

CORPORATE FRAUDS AND THEIR REPORTING UNDER THE COMPANIES ACT 2013

CMA Raghavendra Ray

Assistant Professor of Commerce

Shree Agrasen Mahavidyalaya, Dalkhola, Uttar Dinajpur, West Bengal, India

Abstract: India is a land of diversity where people forget scandals as quickly as sorrows. Along the lines of its growth the novel ways of committing frauds are also growing. Each and every corporate of our country are subject to fraud risks. The Companies Act 2013 focuses on the issues related to corporate frauds. There are so many activities that attract punishment for fraud. As most of the corporate frauds are perpetrated by people inside the organization, the stringent provisions of the new Act regarding reporting of fraud and punishment for such frauds will help in minimizing fraud committed by people inside the organization. Under the Companies Act 1956 there was no compulsion to report fraud by auditors. But under the Companies Act 2013 an auditor is to report fraud against the company by its officers or employees. The SFIO is vested with the requisite legal authority to conduct investigation under section 212. Now it also holds the power to arrest. Nowadays fraudsters use new technologies to perpetrate fraud. So the corporates need to think proactively and strengthen their internal control system. They must have proper fraud risk management policy. They should leverage technology in fighting against fraud. The general decline in ethical values is certainly one of the main reasons behind fraud. We should come forward to curb such decline in ethical values and play a vital role in this respect.

Key words: Companies Act 2013, Fraud, Reporting, SFIO

I. INTRODUCTION:

India is a land of diversity where people forget scandals as quickly as sorrows. Along the lines of its growth the novel ways of committing frauds are also growing. Each and every corporate of our country are subject to fraud risks. Large value frauds have led to the overall downfall of entire organization, massive investment losses, significant legal costs, imprisonment of key personnel, and erosion of confidence in capital markets. It also negatively impacts the reputations, brands, and images of corporates. In present days most of the corporate frauds are transformed to white collar crimes, which are difficult to detect because they are the outcome of well-trained brains. India has witnessed several corporate frauds till date, e.g. Harshad Mehta scam in 1992, Ketan Parekh scam in 1999, Satyam scam in 2009, 2G Spectrum scam in 2010, Saradha Group financial scandal in 2013 and recent PNB scam in 2018. The Companies Act 2013 focuses on the issues related to corporate frauds. As most of the corporate frauds are perpetrated by people inside the organization (PWC's Global Economic Crime and Fraud Survey 2018), the stringent provisions of the new Act regarding reporting of fraud, punishment for such frauds, establishment of vigil mechanism, appointment of qualified independent directors in the audit committee, compulsory rotation of statutory auditor and strengthening the internal control system will help in minimizing fraud committed by people inside the organization. In addition to this, now the independent professionals shall also be held liable for action and proceeded against under the Act. The present paper will concentrate on corporate frauds and related issues.

II. OBJECTIVES OF THE PAPER:

- To understand fraud and provisions relating to punishment of fraud under the Companies Act 2013
- To search for the activities that attracts punishment for fraud
- To know the provisions relating to reporting of fraud by auditors
- To examine the role of SFIO in investigating fraud

III. RESEARCH METHODOLOGY:

The paper is based on secondary data sourced from the Ministry of Corporate Affairs (MCA), Serious Fraud Investigation Office (SFIO), research journals, magazines, various websites and blogs. Looking into requirements of the objectives of the study the research design employed for the study is of descriptive type which has greater accuracy and in depth analysis of the research study.

IV. DEFINITION OF FRAUD:

The Companies Act 1956 did not provide any definition of fraud. Fraud has been defined under the Companies Act 2013 for the first time as a substantive offence, and covers many dubious activities which were not specifically covered under the earlier Companies Acts. As per the Companies Act 2013, "Fraud" in relation to affairs of a company or any body corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.

