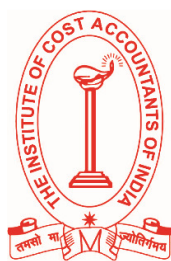


Guidance Note

on

Reporting on Fraud under Section 143(12) of the Companies Act, 2013



November, 2015
PROFESSIONAL DEVELOPMENT COMMITTEE
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(Statutory body under an Act of Parliament)

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CHAPTER – 1

Background

1.1 Fraud is a broad legal concept that generally refers to an intentional act committed to secure an unfair or unlawful gain and misconduct is referred to as violation of laws, regulations, internal policies, and market expectation of ethical business conduct. Fraud can loosely be defined as “any behaviour by which one person intends to gain a dishonest advantage over another”. In other words, fraud is an act which is intended to cause wrongful gain to one person and wrongful loss to the other, either by way of concealment of facts or otherwise.

1.2 In the context of cost accounting, Fraud & Misconduct, together fall into the following categories of risk that can undermine public trust and damage a company’s reputation for integrity:

- Fraudulent Cost Reporting(e.g. overstatement of cost of goods sold, last minute adjustment that significantly affect cost results, missing inventory or physical assets of significant magnitude)
- Misappropriation of assets (e.g. embezzlement, payroll fraud, theft, procurement fraud, counterfeiting, wrong product mix)
- Revenue or assets gained by fraudulent or illegal acts (e.g. over-billing customer, deceptive sales practices, accelerated revenue, bogus revenue)
- Cost accounting policies that appear to be at variance with industry norms
- Tolerance of violation of the company’s Code of Conduct
- Other misconduct (e.g. conflicts of interest, denial of access to records, facilities, certain employee, customer / vendor or other from whom cost audit evidence might be sought)

Meaning of Fraud defined under-

Indian Penal Code, 1860

1.3 Indian Penal Code, which is the mother law concerning frauds has, as such, not defined the term 'fraud'. However, it has defined other related terms such as 'wrongful gain', 'wrongful loss', 'dishonestly', 'fraudulently', and 'reason to believe'. These are as under:

Section 23 "Wrongful gain"

"Wrongful gain" is gain by unlawful means of property which the person gaining is not legally entitled.

"Wrongful loss" is the loss by unlawful means of property to which the person losing it is legally entitled.

Gaining wrongfully, losing wrongfully- A person is said to gain wrongfully when such person retains wrongfully, as well as when such person acquires wrongfully. A person is said to lose wrongfully when such person is wrongfully kept out of any property as well as when such person is wrongfully deprived of property.

Section 24 "Dishonestly"- Whoever does anything with the intention of causing wrongful gain to one person or wrongful loss to another person, is said to do that thing "dishonestly".

Section 25 "Fraudulently" - A person is said to do a thing fraudulently if he does that thing with intent to defraud but not otherwise.

Section 26 "Reason to believe"- A person is said to have "reason to believe" a thing, if he has sufficient cause to believe that thing but not otherwise.

Indian Contract Act, 1872 – Section 17 states as follows

1.4 ***"Fraud" means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agents, with intent to deceive another party thereto his agent, or to induce him to enter into the contract;***

- the suggestion as a fact, of that which is not true, by one who does not believe it to be true;
- the active concealment of a fact by one having knowledge or belief of the fact;
- a promise made without any intention of performing it;
- any other act fitted to deceive;
- any such act or omission as the law specially declares to be fraudulent.

Explanation.—Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud, unless the circumstances of the case are such that, regard being had to them, it is the duty of the person keeping silence to speak, or unless his silence, is, in itself, equivalent to speech.

Reserve bank of India

1.5 RBI had, *per se*, not defined the term 'fraud' in its guidelines on Frauds. A definition of fraud was, however, suggested in the context of electronic banking in the Report of RBI Working Group on Information Security, Electronic Banking, Technology Risk Management and Cyber Frauds, which reads as under:-

"A deliberate act of omission or commission by any person, carried out in the course of a banking transaction or in the books of accounts maintained manually or under computer system in banks, resulting into wrongful gain to any person for a temporary period or otherwise, with or without any monetary loss to the bank."

The Insurance Fraud Monitoring Framework

1.6 In the context of insurance business, Insurance Regulatory and Development Authority (IRDA) has defined fraud as:

"an act or omission intended to gain dishonest or unlawful advantage for a party committing the fraud or for other related parties."

The Companies Act, 2013

1.7 With reference to the provisions for punishment for fraud, Section 447 of the Act has explained the terms fraud, wrongful gain and wrongful loss as under:

*"**fraud**" in relation to affairs of a company or any body corporate, includes any act, omission, concealment of 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;*

*"**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.*

1.8 The above definition of fraud is so broad that it conceivably include any act committed by anyone with wrongful intent.

1.9 Section 447 provides punishment for fraud, as below:

- **Criminal Liability (Imprisonment)**–Minimum of 6 months (3 years in case public interest is involved) and Maximum of 10 years
- **Civil Liability (Fine/Penalty)**–Minimum of amount equivalent to fraud and Maximum of 3 times of the amount involved in fraud. Further, the penalty is non compoundable

CARO, 2015

1.10 Para (xii) of the Companies (Auditor's Report) Order [CARO], 2015 requires the auditor to report,

"whether any fraud on or by the company has been noticed or reported during the year; If yes, the nature and amount involved is to be indicated."

Clause 49 of Listing Agreement

1.11 Clause 49 of the Listing Agreement has following provisions relating to fraud:

- a) The Audit Committee shall review the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the Board.
- b) CEO/CFO shall certify to the Board that (i) there are, to the best of their knowledge and belief, no transactions entered into by the company during the year which are fraudulent, illegal or violative of the company's code of conduct; and (ii) they have indicated to the auditors and the Audit committee instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the company's internal control system.
- c) Whistle Blower Policy: The company may establish a mechanism for employees to report to the management concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy.

Association of Certified Fraud Examiners [ACFE], USA

1.12 ACFE is the world's largest anti-fraud organization. Its literature on fraud provides the following relevant information.

What Is Fraud? - In the broadest sense, fraud can encompass any crime for gain that uses deception as its principal modus operandus. More specifically, *fraud* is defined by *Black's Law Dictionary* as "A knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment." Consequently, fraud includes any intentional or deliberate act to deprive another of property or money by guile, deception, or other unfair means.

Types of Fraud - Fraud against a company can be committed either internally by employees, managers, officers, or owners of the company, or externally by customers, vendors, and other parties. Other schemes defraud individuals, rather than organizations.

Internal Fraud - Internal fraud, also called *occupational fraud*, can be defined as: "*the use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the organization's resources or assets.*" Simply stated, this type of fraud occurs when an employee, manager, or executive commits fraud against his or her employer.

External Fraud - External fraud against a company covers a broad range of schemes. Dishonest vendors might engage in bid-rigging schemes, bill the company for goods or services not provided, or demand bribes from employees. Likewise, dishonest customers might submit bad checks or falsified account information for payment, or

might attempt to return stolen or knock-off products for a refund. In addition, organizations also face threats of security breaches and thefts of intellectual property perpetrated by unknown third parties. Other examples of frauds committed by external third-parties include hacking, theft of proprietary information, tax fraud, bankruptcy fraud, insurance fraud, healthcare fraud, and loan fraud.

Fraud Against Individuals - Numerous fraudsters have also devised schemes to defraud individuals. Identity theft, Ponzi schemes, phishing schemes, and advanced-fee frauds are just a few of the ways criminals have found to steal money from unsuspecting victims.

Corporate Governance and Fraud

1.13 No fraud prevention system can ever completely eliminate the risk of fraudulent activity; to achieve such a result would inevitably suffocate a company's ability to function. However, the strategic deployment of resources to address the threat of the highest value fraudulent activity can be effective. Corporate governance, being a broad brush term for principles of transparent and accountable company management, can help in the fight against fraud. Arrangements that seek to mitigate the risks effectively should include:

- Developing a strategy for the management of risks associated with fraud, and for addressing specific fraudulent conduct activities when they arise.
- Clear allocation of responsibility for the management of such risks at senior management and Board level.
- Compliance with all applicable corporate governance standards and rules (e.g. the Combined Code).
- Arrangements for the regular consideration of such issues by the Board.
- Arrangements for the effective supervision and regular review of the company's internal audit and compliance functions.

