

Companies Act 2013

What will be its impact on fraud in India?



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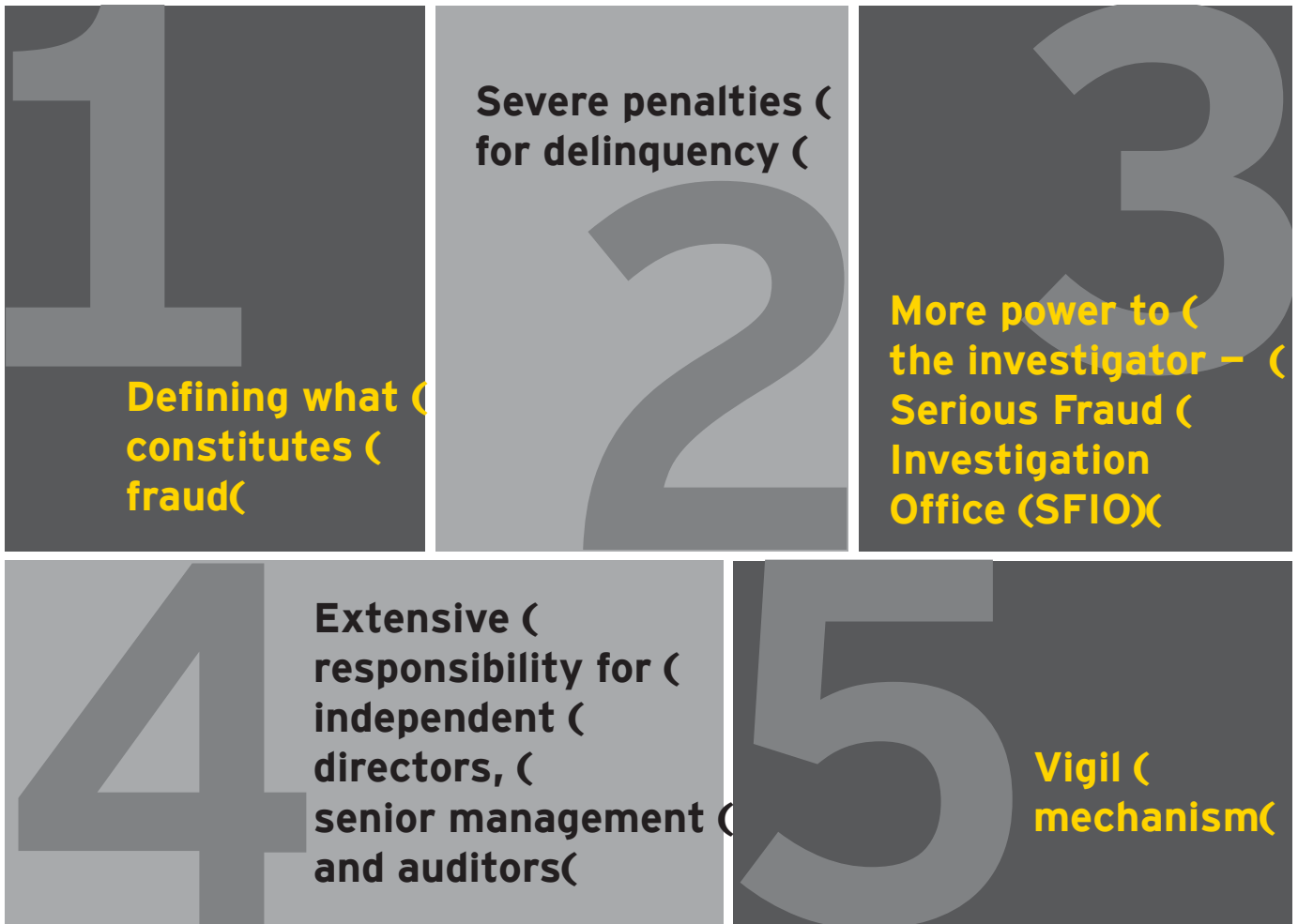
...the M&A Agreement, provided that any Intellectual Property Rights owned or controlled by HD4M remaining in the possession of HD4M at the Closing Date shall be assigned to HD4M pursuant to the M&A Agreement, and that the assignment of such Intellectual Property Rights shall be subject to the terms and conditions set forth in the M&A Agreement, including the requirement that HD4M shall provide all necessary information to the assignee in order to effectuate the assignment of such Intellectual Property Rights.