V. PUNISHMENT FOR FRAUD:

Punishment for fraud is not really a new concept because Companies Act 1956 already provided punishment for fraud in different sections. For instance:

- Penalty for fraudulently inducing persons to invest money: Upto 5 years imprisonment or with fine or with both. [Sec. 68]
- No compensation shall be made to the managing or whole time director for loss of office where such directors have been guilty of fraud or breach of trust. [Sec. 318]
- If the Central Government is of the opinion that any person concerned with the conduct and management of the company is guilty of fraud, it may refer the case to the Tribunal for inquiry. [Sec. 388B]
- Penalty for falsification of books during winding up: Upto 7 years imprisonment and also fine. [Sec. 539]
- Penalty for frauds by officers during winding up: Upto 2 years of imprisonment and also fine. [Sec. 540]
- Liability for fraudulent conduct of business in the course of winding up: Upto 2 years of imprisonment or with fine or with both. [sec. 542]

Sec. 447 of the Companies Act 2013 provides that “any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine starting from the amount involved in the fraud to three times the amount involved in the fraud.” So it did not mention the thresholds of fraud. As a result, fraud involving little amount came under the purview of this section. But the Companies (Amendment) Act 2017 has introduced the monetary thresholds of fraud to distinguish fraud of non-serious nature with fraud of serious nature and to make the provisions clear, consistent and logical. The Amendment Act 2017 provides that any person who is proved to be guilty of fraud “involving an amount of at least ten lakh rupees or one per cent of the turnover of the company, whichever is lesser”, shall be punishable with imprisonment.....” If the fraud being discussed involves public interest, the term of imprisonment is at least three years. Otherwise, any person guilty of fraud with a quantum below the prescribed limit shall be punishable with imprisonment for a maximum period of five years or with maximum fine of 20 lakh rupees or with both. As section 447 stipulates both imprisonment and fine for punishment of fraud, it will become a non-compoundable offence which makes the commission of fraud a more severe matter.

