BEFORE THE ADJUDICATING OFFICER

SECURITIES AND EXCHANGE BOARD OF INDIA

[ADJUDICATION ORDER No. Order/BS/SL/2024-25/30612-30613]

UNDER SECTION 15I OF SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 READ WITH RULE 5 OF SECURITIES AND EXCHANGE BOARD OF INDIA (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES) RULES, 1995

In respect of:

Noticee No.	Name of the Noticee	PAN / DIN No.
1	Mr. Ratan Sagar Khanna	ADRPK7506P
2	Ms. Ankita Mehrotra Khatri	BGFPM0978R

(*hereinafter collectively referred to as “***Noticees***”***)**

In the matter of Kwality Limited

BACKGROUND

1. Securities and Exchange Board of India (herein after referred to as “**SEBI**”) received a reference from the Income Tax Department (herein after referred to as “**ITD”**) in respect of the company Kwality Ltd. (herein after referred to as “**Kwality/Company”**).

2. Subsequently, SEBI conducted an investigation in the matter on receipt of Transaction Audit Report (herein after referred to as “**TAR**”) by Resolution Personnel (**RP**) Bagchi & Gupta. Meanwhile, various references were received from enforcement agencies with copies of FIR dated September 10, 2020 registered by Bank of India against the Company and its office bearers.

3. The Transaction audit of the books of accounts of the company was carried out by Bagchi & Gupta for the period December 11, 2016 to December 10, 2018. The focus of the investigation by SEBI, was to ascertain whether there was any violation of the provisions of Securities and Exchange Board of India Act, 1992 (hereinafter referred to as **"SEBI Act**"), SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 (hereinafter referred to as "**PFUTP Regulations**"), SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (hereinafter referred to as "**LODR Regulations**") during the period starting from December 11, 2016 to December 10, 2018 (hereinafter referred to as "**Investigation Period**").

APPOINTMENT OF ADJUDICATING OFFICER

4. Vide communique dated January 27, 2023, Shri Vijayant Kumar Verma was appointed as the Adjudicating Officer (hereinafter referred to as 'AO') under Section 15-I of the SEBI Act and Rule 3 of the SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995 (hereinafter referred to as '**Adjudication Rules'**) read with Section 19 of the SEBI Act, to inquire into and adjudge under Regulation 18(3) read with Para A of Part C of Schedule II of SEBI (LODR) Regulations, 2015. Further, pursuant to the transfer of erstwhile Adjudicating Officer, the instant matter was re assigned to the undersigned vide order dated May 22, 2024 to inquire into and adjudge under the provisions of:
   Section 15HB of SEBI Act, 1992, the alleged violations of provisions of
   - Regulation 18 (3) read with Para A [(1), (4) (e) (d), (11), (12)] of Part C of Schedule II of SEBI (LODR) Regulations, 2015 against the Independent Directors who were members of the Audit Committee.

Details of the Noticees:

5. As per information available on record, it is noted that the details of Noticees as Independent Directors of Kwality is given in the following table:

Sr No	Name	Designation	Appointment Date	Cessation Date
1	Dr. Rattan Sagar Khanna	Independent Director	May 18, 2010	October 08, 2015
		Independent Director and Non – Executive Chairman	October 08, 2015	-
2	Ms. Ankita Mehrotra	Independent Director	January 23, 2016	July 28, 2018

6. **Pursuant to investigation following was observed by SEBI:**

6.1 The company and its directors have misrepresented the financials for more than 8 years as per Income Tax observations and for the period from December 2016 till December 2018 as per TAR. The same was allegly done through fictitious revenue, inflated expenses receivables and accounts position etc. in collusion with debtors and creditors of the company. Majority of the transactions were with connected entities, stuck off companies, and with entities who are not into diary business. The transactions were created to indicate that the financials of the company show a rosy picture through such misrepresentation.

6.2 The exclusive dependency of the customers and vendors on Kwality, inter purchases and sales indicated that the figures have been fabricated. The interconnection of corporate entities (customers & vendors include both Corporate and Non-Corporate entities) between themselves and with Kwality through common directors, substantial write off of their outstanding (Rs. 863 crore) and outstanding balances clubbed with the observations from site visit indicated the non – genuineness of these transactions.

6.3 The company has also deliberately misreported its receivables position to the financial creditors and auditors with an intent to defraud the bankers.

6.4 The Company diverted funds through fictitious purchases and there have been deliberate falsification of books of accounts through further booking of fictitious sales in collusion with the parties. The Company had not initiated any legal steps for recovery of the receivables despite going through a severe liquidity crisis, which indicated that there is a deliberate misrepresentation of books of account by the company, in as much as admitting that the amount may not be recoverable from these Customers.

6.5 Hence, the amount of misrepresentation and diversion, as calculated by the TAR is as under:

(Amount in Crs)

Under Section	Particulars	Amount	Total
66 (1) of IBC – any business of the corporate debtor i.e. company, has been carried on with intent to defraud creditors of the corporate debtor or for any fraudulent purpose	Net Off transactions through book entries	4879.18	7574.88
	Doubtful capital equipment purchase transactions	31.44	
	Receivables written off or provided:- Scheme Discounts 760 | Written-off - 102 | Provisions - 1277 & 325	2464	
	Advances to suppliers provided as bad debts)	200.26	

6.6 It is observed that ITD has also concluded that the purchaser entities / companies / concerns were merely paper companies and have no actual business and meant for bugs billing for Kwality. Money trail also shows that funds were infused in various paper entities and returned back to its beneficiaries. It is observed that it has raised a demand notice for a total amount of Rs. 72,05,26,98,760/- till 2018-19 under section 146 of Income Tax Act, 1961 with a conclusion that "*it may be stated without an iota of doubt that Kwality Ltd, had allegedly shown bogus purchases from the billing, which did not have any real business related to supply of milk and was only created with the sole purpose of providing accommodation entries to the Kwality group of companies, in lieu of commission.*"

6.7 It is observed that, SEBI vide order QJA/KS/CFID/ CFID/ 30556/ 2024-25 dated June 28, 2024 have found that there were financial mis-statements by the Company. In view of the same, SEBI vide the aforesaid order imposed monetary penalty on the Company and its Directors. SEBI also initiated Adjudication Proceedings against the Noticees who were the Independent Directors of the Company.

SHOW CAUSE NOTICE, REPLY AND HEARING

7. In view of the above, a common Show Cause Notice (**SCN**) dated February 17, 2023, was issued, *inter-alia*, to the Noticees under the provisions of Rule 4(1) of the Adjudication Rules, to show cause as to why an inquiry should not be held against them and why penalty, if any, not be imposed under Regulation 18(3) read with Para A of Part C of Schedule II of SEBI (LODR) Regulations. The SCN was issued to the Noticees through Speed Post Acknowledgement Due (**SPAD**). Noticees were granted fourteen days (14) time from the service of the SCN to submit the reply to SCN.

8. The allegations levelled against Noticees in SCN are summarized as under:

8.1 It was observed from SCN, that the Noticees were members of the audit committee of the company. Noticee 1 i.e. Mr. Rattan Sagar Khanna had attended 26 out of 27 Board Meetings held during the FY 16-17 to FY 2018-19, and all the Audit Committee meetings i.e. 22 held during the FY 16-17 to FY 2018-19. While Ms. Ankita Mehrotra attended 16 out of 18 Board Meetings and 12 out of 13 audit committee meetings held during the FY 16-17 to FY 2018-19. In the statement of recording before the Investigating Authority of Noticee 1 and Noticee 2 were held on March 25, 2022 & March 23, 2022 respectively. In their statement recording they submitted that they had no information of netting off accounting entries between debtors and creditors and written off debtors outstanding balances as no such discussions were taken up in the audit committee meetings. Hence, it is noted that the aforesaid Noticees were members of the audit committee and both of them had attended majority of the audit committee meetings.

8.2 It is alleged in the SCN, that the Noticees have failed to undertake their responsibilities, assigned to them as members of the audit committee, under Regulation 18(3) read with Para A of Part C of Schedule II of LODR Regulations.

8.3 In view of the above, the following violations are alleged against the Noticees:

Noticee 1	**Noticee 2**
Regulation 18 (3) read with Para A [(1), (4) (e) (d), (11), (12)] of Part C of Schedule II of SEBI LODR Regulations 2015.	Regulation 18 (3) read with Para A [(1), (4) (e) (d), (11), (12)] of Part C of Schedule II of SEBI LODR Regulations 2015.

