



Western India Regional Council of
The Institute of Chartered Accountants of India

(Set up by an Act of Parliament)

FORENSIC AUDIT / TRANSACTION AUDIT UNDER IBC

Powered by Professionalism
Driven by Values



INSOLVENCY



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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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Published by

CA. Priti Paras Savla,

Chairperson, Western India Regional Council of
The Institute of Chartered Accountants of India,
ICAI Tower, Plot No. C-40, G Block, Opp. MCA Ground,
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Tel.: 022-336 71400 / 336 71500 • E-mail: wirc@icai.in • Web.: www.wirc-icai.org

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Foreword



India is fast integrating into the global accounting industry. This integration is bringing about increased demand for specialized verticals such as forensic accounting whose demand continues to grow at a rapid pace.

Professional Accounting and business magazines and newsletters alike predict the trend requiring more forensic aware accountants will only continue. To that end, WIRC has also been increasingly focusing on this specialized area through more seminars, conferences and lectures aimed at increasing awareness of this field.

With more and more instances of financial improprieties and related litigation taking place, expanding the contexts and the venues to increase the relevant skill set of our members is an invaluable asset towards resolving the matter.

This book will cover important topics including the IBC and Relevant Sections for Transactional / Forensic Audit / Transaction Audit under IBC like Preferential Transaction & Relevant Time, Undervalued Transactions, Transactions Defrauding Creditors, Extortionate Credit Transactions and Fraudulent Initiation of Insolvency to name a few.

WIRC publication on 'Forensic Audit / Transaction Audit under IBC' looks forward to expand the knowledge base of Chartered Accountants.

Today, as the world favours India with ever increasing commerce, trade and services, Chartered Accountants are in the right place to provide services which will further the goal of putting India on the global accounting map.

I would like to say that the entire exercise of compilation of this unique work is in itself a great learning experience.

I would like to thank WIRC Internal Audit Committee and Insolvency & Bankruptcy Code Committee Chairman and all the Contributors who have gifted their most invaluable assets - knowledge and time; in order to make 'Forensic Audit / Transaction Audit under IBC' a premium WIRC publication.

I am sure that this book will be immensely useful to my professional colleagues and will help them to serve their clients and society better.

CA Priti Savla
Chairperson, WIRC

Preface



Every year billions of dollars are lost to fraud and corruption resulting in inefficiencies, aborted projects, financial challenges, organizational failure, and, in extreme cases, humanitarian disaster. Often fraud occurs because of poorly designed controls and weak governance undermining the organization's processes.

Internal auditors must have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organization.

It should consider where fraud risk is present within the business and respond appropriately by auditing the controls of that area, evaluating the potential for the occurrence of fraud and

how the organization manages fraud risk through risk assessment, and audit planning

Operationally, internal audit should have sufficient knowledge of fraud to:

- Identify red flags indicating fraud may have been committed.
- Understand the characteristics of fraud and the techniques used to commit fraud, and the various fraud schemes and scenarios.
- Evaluate the indicators of fraud and decide whether further action is necessary or whether an investigation should be recommended.
- Evaluate the effectiveness of controls to prevent or detect fraud

The threat of fraud is one of the most common challenges to governance that organizations face without regard to size, industry, or location. Having proper internal control procedures in place that include an appropriate response plan is fundamental to battling fraud. Internal audit possesses intimate control knowledge of the organization. A combined assurance approach is key in this regard to understand the gaps in controls to allow for the manifestation of fraud

CA. Murtuza Kachwala

Chairman, Internal Audit Committee, WIRC

Preface



With the advent of the Insolvency and Bankruptcy Code (IBC), one of the supplementary area that is picking up is the transaction Audits for the past transactions in which the Insolvency Professional can appoint a competent external agency for conducting the same. Also there are other area wherein the review of the resolution applicant is required to be investigated for various pre-conditions under Sec 29A. These reviews are alike a forensic audits and also commonly called so. Specialising in this kind of review can be a good opportunity which is evolving and can be of interest for many emerging and growing firms.

While running assignments in this regard, we found that the effectiveness of such assignments will be higher if the Auditors are aware about the legal landscape and procedures under this code. At the same time, it will be of great help if the Insolvency Professionals are aware about the tactical aspects of such assignments. Hence, we have included practical case studies as well in this book.

This book is like a complete wrap up of all the relevant areas which an auditor should be aware of including the legal side before taking up such professional assignments. This may be of interest to the Insolvency professionals who may get answers to various procedural and basic legal aspects.

We have Delved upon various questions that an auditor and an Insolvency Professional Faces in the appointment, process and reporting of such assignments. Since the law is meagre 4 years old, we have used our interpretations by the courts wherever available. Wherever there is a prevailing ambiguity, we have gone ahead with our personal interpretations basis our discussions, past experience and best understanding. The interpretations can be challenged and changed over a period of time and even the law may evolve. Hence this remains a humble attempt of path finding and not the ultimate verdict. In this backdrop, we may work on coming up with fresh editions of this work, given a opportunity and update our interpretations and views in a periodical manner.

We acknowledge the WIRC of the ICAI for allowing us to work on this publication and make it available to the fellow professionals at different levels.

CA Mitesh Katira

Author, Forensic Audit Manual

Preface



India is fast integrating into the global accounting industry. This integration is bringing about increased demand for specialized verticals such as forensic accounting whose demand continues to grow at a rapid pace.

Professional Accounting and business magazines and newsletters alike predict the trend requiring more forensic aware accountants will only continue. To that end, WIRC has also been increasingly focusing on this specialized area through more seminars, conferences and lectures aimed at increasing awareness of this field.

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WIRC's 'Forensic Audit' publication looks to expand the knowledge base of Chartered Accountants as well as other finance professionals by covering relevant subjects in one book.

Today, as the world favours India with ever increasing commerce, trade and services, Chartered Accountants are in the right place to provide services which will further the goal of putting India on the global accounting map. To that end, 'Forensic Audit' has been thoroughly updated and the latest amendments and changes have been included.

I would like to say that the entire exercise of compilation of this unique work is in itself a great learning experience. We appreciate the tremendous time and effort invested into the making of this book and thank all the members for their coordination, support and guidance for completing and publishing it amidst tight deadlines.

I would like to thank WIRC Digital Transformation & Technology Committee Chairman CA. Yashwant Kasar and all the Contributors who have gifted their most invaluable assets - knowledge and time; in order to make 'Forensic Audit' a premium WIRC publication.

I am sure that this book will be immensely useful to my professional colleagues and will help them to serve their clients and society better.

CA. Vikash Jain

Chairman, Insolvency & Bankruptcy Code Committee, WIRC

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CA. Tarun Ghia

Contributors

CA Mitesh Katira
CA Huzeifa Unwala

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CA Chetan Dalal
CA Hemant Mehta
Mehul Pawani

INDEX

| Particulars | Page Nos. |
|---|-----------|
| Foreword | |
| CA. Priti Savla, Chairperson, WIRC of ICAI..... | i |
| Preface | |
| CA. Murtuza Kachwala, Chairman, Internal Audit Committee, WIRC..... | ii |
| CA Mitesh Katira , Author, Forensic Audit Manual..... | iii |
| CA. Vikash Jain, Chairman, Insolvency & Bankruptcy Code Committee, WIRC..... | iv |
| Forensic Accounting..... | 1 |
| Quick overview of the Insolvency & Bankruptcy Code..... | 7 |
| Applicability..... | 7 |
| Institutional Framework..... | 7 |
| Judicial Framework of the Code..... | 7 |
| Operational Framework..... | 8 |
| History of Debt Resolution Mechanisms in India..... | 8 |
| Global Practice Laws (Country-wise)..... | 8 |
| Reasons for Insolvency..... | 9 |
| Statistics on modus operandi identified under Fraud..... | 10 |
| Relevant Sections for Transactional / Forensic Audit under Insolvency and Bankruptcy Code..... | 13 |
| Section 43 : Preferential Transaction & Relevant Time..... | 13 |
| Bare Act :..... | 13 |
| Explanation & Understanding:..... | 14 |
| Time Frame to go back:..... | 14 |
| Analysis of relevant quoted Case Law:..... | 14 |
| Reported Relevant Case Laws:..... | 16 |
| Section 45 : Undervalued Transactions..... | 17 |
| Bare Act :..... | 17 |
| Explanation & Understanding:..... | 17 |

| | |
|---|----|
| Time Frame to go back:..... | 17 |
| Practical Illustrations | 17 |
| Reported Relevant Case Laws:..... | 17 |
| Section 49 : Consequence of entering into an Undervalued Transaction..... | 18 |
| Bare Act : | 18 |
| Explanation & Understanding: | 18 |
| Section 50 : Extortionate Credit Transactions..... | 18 |
| Bare Act : | 18 |
| Time Frame to go back:..... | 19 |
| Illustration:..... | 19 |
| Section 66 : Wrongful and Fraudulent Trading..... | 19 |
| Bare Act : | 19 |
| Explanation & Understanding: | 20 |
| Time Frame to go back:..... | 20 |
| Reported Relevant Case Laws:..... | 20 |
| Section 29(a) :..... | 20 |
| Bare Act : | 20 |
| Explanation & Understanding: | 21 |
| Reported Relevant Case Laws:..... | 22 |
| Section 65 : Fraudulent Initiation of Insolvency Process..... | 22 |
| Bare Act : | 22 |
| Explanation & Understanding: | 23 |
| Time Frame to go back:..... | 23 |
| Illustration:..... | 23 |
| Reported Relevant Case Laws:..... | 23 |
| Sec 5(24): Defining the related parties | 23 |
| Explanation & Understanding: | 26 |
| Relevant questions with respect to Transaction Audits: | 26 |
| Appointment of an Transaction Auditors..... | 26 |
| Who is liable to report PUF E Transactions to the | |

| | |
|--|----|
| Adjudicating Authority ? | 26 |
| Is it mandatory to appoint a transaction auditor for an Insolvency Resolution matter? | 27 |
| What is the typical Process flow for appointing a transaction auditor in a matter?..... | 27 |
| At what juncture in the process, is it required to appoint a transaction auditor? | 28 |
| What is a typical scope for the transaction audit?..... | 28 |
| Can an RP ask for names of the past cases handled by the Transaction Auditor?..... | 29 |
| Does the CoC have a say in identifying a transaction auditor?..... | 30 |
| Transaction Audit Process | 30 |
| Understanding of the business of the Auditee..... | 30 |
| Chain of transactions | 30 |
| Major Risk areas of review under the Transaction Audit | 31 |
| Typical Audit Program | 31 |
| What are the suggested Tools and techniques for the handling the assignment? | 33 |
| Can't the auditor go beyond the given time frame as "relevant time frame"?..... | 34 |
| What is a Potential Phoenixing? | 35 |
| Meaning | 35 |
| Reporting by the Forensic Auditor..... | 36 |
| What is the timeline for submission of Forensic Audit Report?..... | 36 |
| What is the reporting hierarchy for the Transaction Auditor? | 37 |
| Is the Transaction Auditor Required to Classify the Transactions into various Sections of the I & B Code? | 37 |
| Limitations and Disclaimers..... | 37 |
| Whether the RP can use the report to pursue further legal action of the alleged parties?..... | 37 |
| Whether the Transaction Auditor be called for giving an Expert witness in the court of law?..... | 37 |
| Qualifications for the Forensic Auditors | 38 |

| Particulars | Page Nos. |
|--|------------------|
| Academic accreditations to look for in the Forensic Auditors | 38 |
| Opportunities for Chartered Accountants in Forensic Audit..... | 38 |
| Few agencies where an empanelment can be helpful in getting forensic audit assignments..... | 39 |
| Acronyms:..... | 40 |
| Bibliography | 41 |
| Disclaimer | 41 |
| Annexures | 41 |
| Annexure I: | |
| Draft Format of an Request for Proposals from the Transaction Auditors..... | 42 |
| Annexure II: | |
| Draft Format of an Appointment Letter for the transaction auditors..... | 44 |
| Annexure III: | |
| Disclaimer for a Transaction Audit Report | 46 |

FORENSIC ACCOUNTING

1. Fraud definition

The term Fraud is associated with intentional deception, lies or illegal activities carried on by an individual or group of individuals who look at exploiting internal control weaknesses or loopholes in the system. Such opportunities to perpetrate fraud are possible where there are open vulnerabilities in systems, processes or casual attitudes of entities, these act like invitation to fraudsters who design well thought out schemes to exploit them for illegal gains.

