

Secretarial Auditor's Duty of Reporting Frauds Under Section 143 of Companies Act, 2013

Section 143(12) of the Companies Act, 2013 ('the Act') casts a duty on the auditors of companies to report frauds committed by officers or employees of the companies. Section 143(12), as amended by the Companies (Amendment) Act, 2015, reads as follows: "(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."



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INTRODUCTION

STATUTORY FRAMEWORK AS REGARDS AUDITOR'S DUTY AS TO REPORTING OF FRAUDS

Section 143(12) of the Companies Act, 2013 ('the Act') casts a duty on the auditors of companies to report frauds committed by officers or employees of the companies. Section 143(12), as amended by the Companies (Amendment) Act 2015, reads as follows:

"(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."

APPLICABILITY OF SECTION 143(2) TO SECRETARIAL AUDITORS

As per sub section (14)(b) of Section 143, the provisions of this Section shall *mutatis mutandis* apply to the company secretary in practice conducting secretarial audit under Section 204.

The Latin phrase *mutatis mutandis* means the necessary changes having been made. 'Mutatis mutandis' translates to 'all necessary changes having been made' or 'with the necessary changes'. The phrase *mutatis mutandis* indicates that whilst it may be necessary to make some changes to take account of different situations, the main point remains the same. The phrase *mutatis mutandis* is used within contracts to incorporate terms from one agreement into a different and separate agreement. For example, a lease renewal with similar terms to a previous agreement, save for changes to the tenants, may incorporate terms 'mutatis mutandis'. [see LexisNexis Legal Glossary]

Consequently, Section 143(12) is applicable when a secretarial auditor of a company in the course of the performance of his duties as the secretarial 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 secretarial auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed.

CONDITIONS TO BE SATISFIED IN RESPECT OF REPORTING A FRAUD

According to sub-section (12) of Section 143 of the 2013 Act, if the auditor suspects, in the course of the performance of his duties as an auditor, and forms a belief based on a reason, he must report it in the manner set out in sub-section (12) and as prescribed under rules made

by the Central Government. While a fraud involving an amount in excess of the prescribed amount is required to be reported to the Central Government, a fraud of an amount less than the prescribed amount has to be reported to the audit committee of the company. The provision applies to all types of companies.

Sub-section (12) is attracted if the following conditions are fulfilled:

- The auditor of a company has, in the course of the performance of his duties as auditor, fostered a reason to believe that a fraud has been committed in relation to the affairs of the company;
- The fraud has been committed by any of the company's officers or employees;
- The fraud involves any amount (more or less than the prescribed amount);

A fraud involving the prescribed amount (which is Rs. One crore or more), the auditor shall report it to the Central Government within such time and in such manner as may be prescribed; but if the fraud involves a lesser amount than the prescribed amount (i.e. less than Rs. One crore), the auditor must report it to the audit committee constituted under Section 177 of the Companies Act, 2013 or to the Board in other cases within the prescribed time and in the prescribed manner.

The auditor's right to investigate and report a fraud under subsection (12) is limited to frauds committed by officers or employees of companies. The auditor cannot investigate to unravel a fraud committed by any other person. The term 'officer' is defined in Section 2(59) of the Act to include any director, manager or key managerial personnel or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is or are accustomed to act. The term 'employee' has not been defined in the Act; so, ordinary meaning of this word has to be taken.

According to rule 13(2) of the Companies (Audit and Auditors) Rules 2014, the auditor shall report the matter to the Central Government as under:-

- (a) the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than two days of his knowledge of the fraud, seeking their reply or observations within forty-five days;
- (b) 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 from the date of receipt of such reply or observations;
- (c) 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 for-awarded to the Board or the Audit Committee for which he has not received any reply or observations;

- (d) 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;
- (e) the report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and
- (f) the report shall be in the form of a statement as specified in Form ADT-4.