9. Noticee 2 Vide her email as well as letter dated March 06, 2023, submitted reply to the SCN while Noticee 1 vide email dated March 04, 2023, requested additional time of 2 weeks, for submitting reply to the SCN. Subsequently, Noticee 1 submitted its reply to the SCN vide email dated April 03, 2023.

10. On receipt of the submissions made by the Noticees, an opportunity of personal hearing was granted by the erstwhile AO, to the Noticees on April 25, 2023. In respect of Noticee 1, Mr. Mukesh Agarwal - Authorised Representative **(AR)** of Noticee 1 attended the meeting. During the hearing, the AR of Noticee 1 requested time till May 04, 023, for submitting the additional reply, which was duly acceded to. Vide Email dated May 04, 2023, Noticee 1 filed additional submissions in the matter. Noticee 2 attended the hearing, through virtual mode, and made submissions vide her letter as well as email dated March 06, 2023.

11. Pursuant to reallocation of the captioned matter to me, in the interest of natural justice, an opportunity of personal hearing was granted to Noticees on July 11, 2024, vide hearing notice dated July 02, 2024. The said hearing notice was issued to Noticees through SPAD/email. Vide email dated July 10, 2024, Noticee 1 stated that he was unable to attend the personal hearing as he was unwell. In the email, he has also requested SEBI to consider his reply to the SCN as his

submission. Noticee 2 had attended the said personal hearing and primarily reiterated the submissions vide letter dated March 06, 2023.

12. The submission made by Noticees 1 and 2 are given below: -

Reply of Noticee 1

I. Reply dated April 03, 2023

1. *I hereby submit that I was associated with M/s Kwality Limited as an Independent Director. Being an Independent Director and member of Audit Committee, I had limited access to the internal information/ Documents of the Company. However, I had diligently performed my duties as Independent Director of the Company.*

2. *Further, based on the inputs received from Company & Company Management and based on various formal/ informal discussions in the Board Meeting(s), I want to submit the following points for your consideration:*

   a) *In FY' 16, there was successful execution of a special forensic Audit from April 1, 2010 till September 30, 2015 of Kwality Limited duly accepted by working capital Banks in the Consortium Meeting dated May 2, 2016. In the minutes dated May 2, 2016, it was categorically mentioned that* ***"there is no diversion of funds and utilization of Working Capital Funds is proper, the account is not be declared as fraud"***

   b) *After the period of forensic Audit, i.e. September 30, 2015,* ***the Company had not availed any additional working capital limits (in fact since FY' 14)*** *nor raised any finance from equity market in spite of regular business growth, timely interest payments and term loan related outflows. Afterwards (till NPA of Company Account),* ***the Company was majorly dealing with the same parties*** *that are duly covered in the forensic Audit mentioned above.*

c) *Afterwards, in the year 2018, the Working Capital Bankers had appointed a new forensic auditor for the audit period from October 1, 2015 to June 30, 2018. The Forensic Auditor had submitted its final report on March 22, 2019 to the working capital bankers and the bankers had called upon to explain/ reply on the observations of forensic auditor vide email dated April 4, 2019 (After finalization of forensic audit report). The same is against the principle of natural justice. The working capital lenders on the basis of forensic audit report which was against the principle of natural justice and without considering the reply/ explanations from Company registered a FIR with CBI on 10.09.2020.*

Since the FIR was registered on the basis of biased forensic audit report and against the principle of natural justice, Mr. Sanjay Dhingra & Mr. Sidhant Gupta had approached the high court. ***Hon'ble High Court of Delhi had appointed a new forensic auditor to examine the matter a fresh for the period from October 1, 2015 to June 30, 2018 and the matter is currently pending in the High Court. The Hon'ble High Court has also ordered that no further coercive action be taken against the petitioners.*** *(Copy of High Court Order is attached herewith as Annexure A).*

d) *Further, the Transaction Audit Report by M/s Bagchi & Gupta also mentioned the similar points (as mentioned in the forensic audit report) to a large extent and the application under section 66 on the basis of the same is also pending before the Hon'ble National Company Law Tribunal.*

e) *The Board of Director have always worked with proper prudence to ensure proper working of the Company beneficial for all the stakeholders, as reflected in profitability of the Company over the years. All the transactions entered into by the Company were for enhancing the business & profitability of the Company.*

f) *There was no intent on the part of Board of Directors of the Company to defraud creditors or do any fraudulent or wrongful transaction, as evident from the continuous increase in sales & positive EBITDA over the years (till June' 18)*

g) *The Company was regularly declaring/ paying dividend to its stakeholders over the years. Also, with the continuous increase in profitability of the Company and transparency in into the affairs of the company with high level of Corporate Governance and increase of external credit rating to A for the bank facilities of the Company, the market cap of the Company was increasing continuously over the years and reached more than Rs. 3800 crores in June' 2017. The Board was working towards enhancing the value of the Company for the benefit of all the stakeholders of the Company.*

h) *The Company had also undertaken business transformation process few years ago. Business transformation for Company is more than changing our business model towards B2C, it's about changing the DNA of the organization with an aim to be a world-class company in terms of quality and professional standards. As part of overall business transformation there has been a key focus on building a robust corporate governance framework that included multiple initiatives/ best practices/ compliances/ standard operating procedures. To achieve this, the company appointed MSKA & Associates (MSKA) (member firm of BDO network) as its statutory Auditor from FY 2017-18, as a part of improving/ strengthening its internal control(s)/ internal system(s). India based MSKA, is a member firm of BDO network, which is world's fifth largest in terms of geographic footprint with presence in 159 countries with over 1,400 offices and 67,700 professionals. The renowned Chartered Accountancy Firm specializes in providing high-end services in Tax, Regulatory and Audit Assurance domain.*

Other frameworks includes, implementation of structured ERP platform wef April 1, 2015, hiring of senior & domain experts across *departments from organization of repute, third party(s) audits including financial & tax due diligence from Grant Thornton, Business design/ strategy, IT design/ strategy / enablement by E&Y, legal due diligence by J. Sagar & Associates, HR Audit, Plant audits by various reputed clients, various certifications & related compliances, effective internal Audit system (from outside Auditor) etc.*

i) *Kwality Limited operated in Dairy Products which is largely unorganized with organized share being only 20-25%. Unlike FMCG industry where partners are pretty evolved from process & automation standpoint, in dairy the partners in sourcing as well as distribution space are in initial stages of process maturity and reflect unorganized way of handling operations. On procurement side, Company needs to purchase raw milk from contractors and small villagers and has to reach large no. of villages for daily for collection of milk. Further, contractors (who collect milk from villagers) are also unorganised with many of them operating as sole proprietorship/ partnership with small no. of accounts/ management staff.*

However, there were proper systems in place for material scheduling, credit assessment and payment criterion. The Company was doing proper due diligence before appointment of any vendor & customer with regard to its credit worthiness, reference checks from market & existing channel partners and vendors, KYC's, physical visit to their premises. The payment is essence in the dairy Industry to ensure the regular supply of good quality of milk and purchase is usually made on advance payment basis from bulk contractors.

Further, we need to understand regarding the unorganized nature of industry and of these vendors, wherein they are managed by few individuals and few of vendor directly deal with managing director/ senior officials as they require personal touch, requests on personal level etc.

j) As a part of B2C growth strategy, the Company had done a major capex at its softa (Haryana) plant with increase in milk processing capacity from 34.10 LLPD to 43.10 LLPD (after installation of additional unit of 9.00 Lakhs LLPD capacity). The new plant has been being set-up primarily for manufacturing of value-added products such as flavored milk, paneer, cheese, UHT Milk, Cream in Tetra Packs, Table Butter, Yoghurts besides additional processing capacity for Ghee and Milk Powder(s).

With the increase in processing capacities, Company's working capital requirement has increased. Bank of India (lead bank of the Working Capital Consortium) has assessed the enhanced Working Capital Limit of Rs. 1400.00 Crores (FB – Rs. 1350.00 Crores + NFB – Rs. 50.00 Crores) for the FY 2017-18 against the existing limit of Rs. 1125.00 Crores. We have already taken up with member bank/s of the consortium and few other banks for financial tie-up for the enhanced Working Capital requirement. Bank of India & Allahabad Bank have already sanctioned the enhanced limit by taking up their proportionate share. Further, Indian Bank has also sanctioned the Working Capital Limits (FB) of Rs. 150.00 Crores.

We were confident to complete the financial tie-up for the assessed Working Capital requirement and avail the enhanced limit in due course.

