

IN THE HIGH COURT OF DELHI AT NEW DELHI

W.P. (C) 10672/2009

Reserved on: September 28, 2011

Decision on: October 10, 2011

GUPTA & GUPTA CHARTERED ACCOUNTANTS
& ANR.

..... Petitioners

Through: Mr. Vineet Malhotra, Advocate.

versus

RESERVE BANK OF INDIA & ORS.

..... Respondents

Through: Mr. H.S. Parihar, Advocate for R-1.
Mr. Jagdeep Kishore, Advocate for
R-2 and R-3.

CORAM: JUSTICE S. MURALIDHAR

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| 1. Whether Reporters of local papers may be allowed to see the judgment? | No |
| 2. To be referred to the Reporter or not? | Yes |
| 3. Whether the judgment should be reported in Digest? | Yes |

JUDGMENT
10.10.2011

1. The Petitioner, a firm of chartered accountants, is aggrieved by a decision of Reserve Bank of India ('RBI'), Respondent No. 1, communicated to Punjab National Bank ('PNB'), Respondent No. 2, advising that the PNB may carry out the quarterly review for the quarter ending 30th June 2009 with the five existing statutory central auditors ('SCAs'), excluding the Petitioner firm in view of the circumstances mentioned in the PNB's letter dated 27th May 2009 addressed to the RBI.

Background Facts

2. By a letter dated 6th October 2005 issued by the PNB, the Petitioner was appointed as a Joint SCA along with five other SCAs to carry out half yearly/quarterly review of accounts commencing from 30th September 2005 in terms of the RBI Circular of that date as well as for auditing the final accounts of the PNB for the year ending 2005-06. Admittedly, the Petitioner's appointment was continued on a year to year basis and in terms of the then existing guidelines for a period of four years, i.e., from 2005-2006 to 2008-2009. In terms of a Circular dated 5th June 2003 of the RBI, the Bank for whom

the firm of SCAs has been appointed to audit the accounts of the previous year, is usually also asked to undertake quarterly review for the quarter ending 30th June of the next year. Since the Petitioner along with other five SCAs had signed the balance sheet of PNB on 20th May 2009, the Petitioner legitimately expected to be asked to continue as one of the SCAs for the limited review for the quarter ending June 2009.

3. The Petitioner states that it received on the late night of 24th June 2009 a notice of that date from the PNB fixing a meeting of all the SCAs including the Petitioner on 26th June 2009 at 11 am for finalization of the Long Form Audit Report ('LFAR') for 2008-09, progress of tax audit report for 2008-09 and allocation of review work for the quarter ending June 2009. The Petitioner further states that it attended the said meeting held on 26th June 2009 and also throughout on 27th and 28th June 2009 when the LFAR was finalized. It also signed LFAR for 2008-09 on late night of 28th June 2009. The Petitioner states that despite the advisory by RBI by Circular dated 16th June 2009 advising that banks "may utilize the services of the entire team of statutory central auditors, who had audited your bank accounts during 2008-09 for the quarterly review of the quarter ending June 30, 2009..." it was discontinued as an SCA of the PNB, whereas the other five SCAs continued. The Petitioner came to know of this for the first time when it received a letter dated 1st July 2009 from one of the continuing auditors, M/s. Kalani & Co., Jaipur who sought a 'No objection' from the Petitioner for accepting the appointment as SCA. Similar letters were received from the other SCAs. The Petitioner replied to each of them stating that it had not yet been formally communicated of its discontinuance as an SCA of the PNB.

