

Reporting On Fraud By Auditors
U/S 143(12) Of The Companies Act
2013

AT WIRC OF ICAI, MUMBAI

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BACKGROUND

BACKGROUND

- Section 143 of the Companies Act, 2013 (2013 Act) has been effective from 1 April 2014.
 - The central government seeks to provide more robust framework for Financial Reporting and place more reliance on the work of the Auditors in bringing:
 - Transparency And Discipline
- In the corporate world to protect the interests of the shareholders and public at large.

Definition of Fraud

- Section 447 (Punishment for fraud) explains fraud as: “fraud” in relation to affairs of a company or any body corporate and includes:
 - Any act, omission, concealment of any fact or abuse of position ,
 - Committed by any person or any other person with the connivance in any manner,
 - With intent to deceive to gain undue advantage from or to injure the interests of,
 - The company or its shareholders or its creditors or any other person,
 - whether or not there is any wrongful gain or wrongful loss.
- As per SA 240 : 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.

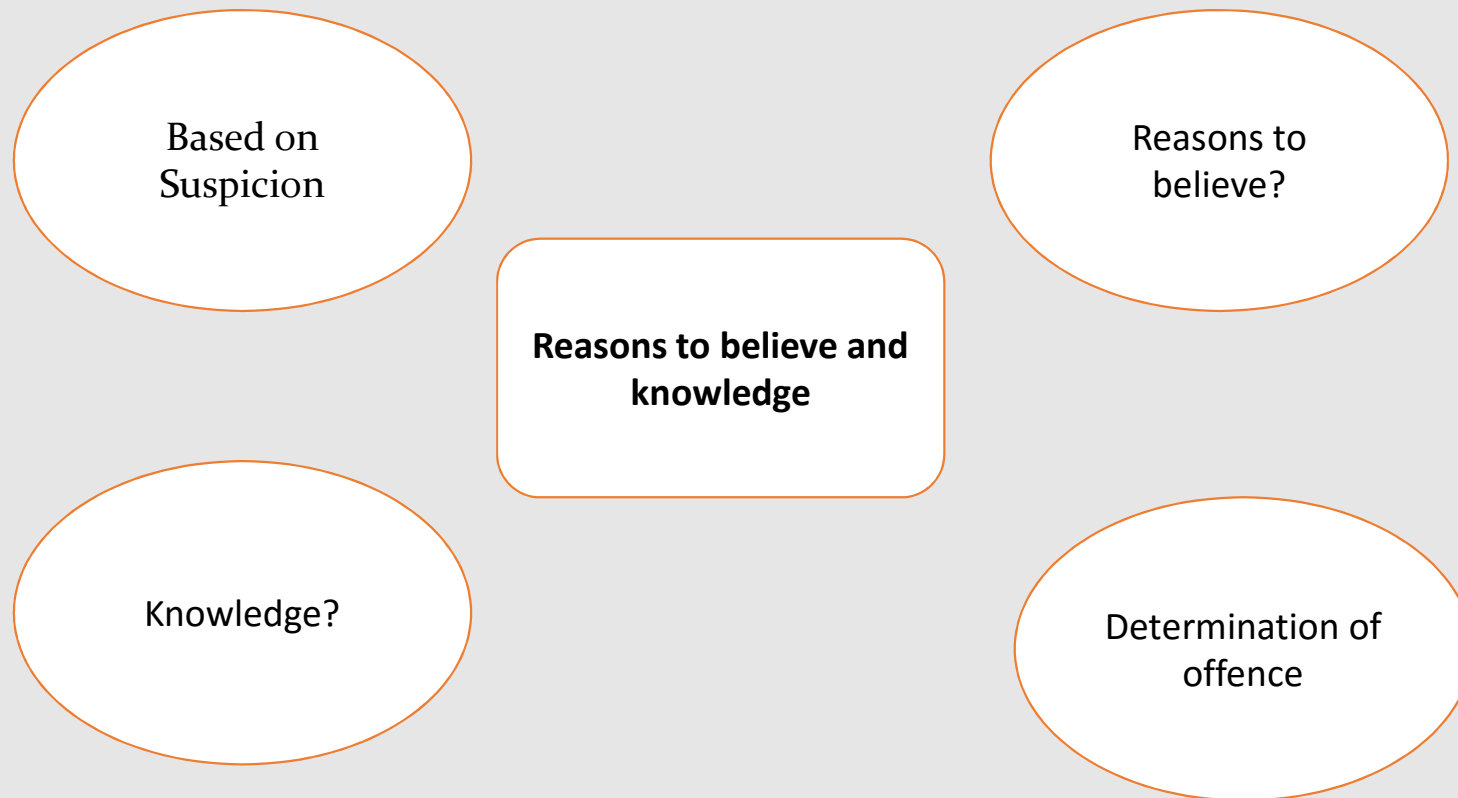
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Overview of section
143(12) of the Companies
Act, 2013

