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Corporate fraud: A legal approach

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Abstract
As long as human exists the fraud exists. We Indians are always interested in making money in any way (ethical or unethical) without looking deep into the technicalities and difficulties in the future. The most common white-collar crime that are committed by persons in the most respectable position in the private or public concern. In today's world, Corporate fraud has become a global phenomenon that needs an immediate stop. These frauds are mostly committed by the sophisticated and so-called high-profile people in the society wherein which leads to large financial losses. The main reason for the increase in corporate fraud is due to the immense development in the economic growth of the country. Thus, when Corporate fraud happens, the Indian economy is ditched. In this article, the author brings to light, the legal approach of corporate fraud, its legal mechanism and the author's insight to prevent the corporate fraud.

Keywords: corporate fraud, financial loss, scam, corporate liability

Introduction

Corporate fraud

CORPORATE FRAUD REFERS TO THE ILLEGAL ACTIVITY DONE BY ANY INDIVIDUAL OR COMPANY IN A DISHONEST OR AN UNETHICAL MANNER. This is a kind of business fraud that gives an advantage to the perpetrating individual or the company.

In other words, corporate fraud can be defined as the intentional misrepresentation of financial information or any activity of a company in order to increase the profit of the company and mislead the public. Corporate fraud is so complex and confidential and if the frauds are found it involves more economic scandal and immense financial losses to the whole nation.

Legal mechanism

The Indian legal system is one of the oldest systems in the world which give recognition to all statutes. The supreme law of India, the constitutional law in its preamble states that *'all its citizens must secure social, economic or political justice'*. The constitution also states that for the proper governance of the country DPSP has to be implemented. The constitution itself imposes the duty to all the citizens to ensure proper economic justice and also imposes restrictions in involving illegal scandals.

After every fraud in the country, certain laws are strengthened to prevent the repetition of the same and impose certain responsibilities on each party to prohibit fraud.

The major enactment which hints the prevention and regulation of corporate fraud are

- The company's Act, 2013
- The Reserve Bank Act, 1934
- The Securities and Exchange Board of India Act, 1992
- Corporate Governance Code read with Clause 49
- The Indian Contract Act,1872
- The Money Laundering Act,2002
- The Competition Act, 2002
- The Information Technology Act, 2000
- The Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1937
- The Indian Penal code, 1860
- The Benami Transaction (Prohibition) Act, 1985

Recent Legislations

In recent years India has passed four legislations pertaining to control the corporate fraud. The anti-fraud regulations are

- Insolvency and Bankruptcy Code
- Personal Data Protection Bill, 2018
- Prevention of Corruption (Amendment) Act, 2018
- Fugitive Economic Offenders Bill, 2018

About 56% of people feel effective about the passing of the Insolvency and Bankruptcy Code. Also, the effectiveness of the Personal Data Protection Bill,2018, and the Prevention of Corruption (Amendment) Act,2018 account to 58%. The positive response to the Fugitive Economic Offenders Bill,2018 accounts for 54%.

On the whole, anti-fraud regulations account for over 47% of the successful curbing of frauds and misconduct.

These anti-fraud regulations mainly aim in preventing corporate fraud, when considering in particular the Insolvency and Bankruptcy Code is now improving the insolvency regulation and prohibits parties from submitting a resolution plan wherein these efforts will help better to manage fraud risk. The prevention of Corruption (Amendment) Act, 2018 is comprehensive legislation that targets bribe givers and curbs fraud at the first step itself. This act also consists of numerous penal provisions which penalize the organisation and associated third parties involved in corruption. While the Fugitive Economic Offenders Bill,2018 specifically aims in the individual involved in fraud to flee from the country to abroad as he wants to escape from criminal prosecutions. The Personal Data Protection Bill, 2018 covers the diverse aspect of data protection by safeguarding the personal information of the organization and giving the power to allow and deny the use of personal information.

Corporate fraud under companies act, 2013

Section 447 of the Companies Act,2013 defines fraud relating to a company or corporate body. Section 447 reads as,

"Without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud 1[involving an amount of at least ten lakh rupees or one per cent. of the turnover of the company, whichever is lower], shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud:

Provided that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

1[Provided further that where the fraud involves an amount less than ten lakh rupees or one per cent. of the turnover of the company, whichever is lower, and does not involve public interest, any person guilty of such fraud shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to 2[fifty lakh rupees] or with both.]

Explanation.—For the purposes of this section—

1. “fraud” in relation to affairs of a company or any body 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;
2. “wrongful gain” means the gain by unlawful means of property to which the person gaining is not legally entitled;
3. “wrongful loss” means the loss by unlawful means of property to which the person losing is legally entitled.

