

FINANCIAL CRIMES IN INDIA

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ABSTRACT

Amongst the financial crimes recognized worldwide and defined differently by them, the present article would analyse the recently emerged escape-route followed by the High Net Worth Individuals (HNWI) after the commission of financial crimes leading to erosion of wealth of the concerned economy, and absconding across national borders to get away with criminal trial. The term ‘financial crime’ has been defined by the Australian Criminal Intelligence Commission to “include activities ranging from fraud through active manipulation of the stock market, or laundering the proceeds of crime”. A region which is prone to financial crimes in a specific sector of economy would discourage investment and would divert the available resources towards law enforcement and fighting crime. The costs associated with this affects the ease of doing business in the country.

This article analyses the recent Nirav Modi fraud case that subsequently led to the introduction of Fugitive Economic Offenders Ordinance, 2018 (FEO Ordinance) which aims at punishing the persons accused of financial crimes in India who have left India like Vijay Mallya, Nirav Modi, etc. The article initially establishes a base of facts as took place in the case and then explains the role of Letters of Undertaking (LoU) in the whole set up. It further discusses the regulations governing

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such bank guarantees and the gaps which were observed in the present case. It also throws light on the recently emerged SWIFT transactions and auditors' duties with respect to bank guarantees.

Along with the introduction of the FEO Ordinance, the Union Cabinet of India, on March 1, 2018, approved the setting up of an independent regulator of auditors named the National Financial Reporting Authority (NFRA). The powers of this authority have also been described further in the article by comparing the same with the institutions existing prior to such Authority.

1. INTRODUCTION

The INTERPOL defines the term 'financial crime' to cover a wide range of criminal offences which are generally international in nature.¹ The term "includes activities ranging from fraud through the active manipulation of the stock market, or laundering the proceeds of crime."² The term 'economic and financial crime' broadly refers to "any non-violent crime that results in a financial loss, even though at times such losses may be hidden or not socially perceived as such. Such crimes thus include a broad range of illegal activities."³

*The Committee of Ministers of the Council of Europe
in 1981, identified 16 offences as economic crimes which*

¹ *Financial Crime*, INTERPOL, <https://www.interpol.int/Crime-areas/Financial-crime/Financial-crime> (last visited June 10, 2018).

² *Financial Crimes*, AUSTRALIAN CRIMINAL INTEL. COMM'N, <https://www.acic.gov.au/about-crime/crime-types/financial-crimes> (last visited June 10, 2018).

³ U.N. Congress on Crime Prevention and Criminal Justice, *Working paper on Economic and Financial Crimes: Challenges to Sustainable Development*, U.N. Doc. A/CONF.203/7 (Apr. 25, 2005).

*included cartel offences; fraudulent procurement or abuse of state or international organizations' grants; fraudulent practices and abuse of the economic situation by multinational companies; computer crime; faking of company balance sheets and book-keeping offences; bogus firms; fraud concerning the economic situation and corporate capital of companies; fraud to the detriment of creditors; violation by a company of standards of security and health concerning employees; consumer fraud; unfair competition, including payment of bribes and misleading advertising; fiscal offences and evasion of social costs by enterprises; offences concerning money and currency regulations; customs offences; stock exchange and bank offences; and offences against the environment.*⁴

Financial crimes worldwide are defined in terms of component crimes with different constituent elements as grouped by nations differently. Money laundering, frauds committed while dealing with credit cards, mortgage, insurance fraud, tax evasion, etc. are some types of financial crimes recognised by most of the countries. Keeping into consideration the complex nature of their *modus operandi*, these crimes are covered by different legislations in India. Also, notably, such crimes majorly have an active participation of financial institutions due to the involvement of huge amounts of money. The Reserve Bank of India Act, 1934 is the chief legislation responsible for regulating the working of banks and has made fraud reporting a mandatory process. Furthermore, other laws regulating financial institutions include Securities and Exchange Board of India Act, 1992, Companies Act, 2013, Insurance Regulatory and Development Authority Act, 1999, etc.

⁴ *Id.*

The degree of vulnerability of a region to financial crimes depends majorly on the effectiveness of the regulatory frameworks and governmental capacity to tackle with such crimes. Furthermore, the financial crime detection systems face the prominent drawback of determining the actual crime rate within the region because of lower reporting rates of financial crimes. The institutions involved in such crimes are generally financial giants like companies enjoying goodwill in the market. Reporting of financial fraud with such a company would lead to a loss to the company in terms of customers and reputation, and would involve scrutiny by related authorities, and other unascertainable losses. Hence such companies prefer internal resolution of crimes.

