

National Stock Exchange of India Circular

Department: Investigation	
Download Ref No: NSE/INVG/62682	Date: June 28, 2024
Circular Ref. No: 342/2024	

To All NSE Members,

Sub: SEBI Final Order in the matter of M/s. Kwaliti Limited.

SEBI vide its order no. QJA/KS/CFID/CFID/30556/2024-25 dated June 28, 2024 has restrained below entities from accessing the securities market and further prohibited from buying, selling or otherwise dealing in securities, directly or indirectly, or being associated with the securities market in any manner, whatsoever, for a period of 2 years, from the date of coming into force of this order.

Sr. No.	Name of the Entity	PAN
1	Mr. Sanjay Dhingra	AAFPD9561J
2	Mr. Sidhant Gupta	AEVPG8722Q
3	Mr. Satish Kumar Gupta	AEUPG2708P

This Order shall come into force with immediate effect.

The detailed order is available on SEBI website (<http://www.sebi.gov.in>).

Further, the consolidated list of such entities is available on the Exchange website <http://www.nseindia.com> home page at the below mentioned link:

<https://www.nseindia.com/regulations/member-sebi-debarred-entities>

Members are advised to take note of the above and ensure compliance.

In case of any further queries, members are requested to email us at dl-invsg-all@nse.co.in

Members are advised to take note of the above and ensure compliance.



National Stock Exchange of India

**For and on behalf of
National Stock Exchange of India Limited**

**Sandesh Sawant
Senior Manager**

ANNEXURE: SEBI Final Order in the matter of M/s Kwaliti Limited.

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

Under Sections 11(1), 11(4), 11(4A), 11B(1), 11B(2) read with Sections 15A(a), 15HA, 15HB of the Securities and Exchange Board of India Act, 1992 read with Rule 5 of the SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995

In respect of:

Noticee No.	Name of Noticee	Designation	PAN No.
1	Mr. Sanjay Dhingra	Managing Director (MD)	AAFPD9561J
2	Mr. Sidhant Gupta	Non-Executive Director and Member of Audit Committee	AEVPG8722Q
3	Mr. Satish Kumar Gupta	Chief Financial officer (CFO)	AEUPG2708P

(hereinafter collectively referred to as "Noticees")

In the matter of M/s Kwality Limited.

BACKGROUND:

1. Pursuant to search and seizure operations conducted by the Income Tax Department (hereinafter referred to as "ITD") on March 23, 2018, the ITD has referred the matter of Kwality Limited (hereinafter referred to as "Company"/ "Kwality") to the Securities and Exchange Board of India (hereinafter referred to as "SEBI") to examine possible violations of securities laws.
2. As per information available on record, Kwality was undergoing the Corporate Insolvency and Resolution Process, and vide order dated January 11, 2021, the Hon'ble National Company Law Tribunal (hereinafter referred to as "NCLT"), New Delhi, had directed initiation of the liquidation process of Kwality, under Section 33 of the Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as "IBC").
3. Upon receipt of copies of the assessment orders of Kwality for the AY 2011-12, (i.e., FY 2010-11) to AY 2018-19 (i.e., FY 2017-18) from the ITD and the Transaction Audit Report (hereinafter referred to as "TAR") for the period December 11, 2016 to December 10, 2018 from Bagchi and Gupta (hereinafter

referred to as “Transaction Auditor” or “**TA**”), SEBI initiated an investigation to ascertain as to whether there was any violation of the provisions of the SEBI Act, 1992 (hereinafter referred to as “**SEBI Act**”), the SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 (hereinafter referred to as “**PFUTP Regulations**”) and the 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**”).

4. As per information available on record, it is noted that the details of directors and KMP(s) of Kquality is given in the following table:

Table 1

S. No.	Name	Designation	Appointment Date	Cessation Date
1	Mr. Sanjay Dhingra	Chairman and Managing Director	-	October 08, 2015
		Managing Director	October 08, 2015	Not Available
2	Mr. Sidhant Gupta	Executive Director	April 18, 2011	May 29, 2015
		Non-Executive Director	May 29, 2015	July 11, 2018
3	Mr Satish Kumar Gupta	CFO	July 04, 2016	October 27, 2018

TRANSFER OF CASE FROM PREVIOUS AUTHORITY

5. Pursuant to an internal re allocation, the present matter was assigned to me on May 31, 2023.

SHOW CAUSE NOTICE, REPLY AND PERSONAL HEARING:

6. On the basis of findings of the Investigation, a Show Cause Notice dated May 23, 2023 (**SCN**) was issued to the Noticees. The summary of allegations against the Noticees, as mentioned in the SCN are as follows: -

- 6.1. Kquality and its directors have misrepresented the financials for more than 8 years as per Income Tax Department’s observations and for the period from December 2016 till December 2018 as per TAR, through fictitious revenue, inflated expenses receivables and accounts position, etc. in collusion with debtors and creditors of the company. Majority of the transactions with

connected entities, stuck off companies and with entities who are not into diary business and just created for these transactions indicate that the financials of Kwality have been misrepresented and cannot be relied upon.

- 6.2. The exclusive dependency of the customers and vendors on Kwality, inter purchases and sales indicates that the figures have been fabricated. The interconnection of corporate entities (customers and vendors include both Corporate and Non-Corporate entities) between themselves and with Kwality through common directors, substantial write-off of their outstanding (₹863 Crores) and outstanding balances clubbed with the observations from site visit indicates the non-genuineness of these transactions. The detailed analysis indicates that these are in the nature of circular transactions carried out by Kwality with an intent to defraud the stakeholders. The same is also corroborated by the fact that during the income tax raid, stamps, seals and letter heads were seized from the premises of Kwality as detailed earlier at para 6 of the SCN.
- 6.3. Kwality is also observed to have deliberately misreported its receivables position to the financial creditors and auditors with an intent to defraud the bankers.
- 6.4. Funds were diverted through fictitious purchases by Kwality and there has been deliberate falsification of books of accounts through further booking of fictitious sales in collusion with the parties. Not initiating any legal steps for recovery of the receivables despite going through a severe liquidity crisis indicates that there is a deliberate misrepresentation of books of account by Kwality, in as much as admitting that the amount may not be recoverable from these customers.
- 6.5. The amount of misrepresentation and diversion, as calculated by the TA is as under:

Table No. 2

Amount in INR Cr.

Particulars	Amount
Net Off transactions through book entries	4,879.18
Doubtful capital equipment purchase transactions	31.44
Receivables written off or provided: - Scheme Discounts - 760	2,464.00

Particulars	Amount
Written-off - 102 Provisions - 1277 and 325	
Advances to suppliers provided as bad debts	200.26
Total	7,574.88

6.6. It is observed that ITD has also found that the purchaser entities / companies/ concerns were merely paper companies and have no actual business and meant for bugs billing for Kwaliti and were controlled and managed by Mr. Sanjay Dhingra and Mr. Sidhant Gupta whose role have been explained in the paragraphs below. Money trail also shows that funds were infused in various paper entities and returned back to its beneficiaries. It is observed that ITD has raised a demand notice for a total amount of ₹7205,26,98,760/- 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 Kwaliti 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 Kwaliti group of companies, in lieu of commission”*.

6.7. Hence, it is alleged that the lack of due diligence, resignation of statutory auditors on the reasons that they were not provided with the information sought by the management, the emphasis of matters detailed by the statutory auditors, non-payment of statutory dues clubbed with the other observations detailed at para 4 of SCN, indicates that these lapses and act were not due to oversight but deliberate act on the part of Kwaliti, its directors and Key Managerial Personnel to divert, misutilise the assets and misrepresent the financials of Kwaliti thus resulting in violation of provisions of the SEBI Act, PFUTP Regulations and LODR Regulations.

7. Based on the above, the following violations are alleged against the Noticees:

Table (S1)

Noticee 1	Noticee 2	Noticee 3
Regulations 3(b), 3(c), 3(d), 4(1), 4(2)(e), 4(2)(f), 4(2)(k) and 4(2)(r) of the PFUTP Regulations read with sections 12A(a), 12A(b) and 12A(c) of the SEBI Act.	Regulations 3(b), 3(c), 3(d), 4(1), 4(2)(e), 4(2)(f), 4(2)(k) and 4(2)(r) of the PFUTP Regulations read with sections 12A(a), 12A(b) and 12A(c) of the SEBI Act.	Regulations 3(b), 3(c), 3(d), 4(1), 4(2)(e), 4(2)(f), 4(2)(k), 4(2)(r) of the PFUTP Regulations read with Sections 12A(a), 12A(b), 12A(c) of the SEBI Act.

Noticee 1	Noticee 2	Noticee 3
Regulations 4(1)(a), 4(1)(b), 4(1)(c), 4(1)(e), 4(1)(g), 4(1)(h), 4(1)(i), 4(1)(j), 4(2)(e), 4(2)(f)(i)(2), 4(2)(f)(ii)(2), 4(2)(f)(ii)(6), 4(2)(f)(ii)(7), 4(2)(f)(ii)(8), 4(2)(f)(iii)(1), 4(2)(f)(iii)(2), 4(2)(f)(iii)(3), 4(2)(f)(iii)(6), 4(2)(f)(iii)(12), 17(8), 33(1)(a), 33(1)(c), 33(2)(a) and 48 of LODR Regulations read with sections 27(1) and 27(2) of the SEBI Act.	Regulations 4(1)(a), 4(1)(b), 4(1)(c), 4(1)(e), 4(1)(g), 4(1)(h), 4(1)(i), 4(1)(j), 4(2)(e), 4(2)(f)(i)(2), 4(2)(f)(ii)(2), 4(2)(f)(ii)(6), 4(2)(f)(ii)(7), 4(2)(f)(ii)(8), 4(2)(f)(iii)(1), 4(2)(f)(iii)(2), 4(2)(f)(iii)(3), 4(2)(f)(iii)(6), 4(2)(f)(iii)(12), 33(1)(a), 33(1)(c), 33(2)(a) and 48 of LODR Regulations read with sections 27(1) and 27(2) of the SEBI Act. Regulation 18(3) read with Para A [(1), (4)(e)(d), (11), (12)] of Part C of Schedule II of the LODR Regulations.	Regulations 17(8), 33(1)(a), 33(1)(c) and 33(2)(a) of LODR Regulations read with Sections 27(1) and 27(2) of SEBI Act.

8. In view of the above, the Noticees 1, 2 and 3 were called upon to show cause as to why appropriate directions under Sections 11(1), 11(4), 11(4A), 11B(1), 11B(2) read with Sections 15HA and 15HB of the SEBI Act including directions to prohibit them from buying, selling or otherwise dealing in securities market, either directly or indirectly, in any manner whatsoever, for a particular period and directions not to be associated with any registered intermediary/ listed company and any public company which intends to raise money from public in the securities market, in any manner whatsoever should not be issued against them.
9. I note that in response to the **SCN** issued by SEBI, Noticee 1 and 2 have submitted their replies vide letters dated August 23, 2023. I also note that Noticee 3, vide his letters dated October 6, 2023 and October 19, 2023 has submitted his reply to the said SCN.
10. Pursuant to reallocation of the captioned matter to me, an opportunity of personal hearing was granted to all the Noticees on October 09, 2023 and the same was attended by the advocate of Noticee 3 (RHP Partners). Noticee 1 and Noticee 2 did not attend the said hearing. The submissions made by Noticee 3 was in line with his written reply submitted to SEBI on October 06, 2023. Further, additional reply was submitted by Noticee 3 on October 19, 2023.
11. Noticee 1 and Noticee 2, vide their respective emails dated October 06, 2023, requested for an extension of 21 days for the personal hearing. Accordingly,

another opportunity for personal hearing was granted to them on October 16, 2023 and the same was attended by Noticees 1 and 2 through video conferencing. Submissions made by Noticee 1 and Noticee 2 during hearing were in line with the respective replies submitted by them to SEBI, through their letters dated August 23, 2023.

12. Further, vide an email dated April 2, 2024, SEBI raised certain queries to Noticees 1 and 2, the response to which was provided by them through respective emails dated April 04, 2024.

13. On perusal of the reply letters dated August 23, 2023 of Noticees no. 1 and 2, I note that the contents of both the letters are identical. The relevant extracts of the said replies, *inter alia*, on the merits of the matter are as follows:

13.1. *Kwality was one of the leading companies in institutional business segment by supplying to leading FMCG brands, government organizations, religious institutions, and retail chains such as Britannia, Hindustan Unilever, ITC, Mother Dairy, Cadbury's, Canteen Stores Department, Vadilal, Cream Bell, Tirumala Tirupati Devasthanams, Shiromani Gurudwara Parbandhak Committee, Amritsar and Delhi Sikh Gurudwara Management Committee etc. Keeping the high growth & high margin potential of the retail branded segment in view, Kwality had increased its focus on this segment significantly.*

13.2. *The company was strategically shifting its business model from B2B to B2C (as B2C business is high profitable business and resulted in better brand image and valuation in long run) by adopting a structured holistic approach which encompasses stepping up of all functions across the value chain with an aim to become best-in-class consumer facing dairy company in India compliant with global standards. The company was working towards brand development, enhancement of product portfolio and strengthening of retail distribution network. The Company was simultaneously working towards improving the ratio of milk procurement from farmers as a part of focus on B2C segment.*

13.3. *Some of the key initiatives taken by Company included signing of Mr. Akshay Kumar as the brand ambassador for the entire range of dairy products under the brand name of KDIL's Kwality, strategic partnership with various renowned agencies for Brand Building exercise like McCANN & Cheil India for Creative, Adfactors for PR, Digital Quotient for Social Media, Zenith Optimedia for Media Planning etc., engagement of Ernst and Young as its IT transformation partner to facilitate transition from B2B to B2C, capital expenditure of more than Rs. 400 crores for setting up of manufacturing plant for value added products, engagement of Earnst & Young for developing comprehensive growth strategy & business plan for B2C expansion, inked MOU with Bank of Baroda and IDBI Bank to finance*

the farmers associated with the Company in order to increase the direct collection of farmers' milk.

- 13.4. 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 was 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).*
- 13.5. With the increase in processing capacities, Company's working capital requirement had also increased. Bank of India (lead bank of the Working Capital Consortium) had 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. The Company had 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 had sanctioned the enhanced limit by taking up their proportionate share. Further, Indian Bank had also sanctioned the Working Capital Limits (FB) of Rs. 150.00 Crores.*
- 13.6. The Company was confident to complete the financial tie-up for the assessed Working Capital requirement and avail the enhanced limit in due course.*
- 13.7. 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. was very much required from all then existing Working Capital member banks.*
- 13.8. 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.*
- 13.9. 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 were further fuelled by default/delay in repayment by Company's Debtors.*

13.10. *The Company had also tried to raise funds through Capital Market / investment by Financial Institutions (FIs) in FY 2018-19. The Company had even filed a Qualified Institutional Placement Document with BSE & NSE. However due to unfavourable market conditions, the Company was not able to raise the funds.*

13.11. *Thus, paucity of working capital funds was prime reason for delay in payment of interest & subsequent NPA(s) of Account of the Company along with delay/ default on the part of Banker(s) as per under:*

- (i) Non-sanction of revised security structure by all the member banks in line with Lead Bank (Bank of India).*
- (ii) Non-release of NOC for ceding pari-passu charge in favour of KKR & Union Bank of India (UK) by all the member banks.*
- (iii) Non-release of NOC for ceding charge in favour of existing / new bank for financial closure of the assessed WCFCB and NFB limits. This delayed the release of sanctioned working capital.*
- (iv) Higher Rate of Interest charged by some of member banks (Higher than Lead Bank ROI) and not reducing the same despite repeated requests and discussion in various consortium meetings. Copy of relevant Consortium Meeting Minutes is attached herewith as Annexure A & B(i) & B(ii).*
- (v) Non-removal of negative lien on 51% of shareholding of promoter, despite various request/ discussions in consortium meetings. This also restricted Company's ability to raise the funds in equity market and ultimately save the business/ Company. Copy of relevant Consortium Meeting Minutes is attached herewith as Annexure B (i) & B(ii).*

14. The above submissions made by Noticee 1 and Noticee 2 are generic in nature. Further, specific submissions made by Noticee 1, 2 and 3, with respect to the allegations made in the SCN are being discussed in the subsequent paragraphs.

CONSIDERATION OF ISSUES AND FINDINGS:

15. I note that the following issue(s) arise for consideration in the present case: -

15.1. Whether the allegations levelled against the Noticees 1, 2 and 3, as mentioned at Para 6 and 7 above are correct?

15.2. If answers to above is in the affirmative, what directions to be issued and/ or penalties to be levied against the said Noticees?

16. I have considered the allegations made in the SCN along with the findings of the investigation by SEBI stated therein, reply received in the matter, submissions made by the Noticees during the personal hearing and written submissions filed by the Noticees. Before going into the merits, I would like to first deal with the preliminary objections raised by certain Noticees:
- 16.1. Noticee 3 has contended that the investigation period pertained to years 2016 to 2018 and the SCN was issued after an inordinate delay of 5 years. I note that the matter of Kquality was received by SEBI subsequent to March 2018. In this regard, I note that the investigation in the instant matter was undertaken by SEBI pursuant to receipt of copies of Assessment Orders of Kquality from ITD and the TAR from the Resolution Professional in January 2021. I note that the investigation generally is a detailed process involving analysis of various data, gathering of evidences, etc. that shall stand the test of legal scrutiny at various judicial fora. This, generally, consumes considerable time and efforts depending on the number of entities involved, the complexity of the transactions, correspondences with the entities involved etc. Pursuant to completion of investigation, enforcement actions in the matter were approved in January 2023. Pursuant to the same, SCN in the matter was issued to the Noticees. Thus, I note that there is no inordinate delay in the matter as argued by Noticee 3.
- 16.2. Noticee 3 has also contended that all the documents requested by him during inspection has been denied, which constricts his ability to adequately defend his case. In this regard, I note that Noticee 3, vide a letter dated July 29, 2023, had requested for inspection of documents in the matter. The said inspection of documents was conducted by the authorized representatives of Noticee 3 on August 22, 2023. The minutes of inspection dated August 22, 2023 is available on record, on perusal of which I note that all available and relied upon documents in the matter, including the Inspection Report and the SCN along with its annexures, were provided to Noticee 3. Therefore, the objections raised by Noticee 3 is without any basis and cannot be accepted.

- 16.3. I note that Noticees 1 and 2 have denied the allegations made in the TAR and the Avoidance Application filed by the Resolution Professional which is pending with Hon'ble NCLT. They have thus argued that SEBI cannot place any reliance on the TAR. In this regard, I note that the proceedings are independent. Further, I note that SEBI has conducted its own investigation and all the relied upon evidence has been shared with the Noticees. Further, the Noticees have been provided opportunity to submit their replies and opportunities of personal hearing. Thus, I find no merit in the aforesaid contention of Noticees 1 and 2.
17. Having addressed the preliminary objections of the Noticees, I now proceed to deal with the matter on merits. Before proceeding further, I reproduce the necessary provisions of law alleged to have been violated by the Noticees hereunder:

SEBI Act 1992

Section 12A

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

12A. No person shall directly or indirectly –

- (a) use or employ, in connection with the issue, purchase or sale of any securities listed or proposed to be listed on a recognized stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of this Act or the rules or the regulations made thereunder;*
- (b) employ any device, scheme or artifice to defraud in connection with issue or dealing in securities which are listed or proposed to be listed on a recognised stock exchange;*
- (c) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person, in connection with the issue, dealing in securities which are listed or proposed to be listed on a recognised stock exchange, in contravention of the provisions of this Act or the rules or the regulations made thereunder;*
- (d) ...*

Section 27: Contravention by companies

- (1) Where a contravention of any of the provision of this Act or any rule, regulation, direction or order made thereunder has been committed by a company, every person who at the time the contravention was committed was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly: Provided that nothing contained in this sub-section shall render any such Person liable to any punishment provided in this Act, if he proves that the contravention was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such contravention.*
- (2) Notwithstanding anything contained in sub-section (1), when an contravention under this Act has been committed by a company and it is proved that the contravention has been committed with the consent or connivance of, or is attributed to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.*

Explanation: For the purposes of this section,

- (a) "company" means any body corporate and includes a firm or other association of individuals; and*
- (b) "director", in relation to a firm, means a Partner in the firm."*

PFUTP Regulations:

Regulation 3: Prohibition of certain dealings in securities

No person shall directly or indirectly –

- (a) ...*
- (b) use or employ, in connection with issue, purchase or sale of any security listed or proposed to be listed in a recognized stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of the Act or the rules or the regulations made there under;*
- (c) employ any device, scheme or artifice to defraud in connection with dealing or issue of securities which are listed or proposed to be listed on a recognized stock exchange;*

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

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

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

Explanation.— For the removal of doubts, it is clarified that any act of diversion, misutilisation or siphoning off of assets or earnings of a company whose securities are listed or any concealment of such act or any device, scheme or artifice to manipulate the books of accounts or financial statement of such a company that would directly or indirectly manipulate the price of securities of that company shall be and shall always be deemed to have been considered as manipulative, fraudulent and an unfair trade practice in the securities market.

