one of the powers which SEBI can exercise is to issue a direction of debarment against persons associated with the securities market.

94. It was contended that the SCSL scam had a direct and adverse impact in the share market. The prices of SCSL scrip fell drastically. Millions of investors lost their hard earned money on account of abject failure on the part of the statutory auditor of SCSL in failing to comply with its duty to the shareholders of ensuring fairness and accuracy in the audited accounts. It was urged that failure to comply with the basic auditing standards constituted fraud and thus it was

vital to uphold the directions in the impugned order against all PW entities.

95. It was contended that even though PW Bangalore is stated to have taken up the audit assignment of SCSL, the audit assignment was accepted on behalf of PW. The letterhead did not mention PW Bangalore. In fact, the letter of acceptance was issued on the letterhead of PW Hyderabad and thus an irresistible inference can be drawn that all PW CA firms were one and the same under a common brand and network. This is further fortified that persons deployed for the audit were sourced from other PW firms of PW network.

96. The learned senior counsel submitted that the PW network enabled the PW entities to set up and maintain standards of auditing which were grossly deficient as per accounting norms prescribed by ICAI. The PW entities were projecting themselves as a brand value under the banner PW. Since the auditing standards across PW entities were deficient, it became imperative to issue directions against all the PW entities network. It was contended that since partners and staff were sourced from other PW entities, the gross non-compliance with accounting standards was not limited to those partners and staff but was related to all PW entities. It was urged that PW Bangalore was not representing the audit of SCSL. In fact, the network of PW entities represented themselves as the single network and functioned

as one “loose knit” unit. It was thus urged that the appellant’s contention that each firm was independent and a separate entity cannot be accepted. In any case, the alleged independence and individuality of the PW entities was not taken upon by them before the regulatory authorities in USA and the action taken against them was accepted by the appellant. Thus, it does not lie in their mouth to contend that they are independent entities.

97. It was further urged that the resource sharing agreement between the PW entities clearly indicated that they were entitled to draw resources from other firms and share notes relating to maintaining professional standards of accounting. The agreements makes it apparently clear that the firms worked closely with each other, as part of the PW network to maintain common standards in auditing and other services and therefore functioned as one consolidated unit.

98. In the light of the aforesaid, the admitted fact that is culled out on which there is no dispute is, that the ten firms are not dealing in the securities market. These firms are auditors registered with ICAI. They are independent bodies and have their own budget, maintain separate books of account and are assessed separately as a separate entity by the Income Tax Authority. These firms have no stakes in

one another. These ten firms were not the statutory auditors of SCSL and were not involved in the auditing of the books of account of SCSL. There is no evidence of revenue sharing between the PW firms.

99. There is no evidence to indicate that the ten firms had any role to play in the audit of SCSL. These ten firms had nothing to do with the audit of SCSL. They had no knowledge of the day to day affairs of SCSL either directly or indirectly. There is not even a whisper of a finding in the impugned order against the ten firms about any connivance or collusion or intention or knowledge on their part in the audit of SCSL. The entire basis of debarring the ten firms is the resource sharing agreement, the brand PW and the networking of PW as a brand. In our opinion, the approach adopted by the WTM is patently erroneous and is flawed.

100. In the absence of any finding of connivance or collusion or intention or knowledge on the part of the ten firms in the audit of SCSL, and in view of the clear cut directions of the Bombay High Court, no directions could have been issued by the WTM against the ten firms. The reasoning adopted by the WTM in relation to the resource sharing agreement, the brand PW and the networking of the PW cannot be accepted.

101. The ten firms have entered into a resource sharing agreement in which resources are shared pursuant to an agreement and on the basis of consideration and without liability being transferred. For facility, the contents of the agreement is extracted hereunder:-

> "WHEREAS the firms of chartered accountants are engaged mainly in providing audit and other related services.
>
> WHEREAS the firms employ qualified and trained resources for the purpose of providing audit and other related services to their respective clients.
>
> WHEREAS the Firms have agreed to work together and maintain certain standard and best business practices.
>
> WHEREAS in view of the growing volume of business of the Firms it is felt that in order to ensure rendering of quality services to their respective clients in the field of audit and other related services the Firms would draw collective resources employed amongst the Firms on an 'as-necessary' basis. The resource would include manpower, relevant technical expertise, administrative and other support (the shared resources) required to execute professional assignments.
>
> NOW THEREFORE it is agreed by and between the Parties and follows –
>
> A. Each Firm on an 'as-necessary' basis would be entitled to draw resources form the other Firms to ensure rendering of quality services to their respective clients.
>
> B. The consideration for rendering the above services would be mutually agreed between the Firms.
>
> C. The Firms shall meet from time to time through their designated representatives to exchange notes and professional learnings and shall

discuss means of enhancing their mutual benefit from one another in relation to shared resources, and maintain quality standards among the resources forming part of each firm.

