

## SECURITIES AND EXCHANGE BOARD OF INDIA

## ORDER

UNDER SECTIONS 11(1), 11(4) AND 11B OF THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 AND REGULATION 11 OF THE SEBI (PROHIBITION OF FRAUDULENT AND UNFAIR TRADE PRACTICES RELATING TO SECURITIES MARKET) REGULATIONS, 2003 IN THE MATTER OF PRICE WATERHOUSE AND ORS. RELATING TO THE CASE OF SATYAM COMPUTER SERVICES LIMITED

In respect of:

Sl.No.	Notices /Name of the entities	PAN
1	M/s. Price Waterhouse, Bangalore (ICAI Registration No. 007568S)	AAEFP5579P
2	M/s. Price Waterhouse & Co., Bangalore (ICAI Registration No. 007567S)	AADFP9359C
3	M/s. Price Waterhouse & Co. Kolkata (ICAI Registration No. 304026E)	AAHFP0187A
4	M/s. Lovelock and Lewes, Hyderabad (ICAI Registration No. 301056E)	AABFL5878L
5	M/s. Lovelock and Lewes, Mumbai (ICAI Registration No. 116150W)	AAFFL0866Q
6	M/s. Price Waterhouse, Kolkata (ICAI Registration No. 301112E)	AAEFP3641G
7	M/s. Price Waterhouse, New Delhi (ICAI Registration No. 12754N)	AAFFP3698A
8	M/s. Price Waterhouse & Co., Chennai (ICAI Registration No. 50032S)	AAAFP8828M

9	M/s. Price Waterhouse & Co., New Delhi (ICAI Registration No.16844N)	AAEFP1428R
10	M/s. Dalal & Shah, Ahmedabad (ICAI Registration No. 102020W)	AAAFD6520G
11	M/s. Dalal & Shah, Mumbai (ICAI Registration No. 102021W)	AAAFD0907D
12	S Gopalakrishnan (ICAI Membership No. 018863)	ATAPS1319R
13	Srinivas Talluri (ICAI Membership No. 029864)	ABAPT0642E

### **Background in brief**

1. Securities and Exchange Board of India (SEBI) received an email dated January 7, 2009 from Mr. B. Ramalinga Raju, the then Chairman of Satyam Computer Services Limited (hereinafter referred to as 'SCSL', 'the company'), admitting and confessing to large scale financial manipulations in the books of account of SCSL. The email, *inter-alia*, stated the following:
  - a. The Balance sheet of SCSL carries, as of September 30, 2008:
    - i. Inflated (non-existent) cash and bank balances of ₹ 5,040 crore (as against ₹ 5,361 crore reflected in the books);
    - ii. An accrued interest of ₹ 376 crore, which is non-existent;
    - iii. An understated liability of ₹ 1,230 crore on account of funds arranged by him;
    - iv. An overstated debtor position of ₹ 490 crore as against ₹ 2,651 crores reflected in the books.
  - b. For the quarter ending September 30, 2008, SCSL had reported a revenue of ₹ 2,700 crore and an operating margin of ₹ 649 crore (24% of revenues) as against actual revenues of ₹ 2,112 crore and an actual operating margin of ₹ 61 crore (3% of revenues) resulting in artificial cash and bank balances going up by ₹ 588 crore in this quarter alone.
  - c. The gap in the balance sheet has arisen purely on account of inflated profits over a period of last several years.

2. In view of the above, SEBI carried out an investigation into the affairs of SCSL to ascertain, particularly, whether the provisions of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as “SEBI Act”) and Rules and Regulations framed thereunder have been violated. The statutory auditor of SCSL from April 1, 2000 was Price Waterhouse, Chartered Accountants.
  
3. The investigation 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 account of SCSL contained false and inflated current account bank balances, fixed deposit balances, fictitious interest income revenue from sales and debtors’ figures and for several years. 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. On the basis of the findings of the investigation, a Show Cause Notice (SCN) dated February 14, 2009 was issued to Noticee Nos. 1 to 4, 12 & 13 and a SCN dated August 25, 2009 was issued to Noticee Nos. 5 to 11 asking them to show cause as to why directions under sections 11, 11(4) and 11B of the SEBI Act shall not be issued against them for the alleged violation of the provisions of section 12A (a), 12A(b) and 12A(c) of the SEBI Act read with regulation 3(c), 3(d), 4(1), 4(2)(a), 4(2)(e), 4(2)(f), 4(2)(k) and 4(2)(r) of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 (PFUTP Regulations). Subsequently, a Supplementary Show Cause Notice (hereinafter referred to as ‘SSCN’) dated February 19, 2010 was issued to Noticee Nos. 1 to 9 and 12 & 13. A show cause notice dated February 19, 2010 was also issued to Noticee Nos. 10 & 11, which contained reference to earlier SCNs. The SSCN also contemplates to disgorge the amount of fees/gains of ₹ 23.31 crore made by the Noticees or any further amount found to have been received by the Noticees for the audit of SCSL from the year 2001 to 2008.
  
4. As regards Price Waterhouse, Chartered Accountants, it has been mentioned in the SCN that the board of Price Waterhouse Coopers International Limited had then approved 11 partnership firms consisting of Chartered Accountants as their partners (Noticee Nos. 1 to 11) to use the name ‘*Price Waterhouse*’ in India. Chartered Accountants who are partners/employees in any of these firms are involved in audit of a company in which Price Waterhouse is appointed as auditor. The auditors’ report, balance sheets and profit and loss accounts of SCSL were signed by S Gopalakrishnan,

Chartered Accountant (Noticee No. 12) for the period April 2000 to March 2007. He was a partner in Price Waterhouse, Bangalore (FRN: 7568S; Noticee No. 1) and Lovelock and Lewes, Kolkata (FRN: 301056E; Noticee No. 4). The auditors' report, balance sheets and profit and loss account of SCSL for the period April 2007 to September 2008 were signed by Srinivas Talluri, Chartered Accountant (Noticee No. 13) on behalf of Price Waterhouse, Chartered Accountants. He was a partner in Price Waterhouse, Bangalore (FRN: 7568S; Noticee No. 1), Lovelock and Lewes, Kolkata (FRN: 301056E; Noticee No. 4) and Price Waterhouse & Co., Kolkata (FRN: 304026E; Noticee No. 3). 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, Noticee Nos. 1 to 9 have entered into an agreement with each other in the year 2000 and Noticee Nos. 10 and 11 in July 2008. Most of the 'engagement team' members which worked on the audit of SCSL was on the payroll of Price Waterhouse, Kolkata (FRN: 301112E; Noticee No. 6) and Lovelock and Lewes, Kolkata (FRN: 301056; Noticee No. 4).

5. A preliminary reply to the SCN dated February 14, 2009 was submitted by Noticee No. 1 on August 10, 2009. The entity, *inter alia*, denied that it has indulged in any fraudulent and unfair trade practices as alleged in the SCN and submitted that the directions contemplated in the notice are in the nature of partial suspension of the license to practice and such action, if at all, can only be taken by the Institute of Chartered Accountants of India (ICAI) and not by SEBI. It was also submitted then that they have been seriously constrained in their ability to respond to the SCN as two engagement partners on the SCSL audit, i.e. Noticee Nos. 12 & 13, were in custody since January 23, 2009 and were unavailable throughout the preparation of preliminary reply. It was also submitted that their ability to respond to the SCN was further constrained by denial of full inspection and copies of all documents referred to and relied upon in the SCN. They also requested for cross-examination of various witnesses, including those whose statements have been relied upon in the notice.
6. Pursuant to the receipt of preliminary reply, the Noticees were granted an opportunity of hearing before the then Whole Time Member, SEBI. During the hearing held on March 30, 2010, the Noticee No. 1 requested for additional time to file reply as inspection of documents was not yet

complete. Accordingly, the noticees were granted time to inspect the documents and file detailed reply. Vide letter dated May 5, 2010, Noticee No. 1 reiterated its preliminary objections that SEBI lacked jurisdiction to issue the directions contemplated under the show cause notice against it as it cannot be said to have 'dealt in securities' nor is it a 'person associated with the securities market'.

7. On July 6, 2010, Noticee Nos. 1 to 11 filed Writ Petitions (No.5249 of 2010 and 5256 of 2010) before the Hon'ble High Court of Bombay for quashing the proceedings initiated on the basis of aforesaid show cause notices on the ground that SEBI lacked jurisdiction to issue the notices in the matter as by doing so, it is encroaching upon the jurisdiction of ICAI. The Hon'ble High Court rejected these Writ Petitions by judgment and order dated August 13, 2010. After considering various judgments and the provisions of the SEBI Act, it was held that the SCNs have not been issued in excess of jurisdiction. Hon'ble High Court observed as under:

*"... . . . . By this judgment, we have only indicated that on the face of it, it cannot be said that SEBI has absolutely no jurisdiction to issue show cause notices against the petitioners simply because they are professionals and whether the facts stated in the show cause notice are correct or not may be adjudicated as per the evidence available, after affording reasonable opportunity of hearing to the petitioners. The SEBI shall now proceed with the matter in accordance with law and adjudicate the matter which is indicated on the basis of show cause notices in accordance with law. . . . . ."*

8. Noticee Nos. 12 & 13 (S Gopalakrishnan and Srinivas Talluri), appeared for hearing on November 30, 2010 and requested that the proceedings initiated vide the aforesaid SCN may be kept in abeyance till the conclusion of their criminal trials in the matter initiated by CBI in the Hon'ble ACMM Court at Hyderabad. After granting an opportunity of hearing, SEBI passed an order dated January 18, 2011 rejecting the request of the noticees to keep the proceedings in abeyance. The engagement partners (i.e. Noticee No. 12 & 13) filed Writ Petitions (WP No. 1899 & 1900 of 2011) in the High Court of Bombay seeking an order staying the proceedings against them, amongst other reliefs. In the said writ petitions, Hon'ble High Court of Bombay, vide order dated February 27, 2012 directed SEBI to commence the proceedings pursuant to the SCNs against S Gopalakrishnan and Srinivas Talluri from the week commencing from May 7, 2012 and that if by then, the trial in criminal case did not get over, SEBI shall ensure that its dates of inquiry do not clash with the dates of the trial. Further, the Hon'ble High Court directed S Gopalakrishnan and

Srinivas Talluri not to issue any certificate with respect to compliance obligation of any listed companies and registered intermediaries of SEBI or access securities market during the pendency of the proceedings before SEBI. Both the said Noticees filed Special Leave Petition (SLP (C) Nos. 18031 and 18065 of 2012) before Hon'ble Supreme Court against the said order of Hon'ble High Court of Bombay. The Supreme Court on July 2, 2013 disposed of the SLP with the following direction.

*“... we direct that the order passed by the High Court, which is impugned herein, shall continue to operate for a period of three months until after the final reply of the petitioner is received in the office of the first respondent. Needless to state that the respondents are expected to follow proper procedure when they take the decision either interim or final on the show cause notice, which decision will be taken within that period after the reply of the petitioner is received.”*

9. In the meanwhile, Price Waterhouse entities (i.e. Noticee Nos. 1 to 11) filed applications dated November 22, 2010 seeking cross-examination of various persons. The applicants were heard on the issue of cross-examination on November 27, 2010 and an order dated December 15, 2010 was passed permitting cross-examination of eight witnesses by Noticee No.1. Request for cross-examination of other persons was rejected for the reasons stated in the said order. The Price Waterhouse entities appealed against this order before SAT (Appeal Nos. 8 & 9 of 2011) on the ground that they have been denied cross-examination of certain witnesses and have been allowed restricted cross-examination of other witnesses, which is against the principles of natural justice. The Hon'ble SAT vide order dated June 1, 2011 allowed the appeals and directed SEBI to allow the appellants to cross-examine the witnesses named in paragraph 4 of the application dated November 22, 2010. Thus, apart from the aforesaid eight witnesses, the Noticees were allowed to cross-examine four additional witnesses. SEBI filed an appeal against the SAT order before Hon'ble Supreme Court (Appeal No. 6003 - 6004 of 2012). The Supreme Court vide order dated January 10, 2017 disposed of the appeals with the direction that all documents collected during investigation shall be permitted to be inspected by the Noticees and the witnesses whose statements are being relied upon by SEBI to be offered for cross-examination. The Supreme Court also directed SEBI to conclude the proceedings within six months from the date of the order. Subsequently, on application of the both parties seeking extension of time, the Hon'ble Supreme Court vide order dated July 3, 2017 extended the time to conclude the proceedings by a further

period of six months.

10. As directed by the Hon'ble Supreme Court, the Noticees were granted an opportunity by SEBI to conduct inspection of all documents collected during the investigation. The representatives of Price Waterhouse entities and the representatives of engagement partners took out separate inspection of records which were running into approximately 200 files. The inspection was carried on by the Noticees for close to a period of one month and concluded on April 13, 2017. The cross-examination of witnesses by the Noticees commenced from May 8, 2017. Between the Noticees, the Price Waterhouse entities and the engagement partners were afforded a separate opportunity to cross-examine the witnesses. The details of the witnesses cross-examined by the noticees are as follows:

- a) Mr. VVK Raju, Senior Vice President (Finance of SCSL), Witness No. 1.
- b) Mr. G Ramakrishna, former Vice-President (Finance) of SCSL, Witness No. 2.
- c) Mr. Girish Bala Kishore Tallam, former Article Clerk with Price Waterhouse, engaged in audit of SCSL from April 2006 to June 2007; Witness No. 3.
- d) Mr. Prekki Srinivas Sudhakar, former Manager at Price Waterhouse, engaged in audit of SCSL from April 2007 to September 2008, Witness No. 4.
- e) Mr. Venkatapati Raju Dhantalluri, former Sr. Manager – Treasury Department of SCSL; Witness No. 5.
- f) Ms. Madduri Naga Venkata Gayatri, former Associate at Price Waterhouse, engaged in audit of SCSL from June 2005 to June 2007, Witness No. 6. (Arranged by SEBI through video-conferencing from Singapore.)
- g) Mr. Srinivas K Anapu, former Head of Internal Information System (IIS) at SCSL; Witness No. 7.
- h) Mr. C H Ravindranath, former Engagement Manager, Price Waterhouse – Was working with Price Waterhouse since 1995, engaged in the audit of SCSL as Team Member from 2000 to 2005 and as Engagement Manager from March 2005 to September 2008; Witness No. 8.
- i) Mr. Siva Prasad Pulavarthi, former Engagement Manager, Lovelock & Lewes, engaged in the audit of SCSL as Engagement Manager from June 2000 to March 2005, Witness No. 9.

- j) Mr. Samvit Durga, former Article Clerk at Price Waterhouse, engaged in the audit of SCSL for the quarter ended September 2008, Witness No. 10.

11. The cross-examination concluded on September 14, 2017. Noticee No. 12 filed his reply to the show cause notice on October 5, 2017 and additional reply on November 6, 2017. The Noticee No. 13 filed his reply dated October 6, 2017 and additional reply dated November 2, 2017. The engagement partners were granted an opportunity of hearing on October 16, 2017 and November 6, 2017. Shri Mustafa Doctor, Senior Advocate, advanced arguments on behalf of Srinivas Talluri and Shri Ashok Mathur, Advocate, argued on behalf of S Gopalakrishnan. Noticee No. 1 filed its final reply on November 10, 2017. Hearings for Noticee Nos. 1 to 11 were held on November 24 and 25, 2017. Shri Shyam Mehta, Sr. Advocate, argued on behalf of Noticee No. 1. Shri Somasekhar Sundaresan, Advocate appeared for hearing on behalf of Noticee Nos. 2 to 11. He adopted the reply and submissions made by Noticee No. 1 and also made additional submissions.

### **Summary of the Show Cause Notices**

12. The Show Cause Notice (SCN) and Supplementary Show Cause Notice (SSCN), hereinafter referred collectively as 'SCNs' and individually as 'SCN' and 'SSCN', issued to the Noticees contain identical charges and are based on the same set of facts. The SCNs primarily allege that the Noticees, while certifying the financial statements of SCSL for the period from 2000 to 2008, have acted in gross violation of the duties and responsibilities cast upon them as auditors and were complicit in or acquiesced in the fraud perpetrated by Ramalinga Raju and others at SCSL and have aided and abetted them in the same. The factual matrix of the aforesaid allegations as brought out in the investigation and narrated in the SCNs is summarised below.

- a. With regard to reporting of non-existent cash and bank balances to the tune of ₹ 5,040 crore during the period 2001 to 2008, the Noticees relied solely on the monthly bank statements provided by the company which had several additional entries. The auditors did not independently check the veracity of the monthly bank statements and fixed deposit receipts (FDRs) and relied upon them for their certification process. Further, they ignored the daily bank statement which has been found to be true. The noticees did not maintain necessary control over the process of sending and receiving balance confirmations from banks directly



and did not follow-up directly with banks for balance confirmations in complete disregard of the Auditing and Assurance Standards (AAS) prescribed by ICAI. The auditors received the monthly statement and FDRs from the office of the chairman of SCSL through company officials. During investigation, they failed to produce even a single copy of balance confirmation request sent by them directly to the Bank of Baroda, New York Branch (which as per books of SCSL held approximately 75% of all current account balances) or any original balance confirmations received from them. They chose to rely on the balance confirmations received from SCSL which had glaring anomalies and huge differences without any further examination or inquiry into the matter and ignored the balance confirmations received directly from banks which were showing true balances. The noticees also did not record in their working papers that they are deviating from the stipulated norms and practices of balance confirmations in its audit papers as mandated.

- b. The Noticees chose not to verify bank balances through alternative balance verification through Internet Banking facility availed by SCSL, despite cash and bank balances occupying a significant part of the balance sheet although this process was used for certain other clients of the noticees.
- c. The annual audit plans of the noticees as regards SCSL did not mandate verification of the cash and bank balances by the internal auditors even though the amount of cash and bank balances of SCSL demanded exhaustive verification of cash and bank balances / fixed deposit balances and interest on it. Further, the Noticees did not expressly acknowledge in their audit reports that internal audit did not conduct verification of bank balances.
- d. Necessary checks and balances in the audit function were not built in despite the fact that Noticees used to make presentations on audit of books before the Audit Committee and the annual internal audit plans were also finalised in these meetings in their presence. Thus the Noticees' comments in the annual reports relating to internal control systems and internal audit were unsubstantiated and false.
- e. SCSL's sales revenues in the audited accounts were inflated by accounting for 7,561 fake invoices raised in respect of fake transactions and 27 invoices with respect to non-existent

customers since the first quarter of 2003 onwards. The noticees were having the Admin ID and password through which they could have detected that these invoices were fake. Further, they did not carry out any reconciliation between invoices in Oracle Financials (OF) and Invoice Management System (IMS) to detect any mismatch which was incidentally pointed out by the Internal Auditors. In view of the fact that a huge number of fake invoices were generated and recorded in the books of accounts of SCSL over a long period of time, it has been alleged that the Noticees were complicit in the manipulation of accounts and failed to perform their duty as auditors.

- f. Fictitious receipts were recorded in the books as sales and were reflected as revenues in the books of SCSL. The overstatement of revenue also had an impact on the actual margins earned by the company vis-à-vis the margins published in the financial statements. The Noticees allowed receipts represented by non-existent additional transactions in the monthly bank statements to be reported in the books of accounts without there being supporting invoices in the IMS database of SCSL.
- g. The debtors' position was overstated by hundreds of crores of rupees in the financial statements. The Noticees, while conducting audit of SCSL did not seek external confirmation of debt from the debtors in violation of its own audit manual and various provisions in AAS and the Guidance Note on Audit of debtors, loans and advances. A total disregard of such stipulated auditing practice indicates complicity of the noticees in the manipulation.
- h. The actual amount of Tax Deducted at Source (TDS) for which benefit was claimed in the Income Tax Return filed by SCSL was at variance with the amount of TDS shown in the books of accounts of SCSL and the figure given in the Audited Balance Sheet. The Noticees did not physically verify the TDS certificates available with SCSL and ignored huge and glaring mismatches in respect of TDS amount in the books of accounts.
- i. An amount of ₹1,425 Crore was received in the bank accounts of SCSL during the years 2007 and 2008, which was not recorded in OF. Further, SCSL made payments of ₹195 Crore to various companies which were reflected in OF as advances paid on behalf of one Panchakalyani Agro Farms Limited. The Noticees failed to detect such large amounts of

receipts and payments in bank accounts of SCSL, which were utilised by it but not recorded in the books of account of SCSL.

j. On December 23, 2008, an independent director of SCSL forwarded an email to Noticee No. 12 in which the modus operandi adopted by the promoters of SCSL to indulge in the fraud by introducing fictitious invoices and overstating bank balances were brought to his knowledge, apparently by a whistleblower. The independent director directed the statutory auditor to revert with possible solutions at the audit committee meeting on December 29, 2008. The auditors did not take any action on it.

13. In view of the aforesaid, it has been alleged in the SCNs that the acts and omissions of the Noticees, were in violation of the provisions of section 12A (a), 12A(b) and 12A(c) of the SEBI Act and regulation 3(c), 3(d), 4(1), 4(2)(a), 4(2)(e), 4(2)(f), 4(2)(k) and 4(2)(r) of the PFUTP Regulations.

#### **Summary of replies/ submissions of the Noticees:**

14. With respect to above charges, Noticee no.1 has submitted its replies on November 10, 2017. This reply has been adopted by Noticee nos. 2 to 11 also. The replies of Noticee Nos. 12 & 13 are almost similar to the reply filed by Noticee No. 1, except that Noticee No. 13 has submitted that he was not involved in the audit of SCSL for the period before April 2007. It has also been submitted that each partnership firm is an independent and distinct entity and as none of partners of other firms has been issued a show cause notice, issuing any direction against them is not justified. The submissions of all noticees are summarised hereunder :

- a. Relying upon judgment of Hon'ble Bombay High Court dated August 13, 2010 (*supra*), it has been submitted that no directions can be issued against them if there is only some omission without any *mens rea* or connivance with any one in any manner who committed the fraud in the matter.
- b. The Price Waterhouse entities are a 'network' of audit firms in India and do not operate as a corporate multinational or a global partnership or a single firm. The network consists of independent firms which have separate registrations with the ICAI. A firm which is a

- member of the Price Waterhouse network cannot act as an agent of any other member firm nor can it obligate any other member firm, and is liable only for its own acts or omissions and not those of other member firms.
- c. The two engagement partners who conducted and signed the audit report, *viz.* S Gopalakrishnan and Srinivas Talluri are no longer part of the Noticee firms. None of the other partners of the firms was ever responsible for the audit of SCSL and out of the 18 present partners of the Noticee No. 1 firm, 11 have joined only after 2009. There is no evidence to show that the two engagement partners and the team involved in the audit of SCSL had any *mens rea* or knowledge of the alleged fraud or had connived in the commission of the alleged fraud. There are statements of individuals which indicate that the engagement team which conducted the audit of SCSL did not play any role in the alleged fraud. In this regard, the statement given by the CFO of SCSL, Vadlamani Srinivas on February 20, 2009 has also been relied upon.
  - d. SCSL was a globally reputed company and had a well-regarded and respected Board of Directors and Audit Committee. There was no indication that the Company's directors, senior management, and employees had been orchestrating a massive fraud.
  - e. The SCNs fail to differentiate between the roles and responsibilities of SCSL's management and that of the statutory auditor, exaggerating the responsibilities of the statutory auditor. The applicable law and relevant auditing standards make it clear that SCSL's management and not the auditors are responsible for preparing the financial statements and for preventing fraud.
  - f. The engagement team members and the engagement partners who worked on the audit of SCSL were trained and very experienced professionals. Price Waterhouse had conducted various training programmes which were attended by the team prior to conducting the audit of SCSL. It has been also submitted that to ensure integrity of operations, each member of the engagement team provided an independence confirmation prior to their involvement in the audit of SCSL.
  - g. The engagement team's audit plan was customized to focus on two areas - payroll and revenue. Since SCSL apparently had robust margins, it was reasonable that SCSL had substantial cash on hand, which the company invested in Fixed Deposits (FDs). Other peer companies had in fact similar and sometimes larger cash on hand and hence this area was quite reasonably considered a relatively low risk in the context of entire audit.

- h. It is settled law that auditors must not be made liable for not tracking down ingenious and carefully laid schemes of fraud when there is nothing to arouse their suspicion, and where those frauds are perpetrated by trained servants of the company. (Hon'ble Bombay High Court in *Tri-Sure India Ltd. vs. AF Ferguson & Co. & Others* (1987)61 Comp. Cas 584 (Bom.))

Audit of Sales Invoice, Revenues & Debtors:

- i. The evidence of VVK Raju on whether the fake invoices were visible to the business process facilitation team or whether they were sent to customers is unreliable as a large part of it contains information which he is not personally privy to.
- j. As per the statements of VVK Raju and G Ramakrishna recorded during the cross-examination, an invoice created in IMS database was saved as a PDF copy. However, the CD containing the alleged 7,561 fake invoices provided to the noticee contains the MS Word format of the invoices and not in PDF format.
- k. There are some discrepancies in the number of invoices and the amount recorded and received in respect of those invoices in the quarter wise details of 7,561 invoices mentioned in the SCN. Therefore, these are unreliable.
- l. With regard to the email-confirmations provided to SEBI by SCSL employees' for certain allegedly false invoices, the same cannot be relied upon as they are not statements made on oath and the authors have not been produced for cross-examination.
- m. The engagement team, while carrying out the audit verified the invoices provided by SCSL and compared the time billed etc. with documents, viz. with work orders, bank statements, timesheets approved by the customers/ milestones mentioned in the agreement and other documents provided by SCSL. In this regard, statements recorded during the cross-examinations of Mr. P S Sudhakar, Mr. CH Ravindranath and Mr. Siva Prasad Pulavarthi and the details of the work performed by the engagement team on revenue audit of SCSL as recorded in the '*MyClient*' files have been relied upon.
- n. The engagement team engaged in a three-step process to access the strength of SCSL's internal control over billing and revenue. First, they obtained an understanding of the billing and revenue process of SCSL by discussing about it with SCSL staff and going through the process documentation provided by SCSL. Second, they performed a step-by-step walkthrough of the key billing process and third by testing a sample of the controls to verify that they operated effectively.

