
CORPORATE FRAUD: ANALYSING PREVENTIVE MEASURES UNDER INDIAN LAW

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ABSTRACT

Corporate fraud not only impacts the financial stability but also effects various traders, investors, shareholders and puts a negative impact upon the corporate governance of India. The various negative impact of corporate fraud is the loss in the finances, losing the confidence of the investors, many of the employees may also loose moral, facing of legal consequences by the company and most importantly damage caused to the reputation of the company. Although, in India there are laws that govern for the same as The Companies Act 2013, Indian Penal Code 1860, Prevention of Money Laundering Act, 2002, SEBI Act 1992 etc. But then also there are rising cases of corporate fraud that not only effects the company but also to the economic market in the society. This paper analysis legal mechanism that are designed for the prevention of various corporate fraud. Further it highlights the cases that have emerged in the society and caused great impact upon the financial market. It explores the main legislative provisions, the function of investigative and regulatory institutions such as the Serious Fraud Investigation Office (SFIO), the Securities and Exchange Board of India (SEBI), and the Enforcement Directorate (ED), and the procedures that are followed in the prosecution of these cases. Through a combination of doctrinal legal analysis, case studies, and comparative insights from global practices, the study finds gaps in legal enforcement, lack of corporate accountability, and procedural inefficiencies that forbids timely justice. Further, the paper focuses upon the importance of corporate governance tools such as independent auditing, whistleblower protection, and internal compliance mechanisms in prevention of fraud at an organizational place. By examining both statutory and non-statutory safeguards, the research ultimately gives a set of reforms aimed at improving transparency, aiming at better compliance, and developing an ethical corporate culture that aligns with global framework.

Keywords: SEBI- Securities Exchange Board of India ED- Enforcement Directorate PMLA- Prevention of Money Laundering Act FDA- Foreign Development Authority BR- Bank Receipt

Introduction:

In this modern corporate world the corporate fraud was the biggest threat to the society, where most of the money laundering, financial statement fraud, insider trading, bribery and corruption take place. Corporate fraud also falls under illegal activities, it was committed by individuals or institutions within an organisation, and this type of fraud often takes place for the personal gain or to misrepresent the company's financial gain or loss. This type of fraud mostly causes consequences to the stakeholders, investors, and the company's reputation. This can make a loss of public trust in the company's reputation. The corporate fraud often caused due to lack of transparency, weak internal controls, poor governance, greed and unethical practices. To tackle corporate fraud, the Indian government came with the legal provisions including the companies Act, 2013, the Securities and Exchange Board of India (SEBI) Act, 1992, and the prevention of Money Laundering Act, 2002. The purpose of this law is to promote accountability and transparency in the corporate sector. In this article we are going to analyse the protective measures under Indian legal provisions to tackle corporate fraud.” n India, scams are integral part of corporate history. It can have devastating consequences for the organization, stakeholders and general public. Certain provisions relating to corporate frauds find its place in few of the Indian statutes. One of such statutes is Companies Act, 2013 which capsulate the concept of fraud and provisions for stringent punishment. Though we have mechanism in the form of enough legal and regulatory provisions, problem lies with the enforcement and implementation which is need of the hour. Thus , the present Article seeks to analyze and examine in depth

- i) the concept of corporate fraud as understood globally
- ii) various legislations incorporating punishment for corporate frauds in India
- iii) certain steps to minimize the occurrence of such frauds in future.

Objective of the Study

This research seeks to critically determine the measures for prevention against corporate fraud under Indian law. The main objectives involves: Inspecting the prevailing legal provisions and structures that focus to prevent such frauds.

- Examining the potency of these preventive mechanisms.

- Recognising gaps and challenges in the current system.
- Providing guidance for building up fraud prevention through legal and regulatory reforms.

Scope of the Research It involves statutory provisions, regulatory frameworks, and institutional mechanisms involved in fraud prevention. Additionally, relevant case studies are analysed to examine how preventive measures have been applied (or failed to apply) in real-world situations. A short comparative perspective with international best practices is also included to conclude meaningful insights for reform

Corporate frauds

The dimensions of financial fraud are many but the most significant among them which needs immediate attention whose consequences may be devastating are corporate frauds. Fraud occurring within an organization is particularly known as corporate fraud. It basically involves deliberate deception to the public, investors, stakeholders or to the financial Institutions resulting in financial gain to the fraudster. It has significant repercussions on the corporates or financial organizations. In corporate frauds, a group of corrupt individuals manipulate the business of a company in order to gain unfair advantage or benefits. It often bestows illegal or improper means. Today, Organizations of all kinds and spheres are victims to fraud in one way or the other. According to Survey on Financial and Corporate Frauds 2016³, it was revealed that the cases of financial frauds are on rise in India and as the economy is growing, increasing corporate frauds will prove to be disastrous for India. Some of the challenges prevalent in the current environment are technology, non-performance of fraud risk assessment, lack of segregation of duties and ethical behavior among the employees.