As per rule 13(3), in case of a fraud involving lesser than the amount specified in sub-rule (1), the auditor shall report the matter to Audit Committee constituted under Section 177 or to the Board immediately but not later than two days of his knowledge of the fraud and he shall report the matter specifying the following:

- (a) Nature of Fraud with description;
- (b) Approximate amount involved; and
- (c) Parties involved.

MEANING OF 'REASON TO BELIEVE'

One of the essential conditions for the applicability of Section 143(12) is that, the auditor has a reason to believe that an offence of fraud involving the prescribed amount is being or has been committed in the company by its officer or employee. A person is said to have reason to believe a thing if he has sufficient cause to believe that thing.

Section 26, IPC explains the meaning of the words "reason to believe" thus. "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".

The expression 'reason to believe' has been interpreted by the Supreme Court to mean that even though formation of opinion may be subjective but it must be based on material on the record. It cannot be arbitrary, capricious or whimsical.¹

The expression "reason to believe" does not mean a purely subjective satisfaction. The belief must be held in good faith: it cannot be merely a pretence. The reasons for the belief must have a rational connection or relevant bearing to the formation of the belief and are not extraneous or irrelevant.²

Shah, J. as a member of the Constitution Bench in *Calcutta Discount Co. v. I. T.O.*, AIR 1961 SC 372 observed that, the expression "reason to believe postulates belief and

¹ *N. Nagendra Rao and Co. v. State of A.P.* AIR 1994 SC 2663

² *S. Narayanappa v. Commissioner of Income-tax, Bangalore* AIR 1967 SC 523

the existence of reasons for that belief. The belief must be held in good faith: it cannot be merely a pretense. The expression does not mean a purely subjective satisfaction of the Income Tax Officer: the form of decision as to the existence of reasons and the belief is not in the mind of the Income Tax Officer. If it be asserted that the Income Tax Officer had reason to believe that income had been under-assessed by reason of failure to disclose fully and truly the facts material for assessment, the existence of the belief and the reasons for the belief, but not the sufficiency of the reasons, will be justifiable. The expression therefore predicates that the Income tax Officer holds the belief induced by the existence of reasons for holding such belief. It contemplates existence of reasons on which the belief is founded, and not merely a belief in the existence of reasons inducing the belief; in other words, the Income Tax Officer must on information at his disposal believe that income has been under-assessed by reason of failure fully and truly to disclose all material facts necessary for assessment. Such a belief may not be based on mere suspicion: it must be founded upon information.”

ORDINARY MEANING OF 'FRAUD'

As will be noted below, the definition in Section 447 is an inclusive definition; so apart from what is stated in the definition as the meaning of fraud, the ordinary meaning of fraud as appropriate in the context of the provision will also apply, since Where in a definition clause the word “includes” is used, it is so done in order to enlarge the meaning of the words or phrases occurring in the body of the statute and when it is so used, these words or phrases must be construed as comprehending not only such things which they signify according to their natural import, but also those things which the interpretation clause declares that they shall include. Where in a definition Section of a statute a word is defined to mean a certain thing, wherever that word is used in that statute, it shall mean what stated in the definition unless the context otherwise requires. But, where the definition is an inclusive definition, the word not only bears its ordinary, popular and natural sense whenever that would be applicable but it also bears its extended statutory meaning. At any rate, such expansion definition should be as construed as not cutting down the enacting provisions of an Act unless the phrase is absolutely clear in having opposite effect.³

The *Black's Legal Dictionary* defines “fraud” as an intentional perversion of truth for the purpose of inducing another in reliance upon it to part with some valuable thing belonging to him or surrender a legal right; a false representation of a matter of fact whether by words or by conduct, by false or misleading allegations, or by concealment of that which should have been disclosed, which deceives and is intended to deceive another so that he shall act upon it to his legal injury.