1.14 Corporate governance needs to be more than a series of well thought out and well written documents and policies; it needs to reflect the way an organisation really behaves and is managed. Honest and ethical behaviour needs to be promoted from the top and form part of the culture of the organisation. Employees are more likely to follow by example than adhere to a policy document that they perceive does not truly reflect reality.

1.15 It is important to respond to actual and suspected fraud consistently and robustly. A culture of zero tolerance can act as a deterrent and as effective fraud prevention, not least because it will help to ensure that inappropriate individuals are less likely to join the organisation in the first place. Management should ensure that everyone knows that fraud includes unethical behaviour even if done with the interests of the business in mind, such as corrupt payments made to secure a valuable contract.

International Standard on Auditing (ISA)

1.16 For purposes of understanding, following terms have the meanings attributed by ISA:

(a) **Fraud** – *An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.*

(b) **Fraud risk factors** – *Events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.*

1.17 The definitions of fraud stated above by/under the Companies Act, 2013, RBI Regulations, Indian Contract Act, 1872, The Insurance Fraud Monitoring Framework, Corporate Governance and Fraud, Clause 49 of Listing Agreement, CARO, 2015 etc. states that such reporting already exists in all the Statutes. Thus, reporting by the auditor on fraud is not a new concept in India.

1.18 This Guidance Note aims to provide guidance to the Cost auditors on matters that may arise pursuant to the reporting requirements on fraud under Section 143(12) of the Companies Act, 2013. Section 143(12) specifically states that the auditor should report to the Central Government if he has reason to believe that an offence involving fraud is being or has been committed against the company by its officers or employees if the auditor has noted it *“in the course of the performance of his duties as auditor”*.

1.19 Accordingly, the Guidance Note should be read in conjunction with the International Standards on Auditing (ISAs), Standards on Cost Auditing (SCAs), and relevant provisions under Section 143 of the Companies Act, 2013.

CHAPTER – 2

What Section 143 and Rules made thereunder states?

2.1 Though provisions made in the Companies Act, 2013, the Central Government seeks the support of auditors in bringing transparency and discipline in the corporate world to protect the interests of the shareholders and public at large.

Section 143 of the Companies Act, 2013

2.2 Section 143 of the Companies Act, 2013 (2013 Act) that deals with the powers and duties of auditors and the auditing standards, has been effective from 1st April 2014. Sub-sections (12) to (15) of section 143 are relevant to the auditor's responsibility relating to reporting of fraud. The original provisions read as under:

"(12) Notwithstanding anything contained in this section, 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.

(13) No duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred to in sub-section (12) if it is done in good faith.

(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.

(15) If any auditor, cost accountant or company secretary in practice do not comply with the provisions of sub-section (12), he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees."

2.3 However, sub-section (12) was amended vide the Companies (Amendment) Act, 2015 but the effective date of this amendment is yet to be notified. The amended sub-section reads as under:

"(12) Notwithstanding anything contained in this section, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed:

Provided 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:

Provided further that the companies, whose auditors have reported frauds under this sub-section 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 in such manner as may be prescribed."

2.4 The basic requirements of sub-section (12) read with sub-section (14), as it originally stands, are summarized as under:

- the provision applies to the auditor, cost auditor or secretarial auditor of the company;
- if the auditor, in the course of the performance of his duties as an auditor has a 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.

2.5 Further, as per the amended version of sub-section (12) [as and when notified], Central Government is required to prescribe the level [i.e. the fraud involving lesser than the specified amount] upto which the auditor is required to report the matter to the audit committee constituted under section 177 or to the Board, as the case may be.

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

2.6 Meanwhile, the Central Government, through the Ministry of Corporate Affairs, vide GSR 246(E) dated 31.03.2014, has notified the Companies (Audit and Auditors) Rules, 2014. Rule 13 of the said Rules relate to reporting of frauds by auditor. This is reproduced below:

"13. Reporting of frauds by auditor.-(1) *For the purpose of sub-section (12) of section 143, 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 Central Government 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 knowledge of the fraud, seeking their reply or observations within forty-five days;

(ii) 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 of receipt of such reply or observations;

(iii) 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 failed to receive any reply or observations within the stipulated time.

(2) The report shall be sent to the Secretary, Ministry of Corporate Affairs 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**.*

(5) The provision of this rule shall also apply, mutatis mutandis, to a cost auditor and a secretarial auditor during the performance of his duties under section 148 and section 204 respectively."

2.7 The significant provisions made in the aforesaid rules are summarized as under:

- Maximum time to make a report to the Central Government is sixty days of his knowledge.
- First, the auditor shall forward his report to the Board or the Audit Committee, as the case may be, seeking their reply or observations within forty-five days.
- On receipt of such reply or observations, the auditor shall forward his report and the Board or Audit Committee's reply or observations along with his comments thereon to the Central Government within fifteen days of receipt of such reply or observations.
- In case the Board or the Audit Committee does not give any reply or observations within forty-five days, the auditor shall forward his report to the Central Government.
- In such case, the auditor will attach 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.

- The report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed post followed by an e-mail in confirmation of the same.
- 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.
- The report shall be in the form of a statement as specified in Form **ADT-4**.
- The provision of this rule shall also apply, mutatis mutandis, to a cost auditor and a secretarial auditor during the performance of his duties under section 148 and section 204 respectively.

2.8 The detailed interpretation and applicability of these provisions, in different circumstances, is made in the subsequent chapters.

CHAPTER – 3

Responsibility of Management

3.1 The primary responsibility of the management is to establish adequate internal control systems to prevent and detect frauds and errors. The requirements are specified in International Standard on Auditing (ISA) 240, “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements”, (Effective for audits of financial statements for periods beginning on or after December 15, 2009). Based on ISA 240, Institute of Cost Accountants of India has prepared draft of the Standard on Cost Auditing titled, “The Cost Auditor’s Responsibility relating to Fraud in an Audit of Cost Statements”. Relevant paragraph of the draft standard reads as under:

***"Responsibility for Prevention and Detection of Fraud:** The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. It is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment. This involves a commitment to creating a culture of honesty and ethical behaviour which can be reinforced by an active oversight by those charged with governance. Oversight by those charged with governance includes considering the potential for override of controls or other inappropriate influence over the cost reporting process, such as efforts by the management to understate or overstate costs in order to influence the perceptions of analysts as to the entity's performance and profitability."*

The Companies Act, 2013

3.2 In case of a company, the Companies Act, 2013 has cast enormous responsibilities on those charged with governance [i.e. Board of Directors and its Committees] and management [i.e. key managerial personnel as defined under section 2(51)]. These are specified under various provisions of the Act. Extracts of relevant sections are reproduced & discussed in the succeeding paragraphs.

- Section 128 require maintenance of proper books of account;
- Section 129 requires the financial statements to give true and fair view of the state of affairs of the company, comply with the accounting standards, and shall be in the form provided in Schedule-III;
- Section 134(3), clause (c) provides inclusion of Directors' Responsibility Statement in the report by the Board of Directors, and clause (ca) provides inclusion of details

in respect of frauds reported by auditors under sub-section (12) of section 143 other than those which are reportable to the Central Government¹;

- Section 134(5) provides that the Directors' Responsibility Statement referred to in clause (c) of sub-section (3) shall state that—

(a) in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;

(b) the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period;

(c) the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;

(d) the directors had prepared the annual accounts on a going concern basis; and

(e) the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.

Explanation.—For the purposes of this clause, the term “internal financial controls” means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information;

(f) the directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.”

- Section 177 requires [for specified companies] constitution of Audit Committee of the Board comprising minimum of three directors with independent directors forming the majority and further to ensure that majority of its members are persons with ability to read and understand the financial statements. Among others, specific responsibilities of the Audit Committee include:
 - *review and monitor the auditor's independence and performance, and effectiveness of audit process;*

¹Inserted by the Companies (Amendment) Act, 2015 w.e.f. 29.5.2015

- *examination of the financial statement and the auditors' report thereon; and*
- *evaluation of internal financial controls and risk management systems.*
- Section 177 further provides that [specified companies] shall establish a vigil mechanism for directors and employees to report genuine concerns in such manner as may be prescribed; such vigil mechanism shall provide for adequate safeguards against victimisation of persons who use such mechanism and make provision for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases; and details of establishment of such mechanism to be disclosed by the company on its website, if any, and in the Board's report.

