

**BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA
CORAM: MADHABI PURI BUCH, WHOLE TIME MEMBER
FINAL ORDER**

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

**In Re: Securities and Exchange Board of India (Prohibition of Fraudulent and
Unfair Trade Practices Relating to Securities Market) Regulations, 2003**

In respect of:

S. No.	Name of the Entity	DIN/ PAN
1.	Mr. Rajendra Gothi	02211363
2.	C.V. Pabari & Co., Chartered Accountants	AABPP5757A

In the matter of Parekh Aluminex Limited

BACKGROUND

1. Parekh Aluminex Limited (hereinafter referred to as '**PAL / company**') is engaged in the manufacture of aluminum foil containers, aluminum foil rolls and other related products. The company came out with public issue in January, 1997. The equity shares of the company were listed on the BSE Ltd. on December 16, 2004 and on the National Stock Exchange of India Ltd. on November 21, 2006. It is noted that the company has been compulsory delisted by BSE Ltd. with effect from July 04, 2018.

2. The details of Board of Directors of the company for the period 2010-2012 are as follows:

As on March 31, 2010	As on March 31, 2011	As on March 31, 2012
Late Mr. Amitabh Parekh (CMD)	Late Mr. Amitabh Parekh (CMD)	Late Mr. Amitabh Parekh (CMD)
Mr. Rajendra Gothi (ED)	Mr. Rajendra Gothi (ED)	<i>Resigned on October 25, 2011.</i>
Mr. Devanshu Desai (NEID)	Mr. Devanshu Desai (NEID)	Mr. Devanshu Desai (NEID)
Mr. Kiran C Parikh (NEID)	Mr. Kiran C Parikh (NEID)	Mr. Kiran C Parikh (NEID)
Mr. Vikram Mordani (NEID)	Mr. Vikram Mordani (NEID)	Mr. Vikram Mordani (NEID)

The financial statements of the company have been audited by Mr. Chetan Pabari, Proprietor of M/s C V Pabari & Co. for FY 2009-10, 2010-11 and 2011-12.

3. From the share price table below, it is observed that there was a major fall in the share price of the company after the demise of late Mr. Amitabh Arun Parekh in January, 2013. Subsequently, the stock has fallen to still lower levels of around ₹ 10/-



4. The last available shareholding pattern as available on BSE Ltd. website is as on

December 31, 2013 which is as follows:

S. No.	Category	% of share held as on December, 2013
1.	Promoters	6.22
2.	Non-promoters	
	Institutional Shareholding	15.83
	Non-institutional Shareholding	77.95
	Total	100.00

5. Securities and Exchange Board of India (hereinafter referred to as '**SEBI**') received a reference dated December 15, 2015 from the State Bank of India (hereinafter referred to as '**SBI**') informing that the "*Due Diligence Audit*" Report dated June 28, 2013 of PAL carried out for the period 2012-2013 by Deloitte Touche Tohmatsu India Pvt. Ltd. (hereinafter referred to as '**Deloitte**') observed various irregularities of serious nature in the day to day affairs of PAL. SBI also informed that they reported the account of PAL as fraud and lodged a complaint with Central Bureau of Investigation. The said complaint filed by SBI *inter alia* alleged that PAL and its Directors fraudulently availed credit facilities from a consortium of banks including SBI, misused such credit facilities with an intention to defraud and cheat the banks, thereby causing a loss to the tune of ₹ 122.07 crore and interest and other charges to SBI.
6. Pursuant to the aforesaid reference, an examination was carried out by SEBI to ascertain the following:
- Whether books of accounts of the company were manipulated?
 - Whether the company has misrepresented its business operations?
 - To examine any other related violations.

INTERIM ORDER CUM SHOW CAUSE NOTICE

7. Consequent to the examination, an *interim order* dated August 30, 2017 was passed against the company, Mr. Rajendra Gothi, Executive Director (hereinafter referred to

as '**Noticee No. 1**') and M/s C.V. Pabari & Co., statutory auditor (hereinafter referred to as '**Noticee No. 2**') in the extant matter. The Noticees were advised to show cause as to why suitable actions/directions in terms of Sections 11(1), 11(4) and 11B of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as '**SEBI Act**') should not be initiated against them for the alleged violation of the provisions of Sections 12A (a), (b) and (c) of the SEBI Act and Regulations 3(b), (c) and (d) read with Regulations 4(1) and 4(2)(a), (e), (f), (k) and (r) of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 (hereinafter referred to as '**PFUTP Regulations**').

8. Further, PAL was advised to show cause as to why suitable actions/directions in terms of Sections 11(1), 11(4) and 11B of SEBI Act should not be initiated against the company for the alleged violation of the provisions of Regulations 4(1) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (hereinafter referred to as '**LODR Regulations**'). Noticees No. 1 was also advised to show cause as to why suitable actions/directions in terms of Sections 11(1), 11(4) and 11B of SEBI Act should not be initiated against him for the alleged violation of the provisions of Regulations 4(2) of LODR Regulations.
9. The *interim order* was passed taking into account the facts and circumstances described therein, which are, *inter alia*, summarised as under:-
 - The financial statements of the company have been prepared till September 30, 2013. After the financial statements for FY 2011-12, provisional financial statements were made for 18 months from April 01, 2012 to September 30, 2013.
 - From the Balance Sheet submitted by the company, it was observed that there was a sharp surge in the Loans and Advances from ₹ 169 crore as on March, 2012 to ₹ 1,353 crore as on December 31, 2012 (an increase of 700% in just 09 months) and ₹ 1243 crore as on September 30, 2013. Further, the operating profit for the FY 2011-12 was ₹ 120 crore but the operating profit for the period April, 2012 –

September, 2013 was negative, i.e., a loss of ₹ 1,423 crore.

- The financial statements of PAL for FY 2010-2011 and FY 2011-2012 were audited by its statutory auditors, Mr. Chetan Pabari, Proprietor of M/s C V Pabari & Co., Chartered Accountants. After the death of Mr. Amitabh Parekh, PAL requested M/s Chaturvedi & Shah to conduct an audit of the interim financial information of PAL. Accordingly, M/s Chaturvedi & Shah audited the Financial Statements for the period of 09 months starting from April, 2012 to December, 2012. M/s Chaturvedi & Shah resigned in June 2014 stating that they could not obtain audit evidence to their satisfaction for nearly all of the assets of the company, hence they could not form an audit opinion on the financial statements. After the resignation of M/s Chaturvedi & Shah in June, 2014, the financial statements for the entire period of 18 months starting from April, 2012 to September, 2013 have been audited by M/s Paresh Rakesh and Associates. They also resigned from the company on November 29, 2016 stating that in spite of their best efforts they were not able to get proper representation/records from the company which they believed were required to complete the audit and form an opinion or otherwise on the accounts of the company.
- The Auditors (M/s Chaturvedi & Shah) noted in their Report that Loans and Advances of ₹ 1,079.18 crore which were given in earlier FYs (which were audited by M/s C V Pabari & Co.) were netted off against the short term bank borrowings. As a result of the same, both bank borrowings and loans and advances given by the company were understated in previous financial statements of PAL (audited by M/s C V Pabari & Co.). It was after their proper classification, both the Loans and Advances as well as the *Borrowings* have increased as on December, 2012 (audited by M/s Chaturvedi & Shah).
- The report of Deloitte further indicates that the Loans and Advances of the company as on April 01, 2012 are ₹ 1,284. 13 crore instead of ₹ 169 crore. This

was also confirmed by Auditors, viz. M/s Chaturvedi and Shah and M/s Paresh Rakesh and Associates as can be seen from the balance sheet of the company (certified by these auditors).