Another driving factor which owes to the increasing rate of such crimes is the lower cases of detection, prosecution and punishment. The reward after the commission of such crimes would by any way outweigh the risks associated with it. The technological advancements have further made the commission of these crimes easier and their detection difficult.

Considering the wide base of what constitute financial crimes, this article will focus on the recent case of fraud with the Punjab National Bank (PNB) by the jeweller Nirav Modi who has absconded and is hiding from the jurisdiction of judicial authorities in India.

2. FACTUAL BACKGROUND

Multiple agencies grounded into the work of tracking the PNB scam proceeds have little to say on where the scam money evaporated or is stocked. It was on March 1, 2018 that the Central Bureau of

Investigation (CBI) while carrying on its investigation recovered the documents related to the alleged LoU from a small room of a *chawl* in Wadala, a central Mumbai suburb.⁵ Bishnubrata Mishra, the Internal Chief Auditor (Retd.), responsible for concurrent audit for the period 2011-2015 at PNB Brady House branch was arrested in relation to the fraud.⁶

It was on February 5, 2018 when the PNB informed India's stock exchanges of Rs. 280 crore frauds.⁷ Again, the bank issued a follow up information on February 14, 2018 to the stock exchanges, bringing into their notice that the fraudulent transactions date back to 2011. The information was an implied notice to the media of the alleged fraud. By January 25, after the devolvement of the first set of LoUs occurred, a liability of \$44.2 million was imposed on PNB.⁸ Subsequently, more LoUs started devolving on PNB thereby leading to the surfacing of the fraudulent transactions.⁹ By February 12, PNB discovered a fraud of Rs. 11,304.02 crores resulting from unauthorized issuances of LoUs and other trade finance instruments to the Modi forms.¹⁰

⁵ Press Trust of India, *Nirav Modi case: CBI recover documents related to LoU from 'chawl'; arrests another executive*, THE ECON. TIMES, <https://economictimes.indiatimes.com/industry/banking/finance/banking/nirav-modi-case-cbi-recoverdocuments-related-to-lou-from-chawl/articleshow/63128234.cms> (last visited Mar. 10, 2018).

⁶ *Id.*

⁷ Tamal Bandyopadhyay, *The Anatomy of the PNB Fraud*, LIVE MINT <https://www.livemint.com/Opinion/oiMKS98wBunYNviWCVq6hJ/The-anatomy-of-the-PNB-fraud.html> (last visited Mar. 3, 2018).

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

Vide clarification dated February 15, 2018,¹¹ the bank confirmed following:

On January 16, 2018, the partnership firm of Nirav Modi approached their branch at Brady House, Mumbai to present a set of import documents with a request to allow buyers' credit for making payment to the overseas suppliers. Since there was no sanctioned limit in the name of the above firms, the branch officials requested the firms to furnish at least 100% cash margin for issuing LoU for raising buyer's credit. On denial, the firms contested that they have been availing such transactions since past several years.

It was further mentioned that the issuance of LoUs had been made by the branch officials through the Society for Worldwide Interbank Financial Telecommunication (SWIFT) without taking approval from the competent authority, submitting the requisite documents for import, and making entries in Bank's trade finance module of CBS system.

An FMR-1 (Fraud Report Format of the RBI) was submitted with the Reserve Bank of India (RBI) on January 29 on confirming the first maturity of LoU as a fraudulently credit against the bank. On January 21, criminal complaint for the offences of cheating, criminal conspiracy, and abuse of official position was registered against the accused and the same was entrusted to the Inspector of Police, CBI.

¹¹ Clarification/Confirmation on News Item Issued by Punjab National Bank, TAXGURU, <https://taxguru.in/wp-content/uploads/2018/02/Clarification-confirmation-on-news-item.pdf> (last visited Mar. 5, 2018).

3. NOT THE FIRST TIME, MANY IN THE ROW

The jeweller-designer Nirav Modi left India on January 1, i.e. much before the bank filed an FIR alleging the company of the fraud.¹² Further, to talk about such offences in India, it was revealed in an RTI¹³ filed by Jeetendra Ghadge that Nirav Modi and Vijay Mallya are not the only two fraudsters involved in economic offences who fled India. It was reported by the Economic Offences Wing, Mumbai that since 2015 there have been hundreds of cases of financial scams. RTI revealed that 184 persons accused of such offences are absconding.

