



## Compliances with Companies Act, 2013 with respect to provisions related to Corporate Frauds – Part VIII

*The Companies Act, 2013, recognizes that corporate fraud is an endemic issue that has been increasing over the last decade both in its frequency and severity. Increasing number of frauds have diluted the reliability of financial reports, contributed to substantial economic losses and battered investor's confidence regarding the usefulness and reliability of financial statements. In light of these, the provision of fraud has been more seriously provided for in the Act.*

*The following is intended to provide a general overview of the Companies Act, 2013 (“**Act**”) as applicable to all the companies in relation to the definition of fraud and fraudulent activities as well as the penalties prescribed.*

### **Definition of Fraud**

Companies Act, 1956 (the “**previous Act**”) did not contain a definition of fraud and consequently did not provide for punishment for fraud. Fraud / misrepresentation provisions were largely in connection with issue of securities to the public.

The Act however sets out specifically the constituents of fraud as well as prescribes stringent penalties for offences.

Section 447 of the Act provides punishment for and also defines fraud. Fraud is “fraud” in relation to affairs of a company or any body corporate, which includes any act, omission, concealment of any fact or abuse of position with intent to deceive, to gain undue advantage from, or to injure the interests of:

- a) the company; or
- b) its shareholders; or
- c) its creditors; or
- d) *any other person*,

whether or not there is any wrongful gain or avoidance of wrongful loss to or by the perpetrator of fraud.

Here “wrongful gain” means the gain by unlawful means of property to which the person gaining is not legally entitled. Similarly “wrongful loss” means the loss by unlawful means of property to which the person losing is legally entitled.

The definition of fraud is not exhaustive but wide and inclusive. Section 447 relates to fraud against any person and does not limit it to only fraud against the company, but includes fraud against the shareholders of the company or its creditors or against any other person. Here the term “any other person” has widened the ambit of fraud.

It is important to note that it will still constitute fraud whether or not such act, omission, concealment of any fact or abuse of position causes any wrongful gain or wrongful loss.



Here intent of the person is given paramount importance and not the outcome of his/her actions.

### ***Punishment for committing fraud***

Section 447 has laid out the punishment for committing fraud *in addition* to any liability including repayment of any debt. The said section provides that, any person who is found to be guilty of fraud, shall be punishable with a minimum fine of an amount *not less* than the amount involved in the fraud and a maximum of *3 times* the amount involved. The punishment may also include at least 6 (six) months imprisonment extending to 10 years and where public interest is involved upto 3 (three) years.

### ***Public Interest***

In order to decide whether a fraud involves substantial public interest it has to be judged by size, either in terms of monetary misappropriation or in terms of numbers of persons affected. In India, “public interest” has been defined and analyzed in various contexts by various judicial fora including the Supreme Court of India. Since there is no explanation on how the term “public interest” is to be construed, it will be a matter of setting of judicial precedents to throw light on this subject.

### ***Persons who can be made liable for fraud***

Section 447, is very widely worded to include any person in connection with the company who may, given a set of circumstances, be made liable for fraud. The following persons may be made liable for fraud under Section 447.

- 1) Company;
- 2) Directors and officers in default including key managerial personnel;
- 3) Any person under whose directions the board of directors of the company is accustomed to act;
- 4) Company liquidator appointed for winding up;
- 5) Any other person committing a fraud.

In addition, the table below highlights some sections, the contravention of which attract penal provisions in line with Section 447.

<b>Section of the Companies Act</b>	<b>Fraud (<i>In relation to</i>)</b>	<b>Person to be penalised</b>
7(5)	Registration of a company.	A person furnishing any false information or suppressing any material information of which that person is aware.
7(6)	Post registration of a company.	The promoters, first directors and any person who signs a declaration as

		required under the Act.
8(11)	Formation of companies with charitable objects	Any non-compliance of Section 8 where done with a fraudulent intention or conducting the affairs of a Section 8 company fraudulently.
34	Issuing, circulating or distributing a prospectus which includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead.	Every person who authorises the issue of such prospectus.
36	Inducing persons fraudulently to invest money.	The person who makes a statement, promise or forecast recklessly or conceals any material fact offering inducement to another person to enter into an investment / underwriting agreement.
38(1)	Personation for acquisition etc. of securities	Any person making or abetting in making fictitious, multiple or inducing a company to allot shares in a fictitious name.
46(5)	Issuance of duplicate share certificates with intent to defraud	Company and every officer in default.
56(7) <sup>1</sup>	Transfer of shares with intent to defraud	Depository or depository participant who makes the transfer.
66 (10) <sup>2</sup>	Reduction of share capital	Officer of the company who conceals name of creditor, misrepresents nature or amount of debt or claim or abets any of the above.
75(1)	Acceptance of deposit with an intent to deceive investors or for any fraudulent purpose.	Every officer of the company who was responsible for accepting the deposit.
140(5) <sup>3</sup>	Acting in a fraudulent manner or abetting or colluding in a fraud by company or any of its directors or officers.	Auditor
206(4)	Conducting business of the company for a fraudulent or unlawful purpose.	Every officer of the company who is in default.
213, Proviso <sup>4</sup>	Pursuant to an investigation it appears that the affairs of the company have been conducted fraudulently with intent to defraud	Every officer in default, persons concerned in the promotion or management of the company

<sup>1</sup> This provision has not been notified.

