
Fraud provisions Companies Act 2013 & Fraud reporting

DFA – Module 1 :

Units 3 & 23

Arijit Chakraborty
Feb 18, 2022

Definition of Fraud, Financial crime

“Financial crime” to encompass illicit activities including:

- Financial statement manipulation
- bank frauds
- money laundering,
- terrorist financing,
- white collar or corporate crime,
- Nepotism, Contract management
- willful non-compliance
- bribery, currency violations, corruption or abuse of office
- financial markets offences,
- tax evasion,
- Collusion with a supplier for personal gain
- cyber or technology enabled crimes, IT frauds
- Employee fraud = data theft, faking degrees, experience (EBC = mandatory), holding multiple jobs in WFH mode (Moonlighting = pandemic advantage)

Definition of Fraud, Financial crime

“Financial crime” to encompass illicit activities including:

- Fraud - Companies Act 2013 – sec 447 : *Fraud includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with his 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 other persons associated with the company, whether or not there is any wrongful gain or wrongful loss.*

- Without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found 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 lower] 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 which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud:
- Provided that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.
- Provided further that where the fraud involves an amount less than ten lakh rupees or one per cent. of the turnover of the company, whichever is lower, and does not involve public interest, any person guilty of such fraud shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to fifty lakh rupees or with both.

“Wrongful gain / loss ”

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

FRAUDS : COMPANIES ACT 2013

Definition of fraud contained in section 447 of the Act, that a person shall be treated as guilty of an offence involving fraud under the Act, if the following is involved:

- **Misstatements in prospectus – section 34;**
- **Fraudulent inducements to invest, making false promises, forecasts or statements – section 36(1);**
- **Presentation for acquisition of securities, or making multiple applications for acquiring securities section 38;**
- **Auditor acting in fraudulent manner or in fraud by or in relation to a company – section 140(5);**
- **Carrying on of business of Company for a fraudulent or unlawful purpose – section 206(4);**
- **Furnishing false statement, mutilation, destruction of documents, falsification of documents during the course of inspection/inquiry/ investigation- Section 229;**
- **False statement in any return, statement, prospectus or other document for purposes of any provision of the Act – section 448.**

Frauds : Companies Act 2013

- In order to amount to Fraud, an act must be confined to acts committed by a party to contract with an intention to deceive another party or his agent or to induce him to enter into a contract.
- Fraud, which vitiates the contract, must have a nexus with the acts of the parties entering into the contract.
- This definition highlights the precondition to prove the intention of the person who has committed fraud.
- If that person has willingly committed a fraud, then he will be punished.
- Here the person means himself or his agent.
- The acts which include fraud are wrong suggestions or concealment of facts or false promises or any fraudulent act to deceive others.

Key sections

- **Section 7**
- Deals with documents to be file with concerned Registrar of Companies (RoC) for incorporating a company
- **Penal consequences:**
- **Sub-Section (5): If a person furnishes false information or incorrect particulars or suppresses material information then person is liable for action u/s 447.**
- **Sub-Section (6): The promoters, the first directors and the fiduciaries viz, chartered accountant, the company secretary in practice or the cost accountant or the advocate, the managing director or the secretary of the company who have given such false declaration in the prescribed format shall also be liable for action under Section 447**

- **Section 34**
- Deals with Criminal liability for mis-statement in Prospectus.
- **Penal Consequences:**
- Every person who has authorized the issue of a prospectus carrying misstatement shall be liable under this provision
- **Section 36**
- Deals with punishment for fraudulently inducing persons to invest money.
- **Penal Consequences: Section 447 can be invoked**

- **Section 56**
- Deals with transfer and transmission of shares.
- **Penal Consequences:**
- **Sub-Section (7): Punishment under Section 447 for intentional fraudulent transfer of shares** by a depository or depository participant
- **Section 75**
- Deals with damage involved in fraud.
- **Penal Consequences:** “When it is proved that the deposits had been accepted with 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, without prejudice to the provisions contained in sub-section (3) of that section and liability under section 447, be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors.”

Section 212: SFIO

- Deals with investigation powers by SFIO into affairs of the Company.
- **Penal Consequences:**
- Notwithstanding anything contained in the Code of Criminal Procedure, 1973, offence covered under section 447 of this Act shall be cognizable and no person accused of any offence under those sections shall be released on bail or on his own bond unless-
- 1. The Public Prosecutor has been given an opportunity to oppose the application for such release;
- 2. And where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail.

