

**IN THE HIGH COURT OF JUDICATURE AT BOMBAY
CRIMINAL APPELLATE JURISDICTION**

BAIL APPLICATION NO.2997 OF 2022

Suhas S. Paranjpe

..Applicant

VS.

Serious Fraud Investigation Office and anr. ..Respondents

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Adv. Shardul Singh a/w Adv. Perna Gandhi for the
applicant.

Ms. P. N. Dabholkar, APP for the State-respondent No.2.

Adv. H. S. Venegavkar a/w Adv. Aayush Kedia a/w Mayank
Joshi i/b. Adv. Pradeep Yadav for the respondent No.1.

CORAM : M. S. KARNIK, J.

DATE : JANUARY 24, 2023

P.C. :

1. Heard learned Senior Advocate Shri Amit Desai for the
applicant, learned counsel Shri Venegavkar for respondent
No.1 and learned APP for the State.

2. This is an application for bail. A criminal complaint
No.418 of 2022 was lodged by the Serious Fraud
Investigation Office (hereafter "SFIO", for short) on
22/04/2022 under Section 447 of the Companies Act, 2013
(hereafter "the Companies Act", for short)

3. The applicant is the partner at a CA audit firm, which

was a statutory auditor with the Company called as Jagat Agro Commodities Private Limited which is the accused No.1 in the criminal complaint. There are in all 14 accused. The applicant is the accused No.7. The applicant was the statutory auditor of the Company right from the time of its inception till the year 2015. The accused Nos.2 and 3 are the promoters of the accused No.1 company.

4. The allegation against the applicant is that he colluded with the directors/promoters of the accused No.1 Company and did not disclose the true and fair state of affairs of accused No.1 and proceeded to audit the financial statements without verifying the primary records as well as actual stock position. It is alleged that the applicant made a sample check of the stocks and never verified the actual position of stock in the godowns of the company. It is alleged that he deliberately relied upon the information provided by the management of the company and finalised the report based on falsified accounts without looking into the actual position and affairs of the company and served his masters as per their instructions. The fraud alleged

against the accused No.1 company was to the tune of Rs.386.99 Crores.

5. In the complaint it is averred that there was enough evidence to conclude that large scale fraud had taken place in the company as the accounts had been fudged for taking loans and increasing credit limits. The dispute is regarding the actual value of the stocks and after a report was submitted, it was revealed that the accused No.1 had manipulated the stock to gain some undue financial advantage. The actual stock which was found in the godowns was not as what was projected by the company. It is alleged that in some instances it was revealed that the godowns itself were not found.

6. So far as the present applicant is concerned, the allegations in the complaint are in paragraph 40 and 41.

The same reads thus :-

"40. A-7 Suhas S. Paranjpe was the statutory auditor since incorporation of A-1 Jagat Agro Commodities Private Limited. The forensic auditor (State Bank of Patiala), in his report dated 08.10.2015 had raised several red flags regarding the transactions being carried out by the A-1 Jagat Agro Commodities Private Limited but being a statutory auditor of the company for the past several years, he failed to identify the areas in which the A-1 Jagat

Agro Commodities Private Limited had been manipulating their books of accounts.

41. A-7 Suhas S. Paranjpe colluded with the directors/promoters of A-1 Jagat Agro Commodities Private Limited and did not disclose the true and fair state of affairs of A-1 Jagat Agro Commodities Private Limited and proceeded to audit the financial statements without verifying the primary records as well as actual stock position. He made a sample check of the stocks and never verified the actual position of stock in the godowns of the company. He deliberately relied upon the information provided by the management of the company and finalized the report based on falsified accounts without looking into the actual position and affairs of the company and served his masters as per instructions."

7. It is the contention of SFIO that the forensic audit which was conducted in the year 2015 revealed a large scale fraud in the matter of actual availability of stocks in the godowns.

8. The applicant was the statutory auditor of the company. The auditor's responsibilities relating to fraud in the audit financial statements is provided for in the Standard on Auditing (hereafter "SA", for short). The primary responsibility of the prevention and detection of fraud rests with both those charged with governance of the entity and management. An auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable

assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs. The SA provides that while the auditor may be able to identify potential opportunities for fraud to be perpetrated, it is difficult for the auditor to determine whether misstatements in judgment areas such as accounting estimates are caused by fraud or error. The SA further recognizes that the risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override control procedures designed to prevent similar frauds by other employees.

9. The guidance note on audit of inventories provide for

internal control evaluation and verification. So far as physical verification of inventories is concerned, it is mentioned that it is the responsibility of the management of the entity. It is provided that however, where the inventories are material and the auditor is placing reliance upon the physical count by the management, it may be appropriate for the auditor to attend the stock-taking. Clause 12 provides that the extent of auditor's attendance at stock-taking would depend upon his assessment of the efficacy of relevant internal control procedures, and the results of his examination of the stock records maintained by the entity and of the analytical review procedures.