- o. None of the characteristics of 7,561 invoices cited in the SCN based on VVK Raju's deposition indicates any fraud, as these invoices are not distinguishable from the genuine ones in appearance. It is denied that all such invoices provided cheque payment as modality of payment.
- p. The visibility of invoices in the system cannot be a criteria for determining the genuineness of invoices or otherwise. An invoice will not be visible in IMS even when the invoiced amount is written off and removed from receivables list.
- q. Non-linkage into PBMS cannot be criteria to categorize an invoice to be fake as it was not disclosed on the face of the invoices. It has been also submitted that apart from PBMS, the invoice could also be generated through Excel Porting. A total of 74,625 invoices were generated over a period of time through Excel porting out of which only 7,561 are allegedly fake.
- r. Very few people in SCSL knew about the existence of Excel Porting feature in the invoicing system. There is no documentary evidence to indicate that the engagement team was aware that fictitious invoices were being inserted into IMS through Excel Porting or any other means.
- s. The engagement team verified sample invoices along with the adequate supporting documentation, included the invoices which were posted by way of excel porting. It cannot be said that invoices posted via excel porting should have aroused any doubt or suspicion in the minds of engagement team about their genuineness.
- t. Even the employees of SCSL did not have any doubt on the genuineness of the customers; in fact they carried out detailed work in relation to the 27 'H' invoices. The said invoices were also supported with documentation and payments were shown to have been received in the books of SCSL. Hence, the charges would, at best, show that there was an elaborate mechanism and design intended to deceive not only the auditors but also the employees of SCSL.
- u. With regard to confirmation of debtors' balance, it has been submitted that the engagement team has performed detailed procedures in connection with verification of debtor balances, which have been recorded in '*MyClient*' files from time to time. The allegation in connection with inflated debtors in the SCNs, which is based on evidence of Mr. VVK Raju, is riddled with inconsistencies, clearly unreliable and contrary to the evidence available on record.

- v. SEBI's assertion that the engagement team failed to perform the basic audit function of seeking and obtaining external confirmation of debtor balances is incorrect. The engagement team sought debtors' confirmations from a sample of SCSL's debtors each year, except for financial year 2008. In 2008, the engagement team elected to not circularize debtor confirmation requests because of the poor response rate in previous periods and instead performed alternative procedures like subsequent realisation verification/ substantive testing of invoices.
- w. The engagement team had access to the test database of SCSL's systems and not the live database or the production database and that the access to the database by a user with Admin ID could be restricted by SCSL. There is no evidence that the Admin ID was used by the engagement team and that by logging in to the system through the ID provided to them, they could have identified the fictitious invoices.
- x. The allegation that the engagement team failed to detect the fictitious invoices despite the fact that SCSL's Internal Audit observed differences between the IMS and OF in three internal audit reports is *ex facie* unsustainable, as the said reports fell outside the period of last audit conducted by engagement team. Further, there is nothing to establish that the engagement team received or was even aware of the said reports.

Audit of Fixed Deposit Balances of SCSL:

- y. The engagement team obtained comprehensive understanding and performed extensive procedures for verification of the fixed deposit balances of SCSL.
- z. The engagement team's primary audit procedure regarding fixed deposit balances was physically verifying the Fixed Deposit Receipts. This is also recommended in para 20 of Guidance Note 20. The external confirmation procedure was carried out as an additional procedure.
- aa. The team checked in detail the information on each FD Receipt and confirmed that the FD Receipts matched the schedule of FDs of FSCSL. The team regarded FD Receipts as primary evidence of FDs of SCSL.
- bb. The amounts placed as FDs were traced by the audit team to the monthly bank statements of SCSL.
- cc. The team conducted the review of SCSL's process for placing FDs and tested controls surrounding the same.

- dd. The team also sent bank confirmations in addition to the primary audit procedure of verification of FD Receipts.
- ee. The detailed procedures carried out by the team regarding audit of cash and bank balances were recorded in detail in the '*MyClient*' files which are electronic records. A number of witnesses have confirmed that the recorded procedures were performed.
- ff. The FD Receipts reviewed, appeared to be genuine and did not arouse any doubt in the minds of the engagement team or the employees of SCSL.
- gg. The team had verified FD receipts till September 30, 2008 as against only till June 30, 2008 contended by SEBI. In this regard, the statement of Venkatapathi Raju Dhantuluri cannot be relied upon.
- hh. In relation to para 28 of the SSCN, the team also performed detailed procedures on verification of interest income on fixed deposits which have been recorded in the '*MyClient*' files quarter by quarter, as confirmed by witnesses.
  - ii. In addition to the audit fieldwork the team conducted to obtain reasonable assurance regarding the existence of SCSL's fixed deposits, the team collected other evidence that indirectly supported the same, like obtaining and reviewing documents relating to SCSL's tax filings for certain years and verification of TDS paid by SCSL. The reliance on statement of VVK Raju in para 28 in connection with the schedule on accrued interest and alleged fictitious interest figures is incorrect.
  - jj. Audit of FDs entails several procedures and steps which were carried out by the engagement team and the bank confirmation process is one of the steps performed in addition to detailed procedure.
- kk. The engagement team received bank confirmation letters in connection with the fixed deposits of SCSL, which included a summary of the deposit balance and interest accrued on the deposits. The team then checked the balance and interest against the schedule of FDs as supporting evidence of the FD balances included in SCSL's financial statements.
- ll. SEBI's allegations in para 4.7.6 of the SCN that the external direct confirmation of balances is a primary validation procedure for a rigorous and diligent auditor is inconsistent with the ICAI guidance and therefore untenable. ICAI guidance allows the auditor to exercise its professional judgment in selecting the appropriate audit procedures for conduct of an audit after considering the facts and circumstances of each case. This is supported by ICAI AAS 30.



- mm. The engagement team sought confirmation of FD balances with banks. They received certain confirmations directly from the banks and certain confirmations through the company. In many instances, the bank did not readily respond to requests from auditors directly and in many instances, there was paucity of time or no response from banks.
- nn. The difficulties faced by auditors in receiving confirmation has been acknowledged by ICAI and RBI. The findings of QRB on SA 505 – External Confirmations show that the general practice followed by audit firms in relation to external confirmations even as late as 2013 is not strictly compliant with SA-505.
- oo. In view of the difficulties faced by the auditors during the conduct of the audit, the engagement team relied upon confirmations received through the company in certain cases.
- pp. There was nothing in the FD confirmations either received directly or received through the company which aroused any doubt or suspicion in the minds of the engagement team in connection with the bank confirmations. They appeared to be genuine and were supported by evidence from physical verification of FD receipts.
- qq. The bank confirmation letters received through SCSL were on original letter heads of the bank, were signed by bank signatories and contained the details of amount held in FD and accrued interest. Balances mentioned in these confirmations tallied with the books of accounts of SCSL and it corroborated with the evidences gathered by the team by examining original FD receipts. Separate balance confirmation letters referred to by SEBI pertained to different accounts. There is no prescribed or any particular format in which banks respond to requests for confirmations. Even the witnesses relied upon by SEBI did not doubt the genuineness of bank confirmations.
- rr. SEBI is not entitled to rely upon banks (annexed at Annexure 10 of SCN) as these are not statements made on oath and their authors have not been cross-examined.
- ss. The observations in para 3.1.4.8 and 4.7.7 of the SCN are made with the benefit of hindsight. An auditor is not charged with examining audit evidence for forgery.
- tt. SEBI's assumption that banks respond to confirmation requests in a prescribed format and that the engagement team did not question its absence while accepting confirmation letters of the banks from SCSL is false. There was no standard or prescribed format for banks to respond to confirmation requests. Thus, receipt of confirmations in different formats did not arouse any doubt or suspicion. Various documents annexed by SEBI to

the SSCN support the same.

- uu. SEBI's allegation that the engagement team received two sets of letters of confirmations of bank balances, one directly and the other through the company and that the team ignored the confirmations received directly and relied exclusively on the confirmations received through the company is baseless, unsupported and contrary to evidence available on record. The two sets of confirmations referred to by SEBI relate to two different accounts and the balances mentioned therein tallied with the balances in the respective accounts. The team took into account both these confirmations and did not choose one over the other as SEBI has sought to suggest. The confirmations were thus complimentary and not contradictory as alleged. The same is supported by *MyClient* documents pertaining to audit work on FDs.
- vv. The engagement team sent confirmation requests to different branches of the bank and therefore it was not surprising when more than one confirmation was received from the banks. The confirmations received directly related primarily to current accounts and Short Term/Margin Money Deposit accounts. The team was not surprised when these confirmations did not reflect the Long Term FD balance because they believed that the confirmation of the same were provided by the other branches of the bank which held those accounts.
- ww. SEBI's allegation in para 4.7.24 of the SCN regarding the availability of core banking facility during the period when audit was conducted is not supported by any evidence. SEBI has not produced any facts or evidence demonstrating that balance verification through internet banking was even possible at SCSL with the banks with which SCSL held accounts and during the period in which the audit was conducted or whether such facility even existed with SCSL.
- xx. A review of publicly available information indicates that such facility was not available in case of number of banks. Even if such facility was available, SEBI has not cited any standard or requirement indicating that internet banking is a reliable or accepted means of verification of balances.

Audit of Current Account Balances of SCSL:

- yy. The engagement team's primary procedure for auditing current account balances was testing of Bank Reconciliation Statements (BRS) prepared by SCSL. The team verified the

current account balances in SCSL's books with the balances as per the BRS. The audit step included tracing the bank balances on SCSL's BRS to the bank statements of SCSL. The detailed procedures followed by the team in this regard for each quarter were recorded in *MyClient* files, which has been supported by cross-examination of witnesses. The company's BRS procedures rely on the authenticity of the monthly bank statements used in the verification process. The engagement team did not suspect the monthly bank statements obtained from SCSL not to be genuine.

- zz. SEBI's allegation that there existed two sets of bank statements namely daily bank statement and the monthly bank statement and that the engagement team chose to rely upon the monthly bank statement provided by SCSL is not supported by any evidence. It appears that the documents which SEBI calls the daily bank statements are in fact not daily bank statements and show transactions for the entire month. The same is not even on letter head of BOB (NY) nor does it bear any logo of authentication. The team in fact relied upon the monthly bank statement provided by SCSL which was on letter head of BOB (NY) and contained transactions for the entire month. There was nothing which aroused suspicion regarding their genuineness. SEBI has not provided any evidence which could indicate that the engagement team was aware of the existence of any daily bank statements or that they chose to ignore the same.
- aaa. It is routine audit practice to audit the current balances on the basis of monthly bank statements and there is no recognized audit procedure to audit on the basis of any daily bank statement received on a day to day basis, if any. The team had no reason to suspect that SCSL maintained bank statements that reflected entries different from the monthly bank statements provided to the audit team by SCSL.
- bbb. In addition to the monthly bank statements, short period bank statements relating to the period subsequent to the balance sheet date, were used to trace reconciling items in the BRS with the entries in the bank statement for subsequent period. This is a standard audit practice as mentioned in para 14 of guidance note on audit of cash and bank balances, issued by ICAI.
- ccc. The format of the short period statements was identical to the format of the monthly bank statements and the transactions tallied. Hence, it did not arouse suspicion.
- ddd. SEBI has alleged that till the time of closing of accounts, certain transactions in the daily bank statements were not accounted for and, the reasons notwithstanding, such

- transactions were never accounted and if accounted, they were reversed. SEBI has alleged that it was stated to SEBI that the auditors also had cognizance of the data pertaining to reversal of entries. The allegations are not supported by any evidence and are unsubstantiated. The engagement team had no knowledge of any such reversal entries and SEBI has not been able to produce any evidence that any such reversal entries existed in the first place.
- eee. As regards BOB (NY) confirmations, the same appeared to be genuine and did not arouse suspicion. The format of the said confirmation was not prepared by SCSL but approved by American authorities. SEBI cannot rely on email dated 23/10/2009 received from BOB since the statement is not on oath and the author has not been cross examined.
  - fff. SEBI's contention that confirmations from banks were received directly by the engagement team whereas confirmation of BOB (NY) was received through SCSL is not correct, as the team had received some other confirmations from banks through SCSL.
  - ggg. SEBI's allegation that the Noticee had relied upon photocopies of purported emails in relation to bank confirmations is not supported by any evidence of such purported emails.

Audit Processes in Connection with the Internal Audit of SCSL:

- hhh. SEBI has alleged in para 4.7.18 – 4.7.22 of the SCN that the engagement team has erred in its evaluation of the adequacy of internal audit and that the engagement team's comments relating to internal control systems and internal audit of SCSL in the annual reports of SCSL are unsubstantiated and are false. The same is contrary to material available on record and the evidence of the witnesses who were cross-examined and is premised on a mistaken understanding of the requirements under the relevant auditing standards. The team performed adequate audit procedures in accordance with CARO 2003 issued by ICAI. Regarding the internal audit, the team obtained sufficient comfort on the internal audit work.
- iii. PW conducted its independent verification of every area of audit and did not rely upon internal audit work.

Verification of Tax Deducted at Source (TDS) and certain receipts and payments:

- jjj. SEBI's allegations concerning SCSL's reported TDS and PW's audit are unfounded and based solely on misunderstanding and mischaracterization of facts on record.
- kkk. The auditor cannot be blamed for failing to detect funds coming into the client where the client fails to either record or disclose receipt of those funds and, in fact, seeks to affirmatively hide the same from the auditors.
- lll. The proposed actions under the SCN including the disgorgement of audit fees are unwarranted.
- mmm. The Noticees have taken various voluntary measures in order to strengthen its existing Quality and Management System (QMS).

**Extract of Relevant Provisions and views on preliminary issue:**

15. Before dealing with the allegations in the SCNs in respect to the noticees herein, it is deemed appropriate to refer to provisions section 12A (a), 12A(b) and 12A(c) of the SEBI Act and regulation 3(c), 3(d), 4(1), 4(2)(a), 4(2)(e), 4(2)(f), 4(2)(k) and 4(2)(r) of the PFUTP Regulations alleged to be violated by the noticees. These provisions are reproduced hereafter:-

***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 recognised stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of this act or the rules or 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 there under;  
(d)....; (e) .....

**PFUTP Regulations**

**Prohibition of certain dealings in securities.**

3. No person shall directly or indirectly—

(a) ... ..;

(b)... ..;

(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.”

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

4 (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.*

16. Regulation 2 (1) (c) of PFUTP Regulations defines “fraud”. The regulation reads as under:-

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

*... ..;*

*(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 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.*

*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 like nature;*

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

17. Having summarised the SCNs and the replies, I note that the SCNs have been issued to the

noticees on the basis of same set of facts and violations alleged therein are also the same and hence the SCNS are considered together against all the noticees and disposed of by way of a common order. I now proceed to deal with the objections of the noticees raised by the PW entities (Noticees 1 to 11), Gopalakrishnan, (Noticee No. 12) and T Srinivas (Noticee No. 13) separately grouping the factual allegations in the SCNs broadly under the heads - (i) “Audit of FDs and Balances in Current Accounts” , (ii) “Audit of invoices and reporting of revenues” , (iii) “Audit of Debtor Balances”, (iv)“TDS and other related issues”.

18. At this stage, I would like to make a mention about one objection related to “jurisdiction” that has been vehemently raised by all the three sets of noticees, i.e. . Noticee Nos. 1 to 11 as one set; S Gopalakrishnan (No.12) and Srinivas Talluri (No.13) individually and separately, at the outset of the proceedings itself and give my preliminary views thereon. I note that the preliminary objections raised by the noticees regarding jurisdiction of SEBI to pass directions, as proposed in the SCNs rests on the common ground that SEBI can pass directions in the instant case, only if sufficient evidence is available to prove the involvement of the auditors in the falsification and fabrication of accounts. The various possibilities of involvement of auditors in the alleged fraud have been articulated in the SCNs and in the order of the Bombay High Court, in many ways such as intention, knowledge, complicity, *mens rea*, connivance, collusion etc. The gist of the observations of the Bombay High Court, as I understand is that there should be reasonably sufficient material evidence before me to show that the auditors have engaged in a manner such that it brings out all or any of these elements. If ultimately, the evidence shows that there were no intentional or wilful omissions or lapses by the auditors, then SEBI cannot pass directions. On the other hand, I note from the order of the Hon’ble High Court that if the evidence sufficiently indicates to the possibility of there being a role of the auditors in the alleged fraud, then SEBI as a securities market regulator, is empowered to protect the interest of the investors and can proceed to pass appropriate directions as proposed in the SCNs.
19. I also take note of the fact that as far as those firms that have not carried out the actual audit of the company (Noticee Nos. 2 to 11) (collectively represented in the Bombay High Court), the Hon’ble High Court has directed the Noticees to point out those facts in these proceedings for the consideration of the Member of SEBI. Thus, based on the submissions / objections of the Noticees in this regard, the most vital and broad issue would be whether there is sufficient



evidence to show that the acts or omissions allegedly committed by the auditors indicates knowledge or intention or complicity or connivance in the accounting fraud that was perpetrated at SCSL. Other issues, such as whether the acts of omissions or commissions by the individual partners who affixed their signatures to the published statements of account of the company would make the other noticees, be it Noticee No.1 or the rest of the firms collectively working as part of the PW network, liable for such actions or not, will be considered after appreciation and evaluation of the evidence.

### **Consideration of Issues on Merit**

20. I now proceed to deal in detail with the issue-wise appraisal of the evidence, as grouped and shown under para 17 above.

### **Audit of FDs and Balances in Current Accounts**

21. The specific allegations against PW in respect of bank confirmations of Current Account Balances and Fixed Deposits of SCSL, as contained in the SCN and SSCN, in brief, are as follows:

(a) As regards the audit of Fixed Deposits (FDs) and balances in the current accounts held by SCSL in different banks, during the investigation it was noted from the books of account of the company (hereinafter referred to as 'the books') that the company had more than 125 bank accounts with various banks throughout the world. The books showed that, as on 30<sup>th</sup> September 2008:

- a. Substantial amounts of ₹ 1782.60 crore or 33.5% of cash and bank balance were lying in Current A/c 120559 of Bank of Baroda (BoB) New York branch.
- b. Another 62.5% of cash and bank balance or ₹ 3,318.37 crore was held in Fixed Deposits with five banks.
- c. The company has disclosed ₹ 5312.62 crore as cash and bank balance in the financial statements audited by PW.

(b) Investigation revealed that over the period from 2001 to 2008, cash and bank balances had

been grossly overstated in the books of accounts of SCSL and the overstatement, as on September 30, 2008, stood at ₹ 5,040.29 crore.

- (c) As per the findings of investigation, the balance in the Current Account No.120559 of SCSL (with Bank of Baroda, New York) was overstated by ₹ 1,731.88 crore as on September 30, 2008. The confirmation of balances received by SEBI, pertaining to six quarters - quarters ended June 30, 2007 to September 30, 2008 - from the bank during investigation did not match with balances as per the bank reconciliation statement that forms a part of the books. The details (figures in ₹ crore) are as under:

**TABLE 1**

Dates	Balance as per the books	Actual Balance as per confirmation	Difference in balance
30-Jun-07	543.06	48.89	494.18
30-Sep-07	415.32	29.47	385.86
31-Dec-07	595.79	25.24	570.55
31-Mar-08	855.00	43.85	811.15
30-Jun-08	1275.58	21.89	1253.69
30-Sep-08	1782.60	50.72	1731.88

- (d) The company allegedly used to receive two sets of bank statements for its current account with Bank of Baroda, New York Branch, which were (i) 'Daily bank statement' received through email and printed and filed in accounts wing, (ii) 'Monthly bank statement' received through 'internal' courier from its chairman's office. The closing balances as well as the number of debit and credit entries in the two statements differed substantially. While the daily bank statements reflected true and correct entries and balances, the monthly bank statements were apparently manipulated bank statements and they showed additional entries which were largely in the nature of extra receipts.
- (e) The daily bank statements were allegedly ignored by the officers of the company as well as the auditors of the company and it was the 'monthly statement' that was used for the purpose of monthly closing of the bank ledger and preparation of monthly bank reconciliation statement that were provided to the auditor. While closing of monthly accounts, there used to be several reversal of entries which were necessitated on account of discrepancies between the daily and

the monthly statements. PW, the auditors, allegedly had cognizance of such data pertaining to reversal of entries.

- (f) The auditors had relied on the balance confirmations purportedly received from BoB, New York, through the company for the confirmation of the balances in the current account with BoB, NY, rather than seeking and obtaining direct confirmation of such balances from the bank. During the investigation, the said confirmations, relied upon by the auditors, were found to be containing fake seals and signatures and were forged.
- (g) PW failed to seek direct confirmation of bank balances from BoB, NY, during its audit exercise of SCSL carried out over a span of eight and half years. BoB, NY confirmed to SEBI that it did not receive any request for confirmation of balance from PW. The working papers available with PW indicated that it had evidence of balance confirmations of BOB, NY, only for 12 quarters out of a total of 34 quarters, and all these confirmations were obtained by PW from SCSL. Even these confirmations were not original documents but were only photocopies of emails purportedly sent by BoB, NY, to SCSL's representative in New York and forwarded to SCSL in Hyderabad. PW had failed to produce a copy of even a single direct request for confirmation of balance to BoB, NY.
- (h) PW had sought balance confirmations from banks with nil or negligible balances while failing to do so for BoB, NY, which was SCSL's most significant current account, purportedly holding huge balances. Further, SCSL had failed to use an alternative mechanism like internet banking for verification of balances.
- (i) Regarding the Fixed Deposit accounts of SCSL, which were held with five banks, investigations revealed that the same had been overstated by ₹ 3308.41 crore as on September 30, 2008, in the books of SCSL. In respect of the Fixed Deposit (FD) balances, it was found that two sets of letters of confirmation of bank balances of the company were available with the auditor: (a) confirmation letter received directly from the bank, and (b) confirmation letter received through the company.
- (j) The deposit balances in the letters of confirmation received directly in the office of the auditor were found to be complete and correct which tallied with bank confirmations received by

SEBI, whereas the balances in the letters of confirmation received by the company and handed over by it to the auditor tallied with the balances in the books which were overstated and false. The comparison between the two balances is shown in the table below (figures as on September 30, 2008; in ₹ crore):

**TABLE 2**

Name of the Bank	Amount as per the books	Amount confirmed by banks
Citi Bank	613.32	1.32
HDFC Bank	704.16	NIL
HSBC Bank	798.95	NIL
ICICI Bank	725.30	NIL
BNP Paribas	476.64	8.64
<b>Total</b>	<b>3318.37</b>	<b>9.96</b>

- (k) The Fixed Deposit Receipts pertaining to the five banks held by the company, which were relied upon by the auditors during each quarterly audit, were *prima facie* fabricated. Further, the letters of confirmations addressed to auditors received through the company by the auditors and relied upon by them, were also fabricated. Further, several such confirmation letters suffered from glaring irregularities.
- (l) Further, the balance confirmation letters were very infrequently received directly at the office of PW, in the prescribed format, as given in the table below. (*yes/no*' indicating receipt/non receipt of the confirmation letters respectively). PW allegedly did not follow up with banks to receive direct confirmations.

**TABLE 3**

Name	June '07	Sept '07	Dec '07	March '08	June '08	Sept '08
<b>Citi Bank</b>	No	No	No	Yes	No	No
<b>HDFC Bank</b>	No	No	No	Yes	No	No
<b>HSBC Bank</b>	Yes	Yes	Yes	No	Yes	Yes
<b>ICICI Bank</b>	Yes	No	No	No	No	No
<b>BNP Paribas</b>	Yes	Yes	Yes	No	Yes	Yes

- (m) The confirmation letters received directly from the bank by the auditors bore no indication of the figures therein being only a part balance. However, PW allegedly proceeded with the presumption that external confirmations from banks were branch-wise thereby inviting a

presupposition that there would be more than one response from a bank, but without any follow up or consequent action by them. The auditors ignored the first set of confirmations received directly from the banks and relied exclusively only on those received from the company, showing deposit balances which were tallying with what was shown in the books. This practice was followed in case of Fixed Deposits with all the five banks. The following should have raised doubts in the minds of auditors regarding genuineness of the letters:

- a. Two separate balance confirmation letters received in respect of fixed deposit balances.
  - b. Balance confirmations were not given in the format in which the information was sought by the auditor.
  - c. Balance confirmation letters were not received from that branch of the bank from which the confirmation was requested, since these bank confirmation letters carried the address of Registered Office or Corporate Office address of the bank.
  - d. As per the books of account, more than 20 Fixed Deposits have been maintained with each bank. However, in the confirmation letters only consolidated balance of fixed deposit account and accrued interest thereon were mentioned *sans* the Deposit Account No. or Fixed Deposit Receipt No. or Account wise detail of the balance, even though it was asked for by the auditor.
  - e. The balance Confirmation letter dated October 04, 2006 from ICICI Bank to PW did not contain even the name of the company for which the balance was being confirmed.
- (n) Further, PW failed to acknowledge that internal audit did not conduct verification of bank balances. Exhaustive verification of cash and bank balances was left to the statutory auditors and the annual internal audit plans did not mandate to conduct such verifications by internal audit team. PW, which had been undertaking the audit of Satyam since the year 2000, knew about the audit plan carried out by internal audit of the company, as the annual internal audit plan used to be formulated in consultation with them. The investigation revealed that, on the suggestion of PW, upon their appointment as statutory auditors, internal audit shifted from transaction-oriented audits to process-based audits. Thus, PW's comments in the annual reports of Satyam that the internal control systems were commensurate with the nature and size of operations of the company were unsubstantiated and false.

