



**Bombay Chartered Accountants' Society's (BCAS)**

**Representation on Fraud Reporting by Statutory Auditors of  
Regulated Entities with reference to National Financial Reporting  
Authority (NFRA) circular NF-25013/2/2023 dated 26.06.23.**

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## Section I:

### Background

This representation is made with the intention to avoid duplication of fraud reporting to different regulatory authorities, to simplify, standardize and bring about uniformity in fraud reporting by Statutory Auditors of regulated entities and removal of hardship and promote ease of doing business amongst regulated entities like Banks, Banking Companies, Insurance Companies, Non-Banking Finance Companies (NBFC) and others

## Section II:

### Requirement of section 143(12) of Companies Act, 2013 (CA) and rule 13 of the Companies (Audit and Auditors) Rule 2014

#### Section 143 (extracts)

*12. Notwithstanding anything contained in this section, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed:*

*Provided that in case of a fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed:*

*Provided further that the companies, whose auditors have reported frauds under this subsection to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed.*

#### Rule 13

*(1) If an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of rupees one crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government.*

*(2) The auditor shall report the matter to the Central Government as under:-*

*(a) the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than two days of his knowledge of the fraud, seeking their reply or observations within forty-five days;*

*(b) on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within fifteen days from the date of receipt of such reply or observations;*

*(c) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of forty-five days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier*

*forwarded to the Board or the Audit Committee for which he has not received any reply or observations;*

*(d) the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;*

*(e) the report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and*

*(f) The report shall be in the form of a statement as specified in Form ADT-4.*

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

*(a) Nature of Fraud with description;*

*(b) Approximate amount involved; and*

*(c) Parties involved.*

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

*(a) Nature of Fraud with description;*

*(b) Approximate Amount involved;*

*(c) Parties involved, if remedial action not taken; and*

*(d) Remedial actions taken.*

*(5) The provision of this rule shall also apply, mutatis mutandis, to a Cost Auditor and a Secretarial Auditor during the performance of his duties under section 148 and section 204 respectively."*

**BCAS Comments:**

To summarize, the current regulatory requirement is:

If an auditor of a company, in the course of performance of his duties as Statutory Auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of rupees one crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government. In case of a fraud involving less than one crore, the Statutory Auditor shall report the matter to Audit Committee or the Board, as the case may be.

Section 143(12), thus, assumes that the Audit Committee/ Board / Company is unaware of the fraud perpetuated against it by its officers or employees, and that the auditor would be the first to inform them about the same.

**Requirements of the Guidance Note (GN) on Reporting on Fraud under Section 143(12) of the Companies Act, 2013 (Revised 2016) issued by the Institute of Chartered Accountants of India (ICAI)**

1. Para 39 of the Guidance note refers to Reporting on Frauds Detected by the Management or Other Persons and already Reported under Section 143(12) by Such Other Person

*It may be considered that Section 143(12) envisages the auditor to report to the Audit Committee under section 177 of the Companies Act, 2013 or to the Board of Directors and thereafter, where applicable, to the Central Government an offence of fraud in the company by its officers or employees only if he is the first person to identify/note such instance in the course of performance of his duties as an auditor.*

*Accordingly, in case a fraud has already been reported or has been identified/detected by the management or through the company's vigil/whistle blower mechanism and has been/is being remediated/dealt with by them and such case is informed to the auditor, he will not be required to report the same under Section 143(12) since he has not per se identified the fraud.*

*For example, in the case of Banks and NBFCs there is a requirement of reporting frauds to the Audit Committee/ Board and to the Reserve Bank of India and, hence, to the extent such cases have already been identified and reported by the management, the auditor cannot be considered as the person who first identified them. Further, many companies have or are required to have a vigil/whistle blower mechanism through which instances of fraud may have already been reported.*

*Accordingly, in case a fraud has already been reported or has been identified/detected by the management or through the company's vigil/whistle blower mechanism and has been/is being remediated/dealt with by them and such case is informed to the auditor, the latter will not be required to report the same under Section 143(12) since he has not per se identified the fraud.*

*Since reporting on fraud under Section 143(12) is required even by the cost auditor and the secretarial auditor of the company, it is possible that a suspected offence involving fraud may have been reported by them even before the auditor became aware of the fraud. Here too, if a suspected offence of fraud has already been reported under Section 143(12) by such other person, and the auditor becomes aware of such suspected offence involving fraud, he need not report the same to the Audit Committee under section 177 of the Companies Act 2013 or the Board of Directors and thereafter, where applicable, to the Central Government under the section since he has not per se identified the suspected offence of fraud.*

