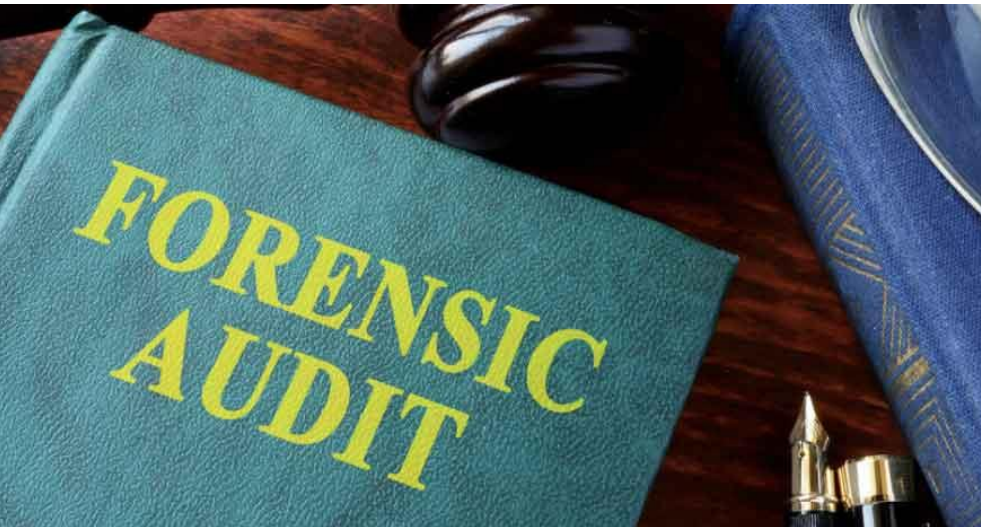


WEBINAR on **Transaction Audit & Forensic Audit Under IBC**



Bengaluru Branch of SIRC of
The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)



Thursday ♦ 7th MAY 2020 ♦ 04:00 PM to 06:00 PM ♦ www.3spro.blogspot.com

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Agenda

- **Claims**
- **Verification of Transactions (RP / CoC)**
- **Transaction Audit**
- **Forensic Audit**
- **Tracing of Assets**
- **Understanding CIRP Regulation 35(A) and 39(2)**

Views

- **Scope of Forensic / Transaction Audit**
- **Who has the Authority to appoint Forensic Auditor? (RP / CoC)**
- **Whether draft Forensic Audit report needs to be shared with directors or Corporate Debtor?**
- **On what basis RP can form his opinion that there are PUEF transaction?**
- **Should Forensic Audit Report be annexed to the application to be filed by RP before Adjudicating Authority?**
- **Whether all the entities, who have been named as parties in these transactions, be made respondents**

Mere Suspicious Nature of Transactions Cannot form basis to Conclude Fraud



In **State Bank of India vs. Adhunik Steels Limited MANU/NC/3078/2019**, a Forensic Audit was carried. The Auditor clearly opined that the creditors of the Corporate Debtor were not defrauded due to transactions in question, but there was some suspicion with respect to some transactions. The Hon'ble NCLT observed:

The transactions cannot be said to be fraudulent in nature. PWC opined some transactions to be suspicious because they did not get some correspondence purchase receipt. In my considered opinion, it is not enough to draw conclusion that transaction in question carried by the respondent in fraudulent manner. In view of all above facts, I hold that it is not a case to direct the respondents to make contribution of such a huge amount invoking provisions of 66 of Insolvency and Bankruptcy Code, 2016.

Claims

Topic:- Claims with Examples

- Verification
- Rejection
- Disputed Claims
- Contingent Claims
- Appeals
- Constitution of CoC
- Practical issues

What is Transaction Audit?

- A transaction audit is a report of the transactions entered.
- TA has two sections.
- The first section shows the transactions as they were entered on the clients accounts, and
- The second section shows the corresponding reflection of transactions of the counter-party

What is Forensic Audit?

- A forensic audit is an **examination** and **evaluation** of a firm's or individual's financial records to derive evidence that can be used in a court of law or legal proceeding.

“Lost” Asset Tracing

- As a preliminary activity to the recovery of stolen assets, the identification and tracing of the proceeds of crime and securing the property for final confiscation is an essential part of the process. This is a demanding task which should be conducted in parallel with the investigation of the criminal offence generating material benefit.
- It requires intense cooperation between law enforcement agencies or those tasked with tracing assets, Financial Intelligence Units and, in most instances, the prosecutor.
- Where an investigation focuses, for example, on a public official's receipt of bribes or otherwise unlawful financial enrichment, this will require the involvement of investigators experienced in gathering and analysing financial evidence. In many instances, it will also require the involvement of a forensic accounting expert to assist in unravelling complex financial transactions, and an understanding of the role played by gatekeepers in assisting (sometimes unwittingly) criminals dispose of their criminal profits.