- (o) Further, since there were negligible or 'NIL' amounts in deposit accounts in respective banks, in contrast to the balances stated in the books, the accrued interest presented in the books was also overstated and misleading.
- (p) The role of PW as the auditor of Satyam Computers Services Limited was examined against the relevant Auditing and Assurance Standards (AAS) issued by Institute of Chartered Accountants of India (ICAI) which are mandated on the external auditor and the findings are summarized as follows:
- (i) Bank balances as percentage of total assets of company were as high as 70% towards the quarters of June and Sept 2008. Therefore the materiality of the asset values in the case of the company, as per para 9 of AAS 13 was all too evident. Given the exceptionally high degree of materiality of the bank balances in question, the auditors had a duty to obtain direct bank confirmations as a primary validation procedure, which they failed to do.
  - (ii) Paras 7 and 15 of AAS 5 unambiguously state that the quality of external evidence is superior to that of internal evidence and when procured directly by the auditor it becomes reliable. PW ignored the same by relying upon confirmations obtained internally from the company, even though the bank balances and FDs had high degree of materiality.
  - (iii) The mandated procedure as per para 32 of AAS 30 strictly places the responsibility of sending the letters seeking external confirmation on the auditor. However, PW failed to adhere to the same during the audit process of SCSL in respect of external confirmation of bank balances and FDs. Neither did PW maintain control over the critical process of sending out letters to the banks nor did it monitor their receipt and meticulously mark the non-receipt or undelivered requests for further follow-up with the banks or its branches.
  - (iv) PW left it to the company to contact the banks to remind them about pending balance confirmation letters, instead of following up directly, as mandated by para 34 of AAS 30.
  - (v) The auditors are mandated to verify the source and contents of confirmation letters by additional audit procedures including telephone calls or by getting original confirmation through mail as directed in para 35 of AAS 30. The quality and authenticity of external

evidence lies at the core of the audit procedures relating to confirmation of bank balances and debtor balances. PW failed to adhere to the prescribed standard.

- (vi) The auditor did not evaluate or made necessary enquiries about the accounting systems, as suggested in AAS 2, leading to ignoring of daily bank statements.
- (vii) The mandatory directions as per para 8 of AAS 7 and para 11 of AAS 8, clearly lay down that the work of internal auditors and their involvement should be evaluated and considered by the external auditor. PW had failed to do so.
- (viii) Under the AAS, the auditor shares the primary responsibility for the prevention and detection of fraud and error with those actually in charge of the governance and management of the entity.
- (ix) The import of AAS 4 cannot be overlooked where it states, *'When obtaining reasonable assurance, the auditor is responsible for maintaining an attitude of Professional Skepticism throughout the audit.'* The several red flags listed above, which were all too obvious for any reasonable professional auditor to miss, failed to engender the necessary professional skepticism in the PW team associated with the audit of Satyam.

(q) Apart from the above, it was found that PW had not followed various provisions of its own audit manual.

22. I have gone through the allegations against the Noticees in respect of the audit of FDs, interest and bank balances. I note that, in the books of account of SCSL, the current account balances and Fixed Deposits (FDs) were overstated to the tune of ₹ 5,040.29 crores, as on September 30, 2008 and the bank statements and balance confirmations of SCSL's current account with Bank of Baroda, New York Branch, and Fixed Deposit Receipts (FDRs) with five banks, which were relied upon by the audit team (PW) were fictitious and forged, as can be seen from the details above. The Noticees have not denied the said facts. However, the Noticees have vehemently denied all the allegations regarding gross negligence and complicity on PW's part in auditing and certifying the same. The Noticees have contended they had duly followed all the applicable accounting standards and principles and had exercised all due care and diligence, as per the prevalent norms, while conducting the audit and verifying the Fixed Deposits and balances in current accounts. They have submitted that there is absolutely no evidence to suggest that the auditors had any *mens rea* or knowledge of the alleged fraud or had connived in the commission

of the alleged fraud. According to the Noticees, the fraud was executed at such a high level and with such precision and sophistication by the higher management of SCSL that there was nothing which could raise the auditor's suspicion regarding the genuineness of the bank statements and records presented to them by SCSL. They have forcefully contended that there is no evidence to prove that they were complicit in or were aware of the alleged fraud.

23. The Noticees have rested their case primarily on the assertion that the auditors must not be made liable for not tracking down ingenious and carefully laid schemes of fraud when there is nothing to arouse their suspicion and where the frauds are perpetrated by trained servants of the company. According to them, an auditor is not required to be a detective in the process of audit and it is sufficient to show that reasonable care and due diligence was administered by the auditor. They have further submitted that the responsibility of any subsequent fraud cannot be that of an auditor, who exercised his duties in accordance with the AAS and the Generally Accepted Auditing Standards (GAAS) at the time of the audit.
24. Having gone through the abovementioned submissions made by the Noticees in their defense, I am of the opinion that before striving to find answers to the larger question of whether the auditors had the knowledge of or were complicit in the fraud perpetrated by the senior management of SCSL, it is imperative to first ascertain whether the auditors fulfilled their basic professional duties of an auditor by complying with the principles governing the conduct of an independent audit, as laid down in the Auditing and Assurance Standards (AAS1, AAS2 etc.), as prescribed by ICAI, the statutory governing body for audit of companies falling within the purview of the Companies Act. These principles mandatorily apply to an independent audit with effect from the date of prescription by ICAI, which means that the auditors, while discharging their attestation function, have to ensure that the AASs are followed in the audit of financial information covered by their audit reports. If, for any reason, an auditor has not been able to perform an audit in accordance with the AASs, his report should draw attention to the material departures therefrom. Whether the auditors have complied with the abovementioned standards and the extent thereof has been examined in the succeeding paragraphs.
25. I note that para 3 of the AAS 13 dealing with 'Audit Materiality' *inter alia* provides that "*Information is material if its misstatement (i.e. omission or erroneous statement) could influence the economic*



*decisions of users taken on the basis of the financial information. As per para 5 of the said AAS 13, the concept of materiality recognises that some matters, either individually or in aggregate, are relatively important for true and fair presentation of financial information in conformity with recognised accounting policies and practices.”*

In this context, I note that the confirmation of the current account balances and FD receipts was the most vital and material part of the audit exercise in case of audit of financial statements of SCSL. The bank balances, as percentage of total assets of the company, were significant and were as high as 70% towards the quarters of June and September 2008. As on September 30, 2008, the company had disclosed ₹ 5312.62 Crores as cash and bank balances in the financial statements audited by PW, out of which ₹ 1782.6 crore (around 33.5% of the cash and bank balances) was shown as lying in the Current account No. 120559 held with Bank of Baroda, New York branch, and ₹ 3318.37 crore (around 62.5% of the cash and bank balances) was shown as held in Fixed Deposits with five other banks. Given that the company was holding an overwhelming part of its net worth in FDs and current account, independent and fool proof verification of the same lay at the core of the audit process for correctly attesting the financial statements of the company. Thus, the verification of cash and bank balances assumed material significance in PW's audit plan in respect of SCSL.

26. It is pertinent to point out that Para 3 of the ‘Guidance Note on Audit of Cash and Bank Balances (GN 20)’ issued by ICAI, provides the following:

*“Cash and bank balances may constitute a significant proportion of the total assets of an entity. An important feature of cash and bank balances which has a significant impact on the related audit procedures is that these assets are highly prone to misappropriation, misapplication and other forms of fraud.”*

27. It is seen from the Guidance Note quoted above that ICAI itself has recognized that cash and bank balances are highly prone to misappropriation, misapplication and other forms of fraud. When the bank balances and fixed deposits of SCSL possessed such high degree of materiality in terms of their value and formed the most vital part of the books of accounts of SCSL, the auditors ought to have employed apt procedures, under the AAS mandates. The more reliable and convincing the auditing evidence obtained from the applied methods are, the more trustworthy is the auditor’s opinion. The reliability of audit evidence depends upon its nature, the source from which it is obtained and also the process employed to obtain it. As a general

rule, the evidence obtained from external independent resources is more reliable, as it provides greater assurance of reliability for the purposes of an independent audit than that secured solely within the company.

28. It is also pertinent to note that AAS 5, which deals with 'Audit Evidence', specifically provides in para 7 that external evidence is usually more reliable than internal evidence and that evidence obtained by the auditor himself is more reliable than that obtained through the entity. Further, para 4 of the AAS 5 *inter alia* provides that the auditor's judgment as to what is sufficient appropriate audit evidence is influenced by such factors as the materiality of the item. The AAS 5 further provides, in para 9, that the auditor should be thorough in his efforts to obtain evidence and be objective in his evaluation. In this context, it is worth mentioning that in respect of bank balances and deposits, the respective banks where such accounts or deposits are held, act as the singular and the most authentic and direct source of confirmation of such balances and deposits. Further, considering that around ₹ 5,312.62 crore was shown in the books to be held in bank balances and fixed deposits by SCSL as on September 30, 2008, which accounted for around 70% of the total assets of the company, the confirmation of bank balances and deposits directly from the banks assumed utmost importance.
29. The Noticees, in their first reply to the SCN, have contended that SEBI's allegations that external confirmation of balances is a primary validation procedure for a rigorous and diligent auditor is inconsistent with the ICAI guidance and therefore untenable. They have further contended that while the external confirmation process is one of the validation procedures an auditor may perform, the ICAI guidance allows the auditor discretion in choosing the appropriate procedures for his audit. In this regard, they have referred to AAS 30, which deals with the aspect of 'External Confirmations' and have placed reliance on para 2 thereof which, *inter-alia*, provides that the auditor should determine whether the use of external confirmations is necessary to obtain sufficient appropriate audit evidence to support certain financial statement assertions. I note that though Para 2 of AAS 30 provides discretion to the auditors to determine whether to use external confirmations, such discretion is not unfettered and cannot be exercised as per the whims and fancies of the auditor. The said para 2 of AAS 30 itself provides that in making such determination, the auditor should consider materiality and the level of inherent and control risk, among other things. As such, the bank balances and FDs occupied a high degree of materiality

in the entire audit exercise and at the same time, were prone to various forms of fraud. I, therefore, am of the firm opinion that the exercise of discretion by the auditor should have been driven by these factors so as to further the objective of the audit process rather than compromising it. Thus, given the high materiality of the bank balances and FDs of SCSL, the necessity for external confirmation of the same was highly imperative and the same could not have been bypassed by the auditors by opting for less stringent alternative procedures.

30. It is further pertinent to note that PW's own audit manual in the chapter '5171.2 Bank Confirmations', provides - "*Bank confirmations are the primary and ordinarily the most reliable source of audit evidence to verify the existence and accuracy of bank balances, and to address the completeness, accuracy, rights and obligations and presentation and disclosure assertions for other banking facilities. While it may be possible to perform alternative procedures to verify certain bank accounts, it is difficult to perform alternative procedures to audit the "other information," in particular to confirm its completeness; thus bank confirmations may be the only source of audit evidence for the completeness assertion.*" Thus, I note that PW's own audit manual unambiguously mandated external confirmation of bank balances and FDs.
31. I note that ICAI has prescribed the AAS 30 to establish standards on the auditor's use of external confirmations as a means of obtaining audit evidence. The said AAS 30, as applicable at the relevant time, prescribes the following in Para 32:

*"When performing confirmation procedures, the auditor should maintain control over the process of selecting those to whom a request will be sent, the preparation and sending of confirmation requests, and the responses to those requests. Maintaining control means maintaining direct communications between the intended recipients and the auditor to minimize the possibility that the results of the confirmation process will be biased because of the interception and alteration of confirmation requests or responses. The auditor may give a list of accounts selected for confirmation to the management for preparing requests for confirmations, which should be properly addressed and stamped, alternatively, the auditor may request the management to furnish duly authorised confirmation letters and fill in the names, addresses and other relevant details relating to the accounts selected by him. **The auditor should, however, ensure that it is the auditor who sends out the confirmation requests, that the requests are properly addressed, and that it is requested that all replies and the undelivered confirmations are delivered directly to the auditor. The auditor considers whether replies have come from the purported senders.**"*

32. From the above, it is unambiguously clear that an auditor ought to maintain control over the process of external confirmations which means maintaining direct communications between the intended recipients and the auditor. It is further important to note that PW's internal audit manual under chapter '5171.3 Practical Guidance for Obtaining Bank Confirmations' provides that *"Confirmations must be sent out under our control, and replies sent direct to us - otherwise there is a risk that the client withholds confirmations which they know will reveal discrepancies, or manipulates the responses."*

**Current Account Balances:**

33. I note that as per the SCN, the balance in current account of SCSL with Bank of Baroda, New York Branch (Account no. 120559), as reflected in the books and accounts of SCSL, as on September 30, 2008, was overstated by ₹ 1,731.88 crores.
34. The company allegedly used to receive two sets of bank statements for its current account operations pertaining to Bank of Baroda, New York Branch, one being 'Daily bank statement' received through email and printed and filed in the accounting wing and the other being 'Monthly bank statement' which was being received through 'internal' courier from chairman's office. It is alleged that the closing balance as well as the number of debit and credit entries in the two statements differed substantially. The daily statements allegedly reflected the true and correct balances with the BOB New York Branch, whereas the monthly statements were apparently manipulated which showed additional entries which were largely in the nature of extra receipts. The monthly statements were allegedly relied upon for the preparation of books of accounts and in turn used by the auditors of the company for certification of the accounts. The charge against PW is that they had relied upon the monthly statements instead of the daily statement. The SCN also alleges that PW was also provided with short period statements, apart from monthly statements, which indicated the existence of a daily statement and that entries were passed on a regular basis using the data contained in the daily bank statement and several of them were later reversed before closing of accounts for the month, due to discrepancies between the daily and monthly statements. PW was allegedly aware of the same.
35. The Noticees have vehemently denied that they had any knowledge of any daily statement

altogether. They have submitted that they were not aware of the existence of any such daily statement and have contended that what is being referred to as the daily statement in the SCN is also a monthly statement. They have further submitted that PW had relied upon the monthly bank statement provided by SCSL which in fact was on the letter head of BOB, NY Branch, and contained transactions for the entire month. The Noticees have also contended that PW's audit of current account balances on the basis of monthly bank statements is a standard audit practice. The Noticees have also denied having any knowledge of reversal of entries, as alleged in the SCN. Regarding the short period statements, the Noticees have submitted that the same are requisitioned routinely as a standard audit practice for tracing subsequent entries for reconciling items in Bank Reconciliation Statement (BRS) and there is nothing alarming about the same. Further, the short period statements were on BoB's letterhead and their format was identical to that of monthly bank statements and the transactions tallied. They have further submitted that there was nothing on the face of these documents which aroused any doubt or suspicion in the minds of the auditors and they believed that these documents were genuine. The Noticees have referred to the statements made by various persons during investigation, as well as the records of their cross-examination by them, in support of their contentions.

36. I have considered the submissions of the Noticees that they were not aware about the existence of any daily bank statement and any reversal of entries in the books of accounts, as alleged in the SCN. I find that the material available on record does not conclusively establish that the auditors were aware of the existence of any daily bank statement or the alleged reversal of entries in the books of accounts. Going by the evidence available, I am inclined to accept the Noticees' submission on this account. However, it is important to see whether the auditors, in the first place, were justified in relying upon the monthly bank statement pertaining to BoB which turned out to be forged and manipulated.
37. The Noticees have submitted that PW's primary substantive audit procedure with respect to the audit of current account balances was testing of Bank Reconciliation Statements (BRS) prepared by SCSL. The team verified the current account balances in SCSL's books with the balances as per the Bank Reconciliation Statement (BRS). The audit step carried out by PW included tracing the bank balances on SCSL's BRS to the bank statements of SCSL. The detailed procedures carried out by PW in connection with the audit of current account balances of SCSL were recorded in detail for each quarter in the '*MyClient*' files which are the electronic records

maintained by the audit team. The Noticees have further submitted that PW tested mathematical accuracy of reconciliation, traced book balances on SCSL's bank reconciliation to the comparative summary etc. and also attached various documents in the '*MyClient*' files. As per the Noticees, the company's BRS procedures rely on the authenticity of the monthly bank statements used in the verification process and the auditors did not suspect the monthly bank statements obtained from SCSL to be fabricated.

38. From the above submissions of the Noticees, I note that the auditors had primarily relied upon the monthly bank statements and the BRS procedures in the verification process of the current account balances. The Noticees have harped on the fact that all the procedures were recorded in the *MyClient* files and that a number of witnesses during their cross examination have confirmed that such procedures were indeed followed. However, I note that in all the above mentioned procedures purportedly followed by PW, all the reference material relied upon by the auditors (i.e. BRS, SCSL's books and monthly bank statements) had originated or had been sourced from the auditee company itself. While the BRS and the books of account would invariably be prepared by officials of the company, the monthly bank statements upon which BRS procedures relied upon and which possess high degree of materiality, should have been procured directly from the banks, instead of obtaining from the company. Though the Noticees have admitted, as mentioned above, that the company's BRS procedures rely upon the authenticity of monthly bank statements, there is nothing which suggests that PW took any effort to obtain the same directly from the banks, in order to rule out any possibility of the bank statements suffering from any defect or fraud. I note that in the various *MyClient* files pertaining to the title 'Test Bank Reconciliations' (viz. W4-Doc.14, W6-Doc. 15) or 'Scan year-end bank reconciliations' (viz. W9-Doc. 8 & 9) referred to by the Noticees, which are the electronic records of the tailored procedures to be followed and the results obtained therefrom, there is nothing which indicates that the auditors obtained monthly bank statements directly from the banks. By relying on the bank statements obtained from the auditee company merely on the ground that the statements looked genuine and did not arouse suspicion, PW clearly defied the auditing standards and principles as prescribed under AAS 13 (since current account balances possessed high materiality) and AAS 5 (since the evidence ought to have been confirmed through more reliable external confirmations). The same also shows that the auditor lacked professional skepticism.

39. As stated above, the actual balance in the current account of SCSL with BoB, NY was highly overstated in the financial statements audited by PW. As on September 30, 2008, the balance in the books of the company was approximately ₹ 1782.60 crore, while the actual balance was only ₹ 50.72 crore. The said current account of SCSL with BoB, NY was the main current account of SCSL and held approximately 75% of all current account balance of SCSL. The SCN has alleged that for verifying the balances in the said current account, PW did not seek direct confirmation from BoB, NY Branch, but merely relied upon the copies of confirmations given by SCSL, which were false and manipulated and supported the bogus balances shown in the books of account. These confirmations were allegedly not original documents but were only photocopies of emails purportedly sent by BoB, NY, to SCSL's representative and forwarded to SCSL in Hyderabad. BoB, NY Branch in its email dated October 23, 2009 to SEBI, confirmed that it did not receive any request from PW for confirmation of balances. A copy of the said email was provided to the Noticees as Annexure-9 to the SSCN. Further, PW allegedly had evidence of such confirmations of balances of the BoB NY account, which were obtained from SCSL, only for 12 quarters out of the total of 34 quarters spreading over a span of eight and half years of repeated audit exercise by PW, which were provided in Annexure-11 of the SSCN.
40. In respect of the above allegations, the Noticees have submitted that the audit team had sought and received confirmation of balances from BoB, NY and other banks where SCSL had current accounts. They tallied balances in the confirmations received from the banks with the BRS and monthly bank statements produced by SCSL for verification and the balances mentioned in the confirmations matched with the bank statements and BRS. They have further submitted that the confirmations appeared to be genuine and there was nothing which aroused suspicion in the minds of auditors in connection with bank confirmations. The Noticees have also contested the assertion that they could have taken recourse to alternative channels like core banking internet banking to verify the balances and have stated that there is no evidence to prove that these facilities were available with SCSL.
41. I am of the opinion that even external confirmations may get compromised and become unreliable due to interception and alteration of the confirmation requests or responses, if appropriate procedures are not adopted and adequate control over them is not exercised. In this

regard, it is pertinent to note that para 7 of AAS 30 provides that -*“The reliability of the evidence obtained by external confirmations depends, among other factors, upon the application of appropriate procedures by the auditor in designing the external confirmation request, performing the external confirmation procedures, and evaluating the results of the external confirmation procedures. Factors affecting the reliability of confirmations include the control which the auditor exercises over confirmation requests and responses, the characteristics of the respondents, and any restrictions included in the response or imposed by management.”*

42. I thus note that the manner of obtaining external confirmations has a direct bearing on the reliability of the evidence obtained by external confirmations. While the Noticees have claimed that PW had obtained external confirmation of the current account balances of SCSL of BoB, NY Branch, there are gaping holes in their defense, which indicate otherwise. While AAS 30 clearly provides for the auditor to maintain control over the process of external confirmations which means maintaining direct communications between the intended recipients and the auditor, the Noticees had failed to adhere to the same by not sending confirmation requests directly to the bank (BoB, NY) during repeated audit exercise, as confirmed by BoB, NY, in their email dated October 23, 2009 to SEBI, a copy of which was provided to the Noticees as Annexure-9 to the SSCN. It is noted from the said email that during investigation, SEBI, vide email dated October 23, 2009, had *inter-alia* requested BoB, NY, to provide copies of request letters of SCSL, if any, seeking confirmation of the balance in the accounts of SCSL, for period from June 30, 2001 to December 31, 2008. In response to the same, BoB, NY, vide email dated October 09, 2009 *inter-alia* stated that *“...We inform that we had never received any request letter from M/S Price Waterhouse seeking confirmation of balance in the accounts of SCSL.”*
43. The Noticees have sought to discredit the email dated October 23, 2009 from BoB, NY, whereby the bank confirmed that it did not receive any request for confirmation of balance from PW, as being unreliable, uncorroborated and not having been made on oath. I am of the opinion that the best way for the Noticees to repudiate such claim would have been to produce some documentary evidence of PW having written to BoB, NY, instead of taking recourse to grounds of admissibility. The extent of applicability of strict rules of evidence as enunciated under the Evidence Act, 1872 to a quasi-judicial proceeding like the instant one is elaborated later in this order. I note that the Noticees have failed to provide any documentary evidence, pertaining to even a single quarter out of 34 quarters spread over eight and half years, to prove that PW had



written directly to BoB, NY, seeking current account balance confirmation.

44. The Noticees have referred to the statement of Witness No. 9, Pulavarthi Siva Prasad (Associate Director, Lovelock & Lewes), made during examination on oath on March 23, 2009 (answer nos. 16 & 17), to support their argument that PW had sent confirmation requests to banks and had directly received the same from banks. However, I note that Prasad at answer no. 16 of the said statement, in respect of balance confirmation of BoB, NY, has *inter-alia* stated the following: *“In the initial stages, we used to send the confirmation requests to BoB New York in the regular format adopted in India for which the bank did not respond. Then we learnt that we had to send it in the format as approved by the US Bankers Association, which we did. **One Ms. Radha Raju of Satyam, working at the New Jersey office is the contact person and co-ordinator with BoB New York. She used to send the respective monthly bank statements to the offshore team, which was produced for our verification.**”* Further, Prasad, in his statement of examination on oath on October 16, 2009 at A.20 had made similar submissions and had further added that *“**in the absence of receipt of confirmation of balances directly by us, as explained in the earlier questions, we had followed other procedures such as verification of bank statements, confirmation received through the company and bank reconciliation statements along with the supporting documents for the respective periods.**”* (emphasis supplied) In the above statement, Prasad has indicated that PW used to send requests for balance confirmations to BoB, NY. However, considering the fact that BoB, NY, has confirmed that it did not receive any request for confirmation from the auditors and the Noticees have failed to provide documentary evidence to rebut the same and taking into account the abovementioned statement which shows that Radhu Raju from SCSL used to co-ordinate with BoB for obtaining balance confirmations, it is clear that PW had failed to directly send requests for balance confirmation to BoB, NY, and instead had relied upon the company to do so.
45. As regards the receipt of balance confirmations from banks only for 12 quarters out of 34 quarters, as referred to in Annexure-11 of the SSCN, the Noticees have failed to provide any documentary evidence to show that even these current account balance confirmations, purportedly issued by the BoB, NY, were directly received by PW and not through SCSL. They have also failed to produce any documentary evidence to rebut the charge that the said balance confirmations relied upon by them, were nothing but photocopies of purported emails and not

original confirmations from the bank, as alleged in the SCN. In fact, the statement of Witness No. 9, P. Siva Prasad, as quoted in previous paragraph, clearly indicates that PW used to receive bank confirmations for BoB, NY, through the company's representative at New Jersey and not directly.

46. The Noticees have referred to the statement of CH Ravindranath, in A4 of his re-examination to prove that confirmations, in respect of current accounts, were directly received from the banks. However, I note that the said statement refers to confirmations pertaining to current accounts in general and does not refer specifically to BoB, NY Branch account. Further, considering the failure of the Noticees to provide any documentary evidence of PW having received balance confirmations directly from BoB, NY, and the presence of various corroborative evidences pointing to the contrary, the said statement cannot be given any credence. It is also important to note that PW's own audit manual in chapter "5171.2 Bank Confirmations" provides that *"Confirmation requests should be sent under our control and, further requests, as necessary, should be mailed when responses to confirmation requests have not been received within a reasonable time. All communications with the financial institutions (including oral communications) should be documented on the file as evidence of sufficient follow up."* It is thus seen that even though PW's own audit manual provides for documenting the communications with the banks, PW has failed to do so. The same strengthens the inference that PW had neither sent requests for confirmation nor received them directly from BoB, NY, rendering the external confirmation process routine and meaningless.
47. Apart from the above, it is noted that Srinivas Talluri (Noticee no. 13) has submitted certain records pertaining to balance confirmations as furnished by BoB, NY branch, as contained in the enclosures to the Annexure-T of his additional submissions dated November 02, 2017. From the said records, it appears that Radha Raju, SCSL's representative in New York, used to write to BoB, NY Branch for providing balance confirmations of the current account with BoB, NY, in the attached format. The said records further show that BoB, NY, used to forward the confirmation in the attached format by fax to the number mentioned by Radha Raju in her letter. Further, from documents W5-Doc-2 and W5-Doc-4, which were produced during the cross-examination of V.R. Dhanthuluri on June 06, 2017 by Srinivas Talluri, it appears that Radha Raju subsequently used to forward the bank confirmations to Srisailam Chetkuru and V. R.