- From the report filed by Deloitte, it was noted that as on December 31, 2012, loans amounting to ₹ 1,314.78 crore were granted by PAL to various companies without any documentation specifying the terms and conditions. These loans were disbursed without any security. Out of the total value of loans given by PAL as on December 31, 2012 (which amounted to ₹ 1,314.78 crore), loans outstanding to the extent of ₹ 869.25 crore were advanced to several entities including its related entities as interest free loans.
- The Deloitte report also indicated that PAL had also made payments amounting to ₹ 207.78 crore to related parties during the period April, 2012 to December, 2012 and out of this an amount of ₹ 34.49 crore were adjusted against other liabilities/expenses. The report also observed that there was no movements of receipts or payments in respect of the loan outstanding for 73 borrowers, amounting to ₹ 264.74 crore.
- The Auditors have also raised concerns that the advances are in excess of the limits under the Section 372A of the Companies Act, 1956 and some of them are interest free or given at lower than bank rate, for which approvals required under the said section, have not been obtained.
- The company had not made the provision for obsolescence for such inventories which have remained unused for a considerable period. After this, on an analysis of Balance Sheet as on September 30, 2013 and Profit & Loss Account for the period April, 2012 – September, 2013, it was observed that the company has written off substantial amount of debtors, inventories and other tangible assets in order to provide the correct picture of the affairs. As a result of the same, Reserves have been reduced by ₹ 936 crore.

- The amount of inventories and debtors have reduced considerably as on December, 2012. There is corresponding increase in the Non-current Assets. Referring to the same, Auditors have opined that inventories and debtors should be classified as “*Current Assets*” instead of classifying them as “*Non-current Assets*”.
- The policy of the company to account the gratuity on payment basis is not accordance with Accounting Standard 15- “*Employee Benefits*” which requires to make the provision for gratuity payable based on the actuarial valuation.
- Loans amounting to ₹ 38.16 crore extended to companies trading in bullion were adjusted against expenses not directly attributable to company’s business.

10. Thus, it was *prima facie* alleged that PAL and its Executive Director, viz. Mr. Rajendra Gothi with the aid and assistance of the Statutory Auditor, M/s C.V. Pabari & Co., have manipulated the books of accounts and misstated the financial statements of the company in violation of provisions of SEBI Act and PFUTP Regulations. Further, it was *prima facie* alleged that PAL and its Executive Director, viz. Mr. Rajendra Gothi have failed to make genuine and accurate disclosures regarding the true financial status of the company in violation of provisions of provisions of LODR Regulations.

REPLY & HEARING

11. Pursuant to the *interim order*, Noticee No. 2 through its Authorized Representative (hereinafter referred to as ‘AR’), Finsec Law Advisors, requested for an inspection in the matter vide a letter dated September 14, 2017. Similarly, Noticee No. 1 also requested for an inspection in the matter through its AR, Kartikeya & Associates, matter vide a letter dated October 10, 2017. The request of the Noticees was acceded to and Noticees No. 2 and 1 were provided an opportunity of inspection on October 11, 2017 and November 17, 2017 respectively.
12. Noticee No. 2 conducted inspection on the scheduled date. Vide a letter dated October 26, 2017, the AR of Noticee No. 2 requested for additional 30 days’ time to

reply to the *interim order*.

13. The AR of Noticee No. 2 vide a letter dated November 27, 2017 submitted a reply.

The submissions of the Noticee No. 2 is summarized hereunder:

- Noticee No. 2 were the statutory auditors of the company during the period between FY 1994-95 to FY 2011-12. They resigned after certifying the audit report for FY 2011-12 (hereinafter referred to as '**Audit Report**').
- Noticee is not in possession of any documents pertaining to the audit and the company has not co-operated by sharing the documents with the Noticee. Therefore, the reply is being filed solely on the basis of recollection from memory of the audit functions performed by the Noticee while preparing the Audit Report.
- Noticee No. 2 was diligent in the preparation of the Audit Report and had not negligently certified the loans and advances. It is submitted that the company had borrowed from banks to advance money to suppliers for the purchase of capital goods and raw materials. In certain cases, the company borrowed the money from banks by mortgaging property of third parties, which was advanced to such suppliers.
- It is further submitted that the responsibility to prepare the financial accounts is on the management of the company. During the preparation of accounts, the management had netted off the loans and advances given to various parties against the short term bank borrowings. These financial accounts were placed before and approved by the Audit Committee and the Board of Directors of the company. On the basis of discussions with the management and various documents and information provided the management of the company, Noticee No. 2 had in good faith accepted such a treatment in the financial statements as, in their opinion, it provides a true and fair value of the financial situation of the company.
- Further, the company was on a growth trajectory and had been regularly paying its interest obligations to the banks. It was also regular in payment of its dues to

various government departments in the form of taxes and levies. In light these reasons, the Noticee No. 2 had no reason to suspect the commission of any fraud while certifying the financial statements.

- It is submitted that an auditor is not bound to conduct an investigative analysis and is entitled to rely upon the representations provided by the management with reasonable care. Being in a position of responsibility as statutory auditors, Noticee No. 2 had never blindly relied on such statements and representations and had conducted audit on a widely accepted test check basis by applying sampling techniques.
- It is also submitted that as part of the audit, confidential reports were procured from lending banks by Noticee No. 2 and the banks had not expressed their disagreement over the outstanding amount of bank borrowings in the books of the company. The alleged wrongful netting off treatment would have been rectified had it been mentioned by the banks in the confidential reports.
- The lending banks had steadily increased the limits on the loans advanced to the company year after year. Prior to each such increase, the banks conducted an audit of the financial statements of the Company. It is submitted that even these audits had not revealed any irregularities in the financial statements.
- The alleged irregularities viz., wrong classification of inventories and debtors as "non-current" assets instead of "current" assets, wrong drawing power calculation, sharp decline in inventory, book debts and gross block and loans given to companies trading in bullion, were observed subsequent to the resignation of Noticee No. 2 as the statutory auditors, such alleged irregularities in the financial statements are not certified by Noticee No. 2.
- It is alleged that the company gave Loans and Advances in excess of the limits specified under Section 372A of the Companies Act, 1956. It is submitted that the total amount given as loans and advances by the company is less than 15% of the total paid-up equity share capital and reserves & surplus of the company as per

the annual reports of FY 2011. It is submitted that since the financial statements prepared reflecting these transactions were approved by the Audit Committee and the Board of Directors of the company, Noticee No. 2 genuinely believed that the requisite conditions specified under Section 372A, including obtaining the board approvals, were duly fulfilled by the company.

- As per the prevalent audit practice, it is the duty of the management of the company to provide information on matters of a technical nature such as obsolescence of inventory. As Noticee No. 2 is not technically adept to conclusively determine the quality and efficiency of the inventory, they relied on the representations given by the management. It is further submitted that a stock audit is conducted every year by one of the banks from the consortium of banks. However, there were no adverse findings reported in such stock audit reports.
- Accounting Standard 15 deals with the accounting treatment of the cost of retirement benefits in the financial statements of the employers. As mentioned in the annual reports of the company, the company had only provided provident fund to their permanent employees and the same has been duly recorded during the preparation of the financial statements for FY 2011-12. Gratuity was not paid to the employees by the company and therefore, no provision was created.
- Regarding the lack of documentation for loans entered into by the company, the Noticee submitted that the company had given an explanation to the Noticee No. 2 stating that the company had given such advances to ensure a smooth and regular supply of imported raw materials and capital goods. It is submitted that Noticee No. 2 did not blindly rely on such averments and had perused the loan confirmations and other relevant documents to their satisfaction at the time of preparation of the Audit Report.
- SEBI is required to prove that there is a *prima facie* case that the company employed a device or scheme to defraud investors and the Noticee No. 2 aided and abetted the company in such acts. It is submitted that SEBI has not demonstrated

how investors of the company were defrauded by actions of Noticee No. 2. In the Order, no facts or evidence have been presented to show that Noticee No. 2 intentionally concealed or falsified any of the transactions undertaken by the company to provide an incorrect picture of the financial health of the company. Hence, it is submitted that SEBI has grossly erred in charging Noticee No. 2 of having violated Section 12A (a), (b), and (c) of the SEBI Act and Regulation 3 (b), (c), and (d) of the PFUTP Regulations.

