

ROLE OF SERIOUS FRAUD INVESTIGATION OFFICE IN CORPORATE FRAUD

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ABSTRACT

The increasing number of corporate frauds has a significant impact on the stakeholders and the economy. It has an inevitable existence in the life of the common man which is a huge threat to the economy as a whole. To combat the rising number of corporate fraud cases in India, the Companies Act, 2013 introduced Section 447, which, for the first time, provided a definition of fraud as well as punishment for such an offence. It was felt that the MCA should have the powers to investigate serious frauds without depending on police investigation under the IPC, and thus to eradicate the issue of increasing scams the Serious Fraud Investigation Office (SFIO) was constituted in July 2003 and was granted statutory backing for the first time through the Companies Act, 2013. Keeping this in view, this article examines the role of SFIO as an investigator of corporate fraud and highlights its important functions and powers under the Companies Act, 2013.

Keywords: SFIO, Corporate Fraud, Companies Act, Investigation.

INTRODUCTION

Corporate frauds significantly impact the economy and capital market of the country, as well as the stakeholders involved, including the employees, investors, and creditors of the company. Such actions also adversely affect existing and potential foreign investors, whose presence is quite important for a developing economy like India. To address the growing number of incidents of corporate fraud in India and to protect innocent investors, Section 447 was introduced in the Companies Act, 2013. It seems that Satyam and a few other corporate scandals, which surfaced during the period when the Companies Act, 2013, was before the consideration of Parliament, were the primary cause for the inclusion of this very widely worded definition of fraud, which is an amalgam of several sections of the Indian Penal Code (IPC). It was felt that the Ministry of Corporate Affairs (MCA) should be empowered to investigate serious fraud without depending on police investigation under the IPC. Keeping this context in mind, this article examines certain aspects relating to the powers and functions

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of the Serious Fraud Investigation Office (SFIO) under the Companies Act, 2013, and the important role assigned to it for the investigation of 'fraud' as defined under Section 447¹.

The Government of India constituted Serious Fraud Investigation Office (SFIO) under the jurisdiction of the Ministry of Corporate Affairs vide resolution dated 2nd July 2003² following the recommendation of the Naresh Chandra Committee. It was the time of securities market scams in 2000-02, coupled with the failure of banking companies that had cost the public and the government money, leading to the closure of many small and budding businesses. To tackle these white-collar crimes, Naresh Chandra Committee had recommended setting up a 'Corporate Serious Fraud Office', to uncover corporate fraud, and supervise prosecutions under various economic legislations, that were promulgated by the Government. The setting up of SFIO was approved on 9th January 2003 and it started operations on 01st October 2003.

The Naresh Chandra Committee had also suggested that the organisation responsible for detecting and investigating fraud should have legislative backing. Under the Companies Act, 1956, the SFIO operated without statutory backing. The absence of any special powers or primacy was largely responsible for the SFIO not being the favoured agency for investigating cases by the MCA, which largely relied upon the Registrar of Companies (ROC) for undertaking such actions. However, this position changed when SFIO was granted statutory force for the first time through the Companies Act, 2013. The SFIO's power and status were codified under Sections 211³ and 212⁴ of the Companies Act, 2013 and MCA started entrusting it with investigating matters of corporate fraud. The MCA now appoints the SFIO to investigate corporate frauds involving complex transactions that have interdepartmental and multidisciplinary ramifications or substantial impact on public interest⁵.

The Serious Fraud Investigation Office (SFIO) is a multi-disciplinary organization under the Ministry of Corporate Affairs, consisting of experts in the field of accountancy, forensic auditing, banking, law, information technology, investigation, company law, capital market, and taxation, etc. for detecting and prosecuting or recommending for prosecution white-collar

¹ Companies Act, 2013, s 447.

² Resolution No. 45011/16/2003-Adm-I

³ Companies Act, 2013, s 211.

⁴ Companies Act, 2013, s 212.