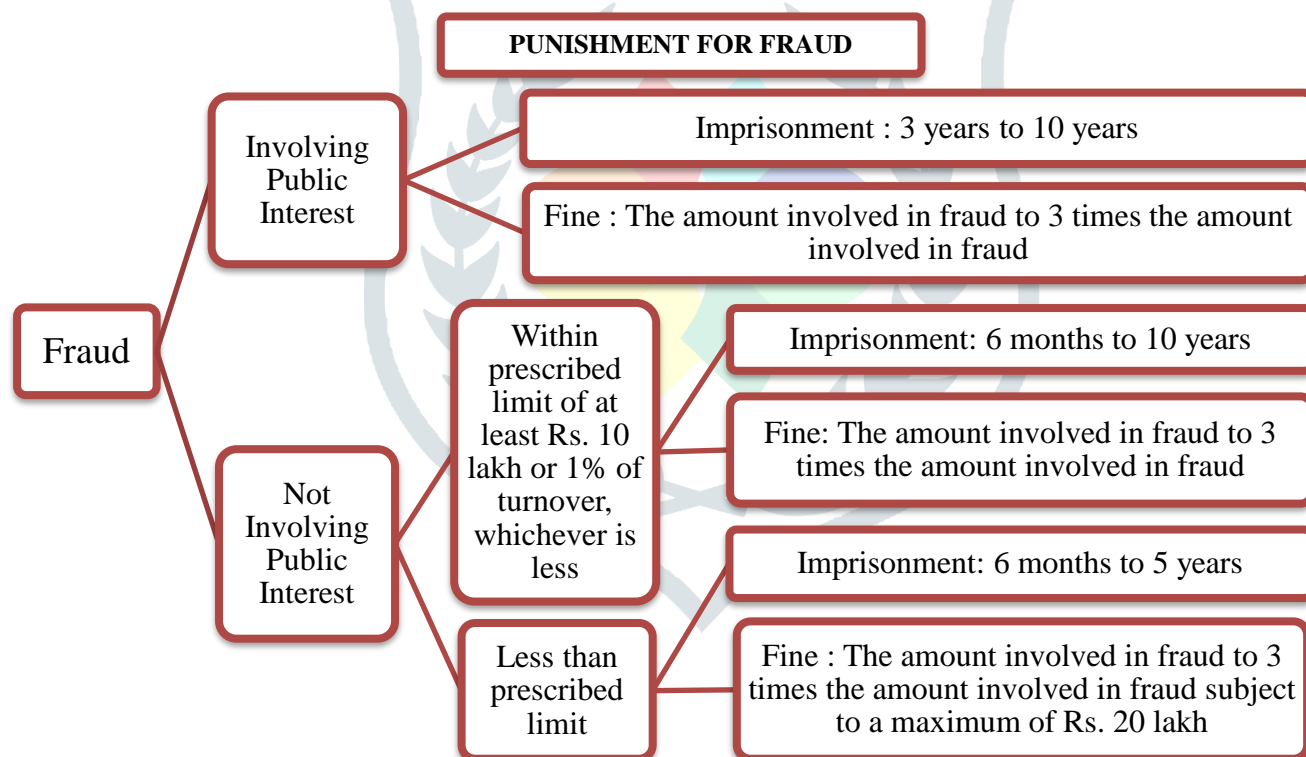


Figure: 1

VI. ACTIVITIES THAT ATTRACT PUNISHMENT FOR FRAUD (SECTION 447):

- In case of incorporation of a company, if anybody furnishes false or incorrect information or suppresses any important information already known to him, in any of the documents filed with the Registrar, he shall be liable for action under section 447. If it is proved in future that the company got incorporated by furnishing false information or suppressing any crucial fact fraudulently, then the promoters, the first directors of the company and, the advocate, chartered accountant, cost accountant and company secretary making the declaration that all formalities under the Act have been complied with, shall be liable for action under section 447. [Sec. 7(5) & (6)]
- When it is proved that the affairs of the company, formed with charitable objects like promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment, etc., were conducted fraudulently, every officer in default shall be liable for action under section 447. [Sec. 8]

- If the prospectus of the company contains any false or misleading statements, includes or omits any field likely to mislead others, every person who gives permission for issue of such prospectus shall be liable under section 447. [Sec. 34]
- If any person fraudulently i.e. by making false statement, by providing misleading information and by concealing material facts, induce other persons to invest money i.e. by entering into an agreement for purchasing, selling or underwriting securities, gaining from fluctuations in the value of securities and obtaining loan from any bank or financial institutions, shall be liable for action under section 447. [Sec. 36]
- Any person who makes/assists an application in a fictitious name or multiple applications in different names or in different combination of his name/ surname to a company for acquiring or subscribing for its securities, or otherwise induces a company to allot or register any transfer of securities to him or to any other person in a fictitious name, shall be liable for action under section 447. [Sec. 38(1)]
- If a company fraudulently issues a duplicate certificate of shares, the company shall be punishable with fine which shall be five times to ten times the face value of the shares involved in the issue of duplicate certificate or rupees ten crores whichever is higher and every officer of the company who is in default shall be liable for action under section 447. [Sec. 46(5)]
- If any depository or depository participant transfers shares to defraud the transferee, it shall be liable under section 447. [Sec. 56(7)]
- If at the time of Reduction of Share Capital, any officer of the company knowingly conceals the name of any creditor entitled to object to the reduction, knowingly misrepresents the nature or amount of the debt or claim of any creditor; or abets or is privy to any such concealment or misrepresentation; he shall be liable under section 447. [Sec. 66(10)]
- If a company accepted deposit before the commencement of this Act but fails to repay the deposit or interest thereon within one year from such commencement or from the date on which such payments are due, whichever is earlier or any further time as may be allowed by the Tribunal and it is proved that the deposits had been accepted with the intent to defraud the depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit, shall be liable for action under section 447. [Sec. 75(1)]
- An auditor, including firm of auditors, against whom final order has been passed by the Tribunal, stating that the auditor shall not function as an auditor and the Central Government may appoint another auditor in his place, shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447. [Sec. 140(5)]
- If after completion of inspection, enquiry and providing the responsible company a reasonable opportunity of being heard, the Registrar is satisfied that the business of a company has been carried on for a fraudulent or unlawful purpose, then every officer of the company who is in default shall be punishable for fraud under section 447. [Sec. 206(4)]
- If after investigation into affairs of a company it is found that the company is engaged in such business with the intent to defraud its creditors, members or others or otherwise for a fraudulent or unlawful purpose, or that the company was formed for any fraudulent or unlawful purpose; or any person concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud, then every defaulting officer of the company and person(s) concerned in the formation/management of affairs of the company shall be punishable for fraud under section 447. [Sec. 213]
- If a person, an officer or other employee of a company is required to provide an explanation, clarification or make a statement during the course of inspection, inquiry or investigation destroys, mutilates or falsifies, or conceals or tampers or illegally removes, or is a party to these damaging activities relating to the property or affairs of the company; makes or is a party to the making of a false entry in any document concerning the company; or provides a false explanation knowingly, he shall be punishable for fraud under section 447. [Sec. 229]
- If it is found that an application has been made to the Registrar for removing the name of the company from the register of companies with the object of evading the liabilities of the company or with the intention to deceive the creditors or to defraud any other persons, the person in charge of the management of the company shall, notwithstanding that the company has been notified as dissolved shall be jointly and severally liable to any person or persons who had incurred loss or damage as a result of the company being notified as dissolved; and shall be punishable for fraud under section 447. [Sec. 251(1)]
- If any business of company is carried on with the intent to defraud creditors or any other persons or for any fraudulent purpose, every person who was intentionally running the illegal business shall be liable for action under section 447. [Sec. 339(3)]
- If in any return, report, certificate, financial statement, prospectus, statement or other documents required in complying with the provisions of this Act, any person makes any false statement knowingly, which is false in any material particulars; or which omits any material fact knowingly, he shall be liable under section 447. [Sec. 448]