*However, in case of a fraud which involves or is expected to involve individually, an amount of rupees one crore or more, the auditor should review the steps taken by the management/those charged with governance with respect to the reported instance of suspected offence of fraud stated above, and if he is not satisfied with such steps, he should state the reasons for his dissatisfaction in writing and request the management/those charged with governance to perform additional procedures to enable the auditor to satisfy himself that the matter has been appropriately addressed. If the management/those charged with governance fail to undertake appropriate additional procedures within 45 days of his request, the auditor would need to evaluate*

*if he should report the matter to the Central Government in accordance with Rule 13 of the Companies (Audit and Auditors) Amendment Rules, 2015.*

**BCAS Comments:**

Since, as per the ICAI Guidance Note, an auditor need not report a fraud to the Central Government if he is not the first person to identify/note such instance. It also mentions an example where in the case of Banks and NBFCs there is a requirement of reporting frauds to the Audit Committee/ Board and to the Reserve Bank of India and, hence, to the extent such cases have already been identified and reported by the management, the auditor is not required to report under Section 143(12).

However, if the auditor is not satisfied with the steps taken by the management/ those charged with governance with respect to the reported instance of suspected offence of fraud, then the auditor may report the matter to the Central Government.

2. Para 42 and 43 of the Guidance note which refers to Reporting on Suspected Offence Involving Fraud in case of Consolidated Financial Statements

*The auditor of the parent company in India will be required to report on suspected offence involving frauds in the components of the parent company, if the suspected offence of fraud in the component is being or has been committed by employees or officers of the parent company*

*and if such suspected offence involving fraud in the component is against the parent company, if:*

*a) the principal auditor identifies/detects such suspected offence involving fraud in the component “in the course of the performance of his duties as an auditor” of the consolidated financial statements; or*

*b) the principal auditor is directly informed of such a suspected offence involving fraud in the component by the component auditor and the management had not identified/is not aware of such suspected offence involving fraud in the component; or*

*c) a component that is not a company or the Component is a foreign corporate since the component auditors of such components are not covered under Section 143(12)*

**BCAS Comments:**

Thus, as per the ICAI Guidance Note, the principal auditor was be required to report on suspected offence involving frauds in the components of the company if such fraud is committed by employees or officers of parent or such fraud is committed against the parent.

This was the accepted position for statutory auditors and followed in all cases till the NFRA circular was issued in June 2023.

### Section III:

#### **What does National Financial Reporting Authority (NFRA) circular NF-25013/2/2023 dated 26.06.23 require?**

NFRA's circular NF-25013/2/2023 dated June 26, 2023 ("the Circular") provided clarification and reiterates certain key aspects with respect to the responsibilities of a statutory auditor on fraud reporting under section 143(12) and SA 240 in course of discharge of audit. The circular reiterated that statutory auditors are under a mandatory obligation to report fraud or suspected fraud if they observe suspicious activities, transactions or operating circumstances in a company that indicate reasons to believe that an offence of fraud is being or has been committed against the company by its officers or employees. In such an event, the statutory auditor shall initiate the steps prescribed under Rule 13 of Companies (Audit and Auditors) Rules 2014 which begins with reporting the matter to the Board/Audit Committee within two days of his/her knowledge of the fraud.

The Circular further reiterated the requirements of reporting u/s 143(12) of The Companies Act, 2013 read along with Rule 13 that, in the case of reporting of a fraud involving or expected to involve individually an amount of Rs. 1 crore or above, if the statutory auditor fails to get any reply / observations from the Board/Audit Committee within 45 days, the Auditor shall forward a report in the specified form viz., ADT-4 to Secretary, Ministry of Corporate Affairs, Government of India.

Para 4.2 of the said Circular states *"that the statutory auditor is duty bound to submit Form ADT-4 to the Central Government u/s 143 (12) even in cases where the statutory auditor is not the first person to identify the fraud/suspected fraud"*. It was further reiterated that resignation does not absolve the statutory auditor of his responsibility to report suspected fraud or fraud as mandated by the law and that the statutory auditor shall exercise his/her own professional scepticism while evaluating fraud and need not be influenced by legal opinion provided by the company or its management.