<sup>2</sup> This provision has not been notified.

<sup>3</sup> This provision has not been notified.

<sup>4</sup> This provision has not been notified.

	any person or any person concerned in the formation or management of the company has been guilty of fraud	
229	Furnishing the false statement or mutilation or destruction of the documents.	Person required to provide an explanation or make a statement during the course of inspection, inquiry or investigation.
251(1) <sup>5</sup>	Application for removal of name from the Register of Companies with the object of evading the liabilities of the company or with the intention to deceive the creditors or to defraud any other persons.	The persons in charge of the management of the company.
339(3) <sup>6</sup>	Conducting business of the company with intent to defraud creditors of the company or any other persons or for any fraudulent purpose.	Every person who was knowingly a party to the carrying on of the business.
448	Making a false statement in any return, report, certificate, financial statement, prospectus, statement, or any other document required by, or for, the purpose of any of the provisions of the Act.	The person making such a statement.

From the above, one can gather the nature of offences as well as persons who can be penalised which includes third parties such as promoters, depositories, depository participants, auditors etc.

### Serious Fraud Investigation Office

The Serious Fraud Investigation Office (SFIO) has been set up under Section 211 of the Act on similar lines with Serious Fraud Office (SFO) UK which is an independent UK Government department that investigates and prosecutes serious or complex fraud and corruption.

The SFIO is empowered to initiate investigation at the direction of the Central Government and has been vested with additional powers that authorises it to collect information from other regulatory authorities.

Additionally, the SFIO shall have the power to arrest in respect of offences which attract the punishment for fraud. The Central Government will appoint its director and members from experts in the fields of banking, corporate affairs, taxation, forensic audit, capital market, IT or law.

<sup>5</sup> This provision has not been notified.

<sup>6</sup> This provision has not been notified.



The SFIO can investigate into the affairs of a company on receiving a report from the registrar or inspector, on intimation of any special resolution passed by the company, in public interest or on request from any department of the Central or State Governments. Also if the investigation has been handed over to the SFIO by the Central Government, no other investigative agency is allowed to proceed further with such investigation.

### By Auditors

Section 227 of the previous Act requires the auditor to make a report to the members of the company in a general meeting of the company on the books and accounts, balance sheets, profit and loss account, vouchers and any other documents examined. The auditor also had the additional duty to report to the shareholders whether in his opinion the company has properly kept the books of account or not, whereas section 143 of the Act in addition to the aforesaid responsibility casts an onerous responsibility on statutory auditor in the course of his duty to do direct reporting of frauds to the Central Government. This is in addition to their existing responsibilities for reporting requirement to the Board or shareholders of the company. Section 143 also stipulates specific reporting obligations.

Similar responsibilities have been cast on the cost auditor conducting the cost audit and company secretary conducting secretarial audit under Section 148 and Section 204 respectively.

In course of performing his duties, if the auditor has a reason to believe that an offence involving certain fraud is being or has been committed against the company by officers or employees, the matter should be reported to the Central Government SFIO (Serious Fraud Investigation Office) immediately but not later than thirty days of his knowledge or information regarding fraud with a copy to the Audit Committee or in case the company has not constituted an Audit Committee, to the Board.

Audit Committee is required to monitor that every listed company shall establish a vigil mechanism for directors and employees to report genuine concerns. The vigil mechanism shall provide for adequate safeguards against victimization of persons who use such mechanism. It shall make provision for direct access to the chairperson of the Audit Committee in appropriate cases.

### Effective Date

As the law governing fraud under the Act has already been notified and effective from 12<sup>th</sup> September, 2013, it is very important for the management to redefine the corporate roles and require the discharge of duties of various officers-in-charge with reasonable care and due diligence.

### Protecting the interest

The above provisions contained in the Act will have far reaching impact on the companies and auditors. It appears that these provisions are being made with a view to curb the present day tendency on the part of some companies to manipulate accounts with a view to benefit those in management or with a view to reduce tax.



The introduction of very stringent provisions regarding fraud shows its seriousness. Also the Act now is armed with enough legal weapons to deal with it, thus it will improve corporate governance, protect the interest of minority shareholders and make it tougher for companies to hide illegal transactions or commit fraud, thereby protecting the interest of all stakeholders.