VII. REPORTING OF FRAUD BY AUDITOR:

Under the Companies Act 1956 there was no compulsion to report fraud by auditors. But under the Companies Act 2013 an auditor is to report fraud against the company by its officers or employees. Section 143(12) of the Companies Act 2013 provides that “an offence involving fraud is being or has been committed against the company” i.e. no quantum of fraud is mentioned. Similarly, Rule 13 of the Companies (Audit and Auditors) Rules, 2014 does not mention any threshold of fraud on the basis of which the statutory auditor would report fraud to the appropriate authority. It is the Companies (Amendment) Act 2015 which provides that “an offence of fraud involving such amount or amounts as may be prescribed” i.e. threshold of reporting fraud is introduced and Rule 13 of the Companies (Audit and Auditors) Amendment Rules 2015 has mentioned clearly the threshold for reporting of fraud. This Amendment Rules 2015 provides that if the statutory auditor of a company has sufficient grounds to

accept that an offence of fraud has been committed against the company by its officers or employees involving individually a threshold of rupees one crore or above, then he shall report the matter to the Central Government.

Companies (Audit and Auditors) Amendment Rules 2015 also provides the timeline and manner in which the auditor shall report fraud. At first the auditor shall report the matter to the Board or the Audit Committee immediately within two days of his knowledge of the fraud, seeking their reply within forty-five days. Then on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within fifteen days from the date of receipt of such reply or observations. In case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of forty-five days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations.

The report on fraud in Form ADT-4 shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with AD or by Speed post followed by an e-mail in confirmation of the same. It shall be on the letter-head of the auditor containing postal address, e-mail address and contact number and be signed by the auditor with seal and Membership Number.

In case of a fraud involving lesser than the threshold of rupees one crore, the auditor shall report the matter to the Audit Committee or to the Board immediately within two days of his knowledge of the fraud. The report of auditor shall specify the nature of fraud with description, approximate amount involved and parties involved. The Companies (Amendment) Act 2015 provides further that the companies, whose auditors have reported frauds under sub-section (12) of section 143 to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board's Report. The Board's Report shall disclose the nature of fraud with description, approximate amount involved, parties involved if remedial action not taken, and remedial action taken. The provisions of section 143(12) shall also apply, mutatis mutandis, to a Cost Auditor and a Secretarial Auditor for performing their duties. If any auditor, cost accountant or company secretary in practice do not comply with the provisions of section 143(12), shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.

