



# Fraud Reporting

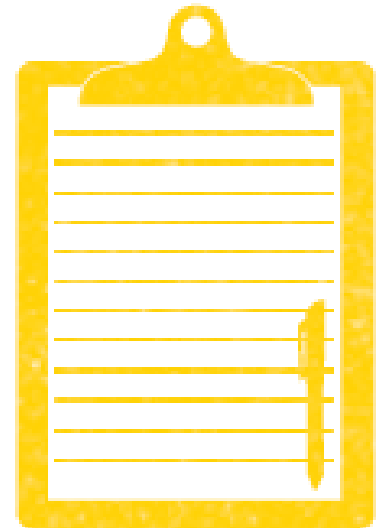
The Companies Act 2013: The dawn of a new era

A presentation by: **BHARAT K SHETTY**

# Companies Act 2013 – Fraud Reporting

## Agenda

- What is fraud?
- Punishment for Fraud under the 2013 Act
- Erstwhile Reporting Requirement of an auditor relating to fraud
- Reporting on fraud under the 2013 Act
- Clarifications provided by the GN on reporting on fraud u/s 143(12) of the 2013 Act
- A Quick recap
- View Checks



# Companies Act 2013 – Fraud Reporting



## What is fraud?

As per the Act- "fraud" in relation to affairs of a company or any body corporate, includes:

- a. any act;
- b. omission;
- c. concealment of any fact; or
- d. abuse of position committed by any person or any other person with connivance of another in any manner.-
  - i. with the intent to deceive,
  - ii. to gain undue advantage from, or
  - iii. to injure the interests of-
    - the company; or
    - its shareholders; or
    - its creditors' or
    - any other person,whether or not there is any wrongful gain or wrongful loss

# Companies Act 2013 – Fraud Reporting



## Punishment for fraud in the 2013 Act:

- A person found guilty of fraud-
  - punishable with **imprisonment** for a term between 6 m- 10 yrs; and
  - liable to **fine** at least for the amount involved in the fraud, extendable upto 3 times the amount involved
- The 2013 Act has provided punishment for fraud as provided u/s 447 in around 20 secs of the Act e.g. u/s 7(5), 7(6), 8(11), 34,36,38(1), 140 (5) etc. for directors, KMPs, auditors and/or officers of company
- Thus, the new Act goes beyond professional liability for fraud and extends to personal liability of the concerned person

# Companies Act 2013 – Fraud Reporting



## Erstwhile reporting requirements of an auditor relating to fraud

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

- Clause 4(xxi) of CARO requires the auditor to report if any fraud **on or by the co** has been **noticed or reported** during the yr. If yes, the nature and the amount involved to be indicated.
- this clause does not require the auditor to discover these frauds; however, the scope of auditor's inquiry under this clause is restricted to frauds 'noticed or reported' during the yr.
- The words "noticed or reported" indicates that the co's management should have the knowledge on these frauds that occurred during the period covered by the auditor's report.
- though fraud is a broad legal concept, the auditor is concerned with fraudulent acts that cause a material misstatement in the FS.
- Two types of intentional misstatements are relevant to the auditor's consideration of fraud:
  - misstatements resulting from fraudulent financial reporting; and
  - misstatements resulting from misappropriation of assets.

# Companies Act 2013 – Fraud Reporting



## Reporting on fraud under the 2013 Act

### Responsibility of the Directors and Management

- The Board Report shall state that the directors had taken due care for preventing and detecting fraud and other irregularities;
- IDs shall also report concerns about suspected fraud

### Responsibility of AC

- As per listing agreement, the AC is responsible for reviewing the findings of an internal auditor into suspected fraud or irregularity of a material nature and reporting to the board

### Clause 49

- Under the CEO/CFO certification, to mention to the auditors and the AC on **the instances of significant fraud** and those involved having a significant role in the company's IFC over financial reporting
- Listing agreement also makes the directors and the AC overly responsible for the fraud related matters

# Companies Act 2013 – Fraud Reporting



## Reporting on fraud under the 2013 Act

### Responsibility of the Auditor

- Auditors to report about the fraud to the CG if sufficient evidence, within 60 days
- Initial report to be given to Board/AC for their comments. Time limit for responses set at 45 days. Within 15 days of receipt of comments or expiry of 45 days (in case comments not received), report to be sent to the CG
- Reporting of fraud by the auditor shall also extend to concerned branch auditor
- Responsibility to report fraud applies equally to secretarial and cost auditors.

