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# WITNESS

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# 2019

## Envisioning The Legal Landscape: An Exciting Year Ahead?

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## expert speak



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# Impact of the Insolvency and Bankruptcy Code (IBC) on Fraud

■ **Sumit Makhija & Aparna Gupta**



Two years post the commencement of the IBC, there have been some success stories, especially in the initial list of the 'dirty dozen' companies who were referred

to resolution proceedings, but there is more that is awaited with bated breath. This success is commendable considering past efforts such as strategic debt restructuring (SDR) and of sustainable structuring of stressed assets (S4A) have been less successful in resolving such cases<sup>1</sup>. Interestingly, several cases seeking resolution under the IBC also reported fraudulent transactions.

As on September 2018, a total of 716 cases were seeking resolution under the IBC, of which 110 cases reported fraudulent transactions worth over INR 400 billion<sup>2</sup>. Further, of the big 12 cases that were referred to the National Company Law Tribunal (NCLT) by the Reserve Bank of India (RBI) last year, suspected fraud was reported in nearly all cases.

The nature of fraudulent transactions in most of these cases followed similar patterns - siphoning of funds through shell companies or letters of credit, purchase of personal assets (under employees/relatives' names) through company funds, transactions with related parties that are not at arms' length and exceptional write-off in books to camouflage fictitious receivables and assets.

Following the arrest of a promoter in connection with a similar case, the Finance Ministry issued a warning to public sector

banks to identify potential fraud in all NPA accounts exceeding INR 50 crores or face charges of criminal conspiracy<sup>3</sup>. We believe such moves will bolster fraud risk management and reporting efforts at banks and also improve collaboration between forensic professionals and resolution professionals.

Currently, forensic professionals are called upon by the Resolution Professional (RP) under section 25 of the IBC that casts a duty on the RP to preserve and protect the assets of the corporate debtor and file an application for avoidance of transactions, if any, as per sections 43 to 51 of the IBC<sup>4</sup>, if such transactions were preferential, undervalued, resulted in extortionate credit.

The intent of law makers to scrutinize corporate defaulters is more focused than ever before as is clear from the various legislations relating to stressed assets, both prior and post commencement of insolvency proceedings. Thus, it is only natural for the corporate boardrooms, bankers and the resolution professionals to be more vigilant. The role and focus would vary keeping in mind the organisations' progress into insolvency:

■ **Prior to insolvency** - As the early signs of a corporate moving into an IBC stage start to appear, the role of the Board of Directors becomes critical. They need to keep a watch out for any management decisions or activities resulting in significant cash outflow, modification of accounts; manipulation/ deletion of records and official documents and senior management exit. Any or all of these could be tell-tale signs of

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either a fraud in making or an attempt to cover the skeletons of the past. It is interesting to note that a lot of early indicators to fraud have been found in the internal control/ audit reports of the Corporate Debtor that somehow get hidden under the carpet.

- Classification of an account as stressed asset – Bankers are privy to significant financial information of the Corporate Debtor (quarterly filing, Service Organisation Control (SOC) reports etc.) and have instruments such as Asset Quality Reviews (AQR) and the more recent advisory to initiate forensic audits - to keep a tab on the operations of the Corporate Debtor. Banks need to use these more effectively and efficiently to identify instances of fund siphoning and fictitious assets (inventory) and receivables.

- Initiation of insolvency proceedings –

Once the CIRP (Chartered Insolvency and Restructuring Professional) is invoked, the IRP/ RP is assigned with the responsibility of preserving the value of the Corporate Debtor and has authority to access information from various sources to validate and review the transactions of the preceding years. He must exercise his powers to gather information from various utilities, bankers and other sources and also take into immediate custody the IT systems/ records database to avoid deletion/ manipulation of sensitive data; the omission of which has appeared to be a major hindrance in carrying out forensic reviews.

Fraud is a culmination of malafide intent and a control failure; while controlling an individual's intent may be a herculean task, stakeholders must focus on tightening the noose to minimize the opportunity to exploit the gap. 



**Sumit Makhija** is a Partner and leads anti-bribery and corruption services within Deloitte's Forensic practice in India. He is a Fellow member of the Institute of Chartered Accountants of India and a Certified Fraud Examiner from the Association of Certified Fraud Examiners, USA. He also serves a Director on the India Chapter of Association of Certified Fraud Examiners.



**Aparna Gupta** is a Senior Manager within Deloitte's Forensic practice in India. She has more than 11 years of experience in the Consulting domain and has worked across various risk and financial advisory solutions. More recently, she has been focused on the IBC space leading some of the large cases from an operational and forensic perspective

<sup>1</sup>Source: <https://www.livemint.com/Industry/VBtrj60rvHtSxcT6CngFbP/Bankruptcy-code-is-key-to-solving-Indias-bad-loan-mess.html>

<sup>2</sup>Source: <https://economictimes.indiatimes.com/news/economy/finance/fraud-cases-under-ibc-cross-rs-40000-crore/articleshow/66015840.cms>

<sup>3</sup>Source: <https://economictimes.indiatimes.com/news/economy/policy/finance-ministry-asks-psu-bank-ceos-to-check-frauds-in-npas-or-face-penal-action/articleshow/65502920.cms>

<sup>4</sup>Source: <http://www.mca.gov.in/Ministry/pdf/TheInsolvencyandBankruptcyofIndia.pdf>