- In the case at hand, the Order has not alleged at any point that Noticee No. 2 dealt in securities or was involved in dealing in securities which operated as fraud or deceit.
- Regulation 4(2)(a) of the PFUTP Regulations would be applicable on the commission of an act which creates false or misleading appearance of trading in the securities market. In the instant case, it is not shown that Noticee No. 2 has even traded in the securities market.
- The language of Regulation 4(2)(e) of the PFUTP Regulations indicates that it would be applicable if there is evidence to show that there has been a 'manipulation of the price of a security'. In the Order, there is not even a hint of evidence to show that any act of Noticee No. 2 amounted to 'manipulation of the price of a security'.
- Noticee No. 2 did not intentionally publish or cause to publish any information which they did not believe to be true. The Noticee No. 2 merely acted as per their professional mandate and undertook the activities in good faith, without having any knowledge of the alleged fraud of fund diversion and misstatements in the books of accounts of the company.
- The Order has not shown that Noticee No. 2 undertook any activity with the objective of luring investors to buy the shares of the company.
- Finally, Regulation 4(2)(r) of the PFUTP Regulations states planting false or misleading news which may induce sale or purchase of securities to be one of the

fraudulent ways of dealing in securities. It is submitted that the Order has not alleged Noticee No. 2 to have knowingly planted false or misleading news/information. Further, there is no evidence to show that any actions of Noticee No. 2 had induced the sale or purchase of securities of the company.

- It is submitted that Noticee No. 2 has been falsely alleged to have aided and abetted the management in the falsification of the accounts. The financial accounts of the company were prepared by the management and Noticee No. 2 had not colluded with the management in the preparation of such statements.

14. Vide a letter dated April 04, 2018, Kanga & Co., informed SEBI that they were the current AR of the Noticee No. 1 and submitted that due to certain inadvertence on part of the erstwhile AR, Noticee No. 1 could not conduct the inspection in the matter. Therefore, the AR requested for another opportunity of inspection. The request of the Noticee No. 1 was acceded to and an opportunity of inspection was granted to the Noticee on April 11, 2018. The inspection was conducted by the Noticee No. 1 on the scheduled date.

15. Vide hearing notice and email dated February 23, 2018, Noticees No. 1 and 2 were granted an opportunity of hearing on April 25, 2018. In response to the hearing notice, Noticee No. 1 requested for the adjournment of hearing. Considering the request of the Noticee No. 1, the Noticee was granted a final opportunity of hearing on May 30, 2018.

16. On the day of hearing on April 25, 2018, Mr. Anil Kumar Choudhary, Partner, Finsec Law Advisors and Mr. Chetan Pabari, Chartered Accountant appeared on behalf of Noticee No. 2 and made *inter alia*, the following oral submissions:

- That Noticee was auditor of PAL from 1995 to 2012 and has carried out its duties diligently.
- That in the present case there might be diversion of funds by PAL and the same is not being challenged by Noticee.

- That Noticee was negligent but there is no material on record to show that they have certified anything with fraudulent intention and Noticee's negligence should be tantamount to be fraud/fraudulent activities.
- In interim order-cum-show cause notice dated August 30, 2017, it has not been proved that as to how the auditor has benefitted himself from his negligence.
- A specific opportunity to reply on whether the negligence by Noticee over a period of time (since Noticee was the auditor of the company from 1995 to 2012) would not amount to abetting and aiding in fraud unless proved otherwise. No reply in this regard was given by ARs.

Further a specific opportunity to reply on the following questions was given to the ARs at the time of hearing. The reply of ARs to the questions is as follows.

- (a) As per the due diligence audit report of Deloitte, Loans and Advances given by the company to various parties as on March 31, 2012 are ₹ 1,284 crore. However, from the annual report 2011-12, it is noted that the amount of Loans and Advances shown in the books of the company as on March 31, 2012 is ₹ 169 crore.

Answer: ARs replied that the Noticee was aware that the actual loans were more than ₹ 1,000 crore. ARs also stated that these loans were advanced by the company to its suppliers. The company has done netting off for loans and therefore, loans and advances given by the company were netted off against the short term bank borrowings. The netting off was being done by the company for 3 to 4 years. On further questioning as to under which provision of Accounting Standard the same is being allowed, ARs failed to reply.

- (b) The advances given by the company were in violation of Section 372A of the Companies Act, 1956. Whether, the Noticee checked the relevant compliances with Section 372A of the Companies Act, 1956 and Companies (Auditor's Report) Order, 2003?
- (c) It has been noted from Audit report of Deloitte that interest free advances as on

April 01, 2011 amounted to ₹ 156.07 crore. However, in the annual report for 2011-12, the total Loans and Advances are mentioned at ₹ 23.16 crore only.

Answer: ARs replied that the Noticee relied on management representation for the same. The Noticee also relied on management representation for interest free advances. ARs, further stated that the Noticee does not remember much details as the matter is 6 to 7 years old. ARs further stated that the Noticee was not aware that the funds were being diverted to real estate.

(d) Whether the Noticee maintained the documentation entered into by the company with the borrowers defining the terms and conditions and security against which these loans were disbursed?

Answer: The Noticee had not maintained any documentation entered into by the company with the borrowers defining the terms and conditions and security against which these loans were disbursed.

- ARs summarized that that the interim order-cum-show cause notice dated August 30, 2017 has been passed by SEBI on the basis of a complaint by State Bank of India and “Draft Audit Report” of Deloitte. SEBI has not done its independent investigation in the matter. SEBI is not entitled to trust on the report of other auditors as these reports can also be false and misleading. ARs accepted that there have been lapse in the Accounting Standard but lapses in the Accounting Standard does not amount to the violation of PFUTP Regulations. Further, SEBI does not have the jurisdiction to determine that lapses in Accounting Standard would amount to fraud. ARs also stated that let other investigative agencies examine the case and submit report to SEBI. Further, the Noticee was not involved in any fraud, therefore, SEBI cannot charge the Noticee under its PFUTP Regulations as alleged in the interim order cum show cause notice dated August 30, 2017. ARs requested to take lenient view in the matter.
- ARs were granted time till May 10, 2018 to submit its additional written

submissions in the matter.

17. Pursuant to the hearing, the AR of Noticee No. 2 made additional written submissions vide its letter dated May 10, 2018. The same are summarized hereunder:

- It is submitted that the alleged offence of negligence in certifying a false and misleading Audit Report of the company and lacking professionalism in audit, is a matter which is not related to the securities market and is outside the regulatory purview of SEBI. SEBI neither has the legislative competence nor the technical expertise or skill-set to investigate and decide whether Noticee No. 2 had certified a false and misleading Audit Report or whether it lacked professionalism while carrying out its audit functions. SEBI is the capital markets' regulator in India and has direct jurisdiction over frauds involving listed companies and their Directors, but such powers are fettered by legislative boundaries.
- SEBI has relied upon a draft report by Deloitte and complaint letters filed by SBI. SEBI has not conducted its own investigation nor has it individually determined whether the contents of the draft report and complaint letters are true and accurate. It is submitted that SEBI cannot rely on the draft report and complaints filed by private persons for issuing any preventive or remedial order against any person. It either has to conduct its own investigation and based on an investigation report can charge an individual/person for any violation of securities laws, or in the alternative SEBI can rely on orders or determination of fraud by any other governmental or regulatory agency and on the basis take preventive and remedial actions against such persons.

18. Mr. Kunal Mehta, Advocate and Ms. Nikita Vardhan, Advocate attended the hearing on behalf of Noticee No. 1 on May 30, 2018 and made *inter alia*, the following oral submissions:

- That as per the interim order-cum-show cause notice dated August 30, 2017, Mr. Rajendra Gothi was a Director of PAL for a limited period of time and he resigned from the post of director on October 25, 2011. Further, he was associated with

PAL from year 1995 and he joined the board in year 2009 i.e. he was Director of PAL from October 01, 2009 and resigned on October 25, 2011. He was the chairman of Audit Committee prior to October 01, 2009.

