

The Institute of Cost Accountants of India

Role of Cost Accountants in Fraud Reporting under the Companies Act, 2013 (31 July 2015)

R.K. Khurana

FCS, FCMA, EMIB, LLB

Advocate

Taxation and Corporate Laws Adviser

Email: khurana02@gmail.com

Mobile No. 9868285999

Tel (011) 22779277

The presentation covers:

1. What is Fraud ?
2. Fraud reporting under the Companies Act 1956
3. Why Cost Accountants for Fraud Reporting ?
4. Responsibility for Fraud Reporting under the Companies Act, 2013
5. Procedure for fraud reporting
6. Questions and Answers

Definition of Fraud

“Fraud” in relation to affairs of a company or any body corporate, includes:

- a. Any act,
- b. Omission,
- c. Concealment of any fact or
- d. Abuse of position

Committed by any person or any other person with the connivance in any manner,

Contd . . .

Definition of Fraud

Intention to commit fraud: The intention to fraud may be:

- i. With intent to deceive, or
- ii. To gain undue advantage from, or
- iii. 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;

Definition of Fraud

- i. “Wrongful gain” means the gain by unlawful means of property to which the person gaining is not legally entitled;

- (ii) “Wrongful loss” means the loss by unlawful means of property to which the person losing is legally entitled.

Fraud Reporting under Cos Act 1956

Reporting on Fraud u/s 227 (4A) of the 1956 Act, CARO, 2003 (as amended):

- Clause 4(xxi) of CARO required the auditor to report if any fraud **on or by the co** has been **noticed or reported** during the yr. If yes, the nature and the amount involved to be indicated.
- this clause does not require the auditor to discover these frauds; however, the scope of auditor's inquiry under this clause is restricted to frauds 'noticed or reported' during the yr.
- The words "noticed or reported" indicates that the co's management should have the knowledge on these frauds.

Fraud Reporting under Cos Act 1956

Reporting on Fraud u/s 227 (4A) of the 1956 Act, CARO, 2003 (as amended):

- Though fraud is a broad legal concept, the auditor is concerned with fraudulent acts that cause a material misstatement in the FS.
- Two types of intentional misstatements are relevant to the auditor's consideration of fraud:
 - misstatements resulting from fraudulent financial reporting; and
 - misstatements resulting from misappropriation of assets.

Why Cost Accountant's Role in reporting Fraud

- i. Combined reading of Sec 148 (5) and Chapter X Audit and Accounts, particularly Section 143 (12).
- ii. Section 148 provides for audit of cost accounts of certain companies by a Cost Accountant.
- iii. **Sec 148 (5)**: The qualifications, disqualifications, rights, **duties and obligations** applicable to auditors under this Chapter shall, so far as may be applicable, apply to a cost auditor appointed under this section.

Why Cost Accountant's Role in reporting Fraud ?

- i. **Section 143** provides for the qualifications, disqualifications, rights, **duties and obligations** applicable to auditors
- ii. **Sec 143 (12)**: If an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe, that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within such time and in such manner as may be prescribed.

Time and Manner of Reporting Fraud

Section 143(14) The provisions of this section shall mutatis mutandis apply to—

- (a) the cost accountant in practice conducting cost audit under section 148; or
- (b) the company secretary in practice conducting secretarial audit under section 204.

Time and Manner of Reporting Fraud

Rule 13 of The Companies (Audit and Auditors) Rules, 2014.

Reporting of frauds by auditor.- (1) In case the auditor has sufficient reason to believe that an offence involving fraud, is being or has been committed against the company by **officers or employees** of the company, he shall report the matter to the C.G. **immediately, but not later than sixty days of his knowledge and after following the procedure indicated herein below:**

- (i) Auditor shall forward his report to the Board or the Audit Committee, as the case may be, immediately after he comes to the knowledge of the fraud, seeking their reply or observations **within forty-five** days;

Time and Manner of Reporting Fraud

Rule 13 of The Cos (Audit and Auditors) Rules, 2014.

Reporting of frauds by auditor

- (ii) On receipt of such reply, the auditor shall forward his report and the reply of the Board or the Audit Committee along with his comments (on such reply of the Board or the Audit Committee) to the C.G. within **fifteen days** of receipt of such reply;
- (iii) In case the auditor fails to get any reply from the Board or the Audit Committee within the stipulated period of forty-five days, he shall forward his report to the C. G. along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he failed to receive any reply within the stipulated time.

Report to be in format ADT 4

- (2) The report shall be sent to the Secretary, MCA in a sealed cover by Registered Post with Acknowledgement Due or by Speed post followed by an e-mail in confirmation of the same.
- (3) The report 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 his seal and shall indicate his Membership Number.
- (4) The report shall be in the form of a statement as specified in [Form ADT 4 For Fraud Reporting.docx](#)
- (5) **The provision of this rule shall also apply, mutatis mutandis (with necessary modification), to a cost auditor and a secretarial auditor during the performance of his duties under section 148 and section 204 respectively.**

Persons covered for reporting

Persons covered for fraud reporting

- statutory auditor of a co
- cost accountant, conducting cost audit u/s 148
- *company secretary, conducting secretarial audit u/s 204*
- branch auditor appointed u/s 139

Note: This sec includes fraud by officers or employees of the co and does not include fraud by third parties such as vendors and customers.

Persons covered for reporting

Persons not covered for fraud reporting

- Other professionals, rendering other services to the co (e.g. tax auditor, sales tax or VAT auditors)
- Internal auditors covered u/s 138
- Some discussions on whether a Cost Accountant appointed under the Central Excise Act/Finance Act, 1994 should be covered ?

(Discussions with reference to the terms of appointment under CE/ST law)

Note: This Section includes fraud by officers or employees of the co and does not include fraud by third parties such as vendors and customers.

FAQs by the ICAI(CMA)

Is there any obligation on the part of cost auditor to report offence of fraud being or has been committed in the Company by its officers or employees?

1. Sub-rule (7) of Rule 6 of the Companies (Cost Records and Audit) Rules 2014 states that “the provisions of sub-section (12) of section 143 of the Act and the relevant rules made thereunder shall apply mutatis mutandis to a cost auditor during performance of his functions under section 148 of the Act and these rules”.
2. As per sub-section (12) of section 143 of the Companies Act 2013, extract of which is given above:

FAQs by the ICAI(CMA)

2. “It is obligatory on the part of cost auditor to report offence of fraud which is being or has been committed in the company by its officers or employees, to the Central Government as per the prescribed procedure under the Rules.
3. As per the proviso to above sub-section, it has been stated that in case of a fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed.

Punishment for Fraud

- i. A person found guilty of fraud is-
 - a. punishable with **imprisonment** for a term between six months to ten years; and
 - b. liable to **fine** at least for the amount involved in the fraud, extendable up to **three** times the amount involved
- ii. The 2013 Act has provided punishment for fraud as provided u/s 447 in around 20 Secs of the Act e.g. u/s 7(5), 7(6), 8(11), 34,36,38(1), 140 (5) etc. for directors, KMPs, auditors and/or officers of company
- iii. Thus, the new Act goes beyond professional liability for fraud and extends to personal liability of the concerned person

Thank you very much.

Have a a great learning.

R.K. Khurana

Advocate

khurana02@gmail.com

Mobile 9868285999

Tel (o11) 22779277