- (2) *Dealing in securities shall be deemed to be a manipulative, fraudulent or an unfair trade practice if It Involves any of the following: -*

- (e) any act or omission amounting to manipulation of the price of a security including, influencing or manipulating the reference price or bench mark price of any securities;*
- (f) knowingly publishing or causing to publish or reporting or causing to report by a person dealing in securities any information relating to securities, including financial results, financial statements, mergers and acquisitions, regulatory approvals, which is not true or which he does not believe to be true prior to or in the course of dealing in securities;*
- (k) disseminating information or advice through any media, whether physical or digital, which the disseminator knows to be false or misleading in a reckless or careless manner and which is designed to, or likely to influence the decision of investors dealing in securities;*
- (r) knowingly planting false or misleading news which may induce sale or purchase of securities.*

LODR Regulations:

Regulation 4: Principles governing disclosures and obligations.

- (1) *The listed entity which has listed securities shall make disclosures and abide by its obligations under these regulations, In accordance with the following principles:*

- (a) Information shall be prepared and disclosed in accordance with applicable standards of accounting and financial disclosure.*

- (b) *The listed entity shall implement the prescribed accounting standards in letter and spirit in the preparation of financial statements taking into consideration the interest of all stakeholders and shall also ensure that the annual audit is conducted by an independent, competent and qualified auditor.*
- (c) *The listed entity shall refrain from misrepresentation and ensure that the information provided to recognised stock exchange(s) and investors is not misleading.*
- (e) *The listed entity shall ensure that disseminations made under provisions of these regulations and circulars made thereunder, are adequate, accurate, explicit, timely and presented in a simple language.*
- (g) *The listed entity shall abide by all the provisions of the applicable laws including the securities laws and also such other guidelines as may be issued from time to time by the Board and the recognised stock exchange(s) in this regard and as may be applicable.*
- (h) *The listed entity shall make the specified disclosures and follow its obligations in letter and spirit taking into consideration the interest of all stakeholders.*
- (i) *Filings, reports, statements, documents and information which are event based or are filed periodically shall contain relevant information.*
- (j) *Periodic filings, reports, statements, documents and information reports shall contain information that shall enable investors to track the performance of a listed entity over regular intervals of time and shall provide sufficient information to enable investors to assess the current status of a listed entity.*

Regulation 4(2)(e) Disclosure and transparency:

The listed entity shall ensure timely and accurate disclosure on all material matters including the financial situation, performance, ownership, and governance of the listed entity, in the following manner:

- (i) *Information shall be prepared and disclosed in accordance with the prescribed standards of accounting, financial and non-financial disclosure.*
- (ii) *Channels for disseminating information shall provide for equal, timely and cost efficient access to relevant information by users.*
- (iii) *Minutes of the meeting shall be maintained explicitly recording dissenting opinions, if any.*

Regulation 4(2)(f): Responsibilities of the board of directors:

The board of directors of the listed entity shall have the following responsibilities:

- (i)(2) The board of directors and senior management shall conduct themselves so as to meet the expectations of operational transparency to stakeholders while at the same time maintaining confidentiality of information in order to foster a culture of good decision-making.*
- (ii)(2) Monitoring the effectiveness of the listed entity's governance practices and making changes as needed.*
- (ii)(6) Monitoring and managing potential conflicts of interest of management, members of the board of directors and shareholders, including misuse of corporate assets and abuse in related party transactions.*
- (ii)(7) Ensuring the integrity of the listed entity's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.*
- (ii)(8) Overseeing the process of disclosure and communications.*
- (iii)(1) The board of directors shall provide strategic guidance to the listed entity, ensure effective monitoring of the management and shall be accountable to the listed entity and the shareholders.*
- (iii)(2) The board of directors shall set a corporate culture and the values by which executives throughout a group shall behave.*
- (iii)(3) Members of the board of directors shall act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the listed entity and the shareholders.*
- (iii)(6) The board of directors shall maintain high ethical standards and shall take into account the interests of stakeholders.*
- (iii)(12) Members of the board of directors shall be able to commit themselves effectively to their responsibilities.*

Regulation 17: Board of Directors:

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

Regulation 18: Audit Committee:

- (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
[See Regulation 18(3)]

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:*
- (a) *...;*
 - (b) *...;*
 - (c) *...;*
 - (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;*

Regulation 33: Financial results:

- (1) *While preparing financial results, the listed entity shall comply with the following:*
- (a) *The financial results shall be prepared on the basis of accrual accounting policy and shall be in accordance with uniform accounting practices adopted for all the periods.*
 - (c) *The standalone financial results and consolidated financial results shall be prepared as per Generally Accepted Accounting Principles in India*
- (2) *The approval and authentication of the financial results shall be done by listed entity in the following manner:*
- (a) *The quarterly financial results submitted shall be approved by the board of directors:*

Provided that while placing the financial results before the board of directors, the chief executive officer and chief financial officer of the listed entity shall certify that the financial results do not contain any false or misleading statement or figures and do not omit any material fact which may make the statements or figures contained therein misleading.

Regulation 48: Accounting Standards.

The listed entity shall comply with all the applicable and notified Accounting Standards from time to time.

18. The allegations made in the SCN against the Noticees, submissions made by the Noticees w.r.t. the allegations made against them and my findings thereon are dealt with in the following parts of the order:

Part A – Allegations of Misrepresentation of financials

- (i) **Misrepresentation by inflating revenue and expenses for diversion of funds**
- (ii) **Misrepresentation of receivable accounts and payables position resulting in diversion of funds**
- (iii) **Misrepresentation through overvaluation of assets by entering into irregular transactions in capital expenditure**

Part B - Allegations of diversion through scheme discount write-off

Part C - Allegations of Non-disclosure of material information

Part D - Allegations of Lack of due diligence and discharging the duties as members of the board of directors of a listed company

Part E - Role of Noticees 1, 2 and 3

Part A – Allegations of Misrepresentation of Financials

19. I note that w.r.t. allegations of “Misrepresentation of financials”, the SCN alleged violation regarding:

19.1. **Misrepresentation by inflating revenue and expenses for diversion of funds:**

The misrepresentation of Financials by inflating revenue and expenses for diversion of funds, as alleged in the SCN is as under (highlighted in bold):

19.1.1. **Absence of records and documentation demonstrating non-dependency on the revenue and sales figures recognized in the financial statements.**

- (a) Parts I, IV, V, VI and VII of TAR indicates that both the purchase and sale processes did not have the required internal controls and checks to regulate the material scheduling, credit assessment and payment criterion, and that these processes were being controlled by a close team regulated by the management of Kwality and that most of the instructions/ decisions of the management were verbally issued.**
- (b) A sample customer agreement submitted by Kwality (refer Part I of TAR), revealed that the available master sales and purchase agreements with the customer and vendor accounts under scrutiny are vague and without important terms on credit assessment, product quality and payment settlement.**
- (c) The sample invoices and balance confirmations (refer Part I of TAR), indicate that Kwality was not maintaining proper records of the transactions with its customers and there was no proper process in place to monitor sales invoice wise collection and settlement. Kwality was also observed to be accounting for receipts on "On Account" basis without according reference to specific sales invoices and was not carrying out invoice level reconciliations.**
- (d) The statistical overview of payment settlement clearing account (refer part II of TAR), indicated that the accounting entries were recorded in "Payment Settlement Clearing Account" (hereinafter referred to as "PSCA") on back date basis in the books of accounts, following the receipt of confirmation letters from debtors and creditors at month/ quarter end. As per explanations given by the representatives of Kwality during the transaction audit, the accounting entries were stated to be authorized on verbal instructions from the management team.**
- (e) The above observations and the observation that the accounting entries were passed on the basis of verbal instructions/ decisions of the management indicate that there was lack of controls by the management in maintaining the records and accounts of Kwality, and thus, the books of accounts cannot be relied upon. It therefore appears, that the books of accounts of Kwality did not give a true and fair picture of the financials and**

operations of Kwaliti and that the financials of Kwaliti have been misrepresented as apparent from the details given in the subsequent paragraphs.

19.1.2. On perusal of submissions made by Noticees 1 and 2, w.r.t. above allegations, I note that:

19.1.2.1. Noticee 1 and 2 have contended that there were proper systems in place for material scheduling, credit assessment and payment criterion and that Company's policy on material scheduling, payments etc. was covered under the Purchase Policy. In this regard a copy of Purchas Policy has been furnished by them. On perusal of the said policy I note that it provides procedure for collection of milk from Village Level Centres and Bulk Contractors, Procedure for approval of Purchase Rates, Payment cycle, procurement of semi-finished products and packing material. I however note that the said policy is neither on the company's letter head nor it is signed by the authorised signatory. Authenticity of the document is not ascertainable.

19.1.2.2. With regards to the observation of purchase and sales processes being controlled by a close team regulated by the management of Kwaliti and the instructions/ decisions of the management being verbally issued, I note that the Noticees 1 and 2 have submitted that the Company operated in dairy products which is largely unorganised and the vendors are managed by few individuals, because of this there is a requirement for the Managing Director/ senior officials to directly deal with them. I note that verbal instructions are not demonstrable and such arguments are not acceptable.

19.1.2.3. I note that the TAR has referred to a sample customer agreement submitted by the company to the TA. On perusal of the said document, I note that the said

agreement was signed between Kwaliti and one of its customers for a period of five years effective from 18/07/2016 to 17/07/2021. Considering the time period for the validity of the agreement, I find that it lacked clarity on periodicity for credit assessment of the customer, product quality and settlement of payment.

19.1.2.4. In this regard Noticee 1 and 2, have *inter alia* submitted that payment terms, rate/ price of milk/ other products etc. are decided on order to order basis and are written in invoices raised/ received and there are no written agreement for the same. I, however note that payment terms are broader concept w.r.t. any industry and includes information like type of payment expected, whether any discounts will be provided, how the customer can make the payment, any late fee and any special terms discussed during the sales process etc. and may be duly incorporated in the customer agreement in order to avoid any payment related dispute in future.

19.1.2.5. The Noticees 1 and 2 have further submitted that quality parameters for deciding the price of the milk and deductions and calculation method was already communicated/ made known to vendors/ customers and the same are standard across the dairy industry. However, they have not furnished any documentary evidence to support their statement like copies of letters sent to the customers/ vendors communicating said information. The Noticees 1 and 2 have further admitted that due to nature of industry there cannot be any definitive agreement with customers and vendors. I, however, note that in dairy industry where the nature of most of the products are perishable, it is very important that terms on product quality must be made part of the customer agreement, in order to protect a company from

situations with vendors/ customers raising disputes related to the quality of product and demanding any undue discount from the company at a later stage. I note that the said situations were in fact faced by the company and the same have been discussed in detail in subsequent paragraphs of this order. Therefore, the arguments given by Noticees 1 and 2 are not acceptable.

19.1.2.6. I note that Noticees 1 and 2 have further contended that the company was maintaining all the records of transactions with its customers including invoice, Gate Records, Weightment Records, Lab Records, Delivery Notes etc. However, the emphasis in the allegation is that the company was accounting for receipts on “On Account” basis without according reference to specific sales invoices and was not carrying out invoice level reconciliations. Here, the requirement was on part of the company to carry out invoice level reconciliations and the same has got nothing to do with the external factors like dairy industry being unorganised. The invoice level reconciliations could have been done irrespective of the above reasons mentioned by Noticees 1 and 2. I note the Noticees 1 and 2 have adduced industry level general reasons when questioned on an internal procedure. This procedural inefficiency only stands to support the observations and allegations of SEBI. The arguments given by Noticees 1 and 2 are, therefore, not acceptable.

19.1.2.7. The Noticees 1 and 2, have further submitted that Kwaliti did substantial capital expenditure by making investments in new facilities dedicated to high margin VAP (value added products) and shifted its business model from B2B to B2C which resulted in an increase in the working capital requirement of the company. I note that the company was availing of working capital loan from a consortium of 10

banks led by Bank of India which assessed the enhanced working capital limit of INR 1400 Cr. for the company for FY 2017-18 against the then existing limit of INR 1125 Cr. and that Kwaliti had taken up with all the member banks of the consortium and few other banks for financial tie-ups for increased working capital requirement. Further, Noticees 1 and 2 have stated that there was inordinate delay in release of enhanced working capital requirement of INR 275 Cr. which led the company to face acute financial crisis and affected optimum utilization of capacity at its different manufacturing plants. The situation aggravated when a part of already sanctioned working capital by a few of the Consortium Members was blocked causing a scenario of financial crunch beyond the control of Kwaliti. They have further submitted that Kwaliti tried to raise capital through other means, however it was not successful in its endeavour due to unfavourable market conditions, and ultimately it could not pay Income Tax dues leading to a situation where the bank accounts of company were either frozen or there was a threat for the same from the Income Tax Authorities. In this regard the Noticees 1 and 2 have shared copies of communication with the Income Tax Department and Show Cause Notices issued by ITD.

19.1.2.8. While the Noticees 1 and 2 have indicated that Kwaliti started facing the situation of financial crunch in FY 2017-18, they have not specified the chronology of the events in their reply. They have also failed to explain reasons as to why the consortium of banks were reluctant to release the enhanced working capital limits and why some of the members of the consortium of banks did not release the existing working capital limit. In this regard, it is pertinent to mention some important observations recorded in the minutes of the meeting of the Consortium of Banks, held

on April 17, 2018 (the minutes of the meeting were furnished by Noticees 1 and 2 along with the reply to SCN) reproduced as follows:

“Consortium enquired from the company about concentration of top 20 debtors as on 31.12.2017, constituting 76% of the total sales of the company leading to concentration risk and balance sheet of debtors are also not very sound. Lenders raised concern over the issue. Company officials clarified that these debtors are associated with them for years and payments are received from them timely. Company confirmed that there were no bad-debts in past from any of these debtors and as per company’s policy they are reducing no. of parties to deal with in terms of B2B sale.

Consortium however, urged upon the company to be cautious with such clients with advise that company should prepare Debtor policy fixing individual debtor wise cap and explore for building mechanism for debtors identification to minimize default risk. Company was requested to submit a prudential limit for main debtors for the FY 2018-19, which was agreed by the company. And also advised to segregate the risk by adding new clients.”

19.1.2.9. From above, it is clearly evident that the consortium of banks had raised a red flag to the management of Kwalitiy. The Noticees 1 and 2 have not furnished any documents to substantiate whether, the Company had taken any corrective measures to address the concerns raised by the Consortium of Banks, pointing out to inaction on part of the company. It shows that the contingent situation of cash crunch faced by Kwalitiy didn’t come as a surprise, as enough concerns were raised by the consortium of banks well in advance and the situation got aggravated because of imprudent business practice followed by Kwalitiy. The Noticees 1 and 2 have also submitted that the use of Payment Settlement Clearing Account (PSCA) was also known to the working capital lenders and covered by the concurrent auditors appointed by working

capital lenders, however, I note that they failed to furnish any documentary evidence like underlying bank account statements to substantiate that the entries recorded under PSCA were genuine. Considering this it is concluded that the entries recorded under PSCA were not genuine and were shown to misrepresent the accounting statements.

19.1.2.10. Further, on perusal of show cause notices issued by Income Tax Department and various communication of the Company with ITD, as provided by the Noticees 1 and 2, I note that Kquality was having pending income tax liabilities for FY 2015-16 and for FY 2016-17. However, on referring to the Assessment Orders of Kquality from the Income Tax Department for FY 2010-11 to 2017-18, I note that the company was having pending income tax liabilities since FY 2010-11 and the same were subsisting even before the period of the examination. Therefore, this cannot be a reason for the sudden strain on the financials of the company.

19.1.2.11. I note that before discussing the reply received from Noticee 1 and 2 regarding allegation of recording accounting entries in the Payment Settlement Clearing Account (PSCA) on back date basis, following observations made in the TAR are noteworthy:

“1- We have examined the ledger accounts of customers and vendors, and the bank books of the Corporate Debtor for the period 11th December 2016 to 10th December 2018.

2- It has been observed that the Corporate Debtor has routed a substantial volume of receipts and payments entries through a control GL (General Ledger) account, which involved select customers and vendors.

3 - The control account has the GL code 11712103 with the name "Payment Settlement Clearing Account" - PSCA and the ledger has been grouped under Bank

Accounts. The entries are recorded in PSCA through bank payment and bank receipt vouchers.

4 - As per the explanations given to us by the representatives of the Corporate Debtor, the Corporate Debtor had released instructions to its debtors to either;

- (a) directly pay its vendors through the debtors' own banking channels or*
- (b) directly set-off through book adjustments, the ledger accounts of Corporate Debtor's vendors in debtors' books of accounts, and*
- (c) issue letters of confirmation periodically to Corporate Debtor on executing the transactions through both banking and other channels.*

5 - The Corporate Debtor had a practice of issuing letters (on Corporate Debtor's Letterhead) to its debtors with the payment instructions at monthly/quarterly intervals. (Sample Corporate Debtor's Instruction letter to Debtor is given in Schedule A)

6 - As per the explanations given to us by the representatives of the Corporate Debtor, the Board of Directors have not established any policy and procedures on PSCA. The account was being maintained on an operational level with verbal instructions from the management team.

7 - The accounting entries of receipts and payments in the PSCA were made on the basis of supporting confirmation letters (on Customers/ Vendors Letter-heads) received from both the debtor and the creditor for the transaction. (Sample confirmation letters from debtors and creditors is given in Schedule B).

8 - We have identified accounting discrepancy of INR 13 Crores in the accounting of transactions related to sample referred in point 7 above and listed in Schedule B. (Details on the accounting discrepancy is given in Schedule C).

9 - The accounting entries were recorded in PSCA on back date basis in ERP (books of accounts), following the receipt of confirmation letters from debtors and creditors at month/ quarter end. As per explanations given to us by the representatives of the Corporate Debtor, the accounting entries were authorised on verbal instructions from the management team.

10 - The accounting entries in PSCA were settled day-wise and had multiple parties entering into one-on-one or one-to-many settlements. (sample day-book of PSCA and receipt and payment voucher is given in Schedule D).

11 - The transaction entries routed through PSCA are all below INR 1 Crore.

12 - On verification of the sample of correspondence evidence of the PSCA transactions, we have found that;

- (a) The letters do not reveal the name and contact details of the signatories.*
- (b) The letterheads of the customers and vendors appear similar in terms of design, font size and message content*
- (c) The letters do not have reference to the account balance or outstanding bills.*
- (d) The letters do not specify the mode of settlement of the transaction amounts. It is not specified whether banking channels were used.*

13 - The Corporate Debtor's reply dt 2 June 2019 states that "The Company is tracking the transactions on daily basis (both payments and receipts by debtors & creditors respectively), as being the essential part of getting the supply of milk from milk suppliers and to keep the business afloat." (point E in Observation 2)

It is observed that the direct involvement of the Corporate Debtor's Management, in the fund management and banking operations of these customers and vendors (who were part of the net-off arrangement), indicates a close nexus and may attract exposure to provisions of "related party" transactions as specified under section 5(24)(t) and 5(24)(g) of the IBC, 2016."

- 19.1.2.12. In this regard I note that Noticees 1 and 2 have admitted the use of the approach under Payment Settlement Clearing Account (PSCA) and have justified it as a step taken to keep the business of the Company afloat so that the Company could pay all its lenders in due course and finally overcome the crisis. The Noticees 1 and 2 have accepted the fact regarding the book adjustments was not recorded (however discussed verbally). Further, the same

was recorded in management committee meeting and copy of minutes has already been provided to the team of Resolution Professional. However, the Noticees 1 and 2 have not produced documentary evidence including copy of minutes of the meetings of the Company's Board/ management committee, granting approval for adopting this approach. The Noticees 1 and 2 have also not produced any document evidencing that the use of PSCA approach was duly informed to the investors of the company, to the TA or to the resolution professional, as claimed by them.