The process which leads to recovery or the repatriation of assets, is divided into four (4) basic phases, i.e.,

- **Pre-investigative phase**, during which the investigator verifies the source of the information initiating the investigation and determines its authenticity. **If there are inconsistencies in the story or incorrect statements and assumptions, then the true facts must be established**
- **Investigative phase**, where the proceeds of crime are identified and located and evidence in respect of ownership is collated covering several areas of investigative work in the process. The result of this investigation can be a temporary measure (seizure) to secure later confiscation ordered by the court
- **Judicial phase**, where the accused person/defendant is convicted (or acquitted) and the decision on confiscation is final
- **Disposal phase**, where the property is actually confiscated and disposed of in accordance with the law

TRACING STOLEN ASSETS

Regulation	Description	Norm	Timeline
Regulation 6(1)	Public announcement inviting claims	Within 3 Days of Appointment of IRP	T+3
Section 15(1)(c) / Regulations 6(2)(c) and 12 (1)	Submission of claims	For 14 Days from Appointment of IRP	T+14
Regulation 12(2)	Submission of claims	Up to 90 th day of commencement	T+90
Regulation 13(1)	Verification of claims received under regulation 12(1)	Within 7 days from the receipt of the claim	T+21
Regulation 13(2)	Verification of claims received under regulation 12(2)		T+97

Regulation: 10 Substantiation of claims.

- The interim resolution professional or the resolution professional, as the case may be, may call for such other evidence or clarification as he deems fit from a creditor for substantiating the whole or part of its claim.

Standard No. 110

VALUATION REPORTS

Type of Valuation Report	Extent of Review and Analysis	Extent of Corroboration
Comprehensive	Comprehensive review and analysis of business and industry and all other relevant information and factors.	Corroboration of significant relevant information and factors.
Estimate	Limited review and analysis of relevant information.	Limited corroboration of significant relevant information.
Calculation	Minimal review and analysis of relevant information.	Little or no corroboration of significant relevant information.

Calculation Valuation Report — a Calculation Valuation Report contains a conclusion as to the value of shares, assets or an interest in a business that is based on **minimal review** and analysis and **little or no corroboration** of relevant information, and generally set out in a **brief Valuation Report**.

Regulation: 11. Cost of proof.

- A creditor shall bear the cost of proving the debt due to such creditor.

Regulation: 12. Submission of proof of claims.

- (1) Subject to sub-regulation (2), a creditor **shall** submit claim with proof on or before the last date mentioned in the public announcement.
- (2) A creditor, who fails to submit claim with proof within the time stipulated in the public announcement, may submit the claim with proof to the interim resolution professional or the resolution professional, as the case may be, on or before the **ninetieth day** of the insolvency commencement date.
- (3) Where the creditor in sub-regulation (2) is a *financial creditor under regulation 8*, it **shall** be included in the committee from the date of admission of such claim:

*Provided that such inclusion **shall not** affect the validity of any decision taken by the committee prior to such inclusion.*

Regulation 13. Verification of claims.

- (1) The interim resolution professional or the resolution professional, as the case may be, **shall** verify every claim, as on the insolvency commencement date, within **seven days** from the last date of the receipt of the claims, and thereupon maintain a **list of creditors** containing names of creditors along with the amount claimed by them, the amount of their claims admitted and the security interest, if any, in respect of such claims, and update it.
- (2) The list of creditors **shall** be –
 - (a) *available for inspection by the persons who submitted proofs of claim;*
 - (b) *available for inspection by members, partners, directors and guarantors of the corporate debtor;*
 - (c) *displayed on the website, if any, of the corporate debtor;*
 - (d) *filed with the Adjudicating Authority; and*
 - (e) *presented at the first meeting of the committee.*

Regulation 14. Determination of amount of claim.

- (1) Where the amount claimed by a creditor is not precise due to any contingency or other reason, the interim resolution professional or the resolution professional, as the case may be, shall make the best estimate of the amount of the claim based on the information available with him.
- (2) The interim resolution professional or the resolution professional, as the case may be, shall revise the amounts of claims admitted, including the estimates of claims made under sub-regulation (1), as soon as may be practicable, when he comes across additional information warranting such revision.

Section 38. Consolidation of claims. -

- (1) The liquidator shall receive or collect the claims of creditors within a period of **thirty days** from the date of the commencement of the liquidation process.
- (2) A financial creditor may submit a claim to the liquidator by providing a record of such claim with an information utility:
- *Provided* that where the information relating to the claim is not recorded in the information utility, the financial creditor may submit the claim in the same manner provided for the submission of claims for the operational creditor under sub-section (3).
- (3) An operational creditor may submit a claim to the liquidator in such form and in such manner and along with such supporting documents required to prove the claim as may be specified by the Board.
- (4) A creditor who is partly a financial creditor and partly an operational creditor shall submit claims to the liquidator to the extent of his financial debt in the manner as provided in sub-section (2) and to the extent of his operational debt under sub-section (3).
- (5) A creditor may withdraw or vary his claim under this section within **fourteen days** of its submission.