**Punishment for auditor** – In case auditor fails to report fraud to CG within 60 days

Auditor, cost accountant or company secretary shall be punishable with fine (Rs. one lakh- twenty-five lakh)

### Key take away points

- The term “Fraud” as defined under the 2013 Act is very wide and perhaps encompasses every act of omission or commission
- Further, there is no materiality limit set for reporting to the CG
- Reporting fraud by the officers or employees on the co is only required. However, the fraud committed by others on the co and frauds reported by the co on these or others is currently not required to be reported

# Companies Act 2013 – Fraud Reporting



## Clarifications provided by the GN on reporting on fraud, u/s 143(12) of the 2013 Act

### Persons covered for fraud reporting

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

### Persons not covered for fraud reporting

- other professionals, rendering other services to the co (e.g. tax auditor, sales tax or VAT auditors)
- internal auditors covered u/s 138

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



# Companies Act 2013 – Fraud Reporting



## Clarifications provided by the GN on reporting on fraud, issued by ICAI (Cont'd.)

### Auditor's responsibility for consideration of fraud

- Sec 143(12) requires an auditor to report on fraud if **in the course of performance of his duties as an auditor**, the auditor has reason to believe that an offence involving fraud is being or has been committed against the co by its officers or employees.
- The term, “**in the course of performance of his duties as an auditor**” implies in the course of performing an audit as per the SAs. The definition of fraud as per SA 240 and the explanation of fraud u/s 447 of the 2013 Act are similar, except that **u/s 447, fraud includes ‘acts with an intent to injure the interests of the co or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.’**
- However, an auditor may not be able to detect acts that have intent to injure the interests of the co or cause wrongful gain or wrongful loss, unless the financial effects of such acts are reflected in the books or FS of the co.
- Therefore, the requirements of the SAs would be considered, insofar as it relates to the risk of fraud, **including the definition of fraud as stated in SA 240** while performing his audit of FS to address the risk of material misstatements due to fraud.

# Companies Act 2013 – Fraud Reporting



## Clarifications provided by the GN on reporting on fraud u/s 143(12) of the 2013 Act (Cont'd.)

### Reporting on suspected offence involving frauds identified during audit/limited review etc.

- If a suspected offence involving fraud identified during limited review/audit of the quarterly financial results, tax Audit etc.;
  - is of such amount that may be considered to be material to the FS of the co prepared under the 2013 Act or;
  - if the auditor uses or intends to use the information that is obtained in the course of performing such attest or non -attest services when performing the audit under the 2013 Act, then in such cases, the matter may become reportable u/s 143(12).
- This would require exercise of professional judgment in evaluating if the amount involved **will be** material to the FS to be prepared under the 2013 Act.
- If the auditor considers that the amount involved will be material to the FS to be prepared under the 2013 Act, **the auditor should report the offence involving such fraud to the CG** as required by the 2013 Act

# Companies Act 2013 – Fraud Reporting



## Clarifications provided by the GN on reporting on fraud u/s 143(12) of the 2013 Act (Cont'd.)

### Reporting on frauds detected by the management or other persons and already reported u/s 143 (12) by such other person

- If the fraud is already reported or detected by the management/ co's vigil mechanism and has been/is being dealt with by them, then the auditor will not be required to report the same u/s 143 (12)
- The auditor should apply professional skepticism to verify that the fraud was indeed detected by the management etc.
- Distinction should be clearly made with respect to **frauds detected due to matters raised by the auditor** vis-à-vis those identified by the co through its internal control mechanism.
- However, the auditor should review the steps taken by the management w.r.t. such fraud, and if he is not satisfied, he should request the management to perform additional procedures to enable the auditor to satisfy himself that the matter has been appropriately addressed.