10. Shri Venegavkar, learned counsel for SFIO submitted that the applicant as a statutory auditor has failed to perform his duties as expected by the guidance note on the audit of inventories and it was the responsibility of the applicant to have been vigilant during audit. Learned counsel submitted that as a result of the applicant not discharging his duty of physically verifying the stock before conducting the audit, he has helped in the perpetration of

the fraud by the company through its promoters and other accused. According to the learned counsel, failure on the part of the applicant to perform his duties diligently and in accordance with the guidelines would be sufficient to attract the ingredients of Section 447 of the Companies Act, 2013.

11. The applicant is alleged to have committed an offence under section 447 of the Companies Act. Section 447 in chapter XXIX provides for the punishment for fraud. The provision reads thus:

"447. Punishment for fraud.— Without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud involving an amount of at least ten lakh rupees or one per cent of the turnover of the company, whichever is lower, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud:

Provided that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years:

Provided further that where the fraud involves an amount less than ten lakh rupees or one per cent of the turnover of the company, whichever is lower, and does not involve public interest, any person guilty of such fraud shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to fifty lakh rupees or with both

Explanation.—For the purposes of this section—

(i) "fraud" in relation to affairs of a company or any body corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss;

(ii) "wrongful gain" means the gain by unlawful means of property to which the person gaining is not legally entitled;

(iii) "wrongful loss" means the loss by unlawful means of property to which the person losing is legally entitled."

12. Section 447 was enforced with effect from 12/09/2013 vide notification dated 12/09/2013. The forensic audit was conducted for the period 2013-2014 and 2014-2015 for which the fraud is alleged. Reading of the allegations in the complaint, reproduced hereinabove, would reveal that the applicant has failed to identify the areas in which the accused no. 1-company has been manipulating their books of accounts. It is further alleged that the applicant proceeded to audit financial statements without verifying primary records as well as actual stock positions. It is alleged that the applicant made a sample check of the stock and never verified the actual position of the stock in the godowns of the company. It is alleged that the applicant

deliberately relied upon information provided by the management of the company and finalised the report based on falsified accounts without looking into the actual position and affairs of the company and served his masters as per instructions.

13. In my prima facie opinion, it may be that the applicant was not absolutely diligent in the discharge of his duties. The applicant, as per the complaint, appears to have conducted an audit based on the accounts submitted by the company. It is not the allegation that the applicant has physically verified the stock despite which he gave a false report not in conformity with the physical verification. In fact, it is the allegation that the applicant failed to physically verify the stock. The case of SFIO is that had he done so, there could have been a timely check on the fraud perpetrated by the company. In my prima facie view, having gone through the guidelines as regards standards of auditing, merely because the applicant did not physically verify the stocks before conducting an audit, is not sufficient to attract the offence under section 447 of the Companies

Act. There is nothing to indicate that the audit report submitted by the applicant was with the intent to deceive or to gain undue advantage from or to injure the interest of the company or its shareholders or its creditors or any other persons. There is no allegation that the applicant is the recipient of any pecuniary gain as a result of such fraud nor is there any material to support the bald assertion of the SFIO that the applicant colluded with the promoters of the company. The applicant conducted the audit on the basis of the information supplied by the management.

14. This Court in the case of **Tri-Sure India Ltd. Vs. A.F. Ferguson and Co. and Others**¹ had an occasion to consider the question in the context of auditor's negligence in the discharge of their duties. Paragraphs no. 23, 24, 36 and 37 which has a bearing in the present context reads thus:

"23. The word "audit" has been defined in the Oxford English Dictionary as "an official examination of accounts with verification by reference to witnesses and vouchers". Audit is concerned with the verification of accounting data with determining the accuracy and reliability of accounting statements and reports. Auditing primarily involves testing the reliability, competency and adequacy of evidence in

1 1985 SCC OnLine Bom 342

support of monetary transactions. The main objective of the company audit is to conduct an independent review of the financial statements and offer an opinion about their reliability in representing the organisation's financial condition and working results. The main function of the auditor is to ascertain whether the financial statements fairly represent the actual financial position and the working results of an organisation. The International Auditing Guideline No. 1 published in January, 1980, prescribes that while the auditor is responsible for forming and expressing his opinion on the financial statements, the responsibility for their preparation is that of the management of the entity. The management's responsibilities include the maintenance of adequate accounting records and internal controls, the selection and application of accounting policies, and the safeguarding of the assets of the entity. The audit of the financial statements does not relieve the management of its responsibilities. The auditor assesses the reliability and sufficiency of the information contained in the underlying accounting records and other source data by making a study and evaluation of accounting systems and internal controls on which he wishes to rely and testing those internal controls to determine the nature, extent and timing of other auditing procedures.