D. The agreement shall have effect from 1st April, 2000. Any Party may terminate the above arrangement at any point by giving prior written notice of at least 90 days to that effect to the other Party. Such termination shall be without prejudice to the rights and obligations accruing prior to the termination taking effect.

E. Each Firm shall be responsible and liable for the delivery of services to clients and for all consequences relating to the professional assignments executed by such firm regardless of whether any of the shares resources have been deployed in the provision of services relating to the respective assignments.

F. Nothing contained in the agreement shall constitute an authority in favour of any of the Firms to represent, commit or engage on behalf of the other Firms merely by reason of the sharing of resources or any other act pursuant to the agreement. Nothing contained in the agreement shall constitute a partnership or an agency or donation of a power of attorney in fact or in law to represent, bind or liaise in favour of any Firm on behalf of any of the Firms. The sharing of resources pursuant to this agreement shall be purely on a principal-to-principal basis alone.

G. Any dispute or difference in relation to this agreement shall be resolved by binding arbitration by a sole arbitrator to be appointed by mutual consent in accordance with the Arbitration and Conciliation Act, 1996

IN WITNESS whereof this agreement has been duly executed the day and year abovewritten."

102. The resource sharing agreement makes it clear that the firms could draw collective resources employed amongst the firms on an "as necessary" basis in order to ensure rendering of quality services to their respective clients in the field of audit, etc. For the services rendered consideration would be paid to the said firm. Clause (E) of the agreement makes it apparently clear that the responsibility and liability will remain with the audit firm relating to the professional assignment executed by such firm and the firm which is providing any kind of resources would not be made liable or responsible. Clause (F) further amplifies that firms providing resources would not give any authority in favour of that firm to represent on behalf of other firms of the firm which has been given the audit. Further, the resource sharing agreement would not constitute a partnership between them and the sharing of resources would be purely on a principal-to-principal basis.

103. The WTM on the basis of this resource sharing agreement has concluded that the said agreement indicates a network between the PW firms. It is an admitted fact that one of the PW firms, namely, Lovelock & Lewes provided the staff which formed part of the engagement team deputed to work on the SCSL audit. As per the resource sharing agreement, this arrangement was permissible. There is evidence to the effect that the Bangalore firm paid Lovelock &

Lewes for the services rendered by them. No evidence of any misconduct of any kind has surfaced with regard to any member of the engagement team.

104. Thus, engaging staff from another PW firm was permissible under the resource sharing agreement which was allowed by ICAI. Therefore, no adverse inference of any kind of networking can be drawn. Further, the mere fact that Srinivas Talluri and S. Gopalakrishnan were also partners in other PW firms does not mean that all PW entities is one big entity or are working under one umbrella. If the law permits a person to be a partner in two or more firms, then it is permissible for that person to become partners in more than one firm. Misconduct committed by a partner in one firm will not make the second firm liable. Under the Companies Act it is permissible for a person to be a director in many Companies. If one director of a Company commits a violation of any SEBI laws and is penalized it does not mean that other Companies in which the said person is also a director are also penalized. Thus, if Srinivas Talluri and S. Gopalakrishnan are partners in a CA firm, a fault committed by them in that firm would not affect their liability in other CA firms.

105. ICAI has formulated Rules of Network amongst the firms registered with the ICAI. These Rules enable the practice of CA firms as a Network on a sharing of resources basis. In order to

appreciate as to what in fact is a network, it would be relevant to extract a few provisions of the Rule:-

***"RULES OF NETWORK***

*1. These Rules are called Rules for Network amongst the firms Registered with. The Institute of Cost Accountants of India.*

***2. Definition.***

*(i) Network –*

*"Network amongst two or more firms means an arrangement to facilitate the better function of the affiliate member firms in the interest of the profession and not for acquisition of any gain Such Network shall include the formal Network to use collective resources such as turnover, infrastructures manpower location for execution of Professional services of one or more type.*

*[Explanation –*

*1. An affiliation as referred to above shall also include:*

*(i) Having an association with an accounting entity within or outside India such that it results directly or indirectly in a common professional economic of beneficial interest.*

*(ii) One or mode of the entities holding out that it so affiliated or networked.*

*2. An entity shall not be treated as an affiliated of another merely for the reason that they*

*(a) Share professional knowledge and data base.*
*(b) Refer certain professional assignment or authorize the other to represent certain specific matters.*

*3. If different Indian firms are network with a common Multi-National Accounting Firms (MAF) then irrespective of the presence/absence of any affiliate relationship between the Indian firms inter-set they shall be considered as part of a network)*

