

SEBI penalises Independent Directors and KMP for misstatement in financial statements

Summary of adjudication order in the matter of Bombay Dyeing and manufacturing company limited dated October 31, 2022

Background

SEBI conducted an investigation to ascertain whether the books of accounts of Bombay Dyeing and Manufacturing Company Limited (**Company**) were manipulated for the financial years beginning from FY 2011-12 up to FY 2018-19 (**Investigation Period**). The investigation revealed that the Company, by entering into various memoranda of understanding (**MoUs**) with Scal Services Limited (**Scal**) (a group company of the Company whose entire shareholding was directly/ indirectly held by the Company) during FY 2011-12 to FY 2017-18 and by subsequently recognizing revenue on the basis of aforesaid MoUs and not consolidating the transactions carried out with Scal, had inflated its sales and profits with respect to its real estate segment during FY 2011-12 to FY 2017-18 to the tune of approximately INR 2500 crores and INR 1300 crores respectively.

Allegations under the SCN

The SCN alleged that the independent directors who were also members of the Audit Committee of the Company (Notices No. 1 to 5) failed to carry out adequate due diligence and exercise independent judgment as members of the audit committee of a listed company, to ensure that financial statements are free from material misstatement.

Further, the SCN has alleged that Notices No. 6 to 9, in their capacities as CFOs of the Company throughout the Investigation Period, have issued certificate in the annual reports of the Company during the Investigation Period *inter alia* certifying that the financials of the Company presented true and fair view of its affairs and did not contain any misleading statement.

Key points regarding the facts of the matter:

On an analysis of the shareholding patterns of the Company and Scal and other group companies, the Adjudicating Officer (**AO**) found that during the Investigation Period, the Company held the entire share capital of Scal directly as well as indirectly through other group companies. The Company, along with Scal, executed a scheme to record non-genuine sales made to Scal to the tune of approximately INR 2,500 crores and profits to the tune of approximately INR 1300 crores during FY 2011-12 to FY 2017-18 by entering into MoUs with Scal. During the said period, the entire shareholding of Scal was structured in a manner to camouflage the actual shareholding of the Company in Scal. The entire shareholding in Scal was held by the Company through various other investment companies of the Group, and therefore, the Company was indeed exercising significant influence over Scal directly/ indirectly.

Issue No.	Issue	Observations/ Findings of the AO
I.	Whether the Noticee 1 to 5 (Independent Directors and members of the Audit Committee of the Company) have failed to comply with provisions of Clause 49(II)(D)(1) of the Listing Agreement, Clause 49(III)(D)(1) of the Listing Agreement (post amendment dated April 17, 2014) read with Regulation 103 of the	<p>A. Role of members of the audit committee</p> <p>In order to understand the role of the members of the Audit Committee, the AO noted a recommendation of the Kumar Mangalam Birla Committee, which led to the insertion of Clause 49 in the Listing Agreement: <i>“a qualified and independent audit committee should be set up by the board of a company. This would go a long way in enhancing the credibility of the financial disclosures of a company and promoting transparency”</i>. In this regard, the Kumar Mangalam Birla Committee had <i>inter alia</i> observed that:</p> <p><i>“The audit committee has an important role to play in this process, since the audit committee is a subgroup of the full board and hence the monitor of the process....”</i></p>