- That after the resignation of Mr. Rajendra Gothi on October 25, 2011, he was no longer associated with PAL. Further, he is also not shareholder of PAL.
- That the alleged irregularities/wrongdoing mentioned in the interim order pertain to the period when Mr. Rajendra Gothi was not the Director of PAL.
- That these proceeding was initiated on the basis of reference received from State Bank of India on December 15, 2015, the reference was on the basis of due diligence report of PAL i.e. Deloitte report dated June 28, 2013 for a period between financial year 2012-13.
- That State Bank of India (Lender) complaint dated December 14, 2015 to SEBI regarding alleged irregularities/wrongdoing does not mention the name of Mr. Rajendra Gothi i.e. the initiator of the complaint does not deemed fit to pursue complaint against Mr. Rajendra Gothi.
- That Mr. Rajendra Gothi had not signed the financial results for financial year 2011-12.
- That the interim order-cum-show cause notice dated August 30, 2017 passed by SEBI was on the basis of "Draft Audit Report" of Deloitte which is not yet finalized.
- That interim order-cum-show cause notice is vague as it did not state in which years PAL has taken loans and whether Mr. Rajendra Gothi was also charged in the capacity of Chairman/member of Audit Committee.
- That Mr. Rajendra Gothi was not aware about any alleged irregularities/wrongdoing mentioned in the interim order.
- That PAL was a company driven by single Promoter namely Late Mr. Amitabh Parekh and he was a sole decision making person and same was also confirmed by the Indian Overseas Bank.
- That there is no allegation in the interim order as to how the misstatement of

financials in balance sheet of PAL had an impact on securities market or has resulted into manipulation in the price of shares of PAL.

- That Mr. Rajendra Gothi had not violated any provision of SEBI Act and PFUTP Regulations as alleged in the interim order.
- That insolvency proceedings are being carried out under Insolvency and Bankruptcy Code for PAL. Mr. Rajendra Gothi had resigned from PAL in October, 2011 and has not associated with PAL and he does not have any access to the documents.
- Noticee/ARs were advised to submit following information along with documentary evidence:
 - ARs were advised to submit the date on which the resignation of Mr. Rajendra Gothi was uploaded on ROC/MCA website along with documentary evidence.
 - ARs were advised to submit the date on which the loan was taken by PAL from SBI along with documentary evidence.
 - ARs were advised to submit the bank loan agreement.
 - During the tenure of Chairman/Member of Audit committee as well as Director of PAL, ARs were advised to furnish an affidavit stating that Mr. Rajendra Gothi was not aware about any alleged irregularities/wrongdoing mentioned in the interim order. Further, affidavit should be specific in nature i.e. Mr. Rajendra Gothi was not aware of netting, Loans and Advances given/received without documentation etc. In affidavit, Mr. Rajendra Gothi is also required to give the reason for signing the financial results despite not being aware about the above matters.
- ARs were granted time till June 14, 2018 to submit aforesaid documentary evidence, affidavit and additional written submissions in the matter.

19. Pursuant to the hearing, the AR of Noticee No. 1 made written submissions vide his letter dated July 17, 2018. The same are summarized hereunder:

- Noticee No. 1, though was a Director on the board of PAL but was never in charge

of day to day affairs of business. He was only in charge of marketing activities in respect of PAL. He was not aware of any financial dealings of PAL and was not privy to any details pertaining to the same. Therefore, his act of merely signing PAL's financial statements for the Financial Years 2009-10 and 2010-11 ought not to be construed as him having knowledge of their contents. He signed the financial statements for the FYs 2009-10 and 2010-11 in good faith and on account of trust reposed on Late Mr. Amitabh Parekh, the erstwhile Chairman and Managing Director of PAL and the auditors of PAL. His signature was taken only for the purpose of fulfilling legal requirements and compliances.

- Mr. Rajendra Gothi was the Chairman of the Audit committee of the PAL for the period 2010-11.
- He resigned from PAL's Board of Directors on 25th October 2011. He has signed financial statements of PAL for the FYs 2009-10 and 2010-11. The relevant period for the purpose of SEBI's order and investigation report are FYs 2010-11, 2011-12 and 2012-13.
- It is submitted that there is no valid show cause notice in law; that the same does not disclose any material particulars or allegations against him and he is therefore not in a position to ascertain the charge which is levelled against him.
- Mr. Rajendra Gothi served as a purported Director on PAL's board till October 25, 2011. As against this, the entirety of the allegations of purported wrongdoings in relation to PAL's financial statements, pertain to a period subsequent to March 2012.
- Further, assuming whilst denying that there were any misstatements or increase in the value of loans and advances in the year prior to 2011, Mr. Rajendra Gothi cannot be held liable for the same since the alleged loans/advances were not brought to the notice of the Board of Directors of PAL. The show cause notice issued by SEBI also does not clearly mention the allegations with respect to the previous financial years.

- As the alleged offence is alleged to be an offence committed by PAL, Section 27 of the SEBI Act is also to be considered and its provisions are to be given effect to. If this is done, it would then become apparent that Mr. Rajendra Gothi's knowledge and participation in the alleged wrongdoings would become necessary for SEBI to proceed against him and a finding of fact would have to be rendered for this purpose. In the present case, firstly, apart from a mechanical reproduction of the statutory language contained in the SEBI Regulations, there is no independent allegation against Mr. Rajendra Gothi which would implicate him or even disclose a cause of action in relation to the alleged wrongdoings alleged in the impugned Order show cause notice. This by itself demonstrates that the requirements of Section 27 of SEBI Act are not fulfilled and it is not a fit case for Mr. Rajendra Gothi to be proceeded against. Secondly, going by the factual position that the allegations pertain to a period post Mr. Rajendra Gothi's resignation and in any event, Mr. Rajendra Gothi was involved in the marketing activities of PAL and was not involved in his day to day management or financial dealings. In any event and without prejudice, the aforesaid proves that the alleged offence was committed without his knowledge.
- The alleged misstatements in the financial statements of PAL do not have any connection with the securities of PAL which were listed on the stock exchanges. As such, SEBI does not have jurisdiction in the matter.

20. It is noted from the material made available on record that except submitting Form 32 of Noticee No. 1, the ARs have not submitted the other documents sought from them at the time of hearing including the Affidavit referred to in paragraph 18.

FINDINGS & CONSIDERATIONS

21. I have perused the *interim order*, written and oral submissions and other materials available on record. On perusal of the same, the following issues arise for consideration. Each issue is dealt with separately under different headings.

- (i) Whether PAL has misstated its accounts, adopted dubious practices in drawing up accounts and misrepresented its business operations?
- (ii) If answer to issue No. (i) is in affirmative, who all are liable for misstatement of accounts and misrepresentation of company's business operations?
- (iii) If answer to issue No. (ii) is in affirmative, whether the Noticees have violated the provisions of SEBI Act read with PFUTP Regulations?
- (iv) Whether Noticee No. 1 has violated provisions of LODR Regulations?
- (v) If answer to issue Nos. (iii) and (iv) are in affirmative, what directions, if any should be issued against the Noticees?

22. Before proceeding to deal with the above mentioned issues, I deem it necessary to deal at the outset of the proceeding itself, with a common preliminary issue raised by the Noticees related to "jurisdiction". Noticees have submitted that the alleged offence of negligence in certifying a false and misleading Audit Report of the company and lacking professionalism in audit, is a matter which is not related to the securities market and is outside the regulatory purview of SEBI. Further, it has also been submitted that the alleged misstatements in the financial statements of PAL do not have any connection with the securities of PAL which were listed on the stock exchanges. As such, SEBI does not have jurisdiction in the matter. In this regard, I note that SEBI is required to regulate the securities market and, therefore, can take remedial measures in connection with safeguarding the interest of investors which is within the domain of SEBI. Further, SEBI has got inherent powers to take all necessary steps to safeguard the interest of investors and securities market. The powers conferred under various provisions of the SEBI Act viz., Sections 11 (1), 11 (4), 11B and 12 are wide enough to cover an eventuality as in the present matter and it cannot be given any restrictive meaning as suggested by the Noticees. Investors, amongst others, are guided by the books of account and financial statements of the company while dealing in its securities. Therefore, in a given case, if the financial statements have been drawn up without following the norms and standards of

accounting, SEBI has jurisdiction to take regulatory measures for protecting the investors interest by taking appropriate steps against the Auditor.

23. In this context, I would like to quote the observations of the Hon'ble High Court of Bombay in the matter of *Price Waterhouse & Co. et. al. Vs. SEBI* in the Writ Petition No. 5249 of 2010:

"The SEBI in its capacity as a Market Regulator can take any of the measures mentioned in subsection (2) of Section 11 towards the said end. The said measures are only illustrative and not exhaustive and in a given case the SEBI considering the duty it is enjoined with may take such measures as it deems appropriate. In our view, the words employed in the aforesaid provisions are of wide amplitude and would therefore take within its sweep a Chartered Accountant if his activities are detrimental to the interest of the investors or the securities market."