Dhanthuluri, the officials of SCSL. Thus, the records amply demonstrate that PW neither sent confirmation requests directly to BoB, NY, nor did it receive the confirmation directly from the bank but relied on the company for the same.

48. In addition to the above, I note that the 'Working Paper' forming part of the *MyClient* files, as available in PW's laptop available with SEBI, record that for the audit period 2001-02, PW had not received confirmation from the bank for the current account with BoB, NY (A/c No. 120059). In this respect, the file further records that *"For the confirmations not directly received by us traced the original confirmations received by the client to the bank reconciliation statements. There are no unconfirmed balances at the end of the each accounting period. In case of deposits traced the original confirmations received by the client to the bank deposit balance."* The said *MyClient* file further records, in respect of Quarters ended 30.09.2001 and 31.12.2001 that *"As decided at the planning stage for the quarter ended 31.12.2001 no requests for confirmation have been sent."* It is thus seen from the said *MyClient* files that PW had relied upon balance confirmations for account with BoB, NY, received through the company. Further, the said *MyClient* files also show that confirmation requests were not sent to banks for various quarters.
49. It is also significant to note that while PW chose not to seek balance confirmations from BoB, NY, which was holding the most significant part of SCSL's current account balances, it had sought balance confirmations directly from certain banks in India as well as outside India, where SCSL had accounts with negligible or nil balances. I have considered and am inclined to accept the submissions of the Noticees that there is no evidence to suggest that PW could have used core banking and internet banking for verification of bank balances. However, from all the above facts, it is amply clear that PW, in respect of seeking external confirmation of the current account balance of SCSL with BoB, NY, had failed to exercise care and prudence and adhere to even the basic standards and procedures as prescribed under AAS 30.
50. The Noticees have repeatedly asserted that there was nothing in respect of the bank balance confirmations, relied upon by them, which could arouse their suspicion. They have further contended that all inscriptions including the numbers in balance column and signatures in allegedly forged confirmation letters relied upon by them match with those contained in the confirmation letters obtained by SEBI directly from BoB, NY Branch. In this regard, S. Talluri

(Noticee no. 13) has also submitted a report from a handwriting expert substantiating the same (Annexure-T of the additional reply of Srinivas Talluri dated November 02, 2017). However, by taking this plea, the Noticees are exposing their grave failure to give due weightage to the materiality of the current account balance held with BoB, NY, which objectively and prudently called for their external verification directly from the concerned bank, instead of relying on confirmations received from the auditee company. As stated in above paragraphs, the Guidance Note on Audit of Cash and Bank Balances (GN 20) issued by ICAI, categorically points out that bank balances are highly prone to various forms of fraud. Thus, PW ought to have obtained external confirmation of the same without compromising mandated procedures, instead of relying on the confirmations obtained from the auditee company. I am of the view that the relevant question here is not whether the bank confirmations relied upon by PW were forged or not but whether PW had duly carried out the basic procedures and employed safeguards as prescribed under the auditing standards, more particularly AAS 30, in the process of obtaining external confirmation of the said bank balances, which would have exposed the fraud. From the above facts and circumstances, it is amply clear that by failing to send requests for balance confirmations directly to BoB, NY branch and by relying on confirmations obtained through SCSL, which were nothing but photocopies of purported emails and not on original confirmations from the bank, PW showed scant regard for the mandatory auditing standards and procedures prescribed by AAS and its own Audit Manual.

#### **Bank Confirmations for Fixed Deposits:**

51. As per SCSL's books of accounts, the company had ₹ 3318.37 crores in Fixed Deposits (FDs) in five banks, as on September 30, 2008, which accounted for around 62.5% of the cash and bank balances of SCSL. Investigation revealed that the FDs held by the company were allegedly overstated by ₹ 3308.41 crores as on September 30, 2008. The Fixed Deposit Receipts (FDRs) relied upon by the auditors were *prima facie* fabricated.
52. The SCN has alleged that two sets of letters of confirmation of deposit balances of the company were available with the auditor:

- (a) A confirmation received directly in the office of the auditor, in the format prescribed by it, confirming *inter alia*, the balances of all accounts held by the company with the respective bank as on a particular quarter ending date.
- (b) A confirmation from the bank, not in the prescribed format, addressed to the auditor, but received by the company, stating, in a single sentence, balances of fixed deposits held by the company with the respective bank. (Copies of these are provided in Annexure-7 of the SCN.)
53. The SCN has alleged that the deposit balances mentioned in the letters of confirmation, in the prescribed format and received directly in the office of the auditor, were found to reflect the actual and correct balances, whereas the deposit balances mentioned in the letters of confirmation received by the company and handed over by it, to the auditor, tallied with the balances in the books which were substantially higher the actual balances and were fabricated. The difference in the figures of the actual balances of fixed deposit accounts as directly confirmed by the banks to SEBI and the fabricated balances as appearing in the bank ledger in the books of SCSL have already been provided above. It was further alleged that the bank confirmations received through the company were not in prescribed format and merely mentioned the consolidated balance of fixed deposit accounts and accrued interest thereon without any reference to Deposit Account No. or Fixed Deposit Receipt No. or Account wise detail of the balance. Further, during investigation, all the five banks in which substantial FDs were maintained, as per the books, confirmed to SEBI that the letters supposedly addressed by them to the auditors (which were obtained by SEBI from the auditors) had not been sent by them. The said letters received by SEBI from the five banks were provided as Annexure-10 to the SCN. Further, since the FDs were overstated, the accrued interest presented in the books was also allegedly overstated and misleading.
54. I note that similar to the case of the current account balances, the auditors had a mandate to follow the basic standards prescribed under the AAS, more particularly AAS 13, AAS 5 & AAS 30, even in respect of the FD balances of the company. It is to be seen whether the auditors had adhered to the said norms in respect of FDs or had abdicated their duties likewise.
55. The Noticees have submitted that PW's primary audit procedure in connection with the FD

balances was physically verifying the FDRs. According to them, the auditors checked in detail the information on each FDR and confirmed that the FDRs matched the schedule of FDs in the books of SCSL. The auditors regarded FDRs as primary evidence of existence of FDs of SCSL and the amounts placed as FDs were traced to the monthly bank statement of SCSL. Further, the auditors conducted the review of SCSL's process for placing FDs and tested controls surrounding the company's placement of FDs. They have further submitted that PW also obtained bank confirmations in addition to the primary audit procedure of verification of FDRs.

56. In the preceding paragraphs, the significance and materiality of the FDs totaling ₹ 3318.37 crore as on September 30, 2008, which comprised around 62.5% of the cash and bank balances of SCSL (cash and bank balances accounted for 70% of the net assets of the company), and the overwhelming necessity for their external confirmation have already been explained and emphasized upon. Thus, even though the Noticees claim that the FDRs were taken as the primary evidence of existence of FDs, given the materiality of FD balances, prudence required that the same ought to have been verified directly with the banks where such FDs were held, as per the procedure and mandate prescribed under AAS 30. The Noticees have contended that PW had obtained bank confirmations in addition to the primary audit procedure of verification of FDRs. However, I note that the facts on record, as provided below, indicate that the auditors had not obtained external confirmation of the said FDRs in a manner consistent with the mandate of AAS 30.
57. As per the procedure mandated under 32 of AAS 30, the responsibility of sending the letters seeking external confirmations strictly rests on the auditors. However, it is noted that the Noticees in para 101 of their preliminary reply dated August 10, 2009 to the SCN have submitted the following: *“Every quarter, the engagement team worked with the Company to request that the branches of the five banks holding Satyam's long-term fixed deposits confirm the balance of the deposits. A manager on the engagement team signed a confirmation request letter prepared on PW letterhead and addressed to the branch at which Satyam had placed the fixed deposit. Satyam sent the engagement team's letter to the relevant banks, along with its own cover letter consenting to provision of the information to the engagement team and requesting that the banks cooperate with the team's request.”*

58. The Noticees have submitted that the procedures followed for confirmation of bank balances have been recorded in *MyClient* files. In this regard, they have referred to a number of *MyClient* documents with Titles –‘Test deposits held with banks’ (viz. W4-Doc.13, W6-Doc.14, W8-Doc.8, W9-Doc.6 & 7 and W10-Doc.1) and have also referred to the cross-examination of various witnesses to prove that the procedures recorded therein were followed. However, I find from the results of procedures recorded in the said *MyClient* files pertaining to ‘Test Deposits held with Banks’ that there is nothing therein which indicates that the confirmation requests were sent by PW directly to the banks, as per the mandate of AAS 30.
59. Further, a number of witnesses from PW in their statements of examination on oath have confirmed that PW used to send confirmation requests to bank through SCSL and not directly. This is evident from the following:
- a) A.7 & A.9 of the statement of examination on oath of CH Ravindranath, recorded on January 15, 2009, as furnished vide Letter dated January 16, 2009
  - b) A.12 of cross–examination of V.R. Dhanthuluri, conducted on June 06, 2017
  - c) A.3 of statement of examination on oath of M.N.V. Gayatri recorded on January 23, 2009
60. From the above, it is amply clear, as admitted by the Noticees, that the letters for confirmation of FD balances to the bank were not sent by the auditors directly but were routed through the company. The same is in clear violation of the mandate of Para 32 of AAS 30, which requires an auditor to maintain control over the process of external confirmation by having direct communication with the external entity. While the said Para 32 provides that the auditor may request the management to furnish duly authorized confirmation letters, it simultaneously emphasizes that “***The auditor should, however, ensure that it is the auditor who sends out the confirmation requests, that the requests are properly addressed, and that it is requested that all replies and the undelivered confirmations are delivered directly to the auditor. The auditor considers whether replies have come from the purported senders.***”
61. As regards receiving two sets of bank confirmations (i.e. one directly from the bank and one through the company), the Noticees have denied the allegation that PW ignored the letters of confirmations directly received from the banks and instead relied exclusively only on those

received from the company, which were fabricated. According to the Noticees, the auditors sought confirmation of fixed deposit balances with banks and had received certain confirmations directly from the banks and certain confirmations through the company. The two sets of confirmations received by them (i.e. one directly from the bank and one through the company) were taken as relating to two different types of deposits held with two different branches of the same bank. The Noticees have further submitted that the two different confirmations were treated as complementary and not contradictory to each other, as the aggregate of the two tied up to the balances contained in the books of account of the company. For instance, in the case of BNP Paribas for the quarter ended September 30, 2008, the auditors had taken into consideration the confirmation received directly from the bank showing a balance of ₹ 8.64 crore as well as the confirmation received through the company showing a deposit balance of ₹ 468 crore. Accordingly, the total figure of ₹ 476.64 (i.e. ₹ 8.64 crore + ₹ 468 crore) was taken as the final figure, which matched with the figures in the books of account. Apparently, a similar practice was followed in case of other banks as well.

62. The Noticees have further submitted that since the physical verification of original fixed deposit receipts formed the primary source of verification, the balance confirmations from the banks only provided additional comfort. As regards the bank confirmations received through the company not being in the prescribed format and not containing various relevant details like FDR nos., account wise details etc., the Noticees have submitted that the banks did not follow any uniform format for providing confirmations. They have cited multiple instances where banks have responded in different formats for balance confirmations. Moreover, the balance confirmations received through SCSL were on the original letter heads of the banks, were signed by bank signatories and contained the details of the amount held in FDs and interest accrued. Thus, they did not suspect that the bank confirmations received through the company were forged and manipulated. Further, Srinivas Talluri (Noticee no. 13), in order to prove that bank confirmations could reflect partial balance, has additionally contended that even the bank confirmations provided by Citibank and BNP Paribas to SEBI vide their letters dated January 10, 2009 (Annexure-8 of SCN) were incomplete, as they did not include dividend accounts of SCSL with the said banks. Srinivas Talluri has also cited a letter dated October 03, 2008 from Citibank (Annexure-Q of additional reply dated November 02, 2017 of Srinivas Talluri) confirming balance in dividend accounts of SCSL, as not containing any references of respective



bank accounts like account number etc., though it reflected the genuine balance. The Noticees have further contended that since the balance confirmations received directly from the banks were incomplete, they invariably resorted to alternative procedures (like verification of balance confirmation letters as received by the company, bank statements etc.), as provided under AAS 30 dealing with external confirmations. The Noticees have also referred to the difficulties generally faced by auditors in bank confirmations during the relevant time period and have drawn attention *inter-alia* to the RBI Circulars issued in 2011 to the banks in this regard. I also note that S. Gopalakrishnan has also furnished affidavits from two independent practicing chartered accountants in order to justify the procedures adopted by PW *inter-alia* in respect of confirmation of bank balances.

63. The Noticees have admitted that the auditors had relied upon bank confirmations received through the company. I note that reliance on confirmations obtained through the company or use of alternative procedures could be justified only in a situation where the auditors are unable to obtain direct confirmations from banks, even after following due process of external confirmation and taking reasonable efforts as mandated under AAS 30. It was observed during investigation that balance confirmation letters were very infrequently received directly at the office of PW, as given in the table above. As per Para 34 of the AAS 30, the auditors ought to have followed up on requests for external confirmations from banks or, alternatively, contacted the banks to elicit a response. Para 34 further provides that only where the auditor is unable to obtain a response, the auditor would need to use alternative audit procedures. However, I note that PW has failed to show that it had followed up with the banks even on a single occasion to obtain direct confirmations, as mandated under Para 34 of AAS 30. In fact, I note that M.N.V. Gayatri in A7 of her statement of examination on oath, recorded on January 23, 2009, has stated that – “... *For all other fixed deposit the question was raised with the company officials as to why the direct confirmations were not received from other bank branches. But this was not pursued and comfort was taken from FD receipts produced by the company and also the confirmations obtained through the company.*” It is amply clear and irrefutable that the process of external confirmation was not carried out properly and the audit exercise was completed by simply relying on the bank confirmations furnished by the company.
64. While the auditors acted contrary to the mandate of AAS 30 by not obtaining external

confirmation of bank balances directly from the respective banks, even the bank balance confirmations provided by the company to the auditors and relied upon by them suffered from glaring irregularities which were enough to raise red flags about their authenticity. While I have considered and find merit in the contention of the Noticees that the banks did not follow any prescribed or uniform format for confirmation, I find that the Noticees' presumption that the confirmation from banks were branch-wise, even though there was not even one instance in the past in which PW had received letters directly from more than one branch of the same bank, defies logic and prudence. From the copies of the confirmation letters received by PW through the company and relied upon by them, which are available at Annexure 7 of the SCN, I note that there is nothing which indicates that the figures therein pertain only to a particular branch and are merely part balances. The confirmation letters received through the company and relied upon by the auditors mentioned only consolidated balance of fixed deposit account and accrued interest thereon sans Deposit Account No. or Fixed Deposit Receipt No. or Account wise detail of the balance, though it was asked for by the auditor. This ought to have prompted the auditors to cross-check their veracity directly from the bank, instead of blindly relying on them. This is more so given that while SCSL was holding more than 20 Fixed Deposits with each bank as per its books of account. The casual approach of the auditors is also exposed by the fact that they had even relied upon a confirmation letter of ICICI dated October 04, 2008 wherein SCSL's name was not even mentioned. I note that the letters dated January 10, 2009 of Citibank and BNP Paribas referred to by Srinivas Talluri for showing that banks could provide incomplete balance is not relevant here as these letters were submitted to SEBI in response to a request for details of current accounts and FDs of SCSL and thus did not include dividend accounts. Further, I note that even the argument of Srinivas Talluri that the letters dated October 03, 2008 of Citibank confirming balances in dividend account were not containing the account numbers is not true, as the same are indeed mentioned therein. Thus, it is clear that the auditor did not perform the necessary audit procedures for externally confirming the fixed deposit balances and simply accepted internal evidence, even though the FD balances possessed high degree of materiality in the context of the net assets of the company.

65. The Noticees in their defence have submitted that since the company and its management enjoyed a very good reputation for corporate governance and compliance, the auditors had every reason to believe the company's representations. However, getting influenced by one's

reputation during the critical process of evaluation and confirmation of audit evidences does not behove an auditor who is supposed to proceed with the audit with an attitude of professional skepticism, as mandated under para 18 of AAS 4.

66. From the above paragraphs, it is amply clear that the auditors, during the audit process of the company, 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 of audit evidence and having an attitude of professional skepticism. Having found as above, it is important to see whether PW had followed applicable norms in respect of assessment of adequacy of internal audit procedures.
67. The Companies (Auditor's Report) Order, 2003 in Para 4 provides that the auditor's report on the account of a company to which this Order applies shall include a statement on inter alia the following: *in the case of listed companies and/or other companies having a paid-up capital and reserves exceeding ₹ 50 lakhs as at the commencement of the financial year concerned, or having an average annual turnover exceeding five crore rupees for a period of three consecutive financial years immediately preceding the financial year concerned, **whether the company has an internal audit system commensurate with its size and nature of its business; (emphasis supplied)***
68. Further, it is noted that AAS 7, which pertains to relying upon the work of an internal auditor, in para 8 provides that: *The external auditor should, as part of his audit, evaluate the internal audit function to the extent he considers that it will be relevant in determining the nature, timing and extent of his compliance and substantive procedures. Depending upon such evaluation, the external auditor may be able to adopt less extensive procedures than would otherwise be required.*
69. It is alleged in the SCN that PW used to make presentations on audits of books before the Audit Committee of the company and that annual internal audit plans meetings were finalized in these meetings in the presence of the statutory auditors (PW). It is further alleged that PW was part of the audit committee meetings in which annual plans for internal audit were concluded and the said meetings on successive occasions had decided not to include verification of bank balances by the internal auditors in the internal audit plan, on the ground that the same would be undertaken by external auditors. Allegedly, on the suggestion of PW, internal audit had shifted

from transaction oriented audits to process based audits where only sample transactions are taken to check adherence to the process. As a result of the same, internal audit did not audit the deposit accounts at any time, nor did it verify deposits or accrued interest. The audit of bank balances done in 2007-08 by internal auditors was limited to a sample of operational bank accounts, which did not include deposit accounts, and thus failed to report the non-existence of bank balances. Further, the internal audit reports were not sent to the audit committee and only copies of presentations were sent to them. All the above allegedly resulted in PW issuing misleading certificates on the adequacy of internal controls and quality of internal audit.

70. The Noticees have denied the abovementioned allegations pertaining to assessment of adequacy of internal audit functions and procedures in SCSL. They have contested the allegation that in the audit committee meetings, it was decided that the internal auditors would not undertake verification of bank balances. They have *inter alia* submitted that they were not aware that internal auditors had not conducted verification of bank balances and the statutory auditors did not rely on the work of internal auditors in the first place. I have noted the submissions of the Noticees. I find that in the event of PW not relying on the work of internal auditors, they should have diligently followed the process of external confirmation of the bank balances. However, it is amply clear that the auditors did not independently obtain external confirmations of bank balances as per AAS 30 but relied upon material obtained through the company, as discussed in detail above. This indicates that the auditors had relied upon the work of internal auditors even without assessing the adequacy of the internal audit procedures.
71. I find that from the above paragraphs, it is clear that PW had carried out verification of current account balances and FDs in total disregard for the mandated procedures as prescribed under AAS.

#### **Audit of invoices and reporting of revenues**

72. As per the SCNs issued, the falsification of the invoices – numbering at least 7,561 - in the Invoicing Management System (IMS) of SCSL began from at least 2003 onwards, and the falsification of bank balances from 2001 onwards. Most of these fake invoices were exported (manually) from the IMS into the Oracle Financials (accounting software used by SCSL) where

the revenues were recorded in the company's general ledger. In view of the fact that a huge number of fake invoices were generated and recorded in the books of accounts of SCSL over a long period of time and the fact that the Noticees did not carry out any reconciliation between invoices in Oracle Financials (OF) and IMS to detect large scale mismatch and this aided promoters/employees of SCSL in concealing fake revenue, it has been alleged that the Noticees were complicit in the manipulation of accounts and failed to perform their duty as auditors. It has also been mentioned in the SCN that the internal auditors of SCSL had pointed out certain differences in the reconciliation of sales invoices in OF and IMS due to lack of synchronisation between OF and IMS, which were ignored by the Noticees.

73. With regard to the creation of 7,561 fake invoices, it has been brought out in the SCN that all invoices at SCSL were raised through a software tool named Invoice Management System (IMS). The IMS was integrated with five other software applications details of which are explained at length later in this order.
74. The data from the IMS is manually ported into the Oracle Financials (OF), at which stage revenue gets recorded in the books of SCSL. The system also permitted manual introduction of data directly into the IMS, by porting it through MS Excel. To generate invoices through this process, login through Admin ID was required. The investigation, as recorded in the SCN, has revealed that the fictitious invoices were introduced into the system by making use of this Excel Porting facility. V.V.K Raju, in his statements recorded before the Investigating Authority on October 9, 2009, furnished the details of 7,561 fake invoices (tagged with the letter 'S') generated in the IMS since the first quarter of the financial year 2003-2004. He has further stated that these invoices were fake as they did not have roots in OPTIMA, SPR etc. and were not visible to Business Finance Team in the 'e-IMS tool', i.e., a web version of IMS which the business finance team uses for verifying invoices and receivables. The quarter wise details on the number of "S" series invoices generated in IMS and total invoiced amount, number of such invoices posted into OF and their reconciliation with Oracle Financials as stated in the SCN are as under:

**TABLE 4**

**QUARTER-WISE DETAILS OF S SERIES INVOICES ENTERED INTO OF**

Quarter	Invoices ( S series) raised in IMS		Invoices (S series) entered in Oracle Financials (OF)		Invoices (S series) reconciled in OF	
	A		B		C	
	No. of Invoice Raised	Invoice Amount (in Rupees)	No. of Invoice entered	Invoice Amount (in Rupees)	No. of invoices for which receipts shown	Invoice Amount shown as received (in Rupees)
Q1 (Apr 03-Jun 03)	97	675,773,058	97	675,773,058	99	655,402,055
Q2 (Jul 03-Sept 03)	8	48,458,754	8	48,458,754	8	48,776,309
Q3 (Oct 03-Dec 03)	50	402,460,265	50	402,460,265	49	398,273,916
Q4 (Jan 04-Mar 04)	112	1,005,375,943	112	1,005,377,693	111	1,041,036,044
<b>Total</b>	<b>267</b>	<b>2,132,068,021</b>	<b>267</b>	<b>2,132,069,771</b>	<b>267</b>	<b>2,143,488,323</b>
Q1 (Apr 04-Jun 04)	112	863,756,818	111	863,656,833	111	891,163,007
Q2 (Jul 04-Sept 04)	64	414,972,335	63	407,071,698	62	391,741,949
Q3 (Oct 04-Dec 04)	73	502,355,438	69	495,526,123	69	481,194,041
Q4 (Jan 05-Mar 05)	217	1,423,958,105	208	1,328,135,486	208	1,288,458,799
<b>Total</b>	<b>466</b>	<b>3,205,042,696</b>	<b>451</b>	<b>3,094,390,141</b>	<b>450</b>	<b>3,052,557,796</b>
Q1 (Apr 05-Jun 05)	249	1,547,384,062	249	1,546,913,816	249	1,494,243,548
Q2 (Jul 05-Sept 05)	243	1,344,669,701	242	1,344,637,972	238	1,334,649,309
Q3 (Oct 05-Dec 05)	296	1,634,775,652	291	1,501,734,841	262	1,414,381,192
Q4 (Jan 06-Mar 06)	400	2,133,425,996	398	1,934,497,015	361	1,840,686,424
<b>Total</b>	<b>1,188</b>	<b>6,660,255,411</b>	<b>1,180</b>	<b>6,327,783,645</b>	<b>1,110</b>	<b>6,083,960,473</b>
Q1 (Apr 06-Jun 06)	25	7,564,980	12	1,307,021	11	1,139,585
Q2 (Jul 06-Sept 06)	101	1,417,512,548	30	1,348,426,093	20	1,326,829,000
Q3 (Oct 06-Dec 06)	385	2,839,480,411	237	2,423,440,830	237	2,273,743,060
Q4 (Jan 07-Mar 07)	457	3,405,583,824	375	3,019,854,978	373	2,499,668,381
<b>Total</b>	<b>968</b>	<b>7,670,141,763</b>	<b>654</b>	<b>6,793,028,922</b>	<b>641</b>	<b>6,101,380,025</b>
Q1 (Apr 07-Jun 07)	680	3,941,982,560	473	3,226,186,008	473	2,890,777,863
Q2 (Jul 07-Sept 07)	741	4,151,276,136	486	3,205,579,254	485	2,772,499,610
Q3 (Oct 07-Dec 07)	889	5,987,744,197	730	5,258,217,184	728	4,836,825,391
Q4 (Jan 08-Mar 08)	794	5,653,003,861	794	5,653,003,861	794	5,401,277,947
<b>Total</b>	<b>3,104</b>	<b>19,734,006,754</b>	<b>2,483</b>	<b>17,342,986,307</b>	<b>2,480</b>	<b>15,901,380,811</b>
Q1 (Apr 08-Jun 08)	791	5,889,432,614	791	5,889,432,614	791	5,483,034,760
Q2 (Jul 08-Sept 08)	777	5,885,986,975	777	5,885,986,975	150	1,067,531,809
<b>Total</b>	<b>1,568</b>	<b>11,775,419,590</b>	<b>1,568</b>	<b>11,775,419,590</b>	<b>941</b>	<b>6,550,566,569</b>
<b>GRAND TOTAL</b>	<b>7,561</b>	<b>51,176,934,235</b>	<b>6,603</b>	<b>47,465,678,376</b>	<b>5,889</b>	<b>39,833,333,996</b>

75. Apart from the aforesaid fake invoices with respect to non-existent transactions/work orders, there were also certain invoices in the IMS which were for the development of certain customized products in respect of non-existent customers. The SCN provides details of 27 such ‘product invoices’. The investigation has revealed that these fictitious invoices were tagged with the letter ‘H’. The details of such invoices are given in the table below:

**TABLE 5**  
**DETAILS OF H SERIES INVOICES I.E. INVOICES RAISED WITH RESPECT TO**  
**NON-EXISTENT CUSTOMERS**

Sl. No.	Invoice no.	Date of invoice	Invoice Amount (in USD)	Name of customer
1.	OFF-0607-1859.	31-May-06	3,800,000	AutoTech Service Inc.
2.	OFF-0607-1900.	31-May-06	3,250,000	AutoTech Service Inc.
3.	OFF-0607-12733	26-Oct-06	1,350,000	Cellnet Inc.
4.	OFF-0607-1946.	31-May-06	2,800,000	Cellnet Inc.
5.	OFF-0607-2135.	31-May-06	2,500,000	Cellnet Inc.
6.	OFF-0607-3860	30-Jun-06	1,320,000	Cellnet Inc.
7.	OFF-0607-9204	31-Aug-06	1,850,000	Cellnet Inc.
8.	OFF-0607-11765	30-Sep-06	2,900,000	eCare Inc.
9.	OFF-0607-2038.	31-May-06	2,150,000	eCare Inc.
10.	OFF-0607-2170.	31-May-06	1,650,000	eCare Inc.
11.	OFF-0607-4229	30-Jun-06	1,300,000	eCare Inc.
12.	OFF-0607-7050	31-Jul-06	1,850,000	eCare Inc.
13.	OFF-0607-2044.	31-May-06	3,300,000	Hargreaves Inc.
14.	OFF-0607-5049	30-Jun-06	2,050,000	Hargreaves Inc.
15.	OFF-0607-7099	31-Jul-06	1,500,000	Hargreaves Inc.
16.	OFF-0607-9323	31-Aug-06	2,800,000	Hargreaves Inc.
17.	OFF-0607-12729	26-Oct-06	1,780,000	Mobitel Inc.
18.	OFF-0607-1944.	31-May-06	1,825,000	Mobitel Inc.
19.	OFF-0607-2067.	31-May-06	2,325,000	Mobitel Inc.
20.	OFF-0607-4145	30-Jun-06	1,750,000	Mobitel Inc.
21.	OFF-0607-7975	31-Aug-06	1,960,000	Mobitel Inc.
22.	OFF-0607-2370.	31-May-06	2,150,000	North Sea Inc.
23.	OFF-0607-4868	30-Jun-06	1,750,000	North Sea Inc.
24.	OFF-0607-2502.	31-May-06	1,850,000	North Sea Inc.
25.	OFF-0607-6300	31-Jul-06	1,550,000	North Sea Inc.
26.	OFF-0607-1997.	31-May-06	2,750,000	Synony Inc.
27.	OFF-0607-5425	30-Jun-06	2,100,000	Synony Inc.
	<b>TOTAL</b>		58,160,000	

76. As regards the 7,561 invoices that are alleged to be fake, the Price Waterhouse entities have submitted that the allegation of complicity in manipulation will depend upon first establishing the number and identity of fake invoices that the engagement team reviewed but allegedly did not identify as fake/fraudulent. In this regard, the Noticees have adopted a three-pronged defence:-
- (i) A part of the oral testimony of VVK Raju relied upon by SEBI is not admissible in evidence as he is not personally privy to that information.
  - (ii) Some of the alleged fake invoices had an email id [AccountsReceivable@Satyam.com](mailto:AccountsReceivable@Satyam.com) which was created subsequent to the date of invoices.
  - (iii) The invoices provided to the Noticees are in MS Word format and not in PDF format in which it is generally saved in IMS.
77. It is observed that in connection to the number and identity of fake invoices, the SCN relies upon the deposition of VVK Raju, who was working as Head - Business Finance in SCSL, and the details provided by certain other persons in the business finance team. These persons were those who *inter-alia* interact with customers and pursue collections from customers. They performed certain tests to examine whether the 7,561 invoices tagged as “S” were fake or genuine. The Noticees have contended that the evidence of VVK Raju on whether the fake invoices were visible to the business finance team or whether they were sent to customers is unreliable as a large part of it contains information which he is not personally privy to relies on analysis of others.
78. With regard to the above contention, it is noted that VVK Raju has stated during the cross-examination that he became aware about the existence of ‘S’ type invoices during the investigation when CBI gave him the Compact Disc (CD) in which they had compiled the said 7,561 invoices which were tagged as ‘S’ and requested him to verify the genuineness of the invoices. With regard to the reason as to why the invoices contained in the CD are fake, it has been deposed by VVK Raju on October 9, 2009 before SEBI that these invoices are fake as they are not visible to business finance team in the e-IMS tools, they did not have roots in the project ID and SPR tools and that they were not sent to customers.
79. During the cross-examination, in response to a question as to how he verified whether the invoices were sent to customers, VVK Raju stated that, *“For my business units I verified with concerned sales*



*managers through the associate in-charge (AIC). For the business units pertaining to Mr. V Ramesh Kumar and Mr. Subbu G, I asked them to verify and they had undertaken similar exercises. The sales managers and business unit heads had confirmed that these invoices have not been sent to customers.” To the question whether he verified that these 7,561 invoices were visible to the business process facilitation team or not, VVK Raju replied that “I did make a sample check and I asked for verification of such invoices by all FICs (Finance In-Charges) and FICs have confirmed that the said invoices were not visible in their access.” With regard to the question as to who carried out the exercise to determine whether the 7,561 invoices had linkages into PBMS or not, VVK Raju stated that “Finance In-Charge of various units have carried out this exercise. They have validated that these invoices have not been generated from any billing advice advised by them.”*

80. From the testimony of the witness, I find that VVK Raju had initiated a verification process with respect to ‘S’ tagged invoices contained in the CD given to him by CBI as part of CBI’s investigation. It is also noted from his statements that:

- (i) With respect to business unit of VVK Raju, he has personally checked the visibility in the system of some sample invoices and for other invoices pertaining to his team, he got the verification done with the help of concerned sales managers and Finance In-Charge apart from personally performing a sample check.
- (ii) With respect to the business units pertaining to V Ramesh Kumar and Subbu G, he asked them to verify the same and he has deposed that they undertook a similar exercise.

81. With respect to the verification done by the concerned sales persons and Finance In-Charge personnel in his team, it is observed that the same was done by the employees of SCSL in their official capacity and under the supervision of VVK Raju. Further, VVK Raju has also made a sample check for some of those invoices which were so verified. I also note that VVK Raju has additionally carried out personal verification with respect to 709 invoices. Thus, it can be said that the deposition made by VVK Raju on the genuineness of invoices with respect to his business unit is based on his personal knowledge as well and not just a mere reliance on the verifications / statements of others.

82. With respect to business units headed by V Ramesh Kumar and Subbu G, it has been stated by VVK Raju during the cross-examination that he asked V Ramesh Kumar and Subbu G to verify

the genuineness or otherwise of the invoices. These business heads and sales managers of their teams confirmed to him that the invoices pertaining to their respective business units were not sent to customers. The Noticees have not cast any doubt on the fact as to whether the business leaders and their sales managers have made such a statement to VVK Raju. What has been questioned is the veracity of the fact of absence of visibility in the system of those invoices which were stated to be examined by persons in the business units headed by V Ramesh Kumar and Subbu G. In this regard, I also note that, during the course of investigation, SEBI had sent emails independently to certain other Business Leaders of SCSL, namely, Keshab Panda, T R Anand, Virendra Agarwal and Subu D, giving them details of certain invoices for which they were shown as team leaders and requested them to furnish complete set of source documents including purchase order, statement of work etc. I note that in response to the email, Keshab Panda, T R Anand and Virendra Agarwal replied vide emails dated January 20, 2009 and Subu D vide email dated January 21, 2009, that they have not been able to find the invoices in the e-IMS tool from their respective access/login. It is pertinent to note here that these email correspondences have been addressed to the investigating officer of SEBI by employees of SCSL who had tried to trace the source of such invoices pertaining to their area/ business units from their access. These persons have stated that they were not able to find the invoices in the e-IMS tool from their respective access/login. This shows that those invoices had no linkages to PBMS and were not visible to them. It is noted from the statement of VVK Raju that he was in-charge for Subu D and Virendra Agarwal as business heads while Subbu G was in-charge for T R Anand and Keshab Panda as business heads. Thus, the statement given by VVK Raju that the other the business heads/ finance in-charge personnel in SCSL also undertook a similar exercise with respect to invoices pertaining to their respective business units and found that the invoices were not visible to them in the e-IMS from their access stands independently corroborated. Apart from this, VVK Raju has also provided the quarter wise details of all 7,561 'S' series invoices entered in Oracle Financials and the amount shown as received against those invoices. This also shows that the employees of SCSL working in the business units of VVK Raju as well as the others, in fact, also personally checked the genuineness of the invoices from their access to e-IMS without which they could not have provided the details as to how many of such fake invoices were entered into Oracle Financials. Thus, the statement of VVK Raju that other finance in-charge personnel had also undertaken a similar exercise and confirmed that they were not sent to customers or were not visible in their systems is also corroborated by other evidences as explained above.

83. I also note from the statement made by VVK Raju during the cross-examination that the verification was done by his team and persons working in the business units headed by V Ramesh Kumar and Mr. Subbu G at the instruction of CBI and during the course of investigation. In such circumstances, it cannot be said that the statement of VVK Raju was made irresponsibly or without any basis or that it carries no probative value at all. In this connection, the observations of Lord Denning, M. R. in *T. A. Miller Ltd. v. Minister of Housing and Local Govt.* (1968) 1 WLR 992 are apt and very much to the point:--

*"A tribunal of this kind is master of its own procedure, provided that the rules of natural justice are applied. Most of the evidence here was on oath, but that is no reason why hearsay should not be admitted where it can fairly be regarded as reliable. Tribunals are entitled to act on any material which is logically probative, even though it is not evidence in a court of law, ... Hearsay is clearly admissible before a tribunal. No doubt in admitting, the tribunal must observe the rules of natural justice, but this does not mean that it must be tested by cross-examination. It only means that the tribunal must give the other side a fair opportunity of commenting on it and of contradicting it: see Board of Education v. Rice, (1911) AC 179 at 182, R v. Deputy Industrial Injuries Commr., ex-parte Moore (1965) 1 QB 456."*

84. This would mean that hearsay evidence can be relied upon even if cross-examination is not afforded. The essence of the entire legal position is that if hearsay evidence is otherwise credible going by the surrounding circumstances, then the same becomes admissible in these proceedings even if the same may be deficient as legally admissible evidence under the Evidence Act. Justice Krishna Iyer in the case of *State of Haryana and Anr. vs Rattan Singh* on 22 March, 1977 (AIR 1977 SC 1512) observed:

*"It is well settled that in a domestic enquiry the strict and sophisticated rules of evidence under the Evidence Act may not apply. All materials which are logically probative for a prudent mind are permissible. There is no allergy to hearsay evidence provided it has reasonable nexus and creditability. It is true that departmental authorities and administrative tribunals must be careful in evaluating such material and should not glibly swallow what is strictly speaking not relevant under the Evidence Act."*

85. Thus, there is corroborative evidence to test the veracity of the statement on which reliance has

been placed and the circumstances suggest that the statement was not made irresponsibly. Thus, in view of the facts and circumstances under which the statements were made, I am of the view that the judgments relied upon by the Noticees in the matter of *New India Assurance Company Ltd. Vs. Nusli Neville Wadia and Another* (2008) 3 SCC 279 and *Sir Mohammed Yusuf & Anr. Vs. D & Anr* (1961 SCCOnline Bom 5) are not applicable in the present case. In view of above, I am inclined to accept the statement of VVK Raju for the probative value of its contents in these proceedings.

86. Further, it has been deposed by VVK Raju on February 25, 2009 that in order to test as to whether the invoices were visible in the 'e-IMS tool' and had linkages into PBMS, he performed a sample check. During the cross-examination he was not able to provide the details of sample taken by him and therefore, the Noticees have contended that his statement is unreliable. In this connection, it is observed that the cross-examination of VVK Raju by the Noticees spanned across three days on almost all the charges made in the SCN and he has been consistent in his replies. The Noticees do not seem to have any issue with the rest of the answers to questions posed to VVK Raju by them. I do not find any reason to doubt the credibility and trustworthiness of VVK Raju as a witness in this case. The mere fact that he is not able to recall in the year 2017 as to the sample taken by him in the year 2009 for verifying whether the invoices are visible in the e-IMS or not is by itself not sufficient to discredit his testimony. In this connection, in *State of H.P. Vs. Lakh Raj and another* (AIR 1999 SC 3916), the Hon'ble Supreme Court has observed that the evidence of the witness should be read as a whole for arriving at a conclusion on the credibility or veracity of the said witness and not by splitting word by word and reading in between lines adopting hyper technical approach. In the light of the foregoing and also keeping in mind the said decision of the Supreme Court, I am of the view that the witness' inability to recall the sample from the memory does not invalidate the whole exercise of verification of invoices contained in CD done by him in 2009 nor discredit the deposition / cross examination.

87. The Price Waterhouse entities have further contended that some of the invoices issued before May 2008 contain the email ID [AccountsReceivable@Satyam.com](mailto:AccountsReceivable@Satyam.com) which was created in May 2008, therefore, such invoices cannot be a basis of the charge. In this context, I observe that SEBI has also done a separate examination to test the genuineness of the invoices. The test of the sample, when applied to all the invoices, results in a total of 7,561 invoices having the same characteristics – that they were not visible to business finance team and hence are fictitious. The

CBI, independently, by using the services of VVK Raju, has got this test done on the IMS on all the invoices and that is how a total of 7,561 invoices are being termed as fictitious. As such, the fact as to how such an email id became part of the invoices collected by CBI is not very clear. I do find that in the normal course the subsequently created email ID ought not to have been there. There is a possibility that the same may have been created while retrieving the invoices for providing to CBI, by some officials of SCSL. However, weighing the probability of alleged fake invoices being tampered with or falsely created to implicate the noticees or being unreliable totally, I find that the preponderance of probability weigh more in favour of accepting the invoices to be fake, as identified than discarding the whole exercise. Moreover, the e-mail id affixed to the invoices is not sufficient to invalidate the evidence on hand. Further, this does not by itself go to disprove the fake invoices.

88. The Noticees have also contended that they have been provided with copies of the 'S' type invoices on a CD in MS Word format and not in the PDF format, i.e., the format in which it is usually saved in IMS of SCSL. In this connection, it is noted that this factual issue has been raised by the Price Waterhouse entities for the first time in the final reply filed by them on November 10, 2017. The fact that the total of the fake sales, the debtors and the non-existent cash & bank balances as investigated and brought out by SEBI are also corroborated by the facts mentioned in the confession email of B Ramalinga Raju dated January 7, 2009 puts a lid on the debate and leaves no room for any doubt whatsoever, in this front.
89. Apart from the above, the Price Waterhouse entities have also submitted that the details contained in Table 4 above, pertaining to 7,561 invoices provided by VVK Raju are unreliable as they apparently contain some discrepancies and VVK Raju was unable to clarify those discrepancies during the cross-examination. In this regard, I note that questions asked from him was why the number of invoices for which receipt has been shown in column 'C' for Q1 (Apr 2003-Jun 2003) is more than the number of invoices which was raised in the quarter and why the amount mentioned in column 'C' is higher than the amounts mentioned in columns A and B in respect of the entry in Q1 (April 2004-Jun 2004).
90. With regard to the above queries, it is noted that there is no denial by VVK Raju of the statements made by him before SEBI earlier. He stated that he is unable to recollect the reasons for the

differences. Considering the lapse in time between when VVK Raju provided the data to SEBI (2009) and the cross examination (2017), nothing adverse can be inferred from his inability to answer the queries. I note that this minor difference exists only for one quarter out of 22 quarters for which the evidence has been provided, which, in my opinion does not invalidate the overall findings. As far as the other query relating to difference in the amount raised through the fake invoices in the IMS and the amount entered in the OF is concerned, VVK Raju attempted to answer the same by stating that while he does not fully recollect, it could be on account of difference in the exchange rate between the date of invoice and the date of receipt. Further, the documents at Annexure 13 of the SCN carries an email dated January 26, 2009 from VVK Raju to G Jayaraman, the then Company Secretary of SCSL, where the figures of debtors are provided for onward submission to SEBI. In the said attachment to the email, it has been clarified that the amounts shown as debtors obtained from e-IMS could be a little different on conversion into rupees due to conversions from the invoiced currency to USD and USD to rupees. This appears to be a reasonable answer and hence the contention of the Noticees that the information contained in Table 4 above is unreliable merely because of the slight variations is not material enough to vitiate the details in this regard.

91. Thus, I conclude that the details and information provided by VVK Raju with respect to 7,561 invoices are reliable. In order to say that these invoices were fake, the SCN, based on the deposition of VVK Raju, points out the following characteristics of the invoices:

- These invoices were in the nature of off-shore invoices.
- The payment instruction in these invoices was different than the normal (wire transfer to specific bank), as it requested for payment through cheque.
- These invoices were not visible to business finance teams.
- These invoices had no linkages in PBMS and had no roots in OPTIMA, SPR etc.
- These invoices were not sent to customers.

92. With regard to the observations that most of these invoices were 'off-shore invoices' (i.e. invoices for services rendered to customers in foreign countries by employees of SCSL in India) and it had requested for payment for the services in cheque, the Noticees have submitted that a side-by-side

comparison of fake and genuine invoices would not have revealed anything as they were not distinguishable in their appearance. In this regard, it is noted that during the cross-examination, VVK Raju was shown several invoices, fake as well as genuine, and he was not able to distinguish between fake and genuine ones. It is observed that the invoices in appearance would not be distinguishable as they were generated in the same system i.e. IMS and the idea behind creating something fake is to ensure, as far as possible, that it mingles with the genuine ones. Therefore, I agree with the submission of the Ld. Sr. Counsel for the Price Waterhouse entities that, on the face of it, the invoices appear the same. Further, the argument that the off-shore character of invoices could not have aroused any suspicion of fraud as SCSL was rendering services to a significant number of off-shore clients also appears reasonable. With regard to the instruction regarding payment through cheque in off-shore invoices, the Noticees have submitted that many of such invoices had payment requests by wire and not by cheque and therefore it is devoid of any substance. Further, VVK Raju has also confirmed during the cross-examination that though customers outside India were predominantly using wire transfer as a mode of payment, they could pay by cheque also. While I agree with the submission of the Ld. Sr. Counsel that, on the face of it, a fake invoice would obviously not be very different from an original one, I would opine that this is where the duty of the auditor lies because he has the benefit of going through the details, examining the software and the package and conducting a check, by way of a sample, large or small as per his judgment, which are all indicative of the professional skepticism required on the part of the auditor and the diligence with which the work is undertaken.

93. With regard to the character of these 'S' type invoices being invisible to the business finance team in the e-IMS tool when checked from their login ID, it has been submitted by the Noticees that visibility or lack of it in the system cannot be a criteria for determining the genuineness of invoices or otherwise as an invoice will not be visible in IMS even when the invoiced amount is written off and removed from the receivables list. In this connection, it is observed that the invoices at SCSL were raised through the software tool IMS which was integrated with five other applications viz. OPTIMA (Operational Real Time Project Management), SPR (Satyam Project Repository), eSupport (Application for manpower and resources allocation), ONTIME, PBMS (Project Billing Management System). Executives from the Business Finance Team of SCSL are involved in preparing data for invoicing which involves validation of rates, efforts, milestones etc. and keep the data ready in PBMS for pushing into IMS. Once the invoicing inputs are completed and ready

in PBMS, the Finance In-Charges of respective Business Units triggers billing advice for invoicing. The IMS imports data/partial bills from PBMS to generate final bills. Apart from this, in case of a need to generate invoices urgently, the system also permitted porting of data from MS Excel directly into IMS for generating invoices and in this process also, approval was required to be taken by Finance In-Charges of respective business units from Circle Chief Finance Officer. Further, it also required the usage of the Admin login ID for the purpose. Thus, business finance teams were involved in obtaining requisite data, taking necessary approvals and keeping them ready in PBMS for feeding into IMS. Further, the business finance teams were also involved in following up with customers for payments due from them which required them to view invoices in IMS. It is also noted that when an amount with respect to an invoice was received by Accounts Receivable Team, they used to update the same in the IMS and the business finance team used to access such report as and when required. Therefore, the procedure for raising invoices, including through excel porting, necessitated that all invoices must pass through at least some official from the business finance team for validation and the nature of the work performed by them also demanded that invoices raised pertaining to their business unit must be visible to them so that they could do the necessary follow up. Thus, all genuine invoices would have necessary details in the IMS and a genuine invoice would be visible in e-IMS to Business Finance Team from their access. With regard to contention of the Noticees that an invoice would not be visible even when the invoiced amount is written off and removed from the receivables list, it is observed from the cross-examination of G Ramakrishna, former Vice President - Finance, SCSL, that such invoices are not deleted from the IMS but are visible to the Business Process Facilitation Team in the IMS. Therefore, visibility of invoices will depend upon the login ID which is used to view the invoices. It is observed that from the details of the 7,561 'S' tagged invoices, only 6,603 invoices were ported into the Oracle Financials. Out of these 6,603 invoices, payments have been shown to be received in respect of 5,889 invoices. It is also observed from the SSCN that an amount of approximately ₹ 500.2 crore has been shown as appearing as fake debtors outstanding as on September 30, 2008. Therefore, it appears that a majority of the balance 'S' tagged invoices entered into the IMS through excel porting were not written off. Thus, the contention of the Noticees is not supported by sufficient facts and not convincing.

94. The Noticees have also contended that the fact that the fictitious invoices did not have linkage in the PBMS cannot be a criteria to determine the genuineness of invoices. In this connection, it is



observed that all the invoices at SCSL were raised through the software tool IMS which was integrated with five other applications, namely, OPTIMA, SPR, *eSupport*, ONTIME and PBMS.

- OPTIMA is the application where when work is received by SCSL from any customer the work/project is assigned a Project ID and Customer ID. Without a project ID, work would not commence.
- The SPR contains details of all projects done at SCSL.
- The application *eSupport* is used to allocate manpower and resources and ONTIME is used to capture and calculate man hours spent on a project for billing a customer.
- The PBMS is the billing application of SCSL. It is used to bill the efforts entered in ONTIME and to port the billed efforts to IMS for invoicing.

A bill generated in PBMS has a unique serial number and it gives the details of the associates, their man hours, etc. This bill is called a partial bill. Once the invoicing inputs are completed and ready in PBMS, the Finance In-Charge of respective Business Units triggers billing advice for invoicing and final bills are generated in IMS. Thus, all these six applications are integrated and information flows from OPTIMA to SPR to *eSupport* to ONTIME to PBMS in sequence and from PBMS to IMS. When an invoice is created, it has to pass through the PBMS stage. All genuine invoices will have roots in all these six stages, more particularly the linkage to PBMS being a primary component.

95. Apart from aforesaid process, invoices could also be generated by porting data from MS Excel directly into IMS. VVK Raju has stated that to raise a genuine invoice through this facility, specific approval from appropriate authorities was required and this facility was used only when PBMS was unavailable, or invoicing data in PBMS was incomplete. I also note that G Ramakrishna, in his statement dated March 3, 2009, has stated that “... *Even in case of Excel Porting, the advice for excel porting comes to my team from the business unit finance only with reasons for the need for excel porting. After such excel porting has been done, the business finance unit has to consolidate the ported billing advice from their log in and only after that my team can raise an invoice.*” It is discernible from these statements that the usage of excel porting was to facilitate easy and smooth creation of invoices in case of any technical bottleneck in the system as well as in case of emergent situations and this could be done only after obtaining necessary approvals and that the business finance units used to consolidate the billing

advice given by them with respect to a genuine excel ported invoice, from their login to the system. It is thus noted that in the case of an excel ported genuine invoice it would relate to the work done on an approved project for a genuine customer and will have details *viz.* customer ID, project ID, details of man-hours spent/milestone achieved etc. in the upstream systems integrated with IMS. Thus, the details of a genuine invoice entered through excel porting method will have definite linkages to the PBMS.

96. In view of the above, the contention of the Noticees that invoices not having roots in PBMS cannot be termed as fake is not acceptable. Further, it has been also confirmed by VVK Raju during the cross-examination by the Noticees that the Finance In-Charge personnel of respective Business Units had verified and found that all other excel ported invoices, apart from the 7,561 invoices, were advised by them and hence genuine. Thus, the contention that linkage into PBMS cannot be a criteria for genuineness is not correct; in fact it is the other way around – linkage with the PBMS is *de rigueur*.

97. With regard to genuineness of these 7,561 invoices, I note that VVK Raju has also stated in his deposition to SEBI on February 25, 2009 that he has not come across any instance where an invoice sent to a customer would not be visible in the login of Business Finance Team members. As these invoices were not visible to business finance team, it has been alleged that these invoices were not sent to customers; hence they were fake. In this regard, on the basis of the statement made by Mr. VVK Raju during the cross-examination that even '*knock off*' invoices were not sent to customers, it has been submitted by the Noticees that there is a contradiction in his statement. I note the relevant portion of the cross examination in this connection :

*Q.105. Are you in a position to say whether this invoice was genuine or fake?*

*A.105 It looks to be a genuine invoice*

*Q.106. On what basis do you say this?*

*A.106 On its face, there is nothing to show that there is any peculiarity in the invoice. However, this invoice is not sent to the customer as it is a knock off invoice. A knock off invoice is generated to recognize revenue against an advance invoice raised on a customer.*

98. The Noticees have contended that VVK Raju's statement on '*knock off*' invoices not being sent to customers despite being genuine is a contradiction with his earlier statement that all genuine

invoices are sent to customers. I find no contradiction as VVK Raju has not made any specific mention about the '*knock off*' invoice in his earlier statements. On the contrary, he has only stated that he has not come across any instance where an invoice sent to a customer is not visible in the system from the login of Business Finance Team. It has been also explained by him that the invoices referred to as '*knock off*' invoices are those invoices which are generated to recognise revenue against an advance invoice raised on customers. The '*knock off*' invoice, is at best an additional invoice that tails the original invoice and is not a separate invoice in itself. It can be seen that this invoice is only intended to be a subset of the original invoice and not to replace the original invoice itself. Hence, unless the invoice itself is materially different as regards the particulars - such as the invoice amount, there may not be any need to send such an invoice to the customers. Further, he has not said anything on the visibility in the system of such '*knock off*' invoices. Thus, the contention of the Noticee is not valid.

