

## ROLE OF SERIOUS FRAUD INVESTIGATION AGENCY IN PROMOTING CORPORATE GOVERNANCE: A NEED FOR MORE TEETH

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### **Abstract**

*Over the last few decades there are number of Corporate fraud are increased around the globe. These corporate frauds are done by the high corporate officials i.e. white color crimes. Firstly, in U.S the wake of Enron Case which led to the enactment of Sarbanes-Oxley Act, Secondly in India the Satyam Scam these are rising regime of corporate fraud which led to suffering of investors, shareholders etc...due to growth of new regime of Fraud there is need of effective Corporate Governance mechanism with attributes of ethics, fairness, transparency as well as economic efficiency to prevent corporate fraud. That's why India set-up a committee in 2002 to study Corporate Governance under the chairmanship of Naresh Chandra i.e. Naresh Chandra Committee. Several, Recommendations were made by the Committee and one of which is to set-up 'Corporate Serious Fraud Office' which has given statutory enactment under the Companies Act 2013 to investigate serious frauds. Which is a Specialized, Multi-disciplinary organization to deal with Serious Corporate Frauds. The whole theme of this idea has been brought from U.K, but in terms of theme only not in terms of functioning. As the Role which assigned to 'Serious Fraud Investigation Office' under the newly amended Companies Act is firstly, the action cannot be taken on suo-motu basis as it is entirely depends upon the discretion of Central government. Secondly, Individual applications are barred in directly approaching the SFIO for any fraud allegation to investigate. Thirdly, there is Lack of Allocation of funds as well as Inadequacy of Manpower.*

**KEYWORDS:** *SFIO, Investigation Fraud, Corporate Governance, Functioning, Central Government*

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### **INTRODUCTION:**

In every company there are number of interest working together these are board of directors, managers, shareholders, investors, auditors and other stakeholders in order to function systematically and

ethically there is need of strong corporate governance measures. As we already know “if the leadership is rotten how can the rest of company succeed in long run” so for the purpose of balancing as well as doing equity to the abovementioned interest every company must have strong corporate governance mechanism. <sup>1</sup>The term ‘governance’ derives from the Latin gubernare, meaning ‘to steer’, which implies that corporate governance involves the function of direction rather than control. It assign the rights and responsibility among different interest in the corporation as well as it also balance between economic, social, individual, and communal goals. Around the globe number of corporate failures are there some of these are Enron, WorldCom in USA, Satyam Scandal in Indian also called as Indian Enron, Maxwell in U.K these are the major scandals which is happen because of lacking in their corporate governance mechanism. Apart from assigning rights and responsibilities corporate governance also perform the task of developing Transparency and Accountability and these task are perform through government as well as independent regulators for instance in USA, Security and Exchange Commission (SEC), In U.K, Independent regulator from government i.e. serious fraud office (SFO), In India, Security Exchange Board of India (SEBI) as well as Serious Fraud Investigation Office (SFIO), these are the regulators which conduct investigation if any kind of fraudulent activities either in terms Accounting, Auditing, Balance sheet etc...done by the corporation. These are the agencies which are promoting corporate governance mechanism, but in order to promote effectively these agencies are required more teeth in the sense they required more freedom, more power, more resources so that they can perform the task efficiently. In India for the purpose of preventing fraud and conducting investigation presently the role is assign to the “Serious Fraud Investigation Department” which is established under section 211 of amended Companies Act 2013.

### **WHO IS SFIO:**

The serious fraud investigation office is a multi-disciplinary organization which act in coordination with other agencies to investigate Fraud. It has experts from law, auditing, accountancy, financial sector, capital market, taxation, information technology, investigation expertise etc...and the criteria

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<sup>1</sup> D Geeta Rani and R K Mishra, Corporate Governance: Theory & Practice pg no. 1,( Anurag Jain for Excel Books, New Delhi, 2013).

of selecting these expert is done through regulatory department like banks, SEBI, Comptroller and Auditor General and other government department<sup>2</sup>.

### **AREAS OF FRAUD COVERED BY THE SFIO:**

Presently in India in comparison to the U.K, only the cases of Fraud are investigated by the SFIO. In the companies act 2013 the status of SFIO recognized by creating the specific statute apart from that there is also need to explain the ambit of fraud, that's why in the newly amended companies act 2013 under section explain the ambit of fraud specifically.

Earlier position before the companies act 2013 is that fraud are defines in both civil law as well as criminal law and several other specific legislation. These are as follows:-

<b>LEGISLATIONS</b>	<b>FRAUD INGREDIENTS</b>
Indian contract act, 1872	Section- 17 defines fraud
Indian penal code, 1890	<p>Fraud not define but ingredients of fraud can be seen in I.P.C.:-</p> <p>Section-25 defines 'fraudulently'</p> <p>Cheating covers 415 to 420.</p> <p>Concealment covers 421 to 424.</p> <p>Forgery covers 463 to 477A.</p> <p>Counterfeiting covers 489A to 489E.</p> <p>Misappropriation covers 403 to 404.</p> <p>Criminal Breach of trust covers 405 to 409.</p>

<sup>2</sup> D Geeta Rani and R K Mishra, Corporate Governance: Theory & Practice pg no. 1,( Anurag Jain for Excel Books, New Delhi, 2013).