24. In view of the above, it is held that SEBI Regulations are wide enough to be attracted to cover the nature of allegations made in the *interim order* and it cannot be said that SEBI is transgressing its jurisdiction while inquiring into the conduct of Auditors in certifying the books of accounts of a listed company as the same is to effectuate the purpose of the SEBI Act and the Regulations framed thereunder.

Issue No. 1 - *Whether PAL has misstated its accounts, adopted dubious practices in drawing up accounts and misrepresented its business operations?*

25. I note that to arrive at a finding, the following two sub-issues needs to be addressed:

a) Whether the accounts of the company were showing understated figures of Borrowings and Loans and Advances as on March, 2012?

b) Whether the company has misrepresented its business operations?

i. Whether the accounts of the company were showing understated figures of Borrowings and Loans and Advances as on March, 2012?

26. It is noted from the Balance Sheet of the company for the FY 2011-12 that the outstanding Loans and Advances were ₹ 169 crore. The same had increased to ₹ 1,353 crore as on December, 2012. The financial due diligence report prepared by Deloitte provided the following summary of Loans and Advances given by the company:

Particulars	Balance as on April 01, 2012 (₹ in crore)	Balance as on December 31, 2012 (₹ in crore)
J K Shah Group	119.25	110.54
Kamlesh Kanungo Group	706.04	548.50
Kirti Kedia- Transcon Group	306.94	513.08
Orbit Group	10.73	10.73
Related entities	18.80	27.45
Shanti Dalal	1.95	3.50
Vishal Sharma Group	28.88	23.67
Y A Mamaji Group	7.83	7.83
Other Unsecured Loans	83.71	69.49
Total	1284.13	1314.78

27. Noticee No. 2 has submitted that Loans and Advances given to various parties were netted off against the short term borrowings. I note that at the time of the hearing when a specific question was put to the ARs of the Noticee No. 2 as to under which provision of Accounting Standard the same is being allowed, the ARs had failed to reply. Further, Noticee No. 2 did not submit any response to aforesaid query in its additional written submissions, post hearing. ARs at the time of hearing had accepted that there have been lapse in the Accounting Standard. I find that netting off Loans and Advances against the short term borrowings, is not in line with the prevalent accounting practice. When a company has borrowed money from the bank and uses it to provide as loans or advances, the company has to reflect in its books of account, both the legs of the transaction, one on the asset side and the other on the liability side. In the absence of the same, the shareholders of the company and investors placing reliance on the financial statement of the company, will not come to know / identify the source and application of funds by the company and the same would

tantamount to understatement of both assets and liabilities. The adoption of such a practice will distort the true and fair picture of the financial health of the company.

28. In light of the above, I note that if proper classification was done by the company, the Borrowings of the company would have also increased as on April 01, 2012.

29. In view of the above, it is held that Loans and Advances that were shown to be ₹ 169 crore as on March 31, 2012 are actually ₹ 1,284.13 crore. Thus, the books of account of the company were understated by 660% with respect to the Loans and Advances. Further, the books of account of the company also did not reflect the correct figures for the Borrowings done by the company.

ii. Whether the company has misrepresented its business operations?

30. It is noted from the confirmations obtained from various parties to whom Loans and Advances were given by the company that the same were given for the purpose of real estate which is a non-core activity of the company. The fact of diversion of funds has been accepted by the company itself in its letter dated January 13, 2017. Further, at the time of hearing of Noticee No. 2, the ARs of the Noticee No. 2 also stated that in the present case there might be diversion of funds by the company and the same is not being challenged by Noticee No. 2. Moreover, as noted from the examination report and Deloitte report that the company had transferred money to companies trading in bullion which is diversion of fund as the company is engaged in the manufacture aluminum foil related products. In addition, as noted from the material made available on record, a sum of ₹ 32,03,00,400/- was transferred to Sikkim Ferro Alloys Ltd. during the period between May- June, 2011 and ₹ 5,00,00,000/- to Trison Impex on July 08, 2011 by the company from its State Bank of India account. The said companies are engaged in activities different from those that PAL represented in its Annual Reports.

31. In view of the above, it is held that the company has misrepresented its business operations to its shareholders and to the public in general.

32. In light of the findings arrived at preceding paragraphs, it is concluded that PAL has misstated its accounts and misrepresented its business operations.

Issue No. 2- *If answer to issue No. (i) is in affirmative, who all are liable for misstatement of accounts and misrepresentation of company's business operations?*

33. It is noted from the material made available on record that Late Mr. Amitabh Parekh was the Chairman and Managing Director of the company as on March 31, 2012. As per Mr. Rajendra Gothi's submissions, he was the Executive Director of the company from October 01, 2009 till October 24, 2011. He resigned from the company on October 25, 2011. Thereafter, as per records, till March 31, 2012, no one was appointed in his place. The financial statements of the company have been audited by M/s C.V. Pabari & Co., Noticee No. 2, for the period 1995 to 2012.

34. I note that Mr. Amitabh Parekh has passed away on January 06, 2013 and the *interim order* does not have him as a Noticee. I, now will deal with the two of the Noticees named in the *interim order*.

Role of Mr. Rajendra Gothi

35. Noticee No. 1 has submitted that though he was a Director on the board of PAL but he was never in charge of day to day affairs of business. He was only in charge of marketing activities in respect of PAL. He was not aware of any financial dealings of PAL and was not privy to any details pertaining to the same. Therefore, his act of merely signing PAL's financial statements for the FYs 2009-10 and 2010-11 ought not to be construed as him having knowledge of their contents. He signed the financial statements for the FYs 2009-10 and 2010-11 in good faith and on account of trust reposed on Late Mr. Amitabh Parekh, the erstwhile Chairman and Managing Director of PAL and the auditors of PAL. His signature was taken only for the purpose of fulfilling legal requirements and compliances. Further, he submitted that Late Mr. Amitabh Parekh was the sole decision making person and the same has been confirmed by the Indian Overseas Bank.

36. I note though the Noticee has stated that he was associated with the company since 1995, he has not stated in what capacity he was associated with the company. From the MCA records, it is noted that he was the Director of the company since May 01, 1995 till the date of his resignation on October 25, 2011. It is also noted that he was a Director on the Board of related entities viz., AAP Entertainment Ltd., AAP Racing and Stud Farms Ltd, Deepen Holding Ltd., AAP Securities Ltd. and AAP Equity Capital Ltd. Further, it is noted from the Annual Reports for the years 2009-10 and 2010-11 that the Noticee was the Chairman/ Member of the Audit Committee of the company. It is also noted from the Annual Report for the year 2011-12 that before resigning from the company, the Noticee was part of the Audit Committee and had attended 04 Audit Committee meetings.

37. From the above, it is noted that not only the Noticee No. 1 was involved in managing the affairs of the company being part of its Board and Audit Committee but also involved with the group companies of PAL. Noticee's submission that he was only in charge of marketing activities and was not aware of financial dealings of the company is not acceptable as being part of the Audit Committee of the company, he had access to the records pertaining to the finances of the company. Thus, he had direct knowledge about the financial health of the company. Being Chairman / Member of the audit committee his role envisaged more diligent handling of the accounts and verification of financial details which could have alerted him to the basic irregularities in the accounts. The very fact that the Noticee placed blind reliance on the late Managing Director shows a real abdication of statutory responsibility. In this context, I would like to refer to the observations made by the Hon'ble Securities Appellate Tribunal (hereinafter referred to as "SAT") in the matter of *Mr. N. Narayanan Vs. The Adjudicating Officer* dated October 05, 2012:

"...The members of the audit committee are expected to exercise due oversight of the company's financial reporting process and to ensure that the financial statement is correct, sufficient and credible. It is also expected to conduct a meaningful review with

special emphasis on major accounting entries and significant adjustments made in the accounts before putting up the statements for the approval of the Board. The board of directors of the company has entrusted the audit committee with an onerous duty to see that the financial statements are correct and complete in every respect..."

