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Corporate Fraud in Legal Framework

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ABSTRACT

Corporate governance refers to the system of rules, practices, and processes by which a company is directed and controlled. It involves balancing the interests of a company's many stakeholders, such as shareholders, management, customers, suppliers, financiers, government, and the community. A proper corporate governance is very much relevant for a proper functioning of an enterprise. This article emphasises the basic principles of corporate governance and the transparency that it requires for the expansion and success of firms. But the fraud which occurs in the corporate governance poses a huge constraint to the firms. This is popularly referred to as corporate fraud. When illegal activities are done by the people it creates or poses a huge impending effects upon the firms therefore, the article has highlighted the importance or relevance of preventing corporate fraud. The common effects that corporate fraud generally creates are financial instability of the firms which would eventually lead to the bankruptcy of the firms. Therefore it is high time to completely curb off this issue from the society as the stake or interests of the firms are in trouble. This question of fact and related legal aspects of the same with the help of some case studies have been discussed in this article. Eventually, the relevance of swiping off the hindrances caused by corporate fraud is to be discussed to a great extent and a major chunk of the same has been discussed in this article.

***Keywords**: Corporate Fraud, Corporate Governance, Case.*

I. INTRODUCTION

Corporate governance has become increasingly important in today's world due to the evolving business landscape, heightened regulatory scrutiny, and growing expectations from stakeholders. Corporate governance refers to the system of rules, practices, and processes by which a company is directed and controlled. It involves balancing the interests of a company's many stakeholders, such as shareholders, management, customers, suppliers, financiers, government, and the community. Corporate governance makes sure that the firms have adequate decision-making procedures and controls to balance the interests of all stakeholders that include the shareholders, employees, suppliers, consumers, and community. Corporate governance includes the methods that can be used to achieve the company's objectives. They

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are established and pursued in the context of its social, regulatory, and market environment. It is majorly concerned and considered with the strategies and procedures for ensuring that a company is going on in such a way that its aims are met at the same time also ensuring that stakeholders have confidence in the company. The major principles of Corporate Governance are accountability, fairness, transparency, independence and social responsibility. These principles together contribute a good governance. A good cooperate governance ensures an improved decision- making processes and strategic direction, a better identification and management of risks can be achieved, an increased trust from investors, potentially leading to a higher share price and easier access to capital can also be achieved. Eventually, a good governance framework will enable the firm to enhance company's reputation and brand value. At times the biggest constraints the firm faces will be the fraud in corporate governance. It is popularly known as the 'Corporate fraud'. Corporate fraud is the use of or let's say it is something in which dishonest or illegal activities are done by the people with an intention to inflate accounts and assets of a company. Normally, these operations carried out by individuals have the potential to ruin the financial stability of a firm and eventually lead to its bankruptcy or debt. The most typical types are theft of cash, assets, or other confidential information, account misuse, and financial accounting errors. The main motivation of committing such a crime is to gain benefit for oneself or to gain an advantage over another.

II. CASE STUDIES

When one commits corporate fraud, it has either