4. The Petitioner contends that it was singled out for being discontinued as SCA and that this amounted to blacklisting of the Petitioner firm apart from being *mala fide*. The Petitioner was not served any prior show cause notice and the decision was, therefore, violative of principles of natural justice. There was correspondence exchanged between the Petitioner, the PNB and the RBI in regard to reports sent by the Petitioner firm to the RBI pointing out the irregularities committed by the PNB. The Petitioner alleges that Respondent No. 3 Dr. K.C. Chakraborty who was at the relevant time the Chairman-cum-Managing Director ('CMD') of PNB, prior to being appointed as the Deputy Governor of the RBI on 15th June 2009, had requested the Petitioner to withdraw its qualified report in relation to irregularities since it would otherwise adversely affect his career prospects. Respondent No. 3 even tried to coerce the Petitioner through the

President of the Institute of Chartered Accountants of India. The Petitioner however declined to succumb to the pressure. The Petitioner had pointed out to the RBI that there were irregularities in granting of loans to two real estate companies in the aggregate of over Rs. 1000 crores where the value of security was far less than stipulated in the sanction. This was noticed by the Petitioner in the course of limited review for quarter ending 31st December 2008. In earlier reports the Petitioner highlighted the grossly inflated values of the land and property given as security for the loans advanced by PNB. For the financial year ending 31st March 2009, the Petitioner noticed irregularities in the value of securities in regard to loans to two real estate companies. In addition a loan of Rs. 325 crores had been advanced to Ambience Developers Limited. In its Notes on Accounts in respect of the balance sheet for the year ending 31st March 2009, PNB acknowledged that there was a shortfall in the actual value of the security in relation to the advances given to the aforementioned real estate companies. The other observations in relation to the claiming of interest were also admitted by the PNB. The Petitioner states that it was discontinued as SCA for the limited review for the quarter ending 30th June 2009 since PNB apprehended that the Petitioner would detect further irregularities. The Petitioner states that the caveats filed by the PNB in the Bombay High Court referred to a letter dated 24th June 2009 written by the RBI to the PNB. Thereafter, on 13th July 2009 the Petitioner wrote to the PNB and the RBI requesting for a copy of the said letter. A copy thereof had not been supplied to the Petitioner till the filing of the present writ petition.

RBI's Counter Affidavit

5. In response to the notice issued in the present petition, a counter affidavit was filed by the RBI in which it is stated that no audit firm has a legal right to continue as an SCA of a public sector bank beyond the period of four years and as per the prevailing norms. A firm which has conducted audit as an SCA of a public sector bank was required to be 'rested' for the next two years. The RBI had, for the convenience of the banks, permitted them to continue with their existing SCAs for the limited review exercise for the quarter ending June every year. This was because the fresh panel of names usually took some time for being finalised.

6. The RBI enclosed with its counter affidavit, a copy of letter dated 29th April 2009 written by it to the Petitioner. The said letter pointed out that the PNB had reported to the RBI that the Petitioner had been allotted the statutory audit of three branches of the

PNB, viz., the Mall, Patiala, and Large Corporate Branches ('LCBs') at Bangalore and Delhi. While the audit at the Mall Patiala and LCB Bangalore had been completed, the audit of the LCB in Delhi had been delayed. The PNB had informed the RBI that the audit at LCB, Delhi was started on 27th March 2009 but was discontinued by the Petitioner on the same day without any valid reason. Thereafter, the audit was resumed on 8th April 2009 by two partners of the Petitioner firm. It was stated that one of the senior partners had called for information on 27th April 2009 in respect of twelve borrower accounts. The PNB apprehended that the finalization of the work of consolidation of branch accounts would not be completed within the time period fixed by the PNB, i.e., 2nd May 2009 which in turn would delay the finalization of annual accounts. The RBI asked the Petitioner firm to forward its comments in respect of the above observations not later than 9th May 2009.