#### **BCAS Comments:**

The Circular is applicable for the Statutory Auditors of all companies within the scope of NFRA and does not scope out any covered company/entities which are stringently regulated by specific regulations such as banks and non-banking finance companies (NBFCs) which are regulated by the Reserve Bank of India (RBI) and other regulated entities like Insurance companies etc.

In this context, we bring to the notice, that regulated entities such as banks and NBFCs are governed by very strict governance requirements including elaborate fraud risk management guidelines. We point out salient features of these requirements here below.

Reserve Bank of India (Fraud Risk Management in Commercial Banks (including Regional Rural Banks) and All India Financial Institutions) Directions, 2024 (Ref:RBI/DOS/2024-25/118DOS.CO.FMG.SEC No.5/23.04.001/2024-25) issued on July 15, 2024 establishes a framework for banks and to prevent, detect early, and promptly report fraud incidents to law enforcement agencies, the RBI as well as to facilitate the dissemination of related information by the RBI and address associated matters. The master direction classifies the nature of frauds in 10 types, such as, misappropriation of funds and criminal breach of trust, fraudulent encashment through forged instruments and manipulation of books of accounts or through fictitious accounts and conversion of property and fraudulent electronic banking/digital payment related transactions committed on non-banking financial companies (NBFCs).

*(For details refer Section IV of this representation)*

## Section IV:

**What is the requirement as per the Master Direction on Fraud Reporting and Fraud Risk Management and Reporting as per the Reserve Bank of India ('RBI')?**

- **What is the existing practice for Banking Companies/Non-Banking Financial Companies\_('NBFCs')?**

### **BACKGROUND AND REFERENCE TO LEGAL FRAMEWORK / MASTER DIRECTIONS:**

- Until July 2024, the frauds in connection with Banking Companies and NBFCs were regulated and dealt with under the 'Master Directions on Frauds – Classification and Reporting by commercial banks and select FIs (Updated as on July 03, 2017)' and 'Master Direction - Monitoring of Frauds in NBFCs (Reserve Bank) Directions, 2016', respectively.
- On July 15, 2024, the Reserve Bank of India ('RBI') issued the following revised Master Directions on Fraud Risk Management in the Banks and NBFCs (including Housing Finance Companies) (hereinafter referred to as the '**Master Directions**' or '**MDs**):
  - Master Directions on Fraud Risk Management in Commercial Banks (including Regional Rural Banks) and All India Financial Institutions
  - Master Directions on Fraud Risk Management in Non-Banking Financial Companies (NBFCs) (including Housing Finance Companies ('**HFCs**'))
- The aforesaid Master Directions are issued in exercise of the powers conferred under Chapter III-A and Chapter III-B of the Reserve Bank of India Act, 1934, and Section 21 and Section 35A of the Banking Regulation Act, 1949 for the banks and Sections 45K, 45L and 45M of the Reserve Bank of India Act, 1934 (Act 2 of 1934) and Sections 30A, 32 and 33 of the National Housing Bank Act, 1987 for NBFCs (including HFCs).
- The Master Directions provide a framework for prevention, early detection and timely reporting of incidents of fraud in Banks and NBFCs (including HFCs) (hereinafter referred to as '**Regulated Entities**' or '**REs**') to Law Enforcement Agencies (LEAs), Reserve Bank of India (RBI) and the National Housing Board (NHB).
- Para 1.3 of Master Directions lays down the rationale and purpose of the MDs, as follows:

#### **For Banks:**

*"These Directions are issued with a view to **providing a framework to banks for prevention, early detection and timely reporting of incidents of fraud** to Law Enforcement Agencies (LEAs), Reserve Bank of India (RBI) and NABARD and dissemination of information by RBI and matters connected therewith or incidental thereto."*

#### **For NBFCs (including HFCs):**

*"These Directions are issued with a view to **providing a framework to Applicable NBFCs for prevention, early detection and timely reporting of incidents of fraud** to Law Enforcement Agencies (LEAs), Reserve Bank of India (RBI) and National Housing Bank (NHB) and matters connected therewith or incidental thereto."*

- The requirement of reporting of fraud to various authorities are addressed in specific chapters of the MDs, namely, Chapter- V, VI and VII and are tabulated herein below:

Sr. No.	Reporting to Stakeholders	Reporting Requirement
A)	Reporting of incidents of fraud to RBI	<ul style="list-style-type: none"> <li>▪ REs while reporting incidents of fraud to RBI, need to select the appropriate 'category' within which a fraud would fit. This requirement is not applicable to HFCs. HFCs should report incidents of fraud to NHB in the manner and in returns/formats as prescribed by NHB.</li> <li>▪ Fraud Monitoring Return (<b>FMR</b>) to be furnished for each fraud within 14 days from the date of classification. The time limit has been reduced from 3 weeks for Banks and 21 days for NBFCs (including HFCs).</li> <li>▪ Any incidents of fraud perpetrated in Group entities of REs to be reported to RBI if such entities are not regulated / supervised by any financial sector regulatory / supervisory authority.</li> <li>▪ In case of overseas banking group entity of Indian banks, the parent bank should also report incidents of fraud to RBI.</li> </ul>
B)	Central Payments Fraud Information Registry	<ul style="list-style-type: none"> <li>▪ Banks are required to report payment system related disputed/ suspected or attempted fraudulent transactions to Central Payments Fraud Information Registry (<b>CPFIR</b>), maintained by RBI. This is a new requirement applicable to Banks. However, no such requirement is prescribed for NBFCs (including HFCs).</li> </ul>
C)	Reporting of frauds to Law Enforcement Agencies (LEA)	<ul style="list-style-type: none"> <li>▪ Banks are required immediately to report incidents of fraud to LEAs, subject to applicable laws, as indicated in the MDs. The LEAs include Police Authorities, Serious Fraud Investigation Office (<b>SFIO</b>), Ministry of Corporate Affairs (<b>MCA</b>) and Central Bureau of Investigation (<b>CBI</b>). The reporting to LEA would depend upon the category of bank and amount involved.</li> <li>▪ NBFCs need to report the incidents of fraud to applicable LEAs viz State Police, subject to applicable laws.</li> <li>▪ Insofar as reporting of frauds involving forged instruments, including fake/forged instruments are concerned, reporting shall be undertaken by the paying bank and not by the presenting banker.</li> </ul>



	<p>Fraud Monitoring Group</p>	<ul style="list-style-type: none"> <li>▪ Banks and NBFCs are required to report instances of theft, burglary, dacoity and robbery (including attempted cases) to the Fraud Monitoring Group (FMG), Department of Supervision, Central Office and RBI immediately (not later than 7 days from their occurrence). HFCs should report such incidents to NHB in the manner and in the returns/formats as prescribed by NHB.</li> <li>▪ A Quarterly Risk-Based Return (RBR) on theft, burglary, dacoity and robbery should be submitted to RBI using an online portal, covering all such cases during the quarter. Such return should be submitted within 15 days from the end of the quarter to which it relates.</li> </ul>
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- Further, Para 8.3 of the MDs prescribe the Role of Auditors:

**Statutory Auditors:**

*“8.3.1 During the course of the audit, auditors may come across instances where the transactions in the account or the documents point to the possibility of fraudulent transactions in the account. In such a situation, the auditor should immediately bring it to the notice of the senior management and if necessary, to the Audit Committee of the Board (ACB) of the bank for appropriate action.”*

**Internal Auditors:**

*“8.3.2 Internal Audit in banks shall cover controls and processes involved in prevention, detection, classification, monitoring, reporting, closure and withdrawal of fraud cases, and also weaknesses observed in the critical processes in the fraud risk management framework of the bank.”*

**BCAS Comments:**

- Adherence/compliance with the aforesaid MDs by REs are regularly reviewed by the RBI as part of regulatory inspections; and any deficiencies in the compliance are highlighted and reported by the RBI in it’s Risk Assessment Report (RAR) and if required necessary Risk Mitigation Plans (RMPs) are also directed by the RBI specifying definitive timelines. The RBI has previously also levied penalties on REs for non-compliance with the provisions of these MDs. These compliances and RMPs have also to be considered/approved by the respective Boards of Directors of respective REs.
- Presently, Banks and NBFCs have a well-structured and stringent processes/systems to handle frauds, including inter-alia:
  - An independent department headed by a senior officer to oversee the lifecycle of fraud i.e. from the initial stage of identification to reporting and recovery
  - Each of the instances identified in the RE are examined by an independent team to identify the genuineness of cases, people involved, quantum involved and any control lapses or system issues. Additionally, the team identifies and recommends a corrective action plan to prevent similar lapses in the future.
  - The Fraud Monitoring Committee, Audit Committee & Board of the Regulated Entity are regularly apprised on all frauds, finding of the investigations and root cause analysis of such frauds, at least on a quarterly basis. In cases exceeding specified thresholds, a detailed case-wise note is presented to the aforementioned committees.