Overview of section 143(12) of the Companies Act, 2013

- **Section 143(12) requires that:**
- If an auditor of a company
 - in the course of the performance of his duties as an 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
 - shall immediately report the matter to the Central Government within such time and in manner as prescribed considering threshold limit
 - If fraud is less than specified amount, report to ACM/Board

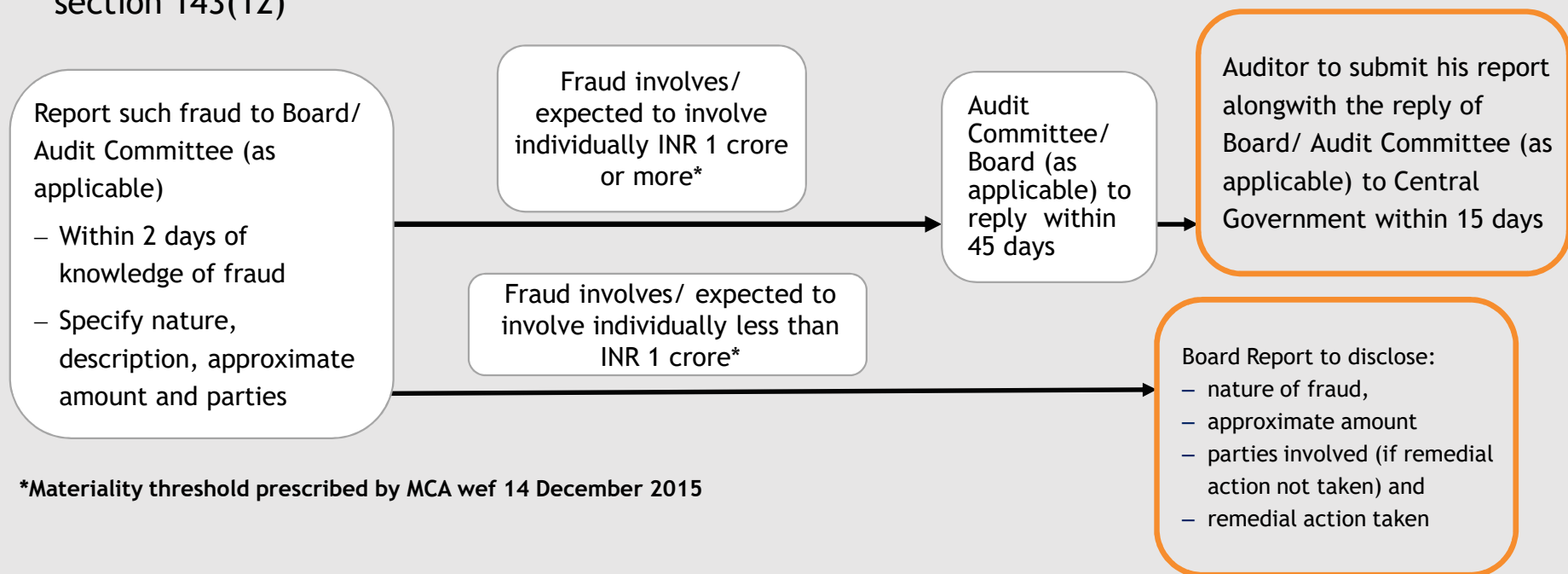
When does an auditor commence reporting under section 143(12) of the Companies Act, 2013