Section 39.Verification of claims.-

- (1) The liquidator shall verify the claims submitted under section 38 within such time as specified by the Board.
- (2) The liquidator may require any creditor or the corporate debtor or any other person to produce any other document or evidence which he thinks necessary for the purpose of verifying the whole or any part of the claim.

Section 40. Admission or rejection of claims. -

- (1) The liquidator may, after verification of claims under section 39, either admit or reject the claim, in whole or in part, as the case may be:
- Provided that where the liquidator rejects a claim, he shall record in writing the reasons for such rejection.
- (2) The liquidator shall communicate his decision of admission or rejection of claims to the creditor and corporate debtor within seven days of such admission or rejection of claims.

Section 41. Determination of valuation of claims. -

- The liquidator shall determine the value of claims admitted under section 40 in such manner as may be specified by the Board.

Section 42. Appeal against the decision of liquidator. -

- A creditor may appeal to the Adjudicating Authority against the decision of the liquidator accepting or rejecting the claims within fourteen days of the receipt of such decision.

Avoidance of Specified Transactions

1 Unauthorised creation of assets

2 Undervalued transactions through related or other entities

3 Circular transactions

4 Preferential transactions with a group of creditors and customers

5 Gold plating of projects

6 Transactions defrauding creditors

7 Diversion or siphoning of funds



**SEVEN
THINGS THAT
INSOLVENCY
PROFESSIONALS
WATCH
OUT FOR**

FORENSIC SERVICES UNDER IBC

I] Assistance in finding irregularities under sections 43 to 66 of the IBC, 2016

II] Detailed forensic audit

III] Background check of potential bidders

IV] Hostile forensic due diligence review on competitive bidders

Finding irregularities

Section 43 & 44 – Preferential Transactions

Approach

- Analysis of nature of related party transactions and their impact on the financial statements
- Verification whether payments / receipts have been done in accordance with the transaction
- Impact of any offset journal entries that may have been passed and its impact
- Investigation of preferential transactions (not at arms length) between entities that have taken place in the following manner:
 - In case of related parties – two years prior to the date of insolvency
 - In any other case – one year prior to the date of insolvency
- Examination of transfer of property / assets/ interest to the benefit of a particular creditor / beneficiary in the presence of an existing debt/ liability such that the creditor is in a beneficial position at the time of distribution of assets
- Genuineness of the nature of funds / loans given / received from parties
- Authenticity of the claims made by related party creditors
- Supporting the legal team in making applications to the Adjudicating Authority

Finding irregularities

Section 45 - 49 – Undervalued Transactions

- Evaluation of transactions that have occurred which are significantly less than the value of consideration.
- Benchmarking such transactions carried out by the company with peer companies (similar industry) to comment on whether they were carried out at arm's length
- Review of transfer pricing orders
- Quantification and nature of such transactions
- Supporting the legal team in making applications to the Adjudicating Authority

Finding irregularities

Section 50 & 66 – Extortionate & Fraudulent

- Ascertaining the nature of receipts of any financial or operational debt during the period within two years preceding the insolvency commencement date
 - Terms & conditions of such debt (interest rate, repayment terms, security interest etc.) and determine if the same is exorbitant in nature
 - Whether the parties who provided the loan are genuine parties or are in effect related parties?
-
- Observation of any apparent fraudulent activity by analyzing the financial statements and other supporting documentation
 - Identification of areas where fraudulent transactions may have occurred
 - Analyzing additional data based on the findings

Finding irregularities

Section 68, 69 & 72

Concealment of Property	<ul style="list-style-type: none">• Obtaining any evidence / information of concealment of any property in the books of the Corporate Debtor, by any officer.• Investigation of any fraudulent activity by any officer (e.g. by making false entries into the books of accounts, manipulation, alteration of accounts, etc.)
Transactions defrauding creditors	<ul style="list-style-type: none">• Evaluating transfer of any gift / charge conspired in execution of an order against the property of the corporate debtor.• Concealment or removal of any part of property of corporate debtor without any satisfactory order for payment of money received against the corporate debtor.
Wilful and material omissions	<ul style="list-style-type: none">• Ascertaining that there is no omission of any wilful and material information relating to the affairs of the corporate debtor.

Finding irregularities

Section 68, 69 & 72

- Detailed analysis of annual financial trends of the company and comment on probable suspicious areas of manipulation, if any
- Excessive provisioning / write offs / losses which are not in the ordinary course of business and are unusual in nature
- Background check of major customers and vendors of the company to establish if they are the front companies of the promoter
- Non-recurring expenditure incurred by the company
- Evaluating whether revenue is booked as per the applicable GAAP
- Non- moving creditors & debtors
- Analytical review of international subsidiaries and associate companies
- Exceptional items to the statement of profit and loss

Forensic Audit



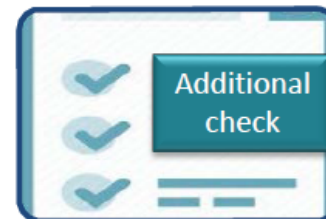
- Gathering basic information about the background of the Corporate Debtor / other concerns.
- Understanding the facts.