The ordinary meaning of “fraud” is any deception, trickery, or humbug; the crime of deceiving somebody in order to get money or things illegally; intentional perversion of truth in order to induce another to part

with something of value or to surrender a legal right; an act of deceiving or misrepresenting; wrongful or criminal deception intended to result in financial or personal gain; dishonestly making a false (untrue or misleading) representation with a view to gain or with intent to cause loss. Fraud is a misrepresentation made recklessly without belief in its truth to induce another person to act. It is a tort arising from a knowing misrepresentation, concealment of material fact, or reckless misrepresentation made to induce another to act to his or her detriment.⁴ A fraud is intentional deception resulting in injury to another. Fraud usually consists of a misrepresentation, concealment or nondisclosure of a material fact, or at least misleading conduct, devices or contrivance.⁵

Section 2(26) of the IPC states that a person is said to do a thing fraudulently if he does that with intent to defraud but not otherwise.

Section 17 of the India Contract Act, 1872 defines fraud as follows:

“Fraud” means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent, with intent to deceive another party thereto of his agent, or to induce him to enter into the contract:-

- (1) The suggestion, as a fact, of that which is not true, by one who does not believe it to be true;
- (2) The active concealment of a fact by one having knowledge or belief of the fact;
- (3) a promise made without any intention of performing it;
- (4) Any other act fitted to deceive;
- (5) 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.

In *S. P. Changalvaraya Naidu v. Jagannath* AIR 1994 SC 853;[1994] 1 SCC 1, the Supreme Court explained ‘fraud’ as follows: “A fraud is an act of deliberate deception with the design of securing something by taking unfair advantage of another. It is a deception in order to gain by another’s loss. It is a cheating intended to get an advantage.”

Fraud means an intention to deceive; whether it is from any expectation of advantage to the party himself or from the ill-will towards the other is immaterial. The expression “fraud” involves two elements, deceit and injury to the person deceived. Injury is something other than

³. *S.K.Gupta v. K.P.Jain* [1979] 49 Comp Cas 342 (SC)

⁴. *See Black's Law Dictionary*, 8th Edn.

⁵. *Barrons Dictionary of Legal Terms*.

economic loss, that is, deprivation of property, whether movable or immovable or of money and it will include any harm whatever caused to any person in body, mind, reputation or such others. In short, it is a non-economic or non-pecuniary loss. A benefit or advantage to the deceiver, will almost always cause loss or detriment to the deceived. Even in those rare cases where there is a benefit or advantage to the deceiver, but no corresponding loss to the deceived, the second condition is satisfied.⁶

Fraud is a conduct either by letter or words, which induces the other person or authority to take a definite determinative stand as a response to the conduct of the former either by words or letter. It is also well-settled that misrepresentation itself amounts to fraud. Indeed, innocent misrepresentation may also give reason to claim relief against fraud. A fraudulent misrepresentation is called deceit and consists in leading a man into damage by wilfully or recklessly causing him to believe and act on falsehood. It is a fraud in law if a party makes representations, which he knows to be false, and injury ensues therefrom although the motive from which the representations proceeded may not have been bad. An act of fraud on the court is always viewed seriously. A collusion or conspiracy with a view to deprive the rights of the others in relation to a property would render the transaction void ab initio. Fraud and deception are synonymous. Although in a given case a deception may not amount to fraud, fraud is anathema to all equitable principles and any affair tainted with fraud cannot be perpetuated or saved by the application of any equitable doctrine including *res judicata*.⁷

MEANING OF FRAUD FOR THE PURPOSES OF SECTION 143(12)

While an auditor is under the statutory obligation to report an offence of fraud under Section 143, the Section does not define the expression “offence of fraud” or the term “fraud”, nor is there a definition in Section 2 of the Companies Act, 2013. However, Section 447 of the Companies Act, 2013, which provides for punishment for fraud, defines fraud. Section 143 itself does not provide for punishment for fraud. But Section 143 refers to “offence of fraud” and Section 447 prescribes punishment if any person who is found to be guilty of fraud. Therefore, a person found guilty of fraud reported by the auditor will be punished (if found guilty) under Section 447.

