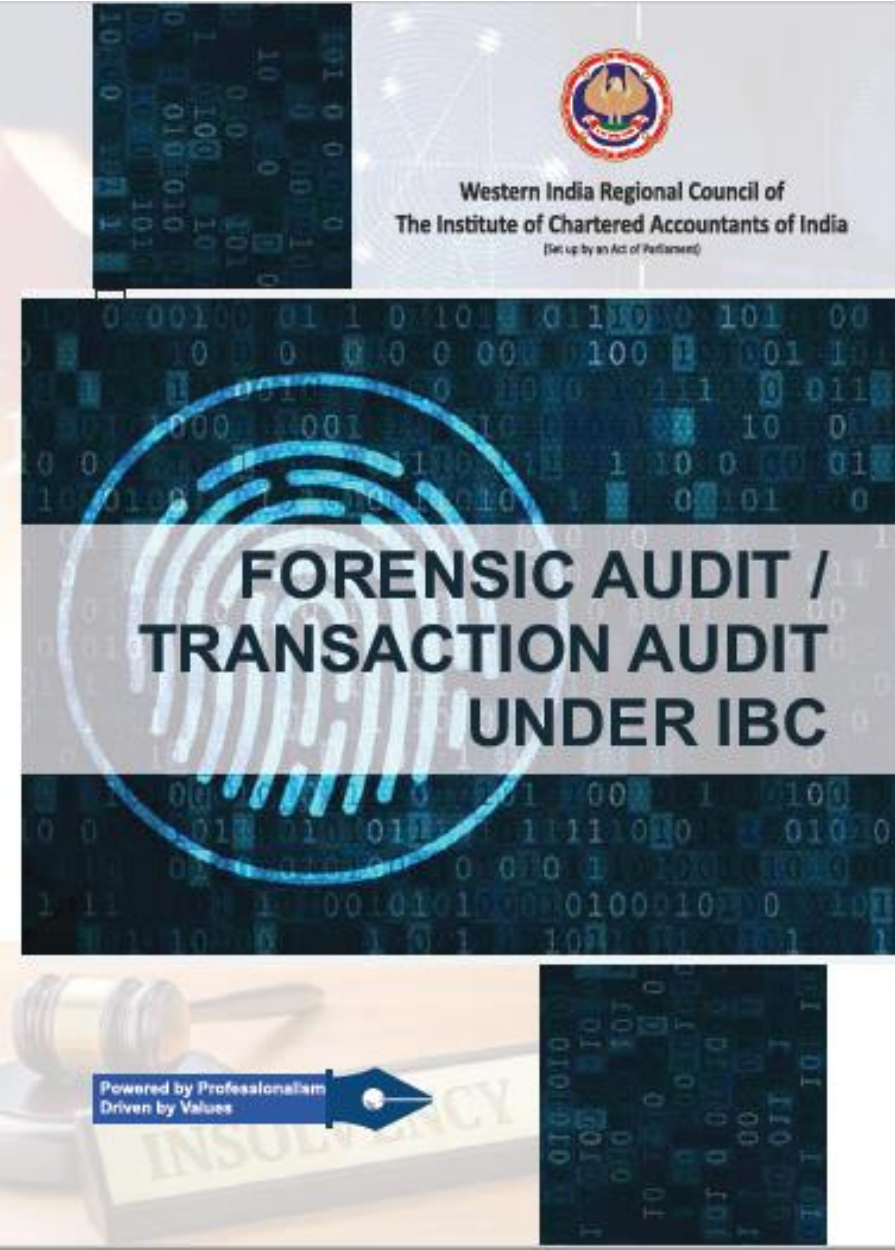


CONDUCTING TRANSACTION AUDIT UNDER PROVISIONS OF IBC, 2016

A PRESENTATION FOR WIRC-ICAI
28/05/2021

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WIRC Guidance on Rules & Process of Transaction Audits under IBC



THE PROCESS

- Transaction Audit is not Mandated under IBC. IRP/RP appoints TA as an Expert u/s 20(2)(a) to help him detecting PUEF (Preferential, Undervalued, Fraudulent & Extortionate) transactions.
- Review by IRP/RP is necessary for transactions of Corporate Debtor undertaken in last 2 years for Related parties and 1 year for other parties looked back from the date of CIRP Commencement.
- PUEF Report needs to be filed in 75-115-135 days of CIRP Commencement date unless extension is granted by NCLT. {Sec 12(a), Regulation 35A} [RP to make opinion-determination-relief application for PUEF Transactions]
- Invitation from IRP / RP for Quotation or EOI
- Submission of Quotation / EOI
- Appointment & NDA Signing
- Transaction Audit Process
 - Managing the Promoters and KMPs
 - Data Integrity
 - Offsite Audit
 - Onsite Audit
 - Third Party / Sources Information
 - Benchmarking of Transactions
 - Interviews & Key point discussions
 - Classification of Transactions
- Draft Report Preparation & Submission
- Presentation Before COC
- Final Report
- Further Legal Hurdles