- Further, the regulator also oversees and monitors fraud reporting very closely as mentioned above. This is done by a special fraud monitoring cell within the Department of Supervision within the RBI.
- In light of the above, it can be reasonably concluded that the guidelines issued by the RBI as regards Fraud Monitoring and Reporting are comprehensive, exhaustive and much more rigorous which elaborate and cover the entire lifecycle of the fraud along its monitoring and reporting.
- As outlined in the background above, the requirements of Section 143(12) of the Companies Act, 2013 are restricted only to the reporting of fraud by the Statutory Auditor.
- Further, as set out above, there is regular and timely inspections by RBI that ensures adherence and compliance with the requirements prescribed in the MDs. Furthermore, the guidelines require the Auditor to highlight any instance of possible fraud in the RE.
- To conclude, the Fraud monitoring and reporting in RE are subject to a higher degree and stricter regulation and continuous oversight by the RBI.

- **What is the existing practice in Insurance Companies**

All insurance companies are required to follow the guidelines set by *Insurance Regulatory and Development Authority of India (Insurance Fraud Monitoring Framework) Guidelines, 2024* which is designed to strengthen the insurance sector against frauds, particularly with the exponential rise in digital transactions. This framework lays down strict norms for detection, prevention and response mechanisms regarding fraud.

These guidelines are issued under Section 34 of the Insurance Act 1938, read together with the relevant sections of the Insurance Regulatory and Development Authority Act, 1999. Read in conjunction with the Corporate Governance Regulations for Insurers, 2024; this framework gives insurers substantial legal and regulatory impetus to foster a culture of accountability and transparency. Key features of the guidelines involve:

#### Types of Insurance Fraud under IRDAI's Framework

Based on the kind of fraudulent activities insurers generally face, IRDAI has identified four major categories of fraud, each having its own characteristics and mitigation methods for effectively combating those:

- ***Internal Misconduct:***

Internal fraud involves employees, managers, and sometimes even board members. It may include unauthorised access to sensitive data, collusion with claimants, and misappropriation of funds. Its detection requires high levels of control, making accountability important within an organisation.

- ***Fraud by Distribution Channels:***

Insurance agents and brokers may sometimes be in direct contacts for policyholders in activities ranging from document falsification and premium theft to policy misrepresentation. To nip these problems in the bud, the framework ensured that vigilance over these channels would be maintained to ensure that customers dealt with trustworthy representatives.

- ***Fraudulent Claims and Policyholder Deception:***

Some policymakers try manipulating the system by providing false information, omitting crucial details, or even creating fictitious identities. Such fraud cases have highly extensive outcomes. They result in increased premiums and financial loads on insurance companies.

- ***External Fraud by Third Parties:***

Fraud might be committed through third-party entities, such as vendors or service providers, such as inflated bills, fabricated documentation, or impersonation to claim benefits. It is here that insurers must establish defences to block these external perils so that financial and reputational loss can be averted.

IRDAI guidelines introduce multiple components to combat fraud comprehensively, forming a solid anti-fraud foundation for insurers:

***Governance Structure for Fraud Risk Management:***

The guidelines provide that every insurer shall have a Fraud Risk Governance Structure established under the leadership of senior management and assisted by committees such as the Audit and Risk Management Committees. Each insurer shall draft an Anti-Fraud Policy that has zero fraud tolerance. They must set up an early detection system and coordinate closely with law enforcement agencies to ensure timely legal action against fraudsters.

***Frauds Monitoring Committee (FMC):***

Insurers shall establish a Fraud Monitoring Committee to focus on deterrence, investigation, and reporting. The FMC shall lead in the fraud management strategy, overseeing investigations and enforcement of anti-fraud policies. It shall report quarterly and annually to the board on fraud activities and their financial impact, reinforcing accountability at all levels of the organisation.

***Creation of a Fraud Monitoring Unit (FMU):***

Each insurer shall establish an independent Fraud Monitoring Unit to extend continued support to the FMC. Such a unit would undertake periodic inspections, collect evidence, and collaborate with various departments to handle fraud cases. The FMU shall also cooperate with regulatory bodies and law enforcement when required to ensure fraud resolution.