⁵ Vijayendra Pratap Singh, Aditya Vikram Jalan Raghav Seth, Sadhvi Chhabra, 'International Fraud & Asset Tracing 2022 – Trends & Developments (India Chapter)' (*AZB & Partners*, 6 May 2022)

<<https://www.azbpartners.com/bank/international-fraud-asset-tracing-2022-trends-developments-india-chapter/>> accessed 20 February 2023.

crimes/frauds. SFIO is headed by a Director as Head of Department in the rank of Joint Secretary to the Government of India. The Director is assisted by Additional Directors, Joint Directors, Deputy Directors, Senior Assistant Directors, Assistant Directors Prosecutors, and other secretarial staff. The Headquarters of SFIO is in New Delhi, with five Regional Offices in Mumbai, New Delhi, Chennai, Hyderabad & Kolkata.⁶

INVESTIGATION BY SFIO

Section 212(1) of the Companies Act, 2013 provides that without prejudice to the provisions of Section 210, where the Central Government is of the opinion that it is necessary to investigate the affairs of a company by the Serious Fraud Investigation Office:

- (a) On receipt of a report of the Registrar or inspector under section 208;
- (b) On intimation of a special resolution passed by a company that its affairs are required to be investigated;
- (c) In the public interest; or
- (d) On request from any Department of the Central Government or a State Government,

The Central Government may, by order, assign the investigation into the affairs of the said company to SFIO, for the purpose of which the Director of SFIO, may designate a such number of inspectors, as he may consider necessary for such investigation, and such Investigating Officer shall have the power of the inspector as prescribed under Section 217 of the Companies Act, 2013⁷.

If an inspector appointed to investigate the affairs of a company considers it necessary for the purposes of the investigation to also investigate the affairs of

- (a) any other body corporate which is, or has at any relevant time been the company's subsidiary company or holding company, or a subsidiary company of its holding company;

⁶ 'About SFIO' (*Serious Fraud Investigation Office*) < <https://sfio.gov.in/en/about-sfio-history/#> > accessed 21 February 2023.

⁷ Companies Act, 2013, s 212(1).
Companies Act, 2013, s 212(4).

- (b) any other body corporate which is, or has at any relevant time been managed by any person as managing director or as manager, who is, or was, at the relevant time, the managing director or the manager of the company;
- (c) any other body corporate whose Board of Directors comprises nominees of the company or is accustomed to act in accordance with the directions or instructions of the company or any of its directors; or
- (d) any person who is or has at any relevant time been the company's managing director or manager or employee,

he shall, subject to the prior approval of the Central Government, investigate and report on the affairs of the other body corporate or of the managing director or manager, in so far as he considers that the results of his investigation are relevant to the investigation of the affairs of the company for which he is appointed.⁸

Where any case has been assigned by the Central Government to SFIO for investigation under the Companies Act, 2013, no other investigating agency of the Central Government or any State Government shall proceed with the investigation in such case in respect of any offence under the Act and in case any such investigation has already been initiated, it shall not be proceeded further with and the concerned agency shall transfer the relevant documents and records in respect of such offences to SFIO⁹. The company and its officers and employees, who are or have been in the employment by the company, shall be responsible to provide all information, explanation, documents, and assistance to the Investigating Officer as he may require for the conduct of the investigation¹⁰. SFIO should conduct the investigation in the manner and follow the procedure provided in Chapter XIV of the Companies Act, 2013 and submit its report to the Central Government within such period as may be specified in the order¹¹. It is important that the Central Government in its order record the necessity for the investigation to be conducted by the SFIO, as the Madras High Court in the case of Church of South India Trust Association v. Union of India¹² held that under Section 212 the words 'is of

⁸ Companies Act, 2013, s 219.

⁹ Companies Act, 2013, s 212(2)

¹⁰ Companies Act, 2013, s 212(5)

¹¹ Companies Act, 2013, s 212(3)

¹² Church of South India Trust Association v. Union of India Writ Petition Nos. 25236 & 25419 of 2018 & 32587 of 2019, Madras High Court, decided on 1 February 2021.

the opinion' enforces a jurisdictional duty on the Central Government to form an opinion on the necessity of an investigation by the SFIO.

INVESTIGATION REPORT

Under Section 212 (11) of the Companies Act, 2013, the Central Government if so directs, the SFIO is required to submit an interim report to the Central Government¹³. However, on completion of the investigation, the SFIO shall submit the Investigation report to the Central Government¹⁴. There is no time limit prescribed under the Companies Act, 2013 for the completion of the investigation, and the submission of the investigation report by the SFIO, however, the Central Government specifies a certain time period in its order for investigation. In the case of SFIO v. Rahul Modi¹⁵, the Supreme Court held that since Section 212 does not prescribe any specific time period for submission of the investigation report, the mandate in favour of SFIO shall not come to an end once the time period mentioned in the Central Government order has been exhausted. It was held that the time period specified in the order is an only directory, and not mandatory. The authority to investigate shall not end once the time period specified by the Central Government has been extinguished.