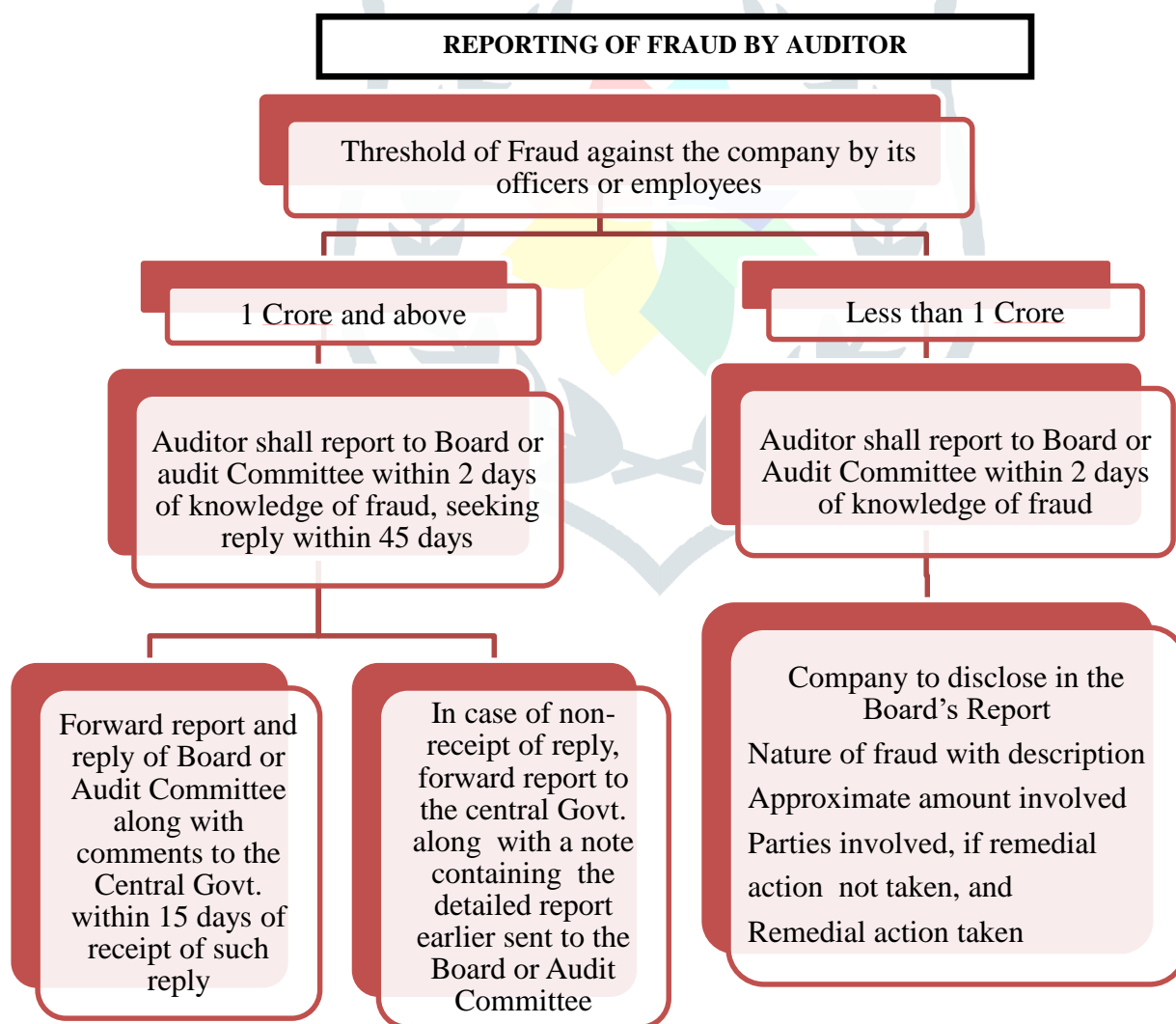


Figure: 2

VIII. SERIOUS FRAUD INVESTIGATION OFFICE (SFIO)

The establishment of 'Serious Frauds Office' was recommended by the Naresh Chandra Committee on Corporate Audit and Governance in 2003. Based on this recommendation and in the backdrop of stock market scams as well as the failure of non-banking companies resulting in huge loss to the public, the Cabinet decided to set up a Serious Fraud Investigation Office (SFIO) in January 2003. Finally, Central Government issued a resolution in July 2003 constituting SFIO. At that time SFIO did not enjoy a formal legal status. It would make investigations under section 235 and 247 of erstwhile Companies Act 1956. Then an expert committee was formed under the chairmanship of former Deputy Governor of RBI, Shri Vepa Kamesam with a view to review the functioning of the SFIO and to make it more effective. The committee gave various recommendations in April 2009 to suggest statutory, administrative and organizational changes for improving the effectiveness and to ensure efficient discharge of duties of SFIO. As per the Companies Act 2013, SFIO has been established through the Government of India Notification No. S. O. 2005(E), dated 21.07.2015. Section 211 of the new Act gives statutory status to SFIO. Now SFIO is vested with the requisite legal authority to conduct investigation under section 212. It is a multidisciplinary organization under the Ministry of Corporate Affairs, consisting of experts in the field of Accountancy, Forensic Auditing, Banking, Law, Information Technology, Investigation, Company