- 19.1.2.13. Further, Noticees 1 and 2 have claimed that the transaction(s) through PSCA were done on the basis of proper documentation and confirmation and duly shown to Auditors. Noticees 1 and 2 have further attached copies of few letters as a sample document in this regard. On perusal of the said letters, I note that one of its customers M/s Roy Dairy Products Private Ltd. owes an approximate payment of INR 16 Cr. during Quarter 2nd of FY 2018-19. Through a letter dated 30/06/2018, Kwaliti had requested M/s Roy Dairy Products Private Ltd. to make the payment of INR 8 Cr. each to two of its vendors, i.e., PNC Enterprises Pvt. Ltd. and Renu Marketing Corporation Pvt. Ltd. The letter sent to Roy Dairy Products Pvt. Ltd. was not accompanied by details of invoices on the basis of which INR 16 Cr. was claimed to be due on it. In reply to the said letter dated 30/06/2018 from Kwaliti, M/s Roy Dairy Products Private Ltd., vide a letter dated 05/10/2018 confirmed that payments of INR 8 Cr. each to the two vendors of Kwaliti referred above have been done and receipt of the said payments were confirmed by the two vendors as well through their letters dated 04/09/2018 and 12/09/2018. I however, note that the letters from the customer and vendors of the

Company were not accompanied by the corresponding bank statements to confirm the transfer and receipt of the said amounts. Therefore, the document furnished by Noticees 1 and 2 cannot be relied upon and gives rise to a doubt if the said transactions have actually happened. Also, there is no documentary evidence submitted by Noticees 1 and 2, in support of their claim that an amount of Rs, 8 crore was due to PNC Enterprises Pvt. Ltd. and Renu Marketing Corporation Pvt. Ltd.

19.1.2.14. In view of above, the submissions made by Noticees cannot be relied upon and are therefore not acceptable.

19.1.3. Vendors and customers' financials not supported by the quantum of transactions:

(a) The verification of the basic details of the vendors and customers of Kwaliti on the Ministry of Corporate Affairs (herein after referred to as "MCA") website showed that the paid-up capital of the majority of the customers/ vendors are equal to or less than ₹.50 Crores as shown in the table below:

Table- 3 (Amount in INR Cr.)

S. No.	Name of the Customer	Paid up Capital	Date of Incorporation	Sales in FY 2017-18 (refer Part IV of TAR)	Bal. O/s as on 10/12/2018 (refer Part IV of TAR)
1	Delhi Foodstech Pvt Ltd	0.04	15/12/2014	251.10	28.15
2	AK Marketing Pvt Ltd	0.02	09/12/2014	260.67	51.22
3	Sahi Marketing Pvt Ltd	0.02	21/01/2015	210.79	63.28
4	Anandh Food Agencies Pvt Ltd	0.02	20/12/2014	212.88	57.02
5	SMBJ Dairy Pvt Ltd	0.08	17/08/2004	264.90	14.30
6	Devidayal Radhey Shyam Traders Pvt Ltd	0.01	27/06/2005	242.72	53.51
7	UA Enterprises Pvt Ltd	0.02	24/12/2014	251.55	5.94
8	Rana Foodstech Pvt Ltd	0.01	18/12/2014	243.14	59.64
9	RK Super Edible Oils Pvt Ltd	0.01	13/04/2005	51.83	16.15
10	Supershakti Cooking Oils Pvt Ltd*	0.01	13/04/2005	51.20	30.73

S. No.	Name of the Customer	Paid up Capital	Date of Incorporation	Sales in FY 2017-18 (refer Part IV of TAR)	Bal. O/s as on 10/12/2018 (refer Part IV of TAR)
11	Delta Agrotech Pvt Ltd	0.21	19/02/2002	80.45	60.88
12	Nand Gopal Marketing Pvt. Ltd.	0.01	11/06/2014	276.0	81.96
13	J.S.M. Vegoils Private Limited	0.38	07/12/2004	8.63	2.23
14	Kwality Foods Industries	NA	NA	173.74	22.53

Table- 4 (Amount in INR Cr.)

S. No.	Name of the Vendor	Paid up Capital	Date of Incorporation	Sales in FY 2017-18 (refer Part IV of TAR)	Bal. O/s as on 10/12/2018 (refer Part IV of TAR)
1	Prakashroy Dairy Pvt Ltd	0.02	28/09/2015	241.58	21.23
2	Y M Foodways Pvt Ltd	0.01	03/11/2008	484.42	30.61
3	Renu Marketing Corporation (India) Pvt Ltd	0.05	19/05/2008	293.73	25.69
4	RN Dairy Pvt Ltd	0.01	19/09/2015	240.63	26.96
5	Kanha Foods Marketing Private Limited	0.10	27/03/2008	NA	1.30

(b) It is observed from the above tables that paid up capital(s) of the vendors and customers of Kwality are equal to less than ₹.50 Crores but the sales and the balance outstanding for the FY 2017-18 were running in crores indicating that the transactions of Kwality with its vendors and customers are not genuine transactions and that the figures in the financials (prior to 2018-19) with respect to the amount recoverable cannot not be relied upon.

19.1.4. On perusal of submissions made by Noticees 1 and 2, w.r.t. above allegations, I note that:

19.1.4.1. Noticees 1 and 2 have accepted that the data presented in Table 3 and 4 are factually correct. However, have argued that the paid-up-capital and sales figures of the entities mentioned in the above table are not comparable. I further note that Noticees 1 and 2 have simply argued that there is no embargo in law which prohibits business transactions with such companies and that there is no reason why such companies cannot have huge business volumes. In this regard, I note that though paid up capital

of a company and the sales figures need not be directly proportional, however, for a huge turnover there should be sizeable and adequate capital in place. It is capital and corresponding capital expenditure that pave way for increased turnover for any business in general. From tables 3 and 4, I note that the paid up capital of the companies listed out there and the corresponding sales figures are largely disproportionate. For e.g. in the case of Y M Foodways Pvt Ltd, the paid up capital is Rs. 1 lac whereas the sales for the FY 2017-18 is Rs. 484.42 crore. On account of which I find there is high disproportionality between the paid up capital and the sales figures in respect of other entities also.

19.1.4.2. Also, I note that Noticees 1 and 2 have not produced any documentary evidence to substantiate the genuineness of the sales figures of the said companies. Therefore, the arguments made by them in this regard are not acceptable.

19.1.4.3. The Noticees 1 and 2 have further submitted that Kwaility has been doing proper due diligence before appointment of any vendor and customer regarding its credit worthiness, reference checks from market and existing channel partners and vendors, KYCs, physical visit to their premises etc. However, the Noticees 1 and 2 failed to furnish any tangible documentary evidence to support these statements with respect to the customers and vendors mentioned in the Table 3 and 4, in the absence of which these statements have got no relevance and therefore cannot be accepted.

19.1.5. **Substantial transactions of sales and purchases with customers and vendors, having common interests with past and present directors of Kwaliti and its related parties.**

- (a) **The verification of the records of transactions with major customers and vendors (refer Part I, IV, V, VI and VII of TAR) indicates that, substantial transactions have been made on the basis of verbal purchase/ sales order.**
- (b) **It is observed that 19 of the top 20 customers were related to at least one party who is also another customer of Kwaliti. The common link is both through directorship and shareholding in the other party, either in the present or at some point of time in the past as detailed under para iii of 4.1.1.3 below. Also, following connections and observations are made based on the TAR:**

(i) **Common Addresses**

Customers and vendors of Kwaliti Ltd. had common registered addresses, as given in the below Table- 5 and some of the vendors and customers were availing company secretary services from common service provider when some of the vendors and customers had a common landlord of their registered offices. The details are tabled as under:

Table 5

S. No.	Common Registered Address	Connection through address	Common Company secretary ("CS")	Common landlord of registered address
1	Shaiyam Enterprises Pvt Ltd (C)	78-B, GF, Old-1450/12-A, KH No.-947/862/861/81 Gali No. 5, Durga Puri Chowk, Jyoti Colony Delhi North East DL 110032 IN	Entity at Sl. No: 1, 12, 24 – Mr. Amit Kaushal as CS for FY 2017-18	
2	Taniska Agencies Pvt Ltd			
3	Prakashroy Dairy Pvt Ltd	B-14, Office no.302, 3rd floor Vikas Marg, Laxmi Nagar New Delhi East Delhi DL 110092 IN	Entity at Sl. No: 3, 4, 5, 17, 18 – Mr. Shukti Ojha as CS for FY 2017-18	
4	Y M Foodways Pvt Ltd			
5	Renu Marketing Corporation (I) Pvt Ltd	Office No. 314, Jaina Tower-1, District Centre, Janak Puri, New Delhi South West Delhi DL 110058 IN		
6	RN Dairy Products Pvt Ltd			
7	Kunal Milk Products Pvt Ltd	Property No. 301, Nitika Tower 1st, Naniwala Bagh, Azadpur		
8	Parul Sales and Marketing Pvt Ltd			

S. No.	Common Registered Address	Connection through address	Common Company secretary ("CS")	Common landlord of registered address
		Commercial Complex, New Delhi North East DL 110033 IN		
9	Devidayal Radheshyam Traders Pvt Ltd	C-364 (Basement), Vikas Puri, Near Dr. S. Kant New Delhi Delhi West Delhi DL 110018 IN		Entity at Sl. No: 9, 10, 17, 18, 23, 24, 25, 26 – Dharmender Kumar Dubey - Designated Partner - D K Dubey and Associates LLP (A Practising CS Firm)
10	SMBJ Dairy Pvt. Ltd.		Entity at Sl. No: 10, 17, 26 – Mr. Rahul Malhotra as CS for FY 2016-17	
11	Delhi Foodstech Pvt. Ltd	SHOP NO-308, HOUSE NO-1		
12	A.K. Marketing Pvt Ltd	SHIVLOK COMMERCIAL COMPLEX KARAMPURA NEW DELHI West Delhi DL 110015 IN	Entity at Sl. No: 1, 12, 24 – Mr. Amit Kaushal as CS for FY 2017-18	
13	Arnav Milk and Products Pvt Ltd	Shop No. 36, 1st Floor, CSC-7, DDA Market, Sector-16, Rohini New Delhi North West DL 110085 IN		
14	GLDN Enterprises Pvt Ltd			
15	Bal Gopal Dairy Pvt Ltd	6535/1, Block -9B, Ground Floor H.S. Road, Dev Nagar, Karol Bagh New Delhi Central Delhi DL 110005 IN		
16	Ranbir Dairy Pvt Ltd			
17	Ameejay Enterprises Pvt Ltd	C-204, RAIL VIHAR, SECTOR-15 PART-2, GURUGRAM HARYANA Gurgaon HR 122001 IN	Entity at Sl. No: 10, 17, 26 – Mr. Rahul Malhotra as CS for FY 2016-17 Entity at Sl. No: 3, 4, 5, 17, 18 – Mr. Shukti Ojha as CS for FY 2017-18	Entity at Sl. No: 9, 10, 17, 18, 23, 24, 25, 26 – Dharmender Kumar Dubey - Designated Partner - D K Dubey and Associates LLP (A Practising CS Firm)
18	Pnc Enterprises Pvt Ltd		Entity at Sl. No: 3, 4, 5, 17, 18 – Mr. Shukti Ojha as CS for FY 2017-18	
19	Prakash Foods Traders Pvt Ltd	Property No. H-8, 2nd Floor G. B. Road New Delhi Central Delhi DL 110006 IN	Entity at Sl. No: 19 and 20 – Mr. Ashutosh Kumar as CS for FY 2017-18	
20	Roy Dairy Products Pvt Ltd			

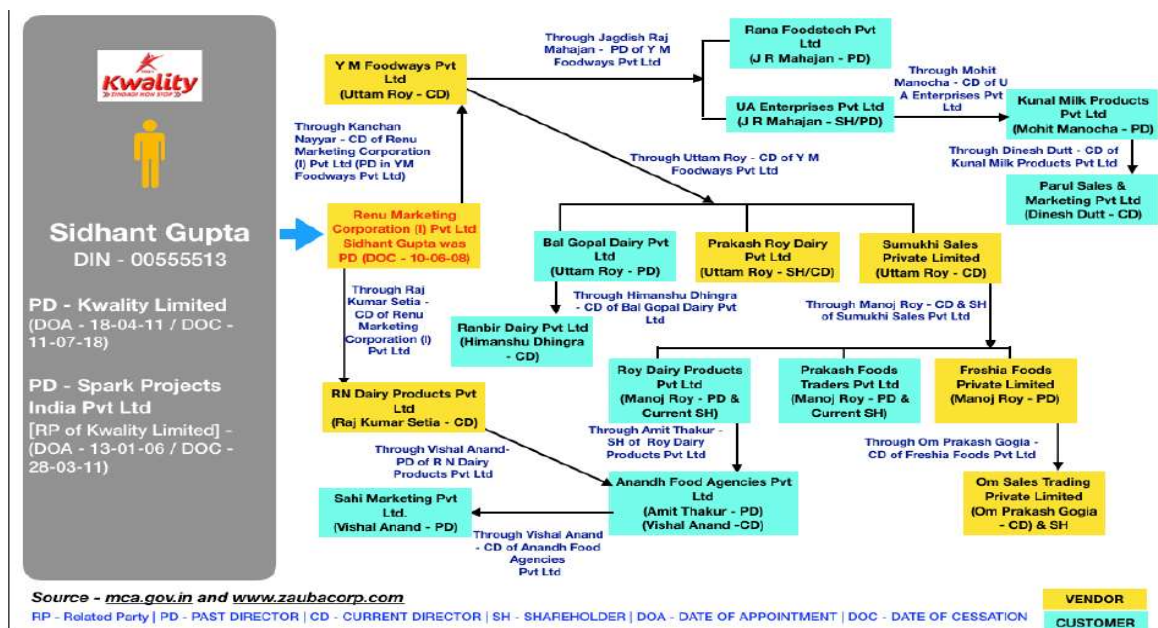
S. No.	Common Registered Address	Connection through address	Common Company secretary ("CS")	Common landlord of registered address
21	Acute Sales and Marketing Pvt Ltd	Property No. RZ-650, Old No. E-500, KH. No. 659, Sadh Nagar, Palam Colony New Delhi South West Delhi DL 110045 IN		
22	Anukul Sales And Marketing Pvt Ltd			
23	Rana Foods Tech Pvt Ltd	RZ-33(C-3/24)KH No.-23/2/1/2 Part of KH No.-23/2/1 Gali No.-26, Vashisth Park New Delhi West Delhi DL 110046 IN	Entity at Sl. No: 1, 12, 24 – Mr. Amit Kaushal as CS for FY 2017-18	Entity at Sl. No: 9, 10, 17, 18, 23, 24, 25, 26 – Dharmender Kumar Dubey - Designated Partner - D K Dubey and Associates LLP (A Practising CS Firm)
24	U A Enterprises Pvt Ltd			
25	Freshia Foods Pvt. Ltd.	RZ-J12A/23 Third Floor, J-12-A, J-Block West Sagarpur, Near Shakuntala Nursing Home Delhi West Delhi DL 110046 IN	Entity at Sl. No: 10, 17, 26 – Mr. Rahul Malhotra as CS for FY 2016-17	Entity at Sl. No: 9, 10, 17, 18, 23, 24, 25, 26 – Dharmender Kumar Dubey - Designated Partner - D K Dubey and Associates LLP (A Practising CS Firm)
26	OM Sales Trading Pvt. Ltd			

The vendors, Neelam Diary (P) Ltd and Sumukhi Sales (P) Ltd had Mr. Bharat Hassani as the CS for the FY 2017-18. Mr. Shukti Ojha, as highlighted for entities at sr. no. 3, 4, 5, 17 and 18, is the designated partner in DK Dubey and Associates LLP, a practicing CS firm.

(ii) Inter corporate transactions (common interest trail)

- 1) **Given below is the illustration with respect to shareholding and director details of few corporate customers and vendors, from the MCA database showing common interests between the corporates and the trail connects with Mr. Sidhant Gupta (Noticee no. 2), ex-director of Kwaliti:**

Figure 1



- 2) The above table indicates that 10 of the top 20 customers (i.e. S. No. 2,5,6,7,10,12,13,16,17 and 18 of Table 5) (during April 01, 2017 to December 10, 2018) had common links with companies where the ultimate trail connects with Mr Sidhant Gupta (Noticee No. 2), who was the ex-director of Kwaliti and that there were common interests of these 10 customers with 7 vendors of Kwaliti (the entities given in the figure / illustration above).

(iii) Analysis of top 20 customers:

- 1) There were instances of common interest observed in 18 of the top 20 customers as under:

Table 6

S. No:	Customer/Common Person Name	Connections
1	Prakash Foods Traders Pvt Ltd	Sl. No: 1 and 5 connected through Manoj Roy as current shareholder and ex-director, and through Zuber Alam and Disha as current directors.
2	SMBJ Dairy Pvt. Ltd	Sl. No. 2 and 13 connected through Gaurav Jain as ex-director
3	A.K. Marketing Private Limited	Sl. No: 3 and 7 connected through Ashok Nayyar and Sunil Nayyar as current shareholder and current directors
4	Kunal Milk Products Pvt Ltd	Sl. No. 4 and 12 connected through Dinesh Dutt as Current director Sl. No. 4 and 6 connected through Mohit Manocha as ex-director and current director

S. No:	Customer/Common Person Name	Connections
5	Roy Dairy Products Pvt Ltd	Sl. No: 1 and 5 connected through Manoj Roy as current shareholder and ex-director, and through Zuber Alam and Disha as current directors. Sl. No: 5 and 15 connected through Amit Thakur as current shareholder in Sl. No: 5 and as ex-director in Sl. No. 15.
6	U A Enterprises Pvt. Ltd	Sl. No: 6 and 11 connected through Jagdish Raj Mahajan as current shareholder and ex-director Sl. No: 4 and 6 connected through Mohit Manocha as Current Director and ex-director Sl. No 6 and 11 connected through Sunita Rana as current shareholder and current director
7	Delhi Foodstech Pvt. Ltd	Sl. No: 3 and 7 connected through Ashok Thakur and Sunil Nayyar as current shareholder and current director
8	GLDN Enterprises Pvt Ltd	Sl. No. 8 and 18 connected through Anil Kumar Gamber as Current Shareholder and Ex-director and Current director
9	Ranbir Dairy Pvt Ltd	Sl. No. 9 and 17 connected through Himanshu Dhingra as Current director
10	Surya Milk Products Pvt Ltd	Sl. No. 10 and 14 connected through Suryakant Bhola as Current director
11	Rana Foods Tech Pvt Ltd	Sl. No. 6 and 11 connected through Jagdish Raj Mahajan as current shareholder and Ex-director and through Sunita Rana as Current Director and Current Shareholder
12	Parul Sales and Marketing Pvt. Ltd	Sl. No. 4 and 13 connected through Dinesh Dutt as current Director
13	Devidayal Radheshyam Traders Pvt. Ltd	Sl. No. 2 and 13 connected through Gaurav Jain as ex-director
14	Sankalpshakti Enterprises Pvt Ltd	Sl. No. 10 and 14 connected through Suryakant Bhola as Current director
15	Anandh Food Agencies Pvt Ltd	Sl. No. 15 and 16 connected through Vishal Anand as Current director Sl. No. 5 and 15 Connected through Amit Thakur as Current Shareholder and ex-director
16	Sahi Marketing Pvt. Ltd	Sl. No. 15 and 16 connected through Vishal Anand as Current director
17	Bal Gopal Dairy Pvt Ltd	Sl. No. 9 and 17 connected through Himanshu Dhingra as Current director
18	Arnav Milk and products Pvt Ltd	Sl. No. 8 and 18 connected through Anil Kumar Gamber as Current Shareholder and ex-director and Current director

2) **As illustrated in the table above, these connections (S. No. 1-18) have been through current directorship/ ex-directorship/ current shareholder/ current shareholder and director/ current shareholder and ex-director.**

19.1.6. I note that Figure 1 has brought out connections between the customers and vendors of Kwalitiy and the ultimate trail connects with Mr. Sidhant Gupta (Noticee No. 2). Further, Table 6 has tabulated the connections between the customers and vendors of Kwalitiy through their current and past directors. In this regard, on perusal of submissions made by Noticees 1 and 2, I note that:

19.1.6.1. Noticee 1 and 2 have neither denied nor objected to the facts presented in the Figure 1 and Table 5 and Table 6. In fact, I find that they have accepted that the customers of Kwalitiy Ltd. were operating through multiple entities for taxation purposes and some of them share common management and infrastructure.

19.1.6.2. However, the Noticees 1 and 2 have contended that the change in Directors and/ or shareholders referred to in the SCN are before one year of Corporate Insolvency start date and therefore the same is outside the relevant scope of TA. They have further contended that the common directors/ shareholders of various companies referred above were at different point of time and due to which they are not related to each other. However, I note that the Corporate Insolvency Start Date (i.e., December 11, 2018) and the period of inspection have nothing to do with the existence of relationship/ connections between the vendors and customers with the ultimate trail connecting with Noticee 2, Mr. Sidhant Gupta and therefore the arguments made by the Noticees 1 and 2 cannot be accepted.