Diamond traders Nirav Modi, Mehul Choksi, Jatin Mehta, and Vijay Mallya are amongst the thirty-one businessmen who are fugitives abroad and are facing a CBI investigation.¹⁴ The Ministry of External Affairs had received extradition requests from the CBI in respect of Mallya, Jobanputra, Baid, Sanjay Kalra, Varsha Kalra and Aarti Kalra which were sent to the concerned foreign countries for consideration.¹⁵

¹² Press Trust of India, *PNB fraud: Nirav Modi left India with family in first week of January*, THE TIMES OF INDIA, <https://timesofindia.indiatimes.com/business/india-business/pnb-fraud-nirav-modi-left-india-with-family-in-first-week-of-january/articleshow/62930682.cms> (last visited Mar. 13, 2018).

¹³ Parth M.N., *Nirav Modi, Vijay Mallya aren't only fraudsters to have fled India; RTI shows 184 others on loose: Exclusive Report*, FIRST POST, <https://www.firstpost.com/india/nirav-modi-vijay-mallya-arent-the-only-fraudsters-to-have-fled-india-rti-shows-184-others-are-on-the-loose-exclusive-report-4375961.html> (last visited Mar. 11, 2018).

¹⁴ Press Trust of India, *Nirav Modi, Vijay Mallya among 31 fugitive business people facing CBI probe*, BUSINESS STANDARD, http://www.business-standard.com/article/current-affairs/nirav-modi-vijay-mallya-among-31-fugitive-business-people-facing-cbi-probe-118031400966_1.html (last visited Mar. 15, 2018).

¹⁵ *Id.*

4. DIVING INTO THE DETAILS

The bank gave the statement in relation to the *modus operandi* of the fraud so committed: “It was found through SWIFT trail that one junior level branch official unauthorisedly and fraudulently issued LoUs on behalf of some companies belonging to Nirav Modi Group for availing buyers’ credit from overseas branches of Indian Banks.”¹⁶

The following is an effort to understand the *modus operandi* of the fraud so employed including the controversial credit instrument which had led to the commission of fraud. It is also an introduction to the new electronic system of communication which has been infamous for its efficiency. However, the same later proved to be a means for the commission of the well-arranged continuing plan. Furthermore, apart from the unsuccessful means employed in the commission of the crime, the presence of the regulatory framework in form of an audit to be performed by the auditors also proved to be deficient. The following is a description of the instruments employed and the existing regulatory framework.

4.1. LETTER OF UNDERTAKING

LoU is a type of bank guarantee issued for both overseas import and export payments (in the present case, import payment). To understand the legal framework in relation to issuance of such instruments the following provisions may be referred to: A ‘contract of guarantee’

¹⁶ PNB detects new fraud at Mumbai branch at heart of \$2 billion banking scam, BUSINESS TODAY, <https://www.businesstoday.in/sectors/banks/pnb-scam-banking-fraud-mumbai-branch-chandri-paper-nirav-modi/story/272661.html> (last visited Mar. 15, 2018).

constitutes of a ‘surety’, ‘principal debtor’ and ‘creditor’. It is defined as “[a] contract to perform the promise or discharge the liability of a third person in case of his default.”¹⁷

The liability of a guarantor would be limited to the terms of guarantee agreed between the parties in the deed. According to Section 127 of the Indian Contract Act, 1872, anything done, or promise made for the benefit of the principal debtor is considered as an adequate consideration for the guarantor to make the contract valid.

If the above guarantee is rendered by a bank, it is known as a ‘bank guarantee’. The banker can also exercise his right of lien on the balance of account of the guarantor in his possession after a default has been made by the principal debtor.

4.1.1. RBI Directions relating to Bank Guarantee

The Reserve Bank of India by issuing various directions regulates the working of banks and its schemes and functions. The following are the directions relating to a bank guarantee in cases where the bank stands as the guarantor:

1. A bank has the authority to issue guarantees on behalf of their customers for various purposes. Furthermore, it is responsible to execute both performance guarantees and financial guarantees.