*(ii)* ***Formal Network*** *- Formal network means a network amongst two or more firms registered with The Institute of Cost Accountants of India (ICAI) where the object of network is to use the collective resources of the affiliates for execution of professional services of one or more type at one and/or at multination points. The resources would include financial technical and other logistic support required to execute the professional assignment. In such type of network, the common resources may be pooled and exhibited together the service user as those belonging to one particular set of professional.*

***3. Name of Network:***

*(i) The Network may have distinct name which should be approved by the Institute. To distinguish a "Network" from a firm "of Cost Accountants, the words "&" Affiliates should be used after the name of the network and the words "& Co" /"& Associates" should not be used. The prescribed formal of application for approval of Name for Network is From 'A'(enclosed)*

*(ii) Standards prescribed in Regulation of the Cost & Works Accountants Regulation 1959 shall be applicable to the name of network.*

***4. Registration:***

*(i) A Formal network is required to be registered with the Institute in a prescribed From 'B'(enclosed).*

***5. Ethical Compliance :***

*Once the relationship of network arises, whether registered or not with the Institute, it with be necessary for such a network to comply with all applicable ethical requirements prescribed by the Institute from time to time in general and the following requirements in particular.*

*(a) If one firm of the network is the statutory of an entity then the associates (including the networked firm(s)) or the said firm directly/indirectly should not accept the internal audit or book-keeping or such other professional assignments which are prohibited for the statutory auditor firm.*

***6. Consent of Client:***

*The network shall obtain consent of the client to engage affiliate in discharging the professional assignment.*

***8. Object of Network:***

*The Network itself will not carry on any business for acquisition of gain for itself and only act as a facilitator for its members/constituents Members firms to pursue their professional jobs.*

***10. Issuing Reports:***

*Only the firm(s)/Member(s) forming network are eligible to issue/sign/attest any certificate/Report/professional document/assignment*

***11. Violation of Act:***

*In case of alleged violation of the provisions of the 'Act' Regulations framed there under guidelines/directions laid down by the Council from time to time and Code of Ethics by the Network firm, the proprietary/partnership*

*firms(s)/Individual Member constituting the Network would be answerable.*

106. From the aforesaid, it is clear that the Rules of Network provide that two or more firms can form a network. Such network share includes the formal network to use the collective resources such as turnover, infrastructure, manpower, etc. Formal network means a network amongst two or more firms registered with ICAI where the object of the network is to use the collective resources of the affiliates for execution of professional services. The resources would include financial, technical and other logistical support required to execute the professional assignments. Common resources could be posted and exhibited together. Further, the network would have a distinct name which has to be approved by ICAI. The Network is distinguished from a "firm" of CA. If the network is approved by ICAI, then the firm shall use the word "& Affiliates" instead of the words "& Co" or "& Associates". Accordingly, standards as prescribed by ICAI under the CA Regulations, 1988 would be applicable to the Network. Under Clause (4) of the Rules, a network is required to be registered with ICAI. Clause (6) prescribes ethical requirements, namely that if one firm of the network is the statutory auditor of an entity, then the associate firms should not directly or indirectly accept the internal auditing or book keeping.

107. In the instant case, there is no evidence on record to show that the network is registered with ICAI under the Network Rules. There is no evidence to show that the network is using the turnover or financial of each firm as a collective resource and the same is being pooled. There is no evidence that the ten firms are using the word "& Affiliates". In fact the evidence is otherwise. All the ten firms are using the words "& Co" or "Associates", which thus indicates that there is no network. However, before the SEC and the PCAOB and even before the Supreme Court some of the firms have admitted of having a network with PWCIL. We are of the opinion that mere admission on the part of the ten firms that there is a network of PW firms would not make all the ten firms guilty of fraud or manipulation of the books of accounts of SCSL. The approach of the WTM in aiming the network responsible for the fraud in SCSL is farfetched, and cannot be sustained. If ICAI allows independent firms to pool their resources it does not make these firms as one big unit. There is no shred of evidence to show that there was revenue sharing between the ten firms. We are further of the opinion that being members or connected with PW Cooper International Ltd., a UK based private limited company, may make them a network of firms under the name PW but that by itself does not make them responsible for the alleged irregularities in the audit of SCSL. The network Rules does not, in our opinion, shows that ICAI perceives a

network of firms as a “single unit”. For the purpose of avoidance of conflict of interest, the clause relating to ethical compliance providing that if one firm of the network is a statutory auditor of an entity, then an associate firm of the same network cannot accept internal audit of the same Company does not amount nor can it lead to an inference that the PW network is working as one consolidated unit. So long as these ten firms are separately registered and are assessed separately under the Income Tax Act, SEBI cannot hold them to be one large unit / entity.