A copy of an investigation report can be obtained by any person concerned by making an application in this regard to the court.¹⁶ On receipt of the investigation report, the Central Government shall examine the report thoroughly, and direct the SFIO to initiate prosecution against the company and its officers or employees, who are or have been in the employment by the company or any other person directly or indirectly connected with the affairs of the company.¹⁷ The Bombay High Court in the case of N. Sampath Ganesh v. Union of India¹⁸ held that it is not required that the SFIO should complete its investigation before initiation of prosecution, it can be initiated on the basis of an interim report, as long as it is sufficient to support a charge. The investigation report filed with the Special Court for framing of charges shall be deemed to be a report filed by a police officer under section 173 of the Code of Criminal Procedure, 1973¹⁹.

¹³ Companies Act, 2013, s 212(11).

¹⁴ Companies Act, 2013, s 212(12).

¹⁵ SFIO v. Rahul Modi (2019) 5 SCC 266.

¹⁶ Companies Act, 2013, s 212(13).

¹⁷ Companies Act, 2013, s 212(14).

¹⁸ N. Sampath Ganesh v. Union of India (2020) 222 CompCas 676 (Bom).

¹⁹ Companies Act, 2013, s 212(15).

A recent and impactful addition to the effect of an SFIO report is the ability to use it as a basis to seek appropriate orders with regard to the disgorgement of assets from such directors, key managerial personnel, other officers, or any other person liable personally for the fraud committed upon the company. In terms of Section 212(14A), the central government has been given the authority to commence proceedings before the Tribunal seeking the disgorgement of assets based on the findings of fraud by SFIO.²⁰ This action for the disgorgement of assets can be started pursuant to the SFIO's interim report or the final report. Such action can be pursued against any person to claw back unjust enrichment obtained through fraud without any limitation on liability. It was observed by a recent ruling that disgorgement of assets based on the SFIO's reports must be for public interest as such claw-backs are in the nature of equitable relief designed to prevent a wrongdoer from unjustly enriching themselves. This recent addition of permitting the use of the SFIO's reports is far-reaching. It considerably increases the weight of a report, as well as the reliance upon it.

In recent times, the MCA has exercised its rights under Section 241(2) of the Act to initiate an action of oppression and mismanagement in cases where the SFIO has issued an interim report or an investigation report.²¹ In such cases, the resort of SFIO has been considered as evidence to admit such an action by the MCA. The Tribunal has passed directions for safeguarding the stakeholders' interests based on the findings in the SFIO's report. The MCA has leaned heavily on such findings to obtain various pre-emptive orders, including orders of attachment before a judgment, and dissolution and takeover of recalcitrant boards of directors. The reports of SFIO are not merely a tool for preliminary investigation, but also form the basis for penal action and prosecution under the Companies Act, 2013 and under other laws in India.

POWER TO ARREST AND STRINGENT BAIL CONDITIONS

The SFIO was given legal status vide the Companies Act, 2013 but it attained the powers to arrest on 24th August 2017, when the Central Government notified sub-sections (8), (9), and (10) of Section 212 of the 2013 Act²², and Companies (Arrests in Connection with Investigation by Serious Fraud Investigation Office) Rules, 2017²³. Section 212(8)²⁴ read with the Companies (Arrests in Connection with Investigation by Serious Fraud Investigation Office)

²⁰ Companies Act, 2013, s 212(14A).

²¹ Companies Act, 2013, s 241(2).

²² Ministry of Corporate Affairs, *Notification* (No. S.O. 2751 (E), 24 August 2017)

²³ Ministry of Corporate Affairs, *Notification* (No. G.S.R. 1062(E), 24 August 2017)

²⁴ Companies Act, 2013, s 212(8).

Rules, 2017 confers the SFIO with the power to arrest if it has a 'reason to believe' that any person has been guilty of any offence punishable under the sections referred to in Section 212(6)²⁵. This 'reason to believe should be recorded in writing by the investigating officer.²⁶ It is pertinent to note that in case an arrest is being made by Additional Director or Assistant Director, the prior written approval of the Director of SFIO is required to be obtained²⁷. However, prior written approval of the Central Government would be required for arrest in case of foreign companies and government companies²⁸.