A performance guarantee is a contingency arising in the event of failure to perform a non-financial obligation to a third party.¹⁸ Such

¹⁷ Indian Contract Act, 1872, No. 9, Imperial Legislative Council, 1872, § 126.

guarantees are generally issued by an insurance company or bank to a contractor to guarantee the full and due performance of the contract according to the plans and specifications.¹⁹ A financial guarantee on the other hand is a guarantee undertaken for the repayment of a contractual financial obligation.²⁰ Hence, such a guarantee provides an additional level of comfort that the investment will be repaid in the event of the securities issuer not being able to fulfil the contractual obligation to make timely payments.

2. A bank guarantee shall not have a maturity of more than 10 years. However, RBI has allowed the banks to issue guarantees for period beyond 10 years for various projects taking into account the impact of such long guarantees on their Asset Liability Management.²¹
3. A bank should restrain from issuing guarantees in large amounts for medium and long-term periods avoiding undue concentration of such unsecured guarantee commitments to a particular groups of persons.²²

¹⁸ Reserve Bank of India, *New Capital Adequacy Framework – Non-market related Off Balance Sheet Items- Bank Guarantees*, D.B.O.D. No. BP.BC.89.21.04.009/2012-13, available at <https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=7924&Mode=0> (last visited Mar. 23, 2018).

¹⁹ *Performance Guarantees*, PERFORMANCE & CUSTOMS BOND SERVICES, <http://www.pcbs.co.za/performance-guarantees-2/> (last visited Mar. 19, 2018).

²⁰ *Id.*

²¹ Reserve Bank of India, *The Asset Liability Management System aims at enforcing the risk management discipline viz. managing business after assessing the risks involved*, D.B.O.D. No. BP.BC. 8/21.04.098/99, available at <https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=16&Mode=0> (last visited Mar. 29, 2018); Reserve Bank of India, *Master Circular – Guarantees and Co-acceptances*, D.B.R. No. Dir. BC.11/13.03.00/2015-16, available at https://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=9879 (last visited Mar. 11, 2018).

²² *Id.*

4. While issuing a financial guarantee, the bank shall be satisfied that the customer would be able to reimburse the bank in case the guarantee is invoked. On the other hand, in case of a performance guarantee, banks should exercise due caution and have sufficient experience with the customer to satisfy themselves that the customer has the necessary experience, capacity and means to perform the obligations under the contract.²³
5. In order to ensure the adequacy and effectiveness of the systems and procedures and for preventing frauds and malpractices by the employees and officials of the bank, bank guarantees issued for Rs. 50,000 and above should be signed by two officials jointly.²⁴

The RBI has further framed directions for the import of goods and services.²⁵

6. AD Category – 1 Banks may particularly adhere to Know Your Customer Guidelines (KYC Guidelines) issued by the RBI (Department of Banking Regulation) in all their dealings.
7. An AD may give a LoU, guarantee or a Letter of Comfort in respect of a debt, obligation or any other liability subjected to by a person resident in India and owed to a person resident outside India for the

²³ *Id.*

²⁴ *Id.*

²⁵ Reserve Bank of India, *Master Direction – Import of goods and Services*, FED Master Direction No. 17/2016-17, available at <https://www.rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=10201#C10> (last visited Mar. 17, 2018).

import of goods subject to such terms and conditions as may be specified by RBI from time to time.²⁶

8. An AD may, in the ordinary course of his business, give a guarantee in favour of a non-resident service provider, on behalf of a resident customer who is a service importer, subject to directions issued by the RBI.
9. Further, no guarantee on behalf of a service importer shall be rendered for an amount exceeding USD 500,000 except a Public Sector Company or an Undertaking of the Government. Furthermore, in cases where a Public Sector Company/Undertaking of the Government serves as the importer, the amount for guarantee shall not exceed USD 100,000 or such amount issued by the Ministry of Finance, Government of India.
10. According to the notification issued by the RBI vide Circular No. 75, the arrangement for reporting of data on issuance of guarantees/ LoUs/ LoCs by all AD banks was shifted to a consolidated statement at quarterly intervals, from manual submission to eXtensible Business Reporting Language (XBRL) platform from September 30, 2013.²⁷

However, in the present case the right to lien could not be performed for the reason that the properties of the fraudster in form of bank accounts

²⁶ *Id.*

²⁷ Reserve Bank of India, *Trade Credit for Imports into India: Online Submission of Data on Issuance of Guarantee/ Letter of Undertaking (LoU)/ Letter of Comfort (LoC) by Ads*, A.P. (DIR Ser.) Cir. No. 75, available at <https://www.rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=8581> (last visited Mar. 20, 2018).

and others were situated beyond the jurisdiction of the Indian Courts and the Courts hence, did not have the authority to exercise their right to lien.