Clause 49 of Listing Agreement

3.3 Besides provisions in the Companies Act 2013, Clause 49 of the Listing Agreement has following provisions with respect to strengthening of corporate governance framework in listed companies and in relation to fraud & risk management:

- a) The Board to lay down Code of Conduct for all Board members and senior management of the company that shall be posted on its website.
- b) The Audit Committee has powers to
 - a. investigate any activity within its reference, seek information from employee, obtaining outside professional advice and secure attendance of expert outsiders in the relevant area;
 - b. review the performance of statutory and internal auditors, and adequacy of the internal control systems;
 - c. review the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the Board;
 - d. review and approve all related party transactions; and
 - e. review the functioning of the Whistleblower system.
- c) CEO/CFO to the Board that (i) there are, to the best of their knowledge and belief, no transactions entered into by the company during the year which are fraudulent, illegal or violative of the company's code of conduct; and (ii) they have indicated to the auditors and the Audit committee instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the company's internal control system.
- d) Board to constitute Risk Management Committee to draw sound policy framework to identify, and mitigate all types of risks associated with the company and to monitor & review its risk management plan.

- e) Whistle Blower Policy: The company to establish a mechanism for employees to report to the management concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy.

3.4 From a reading of the aforesaid provisions, it is amply clear that the responsibility to establish adequate internal control systems and to ensure effective measures in place to prevent and detect frauds and errors vests with those charged with governance [i.e. Board of Directors and its Committees, especially Audit Committee] and management [i.e. key managerial personnel and senior executives]. They are also responsible to ensure that the financial statements of the company are drawn in accordance with the notified accounting standards and gives true and fair view of the company's state of affairs.

3.5 As stated above, the directors' responsibility statement is required to clearly state that the directors had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively. In this context, internal financial controls means

"the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information."

3.6 Therefore, it is the directors' responsibility to take proper and sufficient care for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities.

3.7 The Auditor [including Cost Auditor or Secretarial Auditor] is only required to make a report to the Central Government, in certain cases, as discussed later in this Guidance Note.

CHAPTER – 4

Fraud Reporting – Cost Auditor’s Responsibility under section 143(12) of the Companies Act, 2013

4.1 Fraud has the capacity to undermine the confidence of stakeholders in an organisation and there is a strong nexus between prevention of fraud and good corporate governance. Consideration of fraud in Cost reporting framework and the cost auditor’s responsibility on reporting on fraud has always been an integral part of cost auditor independence. Misstatements in the cost statements can arise from either fraud or error and the distinguishing factor between the two is whether the underlying action that results in the misstatement of the cost statements is intentional or unintentional. ***The cost auditor is required to consider fraud as a risk that could cause a material misstatement in the cost statements and plan and perform such cost audit procedures that mitigate the risk of material misstatement due to fraud.***

Objectives of the Cost Auditor

4.2 As stated in the draft Standard on Cost Auditing titled, “The Cost Auditor’s Responsibility relating to Fraud in an Audit of Cost Statements”, the objectives of the cost auditor are:

- (a) To identify and assess the risks of material misstatement in the cost statements due to fraud;*
- (b) To obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and*
- (c) To respond appropriately to fraud or suspected fraud identified during the audit.*

Responsibilities of the Cost Auditor

4.3 With regard to the prevention and detection of fraud, draft Standard on Cost Auditing titled, “The Cost Auditor’s Responsibility relating to Fraud in an Audit of Cost Statements” states the responsibilities of the cost auditor as under:

- (i) A cost auditor conducting an audit in accordance with Cost Auditing Standards is responsible for obtaining reasonable assurance that the cost statements taken as a whole are free from material misstatement, whether caused by fraud or error. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the cost statements may not be detected, even though the audit is properly planned and performed in accordance with the Cost Auditing Standards.*
- (ii) The potential effects of inherent limitations are particularly significant in the case of misstatement resulting from fraud. The risk of not detecting a material misstatement*

resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the auditor to believe that audit evidence is persuasive when it is, in fact, false. The auditor's ability to detect a fraud depends on factors such as the skilfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved. While the cost auditor may be able to identify potential opportunities for fraud to be perpetrated, it is difficult for the auditor to determine whether misstatements in judgment areas such as cost estimates are caused by fraud or error.

- (iii) Furthermore, the risk of the cost auditor for not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to directly or indirectly manipulate cost records, present fraudulent cost information or override control procedures designed to prevent similar frauds by other employees.*
- (iv) When obtaining reasonable assurance, the auditor is responsible for maintaining professional skepticism throughout the audit, considering the potential for management override of controls and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud. The requirements in this Cost Auditing standard are designed to assist the cost auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement.*

4.4 Although primary responsibility for fraud prevention and detection does not sit with the cost auditor, the draft Standard on Cost Auditing does call for cost auditors to include methods for identifying potential cases of fraud when planning and conducting the audit. It requires cost auditors to:

- discuss the risk of fraud with management and those charged with governance
- discuss with the cost audit team the susceptibility of cost statements to material misstatements due to fraud
- consider whether one or more fraud risk factors are present
- perform audit procedures to address the risk of management override
- perform audit procedure to test production and consumption details vis-a-vis industry norms

- perform audit procedure to test measurement, allocation, apportionment and absorption of costs and review cost accounting estimates for bias
- understand the business rationale for transactions or level of costs outside the normal course of business
- obtain representations from management
- bear in mind the implications for money laundering reporting

Cost Auditor's responsibility under Section 143 of the Companies Act, 2013

4.5 The basic requirements of sub-section (12) of section 143 of the Companies Act, 2013, read with sub-section (14) *ibid*, as it originally stands, is summarized as under:

- the provision applies to financial [statutory] auditor, cost auditor or secretarial auditor of the company;
- in the course of the performance of his duties as an auditor [i.e. means not in the course of any other duties in relation to the company];
- has a reason to believe [i.e. mere belief may not be enough, reason to be substantiated with evidence] that;
- an offence involving fraud is being or has been committed against the company [i.e. it may exclude offences not involving fraud];
- by officers or employees of the company [i.e. not by other persons, or third parties such as vendors and customers]
- he[the auditor] shall immediately report the matter to the Central Government within such time and in such manner as prescribed.

4.6 Rule 13 of the Companies (Audit and Auditors) Rules, 2014 provides the timeline and manner in which the auditor should report on fraud. The significant provisions made in these rules are summarized as under:

- Maximum time to make a report to the Central Government is sixty days of his knowledge.
- First, the auditor shall forward his report to the Board or the Audit Committee, as the case may be, seeking their reply or observations within forty-five days.
- On receipt of such reply or observations, the auditor shall forward his report and the Board or Audit Committee's reply or observations along with his comments thereon to the Central Government within fifteen days of receipt of such reply or observations.

- In case the Board or the Audit Committee does not give any reply or observations within forty-five days, the auditor shall forward his report to the Central Government.
- In such case, the auditor will attach 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.
- The report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed post followed by an e-mail in confirmation of the same.
- 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.
- The report shall be in the form of a statement as specified in Form **ADT-4**.
- The provision of this rule shall also apply, *mutatis mutandis*, to a cost auditor and a secretarial auditor during the performance of his duties under section 148 and section 204 respectively.

Savings available under the Companies Act, 2013

4.7 Section 143(13) states that '*No duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred to in Sub-section (12) if it is done in good faith*'. Accordingly, the auditor will not be subject to professional misconduct if he discloses information acquired in the course of his professional engagement with respect to compliance with Section 143(12), since it is as required by law.

4.8 Further, Section 456 of the Act also, *inter alia*, provides that no suit, prosecution or other legal proceeding shall lie against any person in respect of anything which is in good faith done or intended to be done in pursuance of this Act or of any rules or orders made thereunder.

Punishment/Penalty for non-compliance of Section 143(12)

4.9 As per sub-section (15) of section 143, if any auditor, cost accountant or company secretary in practice do not comply with the provisions of sub-section (12), he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees."