- Obtaining information through extensive public domain research; shareholding, promoter details, KMP etc. of the Corporate Debtor/ other concerns.
- Studying various aspects of the financials.
- Evaluation of Bank statements to understand the nature & fund flow of transactions.



- Data analysis
- Analysis of contracts and identification of critical terms.
- Assessment of genuineness of creditors.
- Risk Assessment in key areas of operations & asset misappropriation
- Analysis of preferential transactions with related parties & others / International subsidiaries



- Additional information gathering based on social media search.
- Relationship assessment of creditors and Corporate Debtor/ other concerns.
- Transaction testing and verification of supporting documentation.
- Fund diversion from Corporate Debtor to any other business



- Reporting of the recoverable amount from the Corporate Debtor.
- Reporting any material findings with regards to the outcome of the project.
- Initiate proceedings, if any.

Regulations 35A: Preferential and other transactions

– Days to remember

- **75th Day**
- **115th Day**
- **135th Day**



Section 21 – Committee of Creditors

Section 21(9)

- The committee of creditors shall have the right to require the resolution professional to furnish any financial information in relation to the corporate debtor at any time during the corporate insolvency resolution process.

Section 25 – Duties of Resolution Professional

Section 25(2)(j)

- file application for avoidance of transactions in accordance with Chapter III, if any;

Regulation	Description	Norm	Timeline
Regulation 35A	RP to form an opinion on preferential and other transactions	Within 75 days of the commencement	T+75
	RP to make a determination on preferential and other transactions	Within 115 days of commencement	T+115
	RP to file applications to AA for appropriate relief	Within 135 days of commencement	T+135

Regulations 35A. Preferential and other transactions.

- (1) On or before the seventy-fifth day of the insolvency commencement date, the resolution professional shall form an opinion whether the corporate debtor has been subjected to any transaction covered under sections **43, 45, 50** or **66**.
- (2) Where the resolution professional is of the opinion that the corporate debtor has been subjected to any transactions covered under sections 43, 45, 50 or 66, he shall make a determination on or before the one hundred and fifteenth day of the insolvency commencement date, under intimation to the Board.
- (3) Where the resolution professional makes a determination under sub-regulation (2), he shall apply to the Adjudicating Authority for appropriate relief on or before the one hundred and thirty-fifth day of the insolvency commencement date.]

Regulations 39: Approval of resolution plan.

39(2)

The resolution professional shall submit to the committee all resolution plans which comply with the requirements of the Code and regulations made thereunder along with the details of following transactions, if any, observed, found or determined by him: -

- (a) *preferential transactions under section 43;*
- (b) *undervalued transactions under section 45;*
- (c) *extortionate credit transactions under section 50; and*
- (d) *fraudulent transactions under section 66,*

and the orders, if any, of the adjudicating authority in respect of such transactions.

Specified (PUEF) Transactions

Section	Particulars
43	Preferential Transactions and relevant Time
44	<u>Order</u> in case of preferential transactions
45	Avoidance of Undervalued transactions
46	Relevant period for avoidable transaction
47	Application by creditor in cases of undervalued transactions
48	<u>Order</u> in cases of undervalued
49	Transactions defrauding creditors
50	Extortionate Credit Transactions
51	<u>Orders</u> of AA in respect of extortionate credit transactions
66	Fraudulent trading or wrongful trading [<u>Order u/s. 66(2)</u>]

what are other
words for
preferential?



advantageous, special,
discriminatory, preferred,
partial, privileged, better,
partisan, superior, favorable



Preferential Transactions

- **Transaction:** A transaction must have occurred between the company and a creditor; usually this can be traced through bank account transfers. This can also be found in the transferring of an asset. This proves that the transaction physically took place to the creditor.
- **Relationship:** The debtor has paid the creditor at the creditors demand and this payment satisfies the debt. You should be aware that payment for goods is not covered under this and would not be considered preferential, also payment in advance for future works or services is not considered preferential. There is also the question of if there was a continuing relationship, and if the debt increased or decreased over a period of time. If it is the case that the debt has decreased, it could be argued that this specific amount of decrease is considered a preference.

Preferential Transactions

- **Time Period:** The transaction should have occurred within a specific time period before the insolvency, this time period will depend on the creditors' relationship to the company and Directors. For creditors that are not related parties to the company this time limit is one year, if they are related, two years *(and if there is evidence that there has been interference and delays in the rights of other creditors then whether a transaction could be voided going back ten years)*
- **Debt:** If the debt is secured and a creditor has a security over various monies and assets then this is not considered preferential. If the creditor received more than they would have through the liquidation process this can also be considered a preference.

Section 43(1) : Preferential transactions and relevant time

Forming an Opinion:

- (1) Where the liquidator or the resolution professional, as the case may be, is of the opinion that the corporate debtor has at a relevant time given a preference in such transactions and in such manner as laid down in sub-section (2) to any persons as referred to in sub-section (4), he shall apply to the Adjudicating Authority for avoidance of preferential transactions and for, one or more of the orders referred to in section 44.