99. Thus, I find that the 7,561 invoices introduced into the IMS through excel porting had no roots in the other tools such as OPTIMA, SPR etc. mentioned above and were not sent to customers; and therefore they were fake. Out of these 7,561 fake invoices, 6,603 found place in the OF and the invoiced amounts got recorded as sales revenue in the books of accounts of SCSL which amounted to ₹ 4746,56,78,376/-, as mentioned in the SCNs. The Noticees have submitted that, as auditors, they performed the audit of SCSL on sample testing basis and ensured that invoices were supported by work done and SCSL was paid by its customers. It has been submitted by Srinivas Talluri, one of the auditors and a Noticee, that certain invoices which later turned out to be 'S' tagged invoices were found in the sample of sales invoices verified by the engagement team. This has been advanced to prove his innocence (or non-involvement) by indirectly stating if he had knowledge of fraud he would not have allowed his audit team to pick such invoices in the sample. This contention of the Noticee only raises further questions inasmuch that if the audited samples included fake invoices, the audit done around such invoices has not resulted in detecting the fictitious nature of such invoices. However, the diligence in the audit and the manner in which the verification was carried out year after year raises questions.
100. It has been submitted by the noticees that the engagement team, while carrying out the audit of time and material contracts, verified the invoices provided by SCSL and compared the time billed with the timesheets approved by the customers and carried out the other related processes. In this

regard, statements made by some of the engagement team members who were involved in the audit of SCSL, namely, P S Sudhakar (W4), CH Ravindranath (W8) and Siva Prasad Pulavarthi (W9) and the details of work performed by them during the revenue audit of SCSL as recorded in the '*MyClient*' files has been relied upon. I observe from W4-Doc 23 that while testing sales/revenue transactions for the quarter ending on March 31, 2008, the engagement team selected a sample of major customers and verified that the balances shown in sales register, which was given to them in an excel sheet, are the same as shown in the books of account. Similarly, in order to test the recorded sales for the period ending on March 31, 2007 they verified that the balances shown in sales register, which was given to them in an excel sheet, are the same as shown in the books of account. Similarly, it is observed from the document titled SCSL- IGAAP – Stat. Audit 2004-05 (W-9 Doc 13) that for testing, the auditors selected the top ten customers of SCSL for high value invoices and verified the balances shown in OF with the sales register which was again given to them in an excel sheet.

101. The other Noticee, S Gopalakrishnan, has contended that selecting a list of invoices from the system in the form of excel sheet for checking supporting documents and different fields in the invoices cannot be termed as relying only on hard copies. In this regard, it is noted that all these documents, including the list in an excel sheet were provided by the company. This only exposes the fact that the auditors placed all reliance on the officials of the company. If one were to go by the fact that the input for the information to be checked as well as the fact that the output that has to be arrived at were both provided by the company, then, I do not find any meaning in such an audit. The genuineness of the invoices was not checked with the input, which was also available with the company.
102. One of the aspects is usage of the software. Another is to use it as a tool for audit. With the armoury of computer aided tools at the disposal of the auditor, there are ways in which an auditor could have verified. The steps stated to be followed by the auditors only shows that their conduct was guided by the information provided by the company in an excel sheet for verifying sales revenue. The auditors have not resorted to any independent verification nor have they verified the information from its original source. By accepting the information provided by the company at face value and performing a perfunctory job, the auditor has failed to live upto the expectations of the shareholders.

103. With regard to the submission of the Noticees that the engagement team also reviewed account statements for collections accounts, including SCSL's current account with Bank of Baroda, New York (account no. 120559), which showed that, consistent with expectations, SCSL was regularly receiving appropriate payments from known customers. These, as subsequent investigation has revealed, were largely fictitious receipts, as detailed in the SCN and commented earlier in this order.
104. The noticees have claimed that they were oblivious of the fact that invoices could be inserted through excel porting facility. It has been submitted that the engagement team performed a three-step process to access the strength of SCSL's internal control over billing and revenue. First, they obtained an understanding of the billing and revenue process of SCSL. Second, they performed a step-by-step walkthrough of the key billing process. Third, they tested a sample of the controls. . In this regard, reliance has been placed upon the '*MyClient*' files documenting these steps.
105. With regard to the above, it is observed that the AAS 6 contains certain provisions as regards Risk Assessment and Internal Control. Relevant paragraphs are as under:
- Paragraph 16 of AAS 6 provides that when obtaining an understanding of the accounting and internal control systems for planning an audit, the auditor obtains a knowledge of the design of the accounting and internal control systems and their operation. It also provides that the auditor may perform a '*walk-through test*', that is, tracing a few transactions through the accounting system.
  - Paragraph 20 provides that the auditor should obtain an understanding of the accounting system sufficient to identify and understand major classes of transactions in the entity's operations, how such transactions are initiated, significant accounting records, supporting documents and specific accounts in the financial statements, and the accounting and financial reporting process, from the initiation of significant transactions and other events to their inclusion in the financial statements.
  - Paragraph 28 provides that tests of control are performed to obtain audit evidence about the effectiveness of the design of the accounting and internal control systems, that is, whether they are suitably designed to prevent or detect and correct material misstatements, and operation of the internal controls throughout the period.

106. The AAS thus very clearly stipulates what an auditor should do as regards the design of the accounting and internal control systems. Emphasis is placed on an auditor acquiring knowledge of the system and its effectiveness in preventing misstatements. As has been brought out in the SCN, the sales revenue of SCSL generated through excel ported invoices was significantly large. I note from deposition of VVK Raju that excel porting facility was misused and therefore its use by the Finance In-charge personnel was discontinued to inculcate invoicing discipline. Therefore, I find it difficult to agree that very few people were aware about excel porting facility. Further, the Price Waterhouse entities, in their reply, agree that it is possible that IT systems may provide certain functionality to enable upload of data which would be similar to excel porting functionality in IMS as it provides convenience to users. From the facts and circumstances surrounding the verification of invoices, I find that the auditors were duty bound to understand the internal control systems adequately well as part of auditing. I also note that excel porting was a feature that was in the system as early as 2003. Thus, in my view, the Noticees cannot take the stand in their defence that they were not aware of excel porting feature in IMS.
107. It has been alleged in the SCN that the engagement team had an Admin ID and password with the use of which they could view all invoices in IMS, including the fictitious ones. It has been contended by the Noticees that Srinivas Kishan Anapu, Head of Inter Information System at SCSL, was not sure as to which database (IMS or PBMS) the Admin ID and password given to the auditors related to and when it was given to the auditors. It has been also submitted that, at best, Price Waterhouse's engagement team had access to the test database of SCSL's systems and not the live database or the production database and that the access to the database by a user with Admin ID could be restricted by SCSL by using Super Admin feature. It has been also submitted that there is no evidence to that the Admin ID was used by the engagement team and that by logging in to the system through the ID provided to them, they could have identified the fictitious invoices. I have noted the contentions of the Noticees.
108. I observe from the documents on record that on December 8, 2005, an email was sent to the Price Waterhouse auditors by Srisailam Chetkuru, working in the Accounts Receivable team of SCSL which provided them with the link (<http://hts-a5-cab012/pbmstest>) to access the test site of the SCSL database and the login ID (*oubmf0124*) / password (*'satyam'*) to access that link along with name of

certain customer, project id, billing period etc. I also note that the user ID and password given to auditors is the same as has been mentioned by Mr. Anapu in his deposition before SEBI on March 3, 2009 which gave Price Waterhouse the admin role access to the database. Thus, the user ID and password was with the engagement team at least from December 8, 2005. Anapu also adds in his deposition that a user with admin login ID had all the privileges, including the privilege to undertake user management and invoke/revoke privileges of others.

109. I note that as per the e-mail of Srisailam referred above, the Noticee was provided the Admin ID for PBMS test database as the link given to the auditors contains the letters "*pbmstest*"). Though Anapu, was not able to recall during the cross-examination as to which database the link would give access to, he said that usually they use the name in URL that links to the server with the same name. Further, it is also noted from the email by which the user id was provided to auditors that it was for viewing bills of customers with project ID, purchase order etc. Thus, it was for viewing details of invoices in the database which would have provided them with all these details. It is also noted that Anapu has stated that the test database is a replica of a live database or production database. The fact remains that Anapu has, in his deposition before SEBI and in the subsequent cross-examination by the Noticees, only confirmed the fact that Price Waterhouse was indeed provided an Admin ID, which gives access to the database.
110. The Noticees have also contended that merely by having an ability to view the invoices in the system, it would not have enabled the engagement team to identify fictitious invoices. In this regard, I note that the Noticee is one of the users of the Admin ID and this could enable them to check the roots of the invoices in PBMS database. In any case, if the Noticees thought that they did not have access to the complete information which would enable them to conduct the audit in a proper manner, they could have demanded the same from SCSL as they were, as auditors of the company, entitled to ask for the same. Neither in their audit observations nor in the working papers has anything been mentioned by the Noticees of access to the database been denied to them, which would have in turn stunted / impaired the audit process.
111. With regard to the contention that there is no evidence to show that the noticees had used the Admin ID, it is observed from the email mentioned in the para above that the user id and password was obtained by the audit team member for using it in the course of the audit. It appears natural

that the same must have been used by them in normal course. If they did not use the ID, then it only raises further questions on the audit procedure followed. I also note from the statement of Anapu that the logs with details of access to the database with login ID, date and time could not be retrieved as most of such logs were destroyed before commencement of investigation. Thus, the investigation could not collect these details. The defence put up by the Noticees in this regard has a lot of loopholes.

112. Notwithstanding the same, the short issue is - whether the auditors could have access to these invoices on the database, whether they could have seen the same and whether there were any external restrictions on such access to databases which would have impaired their quality of audit. I do not find any evidence for the same. The submissions of the noticees suggest that they conducted the audit without using all the available internal resources provided to them for verification by conducting a *walk-through* test etc. The auditors have merely accorded their concurrence to the documents produced by the company. As has been repeatedly pointed out in this order, an auditor is required to exercise professional skepticism in his audit and not accept date and details before testing its veracity.
  
113. SCSL's internal audit had observed certain differences in the status of invoices between those in the IMS and OF having an impact of lack of synchronization between OF and IMS. Reference has been made in this regard in the SSCN to the Internal Audit Reports relating to Bear Stearns, Agilent and Citigroup. The contention of Noticees that SCSL's Internal Audit observing differences between the IMS and OF in three internal audit reports fell outside the period of the last audit conducted by them is incorrect. It has also been the case of the noticees that SCN does not allege that the engagement team received or was aware of the said reports. As regards internal audit reports submitted by the team of VSP Gupta, Head of Internal Audit, SCSL, Srinivas Talluri has submitted that the statutory auditors await resolution of internal audit observations at the level of department head, unless the same is flagged to the statutory auditors either by the internal audit team or the audit committee or others. Accordingly, it is his contention that there was no unresolved/open issue as of the dates of the report. I have examined the internal audit reports in question. The following tables provide the extract of the list of the audit observations made by internal auditors as regards invoices where there is a mismatch between the IMS and OF and the target date by which such observations need to be complied with.



**TABLE 6**  
**EXTRACTS OF INTERNAL AUDIT REPORTS**

<b>Final (Rejoinder) Internal Audit - Agilent-Debtors Management audit</b>				
Internal Audit Report on Process Walk through for the period 1 Jan 2007 to 31 Mar 2007				
Sr.No (as in report).	Internal Audit Observation	Circle	Reply of Auditee	Target Date for Compliance
Standard Practice and Procedures non compliance				
3	Invoices in IMS and Oracle Books of Accounts require to be reconciled	SFIN	Accepted AUDITOR REMARKS: Settled. To be verified in future audits.	23-Aug-07
<b>Satyam Computer Services Ltd - Citigroup Invoicing</b>				
Final Internal Audit Report - SCSL/IA/VMNC/Jan 1, 2007 to March 31, 2007				
Internal Audit Report on Process Walk through for the period 1Jan 2007 to 31 Mar 2007				
4	Need to ensure that invoice wise reconciliation is done for sales revenue as per IMS-Sales register and Oracle Financials (OF)	SFIN	Accepted Settled AUDITOR REMARKS: Observation has been settled by IA now.	30-Jul-08
<b>Satyam Computer Services Ltd - Bear Steams</b>				
Internal Audit Report on Process Walk through for the period 1 Jan 2007 to 31 Mar 2007				
4	Mismatch between invoices data in OF vis-à-vis IMS	SFIN	Accepted Settled AUDITOR REMARKS: To check compliance on scheduled date.	31-Aug- 2008

114. From the tables, it is clear that the last dates of compliance with observations relating to the mismatch between invoice details in the IMS and OF were to be completed before within the period of audit by the noticees. The 'Target date of compliance' shown in the Internal Audit Reports belies the claim of the Noticees that it was after the audit period. The fact that such observations were ignored by the Noticees casts doubts on the audit process and procedures followed by the Noticees.
115. I would also like to note the stipulations made in AAS 7 (SA 610) on Relying upon work of an Internal Auditor. This standard stipulates the procedures that should be adopted by the external auditor to assess the work of an internal auditor for placing reliance upon that work, including the scope and objective of internal audit function, aspects to be considered in evaluating the internal

audit function, coordination between internal and external auditor, evaluating specific internal audit work etc. The following are extracts from AAS 7:

*“...In an ideal situation, he (the internal auditor) reports to the highest level of management and is free of any other operating responsibility. Any constraints or restrictions placed upon his work by management should be carefully evaluated...”*

*“....Coordination with the internal auditor is usually more effective when meetings are held at appropriate intervals during the year. It is desirable that the external auditor is advised of, and has access to, relevant internal audit reports and in addition is kept informed, along with management, of any significant matter that comes to the internal auditor’s attention and which he believes may affect the work of the external auditor...”*

116. While the statutory auditor is responsible for auditing the company’s financial statements and forming an opinion as to their truth and fairness; the internal auditor is responsible for providing objective assurance as to the adequacy and effectiveness of a company’s risk management and control framework. Any external auditor auditing company like SCSL with huge cash balances and revenue generated through customer services documented in invoice ought to have a basic co-ordination mechanism / a working relationship with the internal auditor, which would comprise internal and external audit strategies, assessment of risks and the implications of audit work, implications of internal audit findings and whether there is any major area of risk or concern that internal audit did not appear to cover. Thus, the contention of the noticees that they were unaware of the internal audit report is unacceptable. Further, the defence that the ‘closed’ observations of internal auditor are not a cause of concern by the statutory auditor is not tenable. The issues raised by the internal auditor should have drawn their attention compelling them to understand the circumstances under which these got closed internally.

117. The fact that there were unreconciled items between the IMS and OF should itself have put the external auditor on the alert. With regard to allegation that the engagement team failed to carry out any reconciliation between invoices in the OF and IMS, the Noticees have submitted that the engagement team did verify the OF and IMS balance reconciliation report from time to time and satisfied itself and had also documented these procedures in the “MyClient” files. If the external auditors were verifying reconciliation between IMS and OF from time to time, it again begs the

question as to how they missed the unreconciled items flagged by the internal auditors.

118. In this connection, it is relevant to state that, the ICAI came out with a Guidance Note on audit of revenue (GN 29) in the year 1997. The following are relevant extracts from the same:

*In carrying out an audit of revenue, the auditor is particularly concerned with obtaining sufficient appropriate audit evidence to corroborate the management's assertions regarding the following:*

- *Occurrence – that recorded revenue arose from transactions which took place during the relevant period and pertain to the entity.*
- *Completeness – that there is no unrecorded revenue.*
- *Measurement – that revenue is recorded in the proper amounts and is allocated to the proper period.*
- *Presentation and Disclosure – that revenue is disclosed, classified, and described in accordance with recognised accounting policies and practices and relevant statutory requirements, if any.*

119. The GN 29 states that verification of revenue may be carried out by examining records and analytical review procedures. Some other relevant extracts are given below:

*“...The auditor should examine the efficacy of such procedures. The auditor can examine the despatch documents (such as railway receipts) pertaining to a few days immediately before the year-end and verify that the related sale invoices have been recorded as sales of the current year.*

*“10. The auditor should examine selected entries in the sales journal with reference to the related sale invoices, despatch documents and other supporting documents such as the customers' orders, credit approval notes etc.”*

*“17. In respect of revenue arising from services rendered (i.e., in the form of fees, commission, brokerage etc.), the auditor should examine the related agreements and other documents. Similarly, in respect of revenue in the form of interest, dividends and royalties, the auditor should examine the related documents such as loan documents, lease agreements etc. The auditor may also seek confirmatory certificates from the parties concerned.”*

*“18. The auditor should also verify realisations subsequent to the date of the balance sheet to identify items of unrecorded revenue.”*

*“22. The auditor should maintain adequate working papers regarding audit of revenue.”*

120. The GN is self-explanatory. The Noticees, as external auditors, have not performed their duties which were required from them by the shareholders.
121. With regard to recording of revenue with respect to 27 invoices attributed to 7 non-existent customers, the Noticees, relying upon the statement made by VVK Raju during his cross-examination, have submitted that these invoices were genuinely generated and were visible to business finance teams. Thus, on the basis of the information available in the system, it was not possible to know whether the invoices were fake or genuine as these invoices would have roots in the IMS and the invoices were having supporting documentation. Further, as the payments were shown to have been received in the books of SCSL, it did not raise any doubt. The Noticees have also contended that even VVK Raju has confirmed during the cross-examination that there were no receivables follow up with respect to these invoices as money was reported to have been collected on due dates. Hence, it has been submitted by the noticees that there was an elaborate mechanism and design intended to deceive not only the auditors but also the employees of SCSL and hence, it cannot be concluded that there was complicity or connivance on part of the engagement team.
122. Before looking into the defence put forth by the Noticees, I wish to delve into the details of the case of product invoices. At the relevant time, SCSL was a ‘process’ oriented technology company, like many major Indian software companies. Hence, the ‘product’ side of the business was negligible. These invoices relate to ‘products’ supposedly created / to be created by SCSL for certain customers. To that extent, these invoices were unique. Further, the aforesaid 27 product invoices are in the name of seven companies, namely, (i) AutoTech Service Inc., (ii) Cellnet Inc., (iii) eCare Inc., (iv) Hargreaves Inc., (v) Mobitel Inc., (vi) NorthSea Inc. and (vii) Synony Inc. The name of all these companies is suffixed with the letters ‘Inc.’ therefore it is apparent that these companies must have been incorporated abroad. However, it has come out during the investigation carried out by various agencies, including SEBI that there were no such incorporated

companies and these imaginary names were used by SCSL to issue fictitious invoices and inflate its revenue. These 'H' series invoices were issued with respect to persons who were never in existence, therefore they would obviously be fake.

123. I note that all these product invoices with respect to non-existent persons have been issued between June 4, 2006 and October 26, 2006 and the revenue recorded in respect of these invoices is USD 58.16 million. It is observed from the *MyClient* document testing recorded sales for the period ended March 31, 2007 that for new customers, 100% invoices have been selected for verification, which means that all new customers were also selected. If the collections were verified from receipt from the customers, it would have pointed out the true facts.

124. Further, as per the *MyClient* document of the Noticees, they were verifying sales invoices with respect to all new clients and as such they must have become aware about the fictitious character of the 'product invoices' which were issued with respect to seven new customers in 2006-2007.. The Noticees also ignored the internal audit report on mismatch in the number of invoices between IMS and OF which was due to lack of synchronization between the two systems and manual intervention. Thus, on an overall assessment, my view is that auditors:

- failed to do the walk through tests in respect of the invoices;
- feigned ignorance of the internal control mechanism including excel porting at IMS and OF stages;
- chose to ignore internal audit reports; relied on the ledger entries prepared by the company and
- did not conduct the Audit as mandated by the AS or the Guidance Note with *bonafide* intentions of doing an actual audit.

### **Audit of Debtor Balances**

125. The allegations against PW in respect of debtor balances as contained in the SCNs are that PW failed to perform the basic audit function of seeking and obtaining external confirmation of debtor balances and by doing so it breached various provisions in AAS 5 and AAS 30, and the Guidance Note on Audit of Debtors, Loans and Advances and also its own Audit Manual (“**GN 23**”).

126. In their replies, PW entities (Noticee 1–11) have submitted that every year, the Engagement Team performed what it thought to be reasonable audit procedures around SCSL’s reported debtors based on the facts they understood at the time such as seeking debtor confirmations from a sample of SCSL’s debtors each year, except for the Financial Year 2008. In 2008, the Engagement Team elected not to circularize debtor confirmation requests because of the poor response rate in previous periods and instead performed ‘*alternative procedures*’ examining specific subsequent cash receipts, invoices/related documentation, and year end/quarter end sales. All these steps and reasons were documented. The Noticees have also submitted that SEBI has mischaracterized the relevant *AAS* pertaining to Debtor confirmations. In support of their submissions, the Noticees have relied on the “*MyClient*” files which were marked as “***Docs 24, 25 and 26***”, during the cross-examination of CH Ravindranath.
127. The details of inflated debtors was brought out in the SSCN, and the relevant Table is extracted hereunder –

**TABLE 7**

<b>DETAILS OF DEBTORS – [FIGURES IN ₹</b>				
<b>FINANCIAL YEAR</b>	<b>QUARTER – YEAR</b>	<b>PUBLISHED</b>	<b>‘S’ TYPE INVOICES POSTED IN OF AND APPEARING IN DEBTORS AS OUTSTANDING</b>	<b>DEBTORS AFTER REMOVING ‘S’ TYPE INVOICES</b>
<b>2008–09</b>	Q1–2008	27,542,481,237	5,678,511,382	21,863,969,856
	Q2–2008	28,259,508,992	5,002,091,534	23,257,417,458
<b>TOTAL</b>		<b>55,801,110,228</b>	<b>10,680,602,818</b>	<b>45,121,387,313</b>
<b>2007–08</b>	Q1–2007	18,855,651,939	3,252,882,078	15,602,789,882
	Q2–2007	20,911,242,303	3,162,724,160	17,748,518,143
	Q3–2007	22,145,595,494	4,912,738,832	17,232,656,661
	Q4–2007	23,653,855,468	5,711,279,765	17,942,575,703
	<b>TOTAL</b>		<b>85,566,345,204</b>	<b>17,039,624,835</b>
<b>2006–07</b>	Q1–2006	12,929,949,852	32,375,920	12,897,573,933
	Q2–2006	14,584,343,338	537,418,563	14,046,924,775
	Q3–2006	15,401,235,877	1,498,085,195	13,903,150,082
	Q4–2006	17,671,156,252	2,524,401,678	15,146,754,574
	<b>TOTAL</b>		<b>60,586,685,319</b>	<b>4,592,281,954</b>
<b>2005–06</b>	Q3–2005	11,207,565,089	1,136,391,475	10,071,173,615
	Q4–2005	12,266,974,917	1,790,995,723	10,475,979,193
	<b>TOTAL</b>	<b>23,474,540,006</b>	<b>2,927,387,198</b>	<b>20,547,152,808</b>

128. The Noticees have submitted that the abovementioned table containing details of inflated debtors cannot be relied upon since the cross-examination of VVK Raju has brought out that he has not

personally prepared the abovementioned table and has only conducted a sample verification and that too largely restricted for the 2<sup>nd</sup> Quarter of the Financial Year 2008 and largely for his Circles. The Noticees have also submitted that VVK Raju refers to validation of the contents of the table by team leaders i.e. Ramesh Kumar and Subbu G, whose evidence has clearly not been part of these proceedings and who have not been produced for cross-examination. Further, the Noticees have submitted that there appears to be heavy dependence on the KPMG Report (concerning investigation of SCSL) while preparing the abovementioned table. The Noticees have further submitted that there are inconsistencies in the figure of debtors appearing in the abovementioned table for the Quarter ended March 31, 2008.

129. In his replies dated October 6, 2017 and November 5, 2017, S. Gopalakrishnan has largely adopted the abovementioned submissions made by PW. In his replies dated October 6, 2017 and November 5, 2017, Srinivas Talluri refuted the allegations in the SCN. He relied on the statements of CH Ravindranath dated January 24, 2009, wherein he confirmed that debtor confirmations were forwarded till September 2007 and also that '*alternative procedures*' examining specific subsequent cash receipts, invoices/related documentation, and year end/quarter end sales, were performed in respect of debtor balances. Evidence as contained in the '*MyClient*' documents identified by CH Ravindranath and marked as Doc 53, has also been relied upon.
130. Srinivas Talluri has also relied upon paragraph nos. 2, 4, 18, 24 and 34 of *AAS 30* and paragraphs 6, 9 and 20 of the *Guidance Note on Audit of Debtors, Loans and Advances* ("**GN 23**") to substantiate his submissions that direct confirmation procedure is only one of the procedures in verification of debtor balances. Further, the decision whether to send confirmations or not and the extent to which such procedures (external confirmations and alternate procedures) are required to be applied are matters of professional judgment. He has further submitted that deployment of '*alternative procedures*', either in conjunction with or as a substitution to direct confirmation procedures, is acceptable as per standards of audit.
131. From the SCN, I note that R. Raju has in his confessional e-mail dated January 2009, admitted that the figure of debtors of SCSL for the Quarter ended September 30, 2008 was inflated by ₹490 Crores. As such, the amount of debtors as on September 30, 2008, was ₹460.59 Crores as seen from the books of SCSL.