108. SEBI produced a compilation of documents which included engagement letters, balance sheets signed by auditors, correspondence issued by auditors, minutes of board meetings, in order to make a point that the firms were holding out to the market as one entity and that the various letters and balance sheets showed that they were being signed in the name “Price Waterhouse” and not any particular firm like the appellant in Appeal No. 7 of 2019. SEBI thus contended that it is the network which represents SCSL and that the audit is conducted by the network when it uses the term “Price Waterhouse”. The contention of SEBI is completely misconceived and false. In our opinion the audit opinion is signed by the appellant in Appeal No. 7 and not by the network. Further, the letterhead used for the audit opinions as well as engagement letter is the letterhead of

"Price Waterhouse", i.e. the firm which conducted the SCSL audit and not the network of firms. The address of Hyderabad mentioned on the letterhead is the address of the Hyderabad branch of the firm which conducted the audit. We further find that AAS 28 of ICAI provides for the following:

> *"The report should be signed by the auditor in his personal name, where the firm is appointed as the auditor; the report should be signed in the personal name of the auditor and in the name of the audit firm. The partner / proprietor signing the audit report should also mention the membership number assigned by the ICAI."*

109. In accordance with the AAS 28, the audit opinion has been signed by the engagement partner, namely, Mr. Srinivas Talluri who has also put his ICAI membership number and the name of the firm which conducted the audit i.e. the appellant in Appeal No. 7 of which he was a partner. Clause 27 of the AAS 28 requires "place of signature" to be mentioned in the auditor's report. Accordingly, the place of signature i.e. Hyderabad was mentioned. Thus, it is clear that the letterhead bearing "Price Waterhouse" and the name of "Price Waterhouse" appearing in the signature clause is not the network of firms as suggested by SEBI. It is the name of the firm which conducted the audit namely "Price Waterhouse". The ICAI registration number of this auditing firm is 07568S.

110. SEBI's argument that the audit opinions were signed by the network of Price Waterhouse is legally untenable and contrary to the applicable law. Section 226(1) of the Companies Act, 1956 provides that-

> *"**226. QUALIFICATIONS AND DISQUALIFICATIONS OF AUDITORS.***
>
> *1. A person shall not be qualified for appointment as auditor of Company unless he is a chartered accountant within the meaning of the Chartered Accountants Act, 1449 (38 of 1949):*
>
> ***Provided** that a firm whereof all the partners practicing in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company, in which case any partner so practicing may act in the name of the firm".*

Therefore, the stress on the words "We", "our" etc in the audit opinion means that it represents the PW network is absolutely erroneous in as much as the representation was only by the concerned firm which conducted the audit.

111. SCSL and shareholders knew that they were appointing a firm and not a brand or a PW network. Further, SCSL and its shareholders knew that the specific partner alone would carry out the audit and not entire Firm. Audit can only be performed by a partner on behalf of a Firm and thus, the audit opinions have been signed by the concerned engagement partners of SCSL responsible for the audit. Section 229

of the Companies Act is a complete answer to the aforesaid. It provides:-

> ***"229. SIGNATURE OF AUDIT REPORT, ETC.***
> *Only the person appointed as auditor of the company, or where a firm is so appointed in pursuance of the proviso to sub-section (1) of section 226, only a partner in the firm practising in India, may sign the auditor's report, or sign or authenticate any other document of the company required by law to be signed or authenticated by the auditor."*

112. The definition of "engagement partner" under the ICAI Code of Ethics means the partner or other person in the firm who is a member of the ICAI and is in full time practice and is responsible for its engagement and its performance and its report that is issued on behalf of the firm and, who, where required, as an appropriate authority from a professional, legal or regulatory body. Much stress has been laid by the WTM on the engagement letter to mean that the audit was given to the PW network. The approach adopted is erroneous. The engagement letter is addressed by the firm which was appointed as the auditor viz., the appellant in Appeal No. 7 and not by the network of firms. Clause 12 of the Code of Ethics by ICAI states that-

> *"However, the Council has decided that where a Chartered Accountant while signing a report or, a financial statement or any other document is statutorily required to disclose his name, the member should disclose his name while appending his signature on the report or document. Where there is no such statutory*

*requirement, the member can sign in the name of the firm."*

113. The engagement letter indicates that it is the firm and not the network that has issued the engagement letter as can be seen from the letter heads and the signature clause of the engagement letters issued by firms Dalal & Shah, Price Waterhouse & Co. and Lovelock & Lewes. Similarly, even the letter for appointment of statutory auditors was addressed by SCSL to Mr. Gopalakrishnan at the Hyderabad branch of appellant in Appeal No. 7. The response was addressed by the Mr. Gopalakrishnan of the appellant in Appeal No. 7.