Reporting of fraud (by officers or employees) identified by Auditor - ICAI Guidance

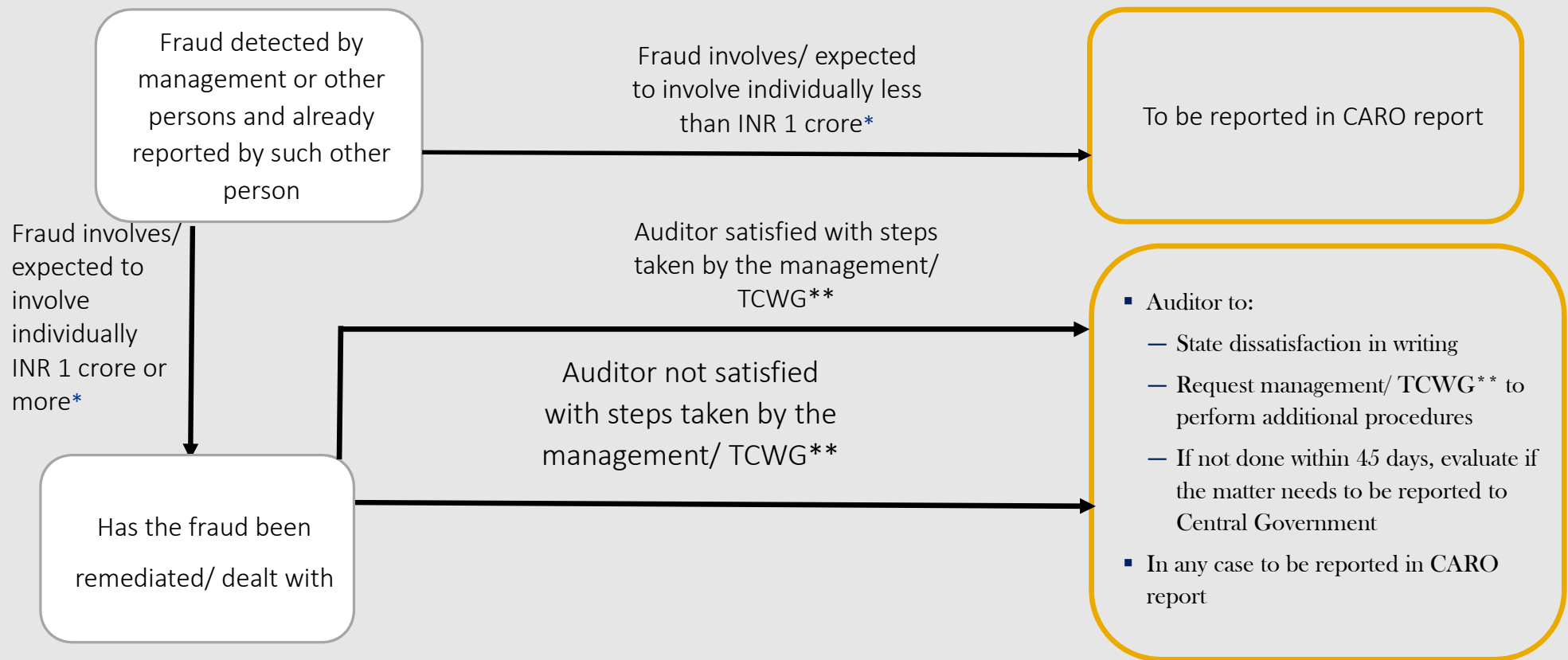
Auditor in course of performance of duties has reasons to believe that fraud is being/ has been committed against company by its officers or employees

In its Revised Guidance Note (February 2016) ICAI has inter alia given guidance/ interpretations of section 143(12)



*Materiality threshold prescribed by MCA wef 14 December 2015

Reporting of fraud not identified by auditor – ICAI Guidance



*Materiality threshold prescribed by MCA wef 14 December 2015

**Materiality threshold prescribed by MCA wef 14 December 2015

Responsibility of the management for prevention and detection of fraud

- As per section 134(5) (c) of the 2013 Act, directors responsibilities include safeguarding of the assets of the Company and preventing and detecting fraud and other irregularities.
- Primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management
- Board's report to include a responsibility statement, *inter alia*, that the directors had taken proper and sufficient care for safeguarding the assets of the company and preventing and detecting fraud and other irregularities.

