

Why rising forensic audits need clear set of rules; ghosts of Sahara, Satyam scams still haunt

December 16, 2020 6:49 PM

With reforms in the process, India would need a clear law and policy on forensic audits.



A rising number of forensic audits across errant companies have proved that the market needs stricter rules.

Sumit Agrawal

The new year may bring some good news. By end of this year or early next year we will see an overarching set of Forensic Accounting and Investigation Standards (FAIS) that will cover all kinds of private and public sector companies, banking and financial services sector companies against all kinds of financial irregularities, misappropriation of funds etc. According to news reports, the Institute of Chartered Accountants of India (ICAI) plans to come out with these new standards. Once set in stone, these will cover

matters related to financial irregularities across companies and give more teeth to regulators and auditors.

Of late, multiple regulators including the Reserve Bank of India ([RBI](#)), the Securities and Exchange Board of India (SEBI), and the Insurance and Regulatory Development Authority of India (IRDAI) have started tightening the noose around companies found to be indulging in dubious transactions. India has seen a rise in complaints of financial irregularities and orders of forensic audits.

The high-decibel cases included that of IL&FS, Franklin Templeton, Housing Development and Infrastructure Limited (HDIL), PMC Bank, Karvy Stock Broking, Rotomac Global Private Limited, [Ricoch India](#), [Parsvnath Developers](#), [Fortis Healthcare](#), [Religare Enterprises](#), CG Power, [Prabhat Dairy](#), [Sun Pharma](#), Amrapali Developers, DHFL, [Adhunik Industries](#), [Infosys](#), [Kavit Industries](#), [GV Films](#), and 331 shell companies (identified by Ministry of Corporate Affairs (MCA) who had to demonstrate their financial soundness through forensic audit).

Seemingly, there is a widespread problem in the manner accounts are casted or disclosed by India Inc. The auditors who are supposed to be the statutory gatekeepers of 'true and fair view' of financials too have a lot to answer. Take for example of the IL&FS scam. Here, the company extended loans to companies that did not service their debt. Then to avoid being categorized as bad loans, the lender gave away funds to the defaulters' group companies that subsequently used to repay the earlier loans. Recently in the case of Franklin Templeton Asset Management India and Franklin Templeton Trustee Service, SEBI ordered a forensic audit in the wake of an abrupt closing down of its six debt schemes.

There are cases of various degrees. In some, there are allegations of collusion to lack of oversight. Similarly, there are cases where financial statements have been misstated while in some cases the disclosures on the stock exchange platform or at MCA are made in a convoluted manner. There are also instances of apathy of regulators and ambiguity in the law.

What is a forensic audit?

The term forensic audit is not statutorily defined by Parliament, and is a term used by virtue of ICAI and ICSI rules as a part of professional skill (for a chartered accountant, auditor, cost accountant or company secretary) and an evidentiary tool to detect fraud for reporting purposes. Companies Act, 2013 expressly requires an auditor to report fraud and has detailed provisions in this regard. Similar provisions are available for regulated entities prescribed by SEBI, RBI, IRDAI in their regulatory domain.

Forensic audit in law is known as a 'special audit'. There are various criteria under income tax act before revenue department can order audit of an assessee. There are no specific provisions under SEBI Act / RBI Act / IRDAI Act explicitly for forensic audit

and such directions are issued as their inherent powers in the interest of investors / economic policy / policy holders as a part of investigation. Forensic audits help uncover embezzlement, bribes, extortion, fictitious transactions, kickbacks, conflict of interest and other financial irregularities.

Who does the forensic audit?

Companies can appoint their own forensic auditors which are essentially independent audit firms. However, the regulators and the stock exchanges being governed by their respective statutes empanel such experts through tender / bid process. Forensic audit reports contain details about the company, their business and commercial activities, details on various agreements and often confidential information of clients / processes / competition / etc. which may be price sensitive information.

But what does the country need?

Everyone agrees that for the benefit of stakeholders and to attract investment, the country needs a safer business environment. Focused, standards-based investigations are the need of the hour. They have the potential to develop a more streamlined market, where chances of another fraud will be lesser. Enforcement actions which are strengthened as a result would act as a deterrent. A safer and compliant environment for all stakeholders is already developing.

If a regulator like SEBI, RBI or IRDAI directs a forensic audit it becomes an input for Serious Frauds Investigation Office (SFIO), Ministry of Corporate Affairs (MCA), Economic Offences Wing (EOW), Central Bureau of Investigation (CBI) and Enforcement Directorate (ED) to start their independent investigation. In law, there is no bar on the probe by multiple agencies. The future challenge will be to streamline resources of all wings of the Government of India in a time-bound manner.

Even after a decade, ghosts of Sahara and Satyam are still roaming in the corridors of regulators and courts.

There is another side. Increasing forensic audits would also mean encouragement to whistleblowers to come forward. As a result, many more fraudsters may get exposed. However, the country will need a stringent set of rules to safeguard the interests of whistleblowers and avoid the misuse of forensic audit by such as warring promoters.

The evolved set of compliances in the country will also force the listed entities to disclose the final findings of such an audit, as issued by the forensic auditor, to the general public. The disclosure itself will prove to be an eye-opener for all stakeholders.

Recently, SEBI has made disclosures of findings of the forensic audit of listed entity mandatory but has left a lot of ambiguity. Here, SEBI will have to come up with some objective criterion what to disclose, when to disclose and how much to disclose. On this aspect, discretion would need to rest with the board and the judgement of independent directors. India is also gearing towards potential monopolising of forensic

audit business. Regulators also have a limited pool available. This has implications from the perspective of competition law. This means there should be a robust code of conduct for auditors and the market too.

While the COVID-19 pandemic has affected commercial activities across the country and the world, forensic auditors seem to be having a field day if one were to go by the number of orders and revenues of the forensic auditors.

The adverse impact of the pandemic is likely to result in more companies coming under the scanner and India would need a clear law and policy on forensic audits covering prevention, regulation and penalization.

Sumit Agrawal is Founder and Partner at Regstreet Law Advisors. Views expressed are the author's personal.

Source: <https://www.financialexpress.com/industry/why-rising-forensic-audits-need-clear-set-of-rules-ghosts-of-sahara-satyam-scams-still-haunt/2151297/>