Lawmakers through various laws around Contracts Act, Companies Act, Corruption/ Bribery, Money Laundering, Insolvency, etc have defined Fraud or activities that may be regarded as fraudulent. However, with each passing year Fraudsters have come up with newer modus operandi and novel ways of beating the system. Rather once a new law is introduced fraudsters use their acumen to design new fraud schemes to beat the law and prevailing systems. The general point of view is that fraud prevention is always better than fraud detection and investigation. It is less expensive and more efficient to prevent fraud from occurring than to detect it after occurrence. Usually, by the time the fraud is unravelled, the money is unrecoverable or the chance to recover the full amount of the loss is very slim. Furthermore, it is costly and time consuming to investigate, re-construct fraudulent transactions, hunt the perpetrators and re-coup the monetary losses especially involving large-scale cross border transactions. Therefore, Board of Directors and regulators lay greater emphasis on designing preventive internal controls and establishing good ethical climate in the organisation through specific and precise internal control design that target open vulnerabilities in the system and processes.

As per the explanation to section 447 of companies Act 2013, fraud 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.

2. Statutory auditor's obligation to report frauds

Sub-section 12 of Section 143 of the Companies Act, 2013 states, *“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 involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within such time and in such manner as may be prescribed.”* According to the section, the auditor should immediately but not later than sixty day from the date of his knowledge and after following the procedure given under the section, report to the central government. The limit set by the Companies Act/ Rules for fraud reporting by statutory auditors is Rs. 1 Core or above.

3. Types of Frauds

There various fraud types, however, we can summarize them into six buckets for ease of reference: -

1. Unethical conduct or behaviour such as theft, robbery, deception/ cheating, breach of trust, etc
2. Fraudulent financial reporting (misappropriation of assets, revenue & misapplication of accounting policies)
3. Bribery & corruption
4. Money laundering
5. Computer crimes & extortion
6. Conflicts of interest – When a fraudster uses his/her influence for personal gains detrimental to the company.

4. Fraud Triangle & Fraud Diamond Theory

The famous Fraud Triangle Theory (FTT, Sutherland & Cressey) consists of three elements that are necessary for fraud to occur: (i) perceived pressure, (ii) opportunity, and (iii) rationalization. David T. Wolfe and Dana R. Hermanson believed that the former FTT must be enhanced to improve both fraud prevention and detection by considering an additional element above the three, mentioned elements of FTT. They considered four-sided Fraud Diamond Theory (FDT) there by adding capability as the fourth element. They state that fraud cannot be successfully concealed unless the fraudster has capability: personal traits and abilities that play a major role in whether fraud may occur even with the presence of other three elements. Further, only the person who has an extremely high intellect and capacity will be able to understand the existing internal control, to identify its weaknesses and to use them in planning the implementation of fraud.

The largest source of fraud discovery continues to be hot tipping/ anonymous complaints where a whistle blower who has observed certain malpractices or illegal activities in the company reports such activities in full confidence and good faith to the highest level in the company. Frauds are discovered by management through supervision, regular audits, etc, however, such channels of fraud discovery are yet to emerge as most effective fraud discovery mechanisms.

Ant-fraud surveys, mock forensics and fraud risk assessments are the new age tools used effectively by senior management to manage the fraud risks effectively.

5. Forensic Accounting & its applications

The word “Forensic” comes from the Latin word “Forensis”, meaning “of the forum”, where the law courts of ancient Rome were held. Today forensic refers to the applications of scientific principles and practices to the adversary process where especially knowledgeable scientists (to be read as “experts”) play a role.

The Concise Oxford Dictionary defines “Forensic” as relating to or denoting the application of scientific methods and techniques to the investigation of crime or relating to courts of law and “Audit” as an official inspection of an organization’s accounts, typically by an independent body. Both put together forensic audit really relates to investigation, examination, calculation of data, creation of evidence in such a manner that it can stand legal scrutiny. On analysing the two meanings under the same light we may define the term “Forensic Audit” as: -

An examination of the records, information, information systems and persons, consequent to a report of suspicious activity or preliminary prima facie evidence produced by any individual or team of individuals, to obtain preliminary prima facie evidence of such suspicious activity and conduct further detailed investigation and interrogations, and record the same in reports as evidence to testify in formal hearings by an authority.

Responsibilities and obligations of a forensic accountant/ auditor include: -

1. Plan the project and carefully review progress at each stage of the project
2. Fact-finding to see whether a Fraud or computer crime has taken place.
3. Develop a chronology of events, facts and records and trace back the money trail
4. Collect direct/ ocular or indirect evidences
5. Compute the amount of damages caused by wilful deceit / fix the quantum of the fraud or computer crime.
6. Provide opinion whether criminal proceedings are to be initiated or not
7. Take verbal or written statements from suspects & other
8. Obtain and collect evidence and preservation of evidence.
9. Write reports of fraud examination to testify to findings.
10. Assist in fraud detection and prevention.
11. Assist in recovering the lost assets.
12. Provide expert testimony in the Court of Law.

Forensic Accounting and Fraud Prevention specialisation is in increasing demand considering increasing incidents of cyber-crimes and frauds detection. It is the practice of utilizing accounting, auditing, CAATs/ Data Mining Tools, and investigative skills to detect fraud/ mistakes.

Forensic accountants are primarily hired by Government and policing agencies, corporates, insurance companies, auditing firms, attorneys and retail companies to conduct forensic investigations on suspected cases of fraud. Forensic accounting services and practice should be handled by forensic accounting experts, not by auditing experts. Forensic experts are hired for Fraud detection where employees commit fraud, Criminal Investigations, Outgoing Partner’s settlement, Cases related to professional negligence, Arbitration Service, Settlement on insurance claims and Dispute Settlement, etc

6. Skills and competency requirement of a Forensic Auditor

General techniques used for collecting evidence in a forensic audit include the following: -

- Networth & Lifestyle comparisons of targets
- Sourcing of information from on-line databases and social media profiling
- Substantive techniques – For example, doing a reconciliation, review of documents, etc
- Analytical procedures – Used to compare trends over a certain time period or to get comparative data from different segments
- Computer-assisted audit techniques – Computer software programs that can be used to identify fraud
- Understanding internal controls and testing them to understand the loopholes which allowed the fraud to be perpetrated.
- Interviewing the suspect(s)

Techniques Used by a Forensic Auditor

An expert investigation analysis is a product of a host of specialized exercises undertaken to tackle a case from all the possible angles of fraud. Each exercise requires expertise that can only be acquired after a concentrated study of the subject. The distinguishing factor between an expert investigator and a regular official appointed as an investigator would be the overlooking of the finer points of the case that could make a vast difference in the quality of evidence. The Forensic Auditor would use the following specialized skills to identify the intent, methodology used and the ramifications of any fraudulent activities: -

1. Transactions / Events Analysis/Computer forensic

The Forensic Auditor is an expert in building the events that finally led to the fraud by means of effective organization of documents and segregating the relevant facts from the irrelevant facts. His areas of investigation would include analysis of paper documents as well as “Information” in “Computer Systems” for this purpose, the terms “information” and “Computer System” shall have the same meaning as stated under Section 2(1) of the Information Technology Act, 2000.

2. Financial Statements Analysis

This would involve application of different analytical ratios and comparisons of similar transactions with the historical data as well as the industry trends. Accurate calculations provide key links to the possibilities of the intent behind the transactions as well as the reasons that can be used to justify the transactions.

3. Documents Analysis

A Forensic Auditor is an expert in identifying relevant facts to a case, which can serve as critical evidence during the trial. Questionable documents can be vital evidence in

proving that fraud has been committed, the nature and scope of fraud and identifying the persons responsible. However, he is not a document expert. The Forensic Auditor procures all the documents relating to the case and segregates them as per their relevance and categories. He is aware of ways to spot phony documents that could alert him as to their fraudulent nature. The ability to identify possibilities of documents tampering and referring them to Scientific Forensic Examiners in the right condition can provide conclusive evidence as to the intent of the case alongwith the acts of concealment. Preserving the documents to deliver them in their original state i.e. with original Fingerprints, Stains, Marks, Gum used, Edges etc., to the scientific expert is a very important function requiring vast experience and knowledge. If the finding of the expert is consistent with his analysis, then his report may be considered conclusive. If otherwise, then he shall further carry on his Investigative Auditing to find out the true intent behind the fraudulent activity.

4. Interviews/Voluntary Disclosures/confession statements.

Dealing with human behavior requires extremely skilled handling. Knowledge of behavioral science, psychology, kinetics is essential among numerous other areas of study to be able to elicit the appropriate facts from the interviewee without making him feel violated.

5. Preserving Forensic Evidence.

Evidence is the foundation of proving facts in the Court of Law. A fact is proved by evidence. Evidence means and includes all statements by the witness in relation to matters of fact under enquiry, and all documents produced for the exhibition in course of the enquiry. Statements made by the witness in relation to matters of fact under enquiry are called oral evidence, documents produced for the exhibition in the course of enquiry are called the documentary evidence. Anything, state of things, or relation of things, capable of being perceived by the senses, and any mental condition of which any person is conscious are taken in the fold of facts.

Preservation of evidence is the key in any civil or criminal investigations as the evidence forms the corpus delicti in most of the cases and it establishes the nature of crime. Evidence is the prime target of the defrauders. It is, therefore imperative that the forensic auditor would take the necessary steps to protect the entire documentary and circumstantial evidence, which have a bearing on the fraud. The Forensic Audit works on the “Best Evidence Rule” and Chain of Custody Principle. He deals with evidence in an extremely cautious and professional manner.

The Forensic auditors will have to consider the various legal aspects while handling the computer evidence. Thus, the skills and competency requirements of forensic auditors is diverse and shall involve the following:

1. Knowledge of legal aspects of investigation.
2. Knowledge of fraud examination process.
3. Domain knowledge of atleast one area of banking operations.

4. Psychological testing and evidence collection through interviews.
5. Usage of computer forensic tools.
6. Preservation of evidence.
7. Knowledge of providing expert testimony in the court of law.
8. Professional Membership of atleast one of the leading fraud prevention bodies to keep abreast with latest types of frauds and modus operandi.

The emphasis of Forensic Audit is on gathering evidence, and application of tools and variety of techniques, often custom-developed, to the requirements of the specific engagement. The Forensic Auditor must know how to legally obtain evidence in the form of documents and statements by interviews and other means of witnesses and related parties.

The unbiased reports written based on the fraud examination may be used to determine facts by the management, attorneys, prosecutors and others. The Forensic Auditor may be required to testify before judicial authorities of their findings

In resolving a case, the examiner postulates a theory, guilt or innocence. He may not pass any opinion on the subject but must try to investigate the case accurately towards the most probable theory.

The forensic auditor needs to be present during court proceedings to explain the evidence collected and how the suspect was identified. They should simplify the complex accounting issues and explain in layman's language so that people who have no understanding of the accounting terms can still understand the fraud that was carried out.

To summarize, a forensic audit is a detailed engagement that requires the expertise of not only accounting and auditing procedures but also expert knowledge regarding the legal framework. A forensic auditor is required to understand various frauds that can be carried out and of how evidence needs to be collected.

Quick overview of the Insolvency & Bankruptcy Code

Insolvency and Bankruptcy Code became applicable from December 2016. The primary purpose of this code is to put the Insolvency Resolution Process into fast track and get the stake holders interested in real resolution. Purpose of this code, being part of Companies (Amendment) Act, 2017 are following :

- Balancing the Interests of the Stakeholders, including alteration in prescribed order of priority of Payments
- Providing Resolution in a Time-Bound manner
- Establishing and amending the laws associated with reorganizing and resolving the insolvency of entities
- Promoting Entrepreneurship in India
- Maximizing the availability of Credit in Indian Market

Applicability

The Code provides creditors with a mechanism to initiate an insolvency resolution process in the event a Corporate debtor (the company itself) is unable to pay its debts. The Code makes available an option to the Operational Creditors (vendors and suppliers) and Financial Creditors (lenders of finance). In the event of inability to pay creditors, a corporate debtor may choose to go for voluntary insolvency resolution process, a measure by which the company can itself approach the NCLT for the purpose of revival or liquidation.

As of now the applicability is limited to a Body Corporate Entity that is Private or Public Limited Companies, whereas it shall become applicable for Partnerships and Proprietary Firms in near future.