Section 447 defines in the Explanation, the term ‘fraud’ as follows:

“fraud” in relation to affairs of a company or any body corporate, 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

The definition in section 447 is an inclusive definition; so apart from what is stated in the definition as the meaning of fraud, the ordinary meaning of fraud as appropriate in the context of the provision will also apply, since Where in a definition clause the word “includes” is used, it is so done in order to enlarge the meaning of the words or phrases occurring in the body of the statute and when it is so used, these words or phrases must be construed as comprehending not only such things which they signify according to their natural import, but also those things which the interpretation clause declares that they shall include.

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.

The essential ingredients of the definition of fraud, read with and for the purposes of Section 143(12), to be reported by an auditor under Section 143(12), are as follows:

1. As the words “*an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company*” point out, a fraud to be reported by the auditor must be concerning the company in question. A fraud in relation to any other company (including holding, subsidiary or associate company) or any other person or entity cannot come within the ambit of this definition. So, a fraud concerning company A cannot be ascribed to company B or body corporate B.
2. As the words “*by its officers or employees*” point out, the fraud must have been committed by an officer or employee of the company either individually or together with two or more officers or employees in connivance with each other, acting together. A fraud committed by any person other than an officer or employee of the company cannot come within the ambit of Section 143(12) although it falls within the definition of fraud in Section 447.
3. Since the definition is inclusive one and it has not been specifically made applicable in the case of Section 143(12), any act which constitutes fraud in its ordinary meaning or as interpreted by a court of law (if the judgement has attained finality) may also amount to fraud for the purposes of this definition. A definition of fraud in any other law can also be taken aid of. In particular, the definition in the Indian Contract Act would be relevant to understand meaning of fraud in ordinary parlance.

⁶ *Dr. Vimla v. Delhi Administration* [1963] 33 Comp Cas 279; and *Indian Bank v. Satyam Fibres (India) Pvt. Ltd.* [1998] 92 Comp Cas 149; [1996] 5 SCC 550

⁷ *Ram Chandra Singh v. Savitri Devi* [2003] 8 SCC 319; *Commissioner of Customs (Preventive) v. Aafloat Textiles (I) P. Ltd.* AIR 2009 SC (Supp) 2320.

4. To constitute fraud, there must be intention on the part of the person(s) 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.
5. A wrongful gain by the fraudster must have been caused by unlawful means to any property of the company by reason of the fraudulent act of the fraudster.
6. A wrongful loss to the company must have been caused by reason of the fraudulent act of the fraudster.

WHAT IS 'MENS REA'

The expression "with intent to" envisages *mens rea* as an essential requirement of offence of fraud. *Mens rea* is variously described, such as guilty mind, blameworthy mind, criminal intention, evil intent, guilty or wrongful purpose etc. *Mens rea* is one of the essentials of a crime. It means 'criminal intent', the essential mental element that in theory has to be proved for all crimes, although in practice some statutory offences are crimes of absolute liability, regardless of criminal intent. Every crime requires a mental element. Even in strict or absolute liability some mental element is required. *Mens rea* or *actus non facit reum nisi mens sit rea*⁸ is considered a fundamental principle of penal liability.

It is a well-established principle of criminal law that unless the statute either clearly or by necessary implication, rules out *mens rea* as a constituent part of an offence an accused should not be found guilty of the offence unless he has got a guilty mind. The broad principles which apply in deciding the question as to whether *mens rea* must be proved in regard to a given criminal offence are well established. Generally speaking, a person cannot be convicted unless he commits an overt act with a wrongful or illegal intention, *i.e.* the presence of *mens rea* is usually treated as a condition precedent for the successful prosecution of a person. It is, however, open to the Legislature to provide for offences where *mens rea* may not be an essential element. If the Legislature expresses its intention in that behalf in unambiguous and clear language, the principle that *mens rea* must ordinarily be established in a criminal case would have no application. Instances where the Legislature has expressed such an intention are not unknown. These, however, constitute statutory offences of a minor and quasi-criminal