***Proactive Risk Assessment and Mitigation Measures:***

The framework focuses on a proactive approach to fraud by mandating provisions for annual risk assessments through all departments. By assessing potential vulnerabilities, insurers can institute a process to balance the risks before they get out of hand. RFIs are encouraged as a means of recognising unusual patterns that may be indicative of fraudulent activity. At the same time, enhanced technological tools are recommended to monitor constantly and quickly squash burgeoning fraud.

***Addressing Cyber Fraud in a Digital Age***

IRDAI guidelines recognise the risks digital fraud creates; hence, the data privacy and cybersecurity strategy must be robust. Insurers must implement systems that protect digital transactions, customer data, and the organisation's reputation from cyber-attacks. The guidelines also include a cyber risk management team that would give insurers the dedicated expertise they need to counter the rapidly evolving digital threats.

### ***Role of IIB in Collaborative Fraud Detection***

The Framework acknowledges that the Insurance Information Bureau (IIB) is an important insurer partner by offering a centralised service for data-based fraud detection. As an industry repository, the IIB lets insurers explicitly share information regarding suspicious activities and, in return, aids in identifying patterns of fraud. Insurers can flag repeat offenders and identify fraud attempts through shared data from past fraudulent cases, strengthening the entire sector's resilience against fraud.

### ***Training and Awareness – Creating a Culture of Vigilance***

These guidelines greatly emphasises awareness and training at all levels. Insurers should conduct fraud-awareness sessions with employees at all levels, from senior management to the front-line staff, equipping them with the skills and tools required for fraud identification and prevention.

Policyholders are also encouraged to participate in fraud-awareness programs to educate them on fraud risk and prevention. This multi-level awareness strategy helps create an environment of vigilant insurance culture in which every stakeholder contributes to fraud prevention.

#### ***BCAS Comments:***

Just like in the case of regulatory supervision on fraud monitoring and reporting in case of Bank, Banking Companies and NBFCs, the IRDA also has a continuous and stringent oversight over the same for Insurance companies.

## Section V:

### **Need for avoiding duplication of fraud reporting by Statutory Auditors in case of Regulated Entities like Bank, Banking Companies, Insurance Companies, NBFC and others**

It must be noted that the requirements under the RBI, IRDA and other such regulatory guidelines with respect to fraud reporting are much stricter and more stringent as compared to those under Section 143(12) of Companies Act, 2013. Reporting to RBI by banks is required within 14 days and there is no quantitative threshold for fraud reporting i.e. even frauds/suspected frauds below Rs. 1 crore, need to be reported by REs. Further, as mentioned earlier, these guidelines require comprehensive board approved policy outlining roles and responsibilities of board/committees and senior management and containing fraud prevention and early detection measures including ensuring compliance with the principle of natural justice (issue of show cause notice). Further, a committee headed by independent or non-executive directors are required to oversee the effectiveness of the bank's fraud risk management. RBI guidelines require embedding fraud risk management in the risk function with a dedicated senior-level role for overall monitoring and reporting of frauds.

Practical challenges/unintended consequences faced currently due to this reporting on frauds by Statutory Auditors:

- **Dual Reporting to agencies of the Central Government-** The reporting of the frauds (already reported to RBI as per the Master Directions) to Central Government as per Para 4.2 is resulting in duplication of the reporting of the same fraud to different regulatory agencies under the Central Government (i.e. RBI, IRDA and MCA).
- **Regulator is better equipped to deal with Industry specific issue:** In recent times, a large percentage of frauds in banks, NBFCs and other REs involve cyber or information technology frauds. The respective regulators have been actively looking into these matters and have been taking corrective actions by issuing comprehensive guidelines to cover IT security, vulnerability assessment, etc. The respective regulator being a sector specific expert has better resources and expertise to deal with these issues as compared to Ministry of Corporate Affairs.
- **Inquiries and Reviews by MCA of subject matters entrusted to a Specific Regulator (RBI or IRDAI)-** The re-reporting of the fraud by the Auditor to MCA may initiate an independent inquiry/review based on the instances of fraud highlighted in Form ADT-4. However, these instances along with the overall mechanism of fraud reporting are subject to inspection by the RBI on an annual basis.
- **Industry/member Feedback:** Based on the responses and feedback from Industry and professions who are mandated to comply to various regulators/Government agencies on the instances of fraud\_hampers the ease of doing business. Sometimes this may also become a contentious issue between the company management and SA.
- **Information already available with the Audit Committee / Board-** Despite not being the first to identify fraud, the re- reporting of the fraud by the Statutory Auditor as required under Section 143(12) of the Companies Act, 2013 to the Audit Committee/Board which is already in possession of information of fraud through persons in management, employees, other persons, the vigilance mechanism or

vigilance committee or through a whistle blower; will result in duplication of reporting of the same matter.