Prevention of Corruption Act	Elements of Fraud Involved.
Prevention of Money laundering Act	Elements of Fraud Involved.
Companies Act,1956	Provides punishment of Fraud under section 447, but does not define fraud. Less scope of personal liability and mostly the liability is jointly i.e. professional.
Companies Act, 2013	Defines Fraud an Provides punishment for fraud under section 447. More scope of personal liability with the stringent condition of compliance.

Under the companies act 2013 fraud has been define in very broad manner and it covers the liability of the person also severrably. Thus fraud define in following manner:-

<sup>3</sup>“fraud” in relation to affairs of a company or anybody corporate, includes

- (a) Any act,
- (b) Omission,
- (c) Concealment of any fact or
- (d) Abuse of position

Committed by **any person or any other person** with the connivance in any manner, -

- i. with intent to deceive,

<sup>3</sup> The Companies Act, 2013, See Explanation to Section 447(1).

- ii. to gain undue advantage from, or
- iii. to injure the interests of,
- iv. the company or,
- v. its shareholders or,
- vi. its creditors or any other person,

Whether or not there is any wrongful gain or wrongful loss;

The above mentioned are the attributes of fraud and if these attributes are present in any of the following sections than such person will be liable upon the investigation assigned to the Serious fraud Investigative team i.e.

- Section 7(5)- Registration of a company
- Section 36- Inducing person to invest money
- Section 75(1)- Acceptance of deposit with intent to defraud depositors or for any fraudulent purpose.
- Section 206(4)- Conducting business of a company for a fraudulent or unlawful purpose.
- Section 213-Other cases
- Section 229-furnishing false statement or destruction of documents.
- Section 251(1)- Application for removal of name from register with the object of evading liabilities with intent to deceive.
- Section 339(3)- Conducting business of the company with intent to defraud its creditors.
- Section 448- Making false statement.

In above mentioned section it is the persons as well as every other officers of the company who are jointly and severally liable. So, the scope of fraud is very wide as compare to the prior Companies act 1956.

But the question arose why? There is need a define fraud and why? There is need to attach liability of the persons with the other official of companies. The answers lies in the history of Corporate fraud Case as there are number of complex cases of frauds are increased which are investigated by SFIO.

## **STATUS OF SFIO BEFORE COMPANIES ACT 2013:**

It is pertinent to note that under the companies act 1956 there is no role of SFIO even investigation is done through other government regulator, but later on specifically after liberalization many countries had open up there barriers to form multi-national institution and companies in order to increased economy efficiency this also led to deregulation of several rules. Due to rampant increased in formation of corporation as well as competitions to gain more profit they use fraudulent practice by which corporate failure is done and one of such example is collapsed of Enron which led to formation of Sarbanes-Oxley Act<sup>4</sup>. This has also open up the eye of Indian government and they set-up a committee to study and recommend for enhancing corporate governance under the chairmanship of Naresh Chandra in 2002<sup>5</sup> (i.e. Naresh Chandra Committee 2002). The committee has suggested overall 30 recommendations out of which recommendation number 26 which specifically talk about establishment of Corporate Serious Fraud Office and one of such suggestion in it is:-

*“that the government of India should make legislative framework, along with the lines of the SFO as in U.K, should be set up to enable the CSFO to investigate all aspects of the fraud, and direct the prosecution in appropriate courts.”<sup>6</sup>*

Under this the committee had also suggested the pattern of U.K though it was not a mandate. But as far as U.K, SFO is concerned presently the role of it is wider with more teeth which are not in Indian SFIO, some of these are:-

1. *Firstly*, its role not only confined to the fraud rather the case of bribery and corruption are also fall under it.
2. *Secondly*, there it is the decision of director of the SFO who consider whether to investigate particular case or not by taking into consideration statement of principle.
3. *Thirdly*, the complaint mechanism of possible criminal activity from variety of sources these are Whistle Blower, victims, corporation (self-report), media as well as other law enforcement agencies etc... this make it unique in its functioning.

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<sup>4</sup> Pub. L. 107-204, 116 Stat. 745 (2002).

<sup>5</sup> Government of India, Report: *Committee on Corporate Audit and Governance* (Naresh Chandra Committee), Ministry of Finance and Company Affairs, December 2002.

<sup>6</sup> See Recommendation no. 26 Government of India, Report: *Committee on Corporate Audit and Governance* (Naresh Chandra Committee), Ministry of Finance and Company Affairs, December 2002.