38. Taking support of aforesaid observation of Hon'ble SAT, I note that the Noticee being member of Audit Committee was responsible for the financial reporting of the company.
39. It is also noted from the Annual Reports that the Noticee's role in the company was not limited to marketing activities as submitted by him, rather, he was part of Audit Committee, Shareholders' Grievance Committee, Share Transfer Committee and Debenture Issue Committee. Thus, the submission of the Noticee that he was not in charge of day to day affairs of the company and that the company was driven by single Promoter is not correct as the Noticee apart from being a Board Member was also part of numerous committees of the company indicating that the Noticee also took a lot of responsibility in running and controlling the affairs / workings of the company.
40. I, further note from the Annual report for the year 2009-10 that out of 13 Board Meetings held during that financial year, Noticee attended 11 of them. Similarly, in the year 2010-11, Noticee had attended all the Board Meeting held during that financial year and before resigning on October 25, 2011, he had attended 15 Board Meetings for the financial year 2011-12. Thus, the Noticee was regularly attending the Board Meetings and hence is expected to be aware of the functioning of the company. The Apex Court in the matter of *Official Liquidator Vs. P.A. Tendolkar* (1973) 1 SCC 602 held that a Director may be shown to be placed and to have been so closely and so long associated personally with the management of the company that he will be deemed to be not merely cognizant of but liable for fraud in the conduct of business of the company even though no specific act of dishonesty is provide against him personally. He cannot shut his eyes to what must be obvious to

everyone who examines the affairs of the company even superficially.

41. In the extant matter, the Noticee was the Director in the company since 1995 and was also a part of the Audit Committee during the years 2009-2011. The facts in this case clearly reveal that the Noticee had failed in his duty to exercise due care and diligence and allowed the company to fabricate the figures and make false disclosures. Facts indicate that he has overlooked the numerous red flags viz., loans were given by the company for non-core business activity, borrowings as approved by the Board of the company was not reflecting in its books of accounts etc., which should not have escaped the attention of a prudent person.

42. Hon'ble SAT in the matter of *Mr. N. Narayanan Vs. The Adjudicating Officer* dated October 05, 2012 observed as follows:

"... It is the responsibility of a director to identify deficiencies wherever possible by employing verification and scrutiny expected of a prudent man. Meetings of Board of Directors are not rituals where documents are signed at the behest of the chairman or managing director. A director cannot take a stand that he has approved the documents totally depending on the integrity and expertise of the managing director. We are not observing that the director of a company should be a know all, but the duty expected of a prudent person cannot be abdicated by him..."

43. Noticee is a signatory to the financial statements of the company for the period between 2009-2011. In this regard, I would like to refer to the order of Hon'ble Supreme Court of India in the matter of *N Narayanan Vs. Adjudicating Officer, SEBI* decided on April 26, 2013. The Apex Court in the said matter observed as follows:

"32. Responsibility is cast on the Directors to prepare the annual records and reports and those accounts should reflect 'a true and fair view'. The overriding obligation of the Directors is to approve the accounts only if they are satisfied that they give true and fair view of the profits or loss for the relevant period and the correct financial position of the company.

...

Directors of the companies, especially of the listed companies, have access to inside knowledge, such as, financial position of the company, dividend rates, annual accounts etc. Directors are expected to exercise the powers for the purposes for which they are conferred. Sometimes they may misuse their powers for their personal gain and makes false representations to the public for unlawful gain..."

44. Taking support of the aforesaid observation of the Hon'ble Supreme Court, it is held that Noticee being a Director and signatory to the financial statements should have satisfied himself to the veracity of the figures mentioned therein and now cannot be allowed to take a plea that the same was done in good faith and on account of trust reposed on late Mr. Amitabh Parekh. I note that with the rapidly changing scenario in the corporate world vis-a vis corporate responsibility, the Director of the company cannot confine himself to lending his name to the company by taking light responsibility for the functions of the Board and the Audit Committee. He cannot shy away from the responsibility by simply placing his blind faith in the Chairman and Managing Director.
45. Noticee has contended the requirements of Section 27 of the SEBI Act has not been fulfilled in the instant matter. In this regard, it is noted from the provisions of Section 27 (2) of SEBI Act that if an offence has been committed by the company and the same can be attributable to any neglect on the part of the Director, then the said Director is deemed guilty of the offence. It has already been brought out in the preceding paragraphs that the Noticee has failed to exercise due diligence and was negligent in certifying the financial statements of the company for the period 2009-11. In light of the same, I reject the contention of the Noticee.
46. The Noticee has submitted that he is not liable for misstatement as the alleged Loans and Advances were not brought to the notice of the Board. The said submission of the Noticee is not acceptable as Noticee was part of the Audit Committee and had

wide powers under Section 292A of Companies Act, 1956 to investigate any matter with respect to the finances of the company. Further, Bank borrowings have to be brought before the Board of the company for necessary Board resolution. As already pointed out in preceding paragraph, Noticee was regular in attending the Board meetings, so it is difficult to ascertain as to how Bank borrowings running into crores escaped the attention of the Noticee.

47. Noticee No. 1 has submitted that the alleged irregularities pertain to the period when he was not the Director of PAL. The said submission of the Noticee is incorrect as it is noted from the investigation report that out of ₹ 1,353 crore which was the outstanding amount for Loans and Advances as on December, 2012, ₹ 1,079.18 crore was given in earlier years. For instance, a sum of ₹ 42,50,00,450/- in tranches was transferred to AAP Minervas Bulticon Ltd. during July 4-29, 2011 and a sum of ₹ 3,70,00,050/- was transferred to AAP Entertainment Ltd. on May 30, 2011 from the State Bank of India account of the company. Further, ₹ 4,50,00,150/- was transferred from cash credit account maintained by the company with the State Bank of India to Raksha Bullion, a company trading in bullion during the period between May, 2011 to July, 2011 and a sum of ₹ 37,03,00,400/- was transferred to Sikkim Ferro Alloys ltd. and Trisons Impex (companies engaged in activities different from PAL) during the period between May- July, 2011 which is diversion of funds of the company to non-core activities and is a misrepresentation of company's business operations to the shareholders and the public at large as per the Annual Reports of the company.

48. The Noticee has submitted that the State Bank of India's complaint to SEBI does not mentions his name. In this regard, I note that, State Bank of India's complaint was the trigger based on which an examination in the matter was conducted by SEBI. SEBI's examination is neither limited by nor confined to the State Bank of India's complaint. The fact that the Noticee No. 1 has been left out in the State Bank of India's complaint does not signify that he is also outside the scope of SEBI's examination. During the

course of examination undertaken by SEBI, material has been unearthed which shows that the Noticee has played a significant role in the irregularities noticed in the books of account of the company and SEBI has deemed it appropriate to take action in accordance with the provisions of law.

49. The Noticee has also submitted that Indian Overseas Bank has confirmed that late Mr. Amitabh Parekh was the sole decision making person. It is noted that the said observation was made by the Indian Overseas Bank vide its letter dated January 07, 2013. It is pertinent to note that at that relevant point of time, the Board of Director of the company did not have any Whole Time / Executive Directors as upon resignation of Noticee No. 1, no one was appointed to replace him and Mr. Amitabh Parekh had just passed away on January 06, 2013. Moreover, the observation of Indian Overseas Bank is not sacrosanct as SEBI's own examination has found Noticee's role in the present matter.
50. Noticee submitted that he resigned from PAL's Board of Directors on October 25, 2011. He has signed financial statements of PAL for the FYs 2009-10 and 2010-11. The relevant period for the purpose of SEBI's order and investigation report are FYs 2010-11, 2011-12 and 2012-13. In this regard, it is noted that SEBI had carried out examination to ascertain whether the books of the company were manipulated as on March 31, 2012. To have a holistic picture, company's books for previous financial years were also looked into for irregularities and wherever deemed necessary, references were made to period subsequent to March, 2012.
51. The Noticee contended that the *interim order* passed by SEBI was on the basis of "Draft Audit Report" of Deloitte which is not yet finalized. It is noted that though a reference has been made to the Deloitte report in the *interim order*, it is incorrect to say that the *interim order* was passed solely on it basis. The *interim order* was passed on the basis of SEBI's own examination of the matter. Moreover, the findings of Deloitte's final report is same as that of its draft report.