Institutional Framework

Insolvency and Bankruptcy Board of India (IBBI) is the Regulatory and Supervisory body, which has the overall responsibility to educate, effectively implement and operationalize the Code. The Code enables the expertise of professional insolvency practitioners known as Resolution Professional (RP).

The I & B Code enables the establishment of Information Utilities, which would enhance the collection, collation, maintenance, provision and supply of financial data to businesses, financial institutions, adjudicating authority, insolvency professional and other relevant stakeholders, which will thereby serve as a comprehensive repository of information on Corporate Debtor.

The First information Utility is the National e-Governance Services Limited (NeSL).

Judicial Framework of the Code

All proceedings under the Code in respect of corporate insolvency are to be adjudicated by the National Company Law Tribunal (NCLT), which has been designed as the special one window forum which can tackle all aspects of insolvency resolution. The NCLT is

referred to as the Adjudicatory Authority in relation to insolvency of corporate persons under the Code. No other court or tribunal can grant a stay against an action initiated before the NCLT. The NCLT order can be challenged only in the National Company Law Appellate Tribunal (NCLAT). NCLAT order can be challenged directly with the Supreme Court of India.

Operational Framework

Operationally the qualified and registered Insolvency Professional shall be appointed as a custodian of the assets of the Corporate Debtor. He is been registered under the designated Insolvency Professional Agency. At the inception, the Insolvency Professional is appointed and known as the Interim Resolution Professional or IRP.

The IRP’s key responsibility is to form a Committee of Creditors or a COC. This is the committee which takes charge of the operations and the assets of the corporate debtors and manages it with the help of the RP or the resolution professional in a process called Corporate Insolvency Resolution Process or the CIRP.

History of Debt Resolution Mechanisms in India

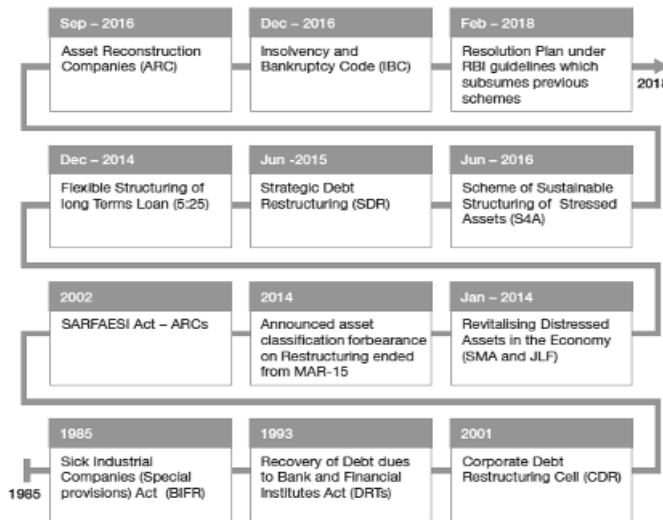


Figure 1:Debt Resolution Mechanism in India

Global Practice Laws (Country-wise)

Following is the country wise list of Acts / Laws / Regulations for Insolvency and Bankruptcy Resolutions :

Australia

In Australia, bankruptcy is governed by the Federal Bankruptcy Act of 1966. In case an individual becomes bankrupt, then a creditor can apply to the Federal Circuit Court for a sequestration order. A person can also seek protection by lodging a debtor’s petition with the Official Receiver. The debtor should owe at least \$5,000 for a creditor to lodge

a petition.

Canada

Bankruptcy is also referred to as insolvency in Canada and is governed by the country's Bankruptcy and Insolvency Act. The office of the Superintendent of Bankruptcy is responsible for overseeing the fair and orderly administration of bankruptcies in the country.

China

China legalized bankruptcy in 1986 and enacted a revised law in 2007, which was more thorough and extensive.

India

The legal definitions of bankruptcy, liquidation, insolvency, and dissolution are contested in the Indian legal system. No law existed in the past, but now the Insolvency and Bankruptcy Code 2016 is in effect, passed by the Parliament of India in May 2016.

United Kingdom

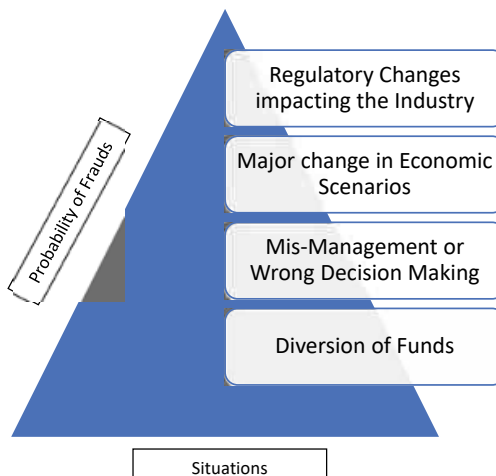
In the United Kingdom, the matter relates only to sole proprietorships and partnerships. Companies and other corporate entities come under differently named legal procedures: liquidation and administration. In Scotland, the matter is referred to as sequestration

United States

The matter of bankruptcy in the United States is placed under federal jurisdiction by the US Constitution. It empowers Congress to enact uniform laws on the subject throughout the country

Reasons for Insolvency

In our experience, major reasons why a company ends up into insolvency are :



Statistics on modus operandi identified under Fraud

Central Vigilance Commission (CVC) has undertaken a review and analysis of top 100 Bank Frauds dt. 15th Oct 2018. This reports gives recent trend analysis in Bank Frauds which could help bank and regulators to understand it. Below is the Summary of the Modus Operandi as identified by CVC in their analysis ;

| | | |
|---|---|--|
| <p style="text-align: center;">1) Fund Diversion - Mediums</p> <ul style="list-style-type: none"> • Routing of funds through non consortium bank accounts • Use of Shell Companies and non operational Companies • Transactions with group Companies / Related Parties • Fictitious Vendor Payments | <p style="text-align: center;">2) Frauds with Respect to Collateral</p> <ul style="list-style-type: none"> • Frauds due to bankers lacking information on the following: • Prior Charge on the Assets • Information on depletion / Sale / disposal of collateral | <p style="text-align: center;">3) Fabricated Debtors / Inventory Statements</p> <ul style="list-style-type: none"> • Fabricated monthly debtor and inventory statements to inflate the drawing powers of and entity and obtain higher limits • Fictitious Valuation Reports showing higher valuation • Misrepresentation of Insurance details / documents of Inventory |
| <p style="text-align: center;">4) Fabricated / Forged Submissions</p> <ul style="list-style-type: none"> • Fake Import Export Documents for remitting funds abroad - Forged Shipping Bills, Suppliers and Information • Misrepresentation of Company's Performance - Forged end use certificates from Chartered Accountants • Incorrect Representation in the Financial Statements and improbable predictions of future Cash Flows. | <p style="text-align: center;">5) Frauds Perpetrated by Employees</p> <ul style="list-style-type: none"> • Fraudulently conveying messages through SWIFT without proper Authorisation • Transactions carried out in Customer Accounts by employees without customer knowledge • Transactions approved in the system by staff in violation of Anti-Money Laundering Guidelines | |

Illustration 1

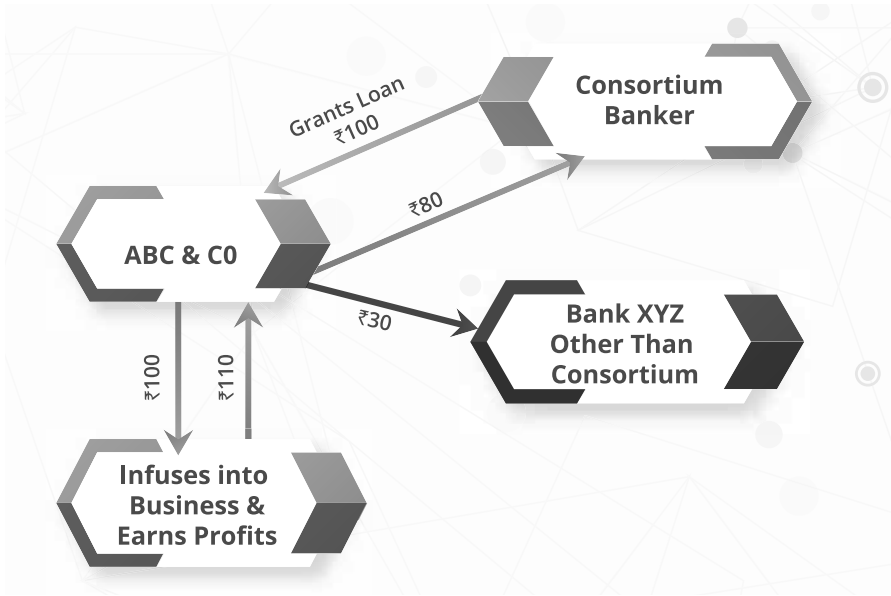


Illustration 2

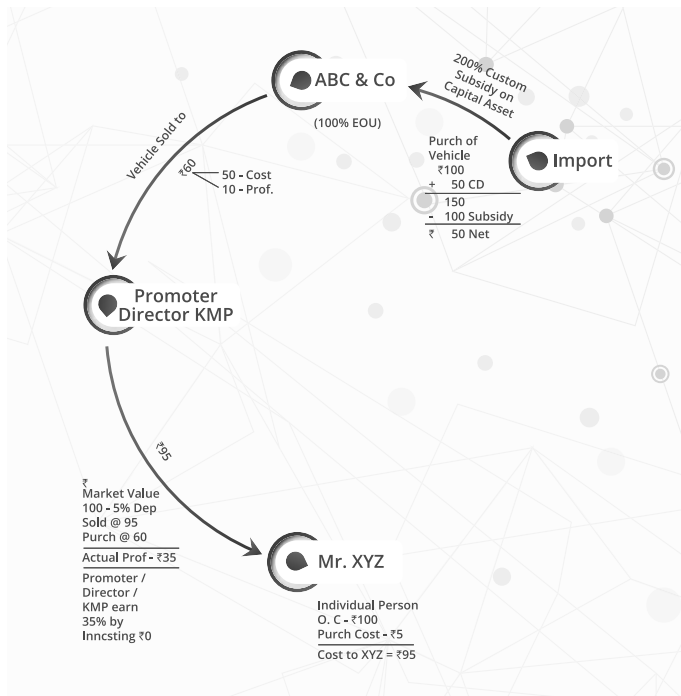
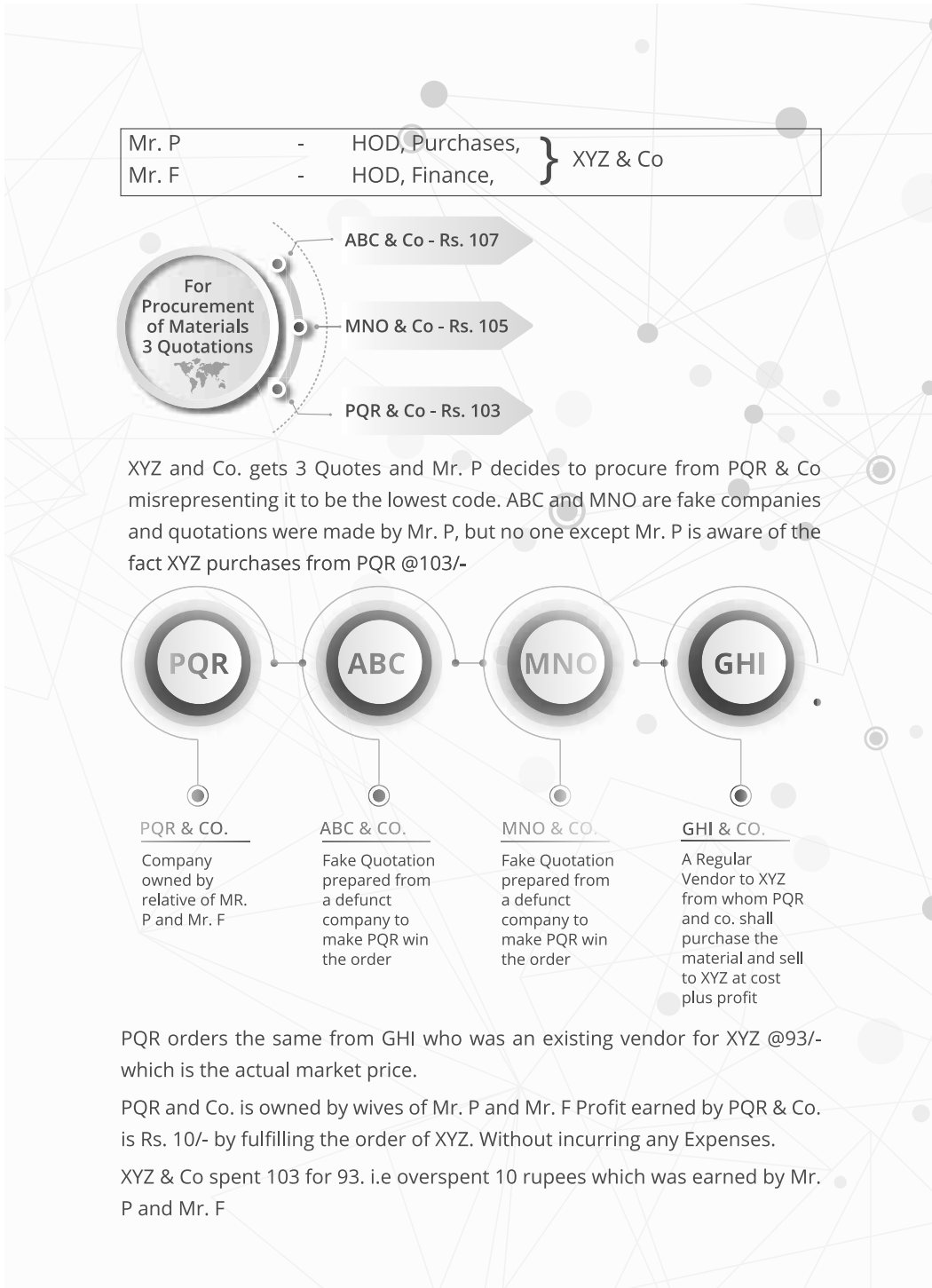