114. The WTM referred to certain letters to show that the letters were being addressed in the name of "Price Waterhouse" from the Shivaji Park office in Mumbai. It was thus urged that it was that PW network that was auditing the accounts of SCSL. The submission of the respondent is untenable for the same reasons that the said letters were issued by the appellant in Appeal No. 7 and not by the network firms. The Shivaji Park address is the branch office of the appellant in Appeal No. 7. It was signed by a partner of the appellant in Appeal No. 7. This does not in any way show any acceptance of responsibility by the network of appellant firms as alleged by SEBI. Section 27 of the Chartered Accountants Act, 1949 permits

maintenance of branch offices for Chartered Accountancy firms "Maintenance of branch offices: where a chartered accountant in practice or a firm of chartered accountants has more than one office in India, each one of the offices shall be in separate charge of a member of the institute. This clearly explains signing of the letter by the Shivaji Park branch of the appellant in Appeal No. 7 by one of its partner.

115. Thus the mere fact that the webpage of PWC India describes that they have offices at various places in India does not mean that they refer to the offices of the ten firms in question. The webpage of PWC global may describe PWC as a brand but it does not mean that it includes the brand PW which is operational in India. In any case, even if there is a network of PW firms, implicating the ten firms on the ground of networking as PW firms is misconceived and untenable. There has to be a specific finding that the ten firms were in collusion and that there was intention and knowledge to play fraud in the audit of SCSL.

116. The webpage of PWC or PWC global does not identify that PW entities are working closely with each other under the same brand and identify themselves with the said brand. Even if the PW brand is being used by the ten firms, it does not lead to an inference that these ten firms are PWC and the same entity. Using the brand PW, does

not make the ten firms liable for the act done by one PW firm. The liability for acts or omissions is certified to individual firms and cannot be passed on to the network firms using PW brand. The resource sharing agreement between the firms relates to sharing of certain types of resources. It was nothing to do with the brand PW. The ten firms have been allowed to use the PW name from the PWCIL UK. The mere fact that PW firms in India are members of PWCIL UK and are allowed to use the brand PW does not make them into a "loose knit network arrangement as one consolidated entity" and thus be made liable. If any advantage is gained by using the brand PW, it does not mean that all the PW firms are working under one umbrella even if the network is omnipresent and identifiable by its name.

117. The contention that investors were misled into believing that the audit was carried out by an international firm called PW is patently erroneous. The international firm is called PWC and the Indian firm is PW. There is a world of a difference between PWC and PW.

118. Much reliance has been placed on the settlement orders of the Securities and Exchange Commission (SEC) and Public Company Accounting Oversight Board (PCAOB). To elaborate on this issue,

we find that in the aftermath of the SCSL scam, the SEC and the PCAOB of the United States of America deemed it appropriate to institute "cease and desist" and censure proceedings against PW, Bangalore, Lovelock and Lewes, Kolkata, Price Waterhouse & Co. Bangalore, PW, Kolkata and Price Waterhouse & Co. Kolkata (Appellant Nos. 1, 5 and 2 in Appeal No. 6 of 2018). These proceedings were instituted pursuant to the relevant provisions of the Securities Act which, inter alia, dealt with an auditor lacking in character or integrity or found to have engaged in unethical or improper professional conduct or willfully violated or aided or abetted the violation of the securities laws. The consenting PW entities anticipated the institution of these proceedings and submitted 'an offer of settlement' which was accepted by the SEC and PCAOB. In the light of the said offers of settlement, consent orders were passed by both, SEC and PCAOB dated 5th April 2011. In the order dated 5th April 2011, the SEC observed that there had been gross violations of the auditing standards in the SCSL audit.

119. The WTM has relied upon certain observations made in these orders, some of which are extracted hereunder:-

> *"4. The failures in the confirmation process on the Satyam audit were not limited to that engagement, but were indicative of a quality control failure throughout PW India. During the relevant period, PW India's quality control system failed to detect that engagement*

*teams throughout PW India routinely relinquished control of the delivery and receipt of cash confirmations to their audit clients and rarely, if ever, questioned the integrity of the confirmation responses they received from the clients. Despite annual quality reviews, PW India did not recognize this compliance failure until after January 2009....*

*11. Lovelock, PW Bangalore, PW Co. Bangalore, PW Co. Calcutta, and PW Calcutta are member firms of PricewaterhouseCoopers International Limited, a United Kingdom-based private company.*

*12. PW India, along with five other India-based PwC network Firms, operate as a domestic Indian network of related audit firms. As such, these firms share common audit and other assurance and assurance risk management leadership and follow common audit and other assurance policies and procedures, including in the areas of audit and assurance risk management, training and supervision.*