Hence, it may be noted that the RBI has by itself issued a number of regulatory norms to standardize the issuance of guarantees by the banks. There is, however, no evidence that the same were followed or not in the present scenario.

4.2. SWIFT TRANSACTIONS

4.2.1. SWIFT

Society for Worldwide Interbank Financial Telecommunication (SWIFT) is a member-owned cooperative and the world's leading provider of financial messaging services.²⁸ It provides with a number of services which set the standards for communicating and to facilitate access, integration, identification, analysis and regulatory compliance. More than 11,000 banking and securities organizations are customers to the services provided by SWIFT with market infrastructures and corporate customers in more than 200 countries and territories.

4.2.2. SWIFT Transactions

With the issuance of a LoU, a message of credit transfer is conveyed to overseas banks through the SWIFT system. This message is an automatic consent of the bank and to guarantee. In order to issue a transaction on SWIFT, an official has to log in to fill information

²⁸ *Introduction to SWIFT*, SWIFT, <https://www.swift.com/about-us/discover-swift> (last visited Mar. 22, 2018).

(confidential in nature) in relation to the bank inclusive of the account number and SWIFT Code. It is a system protected by a three layered security – a maker, a checker and a verifier within the core banking system before it is issued.²⁹

Even in the presence of multi layered protected system whereby an official is responsible for logging in and filling the information in relation to the bank and the SWIFT code, the same has the potential of being exploited.

4.3. DUTY OF AUDITORS TO CHECK BANK GUARANTEE PROPERLY RECORDED

Another crucial aspect of the bank guarantee is the verification process carried on by auditors by auditing and inspecting the books of record of the banking company. The following are the Bank Audit and Inspection measures in relation to the Bank Guarantee as compiled by Tannan.³⁰

Under the Concurrent Audit undertaken for a bank, which is one of the three audits prescribed for a bank, the concurrent auditor should ensure that:

- a. the bank guarantees have been issued in the prescribed Performa;
- b. recorded in the register of the bank;

²⁹ Press Trust of India, *Nirav Modi case: What is LoU, CBS, and SWIFT? Know these terms to understand PNB fraud*, BUSINESS TODAY, <https://www.businesstoday.in/current/economy-politics/pnb-fraud-what-is-lou-cbs-swift/story/270704.html> (last visited Mar. 25, 2018).

³⁰ M.L. TANNAN, BANKING LAW AND PRACTICE IN INDIA (22d ed. 2008).

- c. the counter guarantees/indemnities have been obtained from the constituent before the issue of guarantee;
- d. the commission is properly paid by the constituent;
- e. the contingent liabilities entries are passed on a daily basis;
- f. after the expiry of guarantee period, the branch ensures that the original guarantee is received back and cancelled and the contingent entries are reversed.

5. AFTERMATH

The case is a reverberation of the escape-route followed by HNWI in commission of financial crimes. The following are the recent developments in relation to the regulatory frameworks emerged as a consequence of the commission of such crimes:

5.1. FUGITIVE ECONOMIC OFFENDERS ORDINANCE

The Union Cabinet on March 1, 2018 cleared the FEO Bill after the Nirav Modi Fraud. The President of India then gave his assent to the FEO Ordinance, 2018 on April 21, 2018. The Ordinance is aimed at punishing the accused of financial crimes in India who have left India as in the case of Vijay Mallya and the recent Nirav Modi. It would serve as one comprehensive law to codify the various legislations dealing with the subject.

An essential aspect of the Ordinance is the determination of the offences which are classified as ‘economic offences’. Section 2(f) defines “Fugitive Economic Offender” to mean “any individual against whom a

warrant for arrest in relation to a Scheduled Offence has been issued by any Court in India.” Further, such a person has left India so as to avoid criminal prosecution or if being abroad refuses to return to India to face criminal prosecution. The Schedule to the Ordinance names specifically the legislations and the provisions therein which would constitute an ‘economic offence’ and hence be covered under the Ordinance. Furthermore, the “Scheduled Offence” defined under Section 2(m) means an offence specified in the Schedule if the total value involved in such offence or offences is Rs. 100 crore or more.