Issue No.	Issue	Observations/ Findings of the AO
	<p>LODR Regulations and Regulation 18(3) read with Clause A (1) under Part C of Schedule II of LODR Regulations?¹</p>	<p><i>The committee’s job is clearly one of oversight and monitoring and in carrying out this job it relies on senior financial management and the outside auditors.”</i></p> <p>The AO observed that <u>the Noticees had an important role to play as members of the Audit Committee and as a subgroup of the Board of Directors. The Noticees were required to monitor the disclosures and accuracy of the same as a monitor of the process. As a result of the Noticees’ failure to discharge their function as members of the audit committee, the Company was able to inflate its sales and profits with respect to its real estate segment. In view of the above, the AO found that the Noticees have failed in its duty to exercise oversight of the Company’s financial reporting process and disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.</u></p> <p>B. AO’s Findings:</p> <p>1. In respect of the accounts of the Company:</p> <p>The AO noted that Noticees 1 to 5 were independent directors of the Company as well as audit committee members and that they reviewed the annual accounts of the Company which included balance sheet, profit & loss account, cash flow statement and auditor’s report for FY 2011-12 to FY 2017-18, in their capacities of being the Audit Committee members.</p> <p>In this regard, it was noted that the Audit Committee, under the erstwhile Clause 49 of the Listing Agreement and LODR Regulations has been equipped with the powers to seek information from any employee, obtain outside legal or other professional advice, secure attendance of outsiders with relevant expertise, if it considers necessary.</p> <p>It was observed that the Noticees did not seek any explanation and did not provide any specific reason with respect to reduction in shareholding in Scal by the Company. On an analysis of the facts of the matter, it was observed that Scal was an ‘associate’ of the Company and in terms of the relevant accounting standards, the Company was liable for accounting the sales made to Scal and the revenue generated therefrom to the extent of the Company’s interest in Scal. The Company failed to comply with the same. In this regard, the Noticees submitted that they had relied on the opinions provided by the Chartered Account firm. However, it was noted in the order that the Company had not disclosed all the relevant information to the Chartered Accountant firm to give a true and correct view of whether Scal was an associate. <u>The Noticees being Independent Directors and members of the Audit Committee of the Company should have realized the same and not relied on the Opinion of the Chartered Accountant firm without applying their mind.</u></p> <p>2. In respect of disclosures of related parties and related party transactions</p> <p>The AO found that the Company was exercising significant influence over Scal and therefore, the Company ought to have shown Scal as an “associate” for FY 2014 -15 under the Erstwhile Listing Agreement and from FY 2015- 16 to FY 2016- 17 in terms of LODR Regulations, which it failed to do. The Noticees have submitted that they have relied on the opinions provided by Mr. N. D. Gupta on whether Scal can be treated as “associate company” under AS – 18. However, as noted above, the Company had not disclosed all the relevant information to Mr. N. D. Gupta to enable him to give a true and correct view of whether Scal was an associate company or not. <u>The Noticees being Independent Directors and members of the Audit Committee of the Company, right from the</u></p>

¹ Relevant provisions of law for Issue I have been reproduced in [Annexure A](#) hereinbelow.

Issue No.	Issue	Observations/ Findings of the AO
		<p><u>beginning of the Investigation Period, should have realized the same and not relied on the opinion of Mr. N. D. Gupta without applying their mind.</u></p> <p>C. Conclusion:</p> <p>The Noticees were held liable of violating the provisions of Clause 49(II)(D)(1) of the Listing Agreement, Clause 49(III)(D)(1) of the Listing Agreement (post amendment dated April 17, 2014) read with Regulation 103 of the LODR Regulations and Regulation 18(3) read with Clause A (1) under Part C of Schedule II of LODR Regulations for the period from FY 2014 – 15 to FY 2017 -18.</p>
II.	Whether the Noticee nos. 6 to 9 (CFOs of the Company throughout the Investigation Period) respectively have violated Clause 49(V) of the Listing Agreement, Clause 49(IX) of the Listing Agreement (post amendment dated 17/04/2014) read with Regulation 103 of the LODR Regulations and Regulation 17(8) & 33(2)(a) of the LODR Regulations? ²	<p>A. Role of CFO:</p> <p>In terms of Clause 49(V) of the Listing Agreement/ Clause 49 (IX) of the Listing Agreement/ Regulation 17(8) of LODR Regulations, the CFO of a listed company is required to certify that the financial statements of the company do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading; and that the statements together present a true and fair view of the company’s affairs and are in compliance with existing accounting standards, applicable laws and regulations.</p> <p>B. AO’s Findings</p> <p>The CFOs throughout the Investigation period signed the financial statements of the Company as well as the CEO/CFO certification as required under the applicable laws. The CFOs are expected to ensure compliance with the financial reporting, other regulatory and legal requirements which has been captured in Clause 49(V) of the Listing Agreement/ Clause 49 (IX) of the Listing Agreement/ Regulation 17(8) of LODR Regulations. In this role, the CFO is also required to communicate with the investors in a fair and transparent manner and thereby, enhance the investor’s trust and confidence. Therefore, the <u>CFOs have a critical role to play in the scheme of the things under the erstwhile Listing Agreement and the LODR Regulations.</u> Based on the analysis of the facts of the matter, the AO found that the Noticees had clearly violated the duty cast upon them.</p> <p>The AO found that that Noticee Nos. 7 to 9 (CFOs of the Company throughout the Investigation Period) signed the CEO/CFO Certification to the Board of the Company for the respective financial years as noted above and violated the following provisions which required them to certify that the financial statements of the company do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading; and that the statements together present a true and fair view of the company’s affairs and are in compliance with existing accounting standards, applicable laws and regulations. Furthermore, it was noted that Clause 49 (IX) (A) of the Listing Agreement (post amendment dated April 17, 2014) and Clause A of Part B of Schedule II of the LODR Regulations clearly state that CFO shall certify to the Board that “they have reviewed the financial statements”.</p>
	Delay in issuance of the SCN	<p>The Noticees in their reply dated May 30, 2022 stated that the SCN dated August 30, 2021, with respect to the alleged violations that took place in FY 2011-12 to FY 2018 -19, has been issued after a delay of 9 years. The Noticees have submitted that there has been an inordinate delay in issuing the SCN and therefore, imposition of penalty would be unjustified and arbitrary.</p> <p>In this regard, the AO relied on the observations of the Hon’ble Supreme Court in <i>SEBI v. Sunil Khaitan</i> (Civil Appeal No. 8249 of 2013):</p>

² Relevant provisions of law for Issue II have been reproduced in [Annexure B](#) hereinbelow.