Pre-requisites on Reporting of Fraud under section 143(12)

4.10 Cost auditor shall consider the following additional procedures and use the professional judgement to report on fraud:

- The duty of the cost auditor, in the course of performance of his duties, is required to comply with the cost auditing standards. Therefore, the cost auditor is required to carry out the following procedures to obtain sufficient audit evidence:
 - a. to identify and assess the risks of material misstatement in the cost statements due to fraud;
 - b. to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
 - c. to respond appropriately to the identified or suspected fraud.
- Based on the nature, size and circumstances of the fraud risk factors, the cost auditor will have to design appropriate cost audit procedures to address the assessed risk of material misstatement due to fraud.
- For purposes of reporting under Section 143(12) to the Board [or the Audit Committee] and then to the Central Government, the cost auditor is required to carry out certain specific procedures [as laid down under Rule 13 of the Companies (Audit and Auditors) Rules, 2014] with respect to the identified offence involving fraud against the company by its officers or employees.
- Reporting on fraud by the cost auditor is not a separate engagement. It is part of the performance of his duties as a cost auditor of the company under section 148(3) of the Companies Act, 2013. However, this may require modifications in the terms of engagement. The following clauses may be added to the cost auditor's engagement letter with regard to reporting on fraud under section 143(12):

a) As a part of cost auditor's responsibility

In accordance with the provisions of sub-section (12) of section 143 of the Companies Act, 2013, read with sub-sections (13), (14) and (15) *ibid*, if in the course of performance of my/our duties as cost auditor(s), I/we have reason to believe that an offence involving fraud is being or has been committed against the company by its officers or employees, I/we shall be required to report to the Central Government, in accordance with the rules prescribed in this regard which, *inter alia*, requires me/us to forward my/our report to the Board or Audit Committee, as the case may be, seeking their reply or observations, to enable me/us to forward the same to the Central Government. Such reporting will be made in good faith and, therefore, cannot be considered as breach of maintenance of clients' confidentiality requirements or be subject to any suit, prosecution or other legal proceeding since it is done in pursuance of the

provisions under Companies Act, 2013 or of any rules or orders made thereunder.

Because of the inherent limitations of a cost audit, including the possibility of collusion or improper management override of controls, there is an unavoidable risk that material misstatements due to fraud or error may occur and not be detected, even though the audit is properly planned and performed in accordance with the cost auditing standards.

b) As part of management's responsibility

Management is responsible for taking proper and sufficient care for the maintenance of adequate cost accounting records in accordance with the provisions of the section 148(1) of the Companies Act, 2013 read with the Companies (Cost Records and Audit) Rules, 2015, for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities.

Management is responsible to provide me/us access to reports, if any, relating to internal reporting on frauds (e.g., vigil mechanism reports etc.), including those submitted by chartered accountant or company secretary in practice to the extent it relates to their reporting on frauds in accordance with the requirements of section 143(12) of the Act.

Characteristics of Fraud

4.11 Draft Standard on Cost Auditing titled, "The Cost Auditor's Responsibility relating to Fraud in an Audit of Cost Statements" states characteristics of fraud as under:

"Misstatements in the cost statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement is intentional or unintentional. Although fraud is a broad legal concept, for the purposes of the Cost Auditing Standards, the cost auditor is concerned with fraud that causes a material misstatement in the cost statements. Two types of intentional misstatements are relevant to the cost auditor viz. misstatements resulting from fraudulent cost or revenue reporting; and misstatements resulting from misappropriation of assets. Although the cost auditor may suspect or, in rare cases, identify the occurrence of fraud, the cost auditor does not make legal determinations of whether fraud has actually occurred."

Areas of Misstatements in Cost Statements, either due to error or fraud

4.12 There is no literature that has given an exhaustive list of areas of misstatements in cost records and cost statements, arising either due to error or fraud. However, for the benefit of cost auditors, a tentative list of such areas is given below.

-

- Understatement or overstatement of installed capacities
- Misstatement in measurement, classification, allocation, apportionment and absorption of costs
- Misstatement of costs with a view to claim higher subsidies or evade taxes or due to error
- Over-valuation or under-valuation of inventory either due to error or with a view to manipulate profits and taxes
- Wrong consumption of raw materials, utilities and other inputs resulting in misstatement in cost of production
- Misstatement in production and sales records to evade taxes
- Wrongful recognition of revenues
- Wrong classification of joint-products or by-products
- Significant variations in physical inventories vis-a-vis stock statements
- Non or wrong recognition of idle capacities, idle facilities, idle manpower, etc.
- Overstatement or understatement of scrap, defectives, wastages, spoilage, etc.
- Non-recognition of cases of thefts, pilferage, etc., if any
- Recognition of abnormal costs as normal costs or vice versa
- Recognition of non-cost items as costs or vice versa
- Inappropriate traceability of costs to particular cost objects
- Misstatement in arm's length price in relation to transactions with related parties
- Wrong certification of stocks lying with third parties
- Over or under invoicing of purchases or sales
- Recognition of fake bills of purchases of goods and services
- Recognition of costs not actually incurred
- Treatment of capital as revenue or vice-versa
- Booking of fake manpower costs not actually engaged
- Wrongful recognition of group companies' costs or assets
- Recognition of dead or unserviceable stocks as 'good' inventories or vice versa
- Recognition of third party stocks as own stocks or vice versa
- Non-booking of costs already accrued
- Mistatement in quantities and values showing material mismatch with cost estimates

- Treatment of self-manufactured materials, components, sub-assemblies, tools, etc. as purchases
- Valuation of international transactions at wrong forex rates
- Wrongful recognition of subsidies, grants, incentives, etc.
- Recognition of imputed costs
- Recognition of defectives production as good ones or vice versa
- Recognition of semi-finished goods as finished goods or vice versa
- Under or overstating life of assets [or additions to or deletion of assets] resulting in over or undercharging of depreciation or amortization

4.13 The cost auditor is not required to restrict the audit procedures only to the areas listed above. He should draw his own audit procedure keeping in view the,

- nature of industry;
- scale/size or complexity of operations;
- applicable regulatory framework;
- applicable cost reporting framework;
- consistency in accounting policies and cost accounting policies;
- adequacy & effectiveness of internal control systems;
- performance of statutory and internal auditors;
- relationship of those charged with governance with management;
- level of transactions with related parties;
- level of transactions with governmental agencies;
- level of disputes with government authorities;
- complexity of value chain;
- effect of globalization;
- risk management structure/system;
- whistleblower policy; and
- past behaviour of the company.

When does a Cost Auditor commence Reporting under Section 143(12) – Based on Speculation - Suspicion - Reason to Believe – Knowledge - or on Determination of Offence?

4.14 Section 143(12) states that a cost auditor should report if he has “reasons to believe” that an offence involving fraud has or is being committed against the company by its officers or employees. Rule 13 of the Companies (Audit and Auditors) Rules, 2014 specifies, in case the auditor has “sufficient reason to believe” and further specifies reporting to the Central Government immediately but not later than sixty days of his “knowledge”. Form ADT-4 in which the cost auditor is required to report to the Central Government uses the term “suspected offence involving fraud”.

4.15 It is important to understand the terms “reason to believe”, “sufficient reason to believe”, “knowledge” and “suspected offence involving fraud” to determine the point of time when the reporting requirement is triggered for a cost auditor under Section 143(12) read with Rule 13 of the Companies (Audit and Auditors) Rules, 2014.

‘Speculation’ refers to information from unrelated source that is a rumour, hearsay, gossip, assumption, guess, thought, or supposition. At this stage, the cost auditor may have to perform engagement risk assessment procedures to determine if there is any merit in the speculation and whether or not to accept or continue with the engagement and the level of staffing that will be required to address any fraud risk factors identified from the above.

‘Suspicion’ is a state of mind more definite than speculation, but falls short of knowledge based on evidence. It must be based on some evidence, even if that evidence is tentative – simple speculation that a person may be engaged in fraud is not sufficient grounds to form a suspicion. Suspicion is a slight opinion but without sufficient evidence. In other words, a “suspicion” will lead to identification of fraud risk factors during the course of cost audit. At this stage, the cost auditor will have to identify the information leading to “suspicion” as “fraud risk factor” and design appropriate cost audit procedures to address this assessed risk of misstatement due to fraud.