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1 The Companies Act, 2013 was enacted on 29 August 2013 after the President's assent. The Ministry of Corporate Affairs (MCA) has notified 98 sections of the new Act. These sections came into effect on 12 September 2013. Subsequently, the corresponding sections under the old Companies Act, 1956 automatically stood repealed.

Table 1: The table includes some sections that attract liability u/s 447. These are cognizable offences and a person accused of any such offence under these sections shall not be released on bail or on his or her own bond, unless subject to the exceptions provided u/s 212(6).

Section	Fraud w.r.t.	Who will be penalized
7(5)	Registration of a company	A person furnishing false information or suppressing any material information of which he or she is aware
36	Inducing persons to invest money	The person doing so
75(1)	Acceptance of deposit with intent to defraud depositors or for any fraudulent purpose	Every officer of the company who accepted the deposit.
206(4)	Conducting business of a company for a fraudulent or unlawful purpose	Every officer of the company who is in default
213	<p>Other cases</p> <ul style="list-style-type: none"> ▶ Business of a company being conducted with intent to defraud its creditors ▶ Fraud, misfeasance or other misconduct of the company or any of its members, or ▶ Company withholding information from members with respect to its affairs, which they may reasonably expect 	Every officer of the company who is in default and the person(s) concerned in the formation of the company or management of its affairs
229	Furnishing false statement or mutilation or destruction of documents	Person required to provide an explanation or make a statement during the course of inspection, inquiry or investigation, or the officer or other employee, as required
251(1)	Application for removal of name from register with the object of evading liabilities/intent to deceive	Persons in charge of management of the company
339(3)	Conducting business of company with intent to defraud its creditors, any other persons or for any fraudulent purpose	Every person who was knowingly a party to the business in the aforesaid manner
448	Making a false statement in any return, report, certificate, financial statement, prospectus, statement or other document required by or for the purpose of any of the provisions of this Act or the rules made thereunder	Person making such a statement

Around 77% of the respondents to EY's survey² were of the opinion that the stringent punishment prescribed u/s 447 will succeed in serving as a deterrent, while the remaining 23% were doubtful of the effect such a provision would have. We believe the true outcome of such penalizing provisions relies heavily on their implementation.

² Result of live polling conducted during a EY webcast on "Impact of Companies Act 2013 on Fraud," held on 21 October 2013

2. Severe penalties for delinquency

Liability – encompassing all delinquent parties



Auditors u/s 140 (5)

- ▶ The auditor shall also be liable for action under section 447.
- ▶ Where the auditor is a firm and its Partner or Partners have acted in a fraudulent manner, liability for such acts will be theirs and of the firm jointly and severally.



Independent directors u/s 149(12)

- ▶ Independent directors or a non-executive directors, who are not promoters or key managerial personnel, shall be held liable, only in respect of such acts of omission or commission by a company, which had occurred with their knowledge and was attributable through Board processes and their consent or connivance, or where they had not acted diligently
- ▶ Directors who have resigned shall be liable even after their resignation or for offences that occurred during their tenure (u/s 168(2)).



Actions in pursuance of inspector's report

Disgorgement u/s 224(5)

- ▶ The Central Government may file an application before the Tribunal for appropriate orders with regard to disgorgement of assets, properties or cash generated as a result of fraudulent activity.

Winding up

- ▶ In public interest, the Central Government may bring proceedings for winding up of a company for the recovery of damages in respect of any fraud, misfeasance or other misconduct.



Prohibition and penalty for Insider trading (u/s 195)

- ▶ Imprisonment up to five years or a
- ▶ fine of up to INR250 million or three times the profits made, whichever is higher, or
- ▶ both of the above

Class action S 245 (1g)

Members or depositors can claim damages or compensation or demand any other suitable action from or against :

- ▶ "the company or its directors for any fraudulent, unlawful or wrongful act or omission or conduct or any likely act or omission or conduct on its or their part;
- ▶ the auditor including audit firm of the company for any improper or misleading statement of particulars made in his audit report or for any fraudulent, unlawful or wrongful act or conduct; or
- ▶ any expert or advisor or consultant or any other person for any incorrect or misleading statement made to the company or for any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on his part"