The Director, Additional Director, or Assistant Director shall forward a copy of the arrest order along with the material in his possession and all the other documents including a personal search memo to the office of the Director, SFIO in a sealed envelope with a forwarding letter after signing on each page of these documents, so as to reach the office of the Director, SFIO within twenty-four hours by the quickest possible means²⁹. An arrest register is required to be maintained in the office of the Director, SFIO, and the Director or any officer nominated by the Director shall ensure that entries about particulars of the arrestee, date and time of arrest, and other relevant information pertaining to the arrest are made in the arrest register in respect of all arrests made by the arresting officer³⁰ immediately after receiving such information by the arresting officer.³¹ The arrested person should be produced within twenty-four hours of the arrest before the Judicial Magistrate or a Metropolitan Magistrate, as the case may be, excluding the duration of travel from the place of the arrest to the Magistrate's court.³² The office of the Director of SFIO should preserve the copy of the arrest order along with supporting materials for a period of 5 years either from the date of judgment or final order of the Trial Court (which has not been impugned in an appellate court) or from the date of disposal of the matter before the final appellate court (when the said judgment or final order has been impugned), whichever is later.³³ The provisions in relation to arrest under the Code of Criminal Procedure, 1973, shall apply mutatis mutandis to arrests made by the SFIO³⁴.

²⁵ Companies Act, 2013, s 212(6).

²⁶ Companies Act, 2013, s 212(8)

Companies (Arrests in Connection with Investigation by Serious Fraud Investigation Office) Rules, 2017, r 2(1).

²⁷ Ibid.

²⁸ Companies (Arrests in Connection with Investigation by Serious Fraud Investigation Office) Rules, 2017, r 3.

²⁹ Companies (Arrests in Connection with Investigation by Serious Fraud Investigation Office) Rules, 2017, r 5.
Companies Act, 2013, s 212(9).

³⁰ Companies (Arrests in Connection with Investigation by Serious Fraud Investigation Office) Rules, 2017, r 6.

³¹ Companies (Arrests in Connection with Investigation by Serious Fraud Investigation Office) Rules, 2017, r 7.

³² Companies Act, 2013, s 212 (10).

³³ Companies (Arrests in Connection with Investigation by Serious Fraud Investigation Office) Rules, 2017, r 8.

³⁴ Companies (Arrests in Connection with Investigation by Serious Fraud Investigation Office) Rules, 2017, r 9.

Section 212 (6)³⁵ of the Companies Act, 2013 states that notwithstanding anything contained in the Code of Criminal Procedure, 1973, the offence covered under Section 447 of the Companies Act, 2013 is a cognizable offence and no person accused of any offence under this section shall be released on bail or on his own bond unless:

- i. the Public Prosecutor has been given an opportunity to oppose the application for such release; and
- ii. where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail.

These bail pre-conditions are in addition to the conditions prescribed under Sections 437 and 439 of the Code of Criminal Procedure, 1973³⁶. In *SFIO v. Nitin Johari*³⁷, the Supreme Court cancelled the bail granted by the Delhi High Court on the grounds that the twin pre-conditions prescribed under Section 212(6) and the general principles for grant of bail under Section 439 of the Code of Criminal Procedure, 1973, were not satisfied.

However, a person who is under the age of sixteen years or is a woman or is sick or infirm may be released on bail, if the Special Court so directs. It is pertinent to note that the Special Court shall not take cognizance of any offence except upon a complaint in writing made by:

- (i) the Director, Serious Fraud Investigation Office; or
- (ii) any officer of the Central Government authorized, by a general or special order in writing on this behalf by that Government.³⁸

The government and courts have observed that the economic offences are causing huge losses to public funds very seriously. Keeping this in view, the Courts have considered economic offences as a separate class requiring higher scrutiny and restraint while considering the cases arising from them, such as whether to grant bail to the accused while the investigation or prosecution is ongoing. Bail has been repeatedly refused by the Supreme Court in *SFIO*

³⁵ Companies Act, 2013, s 212(6).

³⁶ Code of Criminal Procedure, 1973, s 437.

Code of Criminal Procedure, 1973, s 439.

³⁷ *SFIO v. Nitin Johari* (2019) 9 SCC 165

³⁸ Companies Act, 2013, s 212(6).

matters, considering such offences as grave offences that pose a serious threat to the financial health of the country.

USE OF SFIO REPORT BY OTHER REGULATORS

When corporate fraud occurs, different laws are potentially violated and this brings different regulators and law enforcement agencies into the picture. Although once a case is assigned to the SFIO, the other law enforcement agencies cannot conduct their own investigation on the same fraud, they are allowed to rely upon the SFIO's reports with regard to determining the offence under their respective jurisdiction. The SFIO has to share any information or documents available with it to other investigating agencies, State Governments, the police, or income tax authorities, if the information or documents may be relevant or useful for them in any investigation or examination of an offence or matter being conducted by them under any other law³⁹.