Section 43(2) : Preferential transactions and relevant time

Preferential Transaction

- (2) A corporate debtor shall be deemed to have given a preference, if—
- (a) there is a transfer of property or an interest thereof of the corporate debtor for the benefit of a creditor or a surety or a guarantor for or on account of an antecedent financial debt or operational debt or other liabilities owed by the corporate debtor; and
 - (b) the transfer under clause (a) has the effect of putting such creditor or a surety or a guarantor in a beneficial position than it would have been in the event of a distribution of assets being made in accordance with section 53.

Antecedent: a thing that existed before or logically precedes another.

In Re: Miditech Private Limited

MANU/NC/2831/2019



- ❧ The Hon'ble NCLT, Principal Bench, in this case, after examination of the forensic report, found that there was no finding that the Respondent had been put in a better place than she would have been under section 53 of the Code. The Hon'ble NCLT noted:

A perusal of the forensic audit report shows that the contention of the non-applicant parties that no analysis has been made with regard to the second criteria – beneficial position of the Nivedith Alva in the event of distribution under Section 53 has been made in the forensic audit report. Further, even the RP has not stated anything in its application to address this second requirement and explain what and how Nivedith Alva's position has been affected due to the repayment of Rs. 10 lakhs in the waterfall mechanism under Section 53 of the Code.

- ❧ Thus, in the absence of establishing beneficial position, the NCLT dismissed the petition.

Section 43(3) : Preferential transactions and relevant time

Exceptions to Preferential

(3) For the purposes of sub-section (2), a preference shall not include the following transfers—

- a) transfer made in the **ordinary course of the business or financial affairs** of the corporate debtor or the transferee;
- b) any transfer creating a security interest in property acquired by the corporate debtor to the extent that —
 - (i) such security interest secures new value and was given at the time of or after the signing of a security agreement that contains a description of such property as security interest, and was used by corporate debtor to acquire such property; and
 - (ii) such transfer was registered with an information utility on or before thirty days after the corporate debtor receives possession of such property:

Provided that any transfer made in pursuance of the order of a court shall not, preclude such transfer to be deemed as giving of preference by the corporate debtor.

Section 43(3) : Preferential transactions and relevant time

- *Explanation.* – For the purpose of sub-section (3) of this section, “new value” means money or its worth in goods, services, or new credit, or release by the transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the liquidator or the resolution professional under this Code, including proceeds of such property, but does not include a financial debt or operational debt substituted for existing financial debt or operational debt.

Section 43(4) : Preferential transactions and relevant time

Relevant Time:

- (4) A preference shall be deemed to be given at a relevant time, if –
- (a) It is given to a related party (other than by reason only of being an employee), during the period of two years preceding the insolvency commencement date; or
 - (b) a preference is given to a person other than a related party during the period of one year preceding the insolvency commencement date.

Section 44 : Orders in case of preferential transactions

(1) The Adjudicating Authority, may, on an application made by the resolution professional or liquidator under sub-section (1) of section 43, by an order:

- (a) require any property transferred in connection with the giving of the preference to be vested in the corporate debtor;
- (b) require any property to be so vested if it represents the application either of the proceeds of sale of property so transferred or of money so transferred;
- (c) release or discharge (in whole or in part) of any security interest created by the corporate debtor;
- (d) require any person to pay such sums in respect of benefits received by him from the corporate debtor, such sums to the liquidator or the resolution professional, as the Adjudicating Authority may direct;
- (e) direct any guarantor, whose financial debts or operational debts owed to any person were released or discharged (in whole or in part) by the giving of the preference, to be under such new or revived financial debts or operational debts to that person as the Adjudicating Authority deems appropriate;
- (f) direct for providing security or charge on any property for the discharge of any financial debt or operational debt under the order, and such security or charge to have the same priority as a security or charge released or discharged wholly or in part by the giving of the preference; and
- (g) direct for providing the extent to which any person whose property is so vested in the corporate debtor, or on whom financial debts or operational debts are imposed by the order, are to be proved in the liquidation or the corporate insolvency resolution process for financial debts or operational debts which arose from, or were released or discharged wholly or in part by the giving of the preference:

Section 44 : Orders in case of preferential transactions

Provided that an order under this section shall not -

- (a) affect any interest in property which was acquired from a person other than the corporate debtor or any interest derived from such interest and was acquired in good faith and for value;
- (b) require a person, who received a benefit from the preferential transaction in good faith and for value to pay a sum to the liquidator or the resolution professional.

Explanation-I: For the purpose of this section, it is clarified that where a person, who has acquired an interest in property from another person other than the corporate debtor, or who has received a benefit from the preference or such another person to whom the corporate debtor gave the preference, -

- (a) had sufficient information of the initiation or commencement of insolvency resolution process of the corporate debtor;
- (b) is a related party,

it shall be presumed that the interest was acquired, or the benefit was received otherwise than in good faith unless the contrary is shown.