7. The RBI also enclosed with its counter affidavit a copy of letter dated 7th May 2009 written by the Petitioner to the RBI explaining what according to the Petitioner had transpired during the audit of the LCB, Delhi. *Inter alia*, it was pointed out that the team for the audit of the LCB, Delhi was headed by a senior partner Mr. Vinod Gupta who has been a partner in the firm since 1988. The other partner Mr. S.B. Gupta had been injured due to a fracture of his knee. His absence did not actually delay the audit of the PNB. The information sought by Mr. Gupta about the twelve borrower accounts was essentially for the finalization of the audit report. These accounts included those of DLF (with an advance of Rs. 1000 crores) and Parsvnath (with an advance of Rs. 100 crores) in which the Petitioner had suspected fraud or fraudulent activity about which the Petitioner had sent reports to the RBI. The Petitioner noted that the PNB has since released another Rs. 700 crores as additional loan to DLF Limited. PNB had re-classified four accounts as standard assets which had been classified by the Petitioner in the limited review of quarter ending 31st December 2008 as non-performing assets (NPAs). These were Parasvnath Developers Limited, Ambience Developers Limited, Ambience Hotels & U Resorts Limited and Gujrat Anjan Cement Limited. It was pointed out that the Petitioner was not responsible for the delay since it was on account of the failure of the PNB to respond to the clarification sought by the Petitioner. The Petitioner further asked the RBI whether the PNB had reported delays to RBI about all the auditors as well as about the Petitioner and that if the Petitioner was being singled out, such an act was *mala fide*.

8. The RBI's counter affidavit proceeded to state that RBI had, by its letter dated 14th May 2009, forwarded the Petitioner's letter dated 7th May 2009 to the PNB for its comments. A copy of letter dated 27th May 2009 by the PNB in response to the letter dated 14th May 2009 has been enclosed by the RBI with its counter affidavit. In the said letter the PNB, *inter alia*, alleged that the Petitioner "has been abrasive *ab initio* and uncooperative in their approach right from the first audit and are lacking in professionalism." The PNB also alleged that "the Petitioner have been keeping the deficiencies noticed during the audit to themselves and have always been hesitant to discuss and conclude in time the audit report in a fair and professional manner, thus putting the entire system to undue stress and holding the bank to ransom." Further, the PNB alleged that the Petitioner's observations "are not only subjective but most of the times frivolous and magnified out of proportion." Further, the Petitioner's "objective has been to embarrass the Bank and harass its officers. The behaviour and attitude is indicative of cynicism and sadism as well." Accordingly, PNB reiterated its "earlier recommendations to replace immediately M/s. Gupta & Gupta, SCA who have completed their term in any case with the audit for March 2009 and provide a new SCA for June 2009 limited review itself." In case this was not possible for any reason, the Petitioner should be removed 'immediately' and PNB "permitted to get the quarterly limited review done by remaining 5 SCAs only."

9. It appears that the above letter dated 27th May 2009 of the PNB was not sent by the RBI to the Petitioner for its comments. Instead, on 24th June 2009 the RBI wrote the following letter to the CMD, PNB:

"Finalization of annual accounts – 2008-09 – Complaint against audit firm – M/s. Gupta & Gupta.

Please refer to your letter dated May 27, 2009 on the captioned subject.

2. In this connection, we advise that you may carry out the quarterly review for the quarter ending June 30, 2009 with the five existing statutory central auditors, i.e., excluding the firm M/s. Gupta & Gupta in view of the circumstances cited in your above letter."

10. In its counter affidavit, the RBI in para 16 stated the procedure adopted by it, as under:

"16. It is submitted as per the practice followed by this Respondent in regard to complaints against audit firms, if any adverse comments/complaints are received against any auditor/audit firm, the matter is examined in detail and

if considered necessary, appropriate action is taken against the auditors/audit firms concerned. The letter of Respondent No. 2 dated May 27, 2009 (Annexure R-1) brought out certain reasons for not continuing with the services of the Petitioner firm for conducting the quarterly limited view for the quarter ending June 2009. As the Petitioner firm had taken more than a month in finalising the branch audit report, besides delaying the finalisation of the consolidation work relating to annual accounts of the Respondent No. 2 and levelled unsubstantiated allegations of suspected fraudulent transactions, it was decided by this Respondent to accede to the request of Respondent No. 2 for not associating the Petitioner firm to conduct the quarterly review of the bank's results for the quarter ending June 30, 2009 and accordingly the Respondent No. 2 was advised vide letter dated June 24, 2009.”

11. However, later in the counter affidavit, the RBI in para 37 stated as under:

“37. The Petitioner firm has only been disassociated with the work of quarterly review for one quarter, as stated earlier. Even otherwise as per the existing norms, the Petitioner firm will be placed under ‘rest’ for a period of two years beginning with 1st April 2009 and may be considered to conduct statutory central audit after the expiry of said period of two years. There is no stigma whatsoever on the Petitioners. Hence, the Petitioners have no locus standi to insist for quarterly review work.”