19.1.6.3. Further, the aforementioned observation is supported by the fact that ITD has also found that the purchaser entities/ companies/ concerns were merely paper companies and had no actual business and meant for bogus billing for Kwalitiy Ltd and were controlled and managed by Mr. Sanjay Dhingra and Mr. Sidhant Gupta,

whose role have been explained in the subsequent paragraphs. I further note that ITD has raised a demand notice for a total amount of ₹7205,26,98,760/- 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”.

19.1.7. **Sample based customer and vendor analysis:**

- (a) ***A sample analysis of the financials of the customers and vendors from MCA portal (refer Part I of TAR) indicates that corresponding purchases and sales have been booked by the customers and vendors for the FY 2017-18 and that they were either dealing exclusively or majorly dealing with Kwality. The goods were stated to be further sold by the customers and no inventory was carried at year-end and that the profit margins of the parties were low. The calculation of percentage of dependency of customer and vendors on Kwality being more than 100% indicates that these were not genuine transactions and mere book entries. The sales and purchases in the books of Kwality were stated to be greater than the corresponding purchases and sales shown in the books of vendors and customers as calculated in the tables below:***

Table 7 Exclusive dependency of customers on Kwality Amount in INR Cr.

S. No.	Name of the Customer	Sales as per the books of Kwality (a)	Total Purchase as per the books of Customer (b)	Percentage of dependency of customer on Kwality (a/b)
1	A.K. Marketing Pvt Ltd	26,067	27,394	95.20%
2	Acute Sales and Marketing Pvt Ltd	14,564	14,616	99.60%
3	GLDN Enterprises Pvt Ltd	25,038	25,038	100.00%
4	Labtech Intellisys Pvt Ltd	3,165	3,119	101.47%
5	Prakash Foods Traders Pvt Ltd	26,710	26,710	100.00%
6	Roy Dairy Products Pvt Ltd	25,959	26,733	97.10%
7	Shaiyam Enterprises Pvt Ltd	20,446	21,022	97.26%
8	U A Enterprises Pvt Ltd	25,155	26,497	94.94%

Table 8 Exclusive dependency of Vendors on Kwaliti**Amount in INR Cr.**

S. No.	Name of the Vendor	Purchase as per the books of Kwaliti (a)	Total Sales as per the books of Vendor (b)	Percentage of dependency of Vendor on Kwaliti (a/b)
1	Ameejay Enterprises Pvt Ltd	30,276	29,866	101.37%
2	Neelam Dairy Pvt Ltd	23,695	23,099	102.58%
3	Pnc Enterprises Pvt Ltd	29,554	29,201	101.21%
4	Prakash Roy Dairy Pvt Ltd	24,158	23,506	102.77%
5	Renu Marketing Corporation (I) Pvt Ltd	29,373	29,053	101.10%
6	Sumukhi Sales Pvt Ltd	19,174	18,441	103.97%

(b) Further, following are observed from TAR (refer Part I of TAR) with respect to:

1) Labtech Intellisys Pvt Ltd (Labtech)- FY 2017-18:

- i. Labtech was stated to be in the business of legal, accounting, book-keeping and auditing activities prior to FY 2017-18. However, its objects clause was changed to dealing in dairy products just prior to entering into transactions with Kwaliti.**
- ii. The net worth and operational results of Labtech was stated to be not reflecting high credit-worthiness as given below:**

Table 9 #**in INR Lacs**

FY	Revenue from operations	Profit	Paid Up capital	Reserves and Surpluses
2016-17	0.33	*	*	*
2017-18	3120.30	1.37	1.5	0.46

#The table format given in SCN has been modified keeping the figures same.

* Not available.

- iii. Labtech had purchased goods with value upwards of ₹1 Crores from Kwaliti in the FY 2017-18 and the entire amount of ₹1.95 Crores, recoverable by Kwaliti from Labtech has been written off in Quarter IV financials dated May 28, 2019.**
- iv. No supporting documents was observed for due diligence and approval on sanctioning of large credit limit to Labtech.**

2) Supershakti Cooking Oil Private Limited (SCOPL):

- i. SCOPL has been stuck off vide notice dated August 8, 2018, (Page No. 296 of Notice of Strike off issued by Registrar of Companies, New Delhi - STK7DelhiNotice_09082018 (mca.gov.in) (refer Part I of TAR) (Annexure 5)***
- ii. Post-strike off transactions consists of receipt of payments amounting to ₹.47 Crore.***
- iii. The entire amount of ₹0.73 Crore, recoverable by Kwality from SCOPL was observed to be written off in the audited financials for the year ended March 31, 2019.***

(c) From the aforesaid it appears that these entries were not genuine and without any underlying transactions and the above referred transactions with these entities were done with a purpose to inflate the financials and divert the funds of Kwality.

19.1.8. On perusal of submissions made by Noticees 1 and 2, w.r.t. above allegations, I note that:

19.1.8.1. For observations with respect to M/s Labtech Intellisys Pvt. Ltd., the Noticees 1 and 2 have contended that there is no restriction in law for a company to do multiple businesses and in different fields. The said Noticees have further submitted that the promoter of the said company was associated with Kwality through an entity with name M/s H G Exims (P) Ltd. as its vendor for more than five years and that Kwality has been doing proper due diligence before inducting/ selecting any customer/ debtor which includes their reference checks from existing customers/ vendors/ bankers, doing KYC, analysing balance sheet, visiting office/ facilities and obtaining D&B Reports etc. However, other than D&B Reports, the Noticees 1 and 2 have not furnished any documentary evidence to substantiate their statements. Moreover, the D&B Reports furnished by Noticee 1 and 2, pertains to some other entity and not to Labtech Intellisys Pvt. Ltd. I note that Kwality had written off entire amount of INR 41.95 Cr. recoverable from Labtech Intellisys Pvt. Ltd.

19.1.8.2. I note that the company M/s Supershakti Cooking Oils Pvt Ltd. (SCOPL) was struck off vide a Notice dated August 08, 2018 by Registrar of Companies, New Delhi. I note that the entire amount of INR 30.73 Cr., recoverable from SCOPL was written off during FY 2018-19. For the observations w.r.t. the said company, Noticees 1 and 2 have contended that while Kwaliti had not done any sales transactions with SCOPL after it was struck off by RoC, the company managed to recovered INR 3.47 Cr. from SCOPL after it was struck-off. The Noticees 1 and 2 have stated that as a result of continuous effort by the company it could recover the amount receivable. They have further tried to play down the seriousness of the captioned allegation by contending that write-off is merely an accounting activity, and it does not mean that the amount written off is lost by the company and that the company can take legal action for recovery of the same.

19.1.8.3. I also note from the replies wherein the Noticees 1 and 2 have stated that Internal authorisation of receivables & trade advances had always been a regular process where in every quarter the same would get formally passed through audit committee with final approval from board members before publishing the results. However, no documentary evidences substantiating their arguments and claims have been submitted by them.

19.1.8.4. In this regard, I note that as per law the audit committee has been entrusted with an important role with respect to 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. The audit committee is also vested with a duty to examine the financial statements. Also, the audit committee is expected to review the quarterly financial

statements. In this regard, I note that in the present matter Noticees 1 and 2 have not brought before me any evidence to suggest that the write off of such huge amounts were brought to the attention of the audit committee and their comments obtained.

19.1.8.5. In the absence of documentary evidences demonstrating compliance with the established legal procedures, it is difficult to accept the arguments advanced by Noticees 1 and 2. Thus, they have failed to disclose the reasons for which Kwalitiy had to write off the entire amount of INR 30.73 Cr.due from the SCOPL and INR 41.95 Cr. due from Labtech Intellisys Pvt. Ltd.

19.1.8.6. The Noticees 1 and 2 have also submitted that proper due diligence was done by Kwalitiy before appointment of SOCPL as its vendor. However, no documentary evidence has been furnished by them to substantiate their claim. Moreover, the D&B Report furnished by them pertains to some other entity and not to SCOPL.

19.1.8.7. Further, Noticees 1 and 2 also failed to furnish any documentary evidence like letters/ emails or legal notices sent to SCOPL to substantiate the efforts/ legal actions taken by the company to recover the amount receivable. In the absence of which, the arguments made by the Noticees 1 and 2 are nothing but afterthoughts and cannot be accepted and therefore I conclude that said entries were not genuine and without any underlying transactions and the above referred transactions with these entities were done with a purpose to inflate the financials.

19.1.9. **Substantial amount written off and provisions made against Trade receivables:**

(a) The outstanding receivables along with the written off receivables are tabulated as under:

Table 10

Details	Amount (INR Cr.)	Remarks
a) Receivables outstanding (as on 10-December-2018)	1618	Source: Receivables as per provisional financial statements for the period ended 10 December 2018.
b) Written off of receivables from the above mentioned group	863	(₹760 Cr + ₹103 Cr.) Quarter II of FY 2018-2019
c) Effective receivables outstanding as on Q III, 2018-19 (a+b)	2481	Materially significant amount owing to the current liquidity position of the company.
d) Bad and doubtful debts against the receivables outstanding from the Customers	1277	Source: Financial results for the quarter ended 31st December 2018
e) Provision for doubtful debts in its audited financials for the quarter ended 31 March 2019	324	Source: Financial results for the quarter ended 31st March 2019
The total amount of receivables write offs and provisioning by Kwaliti for the financial year 2018-2019	2464	b+ d +e = 863+1277+324

As can be seen from the above table, the total amount of receivables write offs and provisioning by Kwaliti has been INR 2464 Crores for the financial year 2018-2019 (schedule G of Part VII of TAR). The total trade receivables shown by the company, as on March 31, 2019 is ₹8.23 Crores. Hence, it appears that company had written off amounts which were 42 times of inter corporate trade receivables, which had negatively impacted the financials of the company.

(b) Write offs and provisions in the FY 2018-19 from the sample customers (top 20- FY2018) as on December 10, 2018 are detailed below:

Table 11**Amount in INR Cr.**

Rank 2017-18 (Amount)	Customer Name	Rank 2018-19 (Amount)	Total Sales*	A=Balance Recoverable 10-12-18	B=Scheme Discount QII 18-19	C=Write-offs in Sept'18	D=Provisioning in Dec'18 and Mar'19	E=Total Write-off/Provision (B+C+D)^
1	Nand Gopal Marketing Pvt.Ltd	3	371	82	38	-	84	122
2	Prakash Foods Traders Private Limited	6	349	76	37	-	78	115
3	SMBJ Dairy Pvt.Ltd	4	356	14	36	35	14	85
4	A.K. Marketing Private Limited	5	349	51	39	-	53	92
5	Kunal Milk Products Pvt Ltd	7	339	73	38	-	73	111
6	Roy Dairy Products Pvt Ltd	2	361	88	36	-	89	125
7	U A Enterprises Private Limited	8	328	6	36	36	6	79
8	Delhi Foodstech Pvt. Ltd	16	308	28	36	-	29	65
9	GLDN Enterprises Pvt Ltd	20	303	59	38	-	59	97
10	Ranbir Dairy Private Limited	18	302	57	36	-	59	95
11	Surya Milk Products Pvt Ltd	15	304	39	37	-	39	77
12	Rana Foods Tech Pvt Ltd	13	315	60	36	-	60	96
13	Parul Sales and Marketing Private Limited	11	317	60	37	-	60	97
14	Devidayal Radheshyam Traders Pvt Ltd	21	288	54	35	-	54	89
15	Sankalpshakti Enterprises Pvt. Ltd	17	295	46	37	-	46	84
16	Anandh Food Agencies Pvt Ltd	9	288	57	34	-	58	92

Rank 2017-18 (Amount)	Customer Name	Rank 2018-19 (Amount)	Total Sales*	A=Balance Recoverable 10-12-18	B=Scheme Discount QII 18-19	C=Write offs in Sept'18	D=Provisioning in Dec'18 and Mar'19	E=Total Write Off/Provision (B+C+D)^
17	Sahi Marketing Pvt Ltd	12	284	63	30	-	65	95
18	Bal Gopal Dairy Pvt Ltd	10	284	72	35	-	75	109
19	Arnav Milk and Products Pvt Ltd	23	252	46	32	-	46	78
20	Shaiyam Enterprises Private Limited	14	267	9	30	31	9	71
	Total Samples		6,260	1,040	713	102	1,056	1,874
	Total for all Debtors			1,618	761	103	1,601	2,464
	Top 20%			64%	94%	99%	66%	76%

^Typographically erroneously mentioned as (B+D+E) in SCN.

As noted from the table above, the write offs and provisions in FY 2018-19 constitutes around 76% of the total debtors and includes 19 entities who were either connected / related (as indicated in the previous paragraphs).

(c) Review of the transactions in 36 major debtor accounts taken as a sample (Refer Schedule A of Part VII of TAR) outstanding as on December 10, 2018 indicates the following:

Table 12

Amount in INR Cr.

Sales FY 2016-17	Sales FY 2017-18	Sales FY 2018-19	Total sales
4994.80	5667.75	1759.95	12422.50

(d) Out of the total sales as stated above, the following was observed (Refer Schedule B of Part VII of TAR):

Table 13

As on Dec 10, 2018

Amount in INR Cr.

Details	Total for sample 36 debtors (A)	Total debtors (B)	% of A out of B
Balance recoverable	1589	1618	98
Scheme Discount QII 18-19 (i)	753	760	99
Write offs in Sep'18 (ii)	103	103	100
Provisioning in Dec'18 (iii)	1259	1277	99
Provisioning in Mar'19 (iv)	324	325	100
Total of (i) to (iv)	2438	2464	99

The total outstanding payable from these sample debtors was ₹ 589 Crores, as on December 10, 2018, which is about 98% of the total receivables outstanding of ₹618 Crores as on December 10, 2018. The substantial sales to these customers were observed during the FY 2016-17 to 2018-19.

(e) Aging schedule of these samples is as under:

Table 14

Amount in INR Cr.

	Total Outstanding (O/s) as on 31 March 2018	O/s upto 90 days	O/s 91 to 180 days	O/s 181 to 365 days	O/s more than 365 days
	1625.12	1409.75	91.41	70.15	53.81

	Total Outstanding (O/s) as on 31 March 2018	O/s upto 90 days	O/s 91 to 180 days	O/s 181 to 365 days	O/s more than 365 days
% to total outstanding		87%	6%	4%	3%

- (f) ***The TAR (Refer Schedule C of Part VII of TAR) indicates that Kwalitiy had classified bulk of the receivables amount as “dues outstanding within 90 days”, and the same were classified as good and without any default in the audited financial statements for year ended 31 March 2018, as well as in the drawing power statements, being submitted periodically to the financial creditors for availing working capital limits.***
- (g) ***The TAR also indicates that these debtors have not executed comprehensive sales agreements with Kwalitiy and no evidence has been provided of any proactive recovery proceedings against the customers by the management.***
- (h) ***The above table 13 indicates that, 99% of the balance outstanding has been either written off or provisions has been made or through scheme discounts. The aging analysis shows that 87% of these write offs/ provisioning has been only outstanding for less than 90 days. No efforts on the part of Kwalitiy was observed for recovering these dues or initiating legal proceedings against them despite Kwalitiy being in a heavy liquidity crunch. Hence, it appears that Kwalitiy has deliberately misrepresented the receivables position in the books of accounts and drawing power statements for the FY 2018-19, with an intent to defraud the financial creditors and has mis-reported its financial position to the auditors and stakeholders.***

19.1.10. On perusal of submissions made by Noticees 1 and 2, w.r.t. above allegations, I note that:

19.1.10.1. Noticees 1 and 2 have neither denied nor objected to the facts brought out in Tables 10 to 14, however as noted in pre-paragraph number 19.1.6, they have contended that the basis of connection or relation alleged by SEBI is faulty and that SEBI failed to prove the diversion of funds in its entirety. In this regard, at the cost of repetition, it is reiterated that Figure 1 has brought out connections between the customers and vendors of Kwalitiy with the ultimate trail connecting with Mr. Sidhant Gupta (Noticee No. 2). Further, Table 6 has

tabulated the connections between the customers and vendors of Kwaliti through their current and past directors. I note that there is no denial of the facts presented in the Figure 1 and Table 6. In fact, I find that Noticees 1 and 2 have accepted that the customers of Kwaliti Ltd. were operating through multiple entities for taxation purposes and some of them share common management and infrastructure. Further, the fact that the Noticees 1 and 2 have failed to furnish any documentary evidence to substantiate that the matter was placed before the audit committee and comments of the audit committee was taken before writing off such a substantial amount, that too at a time when the Company was in deep financial crisis, puts a serious question mark on the intentions of the Noticees who were at helm of affairs at Kwaliti.

19.1.10.2. Further, the aforementioned observation is supported by the fact that ITD has also found that the purchaser entities/ companies/ concerns of Kwaliti were merely paper companies and had no actual business and meant for bugs billing for Kwaliti and were controlled and managed by Mr. Sanjay Dhingra (Noticee 1) and Mr. Sidhant Gupta (Noticee 2), whose role have been discussed in the subsequent paragraphs. I further note that ITD has raised a demand notice for a total amount of ₹7205,26,98,760/- 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 Kwaliti 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 Kwaliti group of companies, in lieu of commission”.

19.1.10.3. Further, Noticees 1 and 2 have repeated that in FY 2018-19, Kwaliti slipped into an extreme situation of cash crunch due to delayed working capital release from its bankers, investments in high-margin VAP (Value Added products), and business model shift towards B2C. This led to delayed payments to sourcing partners of Kwaliti, resulting in decreased milk sourcing and market backlash, causing drastic increase in receivables. The Noticees 1 and 2 have further referred to an old conflict between Kwaliti and its bulk partners with regards to their claims against scheme of discount offered by the company to retail distributors and quality issues. They have submitted that the company took a firm stance, communicating with partners through various channels and even filed an arbitration case against M/S UA Enterprises (P) Ltd., however, the arbitrator upheld the partner's claim, directing the company to provide credit for schemes and quality-related issues. Ultimately the company had to make provision for these schemes and quality issues leading to a huge hit.

19.1.10.4. In this regard, I however note that Noticees 1 and 2 have not furnished any evidence to ascertain whether the said scheme was in existence in reality or whether the comments of the Audit Committee were obtained for writing off/ provisioning for the amount receivables from the customers. In the absence of above, the arguments given by Noticees 1 and 2 appears to be an afterthought more so when the notices have argued that the company has a procedure to approach its audit committee and the Board for such approvals and therefore cannot be accepted.

19.1.10.5. The Noticees 1 and 2 have further submitted that due to demand raised by bulk distributors on account of quality issue, Kwaliti had to take financial hit. The company had gone to arbitration against only one distributor on quality issue which went in favour of the bulk distributor U A Enterprises Pvt. Ltd. In this regard, I note that Kwaliti had filed arbitration only against one out of its 36 major distributors, while no action was taken against other distributors. Further, in case of U A Enterprises Pvt. Ltd., the company had the option to go to court of law which it did not exercise and claimed to have succumbed to the pressures from its distributors resultantly either wrote off or made provisions for the amount receivable from its customers/ bulk distributors. On perusal of chain of communication of Kwaliti with one of the customers/ bulk distributors M/s Tanishka Agencies Pvt. Ltd., furnished by Noticees 1 and 2, I note that the as on June 30, 2017, the said entity was having a total of INR 40,99,91,429 outstanding for payment to Kwaliti, however, till December 2018, no legal action was taken by the company against the said entity. The above points to the intension of the company and only establishes that it was not serious to recover its pending receivable amounts. Therefore, the arguments given by Noticees 1 and 2 cannot be accepted.

19.1.10.6. The Noticees 1 and 2 have submitted that its debtors were having “dues outstanding within 90 days” and the same were good and without any default at the time/ period as on March 31, 2018 in the audited financial statements and that the delay started afterwards, when the Company was not able to supply the required materials due to various reasons stated in their reply. They have further contended that if the debtor were

good and dues were outstanding within 90 days, the same can go bad afterwards.

19.1.10.7. Noticees 1 and 2 have further contended that the outstanding receivables of Kwaliti were duly audited by its statutory auditors MSKA & Associates. I however, note that MSKA & Associates is the same audit firm which resigned on November 05, 2018, citing non-sharing of information by Kwaliti as the primary reason. I further note that its resignation letter also pointed out the fact that Management and Audit Committee of Kwaliti, had chosen not to respond to the auditor's communication with regards to sharing of information on various occasions. Thus, I note no merits in the arguments of the Noticees 1 and 2.