The Ordinance includes offences such as criminal conspiracy, counterfeiting government stamp, cheating, forgery of valuable security or will, etc. under the Indian Penal Code, 1860; dishonour of cheque under Section 138 of the Negotiable Instruments Act, 1881; penalties listed under Section 58B of the Reserve Bank of India Act, 1934; offences and penalties listed under Section 9 of the Central Excise Act, 1944; evasion of duty or prohibitions under Section 135 of the Customs Act, 1962; prohibition of Benami Transactions under Section 3 of the Prohibition of Benami Property Transactions Act, 1988; offences covered by Section 7, 8, 9, 10 and 13 of the Prevention of Corruption Act, 1988; insider trading as prohibited by Section 12A read with Section 24 of the Securities and Exchange Board of India Act, 1992; money laundering as covered by Sections 3 and 4 of the Prevention of Money Laundering Act, 2002; offence of carrying on business with intent to defraud creditors of the Limited Liability Partnership or for any other fraudulent purpose listed in Section 30(2) of the Limited Liability Partnership Act, 2008; penalty for

article or currency or security obtained in contravention of Section 10 listed under Sections 34 and 35 of the Foreign Contribution (Regulation) Act, 2010; offences under the Companies Act, 2013; offences under Section 51 of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015; offences under Section 69 of the Insolvency and Bankruptcy Code, 2016; and under Section 132(5) of the Central Goods and Services Tax Act, 2017.

The Ordinance further describes the meaning of “proceeds of crime” to mean “any property derived or obtained, directly or indirectly, by any person from any criminal activity relating to a scheduled offence or the value of such property or where such property is outside of the country, then the property equivalent in value held within the country.” Also, the director has been conferred with similar powers as in the case of Prevention of Money Laundering Act whereby he may file an application with the Special Court (designated under PMLA) to declare a person as a FEO.

The Ordinance promulgated to cover the specific economic crimes was put into action when a Special Court was formed for the Nirav Modi case. Furthermore, the Enforcement Directorate (ED) moved to the Special Court in Mumbai to pray for “immediate confiscation” of the Rs. 7,000 crore assets of the fraudster.³¹ The ED hence filed its first charge

³¹ Press Trust of India, *PNB fraud: ED to seek immediate confiscation of Nirav Modi's assets under fugitive ordinance*, THE INDIAN EXPRESS, <http://indianexpress.com/article/india/pnb-fraud-ed-to-see-immediate-confiscation-of-nirav-modis-assets-under-fugitive-ordinance-5193199/> (last visited June 12, 2018).

sheet before the Special Court under the Prevention of Money Laundering Act (PMLA) where a total of 24 accused were listed.

5.2. SETTING UP OF NFRA TO REGULATE THE AFFAIRS OF AUDITORS

The Union Cabinet of India, on March 1, 2018 approved the setting up of an independent regulator of auditors called the NFRA.³² The establishment of such a body has been called “requirement of the day” by the 2016 Report of Companies Law Committee.³³ Broadly speaking of the purpose of establishment of the NFRA, it shall provide for “matters relating to accounting and auditing standards under the Act”.³⁴ It is established “for enforcement of auditing standards and ensuring the quality of audits to strengthen the independence of audit firms, quality of audits and, therefore, enhance investor and public confidence in financial disclosures of companies”.

5.2.1. The NACAS and the NFRA

Establishment and Powers

National Advisory Committee on Accounting and Auditing Standards (NACAS) was introduced by the Companies (Amendment) Act, 1999 and was formed under the Companies Act, 1956 to advise the central

³² *Cabinet approves Establishment of National Financial Reporting Authority*, PRESS INFO. BUREAU, <http://pib.nic.in/newsite/PrintRelease.aspx?relid=176918> (last visited June 12, 2018).

³³ REPORT OF THE COMPANIES LAW COMMITTEE 41 (Feb., 2016), *available at* http://www.mca.gov.in/Ministry/pdf/Report_Companies_Law_Committee_01022016.pdf (last visited May 12, 2018).

³⁴ Companies Act, 2013, No. 18, Acts of Parliament, 2013, § 132(1).

government on the formulation and laying down of accounting policies for adoption by companies.³⁵ The Amendment Act made it mandatory for companies to abide by the accounting standards prescribed by the central government in consultation with the NACAS.