⁸ *The maxim actus non facit reum nisi mens sit rea means that the intent and act must both concur to constitute the crime; the act itself does not make a man guilty unless his intention were so or his mind is also guilty. Actus reus (Latin) means a guilty act; the wrongful that comprises the physical components of a crime and that generally must be coupled with mens rea to establish criminal liability. The essential element of a crime that must be proved to secure a conviction, as opposed to the mental state of the accused. In most cases the actus reus will simply be an act (e.g. appropriation of property is the act of theft) accompanied by specified circumstances (e.g. that the property belongs to another). Sometimes, however, it may be an omission to act (e.g. failure to prevent death may be the actus reus of manslaughter) or it may include a specified consequence (death resulting within a year being the consequence required for the actus reus of manslaughter or murder). In certain cases the actus reus may simply be a state of affairs rather than an act (e.g. being unfit to drive through drink or drugs when in charge of a motor vehicle on a road).*

character. In the absence of clear and unambiguous language indicating such an intention on the part of the Legislature it may be permissible to ascertain the intention of the Legislature by examining the object of the statute in question and its general scheme. The nature and extent of the punishment awardable under the statute may also have to be considered. As often happens it is not very difficult to enunciate these broad principles; the difficulty arises in applying them to the facts in a particular case.⁹

Thus, the words of a statutory provision play a decisive role in its interpretation to determine the question whether it involves *mens rea* as an essential ingredient of the offence or not.

REQUIREMENT AS TO DISCLOSURE IN BOARD'S REPORT

As per second proviso to Section 143(12), 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 134(3)(ca) provides: There shall be attached to statements laid before a company in general meeting, a report by its Board of Directors, which shall include—¹⁰(ca) details in respect of frauds reported by auditors under sub-section (12) of section 143 other than those which are reportable to the Central Government.

Rule 13(4) requires as follows:

"(4) The following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) during the year shall be disclosed in the Board's Report:

- (a) Nature of Fraud with description;
- (b) Approximate Amount involved;
- (c) Parties involved, if remedial action not taken; and
- (d) Remedial actions taken."

NFRA'S CIRCULAR

The NFRA (National Financial Reporting Authority) issued a circular on 26th June 2023 on Statutory Auditors' Responsibilities in relation to fraud in a Company,

⁹ *Clayfield Holland Ltd., In re (1953) 55 Bom LR 768.*

¹⁰ *Exceptions, Modifications and Adaptations to an unlisted public company licensed to operate from IFSC located in approved SEZ under Section 462.—In sub-section (3), following proviso shall be inserted, namely:—*

"Provided that in case of a Specified IFSC public company, if any information listed in this sub-section is provided in the financial statement, the company may not include such information in the report of the Board of Directors." [Notification No. GSR 8(E), dated 4-1-2017]

Exceptions, Modifications and Adaptations to a private company licensed to operate from IFSC located in approved SEZ under Section 462.—In sub-section (3), the following proviso shall be inserted, namely:—

"Provided that in case of a Specified IFSC private company, if any information listed in this sub-section is provided in the financial statement, the company may not include such information in the report of the Board of Directors. [Notification No. GSR 9(E), dated 4-1-2017]

wherein the reporting responsibility of statutory auditors would also be applicable in cases where the auditor is not the first person to identify or suspect fraud. The Circular seeks to extend the scope of the reporting requirements of Statutory Auditors to include such frauds that have not been identified by them. This advice runs contrary to the plain language of Section 143(12) and thereby modify the provision in subsection (12), which, as noted earlier, clearly provides that the auditor has a reason to believe that a fraud had been committed in the company and such belief occurred to the auditor in the course of the performance of his duties (as an auditor of the company).