24. In "Statement on Auditing Practices" published by the Institute of Chartered Accountants of India in the year 1968, it is pointed out that it is the directors of a company who are primarily responsible for the preparation of the annual accounts and for the information contained in it. The duty of safeguarding the assets of a company is primarily that of the management and the auditor is entitled to rely upon the safeguards and internal controls instituted by the management, although he will of course take into account any deficiencies he may note therein while drafting the audit programme. The auditor does not conduct the audit with the objective of discovering all frauds, because in the first place it would take a considerable amount of time and it would not be possible to complete the audit within the time-limit prescribed by law for the presentation of accounts to the shareholders. Further, such an audit would have to involve a detailed and minute examination of all the books, records and other

documents of the company, and the cost of doing so would be prohibitive and disproportionate to the benefits which may be derived by the shareholders. Finally, even if such examinations were to be conducted, there will be no assurance that all types of frauds, omissions and forgery, etc., would be discovered. The auditor, while conducting the audit, bears in mind the possibility of existence of fraud and irregularities in the accounts of the company.

36. The decision was approved in the next case reported in [1896] 2 Ch 279 (Kingston Cotton Mill Co., In re (No. 2) where an order under section 10 of the Companies (Winding-up) Act, 1890, was passed against the auditors of the company ordering them to pay to the liquidator certain sums of money being the amounts of dividends improperly declared and paid out of the assets of the company on the faith of certain balance-sheets prepared and signed by the auditors. In appeal, one of the questions considered was "what was the duty of auditors" and Lord Justice Lindley reiterated the view taken in the earlier case of London and General Bank, In re (No. 2) [1895] 2 Ch 673. Lord Justice Lindley made it clear that the auditors should not be suspicious but only reasonably careful. The learned judge further noted that the auditors relied on the manager who was a man of high character and of unquestioned competence and who was trusted by every one who knew him, and observed that it is not sufficient to say that the frauds must have been detected if the entries in the books had been put together in a way which never occurred to any one before suspicion was aroused. Lord Justice Lopes, in a concurring judgment, observed (at page 288) :

"But in determining whether any misfeasance or breach of duty has been committed, it is essential to consider what the duties of an auditor are. They are very fully described in In re London and General Bank [1895] 2 Ch 673 to which judgment I was a party. Shortly they may be stated thus : It is the duty of an auditor to bring to bear on the work he has to perform that skill, care and caution which is reasonably competent, careful and cautious auditor would use. What is reasonable skill, care and caution must depend on the particular circumstances of each case. An auditor is not bound to be a detective, or, as was said, to approach his work with suspicion or with a foregone conclusion that there is something wrong. He is a

watch-dog, but not a bloodhound. He is justified in believing tried servants of the company in whom confidence is placed by the company. He is entitled to assume that they are honest, and to rely upon their representations, provided he takes reasonable care. If there is anything calculated to excite suspicion he should probe it to the bottom; but in the absence of anything of that kind he is only bound to be reasonably cautious and careful."

37. The learned judge further observed : (at page 290) "The duties of auditors must not be rendered too onerous. Their work is responsible and laborious, and the remuneration moderate auditors must not be made liable for not tracking out ingenious and carefully laid schemes of fraud when there is nothing to arouse their suspicion, and when those frauds are perpetrated by tried servants of the company and are undetected for years by the directors. So to hold would make the position of an auditor intolerable."

15. While considering the question of bail, I must be conscious of the provisions of Sub-Section (6) of Section 212 of the Companies Act. In my prima facie opinion, I am satisfied that there are reasonable grounds for believing that the offence under section 447 may not be attracted in the present case. Furthermore, there are no criminal antecedents reported against the applicant. There is nothing on record to suggest that the applicant is likely to commit any offence while on bail. The applicant is a qualified Chartered Accountant. The applicant was arrested on 23/02/2022 and is in custody almost for 11 months. The

trial is not likely to conclude any time soon. The charge-sheet has been filed and the investigation is complete. The applicant therefore, can be enlarged on bail.

16. In the result the application is allowed. Hence, the following order :-

ORDER

- (a) Application is allowed.
- (b) Applicant-Suhas S. Paranjpe shall be released on bail in connection with Special Company Case NO.418 of 2022 registered by the SFIO on his furnishing P.R. bond of Rs.50,000/- with one or more sureties in the like amount.
- (c) The applicant is permitted to furnish cash bail surety in the sum of Rs.50,000/- for a period of 6 weeks in lieu of surety.
- (d) The applicant shall report to the SFIO once a month i.e. on the first Monday of every month between 10.00 a.m. and 1.00 p.m.
- (e) The applicant shall not directly or indirectly make any inducement, threat or promise to any person acquainted with the facts of the case so as to dissuade him from disclosing the facts to Court or any Police Officer. The applicant shall not tamper with evidence.

(f) On being released on bail, the applicant shall furnish his contact number and residential address to the Investigating Officer and shall keep him updated, in case there is any change.

(g) The applicant shall not leave the country without the permission of the trial Court.

17. The Bail Application is disposed of.

(M. S. KARNIK, J.)