# Companies Act 2013 – Fraud Reporting



## Clarifications provided by the GN on reporting on fraud u/s 143(12) of the 2013 Act (Cont'd.)

### **Reporting by auditors u/s 143(12) if the fraud is required to be/has been reported under any other statute**

- For instance, in case of a fraud identified in a bank, the bank auditor should report the fraud to the RBI. If the bank is a co, then additionally the auditor may also report to the CG, if covered u/s143(12)

### **When does an auditor commence reporting u/s 143(12) – based on suspicion - reason to believe – knowledge – or on determination of offence?**

- per para 3 of SA 240, although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determination of whether fraud has actually occurred.
- On a harmonious reading of sec 143(12), Rule 13 of the Companies (Audit and Auditors) Rules, 2014 and Form ADT - 4, reporting on fraud is applicable only when the auditor has sufficient reason to believe and has knowledge that a fraud has occurred or is occurring i.e., when the auditor has evidence that a fraud exists.

# Companies Act 2013 – Fraud Reporting



## Clarifications provided by the GN on reporting on fraud u/s 143(12) of the 2013 Act (Cont'd.)

### **Concept of materiality for reporting on fraud**

- The auditor should continue to apply the concept of materiality in performing the audit as per SA 320, “Materiality in Planning and Performing an Audit”.

### **Reporting in case of corruption, bribery, money laundering and non-compliance with other Laws and Regulations**

- In case of corruption, bribery and money laundering, the direct effect of such act (benefit or penal consequence) is on the co.
- The auditor should comply with the relevant SAs with regard to illegal acts (e.g. SA 240 and SA 250, “Consideration of Laws and Regulations in an Audit of FS”) when performing the audit.
- If the auditor, in the course of performance of his duties, comes across these instances the auditor would need to evaluate the impact of the same in accordance with SA 250 to determine whether the same would have a material effect on the FS.
- The auditor should also consider these for the purpose of reporting u/s 143(12) as per SA 250

# Companies Act 2013 – Fraud Reporting



## Clarifications provided by the GN on reporting on fraud u/s 143(12) of the 2013 Act (Cont'd.)

### Reporting when the suspected frauds relates to prior periods

- if the fraud relating to earlier yrs (1956 Act applicable), reporting u/s 143(12) will be done only if the suspected offence involving fraud is identified by the auditor during the FYs beginning on or after 01 April 2014 and to the extent that the same was not dealt with in the prior FYs either in the FS or in the audit report or in the Board's report under the 1956 Act.

### Evaluation of impact on the FS, audit opinion on the FS and IFC

If a fraud has been reported u/s 143(12), the auditor will evaluate its implications on his audit opinion and on any other related matter u/s 143(1) to (3) including effectiveness of the IFC. Additionally, following will need to be considered by the auditor in this regard:

- When the auditor believes that the management is involved in the fraud, how the auditor **re-evaluated** the risks of material misstatement due to fraud and **reliability of the evidences previously obtained**.
- When the auditor confirms that, or is unable to conclude whether the FS are materially misstated due to fraud, how the auditor evaluated the implications for the audit (**audit finding disposal**).

# Companies Act 2013 – Fraud Reporting



## Clarifications provided by the GN on reporting on fraud u/s 143(12) of the 2013 Act (Cont'd.)

### Consideration of disclosure of frauds in the Board's Report

- SA 720 requires the auditor to read the other information in documents that contain audited FS because the credibility of the audited FS may be undermined by material inconsistencies between the audited FS and other information.
- Pursuant to the **proposed amendments** to sec 143(12), the auditor may be required to report frauds only to the AC or the BOD if the amounts involved are less than the thresholds that may be specified by the MCA.
- Such frauds may have been appropriately dealt with in the audited FS of the co However, **as per the proposed amendment**, the co should disclose details of such fraud in its Board's report.
- Since the BR also includes audited FS, the auditor should read the disclosures relating to fraud in the BR to determine if they are consistent with the matter reported by the auditor and dealt with in the audited FS.
- In case the auditor observes any material inconsistency in the disclosure in the BR in this regard, the auditor should consider the requirements of SA 720 to determine the manner of dealing with the inconsistency observed.