These are some attributes which are not present in the Indian SFIO. In India after the recommendation of Naresh Chadra Committee the working of it carried out under section 235 to 247 Companies Act 1956 though there is no specific mention of SFIO, rather it is only after the amendment of 2013 i.e. Companies Act 2013, which specifically give recognition under the statute.

### **STATUS OF SFIO AFTER COMPANIES ACT 2013:**

#### **LEGAL ISSUES:**

Under the newly amended companies act 2013 the provision which are specifically dealing with SFIO are 211 to 217. Although there is no doubt now the ambit of SFIO is wider, but still as far as Indian SFIO working are concerned there are number of issues. In Comparison to U.K, SFO the Indian SFIO relatively less wide with less teeth. These issues are as follows:-

1. *Firstly*, the case which are dealing by SFIO are only Fraud related aspect.
2. *Secondly*, as per section 210<sup>7</sup> it is central government and section 213<sup>8</sup> it is court can only direct investigation into particular matter otherwise SFIO has no suo-motu power to conduct investigate.
3. *Thirdly*, there is no role of whistle blower as well as particular victims to make SFIO to investigate.
4. *Fourthly*, as per section 212(8)<sup>9</sup>, it only Central government upon whose authorization Arrest can be made.
5. *Fifthly*, as per section 212(12)<sup>10</sup>, on completion of investigation report of that has to be submitted to the central government and it is only the central government under

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<sup>7</sup> The Companies Act 2013, section 210 reads as "Investigation into affairs of the Company".

<sup>8</sup> The Companies Act 2013, section 213 reads as "Investigation into affairs of the company in other cases".

<sup>9</sup> The Companies Act, 2013, Section 212(8) reads as "If the Director, Additional Director or Assistant Director of Serious Fraud Investigation Office authorized in this behalf by the Central Government by general or special order, has on the basis of material in his possession reason to believe (the reason for such belief to be recorded in writing) that any person has been guilty of any offence punishable under sections referred to in sub-section (6), he may arrest such person and shall, as soon as may be, inform him of the grounds for such arrest".

<sup>10</sup> The Companies Act, 2013, Section 212(12) reads as "On completion of the investigation, the Serious Fraud Investigation Office shall submit the investigation report to the Central Government".

section 212(14)<sup>11</sup> after examination of such report direct the SFIO to initiate the prosecution.

6. *Sixthly*, there is another important issue is that there is no such power to keep in custody the document.....

In the above issues as we can easily examine the Supervisory Role and Control of Central Government is more than the SFIO. The question arose about the independency of SFIO working, and what will be the case if central government itself involved in fraudulent activity, is it not unfair as there is always a chance of biasedness.

The Central government has given very wide power in the organizing and functioning of SFIO i.e. Allocation of fund, Recruitment of rules, Permission to investigate, Permission to further prosecute etc...

#### **TECHNICAL ISSUES AS WELL AS ADMINISTRATIVE ISSEUS:**

Apart from legal issues overs there are also issues, which were of technical in nature as well as administrative in nature. Several committees are set-up to suggest and recommend changes in it, but till now no such step were taken by the central government. Even if no adequate step were taken by central government the functioning of SFIO till not hampered, it has very well and timely investigated all such cases which has directed to it, but by increasing in the new complexities of fraud day by day apart from legal reform there lot more to be done. These issues are:-

##### **1. Inadequacy of Manpower**

As per the 17<sup>th</sup> report<sup>12</sup> of the Standing committee on finance in its recommendation number 40<sup>th</sup> it has been clearly mentioned that Central Government failed to equip SFIO with requisite manpower, even if the 3 months' time given to the central government to drafts recriutment

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<sup>11</sup> The Companies Act, 2013, Section 212(14) reads as "On receipt of the investigation report, the Central Government may, after examination of the report (and after taking such legal advice, as it may think fit), direct the Serious Fraud Investigation Office to initiate prosecution against the company and its officers or employees, who are or have been in employment of the company or any other person directly or indirectly connected with the affairs of the company."

<sup>12</sup> Government of India, 17<sup>th</sup> Report: *Standing Committee on Finance see Para no. 40*, (Ministry of Corporate Affairs 2014-15).



rule, the central government failed to that. Such as lack-activeness approach on the part of central government may cause serious discrepancies in the functioning of SFIO.

As per the Thirteenth report<sup>13</sup> of the standing committee on finance there is gap between Sanctioned strength and Actual strength.

Sanctioned strength	Actual Strength	Vacancies left
130	55	75

As we can very well examine from the above point of view that position of SFIO in relation to manpower is below 50 %. And it is the most of the Group B employees are vacant who are acting as checks upon the investigation function, the effect of such inadequacy of manpower may lead to failure of working of SFIO.