‘Reason to believe’ indicates that the matter should be more than just a suspicion. For ‘reason to believe’ to come into existence, it cannot be based on suspicion. ‘Suspicion’ when corroborated with supporting evidence can provide ‘reason to believe’. At this stage the cost auditor is required to perform planned procedures to address the assessed risk of misstatement due to fraud. Certain evidences, which he obtained and evaluated during this process, indicate that there is a “reason to believe” that an offence involving fraud has been or is being committed. The cost auditor would now be required to carry out procedures with a higher level of professional scepticism with a view to obtain more persuasive evidence to enable him to conclude whether he has “sufficient reason to believe” or has “knowledge” of fraud.

4.16 There needs to be sufficient information or convincing evidence to advance beyond suspicion that it is possible someone is committing or has committed a fraud. For example, identification of fraud risk factors in itself cannot cause ‘reason to believe’ that a fraud exists. A cost auditor might be considered to have reasons to believe that a fraud has been or is being committed if he had actual knowledge of, or possessed information that would indicate to a reasonable person, that another person was committing or had committed a fraud. It arises when evaluating audit evidence and information provided; or evaluating misstatements, including deviations noted on audit sampling and further audit procedures carried out; or exercising professional scepticism.

4.17 Rule 13 of the Companies (Audit and Auditors) Rules, 2014 has used the terms ‘sufficient reason to believe’ and ‘knowledge’ (of fraud). **“Sufficient reason to believe”** indicates “reason to believe” with more persuasive evidence based on further procedures performed by the cost auditor. The condition of ‘sufficient reason to believe’ would be met if on evaluation of all the available information with the cost auditor and after applying appropriate level of professional scepticism, the cost auditor concludes that a fraud is being or has been committed on the company. Having ‘knowledge’ means knowing ‘that’ something. In the case of reporting on fraud under Section 143(12), it occurs when the cost auditor has sufficient reason to believe that a fraud has been or is being committed on the company by its officers or employees. This implies that there exists a fraud.

4.18 Whilst Section 143(12) uses the term ‘offence involving fraud’, Form ADT-4 uses the term “suspected offence involving fraud”. Although the cost auditor may suspect or, in rare cases, identify the occurrence of fraud, the cost auditor does not make legal determinations of whether fraud has actually occurred. Determination of **“offence”** is legal determination and accordingly, the auditor will not be able to determine whether under legal parlance an “offence or suspected offence involving fraud” has been or is being committed against the company by its officers or employees,

4.19 Accordingly, based on a harmonious reading of section 143(12), Rule 13 of the Companies (Audit and Auditors) Rules, 2014 and Form ADT-4, reporting on fraud in the course of performance of duties as a cost auditor, would be applicable only when the cost auditor has sufficient reason to believe and has knowledge that a fraud has occurred or is occurring i.e., when the cost auditor has evidence that a fraud exists.

Audit procedures if the Cost Auditor has Reasons to Believe a Fraud has occurred or is being carried out

4.20 As discussed in the earlier sections of this Guidance Note, section 143(12) of the Companies Act, 2013 requires the cost auditor to report to the Central Government if he has **“reasons to believe”** that an offence involving fraud is being or has been committed against the company by officers or employees of the company. Clearly, section 143(12) does not envisage reporting in Form ADT-4 by the cost auditor during the “speculation” and “suspicion” stages.

4.21 Examples of cost audit procedures, which the cost auditor can perform when he has “reason to believe” that an offence involving fraud is being or has been committed are given below:

- a) Evaluating the evidences obtained or misstatements identified with professional scepticism.
- b) Introducing elements of unpredictability/surprise in carrying out specific audit procedures (for example, visiting certain production locations normally not

visited at year-end to evaluate if there are any “fictitious” consumption transactions).

- c) If considered necessary, recommending to the Board or Audit Committee to involve experts such as information technology specialists, forensic experts or, etc., to carry out data analytics and investigation.
- d) Seeking additional cost audit evidence from sources outside of the entity being audited. For example, external confirmations which could be tailored to specific circumstances such as, confirming the stocks lying with third parties, terms and conditions relating to purchase/sale, confirming the occurrence of specific transactions, etc.
- e) Focused testing on periodical or year-end consumption & valuation records by a senior member of the cost audit engagement team.
- f) Carrying out a more critical evaluation and retrospective testing of cost estimates to evaluate the reasonableness of management’s judgment and existence of management bias.
- g) Consulting with experts to evaluate complex operations.
- h) Where related party transactions are involved, critically evaluating the business rationale of the transactions and arm’s length nature of such transactions.
- i) Re-performing certain critical reconciliations carried out by the entity.

Working with the Board or the Audit Committee in case the cost auditor has Reasons to Believe a Fraud may Exist

4.22 There could be circumstances where the cost auditor identifies misstatements in cost statements where a fraud or a significant risk factor was identified by him and therefore has reason to believe that a fraud may exist. However, the cost auditor may not have sufficient reason to believe that a fraud actually exists. In such case, the cost auditor may communicate such misstatements to the management and request them to carry out additional reviews to ensure that there are no other undetected misstatements.

4.23 The cost auditor may perform parallel procedures or work with the management to identify any other misstatement due to fraud within those cost statements that may have remained undetected.

4.24 The outcome of such audit procedures will help the cost auditor conclude whether he has sufficient reason to believe or not, that the suspected offence involving fraud has been or is being committed.

4.25 It may be noted that the above procedures represent enhanced audit procedures which the cost auditor carries out in the course of his cost audit with professional scepticism with the primary objective to ensure that the cost statements are not materially misstated due to fraud. The objective of the cost auditor is to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses.

4.26 Further, although the cost auditor may suspect or, in rare cases, identify the occurrence of fraud, the cost auditor does not make legal determination of whether fraud has actually occurred. Therefore, a cost auditor cannot make an assertion that an 'offence' involving fraud has been or is being committed against the company.

Reporting to the Board or Audit Committee on Cost Auditor's Sufficient Reason to Believe and Knowledge of Fraud against the Company by Officers or Employees of the Company

4.27 Rule 13 of the Companies (Audit and Auditors) Rules, 2014 requires the cost auditor to forward his report to the Board or the Audit Committee, as the case may be, immediately after he comes to (or have) knowledge of the suspected offence involving fraud, seeking their reply or observations within forty-five days. The Rule does not prescribe the form or format in which the cost auditor should communicate to the Board or the Audit Committee.

4.28 Therefore, the cost auditor may use Form ADT-4 itself for reporting to the Board or Audit Committee after duly filling in the necessary details. The cost auditor may send additional details of the basis on which the fraud is suspected, the period to which it relates to and the basis of estimating the amounts involved, to enable the Board or Audit Committee to pursue the matter further.

4.29 It may be noted that the timeline for reporting under section 143(12) starts immediately as soon as the cost auditor has sufficient reason to believe and knowledge of fraud. The cost auditor is not required to investigate the fraud so as to establish the entire magnitude, the period, the modus operandi and the persons involved since section 143(12) read with Rule 13 of the Companies (Audit and Auditors) Rules, 2014 do not require the cost auditor to perform a forensic audit.

Obtaining Response from the Board or Audit Committee

4.30 When a fraud has been reported by the cost auditor to the Board or Audit Committee, it will be the responsibility of the Board or Audit Committee to have appropriate procedures performed to evaluate the matter where necessary and take appropriate action on the matter.

4.31 The action taken by the Board or Audit Committee pursuant to receipt of communication from the cost auditor may involve an investigation or forensic audit

conducted either by their internal auditors, or internal team of senior management, or appropriate internal specialists, or the external specialists/experts.

4.32 An investigation will include a planning stage, a period when evidence is gathered, a review process, and a report to the client. The purpose of the investigation, in the case of an alleged fraud, would be to discover, if a fraud had actually taken place, to identify those involved, to quantify the monetary amount of the fraud (i.e., the financial loss suffered by the client), and to ultimately present findings to the client and potentially to court. It is normally not as in-depth as a forensic audit and in fact may not be performed by forensic auditors.

4.33 Based on the steps taken, including any investigation/forensic audit on the matter reported, they are required reply to the cost auditor within specified period from the date of the cost auditor's communication.