Issue No.	Issue	Observations/ Findings of the AO
		<p><i>“In the absence of any period of time and limitation prescribed by the enactment, every authority is to exercise power within a reasonable period. What would be the reasonable period would depend upon facts of each case, such as whether the violation was hidden and camouflaged and thereby the Board or the authorities did not have any knowledge. Though, no hard and fast rules can be laid down in this regard as determination of the question will depend on the facts of each case, the nature of the statute, the rights and liabilities thereunder and other consequences, including prejudice caused and whether third party rights have been created are relevant factors. Whenever a question with regard to inordinate delay in issuance of a show-cause notice is made, it is open to the noticee to contend that the show-cause notice is bad on the ground of delay and it is the duty of the authority/officer to consider the question objectively, fairly and in a rational manner.”</i></p> <p>The AO noted that SEBI received complaints against the Company in 2019, based on which an investigation was initiated in the matter to <i>inter alia</i> examine possible violations of the provisions of the SEBI Act, SEBI (PFUTP) Regulations, 2003, LODR Regulations and Listing Agreement during the Investigation Period. The Investigation Report was prepared and finalized in June 2021. Thereafter, after examining the relevant evidence, SCN dated August 31, 2021 was issued to the Noticees.</p> <p><i>The AO inter alia observed that although SEBI became aware of the scheme devised by the Company in 2019, the scheme was devised in such a manner that it would not be easily detected by any regulatory body. Therefore, keeping in mind the observations of the Hon’ble Supreme Court in SEBI v. Sunil Khaitan, it was found that the contention of the Noticees that there has been an inordinate delay in issuing the SCN, and therefore, imposition of penalty is arbitrary is not tenable.</i></p>
III.	Does the violation, if any, by the Noticees attract monetary penalty under Section 15 HB of the SEBI Act? ³	<p>Noticee Nos. 1 to 5 have failed to carry out adequate due diligence and exercise independent judgement as members of the Audit Committee of a listed company, to ensure that financial statements are free from material misstatement, and therefore, violated the provisions of Clause 49(II)(D)(1) of the Listing Agreement, Clause 49(III)(D)(1) of the Listing Agreement (post amendment dated April 17, 2014) read with Regulation 103 of the LODR Regulations and Regulation 18(3) read with Clause A (1) under Part C of Schedule II of LODR Regulations.</p> <p>The Noticee Nos. 7 to 9 in their capacities as CFO of the Company have issued certificate in the Annual Reports of the Company during the Investigation Period <i>inter-alia</i> certifying that the financials of the Company presented true and fair view of its affairs and did not contain any misleading statement,</p> <p>All Noticees except Noticee no. 6 (erstwhile CFO of the Company) are liable to be imposed with appropriate penalty under Section 15HB of the SEBI Act, 1992.</p>
IV.	If so, what should be the monetary penalty that can be imposed taking into consideration the factors mentioned in Section 15J of the SEBI Act? ⁴	<p>Because of the failure of the Noticees to carry out their responsibilities laid down in the LODR Regulations, the revenues and profit of the Company were inflated by approximately INR 2500 crores and INR 1300 crores respectively, during the period from FY 2011-12 to FY 2017-18. The AO found that Noticee nos. 1 to 5 as members of the Audit Committee failed in their duty to exercise oversight of the Company’s financial reporting process and disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.</p> <p>Further, Noticee Nos. 7 to 9 as CFOs wrongly certified that that the financial statements of the company do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading; and that the statements together</p>

³ Relevant provisions of law for Issue III have been reproduced in [Annexure C](#) hereinbelow.

⁴ Relevant provisions of law for Issue IV have been reproduced in [Annexure D](#) hereinbelow.

Issue No.	Issue	Observations/ Findings of the AO
		present a true and fair view of the company's affairs and are in compliance with existing accounting standards, applicable laws and regulations. As a result of the same incorrect and misleading financial results have been published on the stock exchange under Regulation 30 of LODR Regulations which have been relied upon by the investors of the securities market to make their investment decisions.

Current Status:

The Company has filed an appeal with the Securities Appellate Tribunal (**SAT**) against SEBI's adjudication order dated October 31, 2022.