Nature and types of Corporate Fraud

The dynamic nature of corporate fraud, often including number of actors and sophisticated techniques to conceal wrongdoing. It may be internal, executed by employees or management, or external, including the vendors, customers, or third parties. Common intentions combine personal enrichment, pressure to get financial targets, or the desire to maintain a company's reputation in the society. There are several types of corporate fraud Financial Statement Fraud This type of fraud includes the changing of financial documents for creation of picture that would mislead company's financial situation. Techniques may involve exaggerating income,

expense minimizing, or concealing debts. Mainly, it's same as dressing up poor financials for good looking. Example: A brilliant case is the Satyam scandal, often dubbed "India's Enron," where the company's earning was overstated by the founder Ramalinga Raju.² Insider Trading Insider trading refers to when the insiders of the company use the information that is confidential, for buying and selling of the stocks, that give them unfair advantage . Example: In the Ranbaxy case, the executives of the company were found to have traded shares by using non-public knowledge about impending regulatory actions by the FDA.

Bribery and Corruption Bribery and corruption harm the ethical standards and fair acts in business and the government. Example: The deal of VVIP helicopter is a well established case including allegations of corrupt practices between an Italian defence company and Indian officials. Embezzlement Embezzlement is the theft or misappropriation of funds endowed to someone, often an employee or official. It's a serious violation of trust that can result in major financial losses.

Example: The Harshad Mehta scandal case is a prime example, where funds from banks were illegally changed by manipulating stock prices.⁴ Tax Evasion Tax evasion refers to the unlawful act of evasion taxes by underreporting income, overstating deductions, or using offshore accounts to hide money. Example: The leak of Panama Papers exposed how many Indian individuals and entities used foreign tax havens to avoid paying taxes.⁵

Categories of corporate frauds

Asset misappropriation: It is a theft or misuse of organization's cash or assets belonging to a company. It can be done by directors, employees or persons who are entrusted with the company's assets. Asset misappropriation schemes include those frauds in which perpetrator employ tricks to steal or misuse organization's assets. Assets stolen can be in the form of cash, credit note or vouchers. Modus operandi for such frauds is fictitious sales, false inventory, falsifying asset requisition and transfer.

Bribery and corruption: Bribery and corruption are serious economic crime as it affects company's economic development. Bribery involves offering, giving or receiving anything that influences an official act. Corruption is much wider concept which includes bribery, illicit gratification and economic extortion. Employees improperly use their power in business transactions to gain some advantage for themselves or another person. It is reflected in latest

cases that CEO and managing directors are found directly involved in bribery to get projects and approval beyond their capabilities with the help of companies board. **Financial fraud statements:** It usually involves misrepresentation of financial statements of the company. It can be most damaging to the company. This type of frauds take the form of manipulating accounts, Overstating revenue assets and investments ,understating liabilities and non-disclosure of certain vital information. Enron, WorldCom and Satyam are recent, high profile cases involving financial statement fraud.

Corporate espionage: The term ‘corporate espionage’ has become synonymous with industrial espionage. With the increase in competition in business ventures, corporates started resorting to innovative methods to obtain information about other companies or competitors. Officials steal the trade secrets by removing or copying confidential or valuable information of a competitor for its company’s benefit. Corporates gets benefited financially through this kind of frauds. **Investment trends:** Investment scams leads to financial loss to the investors and even loss of their lives. Loopholes in the investment system give way to the perpetrator to procure proceeds from the scam. Bogus companies are formed just to manipulate and hide the bogus transactions. Harshad Mehta, Ketan Parekh and Sahara Group scams are few names which the Stock market in India will always remember with grief. **Insider trading:** Insider trading is defined as a trading in company’s stocks or securities by persons who are predicted to gain access to the subtle information in respect to such securities. Taking advantage of such information is prohibited under the respective securities laws of different countries. The Rajat Gupta Case is one of the biggest scandals in history of US for the offence of insider trading.

Concept of corporate frauds in India

India has become a corporate hub in past decades. Corporate frauds have become a threat to the society and financial Industry specifically as financial loss by these kinds of frauds are much greater than loss from robberies, theft, swindling etc. The society cannot survive with them but cannot even live even without them In India, organizations irrespective of their gamut and orbit are subject to fraud. It causes enormous consequences to the organization, stakeholders and general public. Our country being a silent spectator of several corporate frauds, few of them being the Harshad Mehta scam of 1992, Satyam scandal in 2009, Saradha Chit Fund scam and Sahara Fraud Case. These infamous scandals have adversely affected the development of the economic sector of our country

Regulations pertaining to corporate frauds

There are certain sweeping regulations which have helped in preventing and detecting frauds which earlier went undetected. Certain provisions relating to corporate frauds find its room in few of the Indian Statutes. One of such statutes for preventing and curbing corporate frauds is the Companies Act 2013. It consists of both civil as well as criminal liability for the perpetrator. Regulators serve two primary functions in a nation: they implement laws and they enforce it. Regulators for corporate frauds as per the Companies Act are Serious Fraud Investigation Office (SFIO) and National Company Law Tribunal (NCLT).