INVITATION FROM IRP / RP FOR QUOTATION OR EOI

- How to get the Invitation ???
 - If you are in IBA List
 - If you are in Consortium Leader's Bank wise Empanelment List
 - If you are empanelled with other Investigative Agencies like SEBI/ED/SFIO/EOW etc.
 - If you are not empanelled with any agency
- Does the Auditor need special qualification like CFE / FAFD / CISA?
- Formats of Invitation Letters
 - Scope of Audit
 - Period of Audit
 - IBC Sections References for the Audit
 - Locations of the Auditee and Books of Accounts
 - Restrictions on Assignment Acceptance

SUBMISSION OF QUOTATION / EOI

- Reading of the Invitation Letter in depth
- Understanding the Sections Quoted in Invitation letter
- Quotation / EOI Format
 - Cover Letter
 - Firm's Back ground
 - Details of Assignments Handled in past (Appointment Letters copies can be Annexed)
 - Re-drafting the Scope in your proposal
 - Audit Methodology
 - Schedule of Audit
 - Proposed Team Structure
 - Deliverables
 - Fees Structure
 - Expenses Reimbursement
 - Fees Validity
 - Declaration
- Submission by Post / Email
- Presentation before COC (may or may not be)
- Fees Negotiations by IRP / RP for L1 / L2 Cases

APPOINTMENT & NDA SIGNING

- Issue of Appointment Letter
- In-depth Study of the Terms and Conditions
- **Precaution for** : Additional Works Included under same fees proposed like working for Resolution Memorandum or Help in Books of Accounts closing
- Understanding the requirements of Audit and the expanded scope
- Renegotiation with IRP/RP
- NDA Signing
- Arbitrary Clauses in NDA and denial of them
 - **Example: Auditor needs to be responsible for secrecy of all documents received during audit for all time.**

TRANSACTION AUDIT PROCESS

- **MANAGING THE PROMOTERS AND KMPs**

- Promoter is highly networked with Big Politicians.
- Promoter has not done any thing wrong. But all the investments done in foreign countries have gone in vain due to policy changes there.
- Promoter is no more traceable.
- Main promoter resigned from Directorship before Account was declared NPA. Now his relatives are Directors. How promoters can be linked for any mishappening in Audit Period?
- Can Auditor enjoy few hospitalities from Promoters?
- KMPs resigned or retrenched way back when account was declared NPA
- Mishappening took place in family of KMP and he rushed to native place, never came back during the time of audit being conducted
- Managing the Promoters and KMPs is not only an art but it is also needed to have a better report, it is good only for the Auditor for his report not later on to face legal hurdle
- Consent for longer period than mandated (to avoid difficulties of mid year dates for commencement of audit period)
- Determine the Status of Cooperation: Cooperating / Non Cooperating/ Partially Cooperating Promoters

TRANSACTION AUDIT PROCESS

- **DATA INTEGRITY**
- **Access to Accounting Soft-wares**
- **Tally data can be manipulated any time**
- **SAP access normally not obtained**
- **Pirated Accounting Software or License expired**
- **Master Reports**
- **Audit Log of Files received**
- **Confirmation on Control Totals**
- **Storage of Data in secured places**
- **Promoter later on says the staff providing data has given wrong data**
- **Role of Statutory Auditor in Data Integrity**
- **Data is Evidence and Protection of Evidence key to Transaction Audit**
- **Hierarchy of Integrity of Data flow**
- **Direct Access, Email, We Transfer, Secured Server Uploading**

TRANSACTION AUDIT PROCESS

- **OFFSITE AUDIT**
- **Training to Audit Staff**
- **Audit Program**
- **List of Documents Drafting**
- **Background Check**
- **Related Parties Determination { Sec 5(24)}**
- **Analysis of Bank Statements**
- **Analysis of Ledgers**
- **Analysis of Fund Trail, Tax Documents**
- **Master Agreements**
- **Documents Analysis**
- **Balance Confirmation Letters, Sampling (80:20 formulae)**
- **Report Drafting**
- **Benefits: Cost Optimisation, Secrecy of Audit Strategies**
- **Losses: Time is Crucial, Real time Query Solving**