Explanation-II. – A person shall be deemed to have sufficient information or opportunity to avail such information if a public announcement regarding the corporate insolvency resolution process has been made under section 13.

what are other
words for
undervalued?



underestimated, underrated,
unappreciated, neglected,
disregarded, unrecognized,
forgotten, overlooked, ignored



Section 45 : Avoidance of Undervalued Transactions

Determining Undervalued Transactions:

- (1) If the liquidator or the resolution professional, as the case may be, on an examination of the transactions of the corporate debtor referred to in sub-section (2) determines that certain transactions were made during the relevant period under section 46, which were undervalued, he shall make an application to the Adjudicating Authority to declare such transactions as void and reverse the effect of such transaction in accordance with this Chapter.
- (2) A transaction shall be considered undervalued where the corporate debtor—
 - (a) makes a gift to a person; or
 - (b) enters into a transaction with a person which involves the transfer of one or more assets by the corporate debtor for a consideration the value of which is significantly less than the value of the consideration provided by the corporate debtor,
- and such transaction has not taken place in the ordinary course of business of the corporate debtor.

Section 46 : Relevant period for Avoidable Transactions

1 year / 2 years:

- (1) In an application for avoiding a transaction at undervalue, the liquidator or the resolution professional, as the case may be, shall demonstrate that –
 - (i) such transaction was made with any person within the period of one year preceding the insolvency commencement date; or
 - (ii) such transaction was made with a related party within the period of two years preceding the insolvency commencement date.
- (2) The Adjudicating Authority may require an independent expert to assess evidence relating to the value of the transactions mentioned in this section.

Power of NCLT to call for Assessment by Expert Evidence



- ❧ In addition to dealing with the look-back period for an undervalued transaction, section 46(2) also confers a special power on the NCLT.
- ❧ Section 46(2) of the Code provides that *the Adjudicating Authority may require an independent expert to assess evidence relating to the value of the transactions mentioned in this section.*
- ❧ Thus, the NCLT is empowered to refer the matter to an expert, to **access** the evidence, i.e. to give a report on the veracity of the claims made in the application, based on the forensic report.

Manoj Kumar Mishra Vs. Monotona Tyres Limited, MANU/NC/8692/2019



In this case, the Hon'ble NCLT, Mumbai Bench, allowed an application under section 45 of the Code, where the assets worth Rs. 109 crores, were sold at a price of Rs. 52 crores, within the look-back period. The Hon'ble NCLT, allowing the application, made the following observations:

10. In view of above submissions and after perusing the documents, two things are clear:

- i. The sale is an undervalued sale of merely ₹52.5 crore against the total worth of the assets of ₹109 crore.*
- ii. The payment from the proceeds of the sale has been made to Devmata whose name is not even mentioned as creditor in the Notes Forming part of the Balance Sheet. However, no payment has been given to NBFCs or any other unsecured creditor which is revealed in the Balance Sheet of Monotona for the year ending 2017-18.*

11. Hence, it is ordered that the said transaction, being wrong in law, is hereby set aside. Any benefits derived by any person from this transaction be restored to the Corporate Debtor. The financial position of the Corporate Debtor as on the date of insolvency commencement shall be deemed to be as if there was no such transaction entered into by the Corporate Debtor.

Section 47 : Application by creditor in cases of undervalued transactions

Creditor / Member / Partner of a Corporate Debtor

- (1) Where an undervalued transaction has taken place and the liquidator or the resolution professional as the case may be, has not reported it to the Adjudicating Authority, a creditor, member or a partner of a corporate debtor, as the case may be, may make an application to the Adjudicating Authority to declare such transactions void and reverse their effect in accordance with this Chapter.
- (2) Where, the Adjudicating Authority, after examination of the application made under sub-section (1), is satisfied that -
 - (a) undervalued transactions had occurred; and
 - (b) liquidator or the resolution professional, as the case may be, after having sufficient information or opportunity to avail information of such transactions did not report such transaction to the Adjudicating Authority,
- it shall pass an order-
 - (a) restoring the position as it existed before such transactions and reversing the effects thereof in the manner as laid down in section 45 and section 48;
 - (b) requiring the Board to **initiate disciplinary proceedings against the liquidator or the resolution professional** as the case may be.

Section 48 : Order in cases of undervalued transactions

Order

- (1) The order of the Adjudicating Authority under sub-section (1) of section 45 may provide for the following: -
 - (a) require any property transferred as part of the transaction, to be vested in the corporate debtor;
 - (b) release or discharge (in whole or in part) any security interest granted by the corporate debtor;
 - (c) require any person to pay such sums, in respect of benefits received by such person, to the liquidator or the resolution professional as the case may be, as the Adjudicating Authority may direct; or
 - (d) require the payment of such consideration for the transaction as may be determined by an independent expert.