Corporate liability

Under section 447 of the act, any person who is guilty of fraud is publishable for imprisonment for not less than 6 months to 10 years. The punishment may also include a fine which is not less than the amount involved in fraud and that may extend to thrice of the fraud amount. In particular, the fraud which has a public interest is penalized with a minimum of three years of imprisonment.

Also, section 211 authorizes the CG to establish the SFIO (Serious Fraud Investigation Office) to investigate the company fraud and when the investigation is done by SFIO any other agencies have no power to proceed with other investigation.

A way to stop

Despite many legal statutes the fraud continues to happen. This is because of the illiteracy among the investors and complexities in the understanding. Corporate fraud can be curbed firstly by implementing the existing laws in the country.

The other ways to mitigate fraud are by adopting the technology. For say, by using the artificial intelligence, block chain, Radio Frequency Identification (RFID). These technologies operate in a way where it is challenging to commit fraud. By adopting AI in the corporate world it is possible to gather information on the suspicious transaction. In addition to this, AI can be used by large credit card companies wherein it uses AI technology to detect fraud and lessen financial losses. By positively making use of new technologies we can downsize corporate fraud.

The Association of certified Fraud examiners has estimated

that most of the losses are happening due to the employee theft which then amounts to a huge fraud. The corporate fraud by these employees can be controlled by keenly observing the activities of the employees. When their behavior and actions are keenly observed any variation in their actions will be a hint to find their intent to commit fraud which can be restrained to some extent.

Creating and using a reporting system can be done to ease fraud. At each and every step, the process of their work has to be reported whereby for a potential worker, it is tentative to commit an act of fraud as he would fear for reputation. At the same time, this reporting system will serve as an encouragement for a potential employee to speak up and catch fraud that comes to their knowledge.

Despite every step taken to control corporate fraud, the COSO model will be a relevant remedy in controlling fraud. The COSO framework was developed in 1992 which deals with internal control. According to the COSO, internal control focuses on the objectives in the operation, reporting, and compliance.

Landmark case laws pertaining to corporate frauds

The Mundhra Scam

In the history of independent India, the first corporate fraud that came to light was Mundhra Scam.

This was a case of industrialist Haridas Mundhra where he invested 1.24 Crore from the shares of his six companies in LIC which is a government-owned company. It was said that such investment was done due to the pressure of the Government and without consulting the investment committee of the LIC. Due to this, there was a hefty loss of money. This irregularity in the market was highlighted in 1958 by Feroze Gandhi who was a member of parliament from the Indian National Congress. He further demanded an explanation from LIC and the industrialist. This matter was then raised in the parliament by Feroze Gandhi. He then charged Finance Secretary, and Finance Minister for pressure to invest in the LIC. Then a committee was appointed which was led by Chief Justice M.C. Chagla. This is one of the most remarkable investigations made in history wherein Shri M.C.Chagla submitted the report in just 24 days. Finally, Mundra was arrested and imprisoned for a span of 22 years.

2G Spectrum Case

One case that everyone must have heard is this 2G Spectrum case. In this case, P.Raja, then the communication and IT minister allotted 122 licenses of 2G spectrum in the year 2008. He sold these licenses at a very low price and did not follow any rules and regulations that had to be followed. Also, these licenses favored some telecom companies and it caused Rs.1.76 lakh crore loss to the government. After all this, the Supreme Court in the month of February, 2012 canceled all the 122 licenses that were allotted.

Sathyam Scam

The Sathyam scandal is a unusual scam that took place in the year 1928. These Satyam computers were started in 1987 by B Rama Raju and Ramalingam Raju wearing in 2009 became the second largest internet service provider in India and the fourth-largest outsourcing firm in the country after TATA, INFY, and WIPRO. In 2009, Satyam computers were accused of fraud inflating its earnings and assets. The chairman Raju overstated the revenue by 76% and profit by 97%. He confessed that he overstated false revenue and profit for more years. Finally, this time the falsified amount was very high that he was not able to hide it any longer. At last, Satyam was banned from World Bank contracts and due to this the Indian stock market dropped adversely. In 2008, the Sathyam was valued at Rs. 36,000 crore at its highest market capitalization, but a year later Tech Mahindra bought this Sathyam for just Rs. 5,600 crores. This scam is a scam that also involved auditors in it and charged the company auditors (pws) and these auditors were found guilty of professional misconduct by ICAI,2009.

Conclusion

Corporate fraud can be considerably controlled by newer legislation and the gaps in the corporate sectors can be filled by enforcing laws. The reason for the gap in the corporate sector is because of the time lag between the occurrence of fraud and the information reaching the public. When any information about fraud reaches society before its completion, then can be immediately prevented from severe financial loss. Also, some of the laws which are old and outdated need an amendment according to the changes in the society. The author's insight to curb corporate fraud is to have periodic audits and any tiniest distinction in the audits has to be immediately examined. These steps can bring a positive anticipating difference in the corporate fraud.

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