4.34 Rule 13 of the Companies (Audit and Auditors) Rules, 2014, does not state what should be the contents of the reply of the Board or Audit Committee in case a report on a suspected offence involving fraud is received by them from the cost auditor. However, it would be reasonable to presume that the reply of the Board or Audit Committee will include,

- a) an acknowledgement of having received the report on fraud from the cost auditor; brief description of the fraud or suspected fraud; and the steps taken by them pursuant to receipt of the report, including:
 - a. the manner in which they have followed up on the matter reported to them;
 - b. involvement of specialists, internal and/or external, who have carried out investigation/forensic audit on their behalf;
 - c. the period covered by such investigation/forensic audit;
 - d. their assessment of areas impacted by the fraud; and
 - e. the conclusion drawn by them based on such investigation/forensic audit.
- b) Whether the Board or Audit Committee is in agreement with the cost auditor's conclusion on fraud - the cause of the fraud, persons involved, estimate of amounts involved, the period to which the fraud relates to, steps taken by them to remediate the reasons which caused the occurrence of the fraud, including changes to the internal control systems or plans thereto, the action taken on the persons involved in the fraud (including filing of civil/criminal complaints with law enforcement agencies, disciplinary actions, etc.), and the status of reporting the matter to any other regulator (e.g. RBI, Tax authorities, etc.).

- c) If the investigation/forensic audit ordered by them is in progress as on the date of the reply - the status of the investigation, the persons allegedly involved in the fraud, any preliminary amounts quantified on the fraud, steps taken in the interim including any action taken on the persons allegedly involved in the fraud (including filing of civil/criminal complaints with law enforcement agencies, disciplinary actions, etc.), the status of reporting the matter to any other regulator (e.g. RBI, Tax authorities, etc.), remediation plan to prevent further occurrences, etc.
- d) A copy of the investigation/forensic audit report (preliminary/draft/final) or the procedures performed/being performed by them to substantiate the items stated above.
- e) There may be instances where the Board or the Audit Committee does not concur with the cost auditor's belief that a suspected offence involving fraud is being or has been committed. If the Board or Audit Committee is not in agreement with the cost auditor's belief that a suspected offence involving fraud has been or is being committed, the persuasive reasons therefore with supporting evidence should be provided in their reply to the cost auditor along with the other matters.

Evaluating Reply of the Board or Audit Committee

4.35 The cost auditor should evaluate the reply of the Board or Audit Committee received by him in response to his report to them on the suspected offence involving fraud. Such evaluation is required to enable the cost auditor to state if he is satisfied with the reply of the Board or Audit Committee on the matter reported to them.

4.36 Sub-Rule (1)(ii) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014 requires the cost auditor to forward his report along with his comments on the reply received from the Board or the Audit Committee. Form ADT-4 requires the cost auditor to state if he is satisfied or not satisfied with the reply of the Board or the Audit Committee. Accordingly, the cost auditor should review the reply from the Board or the Audit Committee with the supporting evidence provided to determine the reasonability of the same.

4.37 Where the Board or the Audit Committee has provided its reply on the basis of an investigation/forensic audit, the cost auditor is not expected to re-perform or carry out an independent investigation to validate the same. The cost auditor should, however, review the process followed by the investigation/forensic audit to gain comfort on:

- the scope of the investigation,
- the period covered,

- the persons covered,
- information gathered/obtained,
- specific scope exclusions or limitations, if any, in the investigation/forensic audit,
- the reasonableness of the amounts identified as involved based on his professional judgement and his understanding of the suspected offence involving fraud, and
- the competence, experience and seniority of the persons who conducted the investigation/forensic audit and their independence and objectivity.

4.38 If the Board or the Audit Committee disagrees with the belief of the cost auditor that a suspected offence involving fraud exists and provides evidence in this regard, the cost auditor would consider such evidence and perform such further cost audit procedures as may be necessary to determine if his initial belief was appropriate under the circumstances. In addition to reviewing the matters stated in paragraph above with increased professional scepticism, the following additional factors should also be considered by the cost auditor:

- Whether the evidence provided in the reply was available when the cost auditor initially concluded that there was a fraud or is it new evidence;
- Evaluate reasons why the company has considered the same evidence or information, already used by the cost auditor, differently;
- Reliability of the evidence now provided considering the risk of bias to overlook a fraud that is existing; and
- The persuasiveness of the company's evidence or information that the suspected offence involving fraud does not exist, that is included in the company's reply.

4.39 Based on the additional audit procedures carried out by the cost auditor after considering the factors stated in paragraph above, pursuant to the reply of the company disagreeing with the initial belief of the cost auditor that a suspected offence involving fraud is being or has been committed, if the cost auditor is convinced that his initial suspicion was incorrect, the need for reporting the matter to the Central Government would not be applicable. This situation would arise only if the cost auditor did not have the evidence or information that is now provided as part of the reply or additional information has now been provided to the cost auditor and there is persuasive evidence now available to convince the cost auditor that the suspected offence involving fraud does not exist.

Cost Auditor to apply the Concept of Materiality for reporting of Fraud

4.40 The Companies (Amendments) Bill, 2014 that has been approved by the Parliament and received the President assent, has amended certain provisions of the Companies Act, 2013 including an amendment to the provisions relating to auditor reporting on frauds. As per this amendment, in case of a fraud involving lesser than a 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. Accordingly, only those frauds, where the amount exceeds the specified amount, shall be reported to the Central Government. However, frauds that are reported by the cost auditors only to the Audit Committee or the Board of Directors where the amounts involved are less than the threshold that may be specified by the Ministry of Corporate Affairs, the details of such fraud will need to be disclosed in the report presented before Board of Director's or Audit Committee in such manner as may be prescribed.

4.41 The concept of materiality is fundamental for setting up an appropriate system of internal control, preparation of cost statements and its audit. Due to its inherent limitations, internal control systems cannot provide absolute assurance that no fraud or error has taken place. Since the cost auditor is required to comply with the Cost Auditing Standard in performance of duties as an auditor, the cost audit will be performed applying the concept of materiality provided in the Cost Auditing Standards. However, where the concept is not defined in the Cost Auditing Standards, the cost auditor shall perform his duties in accordance with the generally accepted guidelines on audit.

4.42 Section 148(3) requires the cost auditor to comply with the Cost Auditing Standards, which, *inter alia*, includes consideration of materiality, applying materiality in evaluating misstatements and disposition of the same. The cost auditor shall perform the procedure outline in case a misstatement due to Fraud is identified by him.

4.43 Materiality is applicable wherever the amount is quantifiable. Also aggregation is required for each fraud separately to compare with the threshold to be specified by the Ministry of Corporate Affairs. Where the amount is not quantifiable, the cost auditor should apply professional judgement to estimate the likelihood of the amount exceeding the aforesaid threshold. For this purpose, it can be based on management estimate or reasonable range of estimate made by the cost auditor. Subsequent reporting may be required if the amount initially estimated was lower than the aforesaid threshold but was eventually determined to be higher than such threshold. Under these circumstances, the timeline for reporting under Rule 13 of the Companies (Audit and Auditors) Rules, 2014 will commence when the amount involved is determined to be in excess of such threshold.

CHAPTER – 5

Legal Requirement on reporting on Fraud

Reporting on suspected offences involving fraud identified while performing duties as Cost Auditor for only one or more Units or Products or Services

5.1 Section 143(12) deals with auditor's duties and responsibilities in respect of reporting an offence involving fraud if *in the course of the performance of his duties as auditor*, he 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. Provisions of section 143(12) when read with section 143(14), apply to the

- a) Statutory auditor conducting audit under section 139
- b) Cost Accountant in practice conducting cost audit under section 148
- c) Company Secretary in practice conducting secretarial audit under section 204

5.2 It may be noted that for the purposes of applicability of provisions of section 143(12) read with section 143(14), the following shall also be covered under the duties and responsibilities of an 'auditor' to report suspected offences involving fraud:

- a) Branch Auditors appointed under section 139 read with section 143(8);
- b) Cost Auditors appointed under section 148(3) to conduct audit of any one or more units or products or services of the company; and
- c) Lead Cost Auditor appointed by the Board to consolidate cost statements audited by all the cost auditors.