Section 49 : Transactions defrauding creditors

45 vs. 49: Back to the Future

Where the corporate debtor has entered into an undervalued transaction as referred to in sub-section (2) of section 45 and the Adjudicating Authority is satisfied that such transaction was **deliberately** entered into by such corporate debtor -

- (a) for keeping assets of the corporate debtor **beyond the reach of any person who is entitled to make a claim against the corporate debtor**; or
- (b) in order to adversely affect the interests of such a person in relation to the claim, the Adjudicating Authority **shall** make an order-
 - (i) restoring the position as it existed before such transaction as if the transaction had not been entered into; and
 - (ii) protecting the interests of persons who are victims of such transactions:

Provided that an order under this section -

- (a) shall not affect any interest in property which was acquired from a person other than the corporate debtor and was acquired in good faith, for value and without notice of the relevant circumstances, or affect any interest deriving from such an interest, and
- (b) shall not require a person who received a benefit from the transaction in good faith, for value and without notice of the relevant circumstances to pay any sum unless he was a party to the transaction.

Difference between S. 45 and 49(both pertain to avoidance of undervalued transactions)

S. 45

- Presence of any motive is NOT required
- a look- back period has been provided for undervalued transactions under S. 46
- Undervalued transaction-a matter of fact, no intention matters

S. 49

- Deals with transactions undertaken with mala fide or wrongful intent
- no limitation period for fraudulent transactions covered under sections 49 and 66 of the Code
- The intent is “once a fraud, always a fraud”
- Inserted for so-called ‘willful defaulters’. So, no claw back period

K.L. Jute Products Private Limited vs. Tirupti Jute Industries Ltd MANU/NL/0131/2020



Explaining the ambit of section 49 of the Code, the Hon'ble NCLAT in this judgment, observed as follows:

The 'Term', 'Transfer' includes 'sale', 'Relinquishment', 'Exchange', and an Adjudicating Authority under Section 49 of the Code can restore a status quo ante in a given matter by protecting a person's interest. Section 49 of the I & B Code prescribes no time limit for securing an order in respect of a transaction entered into which were meant for defrauding the 'creditors'.

what are other
words for
extortionate?

exorbitant, usurious,
unreasonable, rapacious,
outrageous, severe, steep,
extravagant, greedy



Extortionate transactions

- ✓ If the corporate debtor obtains any credit facility with exorbitant rate of interest or unfair credit terms such as incorporating severe default provision or was in a vulnerable position at the time of the transaction.

Section 50: Extortionate Credit Transactions

Receipt transactions

- (1) Where the corporate debtor has been a party to an extortionate credit transaction involving the receipt of financial or operational debt during the period within two years preceding the insolvency commencement date, the liquidator or the resolution professional as the case may be, may make an application for avoidance of such transaction to the Adjudicating Authority if the terms of such transaction required exorbitant payments to be made by the corporate debtor.
- (2) The Board may specify the circumstances in which a transactions which shall be covered under sub-section (1).
- *Explanation.* - For the purpose of this section, it is clarified that any debt extended by any person providing financial services which is in compliance with any law for the time being in force in relation to such debt shall in no event be considered as an extortionate credit transaction.

Section 51: Orders of AA in respect of Extortionate credit transactions

Restore / Set aside / Modify / Repay / Relinquish

Where the Adjudicating Authority after examining the application made under sub-section (1) of section 50 is satisfied that the terms of a credit transaction required exorbitant payments to be made by the corporate debtor, it shall, by an order –

- (a) restore the position as it existed prior to such transaction;
- (b) set aside the whole or part of the debt created on account of the extortionate credit transaction;
- (c) modify the terms of the transaction;
- (d) require any person who is, or was, a party to the transaction to repay any amount received by such person; or
- (e) require any security interest that was created as part of the extortionate credit transaction to be relinquished in favour of the liquidator or the resolution professional, as the case may be.

Section 66: Fraudulent Trading or Wrongful Trading

- (1) If during the corporate insolvency resolution process or a liquidation process, it is found that any business of the corporate debtor has been carried on with intent to defraud creditors of the corporate debtor or for any fraudulent purpose, the Adjudicating Authority may on the application of the resolution professional pass an order that any persons who were knowingly parties to the carrying on of the business in such manner shall be liable to make such contributions to the assets of the corporate debtor as it may deem fit.

Section 66: Fraudulent Trading or Wrongful Trading

- (2) On an application made by a resolution professional during the corporate insolvency resolution process, the Adjudicating Authority may by an order direct that a director or partner of the corporate debtor, as the case may be, shall be liable to make such contribution to the assets of the corporate debtor as it may deem fit, if-
 - (a) before the insolvency commencement date, such director or partner knew or ought to have known that there was no reasonable prospect of avoiding the commencement of a corporate insolvency resolution process in respect of such corporate debtor; and
 - (b) such director or partner did not exercise due diligence in minimising the potential loss to the creditors of the corporate debtor.
- *Explanation.* – For the purposes of this section a director or partner of the corporate debtor, as the case may be, shall be deemed to have exercised due diligence if such diligence was reasonably expected of a person carrying out the same functions as are carried out by such director or partner, as the case may be, in relation to the corporate debtor.