TRANSACTION AUDIT PROCESS

- **ONSITE AUDIT**
- **Physical Verification – People, Assets, System, Stock**
- **Logistics Documents – Key for Transaction Audit**
- **Original Documents Accessing**
- **Case Study:**
 - **One Company had a big supplier and a big customer. All three have registered office in same building where promoter resides. All three have go-downs in same block. Transactions were huge; more than thousand crores sales / thousand crores purchases among these three parties**
- **Interaction with Staff of Corporate Debtor**
- **Interviews**
- **Benefits: High Level of Interaction, On the spot Query Resolution, Less chances for Delay in Report Delivery**
- **Losses: Cost of Audit shoots up, Probable Collusion of Audit Team Members with Promoters / KMPs**

TRANSACTION AUDIT PROCESS

• **THIRD PARTY / SOURCES INFORMATION**

• Social Media :

Related Parties, Life Styles of Promoters,
Networking

• Government Websites: MCA, GSTN, RBI, IBBI etc.

• Press & Media: News on Activities

• Desktop Research: Google, Bing etc.

• Market Research: Field Verification / Benchmarking

TRANSACTION AUDIT PROCESS

• **BENCHMARKING OF TRANSACTIONS**

- Purchases: Purchase Rate Verification
- Sales: Sales Rate Verification
- Loans taken: Interest Rate Verification
- Loans given: Opportunity Lost
- IPR Acquisitions: Market Value of Similar Acquisitions from third parties of Brands, Goodwill, Copy Right, Trademarks, Patents etc.
- Labour: Staff Turnover in similar industry to ascertain level of operations vis-a-vis actual employment
- Business Agreements: Not in interest of the company
- Doubtful Transactions: Bogus, Circular, Fraud, Suspected to be Fraud, Illegal
- Other Transactions: On Case to Case basis

TRANSACTION AUDIT PROCESS

• **INTERVIEWS & KEY POINT DISCUSSIONS**

- Preferably 2 interviews at least
- Agenda for Discussion
- Major Issues Observed
- First Interview – General Discussions & Informing further Requirements
- Legal Representation – Rights of Auditee
- Exit Interview- Final Discussions & Query Resolution
- Audio / Video Recording of Interview
- Confession / Declaration Signing
- Email Confirmation of Details post interview
- Photographs of Attendees
- Rights to access Basic Amenities for Auditee
- Place of Interview
- Interviews of Suppliers, Transporters, Customers etc.

TRANSACTION AUDIT PROCESS

- **CLASSIFICATION OF TRANSACTIONS**
- **PUEF**
 - Preferential
 - Undervalued
 - Extortionate
 - Fraudulent
- **Mensrea is important consideration**
- **Evidences Available**
- **Legally Sustainable**
- **Clear Identification , No ambiguity, Conclusiveness (RBI Circular 5th June 2019)**
- **Adequately Discussed**
- **Interpretations should not be disclosed to Auditee**

PUEF: PREFERENTIAL TRANSACTIONS – SEC 43

• Covered Cases

- Transfer of property or an interest in it to creditors, surety, guarantors **in preference causing benefit** than the distribution of such assets u/s 53 – bankruptcy proceeding
(Ref.: SC : Jaypee case- IRP Anuj Jain vs. Axis Bank)
- During past 2 years to Related parties, last 1 year to Other Parties
- Creditors: Financial / Operational
- Transactions under ordinary course of business not covered

• Audit Coverage During the Period:

- Loans and advances repayment to related / other parties vs. payment to secured lenders
- All assets transferred to creditors, secured/unsecured lenders
- Unsecured loans repaid vs. Payment to Secured lenders
- Analysis of Journal Entries for Adjustment Entries among Debtors - Creditors
- Preferential Payment to Specified Suppliers from Non-consortium bank accounts
- Ageing analysis of creditors for preferential payment

PUEF: UNDERVALUED TRANSACTIONS – SEC 45

- **Covered Cases**

- Gift or Transfer of Assets significantly less than normal transactions in ordinary course of business
- During past 2 years to Related parties, last 1 year to Other Parties

- **Audit Coverage During the Period:**

- Identify Loss Making Products & Customers: GP Ratio product wise / customer wise
- Selling Price Rate Analysis among Customers
- Benchmarking of Transactions
- Ledger Accounts (discounts, rebates, material rejection, etc.) to identify adjustments in debtor accounts, highlighting subsequent reduction in sales consideration.
- Ledger Accounts to see Gift, Business Promotion, Staff welfare expenses etc.
- Background check and site visit of suspected entities/parties.