According to EY's survey, 75% of the respondents were of the view that introduction of class action suits against defaulting companies will help to curb investor-related fraud

3. More power to the investigator – the Serious Fraud Investigation Office

Statutory status to be conferred on the SFIO

The SFIO to have the power to arrest individuals for certain offences

No other investigating agency to probe cases being investigated by the SFIO

Investigation report filed by the SFIO to be deemed a report submitted by a police officer, thereby conferring the rights of a civil court to it

SFIO to have the right to share any information or document with an investigating agency, income-tax authority, etc., which is relevant for it in respect of an offence being investigated by it

Under certain circumstances, the Central Government may order an investigation into the affairs of a company (S 210):

- ▶ *“on receipt of report of registrar or inspector*
- ▶ *on intimation of a special resolution passed by a company that its affairs are required to be investigated;*
- ▶ *in the public interest on request by department of central/state government”*

Investigation of ownership of company (S 216)

The Central Government may appoint one or more inspectors to investigate and report on matters relating to a company and its members for the purpose of determining individuals :

- ▶ *“who are or have been financially interested in the success or failure, whether real or apparent, of the company; or*
- ▶ *who are or have been able to control or to materially influence the policy of a company”*

Around 89% of the respondents believed that conferring a statutory status on the SFIO and providing exclusivity to it to investigate company-related frauds will increase the number of prosecutions in corporate scams, while only a minimal 11% believed that it will not.

4. Extensive responsibility of independent directors, senior management and auditors

Auditors u/s 143)	Independent Directors Schedule IV)	Audit Committee u/s 177)
<ul style="list-style-type: none"> ▶(Material fraud to be reported to the Central Government within 30 days ▶(Immaterial frauds to be reported to the board or audit committee of the company ▶(Covers fraud that has been perpetrated and those that are in process ▶(Material fraud includes: <ul style="list-style-type: none"> ▶(Frequent fraudulent activity ▶(Fraud involving or likely to involve 5% of net profit or 2% of turnover ▶(No anonymity: The report is to be presented on the letterheads of auditors, signed by them with their seals and provide their membership numbers 	<p>Independent directors need to:</p> <ul style="list-style-type: none"> ▶(Satisfy themselves on the integrity of financial information and financial controls ▶(Ensure that their concerns about the operations of their companies or actions proposed by them are addressed by the Boards of the organizations, and if these are not resolved, insist that their concerns are recorded in the minutes of Board meetings ▶(Ascertain and ensure that companies have in place adequate and functional vigil mechanisms ▶(Report concerns about unethical behavior, actual or suspected fraud or violation of the codes of conduct or ethics policies of their companies 	<p>Audit committees need to:</p> <ul style="list-style-type: none"> ▶(Monitor the end use of funds raised through public offers and related matters instead of only review monitoring reports ▶(valuate internal financial controls and risk management systems ▶(Have the authority to investigate and be empowered to obtain professional advice from external sources and have full access to information in the records of companies (audit committees to operate vigil mechanism according to draft rules under the Act)
<p>Reporting and monitoring - onus on all stakeholders</p>		

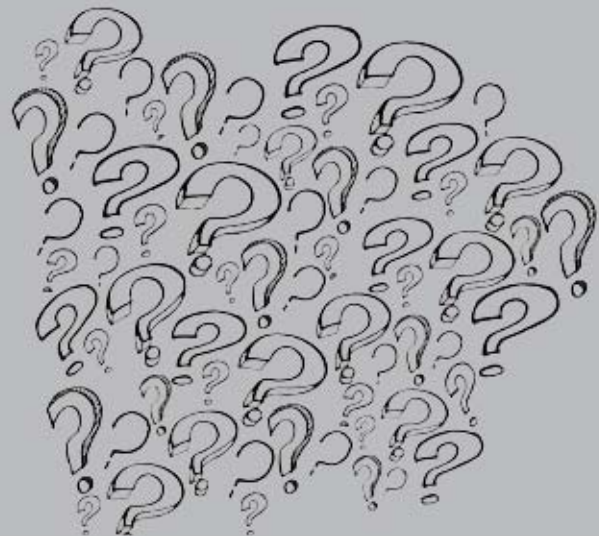
The vast majority of people (around 95% of the respondents) seemed positive that enforcement of the Companies Act 2013 will improve corporate governance standards in India – only 5% had a different opinion.