# Companies Act 2013 – Fraud Reporting



## Clarifications provided by the GN on reporting on fraud u/s 143(12) of the 2013 Act (Cont'd.)

### Responsibility of the management

- Primary responsibility to establish adequate internal control systems to prevent and detect frauds and errors is that of the management of the entity.
- In the case of a co, the BOD, in terms of the provisions of sec 134(5) of the 2013 Act, are required to, inter alia, state as a part of the directors' responsibility statement in the BR to the shareholders, that they had taken proper and sufficient care for safeguarding the assets of the co and for preventing and detecting fraud and other irregularities.
- In the case of a listed co, clause (e) of sub-sec 5 of sec 134 to the 2013 Act requires the directors' responsibility statement to also state that the directors, had laid down IFC to be followed by the co and that such IFC are adequate and were operating effectively.



# Companies Act 2013 – Fraud Reporting



## Clarifications provided by the GN on reporting on fraud u/s 143(12) of the 2013 Act (Cont'd.)

### Reporting on suspected frauds in case of consolidated FS ('CFS')

- The auditor of the parent co in India will be required to report on suspected offence involving frauds in the components of the parent co, if the suspected offence involving fraud in the component is being or has been committed **by employees or officers of the parent co** and if such suspected offence involving fraud in the component **is against the parent co**, if:
  - a) the principal auditor identifies/detects such suspected offence involving fraud in the component “in the course of the performance of his duties as an auditor” of the CFS; or
  - b) the principal auditor is directly informed of such a suspected offence involving fraud in the component by the component auditor and the management had not identified/is not aware of such suspected offence involving fraud in the component; or
  - c) a component that is not a co since the component auditors of such components are not covered u/s 143(12).

# Companies Act 2013 – Fraud Reporting



Clarifications provided by the GN on reporting on fraud u/s 143(12) of the 2013 Act (Cont'd.)

## Consideration in joint audits

- Where a suspected fraud against the co is identified/noted by one of the joint auditors, such joint auditor **should communicate the same to the other joint auditor(s)** to enable them to consider and evaluate for his areas and **each of the joint auditor should individually comply** with the requirements of this GN.
- The reporting to those charged with governance and to the CG may be carried out by the joint auditor who identified/noted the suspected fraud or by any or all of the joint auditors together.
- When the reporting in Form ADT – 4 is carried out, only by the joint auditor who identified/noted the suspected fraud, such joint auditor should provide a copy of the Form ADT – 4 to the other joint auditors.

# Companies Act 2013 – Fraud Reporting



Clarifications provided by the GN on reporting on fraud u/s 143(12) of the 2013 Act (Cont'd.)

## Modifications to terms of engagement with regard to reporting on fraud

- Reporting by the auditor on fraud is **not a separate engagement** and is a part of the performance of the duties as an auditor of the FS of the co. The terms of engagement between the auditor and the client as required under SA 210 **will require certain modifications** to incorporate the management's responsibility with regard to fraud and the auditor's reporting responsibility for reporting u/s 143(12).

**The following clauses may be added to the auditor's engagement letter with regard to reporting on fraud u/s 143(12):**

- As part of auditor's reporting responsibilities
- As part of management's responsibility