Clause 4.2 of NFRA circular states that:

“The Statutory Auditor is duty-bound to submit Form ADT-4 to the Central Government u/s 143 (12) even in cases where the Statutory Auditor is not the first person to identify the fraud/suspected fraud.”

It is a well-settled principle of statutory interpretation that the words used in the Section must be given their plain grammatical meaning.¹¹ This is the ‘literal rule’ (called the ‘golden rule of interpretation’) is the basic and cardinal rule of interpretation of statutes, according to which words that are reasonably capable of only one meaning must be given that meaning whatever may be the result. If the words used are capable of one construction only then it would not be open to the Courts to adopt any other hypothetical construction on the ground that such construction is more consistent with the alleged object and policy of the Act.¹² The intention of the Legislature must be gathered from the words used by the Legislature, for the words declare best the intention. The Legislature might have intended to do a certain thing, but if the words employed do not express that intention, it is not for the courts to assume the role of legislators and give effect to the unexpressed intention. No confusion must be made ... between what the draftsman might have intended to do and the effect of the language which in fact was employed by him. If the words, which are a medium of expressing intention, fall short of declaring the intention, it is for the Legislature to amend the language of the Section. So far as the courts are concerned, where the words are clear and precise, they must be given their natural meaning.¹³

Moreover, it is against the principle of statutory interpretation to insert any words in a statute. No words can be added in, or deducted from, a statute. It is a corollary to the general rule of literal construction that nothing is to be added to or taken out from a statute unless there are adequate grounds to justify the inference the legislature intended something which it omitted to express.¹⁴ The intention of the legislature is required to be gathered from the language used and, therefore, a construction, which requires for its support

with additional substitution of words or which results in rejection of words as meaningless has to be avoided.¹⁵

There does not seem to be any other statutory obligation under any other provision of the Act or Rules requiring reporting of details of frauds in the Board's Report, and therefore, a company is not required to disclose in the Board's Report the instances of fraud as identified by the management and informed to the Auditors and in turn informed to the Audit Committee consequent to the NFRA circular.

The NFRA's circular of 26th June 2023 only advises that the reporting responsibility of statutory auditors would also be applicable in cases where the auditor is not the first person to identify or suspect fraud. The Circular emphasis in its Clause 4.2 that “The Statutory Auditor is duty-bound to submit Form ADT-4 to the Central Government under Section 143(12) even in cases where the Statutory Auditor is not the first person to identify the fraud/suspected fraud.” It does not seek to modify the statutory provisions under Section 143(12) and Rule 13 of the Companies (Audit and Auditors) Rules 2014 by adding a new requirement besides what those statutory provisions lay down.

ICAI GUIDANCE NOTE

The Institute of Chartered Accountants of India has issued a Guidance Note on Reporting of fraud under Section 143(12) of the Act and Rule 13 of the Audit Rules. The following paragraphs of the Guidance Note are relevant in the present circumstances.

- Paragraph 47 of the Guidance Note technically explains the meaning of the terms “reason to believe”, “knowledge” and “suspected offence involving fraud” used in Section 143(12) read with Rule 13.
- Paragraph 48 of the Guidance Note clarifies that based on a harmonious reading of Section 143(12) and Rule 13, reporting on fraud in the course of performance of duties as auditor, would be applicable only when the auditor has 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.
- Paragraph 90 of the Guidance Note clarifies that when a fraud involving an amount above the specified threshold is reported by the auditor to the Board or Audit Committee, they are required to evaluate the matter, where applicable, and take appropriate action, including, where required an investigation/forensic audit conducted either by appropriate internal specialists of the company or external specialists/experts and respond to the auditor within 45 days of their communication.
- Paragraph 96 of the Guidance Note requires the auditor to evaluate the response of the Board or Audit Committee.