5.3 Accordingly, while performing of his duties as cost auditor only for the specified units or products or services, if he/she has identified/noted an offence involving fraud against the company by its officers or employees that is of such amount that may be considered to be material to the cost statements of the company prepared under the Companies Act, 2013 or if the cost auditor uses or intends to use the information that is obtained in the course of performing such audit services under the 2013 Act, then in such cases, the matter may become reportable under Section 143(12). This would require exercise of professional judgement for the purposes of evaluating if the amount involved will be material to the cost statements to be prepared under the 2013 Act. If the cost auditor considers that the amount involved will be material to the cost statements to be prepared under the 2013 Act, the cost auditor should report the offence involving such fraud to the Central Government as per the requirements of Section 143(12) read with Rule 13 of the Companies (Audit and Auditors) Rules, 2014.

Reporting on suspected offences involving fraud identified while performing other Attest Services

5.4 Section 143(12) deals with auditor's duties and responsibilities in respect of reporting an offence involving fraud if ***in the course of the performance of his duties as auditor***, he 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.

5.5 Normally, practicing cost accountants provide many attest services to the companies. Examples are, valuation certification as per CAS-4 for determining excise duty on the goods used for captive consumption; internal audit; financial audit in cooperative sector; compliance audit of Reserve Bank of India for the purpose of lending under Consortium Arrangement/ Multiple Banking Arrangements; VAT audit under various State Value Added Tax Acts/Rules; stock audit for Banks; central excise audit (special audit u/s 14A & 14AA of Central Excise Act, 1944); concurrent audit, special audit of service tax u/s 72 A etc. In many cases, such services may be performed by the cost auditors of the company. The cost auditor may also be engaged by the Board of Directors of the company to carry out cost audit of periodical cost statements prepared by the management.

5.6 In case the aforesaid attest services are rendered for the financial years beginning on or after 1st April, 2014, the following needs to be considered:

- Such attest services may not be pursuant to any requirement of the Companies Act, 2013. They may rather be prepared to meet the specific requirements of the company (such as complying with the Central Excise Rules).
- Wherever a statute or regulation requires such attest services to be performed by the cost auditor of the company, the cost auditor should consider the requirements and provisions of Section 143(12) since any such work carried out by the cost auditor during such attest services could be construed as being in the course of performing his duties as cost auditor, albeit not under the Companies Act, 2013.
- The objective and scope of such attest services and the procedures performed by the cost auditor may not be of the same extent and level as in the case of the audit of cost statements prepared under the Companies Act, 2013. For example, the audit of cost statement for determining the assessable goods used for captive consumption under central excise rules may be subject to a specific review performed in accordance with the Cost Accounting Standards on Captive Consumption. Hence, may not have been performed in accordance with the Cost Auditing Standards.

5.7 If an offence involving fraud against the company by its officers or employees that is identified/noted by the cost auditor in the course of providing such attest services as referred above, is of such amount that may be considered to be material to the cost statements of the company prepared under the Companies Act, 2013 [apply with Concept of materiality specified above] or if the cost auditor uses or intends to use

the information that is obtained in the course of performing such attest services when performing the cost audit under the 2013 Act, then in such cases, the matter may become reportable under Section 143(12). This would require exercise of professional judgement for the purposes of evaluating if the amount involved will be material to the cost statements to be prepared under the 2013 Act. If the cost auditor considers that the amount involved will be material to the cost statements to be prepared under the 2013 Act, the cost auditor should report the offence involving such fraud to the Central Government as per the requirements of Section 143(12) read with Rule 13 of the Companies (Audit and Auditors) Rules, 2014.

Reporting on suspected offences involving fraud identified while performing permitted Non-Attest Services

5.8 Cost Auditor could be engaged to provide non-attest services that are not prohibited under Section 144 of the Act. It is possible that the cost auditor, when providing such non-attest services may become aware of a fraud that is being or has been committed against the company by its officers or employees. It may be noted that reporting under Section 143(12) arises only if a cost 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. If the cost auditor considers that the amount involved will be material to the cost statements prepared under the Companies (Cost Records and Audit) Rules 2014, the cost auditor should report the offence involving such fraud to the Central Government as per the requirements of section 143(12) read with Rule 13 of the Companies (Audit and Auditors) Rules, 2014.

Reporting on Frauds detected by the Management or Other Persons and already Reported under Section 143(12) by Such Other Person

5.9 The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. In the context of the Companies Act, 2013, this position is reiterated in section 134(5) which states that the Board report shall include a responsibility statement, *inter alia*, that the directors had taken proper and sufficient care for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities.

5.10 Based on the above, it may be considered that section 143(12) envisages the cost auditor to report to the management and thereafter the Central Government an offence involving fraud/suspected fraud against the company by its officers or employees only if he is the first person to identify/note such instance in the course of performance of his duties as a cost auditor. If not, then he should mention this fact as a "note" in his audit report.

5.11 The cost auditor, in the course of the performance of his duties as an auditor, is required to make inquiries with the management and the Board or Audit Committee

about reported or identified/detected instances of fraud through any other internal or external sources and, consequently, the cost auditor may become aware of those frauds which have been/are being remediated/dealt with by them. Though the cost auditor becomes aware of such frauds when he/she is informed of the same by the management, he/she, *per se*, has not identified them on his/her own and is, therefore, not the first person to identify the fraud in those cases.

5.12 Accordingly, in case a fraud has already been reported or has been identified/detected by the management or through the company's vigil/whistle blower mechanism and has been/is being remediated/dealt with by them and such case is informed to the cost auditor, the latter will not be required to report the same under Section 143(12) since he has not *per se* identified the fraud. However, he should mention this fact as a "note" in his audit report.

5.13 The cost auditor should apply professional scepticism to evaluate/verify that the fraud was indeed identified/detected in all aspects by the management or through the company's vigil/whistle blower mechanism so that distinction can be clearly made with respect to frauds identified/detected due to matters raised by the cost auditor vis-à-vis those identified/detected by the company through its internal control mechanisms.

5.14 For example, in a fraud involving discrepancies & theft of inventories, if the company identified the fraud and its nature and cause through its internal control mechanism but did not identify all the inventory items involved in the fraud that were identified by the cost auditor, it may need to be considered that the fraud was not identified in all aspects by the management and the cost auditor may need to report the same under Section 143(12) of the Companies Act, 2013. This would require the cost auditor to exercise professional judgement in evaluating if the amount involved will be material to the cost statements to be prepared under the 2013 Act (Refer Concept of Materiality mentioned above). If the cost auditor considers that the amount involved will be material to the cost statements to be prepared under the 2013 Act, the cost auditor should report the offence involving such fraud to the Central Government as per the requirements of Section 143(12) read with Rule 13 of the Companies (Audit and Auditors) Rules, 2014,.

5.15 Since reporting on fraud under Section 143(12) is required even by the financial (statutory) auditor and also the secretarial auditor of the company, it is possible that a suspected offence involving fraud may have been reported by them even before the cost auditor became aware of the fraud. Here too, if a suspected offence involving fraud has already been reported under Section 143(12) by such other person, and the cost auditor becomes aware of such suspected offence involving fraud, he need not report the same to the Central Government under the section since he has not *per se* identified the suspected offence involving fraud.

5.16 However, the cost auditor should review the steps taken by the management/those charged with governance with respect to the reported instance of

suspected offence involving fraud stated above, and if he is not satisfied with such steps, he should state the reasons for his dissatisfaction in writing and request the management/those charged with governance to perform additional procedures to enable the cost auditor to satisfy himself that the matter has been appropriately addressed. If the management/those charged with governance fail to undertake appropriate additional procedures within 45 days of his request, the cost auditor would need to evaluate if he should report the matter to the Central Government in accordance with Rule 13 of the Companies (Audit and Auditors) Rules, 2014.

Should the Cost Auditor Report under Section 143(12) in case of Corruption, Bribery, Money Laundering and Noncompliance with Other Laws and Regulations

5.17 In case of corruption, bribery and money laundering, the direct effect of such act (benefit or penal consequence) is on the company. The cost auditor should comply with the relevant provision with regard to illegal acts, when performing the cost audit. If the cost auditor, in the course of performance of his/her duties as the cost auditor, comes across instances of corruption, bribery and money laundering and other intentional non-compliances with laws and regulations, the auditor would need to evaluate the impact of the same to determine whether the same would have a material effect on the cost statements.