“Lost” Asset Tracing

- As a preliminary activity to the recovery of stolen assets, the identification and tracing of the proceeds of crime and securing the property for final confiscation is an essential part of the process. This is a demanding task which should be conducted in parallel with the investigation of the criminal offence generating material benefit.
- It requires intense cooperation between law enforcement agencies or those tasked with tracing assets, Financial Intelligence Units and, in most instances, the prosecutor.
- Where an investigation focuses, for example, on a public official's receipt of bribes or otherwise unlawful financial enrichment, this will require the involvement of investigators experienced in gathering and analysing financial evidence. In many instances, it will also require the involvement of a forensic accounting expert to assist in unravelling complex financial transactions, and an understanding of the role played by gatekeepers in assisting (sometimes unwittingly) criminals dispose of their criminal profits.

The process which leads to recovery or the repatriation of assets, is divided into four (4) basic phases, i.e.,

- **Pre-investigative phase**, during which the investigator verifies the source of the information initiating the investigation and determines its authenticity. **If there are inconsistencies in the story or incorrect statements and assumptions, then the true facts must be established**
- **Investigative phase**, where the proceeds of crime are identified and located and evidence in respect of ownership is collated covering several areas of investigative work in the process. The result of this investigation can be a temporary measure (seizure) to secure later confiscation ordered by the court
- **Judicial phase**, where the accused person/defendant is convicted (or acquitted) and the decision on confiscation is final
- **Disposal phase**, where the property is actually confiscated and disposed of in accordance with the law

TRACING STOLEN ASSETS

Section 66

Fraudulent trading or wrongful trading

Section 66 (1)

- If during the corporate insolvency resolution process or a liquidation process, it is found that any business of the corporate debtor has been carried on with intent to defraud creditors of the corporate debtor or for any fraudulent purpose, the Adjudicating Authority may on the application of the resolution professional pass an order that any persons who were knowingly parties to the carrying on of the business in such manner shall be liable to make such contributions to the assets of the corporate debtor as it may deem fit.

Section 66

Fraudulent trading or wrongful trading

Section 66 (2) – Silence Spectator is a Serious offence

On an application made by a resolution professional during the corporate insolvency resolution process, the Adjudicating Authority may by an order direct that a director or partner of the corporate debtor, as the case may be, shall be liable to make such contribution to the assets of the corporate debtor as it may deem fit, **if**—

- (a) before the insolvency commencement date, such director or partner knew or ought to have known that there was no reasonable prospect of avoiding the commencement of a corporate insolvency resolution process in respect of such corporate debtor; **and**
- (b) such director or partner did not exercise due diligence in minimising the potential loss to the creditors of the corporate debtor.

Explanation.—For the purposes of this section a director or partner of the corporate debtor, as the case may be, shall be deemed to have exercised due diligence if such diligence was reasonably expected of a person carrying out the same functions as are carried out by such director or partner, as the case may be, in relation to the corporate debtor.

Section 68

Punishment for concealment of property

Section 68.

Where any officer of the corporate debtor has,—

(i) within the twelve months immediately preceding the insolvency commencement date,—

- (a) wilfully concealed any property or part of such property of the corporate debtor or concealed any debt due to, or from, the corporate debtor, of the value of ten thousand rupees or more; or
- (b) fraudulently removed any part of the property of the corporate debtor of the value of ten thousand rupees or more; or
- (c) wilfully concealed, destroyed, mutilated or falsified any book or paper affecting or relating to the property of the corporate debtor or its affairs, or

Section 68

Punishment for concealment of property

- (d) wilfully made any false entry in any book or paper affecting or relating to the property of the corporate debtor or its affairs; or
- (e) fraudulently parted with, altered or made any omission in any document affecting or relating to the property of the corporate debtor or its affairs; or
- (f) wilfully created any security interest over, transferred or disposed of any property of the corporate debtor which has been obtained on credit and has not been paid for unless such creation , transfer or disposal was in the ordinary course of the business of the corporate debtor; or
- (g) wilfully concealed the knowledge of the doing by others of any of the acts mentioned in clauses (c), (d) or clause (e); or

Section 68

Punishment for concealment of property

- (ii) at any time after the insolvency commencement date, committed any of the acts mentioned in sub-clause (a) to (f) of clause (i) or has the knowledge of the doing by others of any of the things mentioned in sub-clauses (c) to (e) of clause (i) ; or
- (iii) at any time after the insolvency commencement date, taken in pawn or pledge, or otherwise received the property knowing it to be so secured, transferred or disposed,
such officer shall be punishable with imprisonment for a term which shall not be less than 3 years but which may extend to 5 years, or with fine, which shall not be less than 1 lakh rupees, but may extend to 1 crore rupees, or with both:
- *Provided that nothing in this section shall render a person liable to any punishment under this section if he proves that he had no intent to defraud or to conceal the state of affairs of the corporate debtor.*



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