Counter Affidavit of the PNB

12. The PNB, in its counter affidavit, has contended that the writ petition has become infructuous since it related to the continuance of the Petitioner as an SCA for the limited review for the quarter ending June 2009. That period had already expired even before the filing of the writ petition. Secondly, it was contended that the writ petition raises disputed questions of fact that cannot be decided by this Court under Article 226 of the Constitution. Thirdly, the dealings between a chartered accountant and its client were supposed to be confidential. The Petitioner firm had tried to exert pressure on the PNB by various actions and inactions to which the PNB did not succumb. Fourthly, the Petitioner firm had been engaged as an SCA hired for a specified period which had expired after the finalization of the accounts. In the circumstances, the question of issuance of any prior notice or granting a hearing to the Petitioner for discontinuing its services did not arise. PNB submits that the Petitioner firm would be considered for being empanelled again after a gap of two years by the appropriate authority. PNB has denied that any irregularity has been committed in relation to any of the accounts as pointed out by the Petitioner firm. PNB reiterated its dissatisfaction with the conduct of the audit by the Petitioner and the unnecessary inconvenience caused by the Petitioner

firm.

13. Despite service of notice, Respondent No. 3 did not enter appearance. Also, no reply has been filed on his behalf. The averments against him in the writ petition remain uncontroverted.

14. The Petitioner has filed rejoinders to the counter affidavits of the RBI and the PNB. The Petitioner has, *inter alia*, sought to demonstrate how the time lines for finalisation of audit was not met by any of the other five SCAs and that in comparison thereto, the Petitioner could not be accused of having delayed the audit. Further, even as regards the finalisation of the consolidated accounts, the Petitioner could not be faulted for causing any delay.

Submissions of Counsel

15. This Court has heard the submissions of Mr. Vineet Malhotra, learned counsel for the Petitioners, Mr. H. S. Parihar, learned counsel for Respondent No. 1 RBI and Mr. Jagdeep Kishore, learned counsel for Respondent Nos. 2 and 3.

16. Mr. Malhotra, apart from reiterating submissions made in the writ petition and in the rejoinder affidavits, pointed out that discontinuance of the Petitioner firm as SCA for the limited review for the extended period ending 30th June 2009 was stigmatic, since the other five SCAs were retained. The discontinuance was on account of the complaint made to the RBI against the Petitioner by the PNB which was accepted and acted upon by the RBI. RBI ought not to have unilaterally accepted the complaint by the PNB without seeking explanation from the Petitioner on PNB's specific allegations. The procedure adopted by the RBI was contrary to the principles of natural justice. Conscious of the limited jurisdiction of this Court under Article 226 of the Constitution, Mr. Malhotra submitted that this Court should while declaring the Petitioner's discontinuance by the impugned letter dated 24th June 2009 of the RBI addressed to the PNB to be illegal, clarify that the said decision would not come in the way of the Petitioner being considered for empanelment as SCA hereafter.

17. Mr. H.S. Parihar, learned counsel for the RBI submitted that the letter dated 24th June 2009 from RBI to PNB should not be viewed as a stigma on the Petitioner. PNB had requested the RBI to discontinue the Petitioner firm as SCA only for the limited

review for the quarter ending June 2009. PNB had furnished reasons in support of such request and the RBI had accepted the request. The RBI had not conducted any enquiry or come to any conclusion on the conduct of the Petitioner. Mr. Parihar reiterated that the Petitioner's case for empanelment in future would be considered in accordance with the procedure already outlined in the counter affidavit.

18. Mr. Jagdeep Kishore, learned counsel for the PNB submitted that the Petitioner could not insist on being continued as SCA beyond the period of four years. He also stated that the PNB was open to the Petitioner being empaneled as SCA in future notwithstanding the exchange of correspondence that took place in regard of retention of the Petitioner for the limited review for the quarter ending June 2009. He too reiterated that discontinuance of the Petitioner for the quarter ending 30th June 2009 should not be viewed as a stigma on the Petitioner.