19.1.10.8. The Noticees 1 and 2 have further argued that the Drawing Power of Kwaliti was much more than the required Drawing Power/ working capital by Banks over the years. Also, Company has not availed of any additional working capital limits for the last more than 5 years (including the period of Audit). In this regard Noticees 1 and 2 have referred to the following table:

Table N1

(in INR Cr.)

Particulars	FY 14-15	FY 15-16	FY 16-17	FY 17-18	FY 18-19 (up to June 30, 2018)
<i>Sales</i>	5269.17	5724.23	6131.27	6724.88	1262.48
<i>B2C Sales %</i>	35%	35%	41%	43%	44%
<i>EBITDA</i>	329.56	378.47	425.32	502.86	89.70
<i>Profit Before Tax</i>	170.47	208.36	233.71	144.11	4.19
<i>Drawing Power</i>	1151.50	1350.97	1393.30	1713.13	1748.96
<i>Bank Limit (CC Balance as per Books)</i>	874.19	1005.45	929.60	1014.05	969.24
<i>Excess Drawing Power</i>	277.30	345.51	463.70	699.08	779.72

- 19.1.10.9. The Noticees 1 and 2 have thus contended that the above table reveals that the Company has not raised fictitious/ inflated receivables and payables nor misrepresented its financial statements in order to avail of working capital funds from the banks or drawing power statement. Also, the payment settlement transactions happened till November; 2018 (after many months of getting the accounts NPA), which shows that the same was not done for availing of the drawing power from Banks or to defraud the creditors.
- 19.1.10.10. It may be noted that Drawing Power is assigned by a bank to a company based on the financials provided by the company to the bank. The present order deals with misrepresentation and manipulation of the financials of Kwality and the same have been established also. Therefore, the arguments given by Noticees 1 and 2 cannot be relied upon.
- 19.1.10.11. The Noticees 1 and 2 have further submitted that the Company has been doing proper due diligence before appointment of any vendor and customer regarding its credit worthiness, reference checks from market and existing channel partners and vendors, KYCs, physical visit to their premises etc. However, the Noticees 1 and 2 failed to furnish any tangible documentary evidence to support these statements with respect to the customers and vendors mentioned in the Table 11, in the absence of which these statements have got no relevance and therefore cannot be accepted.
- 19.1.10.12. The Noticee 1 and 2 have further claimed that there were no two way transactions with the entities mentioned at Table 11, however, no evidence, including the bank statements, has been furnished by them to substantiate

their statements. Therefore, the arguments given by Noticees 1 and 2 cannot be relied upon.

19.1.10.13. Noticee 1 and 2 have further admitted to the fact that Kwaliti was usually purchasing and selling material on order to order basis and for that there are no written agreements with the vendors and customers. However, they have contended that as part of standard operating procedure, the company was communicating with the customers through email and physical letters and in this regard they have shared copies of communication done with an entity with name Taniska Agencies Pvt. Ltd. However, I note that the said entity was not among the top 20 customers mentioned in Table 11 and that no evidence has been furnished to ascertain whether any communication was done with the said customers mentioned in the Table. The Noticees 1 and 2 have also not furnished any evidence regarding in-person meetings conducted with the said customers, as mentioned in Table 11, like minutes of the meeting etc. and in the absence of the same the arguments given by them cannot be relied upon.

19.1.10.14. Noticees 1 and 2 have further argued that Kwaliti being under CIRP could not take / initiate legal action against the said customers. In this regard I note that the CIRP proceeding does not prevent the corporate debtor from taking legal action against its debtors and therefore the argument given by the Noticees is not acceptable. It is also noted that the CIRP proceeding against the company was initiated only on December 11, 2018 and the company had enough time till the said date to take appropriate legal actions, however, there are no signs that the company took any such action. In fact, Noticees 1 and 2 have argued that taking legal action against

these debtors entails involvement of huge court/ legal fee and might have further delayed the recovery process. This cannot be a prudent approach, gives rise to the intensions of the company and shows that it was not serious to recover its pending receivables. It further strengthens the observation that Kwality had deliberately misrepresented the receivables position in the books of accounts and drawing power statements for FY 2018-19, with an intent to defraud the financial creditors and has misreported its financial position to the auditors and stakeholders.

19.1.11. **Other observations:**

- a) *A review of the top 20 customers, by sales turnover during the FY 2017-18 and 2018-19 indicates the following: (Part VI of TAR)*
 - i. *The top 20 customers account for 69% of sales in the FY 2017-18 and 64% of sales in the FY 2018-19 up to December 10, 2018. (Schedule A of Part VI of TAR)*
 - ii. *68% of the sales proceeds from the top 20 customers were adjusted as received through book entries by Kwality during the relevant period. (Schedule C of Part VI of TAR)*
 - iii. *All the customers in the sample, are observed to be lesser known corporates who are dealing in the B2B segment and were observed to be situated in and around Delhi-NCR.*
- b) *The fact that vendors and customers' financials and the site visits conducted do not substantiate the quantum of transactions, the interconnection of corporate entities (customers and vendors include both Corporate and Non-Corporate entities) between themselves and with Kwality through common directors, their operations largely with Kwality alone (exclusive dependency), substantial write off of their outstanding (₹63 Crores) as detailed above at Table 10 and outstanding balances clubbed with the other observations mentioned above and the absence of records and documentation, indicates that the transactions were not genuine and that the sales and the purchase figures have been inflated and misrepresented.*

19.1.12. On perusal of submissions made by Noticees 1 and 2, w.r.t. above allegations, I note that:

19.1.12.1. Noticees 1 and 2 have not disputed the facts and figures mentioned in the above allegations. However, they have repeated their submissions that in FY 2018-19, Kwaliti slipped into an extreme situation of cash crunch due to delayed working capital release from its bankers, investments in high-margin VAP (Value Added products), and business model shift towards B2C. The detailed submissions made by the Noticees 1 and 2, in this regard, have already been discussed by me at para 19.1.2.7 to 19.1.2.14, where it was concluded that the submissions made by the Noticees are after thought and cannot be relied upon.

19.1.12.2. Noticees 1 and 2 have repeated their earlier submissions that the top 20 customers are bulk dealers/ distributors of milk, curd and other dairy products. They have further repeated their submissions that Kwaliti has been doing proper due diligence before appointment of any vendor and customer regarding its credit worthiness, reference checks from market and existing channel partners and vendors, KYCs, physical visit to their premises etc. However, no tangible documentary evidence has been submitted to support these contentions with respect to the customers mentioned in the Table 11, in the absence of which these contentions have got no relevance and therefore cannot be accepted.

19.1.12.3. The Noticees 1 and 2 have further submitted that Kwaliti had a comprehensive framework for fixing the limits based on the type of the customer and these limits would always get duly submitted to the working capital lenders

for their records. They have further claimed that effectiveness of this process could be judged by the smooth functioning of the relationships over a long period of time with statistically insignificant bad debts. Internal authorisation of receivables & trade advances had always been a regular process where in every quarter the same would get formally passed through audit committee with final approval from board members before publishing the results. I however, note that the Noticees 1 and 2 have not furnished copy of comprehensive policy framework, duly approved by the Board. Further, no evidence including minutes of the meeting of the Audit Committee and Board of Directors, has been provided to ascertain if receivables and trade advances were passed by the Audit Committee and duly authorized by the Board Members, in the absence of which the submissions made by the Noticees 1 and 2 cannot be relied upon.

19.1.12.4. Noticees 1 and 2 have further denied the fact that that the transactions referred above were not genuine and that the sales and the purchases figures have been inflated and misrepresented. However, as discussed at para 19.1.2 above, the submissions made by the Noticees 1 and 2 are not supported by any documentary evidence and thus appears to be after thought and cannot be relied upon. I therefore conclude that the said transactions were not genuine and that the sales and purchase figures were inflated and misrepresented.

19.2. **Misrepresentation of receivable accounts and payables position resulting in diversion of funds:**

19.2.1. ***The ledger accounts of customers and vendors and the bank books as provided in the TAR indicates that Kwaliti had routed a substantial volume of receipts and payments entries through a control GL (General Ledger) account i.e. "Payment***

Settlement Clearing Account” (PSCA), which involved selected customers and vendors.

19.2.2. Kwaliti was stated to be instructing its debtors to either: (refer Part II of TAR)-

- a. directly pay its vendors through the debtors’ own banking channels, or**
- b. directly set-off through book adjustments, the ledger accounts of Kwaliti’s vendors in debtors’ books of accounts, and**
- c. issue letters of confirmation periodically to Kwaliti on executing the transactions through both banking and other channels.**

19.2.3. Kwaliti has not established any policy or procedures on PSCA and the account was being maintained on an operational level with verbal instructions from the management team.

19.2.4. Verification of the sample of correspondence evidence of the PSCA transactions (refer Part II of TAR) indicated the following:

- a. Accounting discrepancy of more than ₹3 Crores in the sample confirmation letters as verified by the TA (Schedule C of Part II of TAR).**
- b. The accounting entries were recorded in PSCA on back date basis in Enterprise Resource Planning (books of accounts) following the receipt of confirmation letters from debtors and creditors at month/ quarter end.**
- c. The accounting entries in PSCA were settled day-wise and had multiple parties entering into one-on-one or one-to-many settlements and all below ₹One Crore (Schedule D of Part II of TAR).**
- d. The letters neither reveal the name and contact details of the signatories nor have reference to the account balance or outstanding bills. It also does not specify the mode of settlement of the transaction amounts. It is not specified whether banking channels were used. Also, the letterheads of the customers and vendors appear similar in terms of design, font size and message content.**

19.2.5. Verification of the records of receipts and payments (refer Part II of TAR), related to major customers and vendors indicates that a materially significant proportion of transaction volume

is accounted through book adjustment entries by Kwality and concerned parties. The details are as given below:

Table- 15

Transaction volume during Dec 11, 2016 to Dec 10, 2018

Amount (INR Cr.)

Period	Receipt Entries	Payment Entries
<i>FY 2017-18</i>	4279.57	4279.57
<i>FY 2018-19 (upto 10-12-2018)</i>	599.61	599.61
Total	4879.18	4879.18

Note: List of all the 87 parties involved during the relevant period – provided in Part II of TAR

- 19.2.6. **The total receipts and payments during the FY 2017-18 and FY 2018-19 (upto December 10, 2018) were ₹879.18 Crores and ₹879.18 Crores respectively. The same is analysed in the subsequent paras.**
- 19.2.7. **Following were the entities having common interest (as detailed in point no. ii. and iii. of para 4.1.1.3) and eventual trail with Kwality whose payments were settled by netting off during the period December 12, 2016 to December 11, 2018:**

Table- 16

Amount in INR Cr.

S. No.	Customer/ Vendor	Receipt	Payment
1	Anandh Food Agencies Pvt Ltd	169.41	-
2	Bal Gopal Dairy Pvt Ltd	180.50	-
3	Freshia Foods Pvt. Ltd.	-	243.22
4	Kunal Milk Products Pvt Ltd	253.02	-
5	OM SALES TRADING PVT LTD	-	203.93
6	Parul Sales and Marketing Pvt Ltd	162.40	-
7	Prakash Foods Traders Pvt Ltd	252.56	-
8	Prakash Roy Dairy Pvt Ltd	-	231.47
9	Rana Foods Tech Pvt Ltd	235.68	-
10	Ranbir Dairy Pvt Ltd	231.43	-
11	Renu Marketing Corporation (I) Pvt Ltd	-	230.19
12	RN Dairy Products Pvt Ltd	-	168.26
13	Roy Dairy Products Pvt Ltd	241.59	-
14	Sahi Marketing Pvt Ltd.	165.83	-
15	Sumukhi Sales Pvt Ltd	-	154.41
16	U A ENTERPRISES Pvt Ltd	258.46	-
17	Y M Foodways Pvt Ltd	-	488.15
Total		2150.89	1719.63

Note: There are various companies having common directors within those mentioned above. List of all such parties are provided in Part II of TAR.

- 19.2.8. **No resolutions, minutes of meetings or any other records were available to evidence authorization or sanction of such book adjustments. Also, no details were shared on whether the book adjustments were all related to banking transactions by respective parties. The details on the mode of settlement for the individual net-off transactions, identifying use of banking and other channels therein, were not made available to the TA for examination.**

19.2.9. ***Verification of the sample documentation related to the transaction revealed that the alleged book adjustment entries which were gathered from letters received by Kwaliti from its customers and vendors (refer Schedule B of Part II of TAR), originated from a single source and appears to be a deliberate misrepresentation of the receivables and payables position in the books of accounts by the Company.***

19.3. I note that Noticees 1 and 2 have not disputed the facts and figures given at Table 15 & 16. Further, the submissions made by Noticees 1 and 2 w.r.t. PSCA have already been discussed at para 19.1.2. However, some specific observations in the SCN and reply of the Noticees 1 and 2 are as under:

19.3.1. On perusal of Part II of TAR, it is noted that Kwaliti, vide a letter dated June 30, 2018 had requested one of its distributors, Ms. Roy Dairy Products Pvt. Ltd., which owed INR 22 Cr. to Kwaliti, to make direct payment in the account of following vendors:

- a. PNC Enterprises Pvt. Ltd. – INR 8 Cr.
- b. Renu Marketing – INR 8 Cr.
- c. Y M Foodways Pvt. Ltd. – INR 6 CR.

In reply, Ms. Roy Dairy Products Pvt. Ltd., vide a letter dated October 05, 2018 had confirmed payment to the vendors of Kwaliti:

- a. PNC Enterprises Pvt. Ltd. – INR 8 Cr.
- b. Renu Marketing – INR 8 Cr.
- c. Y M Foodways Pvt. Ltd. – INR 6.35 CR.

The aforesaid three vendors had confirmed the receipt of amounts mentioned above through their respective letters. Y M Foodways Pvt. Ltd., one of the vendors of Kwaliti, vide its letter dated October 05, 2018 had confirmed receipt of a total of INR 13 Cr., which included receipt of INR 6.35 Cr. from Roy Dairy Pvt. Ltd. and INR 6.65 Cr. From another entity named Shaiyam Enterprises Pvt. Ltd. The TA found that the INT 13 Cr. received by Y M Foodways Pvt. Ltd. was not accounted by Kwaliti

19.3.2. In response to the above allegations, Noticees 1 and 2 have submitted that there was typo error by customer/ vendor in a

particular transaction and that in the quoted example there was correct entry in the ERP of Kwaliti on the basis of verbal confirmation from both the vendor and customer. The noticees have further claimed that one of the sample letters shared/ quoted by the TA is the wrong and the same was subsequently replaced by both the parties. The Noticees 1 and 2 further claims that correct letters were later shared with the TA and the same were provided along with their reply to SCN.

- 19.3.3. While the Noticees are claiming that there was only one transaction with typo error and one letter which was wrong, I find that there were 18 different transactions amounting to INR 13 Cr. which were observed to have not been accounted for by Kwaliti and considering this, it is difficult to accept it as a mere typo error. Further, Noticees 1 and 2 have not offered any comments on the said transactions highlighted by the TA and they failed to provide any documentary evidence to substantiate that the correct letters were subsequently shared with the TA and the receipt of same were duly acknowledged by the TA. In absence of any such evidence the argument given by Noticees 1 and 2 cannot be accepted.
- 19.3.4. Noticees 1 and 2 *inter alia* have submitted that Kwaliti was tracking the movement of funds/ credit of vendors Account on daily basis (both payments and receipts by debtors & creditors respectively) and in order to have updated ledger on continues basis and to negotiate the purchase & sale of milk & other products, the Company was passing accounting entries on daily basis on verbal instructions from management team supported by verbal confirmations from vendors & debtors. The same is reconciled on monthly basis based on written confirmations from debtors and vendors, and in case of any difference, the same is rectified.

- 19.3.5. In this regard I note that issuance of verbal instructions by management to make accounting entries on the basis of verbal confirmation received from vendors/ customers is not a healthy practice and cannot be appreciated. It is not clear why to depend upon verbal confirmation when written confirmation can be taken on daily basis. Such practice cannot be called prudent accounting practices and gives scope to potential accounting manipulations.
- 19.3.6. Noticees 1 and 2 have further submitted that the letter(s) issued by the vendors & customers are on their respective letterheads with proper stamp & sign of Authorised Signatory. These debtors & vendors are largely unorganised and do not have professional staff. Further, letterheads of different vendors & customers are different and that the Company had only provided the photocopy of letter(s) to Auditors. The Noticees 1 and 2 have further submitted that Some of the Vendor/ Customer Group operates with more than one Company/ entity for various structuring/ taxation purpose, while sometimes vendor(s) operates with separate entities for different products or separate entities for taxable/ non-taxable products. However, such entities belong to same management and share common working infrastructure. It has been admitted by Noticees 1 and 2 that in some cases Kquality provided the format of letter received from other vendor/ customer to a particular customer/ vendor (as these vendors/ customers are mostly unorganized) and in such cases, pattern of letterhead or content font/ format may be similar.
- 19.3.7. In this regard, as noted above, making accounting entries on the basis of verbal and written confirmations from vendors and customers is not a prudent accounting practice. On a closer examination of the confirmation letters received by Kquality from its vendors and customers, it is noted that there is no reference of the Bill or Order against which the payment is claimed to have been settled. The said letters neither mention the mode of settlement nor mention the details of the bank accounts involved

in the transactions. The Noticees 1 and 2 have not given any response w.r.t. the said observation explaining as to why such details were not provided in the confirmation letter. Further, as against what is claimed by the Noticees 1 and 2, none of the letters is having proper name and designation of the authorized persons.

19.3.8. From the above discussions, I note that the Noticees 1 and 2 have not submitted any documents that suggest that the receivable and payables were not inflated and shows a true and fair picture of the financial position in this regard.

19.4. **Observations on trade advances:**

- a. Kwaliti was stated to be procuring milk and other products from its suppliers on credit terms of 0 to 10 days, as submitted by its management before the TA. There were outstanding trade advances to suppliers amounting to ₹77 Crores as on December 10, 2018 (refer Schedule N of Part I of TAR).***
- b. The suppliers to whom the trade advances were given also included the corporate parties which had close common interests with the director of Kwaliti and ex-director of related party of Kwaliti. It is further observed that Kwaliti has made provision for doubtful recovery of ₹10.51 Crores against these trade advances in its audited financial statements for the year ended March 31, 2019. (refer Schedule O and N of Part I of TAR)***
- c. The parties to the provisioning of ₹00.26 Crores were also part of the suppliers who were made payment through net-off entries (refer above para no. 4.1.2.7) by Kwaliti during the relevant period. It is observed that consideration worth ₹060.15 Crores was settled in these parties through net-off book adjustments. (refer Schedule P of Part I of TAR).***

19.5. On perusal of submissions made by Noticees 1 and 2, w.r.t. above allegations, I note that:

19.5.1. Noticee 1 and 2, have not disputed the figures mentioned in para 19.4. However, they have argued that due to non-release of enhanced working capital by the consortium of bank, Kwaliti was unable to source milk from these vendors. However, the same is beyond understanding because in order to source milk from these

suppliers, all that was required was to place order with them as these suppliers were already having advance provided by Kwality.

- 19.5.2. The Noticees have further contended that Kwality in consultation with Statutory Auditors and Resolution Professional (RP) has provided for these advance in Q-III and Q-IV of FY 2018-19. In this regard, it may be noted that when in financial distress, it is prudent to either have the supply of milk from the vendors/ suppliers or recover the amount already paid to them as advance. The vendors/ suppliers are not stated to be in financial distress. However, Noticees 1 and 2 have not furnished any documentary evidence to substantiate that all possible efforts were taken on part of the Company to recover the advance amount, including the option to take legal action during Q-I and Q-II of FY 2017-18 against such vendors/ suppliers. In view of above, the reply given by Noticees 1 and 2 is illogical and devoid of any meaning.
- 19.5.3. The other submissions made by Noticees 1 and 2 are repetitive in nature and mainly relates to the PSCA arrangement involving customers and vendors, which have already been discussed at para 19.1.2 and for the sake of brevity are not being repeated.
- 19.5.4. Further, I note from records that the substantial receipts volume of ₹4879.18 Crores routed through the net-off route, during the period starting from April 1, 2017 upto November 30, 2018, is an attempt to deliberately misrepresent receivables accounts and payables position with an intent to defraud the financial creditors of Kwality and misreported its financial position to the stakeholders including shareholders.
- 19.6. **Misrepresentation through overvaluation of assets by entering into irregular transactions in capital expenditure**
- 19.6.1. **Through equipment advances and trade advances to vendors for purchase of milk testing equipments:**
- a) ***Kwality had given 23 of its vendors, equipment advance amounting to ₹52.60 Crores for purchase of milk testing***

equipments by these vendors. An amount of ₹01.04 Crores was outstanding as on December 10, 2018 against these capital advances. The details of the same are as under: (refer Part III of TAR)

Table- 17

Amount in INR Cr.