*13. PW India and the five other India-based PwC Network Firms operate their audit practices under resource sharing arrangements that facilitate the provision of audit services as a network of related firms. … PW India partners typically are affiliated with several firms within the domestic network of audit firms simultaneously. During the relevant period, PW India and the other domestic India-based firms shared resources and settled inter-firm balances at the end of each fiscal year.*

*14. PW India and the five other India-based PwC Network Firms operate in a manner that generally does not make any distinctions among the individual firms in the network. For example, the PW India Firms share office space and have identical telephone numbers. In addition, the Respondents' website makes no obvious distinction among the individual PwC Network Firms located in India."*

120. We have perused the SEC order and PCAOB order. We are of the opinion that the observations made in the said orders cannot be relied upon as a piece of evidence in as much as these are settlement orders where the firms agreed to settle with SEC and PCAOB in exchange for a reasonable order involving remedial measures as a result of which the firms were allowed to continue with the existing audit engagement. The settlement orders issued a slew of remedial measures which was accepted and acted upon by the appellants. In our view, the settlement orders have no precedential value in SEBI proceedings. If SEC and PCOAB are to be relied upon by SEBI, then they should have also issued similar measures and further allowing PW firms to continue with the existing audit arrangement instead of debarring them from auditing listed Companies. The appellants have denied the findings and observations in these orders and in our opinion are entitled to deny these findings in any other legal or regulatory proceedings. Whereas, SEC & PCAOB had jurisdiction over auditors of US listed Companies, the same is not the case with SEBI. We may point out that PCAOB in its order acknowledged at multiple places that PW Bangalore served as SCSL's auditor. The PCAOB also recorded that Price Waterhouse & Co., Bangalore, Price Waterhouse, Calcutta and Price Waterhouse & Co., Calcutta did not participate in the audits of SCSL.

121. In our view the observations made in SEC & PCAOB orders that failure in the confirmation process in the SCSL audit were not limited to that engagement but were indicative of a quality control failure throughout PW India or the observations that there had been gross violations of the auditing standards in the SCSL audit cannot be utilized. The WTM, in order to implicate the PW firms was then required to go into the individual accounting standards adopted by each firm in relation to their audit engagement with their listed Company and then arrive at a finding that the accounting standards were not a per the standards prescribed by the ICAI. Resource sharing agreement would not in our view lead to a conclusion that each firm was adopting the same accounting standards as adopted by the audit firm which audited SCSL. Thus, reliance by the WTM on the SEC & PCAOB orders does not prove connivance or collusion, nor leads to a conclusion that these firms do not meet with the prescribed accounting standards as per ICAI.

122. The decision in ***S. Sukumar vs. Secretary, Institute of Chartered Accountants of India, (2018) 14 SCC 360*** relates to possible violation of Section 25 and Section 29 of CA Act and FEMA Regulations. The observations given are only prima facie. In fact the Supreme Court directed the Union of India to constitute a three member Committee of experts to look into the statutory

framework of Sections 25 and 29 of the CA Act and to bring appropriate legislation for oversight of the profession of auditors, etc. In the instant case, the jurisdiction of SEBI to pass orders against CA is governed by the Bombay High Court order which provides that SEBI has to establish intention, knowledge, connivance, collusion, *mens rea* on the part of a CA. The order of Bombay High Court is binding on SEBI.

123. There is one other aspect which nails the issue and this is Section 31(2) of the Indian Partnership Act, 1932. For facility, the provision is extracted hereunder:-

> *Section 31(2)*
>
> *"Subject to the provisions of section 30, a person who is introduced as a partner into a firm does not thereby become liable for any act of the firm done before he became a partner."*

124. The aforesaid provision is patently clear. A new partner inducted into a firm is not liable for any act of the firm done before he became a partner. Further, when a new partner is taken or an existing partner retires with the consent of all the partners, it becomes a case of reconstitution of the partnership firm under Section 187 of the Income Tax Act. Where a firm is dissolved either by agreement of the partners or by operation of law and another firm takes over the business, then it will be a case of succession governed by Section

188 of the Income Tax Act as held by a Full Bench of the Allahabad High Court in ***Dahi Laxmi Dal Factory vs. Income Tax Officer, Sitapur, 1974 All LJ 883***.

125. Thus, the liability of a new partner commences from the date of his admission as a partner in the firm. He is not liable for the pre-existing debts. Unless there is an agreement to show that the incoming partner is liable for the pre-existing debts, a new partner cannot be made liable to honour the liabilities of the old firm before he became a partner.