ANNEXURE A
RELEVANT PROVISIONS FOR ISSUE I

Listing Agreement

Clause 49 - Corporate Governance

The company agrees to comply with the following provisions:

...

II. Audit Committee

...

(D) Role of Audit Committee

The role of the audit committee shall include the following:

1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.

Listing Agreement (post amendment dated April 17, 2014)

49. Corporate Governance

...

...

III. Audit Committee

...

...

D. Role of Audit Committee

The role of the Audit Committee shall include the following:

1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible;

SEBI (LODR) Regulations, 2015

Audit Committee.

18. ...

...

...

(3) The role of the audit committee and the information to be reviewed by the audit committee shall be as specified in Part C of Schedule II.

Repeal and Savings

103. (1) On and from the commencement of these regulations, all circulars stipulating or modifying the provisions of the listing agreements including those specified in Schedule X, shall stand rescinded.

(2) Notwithstanding such rescission, anything done or any action taken or purported to have been done or taken including any enquiry or investigation commenced or show cause notice issued in respect of the circulars specified in sub-regulation (1) or the Listing Agreements, entered into between stock exchange(s) and listed entity, in force prior to the commencement of these regulations, shall be deemed to have been done or taken under the corresponding provisions of these regulations.

SCHEDULE II: CORPORATE GOVERNANCE

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PART C: ROLE OF THE AUDIT COMMITTEE AND REVIEW OF INFORMATION BY AUDIT COMMITTEE

A. The role of the audit committee shall include the following:

(1) oversight of the listed entity's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible;

ANNEXURE B
RELEVANT PROVISIONS FOR ISSUE II

Listing Agreement

Clause 49 - Corporate Governance

The company agrees to comply with the following provisions:

...
V. CEO/CFO certification
The CEO, i.e. the Managing Director or Manager appointed in terms of the Companies Act, 1956 and the CFO i.e. the whole-time Finance Director or any other person heading the finance function discharging that function shall certify to the Board that:
(a) They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief:

(i) these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;

(ii) these statements together present a true and fair view of the company's affairs and are in compliance with existing accounting standards, applicable laws and regulations.

Listing Agreement (post amendment dated April 17, 2014)

49. Corporate Governance

...
IX. CEO/CFO certification
The CEO, i.e. the Managing Director or Manager appointed in terms of the Companies Act, 1956 and the CFO i.e. the whole-time Finance Director or any other person heading the finance function discharging that function shall certify to the Board that:
A. They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief:

1. these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;

2. these statements together present a true and fair view of the company's affairs and are in compliance with existing accounting standards, applicable laws and regulations.

SEBI (LODR) Regulations, 2015

Board of Directors.

17.

...
...
(8) The chief executive officer and the chief financial officer shall provide the compliance certificate to the board of directors as specified in Part B of Schedule II.

Repeal and Savings

103. (1) On and from the commencement of these regulations, all circulars stipulating or modifying the provisions of the listing agreements including those specified in Schedule X, shall stand rescinded.

(2) Notwithstanding such rescission, anything done or any action taken or purported to have been done or taken including any enquiry or investigation commenced or show cause notice issued in respect of the circulars specified in sub-regulation (1) or the Listing Agreements, entered into between stock exchange(s) and listed entity, in force prior to the commencement of these regulations, shall be deemed to have been done or taken under the corresponding provisions of these regulations.

SCHEDULE II: CORPORATE GOVERNANCE

...
PART B: COMPLIANCE CERTIFICATE

The following compliance certificate shall be furnished by chief executive officer and chief financial officer:

A. They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief:

(1) these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;

(2) these statements together present a true and fair view of the listed entity's affairs and are in compliance with existing accounting standards, applicable laws and regulations.

ANNEXURE C
RELEVANT PROVISIONS FOR ISSUE III

“Penalty for contravention where no separate penalty has been provided.

15HB. Whoever fails to comply with any provision of this Act, the rules or the regulations made or directions issued by the Board thereunder for which no separate penalty has been provided, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.”

ANNEXURE D
RELEVANT PROVISIONS FOR ISSUE IV

“Factors to be taken into account while adjudging quantum of penalty.

15J. While adjudging quantum of penalty under 15-I or section 11 or section 11B, the Board or the adjudicating officer shall have due regard to the following factors, namely: —

- (a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;*
- (b) the amount of loss caused to an investor or group of investors as a result of the default;*
- (c) the repetitive nature of the default.*

Explanation. —For the removal of doubts, it is clarified that the power to adjudge the quantum of penalty under sections 15A to 15E, clauses (b) and (c) of section 15F, 15G, 15H and 15HA shall be and shall always be deemed to have been exercised under the provisions of this section.”