## **2. Early Warning System is yet to be fully developed.**

On the account of increasing tactics and complexities of Fraud, the ministry of Corporate affairs initiate the EWS (Early Warning System), which give suspicion alerts of Fraud. But the system is failed as the results are not of that encouraging one. This concerned to developed better Early Warning system has to be developed in further fine-tuned manner by the 17<sup>th</sup> report under Ministry of Corporate Affairs.

## **3. Receipt of Sanction for Prosecution by Ministry of Corporate Affairs with delay.**

In the functioning of SFIO the massive role played by the Central Government and there may be case wherein central government failed to sanctioned Investigation and prosecution due to which the accused get opportunity to destroy material evidence. For example in case of Saradha Chit Fund Scam wherein central government delay in giving sanctioned to prosecute although no such discrepancies are there regarding delay but in the coming future such discrepancies may arise.

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<sup>13</sup> Government of India, 13<sup>th</sup> Report: *Standing Committee on finance on Demands for Grants see page no. 18*, (Ministry of Corporate Affairs 2015-16).

**SFIO INVESTIGATION IN RELATION TO INDIAN CONTEXT:**

<b>Name of the case:</b>	<b>Year of Scam:</b>	<b>Nature of Fraud:</b>	<b>Investigation done by:</b>
1. Satyam Scam	2009	Accounting entries are hugely Inflated and the quantum of fraud is done around 8000.	SFIO and conviction is done.
2. Reebok Fraud Case	2012	Fraud involved Filing of Fictitious invoices to show sales.	SFIO and conviction is done.
3. Saradha Chit Fund Scam	2013	Ponzi scheme run by the company under which fraudulent money was pooled from the public in the name of Chit fund benefits.	SFIO and conviction is done.
4. Deccan Chronicle Holding Ltd. (DCHL) load default case.	2013	Due to financial irregularities company had failed to repay loan amount. Money was availed through sale of non-convertible	SFIO and conviction is done.

		debentures and other commercial papers.	
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Till 2015, SFIO has filed 1165 prosecution cases out of which there are six cases in which conviction is done by the respective authority and for all these cases SFIO had submitted its investigation report to the central government in a timely manner. No delay was there on the part of SFIO. This has shown that although the number of issues regarding Independence, Accountability, Man-power, are over there but the functioning of SFIO has not been hampered till now.

### **CONCLUSION AND POLICY SUGGESTION:**

The office of Serious Fraud Investigation assumes statutory recognition under the Companies Act 2013. This gives SFIO a very important role to investigate corporate failure due to fraud. Although from the above literature it is assumed that the functioning of SFIO is not hampered till now even if the question of dependency arose. But in the phase of increasing such number of cases year by year there is a need to raise the question of dependency of SFIO on Central government even if the officials of Central government itself are involved like in the Saradha Chit Fund Scam where the question of delay arose in sanctioning the investigation and prosecution to the SFIO by the Central Government. These issues may cause a serious threat in the coming future as they hold the question of Transparency and Accountability if a fault is done on the part of Central government. For this there is a need to amend the functioning of SFIO. Some of the Functioning Amendments are as follows:-

1. SUO-MOTU Power to Investigate:

Even if the recognition is given under the new Companies Act 2013, the position of SFIO functioning remains intact. Presently, it is Central government who assign cases to the SFIO and also to further prosecute. This has to be changed. SFIO should be given Suo-motu power to investigate corporate fraud but for the purpose of Further Prosecuting after completion of investigation this role should be assigned to the Ombudsman Independent Committee which is to be created within the SFIO.

2. Individual Complaint Mechanism.

Secondly, there should be Individual complaint mechanism. As far as U.K SFO is concerned there the direct complaint mechanism are available to Private Individuals, Whistleblower etc...But such Mechanism are not presently deal by the Indian SFIO as far as section 177 is concerned establishment of Vigil Mechanism for Whistleblower within the company and even external mechanism but what kind of further remedy available to the such whistleblower who are not getting effective justice. So, there is a need to give direct complaint mechanism to SFIO.

3. Panel of Recruitment Board should be there.

4. Need for more number of Regional Offices.

Companies are performing their task either through sole office i.e. head office or through branch office. Major companies covers most of the states by establishing branch office. In context of SFIO presently the organizational structure of SFIO under which Five regional offices are there that is Delhi, Hyderabad, Mumbai, Kolkata and Chennai. This has to be increased to cover most of the state with better coordination.

5. Early detection of Fraud Should be there.

Early Warning system has failed to give desired result of alerting potentialities of Fraud. This system has to be re-developed.

6. Apart From Fraud other cases also to be handover.

In the cases of Bribery and Corruption there are most of the ingredients Fraud are involved. For such kind of cases also SFIO has to be merged with investigation. As presently it is only the cases which are filled under Companies act 2013 and not to other legislation.