*126.* In this regard, reliance is placed on the judgment of ***Sharad Vasant Kotak and Ors vs Ramnik Lal Mohanlal Chawda and Anr. [(1998) 2 SCC 171]***. Paragraph 16 of the judgment states:-

> *"Each partner is, it is true, the agent of the firm; but as pointed out before, the firm is not distinguishable from the persons from time to time composing it; and when a new member is admitted he becomes one of the firm for the future, but not as from the past, and this present connection with the firm is no evidence that he ever expressly or impliedly authorized what may have been done prior to his admission. This is wholly consistent with the fact that after the admission of a new member, a new partnership is constituted, and thus special circumstances are required to be shown before the debts and liabilities of the old partnership are treated as having been undertaken by the new partnership."*

127. From the aforesaid, it is apparently clear that every time there is a change in the partnership, the firm is treated to have been

reconstituted and appropriate filings are done as per Regulation 190(4) and 190(7) of CA Regulations, 1988.

128. In this regard the appellants have taken a specific plea in paragraphs 6.20 and 6.24 of the memo of appeal, namely, that a majority of the current partners of the ten firms became partners only after 2009. This fact has not been denied by the respondent. As on the date of the impugned order there were 98 partners in the ten firms out of which 70 are new partners who were not partners of the PW firms during the period 2000 to 2009. Thus banning them from doing audit work of listed Company merely because they are presently partners in PW firm is in complete violation of Section 31(2) of the Partnership Act. Specific arguments were raised by the ten firms on this issue before this Tribunal which was not countered by the respondent. However, in the written submission a feeble assertion was made to the effect that the SEBI Act is a standalone statute and the direction issued under the SEBI Act cannot be tested on the basis of the provisions of the other Acts. It was asserted that securities fraud is unique and must be viewed in the context of the securities market and innocent investors which cannot be rectified by resorting to conventional and old laws. Such submissions show bankruptcy of ideas. Instead of conceeding, the attitude of the respondent appears to be that SEBI and SEBI laws are superior, and that SEBI cannot be

brow beaten. The respondent has lost sight of Section 32 of SEBI Act which specifically provides that the provisions of the SEBI Act shall be in addition to, and not in derogation of the provisions of any other law for the time being in force. Such "old" law is the Partnership Act which is still in force and is squarely applicable.

129. Section 4 of The Partnership Act, 1932 defines a "partnership". The Supreme Court in ***Deputy Commissioner of Sales Tax, (Law) Board of Revenue (Taxes), Ernakulam vs. M/s. K. Kelukutty, (1985) 4 SCC 35*** explained partnership as-

> *"The Indian Partnership Act, 1932 has, by Section 4, defined a "partnership" as "the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all". The section declares further that the persons who have entered into partnership with one another are called individually "partners" and collectively "a firm". The components of the definition of "partnership", and therefore of "a firm" consist of (a) persons, (b) a business carried on by all of them or any of them acting for all, and (c) an agreement between those persons to carry on such business and to share its profits. It is the relationship between those persons which constitutes the partnership. The relation is founded in the agreement between them. The foundation of a partnership and, therefore, of a firm is a partnership agreement. A partnership agreement is the source of a partnership; it also gives expression to the other ingredients defining the partnership, specifying the business agreed to be carried on, the persons who will actually carry on the business, the shares in which the profits will be divided, and the several other considerations which constitute such an organic relationship. It is permissible to say that a partnership agreement creates and defines the relation of*

> *partnership and therefore identifies the firm. If that conclusion be right, it is only a further step to hold that each partnership agreement may constitute a distinct and separate partnership and therefore distinct and separate firm. That is not to say that a firm is a corporate entity or enjoys a juristic personality in that sense. The firm name is only a collective name for the individual partners. But each partnership is a distinct relationship. The partners may be different and yet the nature of the business may be the same, the business may be different and yet the partners may be the same. An agreement between the partners to carry on a business and share its profits may be followed by a separate agreement between the same partners to carry on another business and share the profits therein. The intention may be to constitute two separate partnerships and therefore two distinct firms. Or to extend merely a partnership, originally constituted to carry on one business, to the carrying on of another business. It will all depend on the intention of the partners. The intention of the partners will have to be decided with reference to the terms of the agreement and all the surrounding circumstances, including evidence as to the interlacing or interlocking of management, finance and other incidents of the respective businesses."*

130. The aforesaid makes it clear that partners may be different even though the business may be same, still it would constitute two separate distinct partnership and therefore two distinct firms.