NFRA, on the other hand, is an authority deriving its powers from the Companies Act, 2013. The NFRA is an independent quasi-judicial body for monitoring corporate financial management. NFRA would not only continue with the advisory functions of the NACAS but will further recommend the central government on the formulation of accounting and auditing policies for adoption by companies or class of companies or their auditors;³⁶ monitor and enforce the compliance with such standards; oversee the quality of service of the professionals and suggest measures required for improvement in quality of service; and to perform such other functions relating to the above stated matters as may be prescribed.

5.2.2. The ICAI and the NFRA

Establishment

The Institute of Chartered Accountants was established under the Chartered Accountants Act of 1949 (C.A. Act). The Act was enacted to make provision for the regulation of the profession of Chartered Accountants. It provides for the establishment of a Disciplinary

³⁵ Companies Act, 1956, No. 1, Acts of Parliament, 1956, § 210A.

³⁶ Companies Act, 2013, § 132(2) (a).

Directorate, Board of Discipline and Disciplinary Committee for the investigation of matters pertaining to specified misconducts.³⁷

Application

The NFRA has been conferred with the power to investigate Chartered Accountants and their firms of listed companies, large unlisted public companies, and such other entities where public interest would be involved. However, the ICAI would continue to exercise its inherent regulatory role in respect to members of the Institute, private limited companies, and public unlisted companies. Hence, in the presence of clearly demarked spheres of jurisdictions of both the institutions, the problem of overlapping does not arise. According to Arun Jaitley, “NFRA will certainly be an oversight body. It is not intended to replace the disciplinary jurisdiction of the CA Institute.”³⁸

Power to Investigate

Further, the NFRA shall have the power to investigate Chartered Accountants and their firms of listed companies, large unlisted public companies, and such other entities where public interest would be involved,³⁹ either *suo moto* or on a reference made to it by the central government. Besides this, where the NFRA has already initiated an

³⁷ Chartered Accountants Act, 1949, No. 38, Acts of Parliament, 1949, §§ 21, 21A & 21B.

³⁸ K.R. Srivats, *Cabinet nod for National Financial Reporting Authority*, THE HINDU: BUSINESS LINE, <https://www.thehindubusinessline.com/economy/cabinet-nod-for-national-financial-reporting-authority/article22894653.ee> (last visited May 17, 2018).

³⁹ *Cabinet approves Establishment of National Financial Reporting Authority*, PRESS INFO. BUREAU, <http://pib.nic.in/newsite/PrintRelease.aspx?relid=176918>.

investigation, no other institute or body shall initiate or continue any proceedings in such matters of misconduct.⁴⁰

The C.A. Act provides for a Disciplinary Directorate for making investigations in respect of any information or complaint received by it. There are two Schedules under the C.A. Act. The misconducts listed under the Second Schedule are of a graver nature than the acts listed under the First Schedule. If the Director of the Directorate is of the opinion that a member is guilty of any professional or other misconduct mentioned in the First Schedule, the matter shall be placed before the Board of Discipline and if he is of the opinion that the matter falls within the Second Schedule, he shall place the matter before the Disciplinary Committee.⁴¹

The ICAI would continue to exercise its inherent regulatory role in respect of members of the Institute, private limited companies and public unlisted companies.

Power to Punish

If professional or other misconduct is proved, NFRA has the power to make an order imposing a penalty (which varies in cases of individuals and firms) and debarring the member or the firm from engaging himself or itself in practice as a member of the ICAI.⁴² On the other hand, the Committee or Board have the powers listed under the Schedules to the C.A. Act.

⁴⁰ Companies Act, 2013, § 132(4) (a).

⁴¹ Chartered Accountants Act, 1949, § 21(3).

⁴² Companies Act, 2013, § 132(4) (c).

Similarity: Powers of a “Civil Court”

Furthermore, both the authorities have been conferred the same powers as a civil court while trying a suit for matters including: (i) discovery and production of books of account and other documents; (ii) summoning and enforcing the attendance of persons and examining them on oath; (iii) inspection of any books, registers and other documents of such person; and (iv) issuing of commissions for examination of witnesses or documents.⁴³

5.3. LETTER OF UNDERTAKING FOR IMPORTS DISCONTINUE

The RBI decided to discontinue the issuance of LoU and Letters of Comfort for the purpose of extending trade credit for importing in India.⁴⁴ It shows that the RBI accepted the trade instruments to be flawed and therefore discontinued the same.