132. As seen from the deposition of the witness – VVK Raju, the overstatement of debtors by SCSL was to the extent of ₹179.09 Crore at the end of March 31, 2006 and ₹252.44 Crore at the end of March 31, 2007. Thereafter, it was to the extent of ₹571.12 Crore at the end of March 31, 2008 and ₹500.20 Crore at the end of September 30, 2008.
133. PW entities (Noticees 1–11) have submitted that the contents of the aforementioned Table 8, which bring out details of inflated debtors, cannot be relied upon in light of the facts emerging from the cross–examination of VVK Raju. The aforementioned Noticees have sought to discredit the evidence relied upon by SEBI *inter-alia* through an assertion that the figures contained in Table 8 having been collated by other employees of SCSL (who were not available for cross–examination) and not personally by VVK Raju and hence, amounted to hearsay evidence. Further, the aforementioned Noticees have questioned the reliance placed on the KPMG Report on the ground that the KPMG employees were neither on oath nor available for cross–examination and hence, the contents of Table 8 stand vitiated.
134. Before proceeding with the determination of issues, it is to be noted that fictitious sales were generated through fake invoices and the same has been brought out in the preceding paragraphs of this Order. Therefore, fictitious sales would automatically result in fictitious debtors; it is but a natural corollary. I find that the PW entities are again raising the defence of inadmissibility of VVK Raju’s statement. As stated in the preceding paragraphs, the strict rules of evidence will not be applicable in the instant proceedings. In this background, I also note that during cross–examination, VVK Raju clarified that *“while the document was prepared by my team, it was after due validation of team leaders as well as sample verification by myself.”* I find that the contents of Table 8 is an off–shoot of the verification done by VVK Raju, Ramesh Kumar and Subbu G, as discussed under the head *“Audit of Fictitious Invoices and Revenues”*. Hence, the objections raised to this point are not again considered separately.
135. PW entities (Noticees 1–11) have submitted that the contents of Table 8 cannot be relied upon in view of inconsistencies in the figures of debtors for the Quarter ended September 30, 2008 i.e. ₹460 Crore in the SCN; ₹500 Crore in the SSCN and ₹490 Crore in the confession letter of R. Raju. As stated above, Table 8 provides the details of overstatement of debtors for the Quarters



ended December 31, 2005 to September 30, 2008. It is observed that overstatement of debtors by SCSL extended over a substantial period. In light of the aforesaid, I note that the aforesaid discrepancy pointed out by the PW entities is not materially significant to discredit the evidence available in this regard. In any view of the matter, the charge of overstatement of Debtors has not been refuted and the figures are more or less tallying with the disclosure made in R. Raju's statement.

136. PW entities have submitted that they performed detailed procedures in connection with verification of debtor balances, which were recorded in the *'MyClient'* documents. Further, external confirmations were sought from a sample of SCSL's debtors except for the Financial Year 2007–08. Noticees have also submitted that SEBI has mischaracterized the relevant auditing standards by claiming that debtor confirmations were a mandatory part of the Audit. Srinivas Talluri has submitted that direct confirmation procedure is only one of the procedures for verification of debtor balances and deployment of *'alternative procedures'* either in conjunction with or as a substitution to direct confirmation procedures is acceptable as per standards of audit. For this, he has also placed reliance on paragraphs 2, 4, 18, 24 and 34 of *AAS 30* and paragraphs 6, 9 and 20 of *GN 23*, which provide for greater reliance on verification of debtors through *"alternative procedures"*.
137. I note that with regard to debtor confirmations, the *'Basic Principle Governing an Audit'* as contained in *AAS 1* is relevant as it states that an Auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions therefrom on which to base his opinion on the financial information. Likewise, paragraph 4 of *AAS 5* provides that the Auditor's judgement as to what is sufficient appropriate audit evidence is influenced by such factors as the materiality of the item, the experience gained from previous audits, the type of information available, etc. Paragraph 7 of *AAS 5*, paragraph 3 of *AAS 30* and paragraph 5170 of PW's Audit Manual highlight the reliability of external evidence (e.g. confirmation received from a third party) in comparison to internal evidence. The *Introduction to GN 23* provides that debtors may constitute a significant portion of the total assets of an entity and an important feature of debtors, which has a significant effect on related audit procedures is that these assets are represented only by documentary evidence; they have no physical existence. Further, paragraph 5171.1 of PW Audit Manual is also relevant as it

states that the use of Accounts Receivable Confirmations is a procedure that is expected to be performed on every audit.

138. The importance of external confirmations as a source of audit evidence has been clearly documented under the *AAS 1, AAS 5 and AAS 30* read with *GN 23* and PW's Audit Manual. The objective of an Auditor when using external confirmation procedures is to design and perform such procedures to obtain relevant and reliable audit evidence to corroborate the management's assertions regarding the existence, completeness, valuation and disclosure concerning debtors as provided under paragraph 6 of the *GN 23*. In other words, the Auditor should be concerned with obtaining sufficient audit evidence to form the basis for the expression of his opinion on the financial assertions. If the instructions in the *AAS* and *GN 23* were objectively followed by the auditors in the instant case, they would have necessarily examined –

- *Whether all amounts recorded in respect of debtors are outstanding as at the date of the balance sheet?*
- *Whether the stated basis of valuation of debtors is appropriate and properly applied and that the recoverability of debtors is recognised in their valuation?*

139. I note that in case of verification of debtors, external confirmation is not the only mandated procedure. *AAS 30* and *GN 23* provide for resorting to 'alternative procedures' such as examining specific subsequent cash receipts, invoices/related documentation, and year end/quarter end sales, which ought to be performed satisfactorily more so, in view of the fact that the financial assertions made by SCSL in this regard were in respect of assets represented only by documentary evidence. Any variance in audit evidence of such nature received from debtors, would definitely have resulted in further verification by the Engagement Team of the financial assertions made by SCSL in respect of debtor balances. Further, any discrepancies revealed by the confirmations received by the Engagement Team in respect of debtor balances, may have had a bearing on other accounts not included in the original sample list.

140. In light of the importance of external confirmations emphasized by *AAS* and *GN 23* in this regard, it is therefore, surprising that the Engagement Team sought limited external confirmations in respect of debtor balances of SCSL from the 'MyClient' documents marked as **Doc 53** and **Doc 26**. It is seen that limited external confirmations were sought for three Quarters as shown in the Table below.

**TABLE 8**

<b>Quarter ended</b>	<b>Number of debtors from whom confirmations were sought</b>	<b>Responses received</b>
September 30, 2006	22	Nil
March 31, 2007	15	Nil
September 30, 2007	16	1

141. Paragraph 22 of *GN 23* provides that while determining the audit evidence sought to be obtained in respect of debtor balances, the Engagement Team should consider the probability that such confirmations would receive consideration. From the external confirmations sought, I see that they have sought confirmation from the same debtors, who have earlier not replied i.e. Caterpillar Inc., State Bank of India, etc.
142. Further, from the *MyClient*' documents discussed above, I find no specific record of follow up requests either through resending of confirmations or telephonic reminders, etc. having been made by the Engagement Team in respect of those positive external confirmation requests to which responses were not received, as required under paragraph 34 *AAS 30*, paragraph 31 of *GN 23* and paragraph 5174 of PW's Audit Manual.
143. The Noticees have submitted that the Engagement Team documented the reasons for not sending Debtor confirmations contrary to the allegation made by SEBI in the SSCN. Further, they have submitted that the Engagement Team was in the practice of sending out requests for Debtor confirmations till March 2007.
144. I note that in his deposition before SEBI, CH Ravindranath confirmed that Debtor confirmation letter was last sent for September 2007 and thereafter, it was stopped. Even if it were to be accepted that the last confirmation letter sent was in September 2007, it is noted from the *MyClient*' documents for the Quarter ended December 31, 2007, that the Engagement Team failed to document the rationale for not sending external confirmations in respect of debtor balances, as required under Paragraph 5171.1 of PW's Audit Manual.
145. From the *MyClient*' documents having Title – “*(AAS 30) Tailorable accounts receivable confirmation*

*programme for the Quarter*” ended March 31, 2008, it is observed that the rationale for not sending confirmations has been documented merely as – “*The response to the confirmation of the balance is poor based on Cumulative Audit Knowledge and Experience (“CAKE”)*”. In my view, the aforementioned documentation made by the Engagement Team does not qualify as an adequate rationale when viewed in light of the requirement under Paragraph 5171.1 of PW’s Audit Manual and the illustrations detailed therein. The rationale documented by the Engagement Team merely asserts that “*response to confirmation is poor based on CAKE*” without detailing or explaining how such response was poor i.e. factors such as circumstances of the engagement, nature of debtor, historical response rate, etc. In other words, the fallacy of such a bald assertion lies in the fact that effectively no justification has been provided by the Engagement Team as to why external confirmations were not sent in respect of debtor balances.

146. It is also noted from paragraph 20 of *GN 23* that while an Auditor may place greater reliance on the other auditing procedures, he cannot completely ignore the external confirmation procedures, which are a reliable source of evidence. The fact that the Engagement Team chose to completely discontinue external confirmations in favour of ‘*alternative procedures*’ merely on an assertion that poor responses were being received cannot be said to be in conformity with the aforesaid AAS.
147. The Noticees stated that the Engagement Team performed what it thought to be reasonable audit procedures around SCSL’s reported debtors such as seeking debtor confirmations from a sample of SCSL’s debtors each year, examining specific subsequent cash receipts, invoices/related documentation, and year end/quarter end sales, except for the Financial Year 2008. In 2008, the Engagement Team elected not to circularize debtor confirmation requests because of the poor response rate and instead performed ‘*alternative procedures*’.
148. I note that the requirement under paragraph 33 of *AAS 30* provide that the ‘*alternative procedures*’ adopted by PW should be such as to provide adequate audit evidence about the financial statement assertions that the confirmation request was intended to provide. Paragraph 5171.1 of PW’s Audit Manual states that the Engagement Team should be aware of the potential fraud risk associated with the client creating fictitious remittances when performing ‘*alternative procedures*’. Paragraph 36 of *AAS 30* and paragraph 5174 of PW’s Audit Manual also state that when the confirmation process and/or ‘*alternative procedures*’ performed do not provide sufficient audit evidence, the

Auditor shall undertake additional procedures to obtain sufficient appropriate audit evidence. Further, as per paragraph 31 of *GN 23*, in the event of inadequacy of responses received, the Auditor will have to increase the extent of examination of records and analytical review procedures beyond that planned originally as detailed under paragraph 33 of the *GN 23*. By providing '*alternative procedures*', the *AAS* and *GN 23* do not relieve the Auditor from his obligation of conducting a satisfactory confirmation of debtors. On the other hand, the thrust of the *AAS* and *GN 23* is on doing the verification properly by resorting to '*alternative procedures*' laid down and specifically by collecting sufficient audit evidence in this respect. Accordingly, in view of the aforesaid, PW should have evaluated whether the results from any other alternative/additional procedures stated to have been performed provided sufficient appropriate audit evidence regarding the financial statement assertion being audited, as is required under paragraph 39 of *AAS 30*.

149. I have also perused the '*MyClient*' documents marked as **W8 – Doc 53 and Doc 26 and W9 – Doc 22** [P. Siva Prasad (Witness 9)], which were relied upon by the Noticees, to substantiate the '*alternative procedures*' performed by the Engagement Team and also requests for external confirmations sought in respect of debtor balances of SCSL. I find that the aforementioned '*MyClient*' documents when viewed in light of the requirements detailed under *AAS 30*, *GN 23* and PW's Audit Manual reveal certain glaring inconsistencies in the processes adopted by the Engagement Team regarding confirmation of debtor balances of SCSL –
- a. For the Quarters ended March 31, 2005, September 30, 2006 and March 31, 2007, apart from subsequent realisation of debtors, the Engagement Team also performed additional audit procedures to obtain comfort on the existence of debtors including verification of invoice, etc. However, for the quarter ended September 30, 2007, no such additional audit procedures were performed.
  - b. For the Quarter ended September 30, 2006, while the Engagement Team also analysed the top 10 customers to get comfort in addition to performing subsequent realization, no such procedure was observed for the Quarter ended March 31, 2007.
  - c. It is noted that for the Quarter ended March 31, 2007, the Engagement Team sought *negative confirmations* in respect of the debtor balances whereas for the Quarter ended September 30, 2006 and September 30, 2007, *positive confirmations* were sought. As

noted from paragraphs 25 and 27 of *GN 23*, *positive confirmations* are appropriate where individual account balances are relatively large or where internal controls are perceivably weak while *negative confirmations* may be employed in respect of debtors having small balances. From the Debtors' confirmation list for the Quarter ended March 31, 2007, it is observed that *negative confirmations* in respect of account receivables were sought in cases where the amounts were as high as INR 99,726,653.77 (IBM India Private Limited), USD 7,696,273.14 (Caterpillar Inc.), etc. However, it is observed that for the Quarter ended September 30, 2007, the Engagement Team opted for positive confirmation in respect of similar amounts i.e. USD 4,857,807 (State Farm Mutual Automobile Insurance Co.) and INR 2,386,500 (Pricol Limited).

150. Such inconsistency in procedures point to the absence of uniformity in application of diligent and prudent steps or processes by the Auditors while auditing SCSL. In my opinion, the Auditors could not have chosen *ipse dixit* any method for ascertaining the financial assertions made by SCSL because there would have been a likelihood of unreliable results being thrown up, which would not be comparable Quarter to Quarter, thereby defeating the object of verification. Further, no Auditor should be able to manoeuvre around or manipulate the processes of verification to suit the convenience of their client. It is pertinent to note that *AAS* and *GN 23* have rightly highlighted the necessity of audit evidence that is obtained by administering consistent tailored procedures and by applying prudent levels of alertness that is required in these kind of verification processes. The Engagement Team had therefore, not adequately and consistently ensured adherence with the requirements of external confirmations, '*alternative procedures*', etc. in accordance with the requirements under *AAS 30*, *GN 23* and PW's Audit Manual.
151. As stated earlier, some of the '*alternative procedures*' that can be performed by the Auditors include examining specific subsequent cash receipts, invoices/related documentation, and year end/quarter end sales. While certain concerned debtors may not respond and confirm the balances, one of the other '*procedures*' suggested would be to undertake a follow up with the debtors which would have also reveal the status of such debtor – whether the party is in existence or not. I note that in the case of SCSL, there have been sales to certain customers documented elsewhere in this Order, through invoices marked as '*H invoices*', which were bogus customers. These were '*product*' invoices and only 27 in number as against the remaining invoices that were '*process*' invoices. This unique distinguishing factor should have prompted the Auditors to perform these

checks at least on the customers/debtors mentioned in these invoices. Further, even where such checks were performed through subsequent realization of accounts, the same were made as against bank statements which were obtained from SCSL. As detailed earlier in this Order, the confirmation process adopted by the Auditors in respect of account balances, etc. was not in conformity with the *AAS 30*, etc. Therefore, for the Auditors to have carried out the verification by relying on such bank statements would definitely not have resulted in an accurate and reliable result. Passive acceptance at face value of information provided by SCSL does not befit the stature of audit. If it is done, as in this case, it only amounts to gross negligence.

152. Upon a consideration of the preceding paragraphs, I find that PW failed to perform the basic audit function of ensuring adequate external confirmations of debtor balances from the debtors in question, which in turn resulted in it failing to notice the inflated and false figures concerning SCSL.

#### **TDS and other related issues**

153. In respect of TDS, it was alleged that PW failed to detect the mismatches in the books of account of SCSL vis-a-vis the audited Balance Sheet vis-a-vis the actual amount of TDS for which the benefit was claimed in the Income Tax Return of SCSL. It was also seen that PW failed to physically verify the TDS Certificates available with SCSL.
154. In their replies, PW entities have submitted that the net addition in TDS receivable accounts, in the normal course, represents the increase or decrease in the balance of TDS receivable from one period to another and will consist of all movements in the TDS balance including TDS on interest income, professional income, rent and all such income earned by SCSL during the year. This could also include other adjustments such as write-offs, rectifications, etc., during the year in respect of earlier years. SEBI has failed to appreciate that comparing these amounts is as meaningless as comparing apples to oranges. The Noticees have also relied on the statements made by CH Ravindranath during his cross-examination, which indicated that TDS Certificates along with the income tax return as provided by SCSL were verified by the Engagement Team. Srinivas Talluri and Gopalakrishnan have largely adopted the submissions made by the PW entities.

155. I note that in most cases, the figures contained in the books of account and audited balance sheet of an Assesse may differ from the amount for which exemption is/can be claimed by such Assesse, as asserted by the Noticees. I am inclined to agree with the submissions of the Noticees as I note that the SCN had not sufficiently brought out the nexus between the falsification of accounts and failure to detect mismatches in TDS. In light of the aforesaid, I am of the view that the charge contained in the SSCN against the Noticees, concerning TDS is not sustainable.
156. SCSL had come out with a sponsored American Depository Share (ADS) Issue in the year 2005, the draft prospectus of which was filed with the Securities and Exchange Commission, USA on February 25, 2005. SCSL also made a Bonus Issue of 32,76,94,738 equity shares in the ratio of 1:1 to the Indian shareholders in October 2006. In the background of ADS and Bonus Issues, it was alleged that PW mislead shareholders and investors by failing to perform its duties as an Auditor as spurious certifications were issued by them reflecting a wrong business and financial position of SCSL.
157. The PW entities (Noticees 1–11) and S. Gopalakrishnan have denied the allegations contained in the SCN in connection with ADS and Bonus Issues of SCSL. They have submitted that the mere fact that SCSL included audited financial statements in its Annual Report as part of ADS disclosures could not be construed that the Auditors were complicit with the fraud undertaken by the management. The Noticees have further submitted that the Audit Team had no reason to believe that SCSL was creating false or forged documents and furnishing these documents for audit all these years and misrepresenting the facts before the Auditors.
158. I note that in the Prospectus for the ADS Issue, under the heading: “*Experts*”, the following was stated –

*“The consolidated Financial statements and Financial statement schedule of Satyam as of March 31, 2004 and 2003 and for each of the three years in the period ended March 31, 2004 included herein and incorporated in this Prospectus by reference to Amendment No. 1 to the Annual Report on Form 20-FLA for the year ended March 31, 2004 have been so included and incorporated in reliance on the report of PW, independent auditors, given on the authority of said firm as experts in auditing and accounting.”*



159. I further note that in the PW's Report forming part of the disclosures made in the ADS Issue, the following was stated –

*"In our opinion, based upon our audits and the report of other independent auditors', the accompanying consolidated balance sheets, the related consolidated statements of operations, of cash flows and of shareholders' equity and comprehensive income after the restatement as discussed in Note 22, present fairly, in all material respects, the financial position of Satyam Computer Services Limited and its subsidiaries as at March 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2004, in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.*

*On a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits and the report of other independent auditors to provide a reasonable basis for our opinion."*

160. I also note that the Bonus Issue of SCSL in October 2006, was made *inter alia* on the basis of the financial position disclosed in the books of account and financial statements audited and certified by PW.

161. To begin with, I note that if there is a misstatement in the cash and bank balances and the sales, this results in misinformation/wrong disclosures to the investors; it is a natural corollary that any event that was carried out by the company - corporate actions, for example – would be on the basis of such false information foisted upon investors. This would apply to any public announcement or document filed by the company. Upon a consideration of the aforesaid in light of the findings contained in the preceding paragraphs of this Order, I conclude that – PW failed to properly audit the financial statements of SCSL since there was no reasonable basis for the opinion expressed in its Report in view of the serious irregularities prevalent in SCSL. The ADS and Bonus Issues were made on the basis of gross misrepresentations of SCSL's financial position *inter alia* in its Prospectus and also its financial statements. PW's Report formed a vital component of the Prospectus for the ADS Issue and was intended to provide a reasonable assurance to

investors that the financial position of SCSL was correctly presented. PW's certification of the financial statements of SCSL in the context of the Bonus Issue also resulted in investors being induced to trade in the scrip of SCSL believing the company to be in a strong financial position and of considerable value to prospective investors, not only within India but also at New York Stock Exchange and the auditors or Noticees by causing to issue such certifications have misled the investors and induced them to trade. In view of the above, I find no infirmity in the SCN.

162. Another allegation pertained to PW's failure to detect receipt and utilization of ₹1425 crore by SCSL during the course of its audit and the payments of ₹195 crore made by SCSL during the course of its audit.
163. PW entities have submitted that no documentation is available for these receipts at the company level. Further, there was no record of these borrowals in the minutes of the board meetings for the Auditors to have a knowledge of these transactions. PW entities have submitted that it is a clear case of misrepresentation of transactions to the Auditors and the Auditors having been deliberately misguided and misled and hence, this cannot be termed as a failure on the part of Auditors to detect these receipts. As regard the allegation of failure to detect payments of ₹195 Crores, PW entities have submitted that all such payments were made during the period October 2008 to November 2008. Admittedly, Quarter ended September 2008 was the last period for which Audit was conducted by the Statutory Auditors; hence, the question of Auditors having failed to detect the payments of ₹195 Crore does not even arise. Talluri Srinivas has largely adopted the submissions made by the PW entities.
164. From Annexure 17A of the SSCN, it is observed that an amount of ₹1425 Crores was received in certain banks accounts of SCSL, which were paid by cheques drawn on behalf of various companies in 2007 and 2008 and payment of ₹195 crores was made in 2008. However, the aforesaid amounts were not recorded in the OF of SCSL. I am inclined to agree with the submissions of the Noticees as I note that the SCN had not sufficiently brought out the *modus operandi* through which the auditors could have detected the receipts and utilization of the said amounts. In light of the aforesaid, I am of the view that the charge contained in the SSCN against the Noticees is not sustainable.

### **Cumulative Analysis of the role of Statutory Auditors (PW) in SCSL**

165. While the carefully laid out scheme of fraud and falsification of accounts in SCSL does get attributed to the top management of SCSL by its own admission, a dispassionate analysis of the whole episode spanning over a period of at least 8 years would reveal that the perpetration of the fraud could not have been made possible without the knowledge and involvement of the statutory auditors. In the next few paragraphs, I proceed to examine the role of PW in this context, with a specific focus on the following questions:
1. Did the Auditors leave some gaping holes in the auditing process?
  2. Could they have done better?
  3. Do the acts of auditors reveal an element of acquiescence on their part?
166. Given the fact that the accounting process has a tendency to interlink several facets of a company's operations, the falsification exercise which started with faking of invoices, got extended to inflation of debtors and receivables, boosting fake revenues in turn and finally ended with generation of book profits and false bank balances. All these vital points in a company's accounting process presented the auditors with a surfeit of opportunities to sit up, take note and ring alarm bells. Where did the auditors go wrong? Or did they, deliberately look the other way?
167. To quickly recount the auditor's lapses, the auditors had full knowledge that bank balances of the company constituted 70 percent of the company's assets and being a high-risk asset prone to fraud and misappropriation, and thus, it warranted significant audit attention. However, the casual approach of the auditors to this vital area of audit was exemplified by the auditor's failure to maintain essential control over the process of external confirmations, as mandated under AAS 30. To compound it further, there was not even a semblance of any effort put in by the auditors to follow up on the confirmation requests with the banks in case of absence of responses. Further, even though the letters of confirmation received through the company suffered from glaring defects like only stating the aggregated balance of fixed deposits, not carrying the vital details like the number of the FDR, client name etc., it did nothing to stir up alertness in the auditors. The same approach was extended in the case of debtor verification also, despite the asset item 'debtor' being a book based item without a physical existence.
168. I see merit in the defence of the auditors that the fake invoices are not distinguishable to a naked

eye. However, the call of duty of the auditors transcends beyond what is visible to the naked eyes by requiring the auditors to apply an attitude of professional skepticism. Any electronic accounting / operational system maintained by an auditee company certainly requires a very careful ‘walk-through’ by the auditors to understand its functionality thoroughly and, in fact, this should be the first step in any auditing exercise. Such an exercise, if undertaken diligently, would have endowed the auditors with a clear understanding of the processes. Armed with the Admin ID, this knowledge would have come in handy to enable the auditors to run a sample of invoices through the system to check their genuineness and validity. Unfortunately, this exercise was not carried out in a meaningful manner to check the veracity of sales figures, even though the auditor’s familiarity with the company’s systems would have facilitated the auditors to take up a strict regimen of *walk-through* tests, to bring to light the existence of fake invoices.

169. The Auditing Standards lay considerable emphasis on effectiveness of internal audit and the need for an external audit to place reliance on internal audit for obvious reasons of synergy, enhanced coverage and optimal usage of time. It, therefore, again defies logical explanation as to why PW was not put on the alert by the internal audit flagging some unreconciled items between two systems (between OFS and IMS) in the auditing company. There can be only two reasons for such a casual approach to statutory audit – either complacency or complicity.
170. All these lapses and several others as dealt with before in this order, on the part of the statutory auditors, do throw up gaping holes in the auditing process followed by the auditors. The auditors could have done justice to their audit process had they just followed the Auditing Standards and Guidance Notes scrupulously. I find that while the Noticees have justified their acts by selectively quoting from various AAS, the marked departures from the spelt-out Auditing standards and Guidance Notes are too stark to ascribe the colossal lapses on the part of auditors to mere negligence. It is inconceivable that the attitude of professional skepticism was missing in the entire exercise spanning over 8 long years.
171. I note that even a whistle blower’s letter received on December 23, 2008 (which was few weeks before the confessions by Ramalinga Raju), extending a note of warning to the auditors about the inflation of bank balances failed to elicit a response which a prudent auditor would normally provide in case of any sudden exposure of fraud. This becomes more apparent in view of several

important happenings around that time viz. deferment of audit for quarter ended Dec 31, 2008 by the management of SCSL citing 'preparedness', the calling off of acquisition of Maytas Infra Ltd. by SCSL due to investor backlash, calling off of the Audit Committee Meeting scheduled on December 29, 2008, resignation of four independent directors during the last week of December 2008 and the decision of the World Bank to bar SCSL from doing business with it for eight years. All these factors turn the needle of suspicion away from negligence to one of acquiescence and complicity on the part of the auditors.

172. The preceding paragraphs have unambiguously shown that there has been a total abdication by the auditors of their duty to follow the minimum standards of diligence and care expected from a statutory auditor, which compels me to draw an inference of *malafide* and involvement on their part.