Serious Fraud Investigation Office: It is a multifunctional investigative agency consisting of experts for timely and effective detection of frauds. It investigate into affairs or cases of company involving financial frauds as may be assigned to it from time to time by the Central Government. It also has the power to arrest in cases where a person is believed to be guilty of offence under the Companies Act.

National Company Law Tribunal: It is a quasi-judicial authority created to handle corporate disputes arising under the Act. It is vested with powers to provide relief for class action suits, oppression and mismanagement, refusal to transfer shares, assessing against delinquent directors, demerger or winding up and punishment for fraudulent conduct of business. Its orders can remedy a situation, correct a wrong or levy penalties/costs. The Tribunal is not bound by the strict rules relating to procedure. It can decide cases by following the principles of natural justice.

Certain provisions which are significant for dealing with securities frauds are provided below:

Sec.12A: prohibits manipulative and deceptive devices, insider trading and substantial acquisition of securities against the regulations of SEBI.

Sec.15: SEBI provide for penalties in cases of insider trading, nondisclosure of shares, failure to refund moneys to investors and also for fraudulent and unfair trade practices.

Infamous corporate scams in India

In the last few years, scams involving corporate fraud have made headlines in the papers globally. There were high profile cases from Enron to Satyam which have been widely analyzed

and discussed by the professionals and experts. A search for the term 'corporate fraud' in Google, generated more than a 10 million entries, which proves towards the popularity of this issue. On the global piece, India also went through an upheaval, the reason being corporate frauds. Some of the infamous cases are discussed below

Harshad Mehta scam: In April 1992, the Indian Stock market crashed and Harshad Mehta who was considered as architect for Bull Run was blamed for the crash. It grabbed headlines for the notorious BSE security scam when veteran columnist Sucheta Dalal wrote an article in India's national daily The Times of India. He manipulated Indian banking system to siphon off the funds from the banking system and used liquidity to build large positions in selected group of stocks. He diverted funds to the tune of Rs. 4000 crore from the banks to stock brokers. He was later charged with multiple criminal offences.

Satyam scam: Ramalinga Raju was held guilty by trial court which sentenced him to seven years rigorous imprisonment with fine of Rs. 5 crores. The nation all over was shocked and scandalized with the scam. It is also known as India's Enron. It was probably the biggest corporate scam from one of the largest IT Companies in India i.e., Satyam Computer Services Limited (M/s SCSL). The scam triggered the loss to investors to the tune of Rs. 8000 crore. Ramalinga Raju confessed in his letter that he cooked books of accounts of the company and admitted that the accounting entries were wrongly inflated. He overstated the income nearly every quarter over the course of several years in order to meet investor's expectations. Weak independent directors and negligence of auditors also contributed to the scam.

Saradha Group Chit Fund scam: The Ponzi Scheme was started by Saradha Group in collected money from investors by issuing redeemable bonds and secured debentures and promising incredulously high profits from reasonable investments. Local agents were hired throughout the State of West Bengal and given huge cash payouts from investor deposits to expand quickly, eventually forming a conglomerate of more than 200 companies. To keep ahead of regulatory bodies, the group used a nexus of companies to launder money. 15 In April 2013, the group collapsed causing estimate loss of approximately 200 to 300 billion to millions of depositors and agents. SEBI barred Saradha Group and its Managing Director Sudipto Sen from securities market till the company winds up such schemes and refund the amount to investors.

The Impact of Corporate Fraud on Stakeholders:

The stakeholders are the most affected person by the corporate fraud; they have the immediate financial losses when the corporate fraud gets exposed. The shareholders or investors are first persons to get visibly affected by corporate fraud like decrease in share value. This affects every shareholder from individual investors to institutional investors. Most of the investors invest in the company based on the trust of the financial statements provided by the company; this corporate fraud makes investors stay away from the company. Due to the financial losses, legal fees and regulatory fines to the company, they start to cut dividends. In the Ranbaxy case, shareholders saw the company's reputation and value severely damaged, leading to its eventual sale at a discounted price. The \$500 million fine directly reduced the company's assets, impacting its valuation.⁶ Employees are the person who gets emotionally attacked by the corporate fraud among the stakeholders, due to the financial losses by the corporate fraud company start to cut costs by mass layoffs and reduce in their salary, the employees mostly feels betrayed and demoralized. The customers of the company get affected by the degradation in product quality and loss of trust. The creditors, lenders and banks increased default risk and credit downgrades. The suppliers and business partners have to face unpaid invoices, loss of business and reputational damages from the public.