# Companies Act 2013 – Fraud Reporting

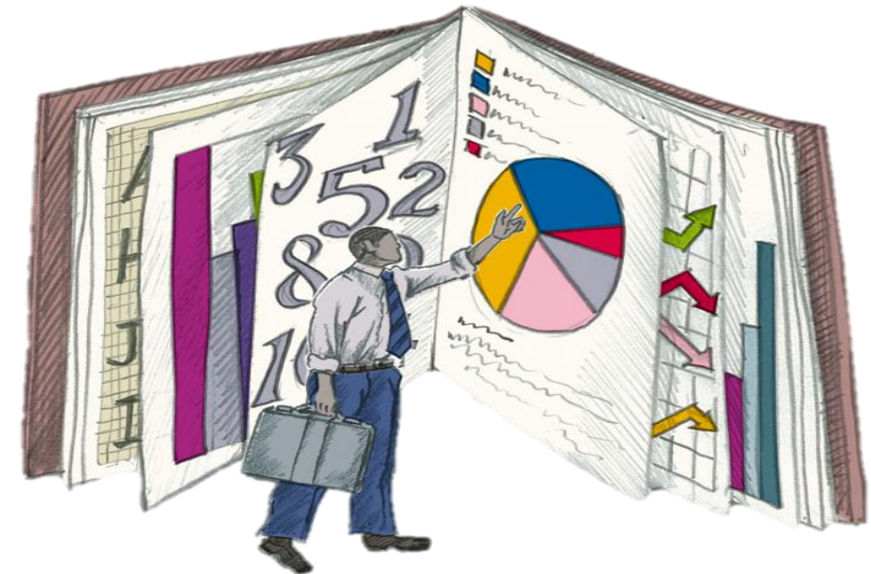


## Clarifications provided by the GN on reporting on fraud u/s 143(12) of the 2013 Act (Cont'd.)

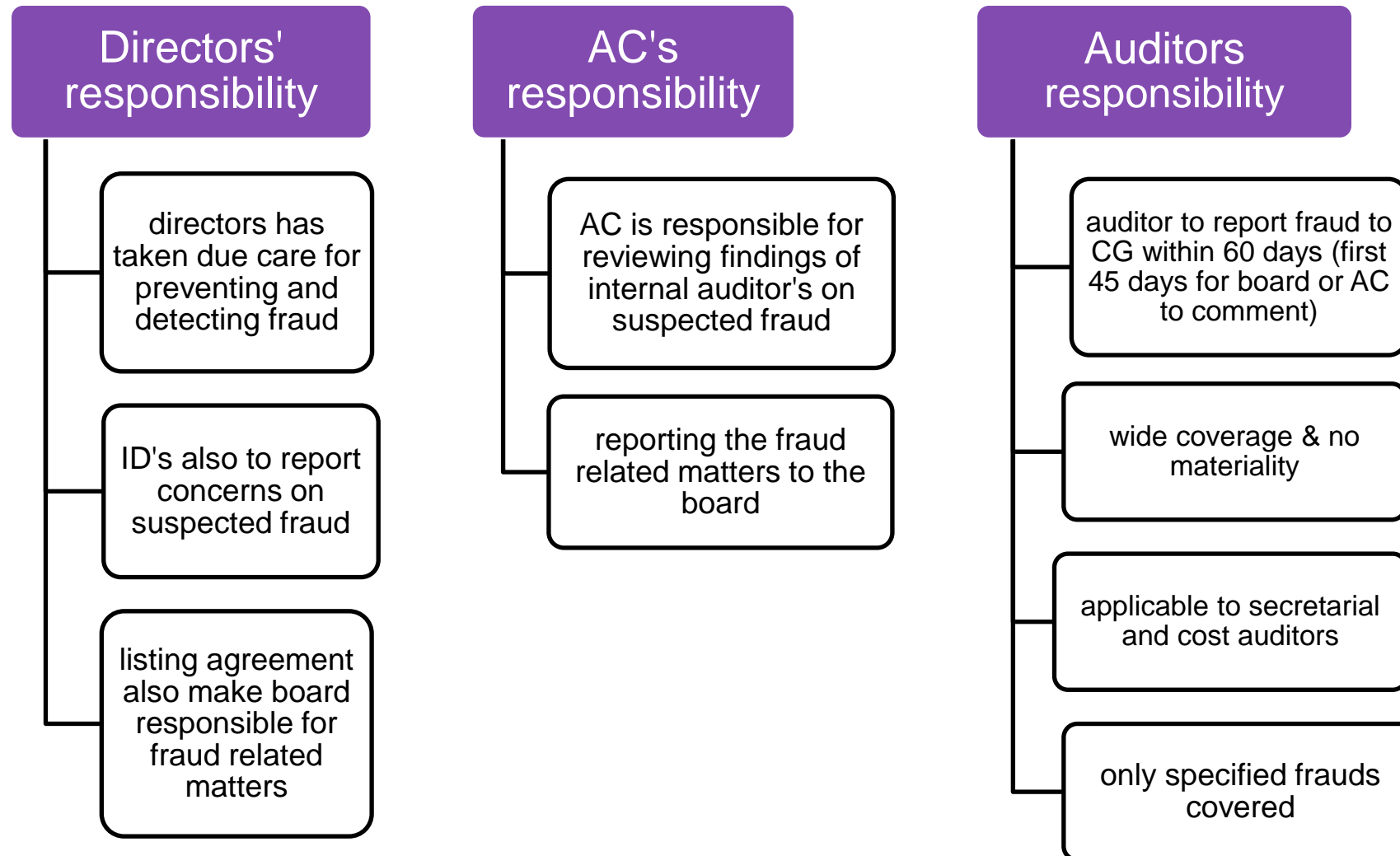
### **Other guidance/ formats provided by the GN (significant ones)**