Law, Capital Market, Taxation, etc. for detecting and prosecuting or recommending for prosecution of frauds. Now the SFIO has more power including the power to arrest. SFIO is headed by a Director as Head of Department in the rank of Joint secretary to the Government of India. The Headquarter of SFIO is at New Delhi, with five Regional Offices at Mumbai, New Delhi, Chennai, Hyderabad and Kolkata.

Considering the report of the Registrar or Inspector, intimation by means of special resolution passed by a company, on request from any government department or in public interest, if the Central Government is of the opinion that it is necessary to investigate the affairs of a company by the SFIO then it may assign the investigation into the affairs of the said company to the SFIO. When a case is assigned to the SFIO for investigation by the Central Government, no other investigating agency of government will be able to take up the case. The SFIO has to submit its report to the Central Government on completion of investigation within the time as specified in the order. Till date SFIO has submitted reports of 312 cases to the Ministry of Corporate Affairs after completion of investigation (Figure: 3).

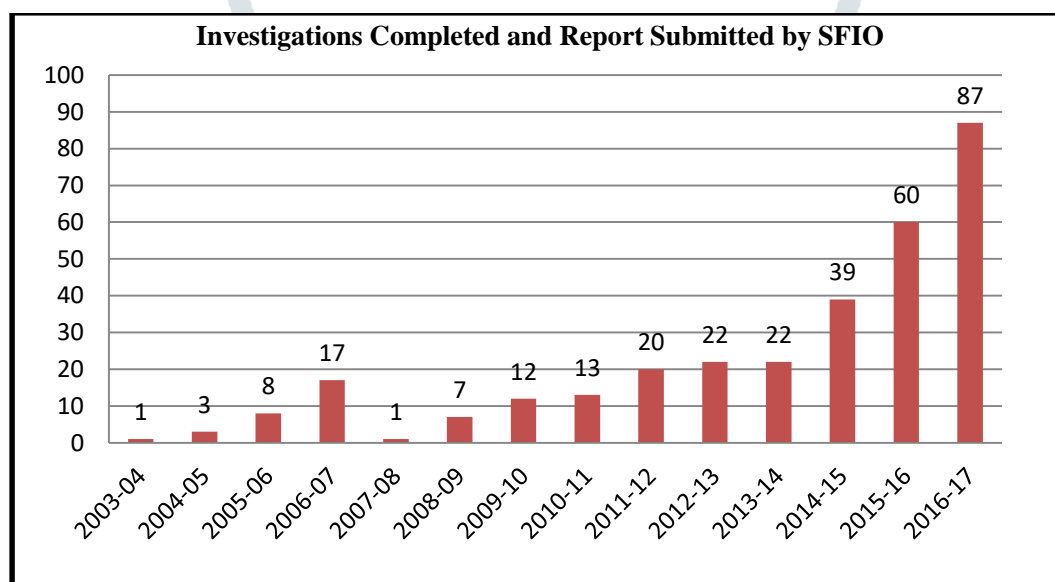


Figure: 3

Source: www.s fio.nic.in

Investigation into affairs of company by SFIO under section 212 of the Companies Act 2013 came into force since 01.04.2014. As a corollary, it is noticed in Figure: 3 that the number of cases, for which SFIO completed its investigation and submitted its report, was increased significantly from the year 2014-15.