- The current scenario of dual reporting leads to different positions and stands taken by different Statutory Auditors on fraud reporting and there is no consistency on the same.
- There is also a question, in case of Joint Audits, currently there is no clarity, on the responsibility for fraud reporting as per SA299.
- As it can be seen from the above, there are specific RBI guidelines/ regulations that mandate the banks and NBFCs to deal with fraud risk management and suspected fraud which are stricter than the requirements of section 143(12). The reporting under Section 143(12) by auditors of banks and NBFCs would not be consistent with the principle of *lex specialis* rule wherein, in a scenario when two regulations govern the same factual situation, a law governing a specific subject matter overrides a law governing only general matter. We also believe that when there are specific regulations governing any REs on any matter, these would prevail over generic regulations on any subject matter. E.g. the term of appointment of Statutory Auditors currently are guided by RBI guidelines rather than as per the provisions of the Companies Act.
- Many a times, in REs. there is a considerable time gap between identification/occurrence of an incident and finally concluding the same as a fraud after a thorough process of forensic audit or an investigation process. Fraud reporting by Statutory Auditor would pose challenges in this interim period.
- Even though the intention of reporting u/s 143(12) is assumed to make the Statutory Auditor aware and involved with the entire incident of fraud, in any REs. the SA automatically is aware of such instances due to robust and policy driven regulatory reporting requirement.
- **Regular Direct Interaction between the Regulator and SA:** Banks and NBFCs are subjected to RBI inspections on a regular basis. During the course of these inspections, the RBI inspection teams generally have direct interaction with auditors of the banks/ NBFCs being inspected. These interactions give adequate opportunity for the regulator to communicate directly with the auditors
- As such, it would be prudent to report matters of fraud to the Audit Committee or the Board, only when the Audit Committee/Board has no prior knowledge of such fraud, and the fraud is discovered by the Auditor/ has come to the knowledge of the Auditor.
- We believe that the requirements of the NFRA circular needs to be interpreted contextually and purposively as the objective of the circular appears to be in the larger public interest of reporting of instances of frauds, fixing accountability on management /fraud perpetrators and overall improving the corporate governance structure, which is already getting served while reporting frauds to sector specific regulators in case of regulated entities such as, banks, NBFCs and insurance companies.

### **Comparable International practice**

Based on a general search by us, we did not get any separate fraud reporting by Statutory Auditors in case of fraud reporting internationally.

We did not find any similar requirements in major jurisdictions, such as, UK, US and European Union for the auditor to separately report fraud or suspected fraud that are to be reported to a regulator in addition to the conclusion of the audit as per the requirements of the auditing standards or even before the audit is concluded. While we understand that such requirements may have merits in a country such as India, but we humbly submit that, in absence of similar international practice, these requirements should not be extended to regulated companies, such as, banks, NBFCs and insurance companies and their auditors.

### **Section VI**

#### **Representation to make suitable amendments to the section 143(12)**

Based on the above discussion, BCAS strongly believes that the section 143(12) be amended to restrict fraud reporting to only companies that are not regulated by other agencies like RBI, IRDAI and similar. Appropriate checks and balances can also be incorporated in the said amendment.

### **Section VII**

#### **Conclusion**

We believe that the intention of the said clarificatory circular issued by NFRA is in the benefit of general public interest and improving the overall corporate governance and assigning accountability and responsibility on the perpetrators of fraud across the companies in India. However, the current dual fraud reporting requirement for regulated entities is posing significant challenges, hardship, and duplication of reporting, causing possible inconsistencies that can be avoided without compromising the extent and rigour of regulatory oversight that sector regulators such as RBI and IRDA have been doing over the years. Therefore, in light of the above, we are requesting your assistance in issuing a clarification/instruction to avoid this dual reporting on frauds by Statutory Auditors of Regulated Entities. We are also sending across a copy of this representation to the Reserve Bank of India, IRDA, NFRA & ICAI for their reference and consideration.