Illustration 3



Relevant Sections for Transactional / Forensic Audit under Insolvency and Bankruptcy Code

Section 43 : Preferential Transaction & Relevant Time

Bare Act :

Corporate Debtor shall be deemed to have given a preference, if : -

- 1) Where the liquidator or the resolution professional, as the case may be, is of the opinion that the corporate debtor has at a relevant time given a preference in such transactions and in such manner as laid down in sub-section (2) to any persons as referred to in sub-section (4), he shall apply to the Adjudicating Authority for avoidance of preferential transactions and for, one or more of the orders referred to in section 44.
- (2) A corporate debtor shall be deemed to have given a preference, if—
 - (a) there is a transfer of property or an interest thereof of the corporate debtor for the benefit of a creditor or a surety or a guarantor for or on account of an antecedent financial debt or operational debt or other liabilities owed by the corporate debtor; and
 - (b) the transfer under clause (a) has the effect of putting such creditor or a surety or a guarantor in a beneficial position than it would have been in the event of a distribution of assets being made in accordance with section 53.
- (3) For the purposes of sub-section (2), a preference shall not include the following transfers—
 - (a) transfer made in the ordinary course of the business or financial affairs of the corporate debtor or the transferee;
 - (b) any transfer creating a security interest in property acquired by the corporate debtor to the extent that—
 - (i) such security interest secures new value and was given at the time of or after the signing of a security agreement that contains a description of such property as security interest and was used by corporate debtor to acquire such property; and
 - (ii) such transfer was registered with an information utility on or before thirty days after the corporate debtor receives possession of such property: Provided that any transfer made in pursuance of the order of a court shall not, preclude such transfer to be deemed as giving of preference by the corporate debtor.

Explanation.—For the purpose of sub-section (3) of this section, “new value” means money or its worth in goods, services, or new credit, or release by the transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the liquidator or the resolution professional under this Code, including proceeds of such property, but does not include a financial debt or operational debt substituted for existing financial debt or operational debt.

- (4) A preference shall be deemed to be given at a relevant time, if—
- (a) it is given to a related party (other than by reason only of being an employee), during the period of two years preceding the insolvency commencement date; or
 - (b) a preference is given to a person other than a related party during the period of one year preceding the insolvency commencement date.

Explanation & Understanding:

Preferential Transaction means if the Corporate Debtor enters into a transaction with any party who is given preference as against the other parties of the Corporate Debtors.

Illustration:

1. Transfer or sale of an asset to creditor under indirect control or ownership, to keep it away from the reach of a genuine creditors in a would be insolvency situation.
2. Knocking off the debtors or receivables against chosen payables or creditors.

These transactions may be classified under preferential transactions because, as per the IBC. This is because, once the matter is admitted by the NCLT, there is a specified manner and waterfall in which payments are to be done. This get's bypassed to protect interest of a dearer creditors as against all others.

Time Frame to go back:

- In case of Related Parties : Within 2 years preceding Insolvency Commencement Date
- In case of any other Person : Within 1 year preceding Insolvency Commencement Date

Analysis of relevant quoted Case Law:

IDBI Bank Ltd. v. Jaypee Infratech Ltd :

(CA No. 26/2018 NCLT Allahabad Bench)

INTRODUCTION

In *IDBI Bank Ltd. v. Jaypee Infratech Ltd*, the Allahabad Bench of the National Company Law Tribunal (“NCLT”) has held that certain mortgages created by Jaypee Infratech Ltd. (“JIL”) in favour of the lenders of its holding company Jaiprakash Associates Ltd. (“JAL”) amounted to preferential, undervalued and fraudulent transactions under the Insolvency and Bankruptcy Code, 2016 (“Code”).

In reaching its decision, the NCLT also held that the transactions fell within the look back period of two years prior to the commencement of insolvency proceedings, as prescribed for preferential and undervalued transactions between related parties under the Code.

Accordingly, the NCLT reversed these transactions and ordered the lenders of JAL to release and discharge the security interest created through the mortgages, thereby directing that the properties so mortgaged be deemed to be vested in JIL henceforth.

FACTS

JIL was a special purpose company promoted by JAL for certain design, engineering, development and construction projects. JAL held approximately 70% of the shares of JIL.

JIL started facing financial difficulties and failed to honour its project completion deadlines. It also started defaulting on its loan payments due to its financial creditors. The Life Insurance Corporation declared JIL as a Non- Performing Account (“NPA”) on September 30, 2015. Other lenders declared it as NPA on March 31, 2016.

JIL mortgaged 858 acres of unencumbered land owned by it to secure the debt of JAL, vide mortgage deeds entered into on March 4, 2016, May 24, 2016, December 29, 2016 and March 7, 2017 (“Impugned Transactions”).

On August 9, 2017, the NCLT admitted an application filed by one of JIL’s financial creditors, IDBI Bank Ltd., for initiating Insolvency Proceedings under the Code, and appointed an Interim Resolution Professional (“IRP”).

The IRP consequently filed an application before the NCLT seeking declarations that the Impugned Transactions were (i) fraudulent transactions under Section 66 of the Code; (ii) preferential transactions under Section 43 of the Code; and (iii) undervalued transactions under Section 45 of the Code; and sought consequent reliefs (“Application”).

JUDGMENT

The resolution professional had ‘formed an opinion: JAL sought to argue that the IRP had mechanically filed the Application instead of ‘forming an opinion’. However, the NCLT disregarded this argument. The tribunal observed that the resolution professional was not required to provide a judgment for initiating action under Section 43. If the resolution professional believed that a corporate debtor had given a preference (i) at the relevant time (ii) in the manner prescribed under Section 43 (2) and (iii) to the persons prescribed under Section 43 (4), he could apply to the NCLT to avoid the transaction. The resolution professional could only form an opinion by perusing the records available with him. In this case, it was clear that the resolution professional had sought an explanation from the relevant parties upon perusing the records. Thereafter, he had filed the Application. Accordingly, it could not be said that he had not ‘formed an opinion.’

Preference had been given at the relevant time to a related party: The NCLT held that it was clear from the definition of ‘related party’ under the Code, that the term included holding and subsidiary companies. As JIL was a subsidiary of JAL, the two entities were patently ‘related parties’ for the purposes of the Code.

The NCLT observed that section 43 (4) of the Code prescribed a look back period of two years prior to the insolvency commencement date for transactions between related parties. Therefore, in this case, the look back period commenced two years prior to the insolvency commencement date (i.e., August 9, 2017) on August 10, 2015. As the

Impugned Transactions were entered into after this date, they fell within the relevant time period.

JAL asserted that certain provisions of the Code, including the provisions on preferential transactions, were prospective sections which only came into force on December 1st, 2016. Accordingly, the look-back period would only apply to transactions made after December 1st, 2016. However, the NCLT dismissed this argument. The Tribunal observed that the look-back period prescribed under the Code triggered from the insolvency commencement date and not on the date on which the relevant provisions of the Code came into effect.

JIL had given a preference in the manner prescribed under Section 43 (2) of the Code:

JAL sought to argue that a transaction could only be considered a preferential transaction under Section 43(2) when there (i) was a transfer of property or interest and (ii) it was for the benefit of a creditor, surety, or guarantor of the debtor. JAL contended that as it was not JIL's creditor, and accordingly it did not meet this criteria.

The NCLT accepted JIL's contention that a given transaction would only amount to a preferential transaction if it was for the benefit of a creditor, surety or a guarantor. However, based on the facts that (i) JAL featured in the list of JIL's operational creditors wherein it had claimed certain amounts, and (ii) JAL's own averments revealed that it had extended substantial financial and managerial assistance to JIL, the NCLT held that JAL was indeed JIL's creditor.

The NCLT also examined the term 'transfer of property or interest' under Section 43 (2). It held that a 'transfer' had been defined in wide terms under Section 3(34) of the Code to encompass a 'sale, purchase, exchange, mortgage, pledge, gift, loan, or any other form of transfer of right, title, possession or lien.' Therefore, a transfer would include a creation of security interest on the assets of a corporate debtor such as JIL's.

The tribunal reasoned that the creation of such security interest through the Impugned Transaction had the effect of putting JAL in a beneficial interest vis-à-vis the position it would have been in if JIL's assets were distributed as per the distribution waterfall prescribed under Section 53 of the Code. Accordingly, the Impugned Transaction had created a preference in favour of JAL

Reported Relevant Case Laws:

Standard Chartered Bank (FC) V/S Prag Distillery Private Limited (CD) [CP 1067 (IB)/MB/2017] NCLT Mumbai

S V Rajakumar v/s. Orchid Pharma Ltd MA/86/2018 at Special Bench NCLT of Chennai

Learnings

1. Preferential transactions can be classified strictly in case the transaction is entered into with a creditor, operational or financial.
2. Any transaction which was carried out in the ordinary course of business shall not be covered as a preferential transaction.
3. There shall be a strict adherence to the look back period mentioned in the sections.

Section 45 : Undervalued Transactions

Bare Act :

- (1) If the liquidator or the resolution professional, as the case may be, on an examination of the transactions of the corporate debtor referred to in sub-section (2) determines that certain transactions were made during the relevant period under section 46, which were undervalued, he shall make an application to the Adjudicating Authority to declare such transactions as void and reverse the effect of such transaction in accordance with this Chapter.
- (2) A transaction shall be considered undervalued where the corporate debtor—
 - (a) makes a gift to a person; or
 - (b) enters into a transaction with a person which involves the transfer of one or more assets by the corporate debtor for a consideration the value of which is significantly less than the value of the consideration provided by the corporate debtor, and such transaction has not taken place in the ordinary course of business of the corporate debtor.

Explanation & Understanding:

Transfer of assets done for significantly lesser value than its market value would be classified as the undervalued transaction. In our view the regular of goods can be included in this as the inventory as also classified as an asset.

Also the transactions like gifts of assets to persons may get classified as a under valued transaction.

Time Frame to go back:

- In the case of Related Parties : Within 2 years preceding Insolvency Commencement Date
- In the case of any other Person : Within 1 year preceding Insolvency Commencement Date

Practical Illustrations

1. Transfer of assets like land and building which has market value of Rs. 10 Cr. For Rs. 2 Cr. This is done with an hidden intention to keep the valuable asset away from the reach of the genuine lenders who are unpaid.

Reported Relevant Case Laws:

Standard Chartered Bank (FC) V/S Prag Distillery Private Limited (CD) [MA267 of 2018, CP (I & B) 1067/NCLT/MB/2017] covers analysis by the courts about both preferential and the undervalued transactions.

Learnings

1. The transactions need to be checked in the holistic view point. Keeping the partial facts in mind may mis fire the judgement.
2. Normal trade practices and calls taken basis the market situation in best interest of the company do not classify a transaction as undervalued meagrely as it appears from the face of it.

Section 49 : Consequence of entering into an Undervalued Transaction

Bare Act :

Where the corporate debtor has entered into an undervalued transaction as referred to in sub-section (2) of section 45 and the Adjudicating Authority is satisfied that such transaction was deliberately entered into by such corporate debtor—

- a) for keeping assets of the corporate debtor beyond the reach of any person who is entitled to make a claim against the corporate debtor; or
- b) in order to adversely affect the interests of such a person in relation to the claim, the Adjudicating Authority shall make an order—
 - i. restoring the position as it existed before such transaction as if the transaction had not been entered into; and
 - ii. protecting the interests of persons who are victims of such transactions

Explanation & Understanding:

Section 49 gives the powers to the NCLT which is called the adjudicating authority, if satisfied that the same is an undervalued transaction, to restore the old position and to protect the persons who are the victims of this transaction.

Section 50 : Extortionate Credit Transactions

Bare Act :

- (1) Where the corporate debtor has been a party to an extortionate credit transaction involving the receipt of financial or operational debt during the period within two years preceding the insolvency commencement date, the liquidator or the resolution professional as the case may be, may make an application for avoidance of such transaction to the Adjudicating Authority if the terms of such transaction required exorbitant payments to be made by the corporate debtor.
- (2) The Board may specify the circumstances in which a transactions which shall be covered under sub-section (1).

Explanation.—For the purpose of this section, it is clarified that any debt extended by any person providing financial services which is in compliance with any law for the time

being in force in relation to such debt shall in no event be considered as an extortionate credit transaction.

Rule 2.4.5

Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.

A transaction shall be considered as extortionate credit transaction where the terms :

- a) Require the corporate debtor to make exorbitant payments in respect of the credit provided. OR;
- b) Are unconscionable under the principles of law relating to contracts.

Time Frame to go back:

In the case of Related Parties : Within 2 years preceding Insolvency Commencement Date

In the case of any other Person : Within 1 year preceding Insolvency Commencement Date

Illustration:

Corporate Debtor has taken a loan at the rate of 36% from a private company to fund the losses and repayments of the institutional borrowers. For taking this private loan, a huge chunk of charge free assets has been mortgaged. Also the mortgagee is has got an option to convert the debt into equity at the face value if the servicing couldn't be done for 180 days continuously.

These terms are exorbitant and unfavourable to the existing financial creditors interest. These have been created knowingly to the situation, for defrauding the creditors.

Section 66 : Wrongful and Fraudulent Trading

Bare Act :

- (1) If during the corporate insolvency resolution process or a liquidation process, it is found that any business of the corporate debtor has been carried on with intent to defraud creditors of the corporate debtor or for any fraudulent purpose, the Adjudicating Authority may on the application of the resolution professional pass an order that any persons who were knowingly parties to the carrying on of the business in such manner shall be liable to make such contributions to the assets of the corporate debtor as it may deem fit.
- (2) On an application made by a resolution professional during the corporate insolvency resolution process, the Adjudicating Authority may by an order direct that a director or partner of the corporate debtor, as the case may be, shall be liable to make such contribution to the assets of the corporate debtor as it may deem fit, if—
 - (a) before the insolvency commencement date, such director or partner knew or ought to have known that the there was no reasonable prospect of avoiding

the commencement of a corporate insolvency resolution process in respect of such corporate debtor; and

- (b) such director or partner did not exercise due diligence in minimising the potential loss to the creditors of the corporate debtor.

Explanation.—For the purposes of this section a director or partner of the corporate debtor, as the case may be, shall be deemed to have exercised due diligence if such diligence was reasonably expected of a person carrying out the same functions as are carried out by such director or partner, as the case may be, in relation to the corporate debtor.

Explanation & Understanding:

If during the corporate insolvency resolution process or a liquidation process, it is found that any business of the corporate debtor has been carried on with intent to defraud creditors of the corporate debtor or for any fraudulent purpose, the Adjudicating Authority may on the application of the resolution professional pass an order that any persons who were knowingly parties to the carrying on of the business in such manner shall be liable to make such contributions to the assets of the corporate debtor as it may deem fit.

This is a typical section wherein the liability is extended to the directors and even to the third party who is involved in that the fraud, without any limitation of liability.

This section carries criminal implications once the default is established.

Time Frame to go back:

There is no time Frame for this kind of a transaction being classified as fraudulent trading u/s 66 of the Insolvency and Bankruptcy Code.

Reported Relevant Case Laws:

IDBI Bank Ltd. v. Jaypee Infratech Ltd

(CA No. 26/2018 NCLT Allahabad Bench)

Learnings

1. It is very unlikely to pull a key managerial personnel or the corporate debtor without clear evidences.
2. This carries criminal implications if proved against and hence needs solid supporting evidences to be proved guilty.

Section 29(a) :

Bare Act :

A person shall not be eligible to submit a resolution plan, if such person, or any other person acting jointly or in concert with such person :

- (a) is an undischarged insolvent;

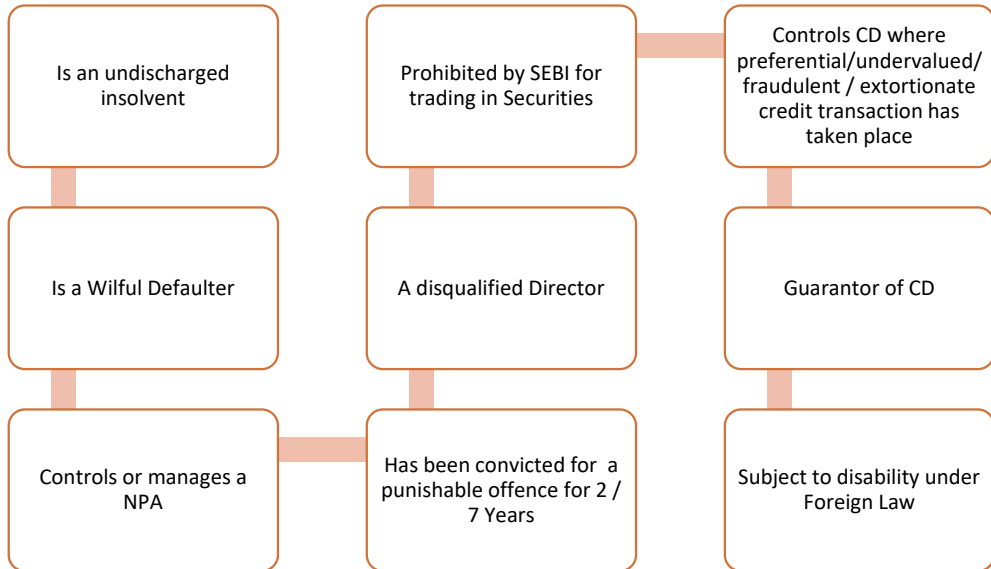
- (b) is a wilful defaulter in accordance with the guidelines of the Reserve Bank of India issued under the Banking Regulation Act, 1949;
- (c) has an account, or an account of a corporate debtor under the management or control of such person or of whom such person is a promoter, classified as non-performing asset in accordance with the guidelines of the Reserve Bank of India issued under the Banking Regulation Act, 1949 and at least a period of one year has lapsed from the date of such classification till the date of commencement of the corporate insolvency resolution process of the corporate debtor: Provided that the person shall be eligible to submit a resolution plan if such person makes payment of all overdue amounts with interest thereon and charges relating to non-performing asset accounts before submission of resolution plan;
- (d) has been convicted for any offence punishable with imprisonment for two years or more;
- (e) is disqualified to act as a director under the Companies Act, 2013;
- (f) is prohibited by the Securities and Exchange Board of India from trading in securities or accessing the securities markets;
- (g) has been a promoter or in the management or control of a corporate debtor in which a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place and in respect of which an order has been made by the Adjudicating Authority under this Code;
- (h) has executed an enforceable guarantee in favour of a creditor in respect of a corporate debtor against which an application for insolvency resolution made by such creditor has been admitted under this Code;
- (i) has been subject to any disability, corresponding to clauses (a) to (h), under any law in a jurisdiction outside India; or
- (j) has a connected person not eligible under clauses (a) to (i).

Explanation & Understanding:

When the company is under CIRP the insolvency professional has to formally float a requirement of Expression of Interest in Public for taking over the Corporate Debtor. This process is called as resolution application. As per IBC to avoid fraudulent Applicants, some conditions have been prescribed under Section 29(A) (a) to 29(A) (i). For purpose of this clause, person includes

- Any Person who is promoter or in the management or control of the resolution applicant
- Any Person who shall be the promoter or in the management or control of business of the corporate debtor during the implementation of Resolution Plan
- The Holding Company, Subsidiary Company, Associate Company or Related Party of a person referred to in above clauses (except : Scheduled Bank, ARC registered

with RBI under section 3 of SARFAESI Act, 2002 and Alternate Investment Fund registered with SEBI



Reported Relevant Case Laws:

The whole fight in the case of the Essar Steel Ltd fired the amendment in the Insolvency and Bankruptcy Code to include Section 29A.

In a lot of matters, the promoters themselves want to acquire the company after all its past sins are washed off with the help of the Insolvency and bankruptcy code. They would do this directly or in the guise of some associate concerns or relatives. This amendment is brought in to avoid such situations with the help of additional due diligence about the resolution applicants.

Section 65 : Fraudulent Initiation of Insolvency Process

This is another important provision touching frauds in the Insolvency and the Bankruptcy Code.

Bare Act :

65 (1) : If, any person initiates the insolvency resolution process or liquidation proceedings fraudulently or with malicious intent for any purpose other than for the resolution of insolvency, or liquidation, as the case may be, the Adjudicating Authority may impose upon such person a penalty which shall not be less than one lakh rupees, but may extend to one crore rupees

65 (2) : If, any person initiates voluntary liquidation proceedings with the intent to defraud any person, the Adjudicating Authority may impose upon such person a penalty which shall not be less than one lakh rupees but may extend to one crore rupees.

Explanation & Understanding:

Section 65 was incorporated in the Code so that the provisions of IBC cannot be misused by any person, who has initiated the insolvency resolution process or liquidation proceedings, with a fraudulent or malicious intent, and for any purpose other than for the resolution of insolvency or liquidation, as the case may be. The article will be particularly focusing on the effect of this provision on persons who have fraudulently or maliciously initiated insolvency proceedings. We will also be relying on a recent case law, wherein NCLT has taken broad and sweeping interpretation, in consonance with the spirit of law.

Time Frame to go back:

Not Applicable

Illustration:

The directors of the corporate debtors have misappropriated the funds from the financial creditors. This has resulted into the enrichment of the promoters of the company which is not just and fair to the deposit holders and the financial creditors. The corporate debtors want to access the IBC route to wash off these liabilities and get away from the defaults.

Reported Relevant Case Laws:

CP NO. 168/ALD/2017 : Shobhnath v. Prism Industrial Complex Limited (05/07/2018)
NCLT Allahabad Bench

Learning

1. If the application has all valid factors required under Sec 7 or Sec 8 of the Insolvency and Bankruptcy Act, the same has to be admitted.

Sec 5(24): Defining the related parties

“related party”, in relation to a corporate debtor, means—

- (a) a director or partner of the corporate debtor or a relative of a director or partner of the corporate debtor;
- (b) a key managerial personnel of the corporate debtor or a relative of a key managerial personnel of the corporate debtor;
- (c) a limited liability partnership or a partnership firm in which a director, partner, or manager of the corporate debtor or his relative is a partner;
- (d) a private company in which a director, partner or manager of the corporate debtor is a director and holds along with his relatives, more than two per cent. of its share capital;
- (e) a public company in which a director, partner or manager of the corporate debtor is a director and holds along with relatives, more than two per cent. of its paid-up share capital;

- (f) anybody corporate whose board of directors, managing director or manager, in the ordinary course of business, acts on the advice, directions or instructions of a director, partner or manager of the corporate debtor;
 - (g) any limited liability partnership or a partnership firm whose partners or employees in the ordinary course of business, acts on the advice, directions or instructions of a director, partner or manager of the corporate debtor;
 - (h) any person on whose advice, directions or instructions, a director, partner or manager of the corporate debtor is accustomed to act;
 - (i) a body corporate which is a holding, subsidiary or an associate company of the corporate debtor, or a subsidiary of a holding company to which the corporate debtor is a subsidiary;
 - (j) any person who controls more than twenty per cent. of voting rights in the corporate debtor on account of ownership or a voting agreement;
 - (k) any person in whom the corporate debtor controls more than twenty per cent. of voting rights on account of ownership or a voting agreement;
 - (l) any person who can control the composition of the board of directors or corresponding governing body of the corporate debtor;
 - (m) any person who is associated with the corporate debtor on account of—
 - i. participation in policy making processes of the corporate debtor; or
 - ii. having more than two directors in common between the corporate debtor and such person; or
 - iii. interchange of managerial personnel between the corporate debtor and such person; or
 - iv. provision of essential technical information to, or from, the corporate debtor;
- (24A) “related party”, in relation to an individual, means-
- (a) a person who is a relative of the individual or a relative of the spouse of the individual;
 - (b) a partner of a limited liability partnership, or a limited liability partnership or a partnership firm, in which the individual is a partner;
 - (c) a person who is a trustee of a trust in which the beneficiary of the trust includes the individual, or the terms of the trust confers a power on the trustee which may be exercised for the benefit of the individual;
 - (d) a private company in which the individual is a director and holds along with his relatives, more than two per cent. of its share capital;
 - (e) a public company in which the individual is a director and holds along with relatives, more than two per cent. of its paid-up share capital;

- (f) a body corporate whose board of directors, managing director or manager, in the ordinary course of business, acts on the advice, directions or instructions of the individual;
 - (g) a limited liability partnership or a partnership firm whose partners or employees in the ordinary course of business, act on the advice, directions or instructions of the individual;
 - (h) a person on whose advice, directions or instructions, the individual is accustomed to act;
 - (i) a company, where the individual or the individual along with its related party, own more than fifty per cent. of the share capital of the company or controls the appointment of the board of directors of the company.
 - (j) Explanation.- For the purposes of this clause,-
- (a) “relative”, with reference to any person, means anyone who is related to another, in the following manner, namely:-
- i. members of a Hindu Undivided Family,
 - ii. husband,
 - iii. wife,
 - iv. father,
 - v. mother,
 - vi. son,
 - vii. daughter,
 - viii. son’s daughter and son,
 - ix. daughter’s daughter and son,
 - x. grandson’s daughter and son,
 - xi. granddaughter’s daughter and son,
 - xii. brother,
 - xiii. sister,
 - xiv. brother’s son and daughter,
 - xv. sister’s son and daughter,
 - xvi. father’s father and mother,
 - xvii. mother’s father and mother,
 - xviii. father’s brother and sister,
 - xix. mother’s brother and sister, and

- (b) wherever the relation is that of a son, daughter, sister or brother, their spouses shall also be included;

Explanation & Understanding:

This definition needs to be kept in the back drop while deciding whether a certain transaction is a PUFEE transactions.

The definition is very wide so as to hold almost all possible varieties of associations or connections between the companies and that of the individuals.

Relevant questions with respect to Transaction Audits:

Most of the audits happening within the Insolvency and Bankruptcy code of India are Transaction Audits. There hundreds of RFPs floating around as almost in all cases, it has become a ritual to get a transaction auditors opinion on the PUFEE transactions.

We have delved upon few critical questions which we have been regularly consulted upon and required expert consultation while taking up these assignments.

We have come up with the possible practical solutions for the same with relevant legal provisions.

The conclusions drawn are limited to the typical transaction audits.

Appointment of an Transaction Auditors

This being a regular requirement of the Resolution Professionals, it is critical for interested Transaction Auditors to understand the legal provisions and process for handling the same.

The Role of Forensic Auditor is very crucial and therefore required in every sphere of Business. The Forensic Auditor can identify the Fund Diversion, Siphoning of Funds and other related activities, which may be carried out by the management of the Company.

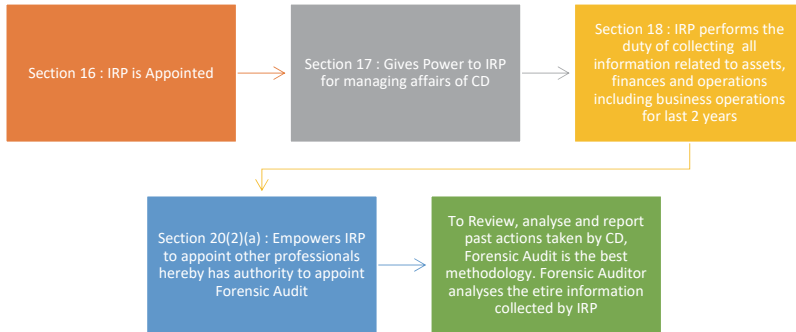
With the support of Forensic Audit Report, the Committee of Creditors can identify and declare the Promoters/ Directors of the Corporate Debtor Company, as “Willful Defaulter” and thereby take necessary steps.

The IRP has to get hold of all the daily routine activities of the CD and therefore it is very difficult to deep dive in each and every transaction carried out in the last two years. Though the IBC itself doesn't put an obligation on IRP to appoint a Forensic Auditor but, for getting through the transactions in details, IRP appoints a Forensic / Transaction Auditor, with a focus to detect PUFEE Transactions.

Who is liable to report PUFEE Transactions to the Adjudicating Authority ?

Under Section 18, the Insolvency professional is required to review the Assets and Liabilities of the Corporate Debtors. The transaction auditor is appointed by the

Insolvency professional is just for an expert opinion on the matter. Hence, the ultimate responsibility to report to the Adjudication Authority remains on the Resolution Professional.



Is it mandatory to appoint a transaction auditor for an Insolvency Resolution matter?

The IBC itself doesn't put any obligation on IRP to appoint a Forensic Auditor. Having said that, for scrutinising the transactions in details, IRP appoints a Transaction Auditor, with a focus to identify the PUFEE Transactions if any.

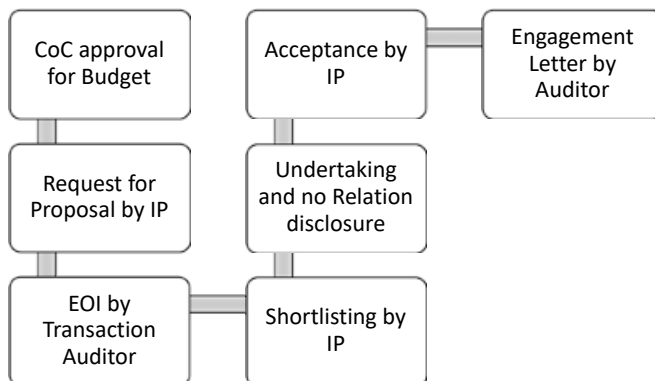
The IRP gets held up with all the daily routine activities of the Corporate Debtors and therefore it is very difficult for him to deep dive in each and every transaction carried out in the last two years.

The role of Forensic Auditor is very crucial and therefore required in every sphere of business. The Forensic Auditor can identify the fund diversion, siphoning of funds and other related activities, which may be carried out by the management of the Company.

Apart from this, with the support of Forensic Audit Report, the Committee of Creditors can identify and declare the Promoters / Directors of the Corporate Debtor Company, as "Willful Defaulter".

What is the typical Process flow for appointing a transaction auditor in a matter?

In our view, following is a step by step enumeration of the process for appointment of a transaction auditor.



*The above process flow an illustrative and idealistic one. It may undergo changes basis the situation.

At what juncture in the process, is it required to appoint a transaction auditor?

The transaction auditor may be appointed to support the opinion of the resolution professional. To ascertain this, we need to examine the time line under which the Resolution Professional needs to be submit such report to the Adjudicating Authority.

As per the Regulation 35A, for Preferential and other transactions, the RP should

- (1) On or before the **seventy-fifth day** of the insolvency commencement date, the resolution professional shall form an opinion whether the corporate debtor has been subjected to any transaction covered under sections 43, 45, 50 or 66.
- (2) Where the resolution professional is of the opinion that the corporate debtor has been subjected to any transactions covered under sections 43, 45, 50 or 66, he shall make a determination on or before the **one hundred and fifteenth day** of the insolvency commencement date, under intimation to the Board.
- (3) Where the resolution professional makes a determination under sub-regulation (2), he shall apply to the Adjudicating Authority for appropriate relief on or before the **one hundred and thirty-fifth day** of the insolvency commencement date.

The above timelines are very indicative of when the Transaction Auditor needs to be appointed.

Since the reporting is to be done on T + 75th Day, the same should be initiated at earliest. The first COC happens latest on 30th days wherein any kind CIRP cost approvals can first be taken.

Hence, ideally in the first COC, there should be an agenda in this regard. The COC just needs to approve the fee budget for such Transaction Audit. Once done an Request for Proposal can be floated for the same.

What is a typical scope for the transaction audit?

Typical Scope of Transaction Audit includes:

- i. To identify Preferential Transactions and transactions defrauding creditors
- ii. To identify Fraudulent and Wrongful Trading
- iii. To identify Undervalued / Overvalued Transactions through related / other entities
- iv. To identify Extortionate transactions executed by the Promoter to benefit themselves / relative / other parties
- v. To identify any Diversion or Siphoning of Funds
- vi. To ensure if the management of CD is involved in the falsification or Alteration of Books of Accounts and records
- vii. To assess the accountability of Suspended Board of Directors
- viii. To check willful concealment / removal / alteration of any property by anyone related or connected to the Corporate Debtor

We have gone ahead and proposed formats of the request for proposal and the engagement letter.

- o Recommended format for Request for Proposal (RFP) Annexure I
- o Appointment letter Annexure II

Can an RP ask for names of the past cases handled by the Transaction Auditor?

This is a common practice followed while appointing the auditors. Since the matters are referred to the COC by the RPs, the COC tends to ask all sorts of comparisons between the qualifications, experience, names of the cases handled, team strength, industry experience, fees, etc.

As per the ICAI guidelines, the members cannot share the names of the clients with the third party unless the same is in the public domain.

However, in our view, the Proposed Transaction Auditor can share the data of the cases handled under the Insolvency and Bankruptcy case as the same have been reported and listed in the NeSL portal or any other information utility by the RP and are available in the public domain.

It can be of great value if letter of appreciation is taken by a transactional auditor and shared with the RP for the reported cases. This can be an additional point for decision making to the RP.

| | | | | | | |
|------------|-------------------------------------|----------------------|---|-----------------------------------|------------|------------------------------|
| IP/P-00443 | IBBI/PA-001/IP-P00443/2017-18/10786 | Rakesh Kumar Agarwal | Appointment of other Professionals by You -Accountant - Kansal Singla & Associates | S P S Metal Cast & Alloys Limited | 01-12-2019 | View Details |
| IP/P-00443 | IBBI/PA-001/IP-P00443/2017-18/10786 | Rakesh Kumar Agarwal | Appointment of other Professionals by You -Registered Valuer - Sandip Bhattacharyya -Registered Valuer - Puneet Tyagi | S P S Metal Cast & Alloys Limited | 01-12-2019 | View Details |
| IP/P-00443 | IBBI/PA-001/IP-P00443/2017-18/10786 | Rakesh Kumar Agarwal | Appointment of other Professionals by You -Registered Valuer - Kaanchan Dutta -Registered Valuer - Debashis Das | S P S Metal Cast & Alloys Limited | 01-12-2019 | View Details |
| IP/P-00443 | IBBI/PA-001/IP-P00443/2017-18/10786 | Rakesh Kumar Agarwal | Appointment of other Professionals by You -Registered Valuer - Partha Pratim Chattopadhyay -Registered Valuer - Dharam Pal Bhatia | S P S Metal Cast & Alloys Limited | 01-12-2019 | View Details |
| IP/P-00443 | IBBI/PA-001/IP-P00443/2017-18/10786 | Rakesh Kumar Agarwal | Financial Creditor - The Constitution of Committee of Creditors | S P S Metal Cast & Alloys Limited | 01-12-2019 | View Details |

Does the CoC have a say in identifying a transaction auditor?

As per Section 20(2)(A) IRP has the rights to appoint a professional, Since IRP is the one who is appointing the Forensic Auditor, he holds the right of identifying, appointing, controlling, reporting, etc. Assign roles and responsibilities

Which means CoC has no role with the Forensic Auditor. CoC directly can no where communicate with the Transaction Auditor. Auditor shall report IRP, he is not bound to share it with NCLT. The report is to be shared with NCLT directly by IRP as a supporting to his application to the NCLT or the disclosure as may be required.

Unlike CoC, NCLT holds the complete right to question the Forensic Auditor and hold him responsible for any false allegations. Also, forensic auditor can be a legal evidence in NCLT .

Stake holders : IP, CoC, NCLT, Forensic Auditor

IRP replaces the Board – IP gains all the powers

IRP forms the CoC – all power are handed over to CoC by IRP

RP Appoints Forensic Auditor – CoC involvement only upto approving the Forensic Auditor Fees Forensic Audit to Report to IRP and IRP to share it with NCLT.

Transaction Audit Process

The Process is a critical piece of the exercise. It is important for the auditor to develop a process so as to add value to the assignment and document the same tightly to safeguard himself from any allegations. Although the process of the same is not defined anywhere in the law. It is a special assignment and hence, in our view, the audit should plan this on the basis of this past experience.

Understanding of the business of the Auditee

Auditor should deep dive into the business of the corporate debtors. This is the basic pretext for forming any view in this regard. This shall come from the following:

1. Interview with the Resolution Professional and his team
2. Interview with the available Key Managerial Personnel
3. Interview with the internal Auditors and the statutory Auditors
4. Site visits to the places where actual activities were carried out
5. Doing a desktop search about the company and latest news in this regard

Chain of transactions

It is very critical to draw a chronology of key activities of the company from when it got promoted to the change of management to the growth phase to the major debt and equity fund raising to the major turmoil to the major bad patch that it has hit currently. It will be a good idea to plot this along with proper supporting documents in the report as well. This will may help the report reader as well to form a better view of the situation.

This exercise is very critical from a forensic angle and may help the auditor to identify places where he will want to deep dive while doing the audit.

Major Risk areas of review under the Transaction Audit

Here is a quick list of the risk areas which may be worth considering while forming your audit program for the transaction audit.

- Related Party Transactions
- Bogus Sales/Purchases
- Inappropriate Expenses
- Fake employees
- Subsidy Utilizations
- Review of purpose and end utilization of loans. Receipt and utilization of funds in last 3 Years
- Comparison of bank statement with cashbook and bankbook maintained by the Company Review of Financial statements, trial balance contractual agreements, Group Company Transaction, etc
- Sales & Purchase transaction and its tracking to cash realization and payments.
- Review of Receivables and payable
- Review of Inventory in the books v/s the available physical inventory
- Asset Tracing and examination and review of Asset Tracing

Typical Audit Program

Unlike the routine audit assignments, the transaction audit is like a special audit. It needs special skill set of connecting the right dots and developing the analogy to form an opinion.



Audit Program starts from the point of collection of data, analysis, some desktop research, business logics, etc.

— Initial Step is to go thoroughly through the financial and other relevant documents like MOA, AOA, etc. Using this data, a preliminary study can be done and one of the necessary items to be prepared is year to year comparison of all the financial data where in a clear movement for each line item is visible. If any unusual jump / fall is noticed, mark it as a Red Flag to deep dive into the transactional data around it. Once this working is prepared, you have enough data to start engagement with clients with your queries

— Secondly, data from public domain plays an important role while carrying out a forensic audit. This may help to know something more about the company, promoters, Industry, etc. This is a part of Desktop Research, wherein, one can get the ROC Search done for any company from Ministry of Corporate Affairs in case of incomplete financials received from the Corporate Debtor, or even if the data is complete, we can check the authenticity from the ROC Search Data. ROC Search gives a data of Financials plus change in directorships, change in share holding pattern, Certificates, Incorporation Documents, Charge Documents, any other forms filed with MCA, etc.

— Another area where you can use the data available at public domain is for getting a listed of related / connected entities. There are third-party service providers are available which helps you the know the relations like common directorship, holding subsidiary, etc. This list can help cross verify the transactions entered into with the corporate debtor. High chances of getting Red Flags once you are ready with these data points.

— Another Grey area in IBC Cases would be the Series of Events occurred since the Incorporation to High Revenue Times to loan Sanctions to slow down and finally to end of business. Making a time map is the best way to get a grip of a series of events. Draw a time frame and plot the events and occurrence on it.

— After all the above-mentioned study, we are at a stage wherein we can define the background of the company. This is important from the readers' point of view, where, the reader will judge you on your comments as to whether you have correctly understood the business of the Corporate Debtor or not. Meeting the promoter and Key Managerial Personnel also plays an equally important, just to get a feel on behavior and nature of the promoters. Making a list of persons met and premises visited is recommended.

— Now, when we are done with the Homework, visiting the premise may give you the real feel where in you will able to gauge that seeing the running company what revenue it shall be reaching. Whether the books are in line with the actual production happening.

— Visit checklist should be consisting of the following tasks:

- Employee head count
- Machine Count
- Efficiency appropriation
- Physical Asset Verification

- Technical industry specific study of whether costing and profitability is same industry wise or not
- Ownership / Lease / Rent Documents of Land and Buildings
- Bank Related Documents
- Inventory Count
- Meet the KMPs at the premise
- Casual interaction with Staff, Security Personnel, etc.
- Meeting the Statutory Auditor of the Corporate Debtor
- Meeting Internal Auditor
- Meeting Company Secretary
- Getting through the documents for any Notices / Orders / Representations of corporate debtor
- Accessing the ERP to cross verify the data received and data audited
- Pictures of some machines, assets, etc., needs to be kept in record
- Documents related to Subsidies needs to be checked
- Documents in relation to the BIFR (Board for Industrial and Financial Reconstruction), CDR (Corporate Debt Restructuring) or OTS (One Time Settlement) if any needs to be studied on

— After the visit, notes to be mentioned in the report. Next we come to the primary scope of the work that is to list down the specific transactions falling under PUF (Preferential, Under Valued, Defrauding Creditors and Extortionate Credit Transactions)

What are the suggested Tools and techniques for the handling the assignment?

Analytic Techniques

- Making three year comparatives of the financial statements with help throwing the issues and exceptions
- Involving an industry experts for calculations of the Cost of Goods Sold. They are the best people to tell whether the consumptions of the material is as per the industry standards
- Doing a thorough use of the applications like Zauba corp & quick company.in for identifying the relationships and the director connections with the company
- Identify Duplicate / Ghost Employees in employee master table
- Review of the Sole Vendor Contracts
- Duplicate Payments
- ERP users vis-à-vis the actual directors and employees on the role

- Doing the independent visits to the auditee's premises
- Look up the individual wealth and lifestyle of the KMPs

IT aspects of the Audit

IT Tools the Forensic Teams must know include the

1. Disk Imaging
2. Disk Mirroring
3. Recuva for deleted data recovery
4. Email forensic for establishing the trail of communications

Databases which can be used as the reference points (Mainly from Sec 29A standpoint)

1. World check
2. Dun and Bradstreet

Software to detect fraud

- Out-of-Sequence Checks
- Large number of Voids or Refunds made by employee or customer
- Manually prepared checks from Large Company
- Payments sent to nonstandard (unofficial) address
- Unexplained changes in vendor activity
- Vendors with similar names and addresses
- Unapproved Vendor or new Vendor with High Activity

Can't the auditor go beyond the given time frame as "relevant time frame"?

The sections for the preferential, undervalued and the extortionate transactions limit the resolution professional to the extent of 2 years before the inception of the CIRP process. Section 66 doesn't have any restriction of the time limit for the described transactions.

This means that technically the transaction auditor may be required to go beyond the time limits for finding out cases described in the Sec 66.

Basis our experience in these audits, many of the accounts have been classified as Non-Performing Assets or NPA 4 to 5 years before the IBC proceedings. There is a Restructuring, SARFASI, BIFR, etc has already been done long before in many cases. There is hardly any transaction in such cases in last two years. This may make the entire exercise just a formality.

Having said that, the transaction auditors can always make their scope clearer by saying that they will not go beyond the specified financial year. This will help the auditor safeguard his position.

What is a Potential Phoenixing?

Meaning

A phoenix company is the term used to describe a new company which is started by individuals involved in a previous company which has gone into liquidation or administration. The Complete process is known as Phoenixing

Explanation and Understanding

Typically, the assets of the old business are purchased by a party connected to the previous company. The clear advantage is that the newly formed company may continue to trade in a similar manner to the old company, and this means that customers and clients may not be affected.

Factors leading to Creation of Phoenixing Company

Innocent Phoenixing : A business gets into a position of doubtful solvency or insolvency, and directors try and recover as much as possible from the business before it collapses.

Occupational Hazard : The nature of the industry may potentially heighten the risk of phoenix activity. Once a company has collapsed, the operators of the business may have little option but to return to the same industry in the form of a new business.

Careerist Offenders : These operators purposely structure their operations in order to engage in phoenix activity and to avoid detection. These offenders are often selective as to which debts they will pay throughout the life of the company.

Phoenix Scenarios

“One After Other” : A closely held company is formed, which operates for a period of 6–24 months. During that time, it accumulates large debts, stalls creditors for as long as possible, and, when pressure becomes too great, it goes into liquidation. Another company, frequently with a very similar name, purchases the productive assets and takes over the operations of the failing company. Often the new company operates out of the same premises, with the same suppliers, employees and customers.

Management Company: The productive assets are kept in a management company, which is kept solvent. A second labour supply company employs the workers and conducts the principal business operations. Profits are stripped from the second company through high rates charged for the use of the first company’s assets, which leaves the second with insufficient funds to pay its liabilities. Eventually, the second company will be liquidated, with little to no capital reserves, and a new one will rise in its stead.

Labour Hire: This structure utilizes a management company, a sales company and a labour hire company. The sales company receives all the income arising from the business, while the management company charges the sales company for the use of the assets. The labour hire company employs the workers, for which the net pay is reimbursed by the sales company but not the payroll deductions or taxes. Often the labour hire company is a façade, merely issuing payment summaries, while the sales

company pays the workers directly. Eventually the labour hire company is forced into liquidation, while the underlying assets are preserved in the management company.

Shadow Directors: Former directors can control a company through spouses, relatives and associates. There is little to prevent a disqualified director from giving advice as an employee of a Successor Company.

Indicators:

- The Failed Entity is formed with only a nominal share capital
- The Directors / Managers / Controllers of the failed and successor company are the same
- The Failed Entity is trading whilst insolvent
- Assets of the Failed Company are depleted shortly before the cessation of Business
- The Failed Company makes Preferential payments to key creditors to assure supply to the Successor Company
- The Failed Entity was operated to evade prior liabilities
- The Successor Company operates in the same Industry
- The Successor Company trades the same or similar name
- The Successor Company commences trading immediately prior to, or within 12 months of, the cessation of the failed entity
- Assets of the failed company are transferred at below market rate (can always be at book value as on date) to the Successor Company
- Many of the employees of the Failed Company are re-employed by the Successor Company

Relevant Case Law :

Australian Securities and Investments Commission (ASIC) v Somerville, the New South Wales Supreme Court.

Reporting by the Forensic Auditor

What is the timeline for submission of Forensic Audit Report?

As explained in the regulation 35A, it is important for the RP to do the submission of his preliminary opinion regarding the PUFU transactions latest by T + 75th Day, it is critical for the auditors to so submit the report before that. However, the quantified report of the defaults if any found can take T + 115 days and for the final submission for any kind reversals by Y + 135th day can be made.

In our experience, it is been tough conclude reports due to dearth of adequate data. Most of the times, there is noncooperation from the promoters in this regard.

The transaction auditors need to be very proactive in digging out the public data and the data from other possible sources to give him satisfactory stuff for forming his view. He should not be solely depending on the RP and the KMPs or Key Managerial Personnel of the corporate Debtors for the same.

What is the reporting hierarchy for the Transaction Auditor?

Transaction Auditor has to Report to the Resolution Professional. Then the same is left on the Resolution Applicant to take it further or use it in his report to the NCLT. There is no way of escalation if there is any issue nexus of the Resolution Professional with the KMPs.

This makes the transaction audit less effective. In our view, this may call for a review while drafting a provision for such escalation in the law.

Is the Transaction Auditor Required to Classify the Transactions into various Sections of the I & B Code?

Law is silent on this, as IBC says IP can appoint any Professional Expert as and when he feels like doing so. But, since IP is appointing a Transaction Auditor for making a view as to whether there are any such transactions, he may include this obligation in the Scope of Work, to get the classification of the transactions in under various sections.

The transaction auditor is not expected to be a legal expert, he cannot be relied upon by the RP for the classification side. We recommend that the transaction auditor should mention this aspect in his disclaimer while submitting the report.