S. No.	Particulars	Amount
1	Total amount advanced to Vendors (which includes ₹61 Crores in FY 16-17 and ₹15 Crores in FY 17-18)	152.60
2	Recovery upto Dec 10, 2018	51.56
3	Balance recoverable	101.04
4	Provisioning in Quarter III and Quarter IV of FY 2018-19	89.75
5	Writing off of Milk testing equipments from fixed assets in Quarter IV of FY 2018-19	67.00

b) Following are the observations on analysis of these transactions:

- i. These assets (milk testing equipment's) were stated to be sourced from lesser known dealers while choosing not to place the order on the original equipment manufacturers.**
- ii. A sample of the fixed assets purchase invoices for the period December 11, 2016 to December 10, 2018 (refer Schedule A of Part III of TAR) involving 8 vendors and 34 invoices amounting to ₹1,66,31,708 indicates the following:**

1) There were discrepancies observed in purchase invoices with books of accounts and the corresponding transit details mentioned in the invoices and Lorry Receipts copies which includes GST information in a VAT period bill and overstated invoices. That there were purchase orders without quantity, calculation errors of ₹2.55 Crore, doubtful vehicle details which cannot carry the quantity as mentioned in the invoices which even includes two wheelers and very small goods carriers and missing vehicle details in vahan.nic.in (refer Part III of TAR). The table below contains the details:

Table- 18

S. No.	Supplier	Invoice discrepancy (INR)	Volume and Vehicle Mismatch (INR)	Vehicle Details Not Verifiable (INR)	Grand Total (INR)
1	Bagadia System Pvt Ltd		123,255,000	51,000,000	174,255,000
2	Benny Impex Pvt. Ltd	3,452,500			3,452,500
3	Dashavatar Overseas Pvt. Ltd		14,250,039	13,500,037	27,750,076
4	MS International			17,802,660	17,802,660

S. No.	Supplier	Invoice discrepancy (INR)	Volume and Vehicle Mismatch (INR)	Vehicle Details Not Verifiable (INR)	Grand Total (INR)
5	Synthesis EPC Projects Ltd.			44,687,500	44,687,500
6	Voizer Marketing Pvt Ltd 2		46,474,988		46,474,988
Grand Total		3,452,500	183,980,027	126,990,197	314,422,724

2) Out of the sample of 34 invoices for ₹1,66,31,708 more than 47% by number and more than 51% by value were incorrect as detailed above and hence, these figures in the financial statements cannot be relied upon.

3) Assets were purchased from parties which were non-compliant under ROC provisions and have been currently listed as “Strike-Off” status. (refer Schedule F of Part III of TAR)

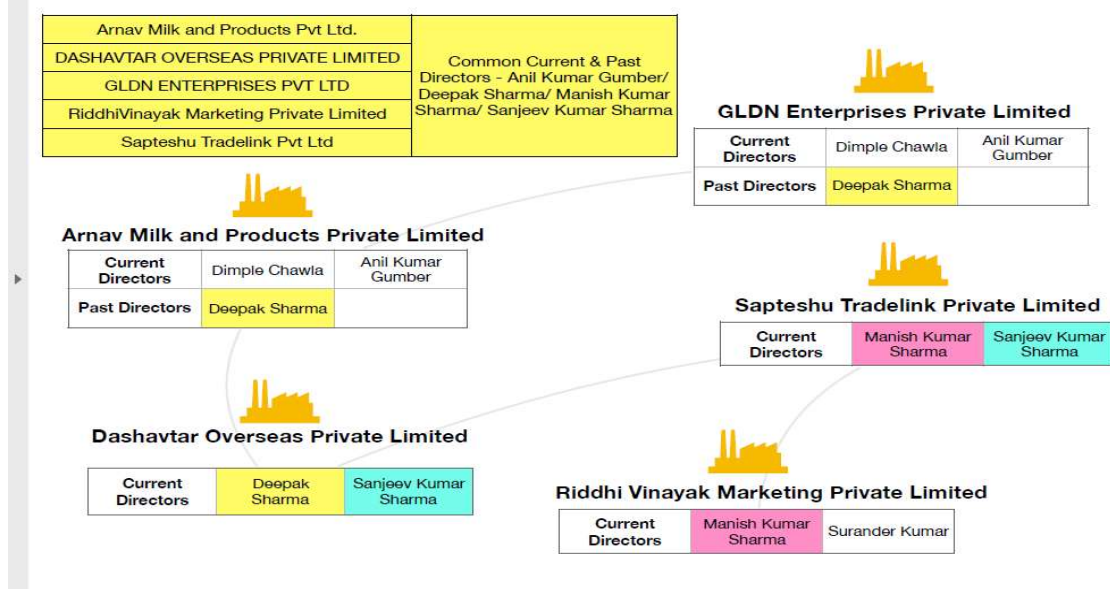
Table- 19

Name of the supplier	CIN	last filed annual returns and financials up to	stuck off date
Voizer Marketing Pvt Ltd	U52190WB2012 PTC182218	FY ended 2015	Jun 29, 2018
Bagadia System Pvt Ltd	U72200WB1999 PTC089722	FY ended 2015	Jun 29, 2018

4) Bagadia System Pvt. Ltd. was stated to be in the business of computer software having revenue from operations of ₹.05 Lacs, paid up capital of ₹.5 Lacs and negative reserves and surpluses of ₹.56 Lacs and a loss of ₹.13 Lacs for 2014-15, as observed in the last filed financials (refer Schedule F of Part III of TAR).

5) Few of the corporate fixed assets suppliers in the sample, have common interests with other fixed assets suppliers. Further, some of the fixed assets suppliers share common directors (current and past) with operational customers and suppliers of Kwaliti, as elaborated below:

Figure 2



6) Proper discharge of the purchase order terms relating to installation and training, and warranty of the milk testing equipment, are not further evidenced in the books and records of Kwaliti. The vendors did not have established track record or capability for servicing a wide network from their location at Howrah, West Bengal (refer Part III of TAR).

- iii. The capital advances have not been recovered fully and Kwaliti could not produce evidence of the procurement and installation of the equipment by the vendors.**
- iv. Kwaliti has made provision for doubtful recovery of ₹ 9 Crores against these capital advances in its audited financial statements for the year ended March 31, 2019 (released on May 31, 2019).**
- v. There is no adequate system /process in place to verify the authorizations and sanction for release of purchase orders for capital purchases, evaluate comparative quotes for capital expenditure, and the company would rely on instructions from the management on procurement decisions. The same was highlighted as “Material Weakness” by Statutory Auditor in the Annual Report for FY 2017-18 as “No competitive quotes are obtained for purchase of fixed assets.”**

19.7. In this regard, before discussing the submissions made by Noticees 1 and 2, on above allegations, following observations made in Part-III of TAR are noteworthy:

- 1- We have examined a sample of the fixed assets purchase invoices for the period 11th December 2016 to 10th December 2018. The sample consisted of purchase of milk testing equipment and involved 8 vendors and 34 invoices amounting to INR 61,66,31,708. (list as per schedule A)
- 2- We had specifically selected sample check of Milk Testing Equipment alone as we had observed that while the company had earlier purchased such kits for deployment at various locations, it had also advanced a substantial amount towards capital purchase of such milk testing equipments to its vendors.
- 3- It was observed that the company had advanced a sum of INR 152 Crores to its vendors for purchase of these kits, out of which INR 61 Crores was in FY 1617 and INR 15 Crores was in FY 1718. A sum of INR 101 Crores was still recoverable against these advances as on 10 December 2018. It is further observed that the Corporate Debtor has written off Milk Testing Equipment amounting to INR 67 Crores** from its Fixed Assets in QIV of FY 2018-19.
- 4- The Milk Collection Centre (MCC) kits include equipment and apparatus for ascertaining fat quality and fat content in the milk samples. The said kits are deployed at the MCC locations of the CD. It is used at the direct milk collection points where farmers and cattle owners directly supply milk to CD's authorised village service providers designated as MCC's.
- 5- The kits comprise of various components which need to be installed together to effectively perform the quality control at procurement centres. (an illustrative list of components along with indicative appearance is given in schedule B)
- 6- It was also observed from fixed assets register that the corporate debtor was sourcing the milk testing equipment from lesser known dealers while choosing not to place the order on the original equipment manufacturers.
- 7- We have verified the purchase invoices with the corresponding entries in the books of accounts and fixed assets register maintained by Corporate Debtor.
- 8- We have observed discrepancies in purchase invoices with books of accounts and the corresponding transit details mentioned in the invoices and LR copies. (summary listed in schedule C and detailed invoice report given in annexures 1 to 11)
- 9- We have observed from MCA (Ministry of Corporate Affairs) database, that few of the Corporate fixed assets suppliers in our

sample, have common interests with other fixed assets suppliers under review. Further some of the fixed assets suppliers share common directors (current and past) with operational Customers and Suppliers of the Corporate Debtor. (Refer schedule D & E)

10-We have observed that few suppliers in our sample have defaulted in ROC compliance in recent past. We have also carried public inspection of one supplier from MCA records. (listed in schedule F) 11 - As per the explanations provided by Corporate Debtor's representatives, there is no system for recording gate entry in ERP and it is manually maintained at plant level. We could not verify the manual records of the gate entries due to paucity of time.

19.8. On perusal of submissions made by Noticees 1 and 2, w.r.t. above allegations, I note that:

19.8.1. On perusal of the submissions made by Noticee 1 and 2, I note that they have provided quotation of only one entity out of a total of eight entities, which supplied milk testing equipment to Kwaliti during the Investigation Period. Quotations of seven remaining entities have not been provided. Similarly, the Noticees 1 and 2 have provided details of financial health of only one vendor out of the eight, which supplied milk testing equipment to Kwaliti during the Investigation Period.

19.8.2. The Noticees 1 and 2 have claimed that the said entities are well known equipment suppliers. However, they have not furnished any document to substantiate the supply and installation of equipments by these entities or whether payments given to them were called back, in case the equipments were not supplied. As the said information has not been provided by the Noticees 1 and 2, I am unable to accept their contention. This further strengthens the allegation that the equipment purchase was not genuine.

19.8.3. On perusal of the submissions made by Noticees 1 and 2 and after referring to Part III of TAR, I note that the TA was already aware of the fact that the milk testing equipment consists of various components, and that they have factored in the said fact while making the said observation. I further note that Noticees 1 and 2

GSTIN NO.: 06AABCK1289R12Z

KWALITY LIMITED
Plant : Vill. Sotia, Distt. Palwal - 121102, Haryana

CHALLAN CUM GATE PASS

S. No. **126** **NON-RETURNALE** Dated: **31/3/17**

Material Dispatch From **Kwality Limited**

Village **Sotia** Distt **Palwal** HR

Material Dispatch To **Om Sales Trading Private Limited**

S.NO.	PARTICULARS	QTY.
1	Water Treatment Unit Rs 31500/-	132 NO
2	EKO MARK Analyser Rs 54500/-	132 NO
3	Remote Assembly Rs 3950/-	132 NO
4	Solar Module Rs 121300/-	132 NO
5	Solar Power Controller Rs 7320/-	132 NO

5 Solar Power Controller Rs 7320/- 132 NO

6 Solar Slated Shingles Rs 3350/- 132 NO

7 Ultra Sonic Sensor Rs 5580/- 132 NO

8 UPS with Battery Rs 11850/- 132 NO

9 Weighing Scale Rs 14000/- 132 NO

Veh NO. HR14F 4808

Total Amount Rs 1902520/-

132 SET

Address not mentioned

Receiving Acknowledgement Doubtful

For OM SALES TRADING PVT. LTD.

Authorized Signatory

Incomplete Packaging Information

GSTIN Information in a VAT period document

- Final Order in the matter of M/s Kwaliti Limited*

- 19.8.7. The Noticees 1 and 2 have further claimed that Kwaliti was doing proper due diligence before appointing suppliers and making payments to these suppliers after proper delivery of milk testing equipment, however, no documentary evidence has been furnished by them to substantiate their claim.
- 19.8.8. Also, no evidence has been furnished to demonstrate that Kwaliti had adequate system in place to authorize and sanction release of purchase orders.
- 19.8.9. The Noticees 1 and 2 have claimed that the changes in Directors and/ or shareholders referred to in Schedule A are before one year/ two year of Corporate Insolvency start date, hence, the same is outside the relevant scope. In this regard, I note that Figure 2 has brought out connections between various suppliers of Kwaliti. Also, Corporate Insolvency Resolution Process (CIRP) start date has got no impact on the connections found between the said supplier entities.
- 19.8.10. The Noticees 1 and 2 have further submitted that Kwaliti had been taking every step to ensure that the services of vendors are obtained in terms of installation, warranty, training service, after sales services as per terms of invoice/ PO. It has also been submitted that the Company had been regularly taking their services for calibration, repair etc. as per terms of PO/ invoice.
- 19.8.11. The Noticees 1 and 2 have further claimed that these vendors have network of technicians in various cities/ village etc. to provide after sales services, and that they have shared the details of only one technician who provides services on behalf of one of the suppliers, i.e., YSM Dairytech, with the TA. However, no evidence has been provided to substantiate their statement for having obtained satisfactory services from the suppliers of milk testing equipments. In the absence of any documentary evidence, it is difficult to accept the contentions of the Noticees 1 and 2.

- 19.8.12. From the submissions made by Noticees 1 and 2, it is noted that the capital advance given to the bulk contractors to purchase milk testing equipment was done in order to improve the quality of milk received by Kwaliti and that cost of distributing such equipment were recovered from such contractors by making deduction from the milk price supplied by them. However, the Noticees 1 and 2 failed to furnish any evidence to substantiate the procurement and installation of the equipment by the vendors. This aspect assumes significance because at one point the said Noticees are claiming that after using the milk testing equipment there was a constant increase in the quality of the milk provided by the bulk contractors while at the same time they have claimed that the company had to take huge financial hit because of issues raised by their bulk distributors w.r.t. the quality of milk provided by Kwaliti. Clearly, the submissions made by Noticees 1 and 2 are contradictory in nature and therefore cannot be relied upon.
- 19.8.13. I note that, Noticees 1 and 2 have not provided any documentary evidence to support their claim that Kwaliti had recovered a substantial portion of the cost of Milk Testing Equipments distributed to its bulk contractors by making deduction from the milk price supplied by them or whether comments of the audit committee was taken w.r.t. the decision to recover the amount within a period of 3 years' time from October 2017. Further, no disclosures were made by Kwaliti in their Annual Report for FY 2017-18, in this regard.
- 19.8.14. The Noticees 1 and 2 have further submitted that during the Quarter I of FY 2018-19, due to non-release of enhanced working capital limit from the consortium of banks and due to inability of Kwaliti to raise funds from other sources, the Company was unable to source milk from the bulk contractors/ suppliers due to which the company was unable to recover the amount given as advance for providing milk testing equipment to such suppliers. However, this is

contradictory to the earlier submissions made by the Noticees 1 and 2, wherein it has been claimed that the Company had requested its bulk distributors/ customers to make direct payments in the account of its bulk suppliers/ vendors and such entries were recorded under Payment settlement and Clearing Account (PSCA). The replies given by Noticees 1 and 2 are self-contradictory and therefore cannot be relied upon.

19.8.15. I further note that no documentary evidence has been provided by Noticees 1 and 2 to ascertain if Kwaliti actually procured the Milk Testing Equipment based on competitive quotes and that it availed of Term Loan and External Commercial Borrowings to part finance the said purchase. The Noticees 1 and 2 have further accepted that while there is no written process for purchase of capital assets, in case of purchase of plant and machinery, the same is done by the plant head under guidance/ direction/ concurrence of the Managing Director of the Company. However, no written policies and procedures in this regard have been produced to substantiate this claim as well. The above observations in light of the qualifications on "Material Weakness" brought out by the Statutory Auditor in the Annual Report for FY 2017-18 that "No competitive quotes are obtained for purchase of fixed assets" assumes significance.

Part B - Allegations of Diversion through scheme discount write-off

20. Diversion through Scheme discount write-off (refer Part I of TAR):

- 20.1. *Company had a scheme where discounts were given on a particular quantity purchase of milk introduced for a particular year.*
- 20.2. *A scheme discount write-off in customer ledgers amounting to ₹760.84 Crores was observed in the Quarter II of FY 2018-19. The timing and quantum of the write-off indicates that the receivables position as on March 31, 2018 was not entirely accurate and there were unreconciled amounts which were not disclosed fully. The MCA inspection of financial statements of vendors indicates that their procurement price levels were low margin. This puts the scheme discount write-offs by Kwaliti under question as the margins were already thin. It also raises the question on whether Kwaliti can claim price/volume discounts from its vendors for earlier period.*

Table- 20

Receivables Comparison for FY 2016-17, 2017-18 and 2018-19 (10th De'18)

Schedule I

Particulars	Amt in INR Crores		
	FY 2018-19 - Unaudited (Upto 10-12-18)	FY 2017-18 (Audited)	FY 2016-17 (Audited)
Revenue from operations	1,921.75	6,724.88	6,131.26
Trade receivables (Net)	1,478.02	1,700.81	1,373.47
Average Receivables (Opening + Closing Receivables /2)	1,589.42	1,537.14	1,396.33
Net Credit Sales	1,921.75	6,724.88	6,131.26
AR Turnover = Net Credit Sales / Average Receivables	1.21	4.37	4.39
Days O/s - Receivables = 365/AR Turnover	302	83	83
Ageing Schedule			
0-3 Months	329.59	1,472.56	1,218.11
3-6 Months	245.89	98.81	
6-12 Months		70.33	153.77
12-24 months		63.12	1.53
24-36 Months	1,046.01	-	0.02
More than 36 Months		-	0.04
Total	1,621.49	1,704.82	1,373.47
Provision	143.49	4.00	
Net Receivables	1,478.00	1,700.82	1,373.47

After Scheme Discount W/off of
INR 760.84 Crores in QII

20.3. **Corresponding scheme benefits and product quality claims have not been sought by Kquality from its vendors. However, Kquality has allowed substantial claims for both scheme discounts and product quality issues to its customers for periods ranging back to the year 2015 and given for the FY 2015-16, FY 2016-17, FY 2017-18 and the FY 2018-19. The explanations and computations for the scheme workings have not been provided to the TA.**

20.4. **Hence, it appears that the huge amount of scheme write-off amounted to falsification of stock statements and sales figures during the relevant period. Further, the substantial write-offs and retrospective discounts indicates that Kquality had deliberately raised fictitious receivables to avail working capital finance and has also deliberately misrepresented its financial statements and drawing power statements to bankers and auditors and diverted funds through scheme write offs.**

21. On perusal of submissions made by Noticee no. 1 and 2, w.r.t. the above allegations, I note that no specific reply has been furnished with regards to the observation that inspection of financial statements of vendors (available on MCA website) by TA indicated that their procurement price levels were low margins which puts the scheme discount write offs by Kquality under question as the margins were already thin. It also raises the question whether the company can claim price/ volume discounts from its vendor for earlier periods. Further, the submissions made by the Noticees 1 and 2 w.r.t allegations related to scheme discount have been appropriately dealt with at para 19.1.10.

Part C - Allegations of Non-disclosure of material information

22. I note that w.r.t. allegations of “*Non-disclosure of material information*”, the SCN alleged violation regarding:

22.1. ***Through the sample balance confirmation letters dated August 16, 2018, shared by Kwaliti from its customers, indicates that the balance amount as on June 30, 2018 has been shown as disputed against product schemes by the customers. (Annexure 6 and 7 of Part I of TAR)***

22.2. ***The workings for the disputed scheme discounts amount has not been shared with the TA and the quantum of discounts mentioned in the confirmation letter by the customer, matches the discount subsequently allowed by Kwaliti in September 2018. The non-disclosure of these disputed issues in its audited financial statements and submissions to financial creditors, appears to be a material omission in disclosure and indicates the intention of Kwaliti to defraud its stakeholders.***

22.3. ***It is observed that the customers have not disclosed/ declared any pending quality issues in the balance confirmation letters dated August 16, 2018. Substantial amount has been written off in December 2018 owing to past quality issues. This raises doubt on the veracity and genuineness of the balance confirmations made available for verification to TA.***

23. On perusal of submissions made by Noticees 1 and 2, with respect to above allegations, I find that:

23.1. No specific reply has been provided with respect to the observations that the disputed issues pertaining to providing benefit of scheme discount offer to bulk distributors were not mentioned in the audited financial statements as well as in the submissions made to financial creditors. It is further noted that the Noticees 1 and 2 have contended that the working for the disputed scheme is available with the company and can be seen on any day by the Auditors. However, no evidence has been supplied by Noticees 1 and 2 to substantiate whether the said information was provided to the TA and whether it was acknowledged by them. In the absence of any such evidence, it is difficult to rely upon the submissions made by the Noticees 1 and 2.