However, in order to have joint documentation for availing the enhanced Working Capital Limit, permission on the revised security structure, NOC for ceding of charge in favour of KKR India Financial Services Private Limited & Union Bank of India (UK) Ltd, issuance of NOC for ceding charge in favour of existing / new bank for financial closure of the assessed WCFB and NFB limits, etc. were very much required from all the existing Working Capital member banks.

Even in the Consortium Meeting held on 17.04.2018, the matter, inter-alia, related to according permission on the revised security structure, *NOC for ceding of charge in favour of KKR & UBI, etc., were discussed in detail & bankers agreed to expedite the matter. However, the Company had received NOC from only 4 of Banks, out of 10 consortium member banks.*

The inordinate delay in release of enhanced working capital requirement of Rs. 275.00 Crores by the Consortium Members, led the Company to face acute financial crisis of working capital and affecting optimum utilization of capacity at its different manufacturing plants. The situation further aggravated by blocking a part of already sanctioned working capital by a few of the Consortium Members which affected day to day working of the Company causing a scenario of financial crunch beyond the control of the Company. The financial constraints are further fuelled by default/delay in repayment by Company's Debtors.

The Company had also tried to raise funds through Capital Market / investment by Financial Institutions (FIs). The Company had even filed a Qualified Institutional Placement Document with BSE & NSE. However due to unfavorable market conditions, the Company could not able to raise the funds.

Thus, paucity of working capital funds is prime reason for delay in payment of interest by the Company.

The Company's balance sheet was leveraged upto a moderate level with debt equity ratio of less than 2 (1.86 as on March 31, 2018 and 1.74 as on March 31, 2017), which is very much acceptable by Banks & FIs. Also, as explained above, the Company was in talks with equity players to raise equity in order to reduce the debt.

There was complete truth and transparency in the transactions of the Company. The Company followed the highest standards of Corporate Governance and was continuously adopting measures to improve upon *the same. The external credit rating agency had given A rating to the bank facilities of the Company.*

k) *With Kwality Limited dealing with unorganized sector and also on account of continuous increase in scale of operations of Company, there may be some lapses in internal control system.* ***However, there is no intent on the part of Board of Directors of the Company to defraud creditors or do any fraudulent or wrongful transaction and to the best of my knowledge, there was no siphoning or diversion of funds outside the business of the Company.***

l) *As an Independent Director and member of Audit Committee, I had regularly asked for various details/ documents and based on the same and based on certification/ Audit/ Reports from Statutory Auditor, Internal Auditor, Stock Auditor Appointed by Banks, Concurrent Auditor, Rating Agencies, Management Certification etc., Board approves the financial statement(s) of the Company****. Hence, I, as an Independent Director had performed my duties properly & diligently to the best possible extent***

II. Additional Reply dated May 04, 2023 by Noticee 1:

"*That at the outset and without prejudice to the other rights of the Undersigned, all averments made in the aforesaid Notice are denied in entirety and the instant submissions are in addition to the submissions already made vide Reply dated March 30, 2023 sent to your good self. Furthermore, it is reiterated that M/s Kwality Ltd. was admitted into Corporate Insolvency Resolution Process under the provisions of Insolvency and Bankruptcy Code, 2016 vide order dated 11.12.2018 passed by the Ld. National Company Law Tribunal and thus, all records pertaining to the Company were in the control and custody of the Resolution Professional appointed by the Ld. NCLT. In addition, the Ld. NCLT, vide order dated 21.12.2021 had approved the going concern sale of the Company in favour of M/s Sarda Mines Pvt Ltd. and therefore, the Undersigned is not in a position to reply on the merits of the transactions* *alleged to be fraudulent in the said letter issued by You and thus, reserves its right to produce additional documents or information at a later stage, as may be available to the Undersigned.*

However, the Undersigned would like to bring forth the following factual as well as legal position which shall be considered sufficient to quash the aforesaid show cause notice, insofar as it pertains to the Undersigned herein below.

1. *That it is a matter of record that the Undersigned herein was associated with M/s Kwality Ltd. only in the capacity of Non-executive, Independent Director of the Company and by virtue of holding such position, was a part of the Audit Committee formed under Section 177 of the Companies Act, 2013 read with Regulation 18 and 22 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. Therefore, the role of the Undersigned herein was limited as per the applicable statutes and Regulations and was, in no way, associated with the day-to-day affairs of the Company.*

2. *Furthermore, in its capacity as an Independent, Non-Executive Director, the Undersigned cannot be held liable for the alleged transactions, only by virtue of its holding a position in the Company especially when the Undersigned is not covered in the definition of "Officer-in-Default" under Section 2(60) of the Companies Act, 2013. Furthermore, in terms of Section 149(12) of the Companies Act, 2013, the liability of an independent director or a non- executive director would be only in respect of such acts or omissions or commissions by a company which had occurred either with his knowledge or with his consent or connivance or where the said director has not acted diligently. However, it is humbly submitted that the aforesaid Show Cause Notice, in no manner, makes out any case of the Undersigned being personally involved in the alleged transactions and no case of knowledge, connivance, consent or absence of diligence has been made out against the Undersigned. Therefore, only by virtue of being an Independent Director and a member of Audit Committee, the*

Undersigned cannot be held liable especially when the Show Cause Notice falls short of the legal standard required to be met for making the relevant allegations, as to how the Undersigned, being an Independent Director, could have been aware or consented to the transactions, unless the same are proven to have been brought to the attention of the Audit Committee through Board Processes.

3. *It is further pertinent to mention that, as an Independent Director, the Undersigned had exercised due diligence and made sure that the Auditor Reports, tabled before the Audit Committee were compliant with applicable laws and statutes. However, it was not possible for the Undersigned, who was an Independent Director, to know if the day-to-day transactions were entered fraudulently or otherwise. In this regard, the allegations made in the SCN are not supported by cogent evidence and are based on surmises and conjectures. Further, the SCN is vague and ambiguous.*

4. *It is further contended that the settled legal standard for due diligence is premised on whether the entity/individual concerned did everything reasonable to discharge its legal obligation and not everything possible as held by the Hon'ble Supreme Court in the matter of Chander Kanta Bansal versus Rajinder Singh Anand (2008) 5 SCC 117 and Hon'ble SAT in the matters of Almondz Global Securities Ltd. v. SEBI and Sharedeal Financial Consultants Pvt Ltd. v. SEBI. That the Show Cause Notice, is rather unclear and vague, as it does not specify the exact nature of non-compliance conducted by the Audit Committee. Furthermore, in acting as an Independent Non-Executive Director, the Undersigned relied upon the documents and records made available to him by the Company including the Compliance Certificates confirming that all the requirements under the existing laws, orders, regulations and all other legal requirements have been complied with.*

5. *It is also pertinent to note that the Ministry of Corporate Affairs ("MCA") has issued circulars clarifying the term Officer in Default as defined in*

the Companies Act 1956 and the Companies Act, 2013. The Circular dated November 12, 1998 clarifies that prosecution should be primarily against Management Director(s)/Whole Time director(s)/manager(s) and the Company Secretary, if any and only if the same are absent should prosecution be initiated against ordinary directors. Circular dated July 29, 2011 clarified that extra care should be taken in identifying officer in default. The circular dated 02.03.2020 further states "in case lapses are attributable to the decisions taken by the Board or its committees, all care must be taken to ensure that civil or criminal proceedings are not unnecessarily initiated against the ID'S and NED's unless sufficient evidence exists to the contrary". Similarly, circular dated 19.01.2015 states that "DFS hereby confirm that the provisions of section 2 [60]/161 [3] of the company act would not be applicable to the nominee directors of the PSB's."

6. *Without prejudice, it is also pertinent to note that the allegations made in the said Show Cause Notice are a mere reiteration of the allegations contained in the Transaction Audit Report conducted during the Corporate Insolvency Resolution Process of the Company. It is submitted that on the basis of the said allegations, the Resolution Professional has also filed an Application bearing CA No. 94119 of 2019 under Section 43, 44 and 66 of the Insolvency and Bankruptcy Code, 2016, which is currently pending for adjudication before the Hon'ble National Company Law Tribunal. Therefore, it shall be against the established principles of law to take any coercive action on the basis of those allegations, which are currently pending for adjudication before the competent forum and thus, the instant proceedings should be kept in abeyance till the said Application is finally adjudicated upon….."*

Reply of Noticee 2

"

1. *This is in reference to notice dated February 17, 2023 issued under Rule 4 of SEBI Rules 1995 read with sub-sections (1) and (2) of section 15-1 of the securities and exchange board of India Act, 1992 In the matter of*

Kwality Limited for giving opportunity was received on 22nd February, 2023

2. *It is submitted that I had joined Kwality Limited as a Woman Independent Director ("Non-Executive Director"} on January 23, 2016 and was associated with the Company as a Women Independent Director upto July 28, 2018. The e-form DIR-12 along with Registrar of Companies filing is attached herewith for your kind reference and perusal.*

3. *I am also sending the copy of resignation letter dated July 28, 2018, which was duly accepted by the Board of Directors. which subsequently filed with the Registrar of Companies ("ROC") Further, in this context I also would like to make an addition that before 28th July, 2018 a resignation was also given on 14th July, 2018 a copy of mail has been attached herewith against which no reply was received from the company. Hence, a next letter was made on 28th July, 2018 which was duly accepted as mentioned.*

4. *It is pertinent to mention that as a Non-Executive Woman Independent Director, I was not in charge and responsible for the management of the day-to-day affairs of the business of Kwality Limited.*

5. *The independent director (non-executive director) of the company cannot actively participate in day-to-day management of the internal affairs of the company. The independent director is not the member of active board who are working as an employee with the company under the designation of whole time Director, Managers, CFO and Managing Director and are managing the company. The Independent director is the passive member of the board who is not involved in the managing the day to day affairs of the company being an independent person and attends the board meeting with the members of the company to discuss the matters raised in the board meeting i.e. the agenda of the meetings. The independent director cannot audit, vouch, analyse or verify the day to day transactions or the decisions taken for running the company. To undertake the mentioned the*

external independent auditors are appointed by the company being statutory or internal. The concerns raised by the auditors are discussed with the management taking into their considerations along with the opinions of the management while preparing the financials.

6. *Further, being a part of an audit committee a Non-Executive Women Independent Director can only act as a bridge between the disputes/dissent raised by an auditor on the financials prepared by the management actively taking part in the internal and day to day affairs of the company and ask for explanation or discuss the points of conflict between the auditor and the management while preparing the financials.*

7. *Considering the above the Non-Executive Independent Director who is not actively engaged into the day to day affairs of the company will only place reliance on the reports of the auditors and their recommendations to understand the financials. As auditors are an independent agency appointed by the board to verify, vouch and audit the financial transactions and their accounting treatment taking into consideration its materiality and sustainability while preparing the financial statements of the company.*

8. *In context to the above points I being a Non-Executive Independent Director also placed the same reliance on the auditors where, no such points were raised by them during the course of board meetings. Even during the last board meeting that was attended by me on 28th May, 2018 with an agenda to discuss and adopt the financial statements for March 2018 (F.Y. 2017-2018). No discrepancies were raised from the auditors' end related to the accounting treatments made by the management while preparing the financial statements and the auditor was of the view that they have send the letter of confirmation to the debtors and have received back the confirmation from almost of the 90% debtors and stock has also been physically verified by their team on 31st March, 2018 at various plants with a note that the financials of the company depict a true and fair view with no fraud determined from their end. Except a point of conflict that was raised between a management and auditor that whether the*

point related to scrutiny undergoing under Income Tax Act, 1961 should be disclosed in the financials. Where the management was of the view that such point should not be covered as the same has already been reflected under previous reports. Where, in my opinion the auditor was correct in mentioning the same in the financial statements and I was in agreement with the auditors.

9. *Further, I would like to bring to your notice that I was not aware about the Transaction audit undertaken by Resolution Personnel. Further, considering the examination based analysis of Transaction audit report as mentioned in the notice issued from your side. The transaction auditor has raised the issue that the processes of finance department was being controlled by a close team regulated by the management I.e. the active management who were indulged In managing the day to day affairs of the company being the Whole time directors, CFO, managers, managing directors who are actually liable to run the company and undertake decisions related to the company being an active part of the board and at the same time being an employee of the company. Whereas the independent director who is not an employee of the company neither it plays an active role in undertaking the decisions related to day to day management of the company. Further, it has also been mentioned in the report clearly that the decisions were taken by the close knitted management verbally. Moving further, if the documents, agreements etc. were not proper and lack the internal financial controls then these matters should have been brought up to the knowledge of the independent director which must flow from active board. Since the independent director is not involved in maintaining the accounts, or making the financial entries or looking deeply into the records or management process of the company.*

10. *Further, as mentioned that the schemes, or write-off of debtors in customers ledgers was made in Q ll of the ,F.Y. 2018-2019 as per your notice and I resigned as a Women Independent Director on July 2018 where the last board meeting attended from my side also mentioned above was held on 28th May, 2018 where the agenda was to discuss the*

financials of 2017-2018 only. Where the management and auditor was of the same opinions as per the report discussed before me that the letter of confirmations have been sent to the debtors from auditors end and the confirmations from 90% debtors have been received by the Auditors itself and the financials of the company depict the true and fair view with no room for fraud Without a dissent or a conflict of the opinions among the two or a qualification from auditors end how can an independent person i.e. an independent director not being act1vely engrossed in the day to day working of the company can depict a picture like this wh1ch has been brought forward through your notice after conducting a transaction audit from an independent person.

11. *Taking into consideration the position of Women Independent Director the position showcased before me in the board meetings of the financials have been filed with the other external agencies also by the company. Perhaps no query was raised by any government agencies ever until the scrutiny was undertaken by Income Tax Department. Who is the government authority having the right to conduct the search operations. Based on their search and seizure operations the income tax department reported the same to SEBI. Finally, which catched the flow to undertake a transactions audit of the financials of the company which depicted the true picture. On the contrary the external audits were also carried on from time to time may be internal audit, statutory audit or the stock and books debts audit which are conducted by the banks against the borrowers from time to time Where no such matter came forward neither reported to me for in discrepancies. Considering the above I also placed reliance on those financial statements being an independent person who is actually not running or managing the company on day to day basis. Placing a note again that an Independent director is not the employee nor the auditor of the company who is either making or entering the transactions or taking decisions for managing the company neither the Independent director is an independent auditor vouching, verifying or analysing each and every peculiar transaction undertaken by the company.*

12. *Further, I would like to make a note on the above considering the responsibilities of audit committee "The job of the audit committee is clearly one of the oversight and monitoring and in carrying out this job it relies on senior financial management and the external auditors. "If the auditors have not dissented with the accounting treatment and no fault found with them, then how can the audit committee members be still held liable? Considering the fact if in case the Independent director looks into the day to day internal affairs of the company then how come the same be Independent from the company. The ultimate intent of Independent director of being an independent person from the management will be hurt.*

13. *At last I would like to mention that I stepped forward and took it as a good opportunity for gaining experience in my life and as per my purview until and unless a person grasp an opportunity how would he/she learn to move forward and learn new things. Further, as understood, the concept of Women Independent Director was initiated to maintain the corporate governance leveraging the same with independence and integrity. In order to maintain the same as being a Women Independent Director and part of audit committee considering the responsibility I have always tried to abide by my duty. Perhaps at the same time I would like to mention that the knowledge must flow from the board members being actively engaged in the day to day working of the company or the other external bodies associated with the organisation who have been appointed to look into the financial transactions made, understanding each and every accounting treatment done w.r.t. the financial transactions and abide by their duties diligently. I would again like to quote that* ***Independent director is an independent person from the company and is not an employee of the company being engaged in the day to day business activities undertaken by the company or undertake the decisions for running of the company*** *an independent director is one who is only attending the meetings with the company and will understand the company's position only with the financial position laid down in board meeting and discuss the agenda of the meetings and have the right to maintain the independence and interfere only if there is any conflict*

between the opinions of the management and the external agencies appointed. In case, the financials prepared by the management and the report prepared by the external agencies does not raise any point of conflict then the independent director will make an understanding that the management is correct and all the financials are prepared on the basis of true and fair view with no suspicions. Hence, An Independent director will place reliance on the Financials prepared by the management in case there is no dissent, qualification raised from independent auditor."

14. *In* addition to the above, Noticee 2 in her reply to the hearing Notice dated July 02, 2024, inter alia, submitted the following:

"….

…..

Further, I would like to draw the reference of the appeals decided by Securities Appellate Tribunal ("SAT") vide appeal no. 207 of 2020 decision taken on 06.01.2023, in case of Mr. Adesh Jain vs Securities and Exchange Board of India, from para no. 11 to para no. 27 wherein the said appeal it was decided and the order hereby mentions to set aside any penalty raised against the non-executive independent director, at para no. 19 taking into a view that independent director was an independent person and was not actively participating in the day to day management of the company. Further again in appeal no. 806 of 2022 and 308 of 2022 decided on 19.07.2023 in M/s Hit Kit Global Solutions ltd., Mr. Kamal Agarwal and Mr. Rajesh Mavani vs Securities and Exchange Board of India with Misc. Application no. 555 of 2022 and Appeal no. 402 of 2022 in the name of Mr. Amit Khandelwal, Mr. Arvind Sharma, Mr. Pavan Kale, Mr. Kiran Nagpal vs Securities and Exchange Board of India wherein appeal no. 402, the four noticee were the independent directors where I would like to draw your attention at para no. 14 where the appeal decided was of the view that since the independent directors do not actively participate in the day to day management of the company and should not be penalised.

…………..

…………..

Therefore, keeping in view of the above facts and considering the position of independent director as explained above, I hereby request you and make humble plea to please drop the proceedings and set aside the case in the matter of justice for the reason as mentioned herein above."

<u>CONSIDERATION OF ISSUES, EVIDENCE AND FINDINGS</u>

13. Having carefully perused the charges levelled against Noticees, replies/ submissions filed by Noticees and other documents/ evidence available on records, I now proceed to deal with the case on merits. The issues that arise for consideration in the present case are:
    - **I.** Whether Noticees have violated Regulation 18(3) read with Para A [(1),(4)(e)(d),(11),(12)] of Part C of Schedule II of LODR Regulations?
    - **II.** Do the violations, if any, attract monetary penalty under Section 15HB of SEBI Act?
    - **III.** If the answer to the aforesaid issues is in affirmative, then what should be the quantum of monetary penalty?

14. Before moving forward, it is pertinent to refer to the relevant provisions of Regulation 18(3) read with Para A [(1), (4)(e)(d), (11), (12)] of Part C of Schedule II of LODR Regulations which are reproduced as under: -

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.*

SCHEDULE II: CORPORATE GOVERNANCE

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;*

4) *reviewing, with the management, the annual financial statements and auditor's report thereon before submission to the board for approval, with particular reference to:*

   d) *significant adjustments made in the financial statements arising out of audit findings;*

   e) *compliance with listing and other legal requirements relating to financial statements;*

   11) *evaluation of internal financial controls and risk management systems*

   12) *reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems;*

Issue (1): Whether Noticees have violated Regulation 18(3) read with Para A [(1), (4) (e), (d), (11), (12)] of Part C of Schedule II of LODR Regulations, 2015?

15. I note from the documents available on record that the following were the directors of Kwality during the investigation period:

<table>
<tr><th>Sl. No.</th><th>Name</th><th>Designation</th><th>Appointment Date</th><th>Cessation Date</th></tr>
<tr><td rowspan="2">1</td><td rowspan="2">Mr. Sanjay Dhingra</td><td>Chairman and Managing Director</td><td>-</td><td>October 08, 2015</td></tr>
<tr><td>Managing Director</td><td>October 08, 2015</td><td>-</td></tr>
<tr><td rowspan="2">2</td><td rowspan="2">Dr. Rattan Sagar Khanna</td><td>Independent Director</td><td>May 18, 2010</td><td>October 08, 2015</td></tr>
<tr><td>Independent Director and Non-Executive Chairman</td><td>October 08, 2015</td><td>-</td></tr>
</table>

Sl. No.	Name	Designation	Appointment Date	Cessation Date
3	Mr. Sidhant Gupta	Executive Director	April 18, 2011	May 29, 2015
		Non-Executive Director	May 29, 2015	July 11, 2018
4	Mr. Manjit Dahiya	Executive Director	-	October 01, 2018
5	Dr. Satyendra Kumar Bhalla	Executive Director	October 08, 2015	October 25, 2017
6	Ms. Pinky Singh	Independent Director	-	January 23, 2016
7	Ms. Ankita Mehrotra	Independent Director	January 23, 2016	July 28, 2018
8	Dr. Kuldeep Sharma	Executive Director	October 25, 2017	October 01, 2018

16. I also note from the material available on record that following meetings of Board of Directors, Audit Committee were held during the FY 2016-17 to 2018-19.

Details of Board Meeting during 2016-17 to 2018-19

S. No.	**Name of the Director**	**Particulars of the meetings**						**Total**	
		2016-17		**2017-18**		**2018-19**			
		Held	Attended	Held	Attended	Held	Attended	**Held**	**Attended**
Executive Directors									
1	Mr Sanjay Dhingra (Promoter Director, Managing Director)	8	8	6	5	13	13	**27**	**26**

S. No.	Name of the Director	Particulars of the meetings						Total	
		2016-17		2017-18		2018-19			
		Held	Attended	Held	Attended	Held	Attended	**Held**	**Attended**
2	Mr. Satyendra Kumar Bhalla (Executive Director)	8	7	3	3	NA	NA	**11**	**10**
3	Mr. Kuldeep Sharma (Executive Director)			3	3	10	10	**13**	**13**
4	Mr Manjit Dahiya (Executive Director)	8	7	6	5	10	9	**24**	**21**
Non-Executive Non Independent Directors									
5	Mr Sidhant Gupta (Non-executive Director)	8	7	6	6	3	3	**17**	**16**
Non-Executive Independent Directors									
6	Mr. Rattan Sagar Khanna (Independent Director and Chairman)	8	8	6	5	13	13	**27**	**26**

S. No.	Name of the Director	Particulars of the meetings						Total	
		2016-17		2017-18		2018-19			
		Held	Attended	Held	Attended	Held	Attended	**Held**	**Attended**
7	Ms Ankita Mehrotra (Independent Director)	8	7	6	6	4	3	**18**	**16**
8	Ms Swati Chaturvedi (Independent Director)	NA	NA	NA	NA	9	9	**9**	**9**
9	Mr Akhilesh Kumar Mishra (Non-Executive Independent Director)	NA	NA	NA	NA	8	8	**8**	**8**

Details of Audit Committee Meeting during 2016-17 to 2018-19

FY	Particulars of the meetings	Dr. Rattan Sagar Khanna (Chairman)	Mr. Sidhant Gupta (resigned w.e.f. July 11, 2018)	Ms. Ankita Mehrotra (appointed w.e.f. July 28, 2018)	Mr Sanjay Dhingra (appointed as member w.e.f.- July 28, 2018)	Ms. Swati Chaturvedi (appointed w.e.f. July 28, 2018)
2016-17	Held	9	9	6	-	-
	Attended	9	8	5	-	-

FY	Particulars of the meetings	Dr. Rattan Sagar Khanna (Chairman)	Mr. Sidhant Gupta (resigned w.e.f. July 11, 2018)	Ms. Ankita Mehrotra (appointed w.e.f. July 28, 2018)	Mr Sanjay Dhingra (appointed as member w.e.f.- July 28, 2018)	Ms. Swati Chaturvedi (appointed w.e.f. July 28, 2018)
2017-18	Held	6	6	6	-	-
	Attended	6	4	6	-	-
2018-19	Held	7	1	1	6	6
	Attended	7	1	1	6	6
Total Meeting held		**22**	**16**	**13**	**6**	**6**
Total Meeting attended		**22**	**13**	**12**	**6**	**6**

17. From the aforesaid tables, I note that Noticee 1 had attended 26 meetings out of 27 Board Meetings and he had attended all the audit committee meeting as a Chairman of Audit Committee of Kwality. Similarly, Noticee 2 had attended 16 meetings out of 18 Board Meetings and 12 out of 13 audit committee meetings. From the reply submitted by Noticees, I note that Noticees have not denied that they had not attended the Board Meeting or Audit Committee meeting.

18. Noticee 1 in his reply contended that he was associated with Kwality only in the capacity of Non-Executive, Independent Director of the Company and by virtue holding such position, was a part of the Audit Committee formed under Section 177 of the Companies Act, 2013 read with Regulation 18 and 22 of LODR Regulations. Therefore, his role was limited as per the applicable statutes and Regulations and was, in no way, associated with the day-to-day affairs of the Company. Similarly, Noticee 2 in her reply contended that she was Non-Executive Woman Independent Director, and was not in charge and responsible for the management of the day-to-day affairs of the business of Kwality Ltd.

Noticee 2 has further contended that she attended the board meetings with the members of the company to discuss the matters raised in the board meeting i.e. the agenda of the meetings.

19. Before dealing with the aforesaid contention of Noticees it is pertinent to refer Section 177 of Companies Act, 2013, relevant provisions of Regulations 16(b), 18 and 22 of LODR Regulations which are reproduced below:

Section 177 of Companies Act, 2013

"177. *(1) The Board of Directors of every listed public company and such other class or classes of companies, <u>as may be prescribed</u>, shall constitute an Audit Committee.*

(2) The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority:

Provided that majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand, the financial statement.

(3) Every Audit Committee of a company existing immediately before the commencement of this Act shall, within one year of such commencement, be reconstituted in accordance with sub-section (2).

(4) Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include, —

(i) the recommendation for appointment, remuneration and terms of appointment of auditors of the company;

(ii) review and monitor the auditor's independence and performance, and effectiveness of audit process;

(iii) examination of the financial statement and the auditors' report thereon;

(iv) approval or any subsequent modification of transactions of the company with related parties;

Provided that the Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions <u>as may be prescribed</u>;

Provided further that in case of transaction, other than transactions referred to in section 188, and where Audit Committee does not approve the transaction, it shall make its recommendations to the Board:

Provided also that in case any transaction involving any amount not exceeding one crore rupees is entered into by a director or officer of the company without obtaining the approval of the Audit Committee and it is not ratified by the Audit Committee within three months from the date of the transaction, such transaction shall be voidable at the option of the Audit Committee and if the transaction is with the related party to any director or is authorised by any other director, the director concerned shall indemnify the company against any loss incurred by it:

Provided also that the provisions of this clause shall not apply to a transaction, other than a transaction referred to in section 188, between a holding company and its wholly owned subsidiary company.

(v) scrutiny of inter-corporate loans and investments;

(vi) valuation of undertakings or assets of the company, wherever it is necessary;

(vii) evaluation of internal financial controls and risk management systems;

(viii) monitoring the end use of funds raised through public offers and related matters.

(5) The Audit Committee may call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial statement before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.

(6) The Audit Committee shall have authority to investigate into any matter in relation to the items specified in sub-section (4) or referred to it by the Board and for this purpose shall have power to obtain professional advice from external sources and have full access to information contained in the records of the company.

(7) The auditors of a company and the key managerial personnel shall have a right to be heard in the meetings of the Audit Committee when it considers the auditor's report but shall not have the right to vote.

(8) The Board's report under sub-section (3) of section 134 shall disclose the composition of an Audit Committee and where the Board had not accepted any recommendation of the Audit Committee, the same shall be disclosed in such report along with the reasons therefor.

Regulation 16(b) of SEBI LODR Regulations 2015 defines the term "Independent Director".

Regulation 18 of LODR Regulations

(1) Every listed entity shall constitute a qualified and independent audit committee in accordance with the terms of reference, subject to the following:

(a) The audit committee shall have minimum three directors as members.

(b) Two-thirds of the members of audit committee shall be independent directors.

(c) All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

Explanation (1). -For the purpose of this regulation, "financially literate" shall mean the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

Explanation (2).-For the purpose of this regulation , a member shall be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

(d) The chairperson of the audit committee shall be an independent director and he shall be present at Annual general meeting to answer shareholder queries.

20. I note that definition of Independent Director is exhaustive in nature, so as to ensure that only people who are not connected in any manner with the company to be appointed as Independent Directors. Further, on a combined reading of Section 177 of Companies Act, 2013, Regulation 18 of LODR Regulations and

Regulation 22 of LODR Regulations, cast responsibilities on the Audit Committee members as well as Chairperson/ Chairman of the Audit Committee. I note that as per Regulation 18(3) read with Para A [(1),(4)(e)(d),(11),(12)] of Part C of Schedule II of SEBI (LODR) Regulations, 2015, being an Independent Director and part of Audit Committee, Noticees have to have an oversight of the listed entity's financial reporting process and disclosures of its financial information to ensure that the financial statement is correct, sufficient and credible. They have to evaluate the internal financial controls and risk management systems. Accordingly, even though Noticees were not involved in day-to-day affairs of the company, Regulation 18 of LODR Regulations cast vide responsibilities on the Audit Committee members to ensure that financial statements are correct, sufficient and credible. Thus, the plea taken by Noticees that they were not involved in to day-to-day affairs of the company are not tenable. Hence, being member of Audit Committee, failure to raise any concern regarding the financials of the Company raise serious questions as to whether they acted diligently in their roles or not.

21. Noticee 1 in his reply contended that in the capacity as an Independent, Non-Executive Director, he cannot be held liable for the alleged transactions, only by virtue of his holding a position in the Company especially when he is not covered in the definition of "Officer-in-Default" under Section 2(60) of the Companies Act, 2013. Furthermore, in terms of Section 149(12) of the Companies Act, 2013, the liability of an independent director or a non- executive director would be only in respect of such acts or omissions or commissions by a company, which had occurred either with his knowledge or with his consent or connivance or where the said director has not acted diligently.

22. Noticee 1 in his reply has contended that Ministry of Corporate Affairs ("**MCA**") had issued circulars clarifying the term Officer in Default as defined in the Companies Act 1956 and the Companies Act, 2013. Noticee 1 has further contended that MCA circular dated November 12, 1998, clarifies that prosecution should be primarily against, Management Director(s)/ Whole Time director(s)/manager(s) and the Company Secretary, if any and only if the same are absent should prosecution be initiated against ordinary directors and MCA Circular dated July 29, 2011 also clarifies that extra care should be taken in

identifying officer in default. Noticee 1 has further contended that circular dated 02.03.2020 states that in case lapses are attributable to the decisions taken by the Board or its committees, all care must be taken to ensure that civil or criminal proceedings are not unnecessarily initiated against the Independent Director and Non-Executive Director, unless sufficient evidence exists to the contrary.

23. In this regard, I note that the allegation levelled against Noticee 1 is that being an Independent Director and Member of Audit Committee, he failed to act diligently and fulfilled his responsibilities in exercising oversight over the affairs of the company. Therefore, plea taken by Noticee that he was not "Officer-in-Default" under Section 2(60) of the Companies Act, 2013 as well as he could not be held responsible under Section 149(12), is not tenable. Further, I note that being a member of audit committee, cast additional responsibilities on the Independent Director, Noticees have to look into the oversight of the listed entity's financial reporting process and disclosures, to ensure that the financial statement is correct, sufficient and credible. They have to evaluate the internal financial controls and risk management systems and they have power to review with the management the adequacy of internal control systems. Therefore, I do not agree with the contention raised by Noticee 1.

24. Noticee 1 being an Independent and Non-Executive Director attended 26 Board meeting out of 27 meeting during the inspection period. Further, I note that being the Chairman cum member of the audit committee, Noticee 1 has to review with the management, annual financial statements and auditor's report in Audit Committee meeting before submitting it to the Board for approval. Therefore, approval of financial accounts has been routed to Board of directors through the processes of Audit Committee.

25. Noticee 1 in his reply contended that, as an Independent Director, he had exercised due diligence and made sure that the Auditor Reports, tabled before the Audit Committee were compliant with applicable laws and statutes. Noticee 1 has further, contended that it was not possible for him as an independent director to know if the day-to-day transactions were entered fraudulently or otherwise. Noticee 1 has further contended that as an Independent Director and member of Audit Committee, he had regularly asked for various details/

documents and based on the same and based on certification/ Audit/ Reports from Statutory Auditor, Internal Auditor, Stock Auditor Appointed by Banks, Concurrent Auditor, Rating Agencies, Management Certification etc., Board approves the financial statement(s) of the Company. Accordingly, as an Independent Director he had performed his duties properly & diligently to the best possible extent. In this regard, I note that being a member of the Audit Committee, Noticee 1 has right to evaluate the internal financial control, risk management systems, adequacy of the internal control systems and to ensure that the financial statements are correct, sufficient and credible. I note that Noticee 1 has not provided any documents or evidence to support about the steps taken by him for evaluating internal financial control and risk management system apart from making a statement that he had raised concerns. However, he has not provided any evidence to substantiate his claim. In this regard, it is pertinent to refer the relevant extract of the statement recorded of Noticee 1 before the Investigating Authority on March 25, 2022.

Q.6 Company neither had maintained proper records of sales nor proper process in place to monitor sales invoice wise collection and settlement. Is it true?
A 6. I had no access to the company's sales and purchases records. I had no idea to whom they were selling and purchasing the products. My role was limited to attending the board meetings and in board meeting the observation highlighted in Transaction Audit report never discussed in any meetings.

Q.8 Why net-off entries for Rs. 4879.18 crs were passed, why receipt and payment not made directly by the company? Is there any procedure or policy adopted by the company for such set off entries?
A8. As a Independent director I have no information regarding all this and all this information were never brought to my notice in Audit committee.