#### **Role of Auditors – Case laws**

173. In their replies, the Noticees have relied upon several judicial pronouncements including *Tri Sure India Limited vs. AF Ferguson & Co. (1987) 61 Comp Cas 548 (Bom)*; *Ernst & Ernst vs. Olga Hochfelder et al., 425 US 185 (1976)*; *In Re: City Equitable Fire Insurance Co. Ltd., 1925 Ch 407 (P)*, to substantiate their submissions. While I have considered the same, I find it important to refer to certain other judgements of Courts dealing with issues such as misconduct, gross negligence, reckless certification, failure in duty to take care etc., which are discussed hereunder.
174. In this context, I would like to quote the observations of the High Court of Andhra Pradesh in a recent matter in 2016 pertaining to the duties of Auditors in *ICAI v. Mukesh Gang* :

*“The Chartered Accountant is a professional whose expertise in accountancy is acknowledged. He is a member of an expert body and of a premier institute in India. The certificate issued by an Auditor has its own impact on the public at large, as it is largely on the basis of this certificate that the general public subscribe to the shares of the company. **Reckless certification by an Auditor, which has resulted in the public being misled into subscribing to the shares of the company in the public issue, would undoubtedly amount to gross negligence.** Large sections of society rely on the certification by the Chartered Accountants for taking many vital decisions. It is imperative that utmost care and caution is exercised in issuing such certificates, and the objectivity, integrity, reliability and credibility of the information therein is ensured. Of late, several instances*

*have come to light where, due to the erroneous/ambiguous advice tendered by Chartered Accountants, borrowal accounts have had to face quick mortality resulting in huge losses for banks and financial institutions. To ensure public faith and protect gullible small investors from being cheated of their life savings, the Institute should ensure that its members possess competence of a high order, their character is above board, and their integrity beyond reproach. Chartered Accountants are responsible to the public for their actions, as heavy reliance is placed on their credibility by the general public consisting of investors, banks, financial institutions, governments etc. The Chartered Accountants duty is not merely to his client, but extends to various segments of society, more particularly in the commercial field, on whose expertise, integrity and impartiality they rely on in taking various decisions.”*

In the said case, the Hon’ble AP High Court had quoted the definition of ‘gross negligence’ in Law Lexicon by P Ramanatha Aiyer as below:

*“Gross negligence, sometimes called ‘wilful blindness’ is the same thing as ‘negligence’, with the additional of a vituperative epithet.”*

175. In *Registrar of Companies, Bombay Vs. P M Hegde (AIR 1954 Mad 1080)* decided on 30<sup>th</sup> April 1954, the Hon’ble Madras High Court, in the context of alleged failure of an auditor to verify the cash on hand as on the date of balance sheet properly, considered the question whether the auditors job is to verify mathematical accuracy of the entries in various documents. The Hon’ble High Court of Madras therein had referred to the following case, before confirming that the auditor failed to discharge his duty as an auditor of the Rural Bank of India Ltd.:

-- *'Leeds Estate, Building & Investment Co. v. Shepherd', (1887) 36 Ch D 787 at p. 802 . Stirling J.*  
observed thus:

*"It was in my opinion the duty of the auditor not to confine himself merely to the task of verifying the arithmetical accuracy of the balance sheet, but to inquire into its substantial accuracy, and to ascertain that it contained the particulars specified in the articles of association (and consequently a proper income and expenditure account) and was properly drawn up, so as to contain a true and correct representation of the state of the company's affairs."*

176. In *Halsbury's Laws of England, Second Edn. Vol. V at page 385*, we find the following:

*"It is the duty of an auditor to verify not merely the arithmetical accuracy of the balance sheet but its substantial accuracy, to see that it includes the particulars required by the articles and by statute, and contains a correct representation of the state of the company's affairs. While, therefore, it is not his duty to consider whether the*

*business is prudently conducted, he is bound to consider and report to the shareholders whether the balance sheet shows the true financial position of the company. To do this he must examine the books and take reasonable care to see that their contents are substantially accurate."*

177. In -- '*In re London and General Bank (No. 2)*', 1895-2 Ch 673 (D) at pp. 682-3 Lindley L. J. after stating that the business of the auditor is to ascertain and state the true financial position of the company at the time of the audit, and that his duty is confined to that, asked the question, "*How is he to ascertain that position?*" and answers it thus:

*"The answer is, by examining the books of the company, But he does not discharge his duty by doing this without inquiry and without taking any trouble to see that the books themselves shew the company's true position. He must take reasonable care to ascertain that they do so. Unless he does this his audit would be worse than an idle farce.....But his first duty is to examine the books, not merely for the purpose of ascertaining what they do shew, but also for the purpose of satisfying himself that they show the true financial position of the company."*

178. Again in the case *C A Rajesh Dudhwala vs. Disciplinary Committee* decided by the Gujarat High Court on 6th November, 2012 where the writ was filed by a Chartered Accountant challenging the decision of the institute to debar him from active practice for a period of one year, it was observed as under:

*"27. A Chartered Accountant has an obligation, not only statutory but also moral and social, to be absolutely and completely diligent and cautious and careful while preparing, signing and certifying Annual Accounts and/or Audit report. Several Government and private organizations and individuals rely on the report / certificate by Chartered Accountant and once a particular factual aspect or entries, etc. are prepared, signed and certified by Chartered Accountant they are ordinarily accepted without further probing or investigation. In such circumstances, the duty and obligation of being absolutely diligent, conscious and careful is multiplied manifold and a Chartered Accountant should not, and cannot take, such obligation or perform his duties lightly or casually. A mistake by a petty clerk or lower level accountant may be dealt with in different manner but a mistake by a Chartered Accountant cannot be treated with indifference or casually or lightly. ...."*

179. In short, the law has assigned a very crucial and pivotal role to independent auditors in a public

company. The certifications issued by Auditors have a definite influence on the minds of the investors. The auditors owe an obligation to the shareholders of a company to report the true and correct facts about its financials since they are appointed by the shareholders themselves. I would put it that, the duty of a Chartered Accountant is not only towards his clients, but also towards the larger public which includes, the banks and other financial institutions, the government departments like tax department, other sectoral regulators in the country etc., besides the investors. Nothing assumes importance to a market regulator than the fact that these certifications appear to be reduced to unseen understandings between the auditors and their paymasters and a mere projection of a paper exercise for record purposes.

180. In my assessment, the circumstances point towards gross negligence and fraudulent misrepresentation. I note that the auditors made material representations in the certifications without any supporting document. The acts of the auditor induced the public to trade consistently in the shares of the company. It is relevant to note that the impact of the fraud was such that as soon as the scam unfolded, the price of the scrip dipped to a low of ₹41.05 on January 7, 2009 from ₹ 178.95 on the previous day's price on NSE. This shows that the acts of the auditor resulted in loss to the investors of the company. As stated earlier, a continuous omission to check the figures of the company with the external sources can definitely lead to complicity as an inference thereof. I find that the auditors have failed in showing any evidence to the effect that they had done their job with standards of professional duty and care as required. The auditors were well aware of the consequences of their omissions which would make such accumulated and aggregated acts of gross negligence scale up to an act of commission of fraud for the purposes of the SEBI Act and the SEBI (PFUTP) Regulations.

181. The auditors, at every instance, have done a passive, peripheral or a superficial verification which apparently is only to show on records that some verifications have been done. For every vital aspect, such as verification of invoices and bank balances, subsequent realization of debtors, they relied on BRS, OF, IMS, bank statements procured from the company. The plea that nothing aroused their suspicion itself shows that they have not looked for any circumstances beyond the comparisons or verifications against the records provided the company. This appears to have been done by them to create records for an eyewash of an audit exercise.



182. After an evaluation of how the entire auditing exercise was conducted by the Noticees, I find that that the allegations in the SCNs cannot be said to be misplaced or unsubstantiated.
183. In the instant case, the noticees have, relying on the decision of the Hon'ble Bombay High Court laid too much of emphasis on the need for SEBI to establish that they were involved in the falsification of books of account of SCSL by adducing positive evidence to prove that the violation was not a result of omissions but it was intentional and committed by the auditors in collusion and connivance etc., as stated in the earlier part of this order. I note that the noticees have made strenuous attempts to draw a distinction between SEBI having the powers to assume jurisdiction but not having the power to pass directions, in the absence of evidence to prove *mens rea* and intention.
184. Having come to a satisfactory conclusion as to the culpability of the auditors from the evidence, it is stated that *mens rea* in the criminal sense of the term is not relevant to be established in a violation alleged under the SEBI (PFUTP) Regulations read with the applicable provisions under the SEBI Act. At this stage, it would suffice to state that the Hon'ble Supreme Court, in a spate of judgments passed very recently namely, *SEBI Vs. Kanaiyalal Baldevbhai Patel and Ors.* vide order dated September 20, 2017 held categorically that *mens rea* is not indispensable in PFUTP violations. To quote:
- “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. ....”*
185. This position was relied upon by the Hon'ble SAT in *Nilesh Kapadia Vs. SEBI* (Appeal No. 329 of 2014) dated December 21, 2017 to uphold the finding of SEBI in a case involving the SEBI (PFUTP) Regulations. It is also relevant to state the same position continued earlier when the instant case was also being initiated as seen from the judgment of Bombay High court in *SEBI Vs. Cabot International Capital Corporation (2004) 51 SCL 307 (Bom)* where the Hon'ble High Court

held:

*“(A) Mens rea is an essential or sine qua non for criminal offence.*

*(B) Strait jacket formula of mens rea cannot be blindly followed in each and every case. Scheme of particular statute may be diluted in a given case.*

*(C) If, from the scheme, object and words used in the statute, it appears that the proceedings for imposition of the penalty are adjudicatory in nature, in contra-distinction to criminal or quasi criminal proceedings, the determination is of the breach of the civil obligation by the offender. The word "penalty" by itself will not be determinative to conclude the nature of proceedings being criminal or quasi-criminal. The relevant considerations being the nature of the functions being discharged by the authority and the determination of the liability of the contravenor and the delinquency.*

***(D) Mens rea is not essential element for imposing penalty for breach of civil obligations or liabilities....”***

186. Some other judgments and observations that are relevant and instructive in the context of the instant case are cited below:

*“We agree that fraud is a serious charge but we do not agree with the learned senior counsel that in civil proceedings like the present, it cannot be established on preponderance of probabilities. In civil proceedings, unlike in criminal proceedings, even a serious charge like fraud has to be established on preponderance of probabilities and since this charge is serious higher has to be the degree of probability to establish the same. Having regard to the manner in which the appellants conducted themselves in transferring the shares of the innocent shareholders, we are satisfied that the charge of fraud in the present case has been established with the required degree of probability..... In civil proceedings of the kind we are dealing with, it is not necessary to establish the motive of the wrongdoer nor is it necessary to prove mens rea....” (SAT In Parsoli Corporation Limited Vs. SEBI (Appeal no. 146 of 2010 decided on August 12, 2011)*

*“The enquiry proceedings being in the nature of adjudicatory proceedings are civil proceedings and not criminal proceedings. Mens rea is not required to be proved before a person can be held guilty of price manipulation or carrying on fraudulent trade practices. Since the SEBI Act and the FUTP Regulations and the Broker Regulations are Regulatory enactments mens rea is not required to be proved when a penalty is imposed under an enactment for breach of a civil obligation in adjudicatory proceedings. The rule that mens rea is required to be proved before a penalty can be imposed is not attracted.” (SAT in Nirmal Bang Securities Limited dated October 31, 2003)*

187. It is yet arguable that the relevance of *mens rea* in the cases cited above are all relating to actual market manipulation and fraudulent practices perpetrated by some trades or trade related causes done with some intent to pump or dump and not to certification activities done by qualified professionals such as chartered accountants. According to the Noticees, the instant case is different from other cases as the Bombay High Court has imposed a strict standard of proof for the exercise of powers by SEBI. At this juncture, I would like to state that frauds of the instant nature involving falsification of book of accounts may differ in the methods adopted but the outcome is no different in that it inflicts a fraud on the public and the securities market. The impact of accounting frauds is far more adverse in dimension that the investors feel cheated on realizing that they were led along the garden path all along. It strikes at the very root of the regulatory fabric which ensures the protection of their interest and secure market integrity. As opposed to the motives of a typical market manipulator, these professionals betray the expectations and reliance placed on them by the shareholders. The auditors should not compromise their position of being agents of the shareholders and get subsumed in the overpowering fame and reputation of the auditee company.

#### **Liability of Audit firms for fraud - SCSL**

188. The noticees in these proceedings are the Audit firms engaged by SCSL as its Statutory Auditor (Price Waterhouse or “PW”) and the two Auditors who signed the Audit report on behalf of Price Waterhouse. I note that S. Gopalakrishnan’s name has been permanently removed from the register of members of ICAI by its order dated May 11, 2012 after holding him guilty of “professional misconduct” under the provisions of the Chartered Accountants Act, 1949. The proceedings initiated by ICAI against Srinivas Talluri is still under appeal before the Appellate Authority of the Institute. The said two auditors are also liable for action under the SEBI Act and PFUTP regulations for their acts of omissions and commissions, as established above.

189. 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 (Price Waterhouse (30112E) and Lovelock and Lewes (301056E)) and not PW Bangalore (007568S). The resources of these firms were utilized as per the resource sharing arrangement between member firms. PW Bangalore (007568S) has paid the other two firms for the services rendered by them in the audit.
- (iii) Talluri Srinivas, one of the partners who certified the accounts of Satyam during the period of the accounting fraud, is a partner in three Price Waterhouse firms (FRN: 7568S, FRN:304026E and 301056E) and S. Gopalakrishnan, the other partner who certified the accounts of Satyam during the period of the accounting fraud, is a partner in two Price Waterhouse firms (FRN:301056E and FRN: 7568S).

190. 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 noticee 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 accounts
  - (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
- (iii) There is no concept of agency in the commission of a wrong.

191. PW Bangalore, Noticee No. 1, in its reply, has submitted, relying on ICAI Accounting Standards that the standards of duty expected from an auditor is different from that expected from the audit firm. It was contended that given that the firm comprises of several other partners, all of them cannot be held liable for the actions of two auditors who may have committed fraud or negligence. In any case, even the aspect of gross- negligence can only be evaluated with respect to the conduct of the Chartered Accountants and not the firms themselves. Regarding the directions proposed, PW Bangalore has submitted that the directions contemplated under the SCNs include prohibiting individual partners of PW Bangalore, from issuing any certificate of audit of listed companies would violate their fundamental rights since the individual partners had nothing to do with the audit of SCSL. Merely because a person is a partner in a firm, he cannot be liable for the criminal acts of another partner unless he in some way connived with them.
192. I have considered the objections of all the firms raised against the directions proposed to be issued in the SCNS. I find that the objections are aimed at restricting the enforcement actions or directions of SEBI to those firms or persons who have been actually responsible for the alleged violations.
193. The noticee firms have essentially distanced themselves from the violations of PW Bangalore and its partners by claiming a separate legal existence, with its liabilities being distinct from other firms, even though they formed part of a common network. The webpage of PWC India (<https://www.pwc.in/about-us.html>) describes itself in the following words: *"In India, PwC has offices in these cities: Ahmedabad, Bengaluru, Chennai, Delhi NCR, Hyderabad, Kolkata, Mumbai and Pune..."* The webpage of PWC global (<https://www.pwc.com/gx/en/about/corporate-governance/network-structure.html>), similarly describes 'PWC' as *"the brand under which the member firms of PricewaterhouseCoopers International Limited (PwCIL) operate and provide professional services. Together, these firms form the PwC network. 'PwC' is often used to refer either to individual firms within the PwC network or to several or all of them collectively."* The webpage also states that the purpose of

PWCIL is "... to act as a coordinating entity for member firms in the PwC network." Member firms of PWCIL can use the PwC name and draw on the resources of the PwC network/member firms of the PwC network. In return for these benefits "...member firms are bound to abide by certain common policies and to maintain the standards of the PwC network as put forward by PwCIL." However while underlining the commonality of the high standards maintained by PwC, the liability for acts or omissions are stated to be restricted to individual firms. I note that the assurance of high standards amongst all the entities in the PW Network is not balanced by corresponding liabilities cast on them for wanton disregard of such standards by any firm in the network.

194. It is relevant for me to make a reference to the settlement order of the Securities and Exchange Commission, US dated April 05, 2011 (hereinafter referred to "the SEC Order") imposing remedial sanctions and a cease and desist order against the Lovelock and Lewes, PW Bangalore, PW & Co. Bangalore, PW Calcutta and PW & Co. Calcutta, in the context of the fraud at SCSL. Relevant extracts of the said order are reproduced hereunder for ease in reference:

*"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.*

*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."*

The SEC Settlement Order was directed against the 5 Indian firms that were registered with the PCAOB and which had given audit certifications with respect to SCSL, in connection with issuance of SCSL's securities in the US. The Order recognizes the liability of the PW network to extend to all India based firms without distinguishing between each firm, as basically it recognized their connection with the global PW network as members of PWCIL.

195. Similarly, the order of the Public Company Accounting Oversight Board (PCAOB), USA dated April 05, 2011 imposing directions against Lovelock and Lewes, PW Bangalore, PW & Co. Bangalore, PW Calcutta and PW & Co. Calcutta, in the context of the fraud at SCSL, made certain observations that indicate that firms forming part of the PW Network functioned as a single unit for all practical purposes. Some of such observations are as follows:

*"7. The assurance practice of the PW India firms has common leadership, including the Assurance Leader, Risk and Quality Leader, Learning and Education Leader, Independence Partner, and Chief Ethics Officer. All of the PwC Network Firms in India share the same Territory Senior Partner and Managing Partner.*

*8. The PwC Network Firms located in India share office space and telephone numbers.*

...

*46... PW India failed to have a system of quality control that provided reasonable assurance that audit personnel were complying with professional auditing standards..."*

196. The ICAI had formulated Rules of Network amongst the Firms Registered with the Institute of Chartered Accountants of India, which came into force with effect from January 06, 2005. The Rules were amended and the new "Guidelines for Networking" came into force with effect from September 27, 2011. Both the old and the new Rules enable the practice of CA firms that are part of Indian or International Networks on a sharing of resources basis. The said Rules treat Networks as being an aggregation of firms which function as a consolidated unit. For instance, one of the requirements of "Ethical Compliance" found in both the old and the new Rules states as follows- *"If one firm of the network is the statutory auditor of an entity then the associate [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 audit firm". Similarly another clause reads - "In those cases where rotation of firms is prescribed by any regulatory authority, no member firm of the network can accept appointment as an auditor in place of any member firm of the network which is retiring."* The said rules too show that ICAI too perceives such networks of firms to be single units for the purposes of avoidance of conflict of interest as well as for the purpose of compliance with regulatory prescriptions.

197. Significantly, the engagement letter (entered into by SCSL with PW) is signed only as *Price Waterhouse* with neither the name of the relevant Auditor nor the specific Audit Partnership firm being recorded explicitly. Similarly, the Annual Reports published by SCSL during 2000-2008 and circulated to its shareholders named SCSL's statutory auditors as "Price Waterhouse, Chartered Accountants" which is an omnibus reference. This kind of certification would appeal to any shareholder/stakeholder to believe that it has been done by the international network of PW. This nomenclature is also seen in the Minutes of the Audit Committee and Board Meetings of SCSL. Therefore, any shareholder or for that matter any stakeholder who is not aware of the distinctly registered partnership firms, would reasonably recognise the statutory auditors as being part of the common entity called Price Waterhouse. All the certifications have been done for SCSL during the relevant period in the name of PW. As such, PWC as an international brand of Auditors, amongst such few multinational brands, was distinctly known and identified by its name. It is but obvious that this global brand recall of PWC carried its own value and influenced the investors to believe in their audit quality of judgment and correctness of the financial statements certified by them. In other words, an unqualified audit carried out by PW would reflect an unimpeachable state of financial affairs of any company audited by the brand.
198. The process of affiliation by the individual firms that are registered with ICAI with the global PW to obtain its affiliation, does not define the inter se rights and obligations of individual firms forming part of the network nor those between the PWCIL vis-à-vis an individual firm. PW India and the firms in its network share the benefits arising out of the brand name and the resources depending on the arrangements/agreements inter se the firms. The brand PWC holds the partner firms in a loose-knit network arrangement, enabling each firm to derive the advantages of the brand value and the synergy without laying down any supervisory mechanisms



to check the quality of the performance of various firms under the network. The network is omnipresent and identifiable by its name. The partners and the individual firms have ostensibly held out to the public to be a single consolidated network of firms under the name PW.

199. A common investor's reliance on the audit certifications of SCSL at the relevant point of time was dependent on the fact that it was attested by one of the internationally reputed firms called PW. The public had no reason to believe that the audit reports were false and misleading. In this context, the long period during which the falsification of account books took place, without the same drawing the attention of PWCIL or other PW entities in India, points to a systemic problem in the audit processes carried out by the PW entities. This failure of quality control system of PW India has also been pointed out by SEC and PCAOB in their orders cited in the foregoing paras.
200. Having taken into account, all the factors relating to the manner in which various firms in India get registered with ICAI showing the name PW (bearing different registration numbers) and the nebulous way in which they are present in various parts of the country, it becomes difficult for me not to take note of the loss of faith of the investors in the brand name. Therefore I am of the view that the directions in the instant case ought to be aimed at the particular Network that was responsible for the fraud in SCSL.

#### **Directions under Sections 11(4) and 11B of the SEBI Act, 1992 for market frauds**

201. The Hon'ble Supreme Court in its judgment dated April 26, 2013 in the matter of *N. Narayanan v. SEBI*, specifically cautioned SEBI in the following words,

*"43. SEBI, the market regulator, has to deal sternly with companies and their Directors indulging in manipulative and deceptive devices, insider trading etc. or else they will be failing in their duty to promote orderly and healthy growth of the Securities market. Economic offence, people of this country should know, is a serious crime which, if not properly dealt with, as it should be, will affect not only country's economic growth, but also slow the inflow of foreign investment by genuine investors and also casts a slur on India's securities market. Message should go that our country will not tolerate "market abuse" and that we are governed by the "Rule of Law". Fraud, deceit, artificiality, SEBI should ensure, have no place in the securities market of this*

*country and 'market security' is our motto. People with power and money and in management of the companies, unfortunately often command more respect in our society than the subscribers and investors in their companies. Companies are thriving with investors' contributions but they are a divided lot. SEBI has, therefore, a duty to protect investors, individual and collective, against opportunistic behavior of Directors and Insiders of the listed companies so as to safeguard market's integrity."*

*(emphasis supplied)*

202. As laid down by the Hon'ble Supreme Court, it is incumbent on SEBI to take stern view of market abuse and fraudulent practices, particularly when persons tasked with protecting the interest of investors are themselves hand- in-glove with the main perpetrators of the fraud. It is in this context that these proceedings must be viewed.
203. It needs to be borne in mind that PW firms have benefited from the relationship from SCSL, by having collectively received a fee of ₹23,31,60,070/- during the years 2000-2008. Out of this amount, ₹13,09,01,664/- was paid towards PW Bangalore (FRN 7568S) for the audit of SCSL, as submitted by it. Given that this remuneration was the identifiable monetary gain made by PW in its association with the audit of SCSL, it is clear that this wrongful gain is liable to be disgorged. Though the legal portions of that gain or costs such as taxes paid are required to be reduced, the noticees have not provided details of such costs or expenses in their replies. Consequently the entire gain made from PW's relationship with SCSL shall be treated as wrongful gain liable to be disgorged.
204. Any enforcement measure taken by SEBI with a preventive and remedial object, as envisaged under section 11B of the SEBI Act, would not serve the purpose unless the directions bring within its fold the PW Network operating in India. The objective of insulating the securities market from such fraudulent accounting practices perpetrated by an international firm of repute will be ineffective if the directions do not bring within its sweep, the brand name PW. The network structure of operations adopted by the international accounting firm should not be used as a shield to avoid legal implications arising out of the certifications issued under the brand name of the network.

205. In view of the above, in exercise of the powers conferred upon me under sections 11 and 11B of the SEBI Act, and Regulation 11 of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to the Securities Market) Regulations, 2003, read with section 19 of the SEBI Act, 1992, I hereby pass the following directions:-

- i. Entities/firms practicing as Chartered Accountants in India under the brand and banner of 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 and the requirements under the SEBI Act, 1992, the SCRA 1956, the Depositories Act, 1996, those provisions of the Companies Act 2013 which are administered by SEBI under section 24 thereof, the Rules, Regulations and Guidelines made under those Acts which are administered by SEBI for a period of two years.
- ii. Noticee Nos. 12 and 13, shall not directly or indirectly issue any certificate of audit of listed companies, compliance of obligations of listed companies and intermediaries registered with SEBI and the requirements under the SEBI Act, 1992, the SCRA 1956, the Depositories Act, 1996, those provisions of the Companies Act 2013 which are administered by SEBI under section 24 thereof, the Rules, Regulations and Guidelines made under those Acts which are administered by SEBI for a period of three years.
- iii. Noticee No. 1 along with Noticee Nos. 12 and 13 shall be liable, jointly and severally, to disgorge the wrongful gains of ₹13,09,01,664/- with interest calculated at the rate of 12% per annum from January 07, 2009 till the date of payment. Noticees shall pay the said amounts within 45 days from the date of this Order either by way of demand draft drawn in favour of '*Securities and Exchange Board of India*', payable at Mumbai or by e-payment to SEBI account as detailed below:

<b>Name of the Bank</b>	<b>Branch Name</b>	<b>RTGS Code</b>	<b>Beneficiary Name</b>	<b>Beneficiary Account No.</b>
Bank of India	Bandra Kurla Branch	BKID 0000122	Securities and Exchange Board of India	012210210000008

- iv. Listed companies and intermediaries registered with SEBI shall not engage any audit firm forming part of the PW 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.

206. This order shall come into force with immediate effect. For removal of operational difficulties, this order will not impact audit assignments relating to the financial year 2017-18 undertaken by the firms forming part of the PW network.
207. A copy of this order shall be served upon the stock exchanges and the depositories for necessary action and compliance.

**DATE: January 10, 2018**

**PLACE: Mumbai**

**G. MAHALINGAM**  
**WHOLE TIME MEMBER**  
**SECURITIES AND EXCHANGE BOARD OF INDIA**