52. Noticee has contended that the *interim order* is vague as it does not state in which years PAL has taken loans. In this regard, I note that books of account are certified as on a date, for e.g., March 31, 2012. Irrespective of when the loans were taken, the outstanding loan amount on that date, needs to be correctly represented, which in the instant matter has been established in preceding paragraphs that the outstanding figure for Loans and Advances of the company was not correct.
53. With respect to the submission of the Noticee that the *interim order* is vague as it does not state whether he was also charged in the capacity of Chairman/member of Audit Committee and does not disclose any material particulars or allegations against him, I note that the *interim order* at 3.3 A (ii)(c)(vii) at pages 20 - 21 states that the Noticee being the Executive Director of PAL has been *prima facie* found to be in violation of provisions of PFUTP Regulations and LODR. Further, the *interim order* has also discussed the role played by the Noticee by laying down its association not only with PAL but also with its group companies, he being part of Audit Committee and the fact of him being a signatory to the financial statements of company for the FYs 2009-10 and 2010-11. In light of the same, the submission of the Noticee is not tenable.
54. In view of the aforesaid findings, it is held that that Mr. Rajendra Gothi is liable for misstatement of accounts and misrepresentation of company's business operations as stated in its Annual Reports.

Role of M/s C V Pabari & Co.

55. Noticee No. 2 was the statutory Auditor of the company during the period between FY 1994-95 to FY 2011-12. Being the statutory auditor, Noticee No. 2 is responsible for auditing the company's financial statements and forming an opinion as to their truth and fairness. The role played by Noticee No. 2 with respect to netting off Loans and Advances against short term bank borrowings.

Netting off Loans and Advances against short term bank borrowings

56. The submission of the auditor regarding netting off Loans and Advances against short term bank borrowings has already been dealt at preceding paragraph 27. In addition to the said paragraph, Noticee No. 2 has also submitted that on the basis of discussions with the management and various documents and information provided by the management of the company, Noticee No. 2 had in good faith accepted such a treatment in the financial statements as, in their opinion, it provides a true and fair value of the financial situation of the company. Noticee being an expert in the field of accounting and finance should have relied on its own expertise / judgment rather than accepting in good faith the treatment of financial statements by the management especially in the area of applicability of relevant accounting standards. If all the auditors certify the books of account in good faith without independent application of mind, the same defeats the whole purpose of certification by experts / statutory auditors.
57. Noticee has submitted that the company was on a growth trajectory and had been regularly paying its interest obligations to the banks. It was also regular in payment of its dues to various government departments in the form of taxes and levies. In light these reasons, the Noticee No. 2 had no reason to suspect the commission of any fraud while certifying the financial statements. The submission of the Noticee with respect to the statutory dues is not correct. As noted from the report of Paresh Rakesh & Associates, Chartered Accountants that undisputed statutory dues including income tax, sales tax, wealth tax, service tax, customs duty, provident fund, investor education and protection fund, cess and other statutory dues have generally not been regularly deposited with the appropriate authorities. It is clear that had the Noticee done the due diligence, the Noticee should have seen the red flags.
58. As per Noticee No. 2, it had never blindly relied on statements and representations of the management and had conducted audit on a widely accepted test check basis by applying sampling techniques. In this regard, I note that if the Auditor had done a

test check on a sample basis, it would have come to its notice that Loans and Advances were given without defining the terms and conditions of the said Loans and Advances, as all the Loans and Advances were given without written documentation. The same would then made the Auditor sit up, take note and question the veracity of the numbers submitted by the management. However, the Auditor failed to do so.

59. It is submitted by the Noticee that it has not blindly relied on averments made by the management and had perused the loan confirmations and other relevant documents to its satisfaction at the time of preparation of the Audit Report. In this regard, it is noted that Noticee has not submitted any documents / material to show how the Noticee obtained the loan confirmations as the records for the loans disbursed were not maintained by the company. If there was any correspondence between the Noticee and the debtors then it must have a paper trail and should have been documented by the Auditor. However, no such documentary evidence has been submitted by the Noticee. Therefore, I am not inclined to accept the submission of the Noticee.
60. The absence of proper loan / advance documentation should have raised red flags for the Auditor. However, the facts in the matter indicate that the Auditor neither resorted to any independent verification nor the auditor verified the information from the debtors. By accepting the information provided by the company at face value and rubber stamping the accounts, the Auditor has comprehensively failed to live upto the expectations of the shareholders. Thus, the auditor has failed to follow the minimum standards of diligence and care as expected from a statutory auditor. The Auditor has merely accorded its concurrence to the averments made by the management. By accepting the same on its face value, the auditor was negligent and has shown lack of professional skepticism in auditing the accounts of the company.
61. Noticee has submitted that as part of the audit, confidential reports were procured from lending banks by Noticee and the banks had not expressed their disagreement

over the outstanding amount of bank borrowings in the books of the company. The submission of the Noticee is vague as it has not specified when, which and how the said confidential reports were accessed by the Noticee.

62. Further, it has been submitted by the Auditor that the lending banks had steadily increased the limits on the loans advanced to the company year after year. Prior to each such increase, the banks conducted an audit of the financial statements of the company. It is submitted that even these audits had not revealed any irregularities in the financial statements. The said submission of the Noticee is not acceptable as Noticee being the statutory auditor of the company has to independently verify the financial health of the company and not place reliance on / accept the audit, if any done by the Lending Bank.
63. I note that if the Noticee had done its due diligence, the Noticee would have known the correct figures of Loans and Advances and of the Borrowings of the company. Further, the Noticee being an expert in the accounting field is expected to know the applicability of the relevant accounting standard for a particular entry in the books of accounts. In addition, in the instant matter, the Noticee has accepted that netting of Loans and Advances was done against short term bank borrowings. Therefore, the act of certification of books of account of the company by the Noticee was not only reckless but the facts indicate that he was having the knowledge incorrect figures in the books of accounts.
64. Noticee has submitted that SEBI has relied upon a draft report by Deloitte and complaint letter filed by State Bank of India. SEBI has not conducted its own investigation nor has it individually determined whether the contents of the draft report and complaint letters are true and accurate. It is further submitted that SEBI cannot rely on the draft report and complaints filed by private persons for issuing any preventive or remedial order against any person.
65. It may be noted that SEBI has conducted its own detailed examination in the extant

matter. Further, it is relevant to note that SEBI has not relied solely on the Report by Deloitte and complaint letter filed by State Bank of India, as contended by the Noticee, but also on various items like the information elicited by SEBI from the company, the reports/responses/disclosures of Stock Exchanges, the observations in Annual Reports of the company and information gathered through correspondences with State Bank of India. Further, I note that the facts in the Report by Deloitte and complaint letter filed by State Bank of India have not been disputed by the Noticee. It is relevant, in this connection to mention that the subject report in the instant matter is a specific purpose forensic report prepared by qualified professionals recognized by and registered with a statutory body. As a matter of practice, forensic investigations relating to accounting frauds are being done by qualified accountants. The expertise of accounting firms to carry out such investigations has been widely recognized. In a case where the findings of such a party's investigations give specific inputs to the Regulator, then the question of such reliance becomes merely academic. Further, the Noticee was provided with inspection and copy of the Deloitte Draft Report (the findings of final report are same as draft report), M/s Chaturvedi & Shah report and M/s Paresh Rakesh and Associates report. The Auditor was also given sufficient opportunity through personal hearing and written submissions to defend its case effectively, thus ensuring full play of principles of natural justice.

66. In view of the findings arrived at preceding paragraphs, I find that there has not only been a total abdication by the auditor of its duty to follow the minimum standards of diligence and care expected from a statutory Auditor. The records reflect that the attitude of professional skepticism was missing for at least two years. The Auditor has not taken reasonable care to ascertain that the contents of the financial statements of the company were substantially accurate and that it contains a correct representation of the state of the company's financial affairs. Since public at large including several organisations / financial institutions both government and private,

rely on the report / certificate of the Auditor, in such circumstances, the duty and obligation of being absolutely diligent is multiplied manifold and the auditor cannot take such an obligation casually.

67. At this juncture, I would like to quote the observations of Hon'ble High Court of Andhra Pradesh in the matter of *The Institute Of Chartered Accountants of India Vs. Shri Mukesh Gang, Chartered* decided on September 26, 2016 wherein the Court observed as follows:

"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."