- **Section 229**
- Deals with penalty for furnishing false statement or destruction of documents.
- **Penal Consequences:**
- This Section deals with falsification or mutilation of records or destroying of documents etc. by any officer of the company who is required to furnish certain information during the course of inspection, inquiry or investigation.
- Such acts attract punishment under Section 447.
- **Section 339**
- Deals with liability for fraudulent conduct of business.
- **Penal Consequences:**
- Sub-Section (3): Punishment can be invoked u/s 447.

Section 448

- Deals with punishment for false statement.
- **Penal Consequences:**
- “The Section calls for punishment under Section 447 for making false statement related to returns, statement, prospectus or any other document, that is false in respect of any material particulars or omits any material fact by a person.”

Companies Act 2013 – Fraud Reporting

Reporting on fraud, u/s 143(12) of the 2013 Act

Persons covered for fraud reporting

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

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

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.

Form No. ADT-4 – Forensic Audit Report

REPORT TO THE CENTRAL GOVERNMENT (See rule 13(4) of the
Companies (Audit and Auditors) Rules, 2014)

Date:

Subject: Report under sub- section (12) of section 143 of the Companies Act, 2013 on suspected offence involving fraud being committed or having been committed

1) (a) Name of the Company

(b) CIN:

(c) Address of the Registered Office:

2) (a) Name of the auditor or auditor's Firm

(b) Membership Number

(c) Address

3) Date of the annual general meeting when the Auditor was appointed or reappointed

Form No. ADT-4 (Contd.)

- 5) Address of the office or location where the suspected offence is believed to have been or is being committed
- 6) **Full details of the suspected offence involving fraud** (attach documents in support)
- 7) **Particulars of the officers or employees who are suspected to be involved in the commission of the offence:**
 - a) Name(s) :
 - b) Designation
 - c) If Director, his DIN
 - d) PAN
- 8) **Basis on which fraud is suspected:**
- 9) **Period during which the suspected fraud has occurred**
- 10) Date of sending report to the Board or Audit committee as per rule 13(1)
- 11) Date of reply received from Board or Audit committee, if any and if so received, attach copy thereof and give gist of the reply
- 12) **Whether the auditor is satisfied** with the reply of the Board or Audit committee.
Yes _____ No _____.
- 13) **Estimated amount** involved in the suspected fraud;
- 14) **Details of steps , if any, taken by the company** in this regard;
(Furnish full details with references)
- 15) Any other relevant information.

Companies Act 2013 – Fraud Reporting

Fraud Reporting – Current position

- Now section 143(12) after Companies (Amendment) Act, 2015 provides that only fraud beyond prescribed threshold need to be reported- Rs 1 crore prescribed for reporting to CG , Auditor should report such frauds as soon as possible but not later than 62 days of his knowledge about the frauds
- Penalty – Sec 448 / 451 threshold Rs 10 lakhs / 1% of T/O whichever is lower – 5 years & / Rs 20 lakh penalty (Companies Amendment Bill 2016)

STEP-I

REPORT TO BOARD & AUDIT COMMITTEE:

Auditor shall forward his report to the Board of Directors or the Audit Committee, as the case maybe, within 2 days of his knowledge of the fraud, seeking their reply or observations within 45 forty-five days;

STEP-II

Report to government after reply of board:

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 15 fifteen days of receipt of such reply or observations

STEP-III

Report to government if no reply received

In case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45(forty-five days), he shall forward his report to the CG alongwith 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 or observations within the stipulated time.

CARO 2020

- As per the Ministry of Corporate Affairs (MCA) order dated 25 February 2020, CARO 2020 was applicable for the Financial Year (FY) 2019-20 onwards.
- Subsequently, the MCA amended the applicability of CARO 2020 from FY 2019-20 to 2020-21 through its order dated 17 December 2020.
- Thus, CARO 2020 is applicable from 1 April 2021.
- CARO 2020 has included additional reporting requirements after consultations with the National Financial Reporting Authority (NFRA)
- The CARO 2020 contains 21 clauses, whereas CARO 2016 has only 16 clauses.
- In CARO 2020, 7 new clauses have been inserted, and the existing clauses of CARO 2016 have been re-drafted to elicit detailed comments from the auditors.

CARO 2020 Reporting

- **11. Fraud and whistle-blower complaints**
- – Has there been any fraud by the company or any fraud done on the company. If any , such fraud has been noticed or reported any time of the year.
- If yes, nature and amount involved have to be reported. –
- Whether the auditors of the company have filed a report in Form ADT-4 with the Central Government as prescribed under the Companies (Audit and Auditors) Rules, 2014. –
- In case of receipt of whistle-blower complaints, whether the complaints have been considered by the auditor.