6. CONCLUSION

The benchmarks for determining the ease of doing business rankings are:⁴⁵ starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts and

⁴³ *Id.* § 132(4) (b); Chartered Accountants Act, 1949, § 21C.

⁴⁴ Vishwanath Nair, *RBI Discontinues Letters of Undertaking for Trade Credit for Imports*, BLOOMBERG, <https://www.bloomberquint.com/business/2018/03/13/rbi-discontinues-letters-of-undertaking-and-letters-of-comfort-for-trade-credit> (last visited Mar. 16, 2018).

⁴⁵ *Measuring Business Regulations: Ease of Doing Business in India*, THE WORLD BANK, <http://www.doingbusiness.org/data/exploreconomies/india> (last visited June 13, 2018).

resolving insolvency. A region which is prone to financial crimes in a specific sector of business would lead to discouragement of investment and would divert the available resources towards law enforcement and fighting crime. A stricter check over the crimes would attract complex crime detection systems to be loaded by the public and private institutions. Further, the quantification of costs associated with financial crimes in form of direct losses and fines for non-compliance and reputational damage has been called to be a significant issue by Deloitte.⁴⁶ The costs associated would hence affect the ease of doing business in the country, where it would be difficult to attract foreign investment if the regulations are proven to be inadequate and prone to frauds.

The financial institutions comprising the major lenders are the most prone to financial crimes since it is expected that high value transactions would float from financial institutions or would in any way have a link with such institutions. Financial institutions can be involved in financial crime in three ways: as victim, as perpetrator, or as an instrumentality.⁴⁷ However, in the present case, the complainant-victim bank PNB has also been accused⁴⁸ time and again of not maintaining

⁴⁶ *Insight on Financial Crime: Challenges facing Financial Institutions*, DELLOITTE, https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Risk/gx-cm-insight_on_financial_crime.pdf (last visited June 9, 2018).

⁴⁷ *Background Paper on Financial System Abuse, Financial Crime and Money Laundering*, IMF, <https://www.imf.org/external/np/ml/2001/eng/021201.pdf> (last visited June 9, 2018).

⁴⁸ Manas Chakravarty, *Who's responsible for the PNB fraud?*, LIVEMINT, <https://www.livemint.com/Opinion/XmchEVqQ2LsLjv4V1sQSeJ/Whos-responsible-for-the-PNB-fraud.html> (last visited June 14, 2018); Sudipto Dey, *PNB fraud: Who's liable and why multiple audits failed to raise an alarm?*, BUSINESS STANDARD, <https://www.business-standard.com/article/opinion/pnb-fraud-who-s-liable-and-why->

proper compliance with the regulations that facilitate protection from such crimes. It was pointed out that amongst the CIBIL's overall list of wilful defaulters against whom lawsuits has been filed as on December 31, 2017, PNB has the highest number of wilful defaulters and the largest amount outstanding from these accounts amongst the nationalized banks.⁴⁹ In order to combat the same, the steps, as discussed before have been taken by the government.

Finally, it can be concluded that this move of the government to bring within the ambit of the FEO Ordinance the economic offences specifically where the wrong-doer is a fugitive is a welcome move since the same would help in combating offences involving HNWI. Also, it is worth mentioning that the RBI has prescribed sufficient framework of regulations to govern the working of financial institutions and the instruments issued by such institutions. Also, in order to strengthen and plug in the gaps of offences involving auditors, the new NFRA will have the power to investigate Chartered Accountants and their firms of listed companies, large unlisted public companies, and such other entities where public interest is involved. Therefore, the setting up of NFRA is an additional safeguard to prevent such economic offences.

The FEO Ordinance has solved the difficulty of unavailability of a universal definition of 'economic offences'. It was iterated during the 11th U.N. Congress on Crime Prevention and Criminal Justice, held in Bangkok from April 18-25, 2005, that the conceptualization of economic

multiple-audits-failed-to-raise-an-alarm-118021800662_1.html (last visited June 14, 2018).

⁴⁹ *Id.*

and financial crimes has been a major problem due to rapid advancements in technology. Furthermore, on the international level, the systems for recording economic and financial crime vary greatly from country to country, and hence it serves as a drawback for recognition of financial crimes globally. This problem has been catered to by introduction of the FEO Ordinance as it clearly defines the ambit of financial crimes as would mean within the national law.