Q.*9* ***Had company not analyzed the creditworthiness of its trade receivables, since company had written off and also made provision of Rs. 2464 Crs during December 12, 2016 to December 11,2018?***

A9. As a Independent director I have no information regarding all this and all this information were never brought to my notice in Audit committee.

Q10. Why no internal control were placed for purchase process, material scheduling, credit assessment & payment criteria?
A10. As a Independent director I have no information regarding all this and all this information were never brought to my notice in Audit committee.

Q11. Any recovery proceeding for substantial over dues from the customers adopted by the company?
All. As a Independent director I have no information regarding all this and all this information were never brought to my notice in Audit committee.

Q12. Company had made capital advances to its vendors for purchasing milk testing equipment's, however no equipment was installed and no recovery proceedings were initiated by the company. Why?
Al2. As a Independent director I have no information regarding all this and all this information were never brought to my notice in Audit committee.

Q.14Lack of internal checks and verification as capital expenditure bills have not been properly verified as to the correctness of the amount mentioned in the invoice, and whether the stated amount matches with the purchase orders. Why?
A14. As a Independent director I have no information regarding all this and all this information were never brought to my notice in Audit committee.

Q15. Why company had entered into substantial transactions of sales and purchases with Customers and Vendors, having common interests with past and present directors of the Company and its related parties?
A15. As a Independent director I have no information regarding all this and all this information were never brought to my notice in Audit committee.

Q17. Why company had not performed due diligence to assess the credit risk for recovery of trade receivables, capital advances and trade

advances? How could company had done transaction with struck off company?

A17. As a Independent director I have no information regarding all this and all this information were never brought to my notice in Audit committee.

Q18. What is scheme discount? If company is already purchasing at low margin and selling the products at thin margin than why company provided discount? Why company had not disclosed this fact in its financials however substantial amount has been written off in QII of 2018 owing to past quality issues?

A18. As a Independent director I have no information regarding all this and all this information were never brought to my notice in Audit committee"

26. Thus, from the statement of Noticee 1 it is seen that he merely stated that as an independent director he has no information and the important aspects as mentioned above was never brought to his notice in the Audit Committee. I note that being an independent director and part of audit committee, Noticee 1 has the ability to understand the basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows. Accordingly, I am not inclined to accept the said contention of Noticee 1 that he was not aware of the important factors having bearing in the financial statements of the company. Thus, during the audit committee meetings, Noticee 1 ought to have raise his concerns regarding net-off entries, writing off-trade receivables recovery process followed by company for substantial over dues, grating capital advances, transactions entered in the nature of sales and purchases with customers and vendors, internal control system for capital expenditure bills, material scheduling, credit assessment of entities, etc. Thus, I note that contention raised by Noticee 1 that as an Independent Director he had performed his duties properly & diligently to the best possible extent is devoid of any merit.

27. Noticee 1 in his reply contended that the settled legal standard for due diligence is premised on whether the entity/individual concerned did everything reasonable to discharge its legal obligation and not everything possible as held by the Hon'ble Supreme Court in the matter of Chander Kanta Bansal versus Rajinder Singh Anand (2008) 5 SCC 117 and Hon'ble SAT in the matters of Almondz

Global Securities Ltd. v. SEBI and Sharedeal Financial Consultants Pvt. Ltd. v. SEBI. In this regard, being a member of the Audit Committee it is reasonable to expect that the Noticee 1 raise concerns regarding aspects affecting the very financial state of the Company. Otherwise, the Noticee 1 should have declined to accept the said position. The judgement referred to by Noticee 1 also emphasize that what is reasonably expected of a person holding that position should have been done in the facts and circumstances of the case. Accordingly, I do not agree with the contention raised by Noticee 1 that he is not liable in view of the fact that the same was not brought to his notice in the Audit Committee.

28. Noticee 2 in her reply has contended that being a part of an audit committee and a Non-Executive Women Independent Director, she can only act as a bridge between the disputes/dissent raised by an auditor on the financials prepared by the management actively taking part in the internal and day to day affairs of the company and ask for explanation or discuss the points of conflict between the auditor and the management while preparing the financials. In this regard, I note that Regulation 18(3) read with Part C Para A of the Schedule-II, specify the terms of reference/ role of the Audit Committee. As mentioned earlier in the order, Audit Committee has to exercise an 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, review with the management, the annual financial statements, evaluating financial controls and risk management systems, review of adequacy of the internal control system etc. Thus, I note that the contention raised by Noticee 2 that she can only act as a bridge between the disputes/dissent raised by an auditor on the financials prepared by the management actively taking part in the internal and day to day affairs of the company and ask for explanation or discuss the points of conflict between the auditor and the management while preparing the financials is not tenable. It is also not clear whether the Noticee 2 raised any concerns regarding various parameters having bearing on the financials of the company.

29. Noticee 2 in her reply further contended that Non-Executive Independent Director is not actively engaged into the day-to-day affairs of the company will only place reliance on the reports of the auditors and their recommendations to understand the financials. Noticee 2 has further contended that as auditors are

an independent agency appointed by the board to verify, vouch and audit the financial transactions and their accounting treatment taking into consideration its materiality and sustainability while preparing the financial statements of the company. In addition to this, Noticee 2 has contended that during the last board meeting that was attended by her on May 28, 2018 with an agenda to discuss and adopt the financial statements for March 2018 (F.Y. 2017-2018), no discrepancies were raised by the auditors' end related to the accounting treatments made by the management while preparing the financial statements and the auditor was of the view that they had send the letter of confirmation to the debtors and have received back the confirmation from almost of the 90% debtors and stock has also been physically verified by their team on 31st March, 2018 at various plants with a note that the financials of the company depict a true and fair view with no fraud determined from their end. In this regard, I note that being an Independent Director and as a member of Audit Committee it is the responsibility of Audit Committee member to ascertain that there is proper internal risk control prevail in the system. I also note that before forwarding the audit report to the Board of directors in Board Meeting, being a member of Audit Committee, Noticee 2 should have raised her concerns regarding net-off entries, writing off-trade receivables recovery process followed by company for substantial over dues, granting capital advances, transactions entered in the nature of sales and purchases with customers and vendors, related parties, internal control system for capital expenditure bills, material scheduling, credit assessment of entities, etc. which I note that Noticee 2 failed to do. In this regard, it is pertinent to refer the relevant extract of the statement of Noticee 2 recorded on March 23, 2022 before the Investigation Authority:

"***Q8. Company neither had maintained proper records of sales nor proper process in place to monitor sales invoice wise collection and settlement. Is it true?***
A8. I only used to visit for board meetings and no auditors had given such remarks in their report. Hence, I could not doubt that there was something which was not fine.

Q9. Why net-off entries for Rs. 4879.18 crs were passed, why receipt and payment not made directly by the company? Is there any procedure or policy adopted by the company for such set off entries?
A9. Whenever the audit report was discussed, there were no such point of netting off. Even in the board meeting I used to ask whether anything is there which I should know about the company but nothing adverse came to my knowledge during my tenor. I'm not aware about any entries which were netoff.

010. Being a CA, it never came to your mind to ask questions or generated any sort of red alert to you?
A10. No, I never observed any red alerts from financials of the company. I always relied on independent auditor's report and on the management of the company.

Q11. Had company not analyzed the creditworthiness of its trade receivables, since company had made written off and also made provision of Rs. 2464 Crs during December 12, 2016 to December 11,2018?
All. No such discussions took place. Even in the meeting with Statutory Auditor, it was told to me that they had taken debtors confirmation and almost 90% of debtors had reverted and balance shown in the books of account was correct.

12. Have you asked the company to reduce the balance outstanding or take proper recovery measures?
Al2. Since, I was not aware about anything, I never doubt on any balance outstanding.

13. Why no internal control were placed for purchase process, material scheduling, credit assessment & payment criteria?
A14. No reply.

015. Any recovery proceeding for substantial over dues from the customers adopted by the company?
A15. No reply.

Q16. Company had made capital advances to its vendors for purchasing milk testing equipment's, however no equipment was installed and no recovery proceedings were initiated by the company. Why?
A16. No reply.

Q18. Lack of internal checks and verification as capital expenditure bills have not been properly verified as to the correctness of the amount mentioned in the invoice, and whether the stated amount matches with the purchase orders. Why?
A18. No reply.

Q19. Why company had entered into substantial transactions of sales and purchases with Customers and Vendors, having common interests with past and present directors of the Company and its related parties?
A19. No reply.