68. *In Registrar of Companies, Bombay Vs. P M Hegde* decided on April 30, 1954 the Hon'ble High Court of Madras, considered the question whether the auditor's job is to verify the figures set out in the balance sheet tally with the figures found in the accounts of the Bank. The Hon'ble High Court therein had referred to the following cases, before holding that the auditor has not discharged the duties which lay on him as an auditor:

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."

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 show 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 show, but also for the purpose of satisfying himself that they show the true financial position of the company."

69. Taking support of aforesaid decisions and findings arrived at preceding paragraphs, it is held that Noticee No. 2 being the statutory Auditor of PAL was not cautious and

careful while certifying the Annual Accounts of PAL but was rather negligent and lacked professional skepticism in its audit. Such reckless certification of Annual Reports by the Noticee No. 2 has resulted in not only the shareholders but also the public being misled about the financial health of the company which undoubtedly amounts to gross negligence. As stated earlier, a continuous omission by the Auditor to independently verify the financial statements indicates that the Auditor has failed in doing its job with standards of professional duty and care as mandated.

Issue No. 3- Whether the Noticees have violated the provisions of SEBI Act read with PFUTP Regulations?

70. Before proceeding further, it will be appropriate to refer to the relevant provisions of SEBI Act and PFUTP Regulations, which read as under:

SEBI Act, 1992

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

Section 12A: No person shall directly or indirectly:

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

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

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

thereunder;

PFUTP Regulations

Regulation 3. Prohibition of certain dealings in securities

No person shall directly or indirectly-

...

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

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

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

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

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

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

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

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

(f) publishing or causing to publish or reporting or causing to report by a person

dealing in securities any information which is not true or which he does not believe to be true prior to or in the course of dealing in securities;

...

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

...

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

71. The object and purpose of the abovementioned statutory provisions are to curb market manipulation. Palmer's Company Law, 25th Edition (2010), Volume 2 at page 11097 states: *"Market manipulation is normally regarded as the "unwarranted" interference in the operation of ordinary market forces of supply and demand and thus undermines the "integrity" and efficiency of the market."*

72. Hon'ble Supreme Court of India in the matter of *N Narayanan Vs. Adjudicating Officer, Sebi* decided on April 26, 2013 while dealing with the concept of market abuse in securities market has observed as follows:

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

predicated on the quality and the manner on which it is made available to market. 'Market abuse' impairs economic growth and erodes investor's confidence. Market abuse refers to the use of manipulative and deceptive devices, giving out incorrect or misleading information, so as to encourage investors to jump into conclusions, on wrong premises, which is known to be wrong to the abusers. The statutory provisions mentioned earlier deal with the situations where a person, who deals in securities, takes advantage of the impact of an action, may be manipulative, on the anticipated impact on the market resulting in the "creation of artificiality". The same can be achieved by inflating the company's revenue, profits, security deposits and receivables, resulting in price rise of scrip of the company. Investors are then lured to make their "investment decisions" on those manipulated inflated results, using the above devices which will amount to market abuse."

73. Further, fraud has been defined under Section 2 (1) (c) of PFUTP Regulations which reads as under:-

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

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

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

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

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

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

false;

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

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

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

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

And “fraudulent” shall be construed accordingly;

74. The Hon'ble SAT in the matter of *V. Natarajan Vs. SEBI*, Appeal No. 104 of 2011, wherein it observed -

"... We are satisfied that the provisions of Regulations 3 and 4 of the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003, were violated. These regulations, among others ... prohibit persons from engaging 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 that are listed on stock exchanges. These regulations also prohibit persons from indulging in a fraudulent or unfair trade practice in securities which includes publishing any information which is not true or which he does not believe to be true. Any advertisement that is misleading or contains information in a distorted manner which may influence the decision of the investors is also an unfair trade practice in securities which is prohibited. The regulations also make it clear that planting false or misleading news which may induce the public for selling or purchasing securities would also come within the ambit of unfair trade practice in securities..."

75. It is by now well settled that financial results do form the basis for the investing public to take informed decisions. Any false information or false accounts depicting a distorted picture of financial health of the company is indeed a very serious wrong and has a direct impact on the securities market and the investors. A basic premise on which the foundation of securities market is laid upon, is that the persons connected with securities market conform to standards of transparency, good governance and ethical behaviour prescribed in securities laws and do not resort to fraudulent activities.
76. On facts, it has been clearly found that the company has employed deceptive devices by hiding the actual figures of Loans and Advances on the one hand and Borrowings on the other and had adopted dubious practices in drawing up accounts for manipulating the financial results of the company to present a rosy picture to its shareholders and to the public at large. Company though a legal entity, cannot act by itself and would not have been able to draw up this elaborate scheme without its Directors and / or its statutory Auditor being part of the manipulative and deceptive device. Even otherwise, by making representations in a reckless and careless manner whether it is true or false, tantamount to fraud. Further, in view of the discussions in preceding paragraphs 46 and 63, the willful shutting of eyes by the Noticees indicates knowledge / connivance on part of the Noticees. Therefore, the claim of the Noticees that they had any knowledge or negligence tantamounting to fraud on their part cannot be accepted.
77. Upon considering all facts and circumstances in totality, I find that such acts and omissions were fraudulent on the part of the Noticees. When the picture is looked at in totality, what is unfolding is a fraud perpetuated on the market / investors. Such acts of serious irregularities threaten the market integrity and orderly development of the market and calls for regulatory intervention to protect the interest of investors. I therefore, find that Mr. Rajendra Gothi and M/s C V Pabari & Co. have violated Sections 12A (a), (b) and (c) of SEBI Act and Regulations 3 (b), (c), (d) and

Regulations 4(1) and 4(2),(a),(e),(f),(k), and (r) of the PFUTP Regulations.

Issue No. 4 - Whether Mr. Rajendra Gothi has violated provisions of LODR Regulations as alleged in the *interim order*?

78. In the instant matter, the irregularities in the books of account of the company were observed prior to April 01, 2012. The provisions of LODR regulations were not in force at the relevant time. Hence, Mr. Rajendra Gothi cannot be made liable for the violation of provisions of LODR Regulations.

Issue No. 5- What directions, if any should be issued against the Noticees?

79. In view of the findings above, I am of the considered view that under Sections 11B and 11(4) of the SEBI Act for the violation of provisions of Sections 12A (a), (b) and (c) of SEBI Act and Regulation 3 (b), (c), (d) and Regulations 4(1) and 4(2),(a),(e),(f),(k), and (r) of the PFUTP Regulations, Mr. Rajendra Gothi and M/s C V Pabari & Co. should be restrained for a suitable period of time.

ORDER

80. In the facts and circumstances of the case, I, in exercise of the powers conferred upon me under Sections 11, 11 (4) (b) and 11B read with Section 19 of the Securities and Exchange Board of India Act, 1992, hereby issue following directions:

- a) Mr. Rajendra Gothi shall not buy, sell or otherwise deal in the securities market in any manner whatsoever or access the securities market, directly or indirectly, for a period of ten years from the date of this order. Further, Mr. Rajendra Gothi is also restrained from associating himself with any listed public company and any public company which intends to raise money from the public, or any intermediary registered with SEBI for a period of five years from the date of this order.
- b) M/s C V Pabari & Co. 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 SEBI Act, Securities Contracts (Regulation) Act, 1956, 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 five years.

- c) Listed companies and intermediaries registered with SEBI shall not engage M/s C V Pabari & Co. and Mr. C.V. Pabari, for issuing any certificate with respect to compliance of statutory requirements which SEBI is competent to administer and enforce, under various laws for a period of five years.

81. It is clarified that the present order does not enter specific findings on the allegations of violations of Companies Act, 1956 not amounting to violations of securities laws.
82. It is clarified that other than the Noticees herein, *interim order cum show cause notice* was also against one more entity namely, the company, Parekh Aluminex Limited in respect of whom a separate order will be passed by SEBI.
83. A copy of this order shall be served upon all the Noticees, Stock Exchanges and Depositories for necessary action and compliance with the above directions for inclusion of the name of the Noticees in the list of SEBI debarred entities.
84. This order is without prejudice to any other actions that SEBI may take in accordance with securities laws.

-Sd-

DATE: October 31, 2018

PLACE: Mumbai

**MADHABI PURI BUCH
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA**