

REBOOTING CORPORATE GOVERNANACE



THE COMPLIANCE & ETHICS ACADEMY

A Legasis Initiative

CRIMINAL LIABILITY AND ROLE OF AUDITORS AND INDEPENDENT DIRECTORS

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Introductions & Expectations





Corporates :Perishable Commodity?





Reboot Agenda.....

Conflict of Interest



Practice and maintain **Transparency**

Co-location services- loss of confidence



Uphold and strengthen **Stakeholder's trust**

Misreporting of NPAs- credibility crisis



Protect and promote **Stakeholder's Trust**

Conflict of Interest- Allegations of compliance failures



Re-establish **Brand Goodwill**



REBOOTING CORPORATE GOVERNANCE: CRIMINAL LIABILITY AND ROLE OF AUDITORS



The Statutory Auditors

- Statutory Auditors : Section 139 of Companies Act 2013 read with Rule 3 of the Companies (Audit and Auditors) Rules. Reporting to the Audit Committee (S.177) or the Board. The Powers and Duties (S.143(1)). Auditing Standards (S.143(9) (10). Reporting Frauds (S.143(12-15)) Rule 13. NAS Prohibited (S 144)
- Punishment For Contravention:** S 147 “.....if an auditor has contravened ..knowingly or wilfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with (simple) imprisonment for a term which may extend to 1 year and with fine which shall not be less than Rs.1,00,000 which may extend to Rs. 25,00,000





Criminal Liability of Audit Firm & Partner/s



“The auditor is a watchdog and not a bloodhound.” - Lord Justice Topes



Rule 9 of the Companies (Audit and Auditors) Rules, 2018 before its omission, read as under:

“In case of criminal liability of any audit firm, the liability other than fine shall devolve only on the concerned partner or partners, who acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud.”



After the Companies (Amendment) Act, 2017 read with Notification S.O. 630(E) dated 9th February 2018 inserted a proviso to **Section 147(5)**, which read as follows:

“Where, in case of audit of a company being conducted by an audit firm, it is proved that the **partner or partners** of the audit firm has or have acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil or criminal as provided in this Act or in any other law for the time being in force, for such act shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally.

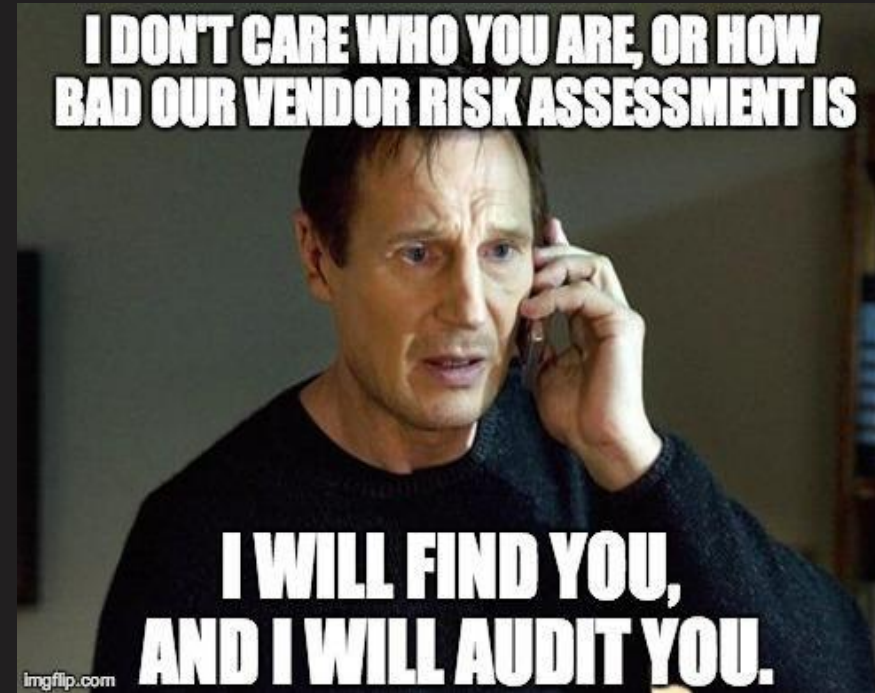
Provided that in case of criminal liability of an audit firm, in respect of liability other than fine, the concerned partner or partners, who ***acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud shall only be liable.***”










The SEBI Order: Interactive Session

- Mens Rea
- Satyam: PWC Order
- Reference Material



RICOH India- Cooking the Books

-  Evidence of accounting shenanigans
-  SEBI passed an order restraining six (current and former) top managers of the company from dealing in the securities market and ordered forensic audits of its past financials
-  PwC's limited-period forensic audit for FY16 has unearthed wide-ranging attempts to cook the company's books. It has found that the company had made "unsupported out-of-book adjustments" to net sales, expenses, assets and liabilities, converting losses into profits
-  Comprehensive cooking of Ricoh's books is unlikely to have occurred without complicity or sheer negligence on the part of the auditors
-  Statutory auditors — M/s Sahni Natarajan and Bahl held office for 15 years before the company decided to replace them to comply with rotation rules in the new Companies Act. One wonders if the ten-year audit rotation rules are too liberal





RICOH Imagine & Change

- Ring-fence issue by asking its CEO, CFO and COO to go on leave (they later resigned), filing a police complaint and appointing new top managers, even as it escalated the matter to SEBI.
- The Japanese parent agreed to write off its equity, infuse new capital and promised a quick turnaround. But that turnaround proved elusive and the company has since approached the NCLT for bankruptcy resolution. Investors in the stock are in limbo as BSE suspended trading in it a year ago.

Imp Timeline

- Jan 2018: Filed appln. u/s-10, IBC, 2016 as Corporate Debtor, for initiation of Insolvency Resolution Process
- Kotak Investment Advisors and Karvy Data Management Services have bid to acquire distressed Ricoh India
- May 2018: Mr. Krishna Camadia appointed IRP
- Mar 2019: Resignation of two independent Directors
- Aug 2019: CIRP under process





The Other Auditors

- Internal Auditor : Chief Audit Executive. S 138 r/w Rule 13 of the Companies (Accounts) Rules,2014. CAE may or may not be an employee. Reporting to Audit Committee / the Board.

Curious Cases of Mr. Gs

- Satyam: Internal Auditor Mr. G. The allegations were based on theory of the prosecution that “internal auditor” knows everything (better than Statutory Auditor) and that BRs generated by the Satyam System were known to Mr. G
- Pune Developer: EoW arraigned Mr. G, the Statutory Auditor and Certifying Auditor by supplementary FIR. ‘End-Use of Proceed’ certificate alleged to have been falsified and fabricated. Moved Mr. G from an accomplice u/s 120B to co-accused. Mr. G has been bailed out and prosecution is angry. IA has been summoned to record statement (evidence against G)
- Special Auditors : 142 legislations applicable to the profession
- Non Audit Services : RSM International (nothing to do with Indian RSM) yesterday was fined for \$ 950,000 by SEC. Stricter EU Regulations.



REBOOTING CORPORATE GOVERNANCE: CRIMINAL LIABILITY AND ROLE OF IDs



Vicarious Liability

- ‘*Qui facit per alium facit per se*’- ‘He who acts through another, acts through himself’
- Director’s act in three capacities:-



- Sunil Bharti Mittal vs. CBI(2015) 4 SCC 609:
 - i. Principle of ‘Alter Ego’- Co. acts through persons in-charge of its affairs and such person’s intent is the *mens rea* in an offence of the co.
 - ii. Principle of **Attribution** applied to impute criminal intention of alter ego.
 - iii. Director can be prosecuted only if sufficient evidence of active role coupled with criminal intent.

- Ministry of Agriculture v. Maycho Monsanto Biotech (India) Ltd. (2016):

Whether *u/s 48, Competition Act, 2002*, a director can be simultaneously prosecuted along with co.?

- i. Vicarious Liability, with exception if the director can prove alleged act was committed **without his knowledge and negligence and has exercised all due-diligence** to prevent such commission.
- ii. Onus of proof- director.

Negotiation of Director Indemnification clauses- imp.





Corporate Criminal Liability-



Identification Doctrine

Theory states that liability of a crime committed by a corporate entity is attributed or identified to a person who has a control over the affairs of the company and that person is held liable for the crime or fault committed by the company under his supervision.

- **Solomon v. Solomon (1897) ac 22:**

- i. Corporate entity- different from the people who are in the business of running of the company.

- ii. A corporate entity can sue and be sued in its own individual name. In criminal cases, the company can be prosecuted against but it is quite ineffectual as the company cannot be punished with imprisonment or death.

- iii. Doctrine of Identification was promulgated so as to affix liability of the crimes committed by the people in charge of running the company.

- **Reliance Natural Resources Limited v. Reliance Industries Limited (2010):**

- Bombay HC- Identification Doctrine: the company was “identified with such key personnel through whom it works”
 - SC- The legal entity of the company was different than the individual entity and in the present case, the company having more than a million shareholders, one person could not be said to have had the knowledge with respect to the company, which knowledge he had in his personal capacity. The court discarded this doctrine on the fact that the facts of the case did not fall into their preview.





Corporate Liabilities of Directors

Liability towards Company	Liability towards Third Party
<p>1. Breach of Fiduciary Duty: Director's powers= 'powers of trust'. Liability if acting dishonestly or in furtherance of self-interest</p>	<p>Sec. 34- Criminal Liability: where circulated, issued or distributed prospectus includes untrue or misleading statements- every person shall be made liable u/s-447.</p>
<p>2. Ultra Vires Acts: Director's powers and duties restricted to MOA and overstepping leads to liability</p>	<p>Sec. 34- Contravention- Imprisonment of 6m-10yrs Fine not less than amount involved in fraud and may extend to 3 times.</p>
<p>3. Negligent Acts: Failure to exercise reasonable care, skill, due-diligence= acted negligently and thus liability for loss/damage</p>	<p>Sec. 40- Allotment of Shares: default in compliance- Director liable to imprisonment of 1 yr, fine of Rs.50,000-1, 00,000.</p>
<p>4. Acts caused by malafide intentions: Directors, trustees of assets of co. Thus, mala fide performance= breach of trust and thus liable to indemnify the co.</p>	<p>Sec. 339- Fraudulent Trading: liability u/s-447</p>





Corporate Liabilities of Directors

- **Liability u/s- 415 and 409, IPC:**

- **GHCL Employees Stock Option Trust v. Kranti Sinha (2013) SCC 505:**

- i. Complaint alleging commission of offences under Section 406/409/420/477A/34/120B IPC.
 - ii. "The following are the ingredients of criminal breach of trust:

- "1. Entrusting any person with property or with any dominion over property.

- 2. That person entrusted (a) dishonestly misappropriating or converting to his own use that property; or (b) dishonestly using or disposing of that property or willfully suffering any other person so to do in violation--

- (i) or any direction of law prescribing the mode in which such trust is to be discharged, or

- (ii) of any legal contract made touching the discharge of such trust."

- **'Knowledge' Test** (including through the Board's processes)-*Immunity granted to NEDs and IDs is limited only for the offences under the Companies Act and not under any other legislation.*Complaint






- **Sec. 138, *Negotiable Instruments Act, 1881:- A. R. Radha Krishna v. Dasari Deepthi & Ors. (2019):***

- Complaint must contain specific averment that Director-in-charge of, responsible for, conduct of the co.'s business.



SFIO vs IL&FS

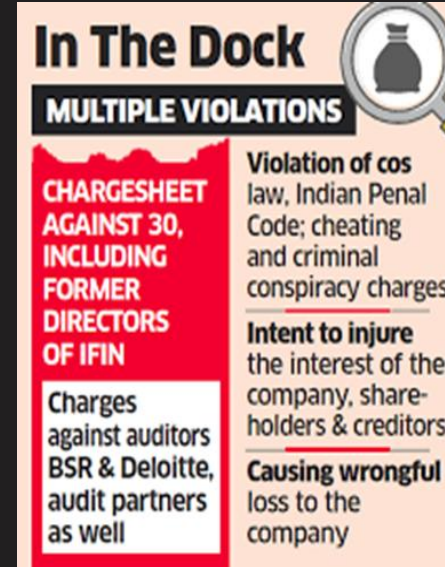
- *From the perspective of 'Independent Directors'*


-  Summary of findings/violations as per the Investigation Report and MCA's Order dated 29.05.2019:
-  **Fraud with the intent to injure the interests of the company, its shareholders and creditors resulting into wrongful loss to the company.**
-  **Statutory Auditors collided with the Management fraudulently finalised the books of accounts and thereby financial statements from FY 2013-14 to 2017-18.**
-  **The members of the Audit Committee connived with the Coterie and overlooked the violations of the norms by them resulting into unlawful loss to the company.**
-  **Deliberately represented false descriptive and misleading statement with a view to obtain credit facilities from banks and financial institutions.**



SFIO vs IL&FS- *The Charges*

- ❏ Fraud punishable under section 447 of the Companies Act, 2013, and section 417, 420 r/w 120B of the Indian Penal Code, 1860
- ❏ Lending to Non Group Companies and Group Companies
- ❏ *“The above acts of the Coterie were known to the Independent Directors A-19 to A-23 and other Directors including the Accused A-17 who was CFO of the IFIN and one of the persons who process the loan applications. Further, these issues got before the Board from time to time as consequence of the RBI Inspection Report.”*
- ❏ *“They did not ensure adequate disclosure or reporting of the facts brought out in these reports based on explanations given by the management. The Committee connived with the management (A2-A9) and overlooked the numerous impairment indicators in contravention of the accounting standards and principles of prudence by agreeing with the decision of management to defer the provision of diminution in books of accounts.”*
- ❏ Violations attracting sections 36 r/w 447 of Companies Act, 2013 and section 68 of the Companies Act, 1956



In The Dock 

MULTIPLE VIOLATIONS

CHARGESHEET AGAINST 30, INCLUDING FORMER DIRECTORS OF IFIN

Charges against auditors BSR & Deloitte, audit partners as well

Violation of cos law, Indian Penal Code; cheating and criminal conspiracy charges

Intent to injure the interest of the company, shareholders & creditors

Causing wrongful loss to the company





IL&FS- *Role of Independent Directors*

As per the Chargesheet dated May 30, 2019:

Independent Directors and CFO of the Company are appointed with objective to help the company in improving corporate credibility and governance standards but they ignored all alarming indicators and failed to save the interest of the Company and its stakeholders by not raising these issues in the Board Meetings and remained mute spectators.

Nature of Charge – *The members of the Audit Committee connived with the Coterie and overlooked the violations of the norms by them resulting into unlawful loss to the business*





Q&A

