
CORPORATE FRAUD AND ITS REGULATION IN INDIA

Ms. Shrishaila B Mudhol, Research Scholar, Karnataka State Law University, Hubballi

ABSTRACT

The rise of large organizations, globalization, and the intricacy of financial markets have all had a significant impact on corporate fraud in India over the last few decades. In the early days of the Indian corporate sector, fraud mostly involved small-scale manipulations and betrayals of trust. However, corporate fraud developed into new forms that often-involved billions of rupees and affected numerous parties as the Indian economy got more liberalized in the 1990s and businesses expanded swiftly.

Corporate fraud is the term used to describe unethical behaviour carried out by a business or an individual with the intention of greatly boosting earnings and outperforming competitors. Public funds provided to the corporation for better operations are severely lost as a result of corporate fraud.¹

Keywords: Corporate Fraud, Causes of Frauds, White collar Crime, Fraud Regulation.

¹ <https://legalwindow.in/corporate-fraud-in-india/>

Introduction

Corporate fraud has emerged as a worldwide issue alongside the progress of commerce and technology. India, like many other nations, is also facing challenges related to corporate fraud. The significant rise in corporate fraud cases over recent decades can be attributed to the rapidly growing economy and industrial development in this emerging nation.²

Corporate fraud and white-collar crime pertain to non-violent, financially motivated illegal activities carried out by individuals, typically within a business or commercial context. These offenses are marked by dishonesty, deception, or a breach of trust for personal or organizational benefit. They often involve individuals holding positions of authority or influence within a corporation.

Instances of corporate fraud and white-collar crimes encompass embezzlement, insider trading, accounting fraud, bribery, money laundering, and securities fraud. Such activities can lead to severe repercussions, both financially and socially, as they may undermine investor confidence, adversely affect employees, and compromise the overall integrity of financial and commercial systems.

In India, the issues of commercial fraud and white-collar crime have attracted considerable attention due to high-profile cases and regulatory measures aimed at addressing these practices. Tackling these challenges is essential for ensuring transparency, accountability, and trust within the commercial sector and the wider economy. This research seeks to investigate the challenges, impacts, and countermeasures associated with commercial fraud and white-collar crime in the Indian context. The relevance and significance of commercial fraud and white-collar crime in India are profound, as they can substantially influence investor confidence, global integration, the regulatory landscape, employment and social welfare, legal and ethical standards, and government initiatives.³

According to the Oxford dictionary, fraud is described as “the act of using misleading representations to achieve an unfair advantage and engaging in criminal deceit.” The Internal Revenue Service (IRS), part of the U.S. Department of the Treasury, states that “corporate fraud

² Rajora, Varsha Mansingh, *Corporate Frauds in the World of Corporate Sector: A Critical Analysis* (January 19, 2010). Available at SSRN: <https://ssrn.com/abstract=1539013> or <http://dx.doi.org/10.2139/ssrn.1539013>

³ Jayanthan.V.T.S. “Corporate Fraud and White-Collar Crime: Challenges and Countermeasures” *International Journal for Multidisciplinary Research (IJFMR)* E-ISSN: 2582-2160

refers to violations of the Internal Revenue Code (IRC) and associated laws perpetrated by large, publicly traded companies and/or their top executives.

According to Section 17 of the Indian Contract Act, "fraud" is defined as any of the following actions taken by a party to a contract, with his consent, or by his agents with the purpose of misleading another party to his agent or persuading him to sign a contract⁴.

Corporate fraud is "a type of fraud that basically involves using deception to make personal gain for oneself dishonestly and/or create a loss for others," according to the Chartered Institute of Management Accountants (CIMA).

Corporate fraud has a long and tumultuous history in India. For many years, ethics have been a murky topic in Indian businesses. Nearly 42% of organizations experience corporate fraud, resulting in a direct loss of \$1.5 million, according to a case study by the IBS Case Development Centre. It claims that the suppliers' kickback is the highest common type of fraud. To combat the evil of corporate fraud, businesses have implemented a number of procedures, such as employee registries, biometric identification, and background checks. In India, corporate fraud has increased dramatically over the last two years, and ironically, businesses view this as expected. A multinational consulting firm claims that this trend.

The "India Fraud Survey 2012," a biennial report from KPMG, is "dangerous" since it compels businesses to take a lenient stance toward fraud charges. "Compared to 45% in the 2010 edition of our survey, nearly 55% of respondents reported that their organizations had experienced fraud in the previous two years," the research stated. According to Ernest & Young (E&Y), in march 2012. The study report concluded, "Companies generally prefer to avoid reporting any economic offence to a regulator because of a perceived threat to their reputation."

"Fraud and Corporate Governance: Changing Paradigm in India," its first study on corporate fraud in India. The survey brought to light the immorality of Indian company executives and

⁴ **'Fraud' defined.**—'Fraud' means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent', with intent to deceive another party thereto or his agent, or to induce him to enter into the contract:—(1) the suggestion, as a fact, of that which is not true, by one who does not believe it to be true;(2)the active concealment of a fact by one having knowledge or belief of the fact;(3)a promise made without any intention of performing it;(4)any other act fitted to deceive;(5)any such act or omission as the law specially declares to be fraudulent

their readiness to cover things up. Merely 35% of those surveyed stated that their employers prosecute scammers.

Corporate fraud takes place when a company or organization intentionally alters or hides information to present a misleadingly positive picture of its health. A firm may engage in fraudulent activities by manipulating its accounting records, concealing debts, or neglecting to disclose loans and bonuses granted to its executives to its shareholders. The distortion of financial data, which includes incorrect accounting entries, fictitious trades aimed at inflating profits or masking losses, and fabricated transactions, enables the organization to secure funding from lenders and investors. There may be various reasons behind a company's decision to commit fraud, but the primary motive is often to generate profit and create a deceptive facade of financial stability in order to maintain its market reputation and mislead government agencies to evade substantial tax liabilities.

In its report, the Commission on 'Prevention of Corruption' in India⁵ noted, "the progress of technological and scientific advancements is leading to the formation of a mass society characterized by a large number of individuals and a small controlling elite, fostering the emergence of monopolies, the rise of a managerial class, and complex institutional frameworks. It is essential to maintain rigorous standards of ethical conduct for the fair and honest operation of the new social, political, and economic dynamics."

The findings of the Vivian Bose Commission of Inquiry regarding the Dalmia-Jain group of companies in 1963 emphasize how large industries engage in fraudulent activities, manipulate financial accounts, alter records for personal profit, and evade taxes. Similar remarks were made by Mr. Justice M C Chagla about the prominent businessman Mundra, who aimed to establish an industrial empire through questionable methods. Between 1958 and 1960, there were numerous legal actions taken against this business magnate and the companies he owned and controlled, with as many as 113 of those cases resulting in convictions.⁶

Types of Corporate Frauds in India

1. Financial Statement Fraud: Financial statement fraud is the deliberate falsification or alteration of financial data. The intention is to deceive regulators, loan officers, and investors.

⁵ Government of India, Report of the Commission on Prevention of Corruption (1964)

⁶ 4th Annual Report on the Working of Indian Companies Act, 1956 Government of India (1960)

This scam presents a business's financial status as better than it actually is. It can increase revenue, increase the value of assets, or decrease the value of obligations. It includes falsifying financial transaction.

2. Asset Misappropriation: Asset misappropriation is the theft of property from a business. It occurs when employees or supervisors utilize business resources for their own benefit. This can happen in a variety of ways, for as through kickbacks, payroll fraud, phony invoices, additional costs, or theft of inventory. Businesses can suffer from this type of behaviour, which damages their trust and reputation.

3. Bribery and corruption: Bribery and corruption refer to the abuse of authority for one's own gain. Typically, it entails requesting or accepting illegal payments. People can participate from all levels of a firm, including senior executives, employees, suppliers, and government representatives.

4. Insider Trading: Insider trading is the illicit purchase or sale of a firm's securities by individuals who possess confidential, significant information about the company. This is frequently done by employees, board members, or managers. They obtain an unfair advantage in the stock market by using confidential information.

5. False or Misleading Disclosures: Businesses that share inaccurate, incomplete, or deceptive information are said to be making false or misleading disclosures. It could entail falsified financial statements, dishonest advertising, or the omission of crucial information. Investment decisions are impacted by all of this.

6. Tax Evasion and Fraud: These crimes occur when businesses purposefully deceive tax systems in order to unlawfully lower their tax obligations. Falsely declaring a lesser income, overstating expenses, concealing funds or property abroad, or employing unfair tax strategies are some examples.

7. Cyber Fraud and Data Breaches: These crimes involve the unauthorized access or theft of critical information, such as financial records, confidential ideas, and customer data. Cyberattacks are the cause of it. For businesses, this fraud may result in lost revenue,

reputational damage, fines, and legal issues.⁷

REGULATORY STRUCTURE

In India, the framework of laws aimed at addressing corporate fraud and white-collar crime consists of multiple statutes, regulatory authorities and legal frameworks. Below are several essential components of the regulatory framework to tackle corporate deceit and white-collar offenses in India:

- **The Company's Act of 2013⁸** is a comprehensive regulation that regulates how businesses are run and managed in India. It contains clauses pertaining to financial reporting, auditing, and company governance. guidelines for preventing and identifying fraud in business. Provisions pertaining to corporate fraud are covered by the Companies Act, 2013 (the "Act"). Anyone found guilty of fraud faces a sentence of imprisonment for a minimum of six months but a maximum of ten years, according to Section 447 of the Companies Act, 2013.⁹ They also face a fine that cannot be less than the amount involved in the fraud but can be up to three times that amount. Section 149: Requires independent directors to be appointed to company boards in order to provide objective oversight and lower the possibility of fraud and insider manipulation. In order to ensure financial integrity and compliance with legal requirements, Section 177 mandates that businesses establish audit committees.
- **Prevent Money Laundering (PMLA)¹⁰**: The PMLA seeks to stop the financing of terrorism and money laundering. It mandates that financial institutions and other middlemen report suspicious transactions and maintain records. Additionally, it gives law enforcement the power to seize the money obtained through criminal activity.
- **Securities and Exchange Board of India (SEBI)¹¹**: The Indian securities and commodities markets are governed by SEBI. It has the authority to look into and punish

⁷ <https://www.geeksforgeeks.org/finance/corporate-fraud-meaning-top-10-cases-reasons-types/>

⁸ The Companies Act, 2013 is Act No. 18 of 2013,

⁹ fraud" in relation to affairs of a company or anybody corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss;

¹⁰ Act No. 15 of 2003. It came into force on July 1, 2005

¹¹ Securities and Exchange Board of India Act, 1992

insider trading and securities fraud. In order to encourage ethical and open business practices, SEBI also publishes rules and recommendations.

- **SEBI (Prohibition of Insider Trading) Regulations, 2015:** prohibits insider trading and requires businesses to swiftly disclose sensitive information in order to avoid manipulating the market.
- **SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015:** maintains high standards of accountability and transparency for listed firms by requiring timely and accurate disclosure of operational and financial data.
- **The Reserve Bank of India (RBI)**¹² oversees banks and other financial institutions as the country's central banking authority. Anti-money laundering (AML) and Know Your Customer (KYC) regulations must be followed.
- **Serious Fraud Investigation Office (SFIO)**¹³ The Ministry of General Affairs' Serious Fraud Investigation Office (SFIO) is a specialist organization tasked with looking into severe incidents of white-collar crime and corporate fraud. It has the authority to detain and bring charges against those engaged in fraudulent activity.
- **The Central Bureau of Investigation (CBI)** is India's top investigative organization that can handle cases involving economic crimes, corruption, and white-collar crimes that have a significant national impact.
- **Enforcement Department (ED):** The ED is in charge of upholding the rules set forth in the Prevention of Money Laundering Act (PMLA) and the Foreign Exchange Management Act (FEMA). It looks into anomalies in finances. with repercussions across borders.
- **Competition Commission of India (CCI)**¹⁴ Price fixing and the misuse of a dominating market position are examples of anti-competitive behaviour that is

¹² Act No. 2 of 1934

¹³ Section 211 of the Companies Act, 2013

¹⁴ According to the Preamble and Section 18 of the Act, the Commission is mandated by law to stop practices that negatively impact competition, encourage and maintain competition, safeguard consumer interests, and guarantee other participants' freedom of trade in Indian markets.

prevented by the Competition Commission of India (CCI), which upholds competition rules and regulations.

- **Whistleblowers¹⁵:** Whistleblower protection measures in the Corporations Act of 2013 enable people to expose wrongdoing and fraud without worrying about reprisals.
- **Securities Appellate Tribunal (SAT):** In matters involving violations of the securities market, the SAT is an appellate tribunal that considers appeals against judgments made by SEBI and other regulators.
- **Insolvency and Bankruptcy Code (IBC), 2016¹⁶:** The IBC has instituted a streamlined procedure to resolve cases of bankruptcy and insolvency in order to prevent fraudulent acts such as asset stripping during insolvency procedures. Additionally, this legislation prevents fraudulent transfers of corporate assets by holding firm promoters accountable.

CONCLUSION

Companies must implement transparent internal control systems that can stop, identify, and discourage dishonest activity by staff members, suppliers, consultants, or other management levels in order to lower their risk exposure.

In an attempt to prevent financial fraud in India, the phrase "internal financial controls" (IFC) was first used in the Companies Act of 2013. The Act requires businesses to put in place safeguards that guarantee the following:

- Respect for the company's rules; protection of its resources;
- Error and fraud detection and prevention;
- completeness and accuracy of the company's accounting records; and prompt production of trustworthy financial data.

The prevention of fraudulent actions within a corporation is the topic of several modifications

¹⁵ The Whistle Blowers Protection Act, 2014 (Act No. 17 of 2014)

¹⁶ Act No. 31 of 2016

to the Companies Act of 2013, which include specific criteria for anti-fraud procedures for enterprises of all sizes and types.

The directors and auditors chosen by the company are held more accountable under the Companies (Amendment) Act, 2017. Additionally, it imposes personal liability on directors and employees who are found to have engaged in fraudulent actions. If non-compliance occurs, the Act entails monetary fines and potentially imprisonment.¹⁷

Directors of companies bear the primary responsibility for the execution of a board's duty of care. Directors are legally required to fulfil their duties to their Board under the duty of care, but their dedication should be motivated by more than just following the law; it should also include a desire to improve the firm and a perceptive understanding of the politics of the sector. Directors should also take the time to reflect on their own behaviour and be receptive to criticism of their work. In the end, directors have a duty of care to their company, which means they are financially, morally, and legally accountable for it at all times. As a result, they should genuinely care for their organization.¹⁸

¹⁷ Rohini Singh “Internal Controls, Anti-Fraud Strategies for Companies in India” <https://www.india-briefing.com/news/internal-controls-anti-fraud-strategies-companies-india-17148.html/>

¹⁸ <https://www.boardpro.com/blog/preventing-fraud-the-boards-responsibility>