5. Vigil mechanism

A large number of the respondents (87%) believed that enabling such a provision will help companies detect fraud and unethical practices and provide optimum solutions for these, while 13% were of the opinion that the true impact of the provision will only be gauged with time.

Questions asked during the webcast on "Impact of Companies Act 2013 on fraud" on 21 October 2013

- ▶ Do you think making certain transgressions cognizable offences will deter potential fraudsters?
- ▶ Do you think an empowered SFIO will increase the number of prosecutions?
- ▶ Do you think the provision for class action suits will help to curb investor-related fraud?
- ▶ Do you think a vigil mechanism will help companies detect fraud and unethical practices?
- ▶ To sum up, do you think the Companies Act 2013 will improve corporate governance standards in India?



How EY can help

Establishing the vigil mechanism: Advise management/audit committees on the policy and vigil mechanism, and thereby help them comply with the mandates of the Act and draft rules

Assessing, improving and monitoring internal control structure with Fraud Risk Management (FRM): Help organizations create an FRM framework as a component of their overall risk management strategies, with the framework including various policies, procedures, tools and mechanisms for prevention, detection and investigation of fraud

Fraud response plan: Help in preparation of fraud response plans relating to:

- ▶ Setting up of frameworks to address various types of concerns
- ▶ Establishment of committees or identification of company executives who can help their audit committees discharge their duties, as mandated in the Act and draft rules
- ▶ Putting in place delegation matrices to evaluate concerns and initiating appropriate procedures for investigation, corrective action and reporting
- ▶ Provision of guidance on how to handle various types of concerns, including investigations
- ▶ Compliance with documentation-related requirements
- ▶ Protocols for reporting
- ▶ Action to be taken against individuals making repeated frivolous complaints



Reviewing design and operation of vigil mechanism : assessment of independent directors

Training audit committees: Conducting training for audit committees or directors on their duties and responsibilities relating to compliance with the provisions of the new Act, specifically with regard to the vigil mechanism and its operation

Providing advice on action to be initiated: Providing options to audit committees or their delegates on the "way forward" on a case-to-case basis, wherever permissible

Carrying out investigations on fraud- or misconduct-prevention activities: Helping audit committees conduct investigations (due to concerns raised) or reviews to mitigate possibility of fraud and misconduct in organizations

Training and creating awareness: Providing advice on strategy, the concept and content of training as well as awareness-related training, including face-to-face and web-based learning, if required, to directors and employees





About Fraud Investigation and Dispute Services (FIDS)

Dealing with complex issues of fraud, regulatory compliance and business disputes can detract from your efforts to achieve your company's potential. Enhanced management of fraud risk and compliance is a critical business priority – whatever the industry sector. With more than 2000 fraud investigation and dispute professionals around the world, we will assemble the right multidisciplinary and culturally aligned team to work with you and your legal advisors. In addition, we will give you the benefit of our broad sector experience, our deep subject matter knowledge and the latest insights from our global activities.

FIDS India

- ▶ **Deep competencies:** our FIDS team has wide industry experience
- ▶ **Forensic technology:** we use sophisticated tools and established forensic techniques to provide requisite services to address individual client challenges
- ▶ **Global exposure:** our team members have been trained on international engagements and have had global exposure to fraud scenarios
- ▶ **Market intelligence:** we have dedicated professionals who are specifically experienced and trained in corporate intelligence, and are capable of conducting extensive market intelligence and background studies on various subjects, industries, companies and people
- ▶ **Thought leadership:** we serve a variety of leading clients, which gives us deep insight into a wide range of issues affecting our clients and business globally
- ▶ **Qualified professionals:** we have a qualified and experienced mix of chartered accountants, certified fraud examiners, lawyers, CIAs, CISAs, engineers, MBAs and forensic computer professionals.

Our services:

- ▶ Anti-bribery program
- ▶ Anti-fraud and fraud risk assessment
- ▶ Fraud, bribery and corruption investigation
- ▶ Dispute advisory services
- ▶ Forensic technology and discovery services
- ▶ Regulatory compliance
- ▶ Ethics and integrity due diligence
- ▶ Third-party due diligence
- ▶ Whistle-blowing services
- ▶ Competition and trade services



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