Whether the discontinuance of the Petitioner as SCA was lawful?

19. In view of the submissions of learned counsel for the parties, the scope of the present writ petition has narrowed down. The only question that arises for determination is whether the discontinuance of the Petitioner firm as SCA for the quarter ending 30th June 2009 was stigmatic and therefore required compliance with the principles of natural justice? This Court therefore does not propose to examine the allegations and counter allegations concerning the Petitioner on the one hand and the PNB on the other in regard to what transpired prior to the impugned decision of the RBI as contained in the letter dated 24th June 2009 addressed to the PNB. This Court is not concerned with the correctness or otherwise of the decision to discontinue the Petitioner as SCA. It is concerned only with the process by which such decision was arrived at.

20. The procedure for the appointment of a firm of auditors as SCA for a public sector bank envisages a primary role for the RBI, which acts as such in exercise of its powers under Section 30 (1A) of Banking Regulation Act, 1949 ['the BR Act']. In terms of Section 10 (1) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 ['1970 Act'] and the corresponding provision in the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 ['1980 Act'], the RBI has to mandatorily grant prior approval to the appointment of SCAs of twenty-six public sector banks. The RBI has issued circulars specifying the norms for appointment of SCAs in public sector banks. Where the total liabilities and assets of the public sector bank is up

to Rs. 50,000 crore the prescribed number of SCAs is four; where it is between Rs. 50,000 crore and up to Rs. 1 lakh crore, the number of SCAs is five and above Rs 1 lakh core, the number of SCAs is six. The SCAs appointed during 2006-07 and thereafter would have a tenure of four years after which they were to be rested for two years. Further, the Office of Comptroller & Auditor General of India ('CAG') is entrusted with the responsibility of calling for applications from auditors/audit firms desirous of being appointed as SCAs in public sector banks every year. After subjecting the applications to scrutiny in terms of the prescribed norms, the CAG prepares a list of eligible auditors/audit firms. That list is then forwarded by the CAG to the RBI. Finally, the selection of auditors/audit firms by the RBI is made from amongst the auditors/audit firms found eligible by CAG.

21. There is merit in the contention of the Petitioner that the discontinuance of an SCA, selected through such a rigorous process, is likely to have adverse consequences for its reputation and goodwill if such discontinuance is as a result of a complaint about its competence or integrity. For a firm of auditors the appointment as SCA of a public sector bank is bound to be seen to be a prestigious one. As a corollary the discontinuance of a firm of auditors as SCA, unless for circumstances unconnected with integrity or competence, is bound to be viewed negatively. Further, since the number of SCAs of a public sector bank is unlikely to be more than six, the appointment and discontinuance of an SCA is likely to be known immediately to all chartered accountants.

22. An SCA of a public sector bank discharges statutory responsibilities traceable to Section 224 (2) of the Companies Act 1956, the BR Act, the 1970 Act and the 1980 Act. In the context of the circulars issued by the RBI on the charging of interest by public sector banks, the Supreme Court in *Central Bank of India v. Ravindra (2001) 107 CC 416* explained that the power conferred on the RBI under Sections 21 and 35A of the BR Act is coupled with the duty to act fairly and reasonably. The RBI's circulars were held to be binding on "those who fall within the net of such directives." By analogy the RBI's circulars as regards the appointment and continuance of SCAs must be viewed as binding on public sector banks including the PNB. RBI discharges a statutory duty when it selects a firm of auditors to act as an SCA of a public sector bank. It is a reflection of both the competence as well as integrity of the firm of auditors. It acknowledges that the answerability of the public sector bank is as much as to the law

as to the public in general whose monies it is the custodian of. On their part the SCAs are expected to discharge their professional duties in the context of the above statutory obligations and their answerability to both the RBI and the public in general. The relationship of an SCA with the public sector bank whose audit they are engaged to undertake transcends the usual client-auditor relationship. The involvement of the RBI in the appointment and discontinuance of an SCA is meant to ensure a degree of protection to the SCA which is expected to discharge its professional duty fearlessly and independently. The discontinuance of an SCA cannot be brought about by the public sector bank acting by itself. Just as there can be no appointment of an SCA without the intervention of the RBI, there can be no discontinuance of an SCA without the RBI taking a decision in that regard. The greater the power to appoint and remove an SCA, the higher the responsibility on the RBI as the holder of such power to exercise it in a fair and reasonable manner after following a just procedure which comports with the principles of natural justice.