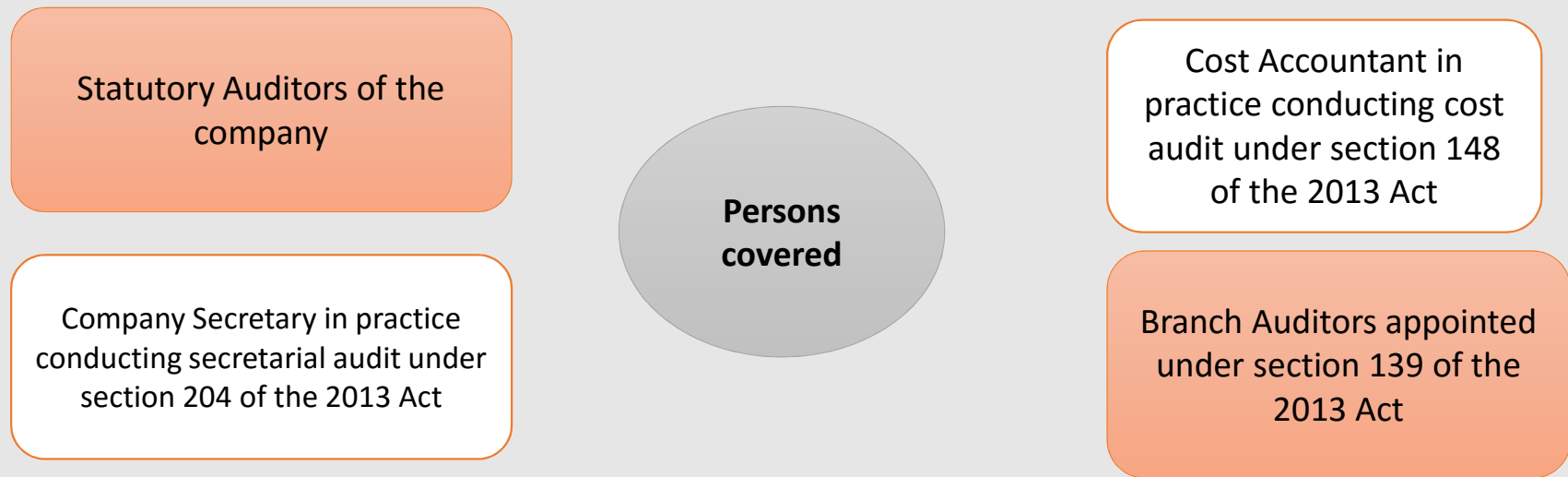
Auditor responsibility for consideration of fraud in an audit of financial statements

- **Scope of the guidance note is as follows:**
 - Frauds detected '*in the course of performance of duties as an auditor*' implies in the course of performing an audit as per the Standards on Auditing
 - An auditor has to consider the requirements of Standards on Auditing for assessing risk of fraud
 - Reporting is applicable only when an auditor has evidence that fraud exists
 - Fraud by officers or employees of the company and not by third parties such as, vendors and customers.

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**Persons covered for reporting under
section 143(12) of the Companies
Act, 2013**

Persons covered for reporting under section 143(12) of the Companies Act, 2013



Persons not covered

Other professionals appointed under other statutes rendering other services to the company such as a tax auditor appointed under Income tax act, Sales tax or VAT auditors appointed under the respective Sales tax or VAT legislations.

Internal Auditors

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Reporting On Frauds

Reporting On Frauds In Various Scenarios

- **It would be an auditor's responsibility to report about frauds in the following scenarios:**
- **Fraud noted by an auditor first before the management**
- Report to the management first and then the Central Government.
- **While providing attest or non-attest services, audit/limited review of interim period financial statements/results**
- Exercise professional judgment to evaluate materiality of the information
- Uses or intends to use the information obtained in the course of attest or non-attest services when performing an audit under the 2013 Act.