- 23.2. In view of above, I conclude that non-disclosures of these disputed issues in the audited financial statements and to the financial creditors is a material omission in disclosure and indicates that the intentions of Kquality was to defraud its stakeholders.
- 23.3. Noticees 1 and 2 have further repeated their submissions which have been appropriately dealt with at para 19.1.10. However, no specific reply has been provided by them w.r.t. the observation that the customers of Kquality had not disclosed/ declared any pending quality issues in the balance confirmation letters dated August 16, 2018. I note that a substantial amount was written off in December 2018 owing to past quality issues and I further note that enough opportunities had been given to the Noticees to furnish their reply on the same. However, instead of utilising the repeated opportunities, I note that Noticees 1 and 2 have contended that the write offs given in December 2018 are outside the scope/ relevant period. In this regard, it may be noted that though the scope of the Transaction Audit was from December 11, 2016 to December 10, 2018, the write off given by Kquality, as recorded in the Annual Report for FY 2018-19, pertains to write offs given during the period April 01, 2018 to December 10, 2018 in relation to earlier transactions. Therefore, I do not find the observation to be out of the period of examination and thus the argument of Noticees 1 and 2 deserves no merit.

Part D - Allegations of Lack of due diligence and discharging the duties as members of the board of directors of a listed company

24. I note that w.r.t. allegations of “Lack of due diligence and discharging the duties as members of the board of directors of a listed company”, the SCN has alleged following violations:
- 24.1. ***The master sales and purchase agreements with the customer and vendor accounts under scrutiny, were vague and without important terms on credit assessment, product quality and payment settlement as detailed at 4.1.1.1 and 4.1.3.3 of SCN (para 19.1.1 of this order)***
- 24.2. **Deficiency in Internal controls placed by the management of Kquality:**

- a. ***The purchase and sales process did not have the required internal controls and checks to regulate the material scheduling, credit assessment and payment and collection criterion. The details of the same have been incorporated under various heads in earlier paragraphs. The procurement and sales process was being controlled by a close team regulated by the management of Kwalitiy, and most of the decisions were verbally issued.***
- b. ***The Board of Directors have not established any policy and procedures on PSCA. The accounting entries of receipts and payments in the PSCA were made on the basis of supporting confirmation letters (on Customers/Vendors Letter-heads) received from both the debtor and the creditor for the transaction (refer Part II of TAR). Further, accounting discrepancy has been observed to the tune of ₹3 Crores in the accounting of transactions related to samples referred in Schedule B of Part II of TAR.***
- 24.3. ***There was lack of evidence of due-diligence by the directors to assess the credit risk for recovery of receivables. The board resolutions for sanction of credit limits and the process note for approval of new customers for accounts receivables were not made available for verification to the TA. Also, the fact that there have been various instances of transactions made with company having ROC status - strike off, indicates that the due diligence process on receivables account was not followed and Kwalitiy was exposed to significant financial risk. (Refer Schedule L of Part I of TAR).***
- 24.4. ***As per the available credit risk assessment reports of few parties, from rating agency–Dun & Bradstreet, Kwalitiy did not have an internal control process commensurate with the risk profile of its customers. The customers were rated as “Average Risk” which denoted moderate business stability and market standing, while recommending close monitoring for sustainable business transactions.***
- 24.5. ***Kwalitiy was stated to be following a practice of not reconciling receipts with sales invoices which was observed to be in contravention of the stated “Credit Risk” policy for credit risk management as stated in Note 42- Financial Risk Management of the notes to the Audited Financial Statements for the year ended March 31, 2018. Further, specific procedure of ascertaining credit risk, where payments more than 30 days past due were categorized as high risk, was not being monitored by the finance team and by the risk management committee or board of directors of Kwalitiy.***
- 24.6. ***It is also observed that ₹1.95 Crores worth of receivables from Labtech Intellisys Private Limited was overdue. During verification of the MCA records of the customer, it was noted to be a party low on creditworthiness and experience in dairy products. It is observed that due care was not taken by the credit team in selection of the customer (para 4.1.1.4 of SCN).***

- 24.7. ***The board resolutions for sanction of credit limits and the process note for approval of new customers for accounts receivables were not made available to the TA for verification.***
- 24.8. ***Thus, from the aforesaid it appears that the Company's books of accounts cannot be relied upon and do not give a true and fair picture of both the financials and operations of Kwality.***
25. On perusal of submissions made by Noticees 1 and 2, I note that submissions w.r.t. master sales and purchase agreements, PSCA and dealing with entities with RoC status strike off, have already been discussed appropriately elsewhere. However, some specific observations in the SCN and reply of the Noticees 1 and 2 are as under:
- 25.1. Noticees 1 and 2 have informed about the due diligence process followed by Kwality before appointing any vendor and customer. However, no documentary evidence has been furnished by them in support of the said process. Further, on perusal of the copy of document disclosing prudential limits for debtors of Kwality, which the Noticees 1 and 2 have claimed to have shared with the working capital lenders, I find that the said document is a generic document which only provides for category wise prudential limits for its debtors/ customers and not entity wise. Further, there is no evidence to substantiate that the said document was shared with the working capital lenders and the same was also acknowledged by them.
- 25.2. In response to the allegation regarding lack of evidence of due-diligence by the directors to assess the credit risk for recovery of receivables, the Noticees 1 and 2 have, *inter alia*, submitted that transactions with companies reported to be average risky ones were done due to the nature of the industry to which the company, i.e., Kwality belongs which is unorganized. They have further contended that there is no bar on dealing with these companies and this cannot be a ground or basis for allegation of inflated/ misrepresented financials or lack of due diligence by Board of Directors. On perusal of the above reply, I note that while there is no bar in dealing with such companies, however the business transactions need close monitoring. However, I do not find any close monitoring being done by Kwality as had there been proper monitoring done, the financial crisis

situation of the company would not have aggravated to the level where it ultimately reached.

25.3. I further note that no specific documentary evidence like Risk Management Policy, has been furnished by Noticee 1 and 2 in support of their claim that the debtors whose payments were due more than their credit period that is 7, 15, 21 and 30 days were being categorised as high risk and the same were being monitored on regular basis by the management / respective sales head. In this regard the argument given by Noticees 1 and 2 that due to Kwaliti being sold under liquidation, the past records of emails are not available is difficult to accept as they have furnished many such documents to support their contentions w.r.t. other allegations.

25.4. Further, no evidence has been submitted to substantiate that Kwaliti was maintaining proper records of transactions with its customers. In fact, Noticees 1 and 2 have admitted that due to unorganised nature of Dairy Industry it is not possible to follow the practice of reconciling receipts with sales invoices. However, the said argument is not acceptable because, here the requirement was on part of the company to carry out invoice level reconciliations and the same has got nothing to do with the external factors like dairy industry being unorganised or customers requesting the company not to present payment cheques. The invoice level reconciliations could have been done irrespective of the above reasons mentioned by the Noticees 1 and 2.

25.5. The Noticees 1 and 2 have further submitted that the Risk Management Committee requirement is not applicable to Kwaliti after FY 2014-15, however, on perusal of the Annual Report of Kwaliti for FY 2017-18, it is noted that the company was in fact having a Risk Management Committee with Noticee 1 being one of its members. In this regard following disclosure is observed at page number 20:

“RISK MANAGEMENT:

Company is sensitive to changing global risk scenario and its adverse impact may be upon the Company's business portfolio. Risk Management Process and Policy are continuously monitored and reviewed for appropriateness to mitigate Risks. Policy and

Procedures enforced are continuously reread with International Standards.

The Company has constituted a 'Risk Management Committee' in line with SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015, duly empowered to frame, implement and monitor Risk Management Plan for the Company. Identified Major Business Risks are systematically addressed on a continuous basis."

- 25.6. From the above I note that the submissions made by Noticees 1 and 2 are self-contradictory and cannot be relied upon. Also, no evidences were submitted whether the risk committee had approved the risk policy of the company.
- 25.7. In response to the allegations regarding not providing board resolution for sanction of credit limits and process note for approval of new customers to TA, the Noticees 1 and 2 have primarily contented that sanctioning credit limits to vendors and customers was in the routine/ ordinary course of business and is covered under the overall powers of management and does not require specific approval of board. However, they failed to furnish any specific reply in respect of the observation on not sharing process note w.r.t. sanction of credit limit to a customer or vendor, with the TA.
26. I also note from the SCN that the observations as brought out by Income Tax Department (ITD) and the same are reproduced below:

Observations by Income Tax Department (ITD) during their raid and SEBI's analysis of Assessment orders:

26.1. Income Tax Raid observations:

- a. *Search was conducted in business premises of Kwaliti by the ITD on August 22, 2017. During the course of search operations (including those of purchasers) and post search enquiries, it was observed that purchaser entities / companies/ concerns were merely paper companies and had no actual business and meant for bugs billing for Kwaliti and were controlled and managed by Mr. Sanjay Dhingra (Noticee no. 1) and Mr. Sidhant Gupta (Noticee no. 2).*
- b. *Documents, stamps etc. were found in the premises of Kwaliti with respect to purchaser entities/ companies/ concerns, prima facie, indicating that they were nothing but paper companies running their financial affairs in a full-fledged manner from corporate office of Kwaliti. Only funds movements were taking place in name of said concerns (i.e.*

purchase and sale transactions) purchase and sale transactions by manufacturing of documents for bogus transactions.

- c. Accommodation entries have been made in the form of bogus bills of purchases of approx. ₹12,862.80 Crores between FY 2010-11 and 2016-17 from various entities controlled and managed by Mr. Sanjay Dhingra and Mr. Sidhant Gupta.*

27. I also note from the SCN the following observations w.r.t. Income Tax Assessment Orders: -

27.1. **Analysis of the assessment orders (2011-12 to 2018-19):**

- a. ITD had found that Kwaliti had debited bogus expenses in the regular books of accounts in the guise of sundry creditors in respect of bogus purchases.*
- b. The directors of an entity named Renu Marketing have admitted before ITD that they are employees of Kwaliti Group and they were made dummy directors and they used to sign papers / documents/ cheques as per the directions/ instructions of Shri. Sidhant Gupta and Mr. Sanjay Dinghra. They have also admitted that M/s Gogia Enterprises, M/s Sukhpeet Dairy, M/s Uttam Enterprises, M/s Nayyar Dairy, Om Sales Corporation, Freshia Foods Pvt. Ltd, YM Foodways Pvt. Ltd have no actual business and they are merely paper concerns. Local enquiry also indicated that the neighbours had never heard or noticed any such dairy business being carried out by these entities whose connections and transactions have been mentioned above.*
- c. During the search conducted by ITD, no physical establishment and existence of godown, chilling center and proof of goods including bills, vouchers, etc. could be found. Also, the rubber stamps, seals, policy documents, accounting documents of these entities were found and seized from Kwaliti's corporate office.*
- d. Money trail also shows that funds were infused in various paper entities and returned back to its beneficiaries i.e. Kwaliti's related/ connected/ promoter entities.*
- e. The assessment orders of the ITD conclude that "it may be stated without an iota of doubt that Kwaliti 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 Kwaliti group of companies, in lieu of commission" (page 107-108 of Assessment order 143(3)/153 A for year 2013-14)*
- f. The aforesaid observations are also present in subsequent assessment orders and it is observed that ITD has send a notice of demand under section 146 of Income Tax Act, 1961 for a total amount of ₹7205,26,98,760/- till 2018-19.*

28. **Impact of publication of manipulated Financial Statements by Kwality Ltd. during Investigation Period and non-disclosure of material information to various stakeholders:**

28.1. From the above discussions I note that the financial statements of Kwality were fraudulently manipulated and the figures contained therein were significantly misstated/ misrepresented including revenue and sales, expenses, capital assets, inventories, debtors payable, creditors receivable, etc. leading to publication of untrue and misleading financial results of the company during FY 2016-17 to 2018-19. Had the above instances of misstatement/ misrepresentation in the financial statements of Kwality been correctly reflected and published in the form of actual financials, the profit/ losses and financial position of the company would have been different from the reported financial statements. The above violations would attract the provisions of PFUTP Regulations and LODR Regulations read with SEBI Act.

28.2. I find that because of such misrepresentation/ manipulations, there is violation of Regulation 4(1) of LODR Regulations including Regulation 4(1)(a) which requires a listed company to prepare and disclose all information in accordance with applicable standards of accounting and financial disclosure, Regulation 4(1)(b) which requires a listed entity to implement the prescribed accounting standards in letter and spirit in the preparation of financial statements taking into consideration the interest of all stakeholders and ensure that the annual audit is conducted by an independent, competent and qualified auditor, Regulation 4(1)(c) which requires a listed entity to refrain from misrepresentation and ensure that information provided to recognised stock exchange(s) and investors is not misleading, Regulation 4(1)(e) which requires a listed entity to ensure that disseminations made under provisions of these regulations and circulars made thereunder, are adequate, accurate, explicit, timely and presented in a simple language, Regulation 4(1)(g) which requires a listed entity to abide by all applicable laws, Regulation 4(1)(h) which requires a listed entity to make specified disclosures and follow its obligations in letter and spirit taking into consideration the interest of all stakeholders, and Regulations

4(1)(i) and 4(1)(j) which requires a listed entity to ensure that all periodic filings contain relevant information that shall enable investors to track the performance of the listed entity.

28.3. I also observe that there is violation of Regulation 4(2) of LODR Regulations including Regulation 4(2)(e) which requires a listed entity to ensure timely and accurate disclosure on all material matters including the financial situation, performance, ownership, and governance in the prescribed manner, Regulation 4(2)(f)(i)(2) which requires the board of directors and senior management to conduct themselves so as to meet the expectations of operational transparency to stakeholders while at the same time maintaining confidentiality of information in order to foster a culture of good decision-making, Regulation 4(2)(f)(ii)(2) which requires monitoring the effectiveness of the listed entity's governance practices and making changes as needed, Regulation 4(2)(f)(ii)(6) which requires monitoring and managing potential conflicts of interest of management, members of the board of directors and shareholders, including misuse of corporate assets and abuse in related party transactions, Regulation 4(2)(f)(ii)(7) which requires ensuring integrity of the listed entity's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards, Regulation 4(2)(f)(ii)(8) which requires overseeing the process of disclosure and communications, Regulation 4(2)(f)(iii)(1) which requires the board of directors to provide strategic guidance to the listed entity, ensure effective monitoring of the management and shall be accountable to the listed entity and the shareholders, Regulation 4(2)(f)(iii)(2) which requires the board of directors to set a corporate culture and the values by which executives throughout a group shall behave, Regulation 4(2)(f)(iii)(3) which requires the board of directors to act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the listed entity and the shareholders, Regulation 4(2)(f)(iii)(6) which requires the board of directors to maintain high ethical standards and take into account the interests of stakeholders, Regulation 4(2)(f)(iii)(12) which requires the board of directors to commit themselves effectively to their responsibilities.

- 28.4. I further note that there is violation of Regulation 33 which outlines the process for preparation, approval of financial results and its disclosure to the recognised stock exchange(s), and Regulation 48 of LODR Regulations which requires a listed entity to comply with all the applicable and notified Accounting Standards from time to time.
- 28.5. I further find that there is violation of Regulation 3 of PFUTP Regulations including Regulation 3(b) which states that no person shall directly or indirectly use or employ in connection with issue, purchase or sale of any security listed or proposed to be listed in a recognized stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of the Act or the rules or the regulations made there under; Regulation 3(c) which states that no person shall directly or indirectly employ any device, scheme or artifice to defraud in connection with dealing in or issue of securities which are listed or proposed to be listed on a recognized stock exchange; Regulation 3(d) which states that no person shall directly or indirectly engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person in connection with any dealing in or issue of securities which are listed or proposed to be listed on a recognized stock exchange in contravention of the provisions of the Act or the rules and the regulations made there under.
- 28.6. On perusal of Regulation 4 of PFUTP Regulations, I note that Regulation 4(1) requires that no person shall indulge in a manipulative, fraudulent or unfair trade practice, Regulation 4(2)(e) prohibits any act or omission amounting to manipulation of the price of security; Regulation 4(2)(f) prohibits publishing or causing to publish or reporting or causing to report by a person dealing in securities any information which is not true; Regulation 4(2)(k) prohibits disseminating information or advice through any media which the disseminator knows to be false or misleading and which is designed or likely to influence the decision of investors dealing in securities; and Regulation 4(2)(r) prohibits knowingly planting false or misleading news which may induce sale or purchase of securities. Here, it is pertinent to note that being a listed entity, Kwaliti was required to adhere

to the said provisions. I further note that the violations as discussed at para number 19 to 25 satisfies the definition of fraud as given under Regulation 2(c) of SEBI PFUTP Regulations. While material available on record are not sufficient to conclude commission of violation of Regulation 4(2)(e), however, on the basis of discussions at Para 19 to 25, violation of other provisions of PFUTP Regulations mentioned above are established.

Part E - Role of Noticees 1, 2 and 3

29. Role of Noticee 1 – Mr. Sanjay Dhingra, Managing Director, Kwality Ltd.:

29.1. Noticee 1 was the promoter and the Managing Director of Kwality as per the disclosures in the Annual Reports of the company during the period FY 2016-17 to FY 2018-19.

29.2. Noticee 1 was also a member of the Board of Directors of Kwality throughout the investigation period and attended 26 meetings out of 27 meetings held during FY 2016-17 to FY 2018-19.

29.3. Noticee 1 also certified in the annual reports of Kwality that the financial statements present a true and fair view of the Company's affairs and are in compliance with existing accounting standards, applicable laws and regulations as required under regulation 17(8) of LODR Regulations.

29.4. I note that the above facts are not disputed by Noticee 1.

29.5. In view of the discussions in pre-pages, I find that Noticee 1 being the managing director of the Company, is responsible for furnishing untrue and fraudulent compliance certificate to the board of directors as required under Regulation 17(8) of the LODR Regulations.

30. Role of Noticee 2, Mr. Siddhant Gupta, Non-Executive Director, Kwality Ltd.:

30.1. Noticee 2 attended 16 out of 17 board meetings from FY 2016-17 to FY 2018-19. Further, he was also member of the audit committee and attended 16 out of 17 audit committee meetings from FY 2016-17 to FY 2020-21. I note that the above facts are not disputed by Noticee 2.

- 30.2. Noticees 1 and 2 were observed to be the decision makers looking after day to day affairs of Kquality.
- 30.3. From the discussions at para 19 to 25, I note that the financials of Kquality were misrepresented by inflating revenue and expenses, misrepresentation of receivable accounts and payables position, undertaking irregular transactions in capital expenditure, deficiency in internal controls, absence of records and documentation for sales transactions and diversion of funds through scheme discount write-off.
- 30.4. In this regard, I find it trite to note that any company being an artificial person and an inanimate legal entity cannot act by itself. It acts through its individual directors, who are expected to discharge their responsibilities on behalf of the company with utmost care, skill and diligence. As noted above the Noticees 1 and 2 were directors of Kquality. As directors they are responsible for the non-compliances committed by the artificial judicial person, viz. Also as per section 179 of the Companies Act, 2013 (corresponding to section 291/292 of the Companies Act, 1956), the Board of a company is entitled to exercise all such powers and do all such acts and things which the company is legally authorized. Also as per section 166 of the Companies Act, 2013, a director of a company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.
- 30.5. I further note that Section 27 of SEBI Act provides that where a contravention of any of the provisions of the SEBI Act or any rule, regulation, direction or order made thereunder, has been committed by a company, every person who at the time the contravention was committed was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.
- 30.6. The duty expected from an individual as a director of a company, has been succinctly expounded by the Hon'ble Supreme Court of India in the

following findings made in the matter of N Narayanan vs Adjudicating Officer, SEBI (Order dated 26 April, 2013): -

“33. Company though a legal entity cannot act by itself, it can act only through its Directors. They are expected to exercise their power on behalf of the company with utmost care, skill and diligence. This Court while describing what is the duty of a Director of a company held in Official Liquidator v. P.A. Tendolkar (1973) 1 SCC 602 that a Director may be shown to be placed and to have been so closely and so long associated personally with the management of the company that he will be deemed to be not merely cognizant of but liable for fraud in the conduct of business of the company even though no specific act of dishonesty is provide against him personally. He cannot shut his eyes to what must be obvious to everyone who examines the affairs of the company even superficially.”