Q20. Most of the customers and vendors are having common registered addresses, availing company secretary services from common service provider. Also, customer and vendor site visit photographs does not substantiate the potential for these entities to have such quantum of transactions with Kwality. What's your comments on the same?
A20. No reply.

021. Why company had not performed due diligence to assess the credit risk for recovery of trade receivables, capital advances and trade advances? How could company had done
transaction with struck off company?
A21. No reply.

Q22. What is scheme discount? If company is already purchasing at low margin and selling the products at thin margin than why company provided discount? Why company had not disclosed this fact in its financials however substantial amount has been written off in QII of 2018 owing to past quality issues?

A22. No idea of scheme discount.

30. From the above statement of Noticee 2, it is obvious that the Noticee 2 did not raise any concern regarding various aspects of the financials of the Company. I note that Noticee 2 failed to ascertain the proper internal control and risk systems. Therefore, I do not agree with the contention raised by Noticee 2.

31. Noticee 2 in her reply has contended that she was not aware about the Transaction Audit undertaken by Resolution Professional and as per Transaction Audit Report it was Whole time directors, CFO, managers, Managing Directors who were actually liable to run the company and undertake decisions related to the company being an active part of the board and at the same time being an employee of the company. Noticee 2 has further contended that if the documents, agreements etc. were not proper and lack the internal financial controls then these matters should have been brought up to the knowledge of the independent director which must flow from active board, as she was not involved in maintaining the accounts, or making the financial entries or looking deeply into the records or management process of the company. In this regard, I note that though Transaction Audit Report took place after the resignation of Noticee 2 as a director of Company, but as a member of Audit Committee, she should ensure that there is proper internal control, risk management systems for the activities carried out by the company. Thus, the contention raised by Noticee 2 is devoid of merit.

32. Noticee 2 in her reply further contended that the job of the audit committee is clearly one of the oversight and monitoring and in carrying out this job it relies on senior financial management and the external auditors. Noticee 2 has further contended that if the auditors have not dissented with the accounting treatment and no fault found with them, the audit committee members cannot be held liable. In addition to above, Noticee 2 has further contended that if in case the Independent director looks into the day-to-day internal affairs of the company then how come the same be Independent from the company. The ultimate intent of Independent director of being an independent person from the management will be hurt. In this regard, I note that being audit committee members, her role is to exercise oversight of the listed entity's financial reporting and the disclosure of

its financial information to ensure that the financial statement is correct, sufficient and credible as well as to adequacy of internal control systems, etc. Thus, even though auditors have not dissented with the accounting treatment, she could have raised concern regarding capital expenditure, trade receivable written-off, due-diligence process followed by Company to assess the credit risk for recovery of trade receivables, capital advance etc. Therefore, the contention raised by Noticee 2 is devoid of any merit. As regards of their contentions, I note that though Independent director does not look after day to day function of the company, but being a member of Audit committee it is the responsibility of the Independent Director to ensure that there should be proper internal control and risk management system prevails in the company, which will ultimately lead to protection of the interest of shareholders of the company. In view of the same, I am not inclined to accept the contention raised by Noticee 2.

33. Further, Noticee 2 in her reply dated July 02, 2024, has contended at para number 14, in this regard, I note that being an independent director and part of audit committee, Noticee 2 have the ability to understand the basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows Accordingly, I am not inclined to accept the said contention of Noticee 2. Thus, during the audit committee meetings, Noticee 2 should have raised his concerns regarding net-off entries, writing off-trade receivables recovery process followed by company for substantial over dues, grating capital advances, transactions entered in the nature of sales and purchases with customers and vendors, related parties, internal control system for capital expenditure bills, material scheduling, credit assessment of entities. Thus, I note that contention raised by Noticee 2 that as an Independent Director and Audit committee member she had performed her duties properly and diligently to the best possible extent is devoid of any merit.

34. Based on the above findings, I conclude that the allegations against Noticee 1 and Noticee 2 that they have violated Regulation 18(3) read with Para A [(1),(4)(e)(d),(11),(12)] of Part C of Schedule II of SEBI (LODR) Regulations, 2015 are established viewed in the facts and circumstances of the case and the evidences available on record.

Issue II: Do the violations, if established, attract monetary penalty under Section 15HB of SEBI Act?

35. I note that the Hon'ble Supreme Court of India in the matter of SEBI v/s Shri Ram Mutual Fund [2006] 68 SCL 216(SC) held that "*In our considered opinion, penalty is attracted as soon as the contravention of the statutory obligation as contemplated by the Act and the Regulations is established...…"*. Therefore, placing reliance on the aforesaid judgement, the above violations, as established in the foregoing paragraphs, make Noticees liable for monetary penalty under Section 15HB of SEBI Act.

36. The text of Section 15HB of SEBI Act is reproduced below: -

<u>SEBI Act</u>
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.

Issue III: If so, what would be the quantum of monetary penalty that can be imposed on the Noticee after taking into consideration the factors mentioned in section 15J of the SEBI Act, 1992?

37. While determining the quantum of penalty, it is important to consider the factors stipulated in Section 15J of the Act, 1992 which reads as follows: -

15J - Factors to be taken into account by the adjudicating officer
While adjudging quantum of penalty under section 15-I, 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 of an adjudicating officer 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;*

38. I note that the material available on record has not quantified the amount of disproportionate gain or unfair advantage, if any, made by the Noticees and the loss, if any, and suffered by the investors as a result of the violations committed by the Noticee. I also note that no prior default of the Noticees available on record.

39. I note that the violations against the Noticees are not performing duties as members of Audit Committee *inter-alia* of non-disclosure, false disclosures, false representations and misrepresentation in financial statements which are serious violations in the securities market. The disclosures in securities market are necessary to bring about transparency and enable the investors to take an informed investment or disinvestment decision. Hon'ble SAT in the matter of Coimbatore Flavors & Fragrances Ltd. vs SEBI (Appeal No. 209 of 2014 order dated August 11, 2014), has also held that "*Undoubtedly, the purpose of these disclosures is to bring about more transparency in the affairs of the companies. True and timely disclosures by a company or its promoters are very essential from two angles. Firstly; investors can take a more informed decision to invest or not to invest in a particular scrip secondly; the Regulator can properly monitor the transactions in the capital market to effectively regulate the same*." Further in the matter of Appeal No. 66 of 2003 -Milan Mahendra Securities Pvt. Ltd. vs. SEBI–the Hon'ble SAT, vide its order dated April 15, 2005 held that, "*the purpose of these disclosures is to bring about transparency in the transactions and assist the Regulator to effectively monitor the transactions in the market*."

40. In the facts and circumstances of this case, the quantum of penalty has to be adjudged taking into account the conduct of the Noticees as found in this case and the principle of proportionality. Considering the role and responsibility of the Noticees in these regards and obligations cast upon the Noticees under the

Regulations, the violations attract monetary penalty. It is noted that, Noticee 1 being a member of the Audit Committee was also held the position of Chairman of the Audit Committee for some time. As regards to Noticee 2 who was in the Audit Committee during the period of two years, a lenient view is taken in this matter considering the shorter time period she held the position in the Audit Committee. In view of the same, in terms of the provisions of Section 15HB of the SEBI Act, 1992, I impose the following monetary penalty on the Noticees:

Noticee	Amount of Penalty (Rs.)
Mr. Ratan Sagar Khanna	5,00,000/- (Rupees Five Lakh only)
Ms. Ankita Mehrotra Khatri	2,00,000/- (Rupees Two Lakh only)

41. Considering the facts and circumstances of the case, I am of the view that the said penalties are proportionate to the violations committed by the Noticees.

42. The Noticee shall remit / pay the said total amount of penalty within 45 days of receipt of this order through online payment facility on the website of SEBI, i.e. www.sebi.gov.in on the following path, by clicking on the payment link: ENFORCEMENT→Orders→Orders of AO→PAY NOW. In case of any difficulties in payment of penalties, Noticee may contact the support at portalhelp@sebi.gov.in.

43. In the event of failure to pay the said amount of penalty within 45 days of the receipt of this Order, SEBI may initiate consequential actions including but not limited to recovery proceedings under section 28A of the SEBI Act for realization of the said amount of penalty along with interest thereon, inter alia, by attachment and sale of movable and immovable properties of Noticee.

44. In terms of the provisions of Rule 6 of the Adjudication Rules, a copy of this order is being sent to Noticees and also to the Securities and Exchange Board of India.

Date: July 31, 2024 **Biju S**

Place: Mumbai **Adjudicating Officer**