¹¹ *Madanlal Fakirchand Dudhediya v Shree Changdeo Sugar Mills Ltd AIR 1962 SC 1543*

¹² *Kanailal Sur v. Paramnidhi Sadhu Khan AIR 1957 SC 907; State of Maharashtra v. Nanded Parbhani Z.L.B.M.V. Operator Sangh 2000 AIR SCW 261.*

¹³ *Madanlal Fakirchand Dudhediya v Shree Changdeo Sugar Milla Ltd [1958] 28 Comp Cas 312 (Bom).*

¹⁴ *Maxwell on the Interpretation of Statutes, 12th edn, page 33*

¹⁵ *State of Maharashtra v. Nanded Parbhani Z.L.B.M.V. Operator Sangh 2000 AIR SCW 261.*



- Paragraph 98 of the Guidance Note provides that where the Board or the Audit Committee has provided its reply on the basis of an investigation/forensic audit, the auditor is not expected to re-perform or carry out an independent investigation/audit of the same. The auditor is only expected to review the process followed by investigation/forensic audit to gain comfort on the scope, period covered, persons covered, information gathered, scope exclusions, reasonableness of the amounts involved and the competence of the expert conducting the competence, experience and seniority of the persons who have conducted the investigation/forensic audit.
- Paragraph 100 of the Guidance Note provides that pursuant to the reply of 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, the need for reporting the matter to the Central Government would not be applicable.

The Guidance Note suggests that when the auditor reports any matter or issue concerning fraud to the Board or the Audit Committee seeking their reply or observations, it is only an initial belief of the auditor regarding a suspected offence. The Guidance Note has introduced an element of natural justice so as to ensure that a reply given by the Board or Audit Committee is properly considered by the auditor before he decides to report the matter to the Central Government. Where the auditor is satisfied with the response given by the Board or Audit Committee, it necessarily follows that the initial opinion of the auditor was not justified and there is no reason for the auditor believe or claim knowledge of a suspected fraud that would attract reporting under Section 143(12) of the Act read with Rule 13 of the Audit Rules to the Central Government. We believe that the Guidance Note correctly and harmoniously interprets the statutory provisions in light of principles of natural justice (which are followed under Indian law in accordance with common law principles) and if the special forensic audit takes a different view of the matter, the statutory auditor India is expected to follow the forensic report, and statutory auditor will then not be required to report the matter to the Central Government.

The provisions of Paragraph 98 of the Guidance Note are particularly relevant. We believe that in cases where on receipt of an initial notice from the auditor, the Board decides to provide its reply on the basis of an investigation/forensic audit, the auditor is not expected to re-perform or carry out an independent investigation/forensic audit to validate the report of the forensic accountant. The auditor is only expected to review the process followed by the forensic accountant i.e. to gain comfort on the scope, the period covered, the persons covered, information gathered/information gathered, scope exclusions, reasonableness of the amounts involved and the competence of the expert conducting the competence, experience and seniority of the persons who have conducted the investigation/forensic audit. It would appear that any other approach would necessarily cause the auditor to lose objectivity. Moreover, the auditor is not an investigating agency and where a specialized investigating agency has been appointed, an auditor will not be justified in substituting his own opinion for that of the specialized agency, so long as the process followed is properly undertaken by forensic auditors of competence, experience, independence, objectivity and seniority.

PENALTY FOR NON-COMPLIANCE

Subsection (15) of Section 143 provides that if any auditor, cost accountant, or company secretary in practice does not comply with the provisions of sub-section (12), he shall,—

- (a) In case of a listed company, be liable to a penalty of five lakh rupees; and
- (b) In case of any other company, be liable to a penalty of one lakh rupees.

This provision does not make the non-compliance an offence punishable with fine and/or imprisonment; rather it makes the non-compliance subject to penalty on adjudication under section 454 of the Act. Of course, any disciplinary action by the respective Institute of which the person is a member may subject him/her to disciplinary action according to the applicable provisions.