Reporting On Frauds In Various Scenarios

Frauds already reported by the management

Frauds already reported by other persons (Company Secretary and Cost Accountant)

No Reporting

But review the steps taken by the management

On dissatisfaction, state reasons and request the management to perform additional procedures

If additional procedures are not performed within 45 days of request, consider reporting the matter to the Central Government

Reporting On Frauds In Various Scenarios

- **Reporting in case of Consolidated Financial Statements: for frauds in any subsidiary, joint venture or associate:**
 - An auditor of the parent company is not required to report on frauds under section 143(12) if frauds are not being or have not been committed against the parent company by the officers or employees of the parent company but relate to frauds in:
 - a component which is an Indian company as the auditor of that Indian company has the responsibility
 - a foreign corporate component that is not a company.
 - An auditor of the parent company to report frauds in a component of the parent company only if:
 - fraud has been committed by employees or officers of the parent company and
 - such fraud is against the parent company.

Reporting On Frauds In Various Scenarios

- **Reporting when fraud relates to periods prior to the 2013 Act became effective**
 - An auditor would report on fraud relating to earlier years under section 143(12) of the 2013 Act only if:
 - The suspected offence involving fraud is identified by the auditor in the course of performance of his duties as an auditor during the financial years beginning on or after 1 April 2014, and
 - To the extent that the same was not dealt with in the prior financial years either in the financial statements or in the audit report.

Reporting On Frauds In Various Scenarios

- **Reporting when fraud relates to Corruption, Bribery, Money Laundering and Non-compliance with other laws and regulations**
- An auditor would report on fraud on the above matters under section 143(12) of the 2013 Act only if:
 - Such acts have been carried out by officers or employees of the company, and
 - Also take into account guidance in para 28 of SA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*.

Reporting On Frauds In Various Scenarios

- **Reporting In Case Of Fraud Noted In An Audit Of A Bank**
 - An auditor would report on fraud in this case under section 143(12) of the 2013 Act to:
 - the Reserve Bank of India in addition to the Chairman/Managing Director/Chief Executive of the concerned bank
 - if the bank is a company under the 2013 Act, then to the Central Government

Certain Other Considerations For Fraud Reporting

- Consider the following scenarios:
- A purchase manager receiving a pay-off to favour a specific vendor
- An employee carries on business parallel to and in competition with the company's business
- The managing director's password is misused by the IT Administrator to leak certain critical information of the company's business to its competitors.
- All the above acts 'injure the interests of the company or its shareholders whether or not there is a wrongful gain or wrongful loss'.
- Is the auditor expected to detect all such acts?
- Is it pertinent to note that the financial effects of such acts are not reflected in the books of account?

Certain Other Considerations For Fraud Reporting

- How does the auditor determine whether the value of individual fraud exceeds rupees one crore?
- Can auditor apply concept of materiality? What if materiality for a particular audit exceeds rupees one crore?
- Can a range of estimates be applied in arriving at the value of fraud where a definite amount determination is difficult?
- Is the auditor expected to perform a 'forensic audit'?

Certain Other Considerations For Fraud Reporting

- Where an auditor reports a fraud under Section 143(12), he would need to evaluate whether there is any reportable matter under Section 143(1) to Section 143(3) as also his report on IFC.
- How would reporting under Section 143(12) work for joint audits?
- On receiving response from the company disagreeing with the initial belief of the auditor that a suspected offence involving fraud is being or has been committed, if the auditor is convinced that his initial suspicion was incorrect, does the auditor still need to report the matter to the Central Government?
- Does the auditor have any responsibility of verifying Board's disclosures around fraud in the Board Report?

CARO 2016 versus CARO 2015 in Respect of Fraud

Frauds already reported by the management

New Clause No.	CARO 2016	CARO 2015	Difference
3(x) earlier (Clause (xii))	whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated;	whether any fraud on or by the company has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.	Responsibility now restricted to fraud by the Officers or employees of the company. This is in line with the provisions of section 143(12).

**“when we are no longer able to
change a situation,**

**we are challenged to change
ourselves!”**

Victor Frank

Source

Guidance Note on Reporting on Fraud under section 143(12) of the Companies Act, 2013 issued by The Institute of Chartered Accountants of India (ICAI).

Thanks