Limitations and Disclaimers

Limitations are the points that the transaction auditor wants to inform the reader of the report. These can be on

1. Non-Availability of data points
2. Non-Availability for the physical meetings
3. Non-Availability of vouchers for verification
4. Limited availability of time
5. Conclusions drawn by correlating of limited facts

It is very critical for the transaction auditor to add a disclaimer in his report. This will help making clear to the reader about the responsibility that the auditor shall not want to take for this matter.

The template of a recommended disclaimer is given in the Annexure III.

Whether the RP can use the report to pursue further legal action of the alleged parties?

In our view, the transaction audit report has a limited perspective and can be used for limited purposes.

However, the RP can take a cue from the report and may request the transaction auditor or some other auditor to do the forensic audit on those highlight points. This can be done if the COC feels that it wants to report the same to the MCA, EOW, RBI, etc for further investigation.

This provides good opportunity to the transaction auditor. It is here that a value add can be displayed in the work to the RP and the COC if so required.

Whether the Transaction Auditor be called for giving an Expert witness in the court of law?

The report may be used by the RP to file an application with the NCLT for reversal of relevant transactions. Once the report is submitted, the NCLT may want to have the Expert Evidence of such transaction auditor. This will help the NCLT to form better judgement about the nature and coverage of such transaction.

This kind of an “Expert Witness” support may be required if the matter is challenged and gone to the NCLAT or the Supreme Court. In this case, the transaction auditor may be called for an evidence.

We recommend creating a clear exclusion of “Expert Witness” from the scope as there are chances that the same may consume a lot unnecessary time and travelling which is uncalled for. This can be take up on the chargeable basis as an additional opportunity for such transaction auditor.

Qualifications for the Forensic Auditors

Academic accreditations to look for in the Forensic Auditors

Although there is no specific requirement found anywhere in the IBC, it is recommended to look for one or more of the below qualifications. The auditors

1. Forensic Accounting Fraud Prevention by the ICAI
2. Diploma in Information Systems Audit from the ICAI
3. Association of Certified Forensic Examiners

Opportunities for Chartered Accountants in Forensic Audit

There thousands of cases which open under the Insolvency and Bankruptcy Code. It is almost a ritual for the RPs to take an opinion from the Chartered Accountants for such matters.

Chartered Accountants are looked at as most competent professionals for this kind of an assignment.

This can be a good starting point to gather experience in the field of Forensic Audit.

Few agencies where an empanelment can be helpful in getting forensic audit assignments

It is not mandatorily required for the firm to be empaneled with any of the agencies. However, following a recommended list of agencies wherein the empanelments are looked out for

Indian Banks' Association (IBA)

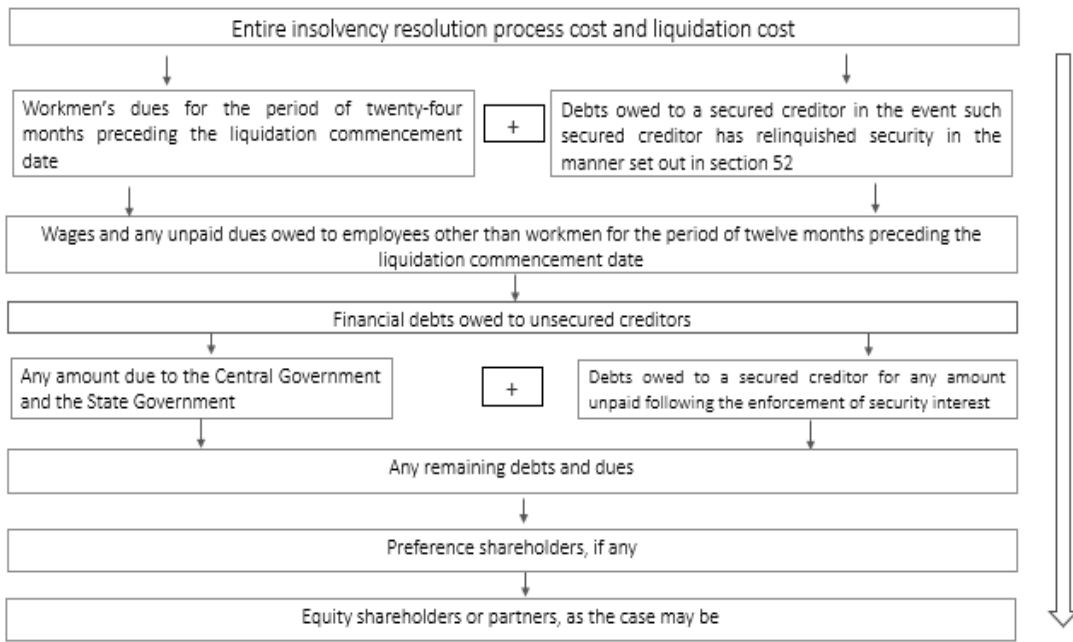
EOW – Economic Offence Wing

SFIO – Serious Fraud Investigation Office

SEBI – Stock Exchange Board of India

IBA is one such empanelments which is looked up when the decision making is put up in front of a banker.

Liquidation Waterfall



Acronyms :

Here are the full forms of the Acronyms used in this book for convenience of the flow of the author. They be referred by the reader as and when he comes across one.

- NCLT – National Company Law Tribunal
- IBC – Insolvency and Bankruptcy Code
- CD – Corporate Debtor
- CoC – Committee of Creditors
- PUFE – Preferential, Undervalued, Fraudulent & Extortionate
- AA – Adjudicating Authority
- IP – Insolvency Professional
- CIRP – Corporate Insolvency Resolution Process
- FC – Financial Creditor
- OC – Operational Creditor
- PUFE – Preferential, Undervalued, Fraudulent and Extortionate Transactions
- KMP – Key managerial personnel

- IBBI – Insolvency and Bankruptcy Board of India
- NCLAT – National Company Law Appellate Tribunal
- IRP – Interim Resolution Professional

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- Regulations under the Insolvency and Bankruptcy Code
- Rules under the Insolvency and Bankruptcy Code
- Central Vigilance Commission (CVC) has undertaken a review and analysis of top 100 Bank Frauds dt. 15th Oct 2018

Disclaimer

This is purely the compilations and enumeration, as per the understanding of the author with the academic interest of the members in backdrop. The legal aspects are correctly drawn up as on date of this compilation. The changes and amendment of various laws and standards may call for changes in this compilation accordingly. This book has also covered a lot of practical aspects and illustrations are given as per the experience of the author which can be used by the members in various forms while actually handling the assignments. The author, firm or the WIRC or ICAI are not liable for any decisions taken basis the understanding from this book.

While making an important decision with regards to the legalities or the procedural aspects, it is recommended to consult the experienced professionals as each case may have different facts which may not be envisaged while forming the views in this book.

Annexures

We have tried to bring in relevant annexure covering templates for various formalities of the Transaction Audits. These are purely author's personal templates based on the current understanding of the legal requirements. These may be improved in light of amendments in the law. Also specific requirements in the certain circumstances or standards prescribed by statutory body like the ICAI.

ANNEXURE I
Draft Format of an Request for Proposals from the Transaction Auditors

..... On the Letterhead of the Insolvency Professional.....

To,
CA _____.

Partner of _____ Associates,
_____ Mumbai,

Dt. _____

**Sub: Request for Proposal for conduction a Transaction Audit for
M/s. _____ Ltd.**

Dear Sir,

I am pleased to inform you, Mr./Ms. _____ is appointed as the Interim Resolution Professional in the matter of _____ Ltd. vide an order CP No. _____ dated _____ by Hon'ble NCLT Mumbai Bench.

In the first Meeting of Committee of Creditors he is resolved to act as Resolution Professional for the Corporate Debtor.

The corporate debtor which is the subject matter is into the business of _____. From our initial observation, there are ____ no. of key financial creditors for the corporate debtors amounting to Rs. _____ Cr. The company's accounts are maintained regularly under Tally.ERP accounting system and Audited till 31st March _____.

The Corporate Debtor has ongoing operations at the following locations:-

1. _____, Khalapur, Raigad - 410203
2. _____, S.A.S. Nagar, Mohali, Uttarpradesh.

We are keen on getting a Transaction Audit done, with regards to same, kindly provide us your best quote for conducting Transaction Audit of the captioned Company.

The Scope of the transaction Audit shall be to form an opinion as to whether any of the transaction in the past two years (FY _____ and FY _____) from the date of inception of the Corporate Insolvency Resolution Process are falling with the definition of the following sections of the Insolvency and Bankruptcy Code:

Sec 43 – Preferential Transactions

Sec 45 – Undervalued Transactions

Sec 50 – Extortionate Transactions

Sec 66 – Fraudulent Transactions

The timeline for the audit shall be 30 days from the date of appointment.

Please also share detailed profile and relevant of the firm. Also the profiles and relevant experience of the persons who are going to get involved in the assignment in case allotted.

Further for confidentiality of information shared with you, Kindly provide us a duly signed and stamped copy of the attached Confidentiality Undertaking.

For any further clarification / details, please feel free to contact us.

Yours Truly

.....

Resolution Professional
Of _____ Ltd.

ANNEXURE II

Draft Format of an Appointment Letter for the transaction auditors

..... On the Letterhead of the Insolvency Professional.....

To,

CA _____.

Partner of _____ Associates,

_____ Mumbai,

Dt. _____

**Sub: Confirmation of Your Appointment of Transaction Auditor for
M/s. _____ Ltd.**

Sir,

I am pleased to inform your appointment as a Transaction Auditor for M/s. _____ Ltd.

The Scope of the transaction Audit shall be to form an opinion as to whether any of the transaction in the past two years (FY _____ and FY _____) from the date of inception of the Corporate Insolvency Resolution Process are falling with the definition of the following sections of the Insolvency and Bankruptcy Code:

Sec 43 – Preferential Transactions

Sec 45 – Undervalued Transactions

Sec 50 – Extortionate Transactions

Sec 66 – Fraudulent Transactions

The timeline for the audit shall be 30 days from the date of this appointment letter.

The Fees for this assignment shall be Rs. _____ excluding applicable GST and including all the out of pocket expenditure incurred for handling the same.

The above fees shall be payable on the submission of the final transaction audit report.

We are given to understand that there is no relationship whatsoever between you or the partners or the employees of the firm with that of the Key Managerial Personnel or the Directors of the company vide your declaration dt. _____

Other Terms

6. There should strict confidentiality to be maintained with respect to the data shared with you or your team in this regard. All the communication in this regard shall be made with the email id _____ and letters must be addressed to _____.
7. You may execute and share the confidentiality agreement with us in the suggested format attached herewith.

8. The Key Managerial personnel Mr. _____ shall be involved and supporting the assignment. He is been intimated about this appointment in parallel.
9. If there is an delay or non-cooperation in providing the information in this regard from the Key Managerial Personnel, please intimate us immediately in interest of time.
10. Please share the initial checklist of requirements for starting the assignment and we shall start putting together the same for your quick perusal.

Kindly counter sign the copy of appointment letter and send it back to our office for officially confirming your appointment with the terms and conditions covered in this letter.

Thanking You

(_____)

RP for M/s. _____

Reg. No. _____

Accepted by

We accept the above mentioned terms and conditions:

M/s. _____ & Associates

Chartered Accountants.

ANNEXURE III

Disclaimer for a Transaction Audit Report

This report is an opinion for the limited purpose of the Resolution Professional to form his view regarding the defaults under sections of the Insolvency & Bankruptcy Code covered in the scope. This is report about the suspicious transactions which we came across and classified basis our interpretation of the law. Having said that, this is not a legal opinion about the classification of the transactions under various sections of the Insolvency and Bankruptcy Code. The report is prepared with the available information within limited time frame, assumptions and data limitations specifically mentioned in the report. This report is not made for any resolution applicant or the Committee of Creditors to support their decision regarding the quality of assets, business, accounts, promoters, etc for their further dealing in this matter. Our Liability is limited to our fees in this regard.



**Western India Regional Council of
The Institute of Chartered Accountants of India**

(Set up by an Act of Parliament)

ICAI Tower, Plot No. C-40, G Block, Opp. MCA Ground, Next to Standard Chartered Bank,
Bandra Kurla Complex, Bandra (East), Mumbai-400 051
Phones : 022-3367 1400/3367 1500 | E-mail : wirc@icai.in | WIRC Website : www.wirc-icai.org

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