5.18 With respect to reporting under Section 143(12), consequent to corruption, bribery, money laundering and other intentional non-compliance with other laws and regulations, the cost auditor should consider, for the purpose of reporting, whether such acts have been carried out by officers or employees of the company for the purpose of reporting.

5.19 For example, if the cost auditor comes to know that the company has filed a fraudulent return of Central Excise to evade excise duty, he may have to report this fraud under Section 143(12) irrespective of whether adequate provision has been made in the books of accounts or not.

Reporting when fraud relates to the periods prior to the enactment of the Companies Act, 2013

5.20 Under the following situations, a cost auditor would report on fraud relating to earlier years under the provisions of section 143 (12) of the Companies Act, 2013 read with Rule 13 of the Companies (Audit and Auditors) Rules, 2014:

- The suspected offence involving fraud is identified by the cost auditor in the course of performing his duties as cost auditor for any previous financial year(s) [prior to the financial year beginning on or after April 1, 2014] provided that the audit is being [or has been] performed after the enactment of the Companies Act, 2013; or

- The suspected offence involving fraud is identified by the cost auditor in the course of performance of his duties as cost auditor for the financial year(s) beginning on or after April 1, 2014 and the same was not dealt with in the prior cost statements or in the audit report or in the Board's report under the Companies Act, 1956.

ANNEXURE

Section 143 of the Companies Act, 2013**Powers and duties of auditors and auditing standards.**

143. (1) Every auditor of a company shall have a right of access at all times to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place and shall be entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor and amongst other matters inquire into the following matters, namely:—

(a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;

(b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;

(c) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;

(d) whether loans and advances made by the company have been shown as deposits;

(e) whether personal expenses have been charged to revenue account;

(f) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading:

Provided that the auditor of a company which is a holding company shall also have the right of access to the records of all its subsidiaries insofar as it relates to the consolidation of its financial statements with that of its subsidiaries.

(2) The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statement which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made there under or under any order made under sub-section (11) and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

(3) The auditor's report shall also state—

(a) whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;

(b) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;

(c) whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company's auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;

(d) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;

(e) whether, in his opinion, the financial statements comply with the accounting standards;

(f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;

(g) whether any director is disqualified from being appointed as a director under sub-section (2) of section 164;

(h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;

(i) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;

(j) such other matters as may be prescribed.

(4) Where any of the matters required to be included in the audit report under this section is answered in the negative or with a qualification, the report shall state the reasons therefor.

(5) In the case of a Government company, the Comptroller and Auditor-General of India shall appoint the auditor under sub-section (5) or sub-section (7) of section 139 and direct such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

(6) The Comptroller and Auditor-General of India shall within sixty days from the date of receipt of the audit report under sub-section (5) have a right to,—

(a) conduct a supplementary audit of the financial statement of the company by such person or persons as he may authorise in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and

(b) comment upon or supplement such audit report:

Provided that any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

(7) Without prejudice to the provisions of this Chapter, the Comptroller and Auditor-General of India may, in case of any company covered under sub-section (5) or sub-section (7) of section 139, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971 (56 of 1971), shall apply to the report of such test audit.

(8) Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139, or where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country and the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be such as may be prescribed:

Provided that the branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.

(9) Every auditor shall comply with the auditing standards.

(10) The Central Government may prescribe the standards of auditing or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949 (38 of 1949), in consultation with and after examination of the recommendations made by the National Financial Reporting Authority:

Provided that until any auditing standards are notified, any standard or standards of auditing specified by the Institute of Chartered Accountants of India shall be deemed to be the auditing standards.

(11) The Central Government may, in consultation with the National Financial Reporting Authority, by general or special order, direct, in respect of such class or description of companies, as may be specified in the order, that the auditor's report shall also include a statement on such matters as may be specified therein.

(12)² Notwithstanding anything contained in this section, 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.

(13) No duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred to in sub-section (12) if it is done in good faith.

(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.

(15) If any auditor, cost accountant or company secretary in practice do not comply with the provisions of sub-section (12), he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.

²Substituted by the Companies (Amendments) Act, 2015 with effect from a date yet to be notified.

“(12) Notwithstanding anything contained in this section, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed:

Provided 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:

Provided further that the companies, whose auditors have reported frauds under this sub-section 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 in such manner as may be prescribed.”

Section 148 of the Companies Act, 2013**Central Government to specify audit of items of cost in respect of certain companies.**

(1) Notwithstanding anything contained in this Chapter, the Central Government may, by order, in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept by that class of companies:

Provided that the Central Government shall, before issuing such order in respect of any class of companies regulated under a special Act, consult the regulatory body constituted or established under such special Act.

(2) If the Central Government is of the opinion, that it is necessary to do so, it may, by order, direct that the audit of cost records of class of companies, which are covered under sub-section (1) and which have a net worth of such amount as may be prescribed or a turnover of such amount as may be prescribed, shall be conducted in the manner specified in the order.

(3) The audit under sub-section (2) shall be conducted by a Cost Accountant in practice who shall be appointed by the Board on such remuneration as may be determined by the members in such manner as may be prescribed:

Provided that no person appointed under section 139 as an auditor of the company shall be appointed for conducting the audit of cost records:

Provided further that the auditor conducting the cost audit shall comply with the cost auditing standards.

Explanation.—For the purposes of this sub-section, the expression “cost auditing standards” mean such standards as are issued by the Institute of Cost and Works Accountants of India, constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government.

(4) An audit conducted under this section shall be in addition to the audit conducted under section 143.

(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 and it shall be the duty of the company to give all assistance and facilities to the cost auditor appointed under this section for auditing the cost records of the company:

Provided that the report on the audit of cost records shall be submitted by the cost accountant in practice to the Board of Directors of the company.

(6) A company shall within thirty days from the date of receipt of a copy of the cost audit report prepared in pursuance of a direction under sub-section (2) furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein.

(7) If, after considering the cost audit report referred to under this section and the information and explanation furnished by the company under sub-section (6), the Central Government is of the opinion that any further information or explanation is necessary, it may call for such further information and explanation and the company shall furnish the same within such time as may be specified by that Government.

(8) If any default is made in complying with the provisions of this section,—

(a) the company and every officer of the company who is in default shall be punishable in the manner as provided in sub-section (1) of section 147;

(b) the cost auditor of the company who is in default shall be punishable in the manner as provided in sub-sections (2) to (4) of section 147.

<p style="text-align: center;">Form No. ADT-4 Report to the Central Government (See rule 13(4) of the Companies (Audit and Auditors) Rules, 2014)</p> <p>Date:</p> <p>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.</p>
<p>1) (a) Name of the Company</p> <p>(b) CIN:</p> <p>(c) Address of the Registered Office:</p> <p>2) (a) Name of the auditor or auditor's Firm</p> <p>(b) Membership Number</p> <p>(c) Address</p> <p>3) Date of the annual general meeting when the Auditor was appointed or reappointed</p> <p>4) SRN and date of filing</p> <p>5) Address of the office or location where the suspected offence is believed to have been or is being committed</p> <p>6) Full details of the suspected offence involving fraud (attach documents in support)</p> <p>7) Particulars of the officers or employees who are suspected to be involved in the commission of the offence, if any:</p> <p>a) Name(s) :</p> <p>b) Designation</p> <p>c) If Director, his DIN</p> <p>d) PAN</p> <p>8) Basis on which fraud is suspected:</p> <p>9) Period during which the suspected fraud has occurred</p> <p>10) Date of sending report to the Board or Audit committee as per rule 13(1)</p> <p>11) Date of reply received from Board or Audit committee, if any and if so received,</p>

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.

Verification

I, _____ Proprietor/Partner of _____, Cost Accountants do hereby declare that the information furnished above is true, correct and complete in all respects including the attachments to this form.

(Name, Signature and Seal of the Cost Auditor)

Attachments:

1. Optional attachments

Note: The report on this form along with attachments thereto is to be given in a sealed cover to the Secretary, Ministry of Corporate Affairs in the manner provided in Rule 13.