The provisions relating to arrest under sub-section (8), (9) and (10) of section 212 have come into force from 24.08.2017, i.e. the date of notification of the Companies (Arrests in connection with Investigation by SFIO) Rules 2017 in the official Gazette. As per this Rule, the Director SFIO is the competent authority for arrest. If an arrest is made by the Additional Director or Assistant Director, then written approval of Director SFIO is necessary. If the Director, Additional Director or Assistant Director of SFIO has reason to believe, on the basis of material in its possession, that any person has been guilty of any offence he may arrest such person and issue arrest order along with personal search memo to the arrestee.

Number of Prosecutions filed by SFIO in Different Designated Courts in India

Period	No. of Prosecutions Filed			Total No. of Prosecutions Filed
	Company Law/IPC	ICAI/ICSI	CLB/(NCLT)	
Up to 31.03.14	1040	28	04	1072
From 01.04.14 to 31.03.15	56	13	03	72

From 01.04.15 to 31.12.15	43	06	01	50
From 01.01.16 to 30.11.16	23	06	00	29
From 01.12.16 to 30.11.17	21	19	(20)	60
TOTAL	1183	72	08	1283

Table: 1

Source: Compiled from different Annual Reports of Ministry of Corporate Affairs

Arrest in connection with a Government Company or a foreign company under investigation shall be made with prior written approval of the Central Government. The offences which attract punishment for fraud under section 447 are cognizable and no person accused of any offence under this section shall be released on bail. Up to 30th November, 2017 the number of prosecutions filed by SFIO in different designated courts in India stands 1283 (Table: 1)

IX. CONCLUSION AND SUGGESTIONS:

The corporate sector in India suffers from considerable weaknesses in governance and regulatory mechanism. Corporate frauds have been rising in India due to the fact that India is a fertile ground for corporate frauds. Fraudsters are being able to get away only with fines rather imprisonment. Deterrence of corporate fraud requires coordinated efforts by the management, audit committee and auditors. Though the laws on curbing fraud is effective (Deloitte India Fraud Survey Edition II), but only laws cannot prevent fraud we need stronger enforcement too. In the words of Justice S. N. Dhingra, “Corporate crimes could have been checked to a greater extent if the courts had taken a pragmatic approach in interpretation and provisions of law keeping in mind the purpose of enactment rather than saving the offender on the ground of personal liberties.” Nowadays fraudsters spend money in developing new techniques and new technologies to perpetrate fraud. So the corporates need to think proactively and strengthen their internal control system. They must have proper fraud risk management policy. They should leverage technology in fighting against fraud by making a balance between the effectiveness of technology and the cost of technology while remaining ahead of fraudsters. The auditors must be properly trained in dealing with new laws and in handling technology. Last but not the least; general decline in ethical values is certainly one of the main reasons behind fraud. The parents, teachers, educational institutions and the society at large should come forward to curb such decline in ethical values and play a vital role in this respect.

REFERENCES:

1. Annual Reports of Ministry of Corporate Affairs, www.mca.gov.in
2. Global Economic Crime and Fraud Survey 2018, PWC, Forensic, <https://www.pwc.com>
3. Ghosh, T. P. 2016. Companies Act 2013, Taxmann, New Delhi, ISBN: 978-93-5071-847-6
4. India Fraud Survey Edition II. 2016. Deloitte India, Forensic, <https://www2.deloitte.com>
5. Kumar, Lalit. 2014. “Companies Act 2013 - A big leap to prevent and punish fraud”, Chartered Secretary, March 2014, Vol-XLIV, No-3, ISSN: 0972-1983, www.icsi.edu
6. Sharma, S. 2013. Corporate Crimes & Financial Frauds, Authors Press, New Delhi, ISBN: 978-81-7273-712-2
7. The Companies Act, 2013, retrieved from www.mca.gov.in/Ministry/pdf/Companies Act 2013.pdf
8. The Companies (Amendment) Act, 2015, the Gazette of India, Extraordinary, part-II section-1, dated 26th May, 2015 retrieved from www.mca.gov.in/Ministry/pdf/Amendment Act_2015.pdf
9. The Companies (Amendment) Act, 2017, the Gazette of India, Extraordinary, part-II section-1, dated 3rd January, 2018 retrieved from www.mca.gov.in/Ministry/pdf/Amendment Act_2017.pdf
10. Website of Serious Fraud Investigation Office, sfio.nic.in