131. In ***Ritesh Agarwal and Another vs Securities and Exchange Board of India and Others, (2008) 8 SCC 205***, the Supreme Court held:-

> *"A citizen of India has a right to carry on a profession or business as envisaged by Article 19(1)(g) of the Constitution of India. Any restriction imposed thereupon must be made by reason of a law*

> *contemplated under clause (6) thereof. In the absence of any valid law operating in the field, there would not be any source for imposing penalty. A right to carry on trade is a constitutional right. By reason of the penalty imposed, the Board inter alia has taken away the said constitutional right for a period of ten years which, in our opinion, is impermissible in law as the Regulations were not attracted."*

132. The said principle is squarely applicable in the instant case. If the appellants have violated the provisions of the Companies Act they can be prosecuted there under but the respondent cannot invoke the SEBI laws in this cavalier fashion which violates the appellants' fundamental right to carry on business as envisaged under Article 19(1)(g) of the Constitution of India.

133. There is yet another aspect. The show cause notice was issued on February 14, 2009 and August 26, 2009. The impugned order was passed on January 10, 2018. It took SEBI nine long years to complete the proceedings and the fault lay entirely on SEBI. The request of the appellants to cross examine certain individuals whose statements were relied upon by SEBI was rejected. This Tribunal on June 1, 2011 allowed the appeal and directed SEBI to allow cross examination. SEBI did not do so and took the matter to the Supreme Court and kept it pending for six years. The Supreme Court on January, 2017 held that the stand of SEBI was incorrect and directed

that cross examination and inspection should be allowed to the appellants.

134. During the pendency of the proceedings, the appellants were carrying on their business and auditing listed companies to the satisfaction of the shareholders and / or of the investors without any blemish. Over the last decade, the appellants have adopted extensive remedial measures as per SEC / PCAOB settlement orders. The independent monitors appointed by SEC / PCAOB have certified that remedial measures have been successfully implemented, meaning thereby that the audit quality met with the requisite standards. Thus looking from this angle also, the order of debarment was not the appropriate choice.

135. Thus, considering the aforesaid we are of the view that the order of WTM debarring the PW firms to audit listed company on the ground of PW network or projecting it as a PW brand cannot be sustained.

136. There is no doubt that there has been a professional lapse on the part of the auditors in conducting the audit especially their failure to seek direct confirmation from the Bank relating to Bank Balances and fixed deposits. These lapses amounted to negligence. Action has already been taken by ICAI against the auditors. Negligence is the

breach of duty caused by omission to do something which a reasonable man is guided by these considerations to do something which a prudent and reasonable man would not do so. Negligence becomes actionable on account of a lapse or omission amounting to negligence. In the concept of negligence amounting to an offence, the element of *mens rea* must be shown to exist, but under Torts, negligence becomes actionable on account of lapse or omission. Once you breach your duty, negligence becomes actionable as there has been a failure to attain that standard of care.

137. A professional such as an auditor comes under a category of persons professing some special skill. Any task which is required to be performed with a special skill would generally be undertaken to be performed only if the person possesses the requisite skill for performing that task. The only assurance which such professional can give is, that he is possessed of the requisite skill in that branch of profession which he is practicing and that he would be exercising his skill with reasonable competence. This is what a person / Company approaching the professional can expect.

138. Thus, a professional may be held negligent if he is not possessed of the requisite skill which he professed to have possessed or he did not exercise with reasonable competence. The standard to be applied for judging whether the person charged has been negligent

or not, would be that of an ordinary competent person exercising ordinary skill in that profession. It is not necessary for that person to possess the highest level of expertise in that branch which he practices.

139. In the light of the aforesaid, the WTM found that for this negligence, the auditors and the firms benefitted by way of charging a fee amounting to Rs. 13,09,01,664/-. The WTM was of the opinion that this wrongful gain was liable to be disgorged. We find that for this professional lapse, there has been a breach of duty and failure to maintain that standard of care. For this lapse / negligence, we are of the opinion that the appellants were not justified to retain this amount. In our opinion, the WTM was justified in disgorging the said amount along with interest. The power was rightly exercised under Section 11 and 11-B of the SEBI Act to persons who in some way was associated with the securities market as well as under the Companies Act.

140. For the reasons stated aforesaid, the order of the WTM of SEBI debarring the PW firms as well as the two auditors from auditing listed Companies cannot be sustained and is quashed. Directions to listed Companies not to engage any audit firm forming part of PW network is also quashed. Appeal No. 6 of 2018, Appeal No. 190 of 2018 and Appeal No. 191 of 2018 are allowed. The order of the

WTM disgorging the amount is sustained and consequently Appeal No. 7 of 2018 is partly allowed. In the circumstances of case, parties shall bear their own costs.

Sd/-
Justice Tarun Agarwala
Presiding Officer

Sd/-
Dr. C. K .G. Nair
Member

09.09.2019
Prepared and compared by:msb