23. Where a complaint is made against an SCA by a public sector bank, it would be the duty of the RBI to examine such complaint carefully. In the audit of large public sector banks, there are bound to be queries raised by the SCAs about the accounts of the large account holders of the bank. If there are complaints by the bank, like in the present case, that the audit is getting delayed on account of the bank having to answer such queries, the RBI will have to examine the tenability of such claim after seeking an explanation from the SCA. In the present case, the PNB first wrote to the RBI on 24th April 2009 blaming the Petitioner for the delay in the finalization of the accounts. The Petitioner's comments on the said letter were sought by the RBI. The Petitioner then submitted a reply dated 7th May 2009 explaining that there was no delay on its part. This reply was furnished to the PNB by the RBI for its response. In response thereto, on 27th May 2009 the PNB made several allegations questioning the Petitioner's professional competence and integrity. In other words, the tenor of the allegations by PNB against the Petitioner in the letter dated 27th May 2009 was not confined to the issue of delay. Specifically, PNB alleged that the intention of the Petitioner was "to malign the reputation and image of the bank"; that the Petitioner was "abrasive ab initio and uncooperative in their approach right from the first audit and are lacking in professionalism."; that they have been "putting the entire system to undue stress and holding the bank to ransom"; "their objective has been to embarrass the bank and harass its officers. The behaviour and attitude is indicative of cynicism and sadism." Then came the impugned decision of the

RBI communicated in its letter dated 24th June 2009 permitting PNB to discontinue the Petitioner as SCA for the limited extended review for the quarter ending 30th June 2009.

24. It is not as if the letter dated 24th June 2009 simply states that the Petitioner will be discontinued. It refers to the PNB's letter dated 27th May 2009 and states that the Petitioner could be discontinued as SCA "in view of the circumstances cited in the above letter." It is therefore not possible to view the said discontinuance as being innocuous and routine and not casting a stigma on the Petitioner. The RBI could not have arrived at the decision without some kind of an inquiry. The RBI was performing an important and sensitive task. Allegations concerning the competence and integrity of an SCA, selected by the RBI through a fairly rigorous process, cannot be permitted to be made lightly and equally accepted on face value without some probe by the RBI. Otherwise it might be easy for a bank to have an inconvenient SCA discontinued. Considering that the accounts of public sector banks are to be audited by employing the best possible standards, the RBI was under a statutory obligation to ensure that the discontinuance of the Petitioner, on a complaint about its professional competence, was preceded by a proper procedure comporting with the principles of natural justice. Admittedly, even a copy of PNB's letter dated 27th May 2009 was not sent to the Petitioner for its comments although it contained serious allegations about the Petitioner's conduct and professional competence. Thereby RBI failed to afford the Petitioner an opportunity of defending itself against PNB's allegations. Also, neither the RBI nor PNB communicated to the Petitioner the decision to discontinue it as an SCA for the extended review period.

25. The Court holds that the impugned decision of the RBI, as communicated in its letter dated 24th June 2009 to the PNB, to discontinue the Petitioner as an SCA, even for the limited extended period ending 30th June 2009, was violative of the principles of natural justice and was, therefore, illegal. However, since the period in question is over no consequential relief can be granted except to clarify that the said decision of the RBI, will not come in the way of the Petitioner being hereafter appointed as an SCA in accordance with the norms devised by the RBI.

26. The writ petition is disposed of in the above terms, but in the facts and circumstances of the case, with no order as to costs.

S. MURALIDHAR, J.

OCTOBER 10, 2011

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