- Various definitions of fraud
- Applicability of SAs
- Fraud risk factors
- Audit procedures to address risk factors
- Stages of identification of fraud
- Illustrative matters for engagement team discussion on fraud
- Illustrative checklist of inquiries with BOD/AC etc.
- Illustrative format for reporting to board or the audit committee
- Form ADT-4
- Illustrative management representation letter

## A Quick Recap.....



# Companies Act 2013 – Fraud Reporting



# Companies Act 2013 – Fraud Reporting



## View Checks

**What is the time limit for auditors to send his report on fraud to Board/AC for their comments?**

45 days

**Which of the following statement is correct with respect to fraud reporting?**

- a) the threshold of material fraud is not prescribed under the Act and the final Rules
- b) the threshold of material fraud is prescribed under the Act itself
- c) the threshold of material fraud is prescribed under the final Rules
- d) there is no concept of material fraud under the Act

**When does an Auditor Commence Reporting u/s 143(12) – Based on Suspicion - Reason to Believe – Knowledge – or on Determination of Offence?**

Reporting on fraud in the course of performance of duties as auditor, is applicable only when the auditor has sufficient reason to believe and has knowledge that a fraud has occurred or is occurring i.e., when the auditor has evidence that a fraud exists.

# Companies Act 2013 – Fraud Reporting



## View Checks

**Which of the following persons are not required to report on fraud?**

- a) Statutory auditor
- b) Branch auditor
- c) Internal auditor
- d) Cost accountant

**Sec. 143 (12) includes all fraud i.e. fraud by officers or employees of the co and fraud by third party such as vendors and customers on co?**

No, sec includes only fraud by officers or employees of the co and does not include fraud by third parties such as vendors and customers.

**Should the auditor report on suspected offence involving frauds that may have taken place in any of the subsidiaries, JV, associates of the co?**

The auditor of the parent co is not required to report on frauds u/s 143(12) if they are not being or have not been committed against the parent co by the officers or employees of the parent co.



# Companies Act 2013 – Fraud Reporting



## View Checks

### **What is the responsibility of the auditor in relation to the fraud relating to prior periods?**

Reporting by auditor u/s 143(12) will arise only if the fraud is identified by the auditor in the course of performance of his duties during the FYs beginning on or after 01 April 2014 and to the extent that the same was not dealt with in the prior FYs either in the FS or in the audit report or in the Board's report under the 1956 Act.

### **As per final Rules, the fraud reporting to the CG has to be done by the auditors within?**

- a) 60 days
- b) 45 days
- c) 30 days
- d) 180 days

### **Whether auditor is required to report on the frauds detected by management or other persons and already reported u/s 143 (12)?**

No, the auditor will not be required to report the same u/s 143 (12), since he has not per se identified the fraud.