Corporate Governance and Fraud Prevention:

Every company has their corporate governance to prevent corporate fraud, every company should have an independent, skilled and active board is important. A majority of the board of directors should be independent where they can provide oversight of the company without arising conflicts. The audit committee plays a crucial role in preventing financial fraud in a company, they can oversee the financial reporting statements, analysing the financial statements. Financial statements and audit reports - Ensures accountability of financial reporting .The company should have the effective internal controls by introducing specific policies and procedures to achieve objectives and prevent corporate fraud, there should be a segregation of duties no single individual should have the overall control of the company. All the activities should require a proper Authorization from the manager. Nomination and Remuneration Committee - Regulates board appointments and remuneration. The company must regularly conduct assessments to identify the place where there's a more possibility that fraud takes place. All the individuals should accurately and timely disclose all the information

to build trust by transparency like financial reporting, Related party transactions.

Money laundering and corporate fraud: Money laundering and corporate fraud interconnected where the political parties, politicians, influential persons and organizations made the black money into legal money by money laundering. The Supreme Court, while denying bail, emphasized the serious nature of economic offences and the high bar set by the "twin conditions" of Section 45 of the PMLA. The court underscored that allegations of money laundering have a debilitating effect on the national economy. 9 To prevent money laundering the Indian government introduced the Prevention of Money Laundering Act, 2002(PMLA) and the Companies Act, 2013.

Laws related to money laundering and corporate fraud: The Prevention of Money Laundering Act, 2002 (PMLA):Offence of Money-Laundering: · The core substantive offense. It covers anyone who is directly or indirectly involved in any process or activity connected with the "proceeds of crime," including its concealment, possession, acquisition, use, or projecting it as untainted property.10 Punishment for Money-Laundering: · Prescribes rigorous imprisonment for a term not less than three years, which may extend to seven years (and up to 10 years for offences under the NDPS Act), along with a fine.11 Offences to be cognizable and Non-Bailable: · Makes the offence cognizable and non-bailable. It sets the stringent "twin conditions" for bail: the Public Prosecutor must be heard, and the court must be satisfied that the accused is prima facie not guilty and is not likely to commit any offence while on bail

Best practices for Corporate Fraud Prevention:

Fraud prevention is not only a single policy to prevent corporate fraud, it should be multi-layered practice and system of controls to detect and prevent fraudulent activities. It is so cost effective to prevent fraud rather than deal with the future consequences. The precious way to prevent fraudulent activities is to avoid the toxic culture and have transparency in all levels of the company. There should be a clear of conduct and have high ethical standards. Four standard ways to prevent fraudulent activities:

1) **Oversight and strong governance:** The board of directors and audit committees with independent directors should have the overlook in internal and external audit functions, review the effectiveness of internal financial controls, there should be a dedicated internal audit with fraud awareness training.

2) **Preventive internal controls:** There should have a introduction of specific policies to prevent corporate fraud like segregation of duties , no single individual should have all the controls of the company , every employees in the company should get Authorization and approval from manager.

3) Proactive detection and monitoring: prevention only can't stop the fraudulent activities, every company should have whistleblower they must be confidential, their reports must be investigated and submitted to the higher officials.

4) **Investigation and response:** The detection of the fraudulent activities only can't stop the fraud, the report must be investigated and the action should be taken seriously.

Conclusion

Corporate frauds are rising globally and in India as well. Fraudsters see financial institutions as a series of process that they need to overcome, but once speared, the rewards can be magnanimous. Fraudulent acts have become a gigantic devil that has petrified the system and the society as a whole. In escalating rate, we are today watching that persons, who are endowed with the significant task of managing businesses, manage for their own interest. Corporate fraud has become an debatable moot point for the academicians who study it, investigators and experts who explore it, and intellects debate it. Thus the society is focusing more towards handling the aftermaths of frauds than preventing it. With the mirror view image of the growing fraud, there is an urgent need to take strict and focused steps is felt. Though a crime free society is idealistic, we should put consistent efforts to keep them at the lowest. Law makers and regulators have to go an extra mile ahead of fraudsters to keep them at bay. Though we have variety of legislations relating to corporate frauds as mentioned earlier which can be looked into as a source to investigate fraud related cases, we can rather take strategic steps such as: Providing more powers to the investigators and regulators especially SEBI, True adoption of international financial reporting standards ,Enforcement agencies should focus more on identification and prevention of such frauds which is a chief concern, Punishment of the culprit and delinquent persons of the corporates can minimize fraud to a greater extent, More emphasis should be laid on enforcement of new regulatory paradigm, Close liaison should be maintained between regulators such as SEBI, CBI, ED and SFIO and Whistle blower policy is one of the best ways in safeguarding against corporate frauds.