30.7. In view of above discussions, I conclude that Noticee 1 and 2 have misrepresented the financials of Kwalitiy by inflating revenue and expenses, misrepresenting receivable accounts and payables position, through scheme discount write-off, undertaking irregular transactions in capital expenditure, through deficiency in internal controls and due to absence of records and documentation for sales transactions and thus violated:

30.7.1. Regulations 3(b), 3(c), 3(d), 4(1), 4(2)(f), 4(2)(k) and 4(2)(r) of the PFUTP Regulations read with sections 12A(a), 12A(b) and 12A(c) of the SEBI Act.

30.7.2. Regulations 4(1)(a), 4(1)(b), 4(1)(c), 4(1)(e), 4(1)(g), 4(1)(h), 4(1)(i), 4(1)(j), 4(2)(e), 4(2)(f)(i)(2), 4(2)(f)(ii)(2), 4(2)(f)(ii)(6), 4(2)(f)(ii)(7), 4(2)(f)(ii)(8), 4(2)(f)(iii)(1), 4(2)(f)(iii)(2), 4(2)(f)(iii)(3), 4(2)(f)(iii)(6), 4(2)(f)(iii)(12), 33(1)(a), 33(1)(c), 33(2)(a) and 48 of LODR Regulations read with sections 27(1) and 27(2) of the SEBI Act.

30.7.3. I note that that Noticee 1 has also violated Regulation 17(8) of LODR Regulations and Noticee 2 has also violated Regulation 18(3) read with Para A [(1), (4)(e)(d), (11), (12)] of Part C of Schedule II of the LODR Regulations.

30.8. Therefore, Noticee 1 and 2 are liable for action owing to the principles of vicarious liability and are also none but “officers in default”.in terms of section 2(60) of the Companies Act, 2013.

31. **Role of Noticee 3 - Mr. Satish Kumar Gupta, CFO, Kquality Ltd.:**

31.1. I note that Noticee 3 (Mr. Satish Kumar Gupta) was the Chief Financial Officer (**CFO**) of Kquality for the period FY 2016-17, FY 17-18 and FY 18-19 (till October 27, 2018). The said fact has not been disputed by Noticee 3.

31.2. Regulation 17(8) of LODR Regulations mandates that while placing the financial results before the Board, the CFO needs to certify that the financial results do not contain any false or misleading statement or figures and do not omit any material fact which may make the statements or figures contained therein misleading. Thus, CFO needs to, *inter-alia*, certify that the financial statements do not contain any misleading statement, present a true and fair view of the company's affairs as well as are in compliance with existing accounting standards, applicable laws and regulations. Further, they need to, *inter-alia*, certify that there were no transactions of the listed entity during the said financial years, which were fraudulent in nature.

31.3. Mr. Satish Kumar Gupta has given CFO certification in the annual reports of Kquality for the periods FY 2016-17 and FY 2017-18 in accordance with Regulation 17(8) of the LODR Regulations wherein he has certified that, financial statements and the cash flow statement of Kquality do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading and they present a true and fair view of Kquality's affairs and are in compliance with existing accounting standards, applicable laws and regulations.

31.4. Further, statement recording of Mr. Satish Kumar Gupta before SEBI was on March 22, 2022. I note that the submissions made by him inter alia, are as follows:

- i. that the bank accounts of Kwality were frozen by the ITD and the Company could not make timely payment to its vendors. To make business operational, customers were asked to make payment directly to vendors. On the confirmation received from vendors and customers, Company pass the settlement entries.
- ii. that Mr. Satish Kumar Gupta is not aware of any written off or provision made by Kwality against balance due from trade receivables and advances to trade payables.
- iii. that Kwality had adequate internal controls and all the departments were performing assigned duties and responsibility very well.
- iv. that issue pertaining to transaction with inter connected entities and directors are responsible to disclose their common interest and about relationship with various entities.
- v. that finance division of Kwality was not under his control.

31.5. I note that Noticee 3 has contended that the investigation is based on the TAR prepared by forensic level auditor and investigation was initiated only after a reference was received by SEBI from the Income Tax Department and not out of its own discovery. In this regard, I note that SEBI has conducted its investigation and in this regard, the investigation report of SEBI has also been shared with Noticee 3 as annexure to the SCN. SEBI's investigation report has highlighted the violations of securities laws for which the Noticee 3 has been alleged. Thus, the contention of Noticee 3 in this regard is devoid of any merits.

31.6. Noticee 3 has contended that the investigation report or even the TAR contains no specific findings against him w.r.t manipulation of the books of accounts of the company and/or planting wrong financials in any manner. The contention of the noticee is not acceptable, as the role of the Noticee as the CEO of the company has already been established.

31.7. Noticee 3 has contended during his tenure he was responsible for reviewing auditor reports and co-ordinating site visits with them for verification and assessments, attending meetings with the consortium of lenders, board of directors, etc. He has contended that his role in the Company was restricted to overseeing the financial systems and making suggestions thereon, and

not reviewing the accounting entries itself for which internal and statutory auditors were appointed. He has contended that he cannot be expected to look into each and every statement and information provided with suspicion unless the circumstances at the relevant time demand so

31.8. Notice 3 further contended that internal auditors as well as external professional agencies conducted detailed diligence of the company in pursuit of various transactions, and the same did not reveal the nature of violations that the SCN was alleging. He, thus, contended that there was no manner in which he could have detected the nature of the violations. However, I note that since the Noticee 3 has signed the certificate certifying that the financial statements do not contain any misleading statement, present a true and fair view of the company's affairs as well as are in compliance with existing accounting standards, applicable laws and regulations and that there were no transactions of the listed entity which were fraudulent in nature, the arguments are not acceptable.

31.9. Noticee 3 has also contended that he was denied access to the systems and records during his tenure at the company. I note that such contentions are nothing but afterthoughts and lack any merits.

31.10. Noticee 3 has mainly contended that he was not involved in or responsible for the alleged actions of the Company, and that fraud was being perpetrated by Noticees 1 and 2 along with other executives of the company who were responsible for the day-to-day affairs of the company. He has contended that the financial statements showed nothing suspicious and there was no manner in which he could have identified the fraud. Noticee 3 has contended that he has faithfully discharged all his duties as prescribed by law and that violations, if any, had occurred without his knowledge. In this regard, I note that Noticee 3 being CFO was heading the finance function in the company. He has blamed the other Noticees, viz. Noticees 1 and 2 for the frauds committed. I note that such arguments are nothing but are mere means to wash off the hands. The Noticee 3, holding a responsible position, cannot claim to be merely a signatory to the financial statements and assume no responsibility for the same.

31.11. In this regards, I note that Section 2(51) of the Companies Act, 2013 has defined “*key managerial personnel*” to include a CFO. Further, Section 2(60) defines “*officer in default*” to include key managerial personnel, which means a CFO is deemed to be an ‘officer in default’ in case a default takes place. A CFO has been recognized as a whole-time key managerial personnel under Section 203 of the Companies Act, 2013 along with other managerial personnel such as the managing director, the manager or in their absence, the whole time director. LODR Regulations defines a CFO as follows:

2(f) “chief financial officer” or “whole time finance director” or “head of finance”, by whatever name called, shall mean the person heading and discharging the finance function of the listed entity as disclosed by it to the recognised stock exchange(s) in its filing under these regulations;

31.12. From the above, I note that the position of CFO has been given a prominent importance by Law. The position calls for an increased responsibility on part of the person holding such position.

31.13. Noticee 3 has contended that SEBI has not proceeded against other members of the key management of the company who were involved in preparing these financial entries in the company. In this regard, I note that the present proceedings, *inter alia*, are against Noticee 3 to look into violations committed only by the Noticees or issuing appropriate directions and assessing the quantum of penalties to be imposed on them, if any. In this connection, I note that Noticee 3 cannot be absolved of the culpability of the alleged violations by contending that the counterparties were not being charged. Therefore, I find no merit in the aforementioned contentions made by Noticee 3. He has not clarified the steps taken by him as a CFO to control the fraud, when he became aware. Further, no details of how the fraud has been perpetrated and how he was kept in darkness about such fraud and what he did to facilitate the statutory auditors, when objections regarding non-cooperation were being raised. In absence of the said

information, the argument given by Noticee 3 appears to be vague, general and is merely an afterthought and is an attempt to wash off his hands.

31.14. Noticee 3 also contended that the financial statements were taken up for consideration by the audit committee of the board of directors, however even those members did not point out any discrepancies as has been pointed out in the TAR. In this regard, I note that it was Noticee's duty and responsibility to present the correct financial statements. Moreover, Noticee 3 has not shared the minutes of the meetings of the Audit Committee to support his argument.

31.15. Noticee 3 has contended that the SCN also notes various write-offs in the company were undertaken in the FY 2018-19, i.e. after he had left the company. In this regard, I note that as per material available on records, Kquality had written off substantial amount receivable from its customers during Quarter – I and II of FY 2018-19 for transactions executed during the Investigation Period. Financial statements for the said quarters pertains to the period during which Noticee 3 was the CFO of Kquality and had certified its financials. Therefore, the argument given by him is not acceptable.

31.16. Noticee 3 has also contended that elements of fraud are not attracted against him. He has also contended that Regulations 3 and 4 of the PFUTP Regulations require "inducement" or "influencing" the decision of an investor or must be in relation to "dealing" in securities and in the absence of showing active "inducement", the violations cannot be directly ascribed upon him. However, it has been already established that the financial statements of Kquality were misrepresented. Being a listed entity, the financial statements of Kquality are publicly available on the websites of stock exchanges and are being referred by the investors before making decision to invest in the company. Any misrepresentation in the financial statements influences the decision making of an investor and therefore the argument given by the Noticee 3 cannot be accepted.

31.17. Noticee 3 has contended that violations of active fraud under the PFUTP Regulations and LODR Regulations cannot be warranted against him and has placed reliance on the judgments of the Hon'ble SAT in the case of

Milind Gandhi vs SEBI (Appeal No. 277 of 2023, order dated March 23, 2023), the case of *Mr. Ajay Kumar Dalmia vs SEBI* (Appeal No. 179 of 2021, order dated April 08, 2022) and the case of *Manoj Kumar Agarwal vs SEBI* (Appeal No. 380 of 2021, order dated June 14, 2021). I note that Noticee 3 being in charge of financial reporting of Kwaliti has been alleged to have violated PFUTP Regulations r/w SEBI Act and LODR Regulations r/w SEBI Act.

31.18. In this regard, I note that the facts of the matter in the instant case are completely different from the cases being referred by Noticee 3 above.

31.18.1. The case of ***Milind Gandhi vs. SEBI***, pertains to misstatement of the financials in the Information Memorandum and advertisement. In the said case it is noted that the CFO was appointed on January 24, 2019 and misstatement in the financials for quarter ending September 30, 2018 and December 31, 2018 was detected by the company in the quarter ending March 31, 2019. It was held that the misstatement in the financials were of the time period before the CFO joined the Company and he was not involved in the preparation and misrepresentation of the financials for the for quarter ending September 30, 2018 and December 31, 2018. Unlike in the aforementioned case, the Noticee 3 was appointed as CFO of Kwaliti on July 04, 2016 and he was associated with the company till October 27, 2018.

31.18.2. Similarly, it is noted that the fact of the matters in the case of ***Mr. Ajay Kumar Dalmia vs. SEBI*** and ***Manoj Kumar Agrawal vs SEBI*** are completely different from those in the present case and therefore the same are not applicable here.

31.19. Thus, unlike in the aforementioned 3 cases, in the instant matter Noticee 3 as CFO of Kwaliti has been held responsible for the misrepresentation of the financial statements of the company. I note that Section 134(1) of Companies Act, 2013, requires that the financial statements of a company which has appointed a CFO and Company Secretary, must be signed by

the said individuals along with the Managing Director and the CEO. This is in line with the stated objects of the Companies Act to give statutory recognition to the CFO and Company secretary as key managerial personnel and to bring greater accountability to these positions.

31.20. The above obligation is further strengthened in terms of Regulation 17(8) of LODR Regulations as per which the CEO and CFO are mandated to provide the compliance certificate to the Board of directors as specified in Part B of Schedule II. Also, in terms of Regulation 33(2)(a) of LODR Regulations, the quarterly financial results submitted shall be approved by the board of directors, provided that while placing the financial results before the board of directors, the CEO and CFO of the listed entity shall certify that the financial results do not contain any false or misleading statement or figures. It is clear that being the CFO, the Noticee 3 was required to exercise proper due diligence before signing the financial statement of the company as he is not an individual who is merely signing the statements but he is also certifying that the financial statements being signed by him do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading and they present true and fair view of company's affair and are in compliance with existing accounting standards, applicable laws and regulations.

31.21. From the above discussions, I note that the financials of Kquality were misrepresented by inflating revenue and expenses, misrepresenting receivables account and payables position, undertaking irregular transactions in capital expenditure, through scheme discount write-off, through deficiency in internal controls and due to absence of records and documentation for sales transactions etc. The submission of Noticee 3 that he was not aware of any of the above activities is wholly untenable when his role is looked in totality as narrated above, especially when he was holding a senior and responsible position in the company.

31.22. In view of the foregoing, I hold that Noticee 3 has violated Regulations 3(b), 3(c), 3(d), 4(1), 4(2)(f), 4(2)(k), 4(2)(r) of the PFUTP Regulations read with Sections 12A(a), 12A(b), 12A(c) of the SEBI Act and Regulations 17(8),

33(1)(a), 33(1)(c) and 33(2)(a) of LODR Regulations read with Sections 27(1) and 27(2) of SEBI Act.

32. In view of the aforesaid violations committed by Noticee No. 1, 2 and 3, I find that directions under Section 11(1), 11(4), 11(4A) and 11B of the SEBI Act needs to be issued.
33. I note that the SCN, *inter alia*, called upon all the Noticees to show cause as to why appropriate directions and / penalty under Sections 11(1), 11(4), 11(4A), 11B(1), 11B(2), 15HA and 15HB of the SEBI Act including directions to prohibit them from buying, selling or otherwise dealing in securities market, either directly or indirectly, in any manner whatsoever, for a particular period and directions not to be associated with any registered intermediary/ listed company and any public company which intends to raise money from public in the securities market, in any manner whatsoever should not be issued against them. The relevant extract of Section 15HA and Section 15HB of SEBI Act is as under:

Extract of Section 15HA and 15HB of SEBI Act:

Penalty for fraudulent and unfair trade practices

15HA.*If any person indulges in fraudulent and unfair trade practices relating to securities, he shall be liable to a penalty which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of such practices, whichever is higher.*

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.”*

34. From the analysis of the aforesaid penalty provisions, I note that Section 15HA of the SEBI Act provides for imposition of penalty in case of fraudulent and unfair trade practices committed by any person. I find that penalty under Section 15HA of the SEBI Act is attracted for the violations of the PFUTP Regulations by Noticees 1, 2 and 3. I also note that for the violation of the LODR Regulations, Noticees 1, 2 and 3 are liable for imposition of penalty under Section 15HB of the SEBI Act which provides for penalty for failure to comply with any provision of

SEBI Act, the rules or the regulations made or directions issued by SEBI for which no separate penalty has been provided.

35. I note that Section 15J of the SEBI Act provide for factors which are required to be considered for adjudging quantum of penalty. Section 15J of the SEBI Act reads as follows: -

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

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

(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;

(b) the amount of loss caused to an investor or group of investors as a result of the default;

(c) the repetitive nature of the default.

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

36. I note that the SCN has recorded the amount of misrepresentation as calculated by the TA as given below:

Table No. 22

Amount in INR Cr.

Particulars	Amount
Net Off transactions through book entries	4,879.18
Doubtful capital equipment purchase transactions	31.44
Receivables written off or provided: - Scheme Discounts 760 Written-off - 102 Provisions - 1277 and 325	2,464.00
(Advances to suppliers provided as bad debts)	200.26
Total	7,574.88

Source: Financial records provided by Kwaliti to the Transaction Auditor.

37. I, however, note that the SCN does not indicate the amount of disproportionate gain or unfair advantage made by the Noticees, as a result of the aforesaid misrepresentations. Further, the SCN does not specify the amount of loss caused to investor or group of investors. I note that there is no material in the SCN to indicate that the Noticees have been found to have committed similar violations

prior to the investigation period. I, however note that as discussed at para 19 to 25, financial statements of Kquality were misrepresented during the investigation period. Further, all the violations which have been identified in the previous paragraphs took place at the time when Noticee 1, 2 and 3 were the director(s)/ KMP(s) of Kquality

Directions:

38. In view of the aforesaid findings and having regard to the facts and circumstances of the case, I, in exercise of the powers conferred upon me under Section 11(1), 11(4), 11(4A), 11B(1), 11B(2) read with Sections 15HA and 15HB of the SEBI Act read with Section 19 of the SEBI Act and Rule 5 of the SEBI (Procedure for holding Inquiry and Imposing Penalties by Adjudicating Officer) Rules, 1995, I hereby issue the following directions:

38.1. The Noticees 1, 2 and 3 are, hereby, restrained from accessing the securities market and further prohibited from buying, selling or otherwise dealing in securities, directly or indirectly, or being associated with the securities market in any manner, whatsoever, for a period of 2 years, from the date of coming into force of this order.

38.2. The Noticees 1, 2 and 3 are, hereby, restrained from holding any position of Director or Key Managerial Personnel in any listed company or any intermediary registered with SEBI, or associating themselves with any listed public company or a public company which intends to raise money from the public or any intermediary registered with SEBI for a period of 2 years, from the date of coming into force of this order;

38.3. The Noticees 1, 2 and 3 are hereby imposed with monetary penalties as specified hereunder:

Table 23

Noticee No.	Name of Noticee	Provisions under which penalty imposed	Penalty Amount (Rs.)
1	Mr. Sanjay Dhingra	Section 15HA of the SEBI Act	1,00,00,000/- (Rupees One Cr. Only)
		Section 15HB of the SEBI Act	50,00,000/- (Rupees Fifty Lakh Only)

Noticee No.	Name of Noticee	Provisions under which penalty imposed	Penalty Amount (Rs.)
2	Mr. Sidhant Gupta	Section 15HA of the SEBI Act	100,00,000/- (Rupees One Cr. Only)
		Section 15HB of the SEBI Act	50,00,000/- (Rupees Fifty Lakh Only)
3	Mr. Satish Kumar Gupta	Section 15HA of the SEBI Act	50,00,000/- (Rupees Fifty Lakh Only)
		Section 15HB of the SEBI Act	25,00,000/- (Rupees Twenty Five Lakh Only)

38.4. The Noticees 1, 2 and 3 shall remit / pay the said amount of penalties within 45 days from the date of coming into force of this order. The Noticees shall remit / pay the said amount of penalties either by way of Demand Draft in favour of "SEBI - Penalties Remittable to Government of India", payable at Mumbai, or through online payment facility available 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 ED/CGM (Quasi-judicial Authorities)-> PAY NOW. In case of any difficulties in online payment of penalties, the said Noticees may contact the support at portalhelp@sebi.gov.in. The demand draft or the details/ confirmation of e-payment should be sent to "The Division Chief, CFID-SEC-2, Securities and Exchange Board of India, SEBI Bhavan II, Plot no. C-7, "G" Block, Bandra Kurla Complex, Bandra (E), Mumbai - 400 051" and also to e-mail ID:- tad@sebi.gov.in in the format as given in table below:

Case Name	
Name of Payee	
Date of Payment	
Amount Paid	
Transaction No.	
Payment is made for: (like penalties/disgorgement/recovery/settlement amount/legal charges along with order details)	

39. The obligation of the Noticees 1, 2 and 3 restrained/ prohibited by this Order, in respect of settlement of securities, if any, purchased or sold in the cash segment of the recognized stock exchange(s), as existing on the date of coming into force

of this Order, are allowed to be discharged irrespective of the restraint/ prohibition imposed by this Order. Further, all open positions, if any, of the Noticees restrained/ prohibited in the present Order, in the F&O segment of the recognised stock exchange(s), are permitted to be squared off, irrespective of the restraint/ prohibition imposed by this Order.

40. This Order shall come into force with immediate effect.
41. A copy of this order shall be forwarded to Noticee 1, 2 and 3, Recognized Stock Exchanges, Depositories and Registrar and Share Transfer Agents to ensure necessary compliance.

Date: June 28, 2024

Place: Mumbai

K. SARAVANAN
CHIEF GENERAL MANAGER
SECURITIES AND EXCHANGE BOARD OF INDIA