# Companies Act 2013 – Fraud Reporting



## View Checks

**Which of the following statement is correct with respect to fraud reporting?**

- a) The requirements are equally applicable for cost auditor and secretarial auditor
- b) The requirements are equally applicable for cost auditor and internal auditor
- c) The requirements are equally applicable for secretarial auditor and internal auditor
- d) The requirements are equally applicable for internal auditor

**As per the recent clarification issued by MCA, for the audit of which of the following, Fraud reporting by auditors is not applicable?**

- a) FS for the periods beginning on or before 31 March 2014
- b) FS for the periods beginning on or before 31 March 2015
- c) FS for the periods beginning on or before 31 March 2016
- d) It is at the choice of the auditor

# Companies Act 2013 – Fraud Reporting



## View Checks

**Which of the following authority has been vested with statutory powers to investigate frauds relating to a co under the 2013 Act?**

- a) Central bureau of investigation (CBI)
- b) Intelligence Bureau (IB)
- c) Serious Fraud Investigation Office (SFIO)
- d) Forensic department of crime investigation bureau

**Which of the following form is required to be filed for reporting of fraud by the auditor?**

- a) ADT 4
- b) ADT 1
- c) ADT 3
- d) ADT 2

# Companies Act 2013 – Fraud Reporting



## View Checks

**In case of joint audit, who should report the suspected fraud to the management and CG?**

The reporting to management and to the CG may be carried out by the joint auditor who identified/noted the suspected fraud or by any or all of the joint auditors together.

**What is the materiality to report frauds or materiality is left to auditors' discretion?**

No limit as of now is proposed under the Companies Bill 2013

**AC is responsible for reviewing the findings of an internal auditors into suspected fraud or irregularity of a material nature and reporting to the board. T or F?**

True

# Companies Act 2013 – Fraud Reporting



## View Checks

**Is cost auditor also required to report fraud?**

Yes

**Which of the following persons are primarily responsible for the prevention and detection of fraud?**

- a) BOD and management
- b) Auditors
- c) AC
- d) All of the above

**IDs are not at all required to ensure or overview the fraud. T or F?**

False, IDs shall report concerns about suspected fraud

# Companies Act 2013 – Fraud Reporting



## View Checks

**Which of the following sec defines the term 'fraud'?**

- a) sec 448
- b) sec 447
- c) sec 347
- d) sec 348

**As per the definition of fraud, it includes-**

- a) Concealment of fact
- b) Abuse of position
- c) Omission
- d) all of the above

# Companies Act 2013 – Fraud Reporting



## View Checks

**Fraud reporting by auditors is first time covered by the 2013 Act. T or F?**

False, CARO 2003 required the auditor to report on any fraud on or by the co.

**Who all are made responsible for prevention and detection of fraud?**

- a) BOD
- b) Independent directors
- c) AC
- d) Auditors

**"Audit is conducted with the intent of detecting fraud". T or F?**

False, as per para 13 of SA 240, *"An audit conducted in accordance with the auditing standards generally accepted in India is designed to provide reasonable assurance that the FS taken as a whole are free from material misstatement, whether caused by fraud or error. The fact that an audit is carried out may act as a deterrent, but the auditor is not and cannot be held responsible for the prevention of fraud and error"*

# Companies Act 2013 – Fraud Reporting



## View Checks

**Which of the following statement is correct w.r.t. "punishment for fraud"?**

- a) Punishment has been prescribed in the form of monetary penalties only
- b) No punishment has been prescribed for the contravention
- c) Punishment has been prescribed in the form of monetary penalties as well as imprisonment
- d) Punishment has been prescribed; however can be waived off by CG

**What should the auditor do in case the he fails to get any reply from BOD or the AC within 45 days?**

He shall forward his report within a period of total 60 d to CG together with the note of details that was earlier forwarded to the BODAC for which he failed to receive the reply.

**Whether auditor is required to report if the fraud is required to be/has been reported under any other statute or to any other Regulator?**

No, however if the entity is a co and is governed by the provisions of the 2013 Act, then in addition, the auditor may also be required to report the offence involving fraud to the CG.



# Companies Act 2013 – Fraud Reporting



## View Checks

**Once fraud is reported u/s 143(12) to CG, No reporting again under CARO. T or F?**

False. CARO 2015 also requires auditors to report on fraud on or by the co. noticed or reported during the yr.

**Fraud reporting by auditors deferred by 1 year (applicable from FY 1 April 2015). T or F?**

False, reporting on internal financial controls has been deferred by 1 year.

**For non-compliance with sec 143(12), auditor shall be punishable with fine and imprisonment. T or F?**

False, he shall be punishable with fine only.

# Thanks....