PUEF: CONSEQUENCES OF UNDERVALUED TRANSACTIONS – SEC 49

- **There should be an Undervalued transaction as per Sec 45(2) i.e. Gift or Transfer of Asset undervalued in period of review**
- **Corporate Debtor deliberately done this transaction for keeping such asset aside from claim by entitled person**
- **Adjudicating Authority shall make order for restoration of such asset for protecting interest of the entitled person / victims of the transaction**

PUEF: EXORTIONATE TRANSACTIONS – SEC 50

- **Covered Cases**

- Exorbitant Payment under the terms against Credit received
- Terms of payment are unconscionable under the principles of law relating to contracts
- Occurred During past 2 years looked back from CIRP Commencement date (1 year for Other than related parties)

- **Audit Coverage During the Period:**

- Financial or Operational debt raised in covered period
- Terms & conditions of such debt (interest rate, repayment terms, security interest etc.)
- Background check of creditors: Whether related parties or not

PUEF: WRONGFUL & FRAUDULENT TRADING – SEC

66

• **Covered Cases**

- Bogus, Frauds, Suspected to be Fraud, wrongful transactions held in past
 - Detection or Red Flags raised during Insolvency Resolution / Liquidation process
 - Corporate Debtor had intent to defraud Creditors or any other fraudulent purposes
 - Adjudicating Authority may pass order to the third parties, *who had knowingly done such transactions with Corporate Debtor*, to contribute for such assets as it may deem fit
 - Directors/ Third Party personal involvement in such transactions are liable for penal action
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- **Audit Coverage During the Period:**
 - Availing of credit facilities by overstating assets, sales, income and profit by submitting false/manipulated financial statement.
 - Drawing from cash credit account by submitting false/inflated/manipulated stock statements.
 - Assets to be financed not purchased and funds borrowed from bank mis-utilised / misappropriated for the purpose other than for which bank has sanctioned the funds.
 - Disposal/removal of assets pledged/ hypothecated/ mortgaged, without knowledge of bank.
 - Utilization of short term working capital for long term purposes, not in conformity of sanction terms.
 - Transferring borrowed funds to subsidiaries/group companies or other corporates for non-business purposes or in contravention of sanction terms.
 - Sale to related parties and subsequently debts written off.
 - Other Fraudulent Practices

OTHER AREAS OF AUDIT

- Money trail analysis of all bank accounts of the corporate debtor in order to understand nature of flow of transaction.
- Identify hidden bank account used by CD for diversion of funds, if any.
- Detailed analysis of financial statements of the company and comment on suspicious areas of manipulation, if any.
- Excessive provisioning / write offs / losses which are not in the ordinary course of business and are unusual in nature.
- Non-recurring expenditure incurred by the company.
- Check whether revenue is booked as per the applicable GAAP
- Non-moving creditors & debtors.
- Physical verification and valuation of inventory.
- Background check of major customers and vendors of the company to establish if they are the shell companies of the promoter.
- Other Areas of Concern – Case to Case basis

DRAFT REPORT PREPARATION & SUBMISSION

- INDEX
- ABBREVIATIONS
- BACKGROUND
- DISCLAIMER
- EXECUTIVE SUMMARY
- DETAILED REPORT ON TRANSACTIONS
- SUMMARISATION OF OBSERVATIONS
- CLASSIFICATION & OPINION
- SUPPORTING ANNEXURES
- PHOTOGRAPHS

PRESENTATION BEFORE COC

- Compact Presentation with Robust Explanations
- Graphs and Analysis Statements for Transactions
- Emphasis on Impact of Transactions
- Pursue your Observation, Do not Argue
- Willingness to Rectify Report where Evidences are not conclusive
- Explanation for Cost Escalations
- Additional Time requests for making the Changes suggested by COC

FINAL REPORT

- Additional Audit Procedures
- Effective Changes and Re-Discussion among Audit Team
- Additional Interview with Promoters if Interpretation changes on submission of new records
- Promoters try maximum to drop all audit observations
- Final Report with ICAI UDIN
- Deliverables as per Quotation / EOI/ Engagement Letter
- Preserving Evidences under Safe Custody

FURTHER LEGAL HURDLES

- Help to Lawyers appointed by RP for Preparation of Petition
- Help to RP for preparation of PUEF Report
- Drafting Explanations against Promoters' Replies in NCLT
- Appearance before NCLT / NCLAT / SC for further explanations (rare incidence)
- Appearance before Statutory Investigation Agencies like CBI / ED/ SEBI etc.
- Budget for Legal Cost of Self, Audit team members, Appearance charges normally not reimbursed by RP
 - **Be Cautious**



THANK YOU

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