Regulators such as the National Financial Reporting Authority (NFRA), the Reserve Bank of India (RBI), the ROC, and the Securities and Exchange Board of India (SEBI) have relied on SFIO's reports to initiate proceedings for violations under their respective regulatory jurisdictions. The findings in SFIO's reports are relied upon by such regulators because often the fraud investigated by the SFIO is considered as a 'bedrock to other violations'⁴⁰.

The NFRA investigates the quality of audits and takes disciplinary action against auditors and audit firms. It is empowered to impose sanctions (for example monetary penalties or prohibition from practising) if the audit performed by an auditor or an audit firm does not meet prescribed standards. In some cases, the NFRA has also imposed fines and barred individual auditors from being appointed as auditors or internal auditors of any company for five to seven years. In the IL&FS scam, the NFRA reviewed the statutory audit and financial statements of IL&FS Financial Services Limited (IFIN) (a key subsidiary of IL&FS) for the last ten years and released Audit Quality Review Reports in which it was alleged that IFIN's statutory auditors had failed to discharge their duty. This was done in response to the SFIO's investigation, in which the role of IFIN's statutory auditors was brought into question. SFIO's report on the same scam was referred to and relied upon by the RBI as well, as it was responsible for regulating IFIN, which was a licensed non-banking finance company. The RBI

³⁹ Companies Act, 2013, s 212(17)(b).

⁴⁰ Vijayendra Pratap Singh, Aditya Vikram Jalan Raghav Seth, Sadhvi Chhabra (n 5).

initiated proceedings to penalise IFIN and cancel its licence on the basis of the SFIO's report, which showed that IFIN had been responsible for ever-greening loans, and had violated norms related to adequate provisioning, credit concentration, and net-owned funds. Furthermore, even SEBI had relied on the SFIO's interim report to initiate an investigation against the IL&FS group companies and their associated intermediaries.

SEBI has also relied on the SFIO's report in the case of the National Spot Exchange Limited (NSEL) scam of 2013 and had consequently banned five major commodity derivatives brokers for 6 months following its investigation⁴¹.

As per Section 212(17)(a) of the Companies Act, 2013, the other investigating agencies, State Governments, the police, and income tax authorities also have a corresponding obligation to the SFIO: if they have any information or documents about the offence of corporate fraud being investigated by the SFIO, they have to provide all that information or those documents to the SFIO⁴².

CONCLUSION

Corporate fraud has considerably increased in recent years. It is truly said that 'necessity is the mother of invention'. An increasing number of corporate frauds has alarmed the Government to follow the strict implementation of laws, proper investigation procedures, and the effective role of investigating agencies. The tendency to commit corporate fraud is growing and hence the role of SFIO is becoming very crucial. A former MCA Secretary had highlighted that since corporate frauds are very complex, the SFIO faces a challenge in recruiting personnel who have the proficiency to investigate frauds of complex nature. For effective enforcement of Section 212, there is an urgent need to scale up the resources and manpower available to the SFIO. For the purpose of effective investigation, the Supreme Court has permitted the SFIO to engage external independent technical experts, such as chartered accountants and valuers, in its investigations. The SFIO has in recent years brought investigation of corporate fraud to the forefront. It is given priority amongst investigating authorities for investigations into corporate fraud, and no other investigating authority can proceed with its investigation once the SFIO is given the order to investigate a matter. Since the SFIO has increasingly conducted more

⁴¹ Khushboo Tiwari, 'NSEL scam: Sebi bans five major commodity brokers for six months' (*Business Standard*, 29 November 2022) <https://www.business-standard.com/article/markets/nsel-case-sebi-slaps-six-months-ban-on-five-commodity-brokers-122112901304_1.html> accessed 23 February 2023.

⁴² Companies Act, 2013, s 212(17)(a).

investigations and achieved more convictions, it has become the preferred authority for the central government to investigate cases of corporate fraud. The role of SFIO has changed from a mere investigating authority to a one-stop authority for the resolution of corporate fraud. An example of the increasing mandate of the SFIO is the Heera Gold Exim case, where the SFIO was directed to assist investors in realizing their claims against the accused by collating all claims and distributing the appropriate amounts. This increasing reliance on, and authority of, the SFIO will define investigations into corporate fraud and asset tracing in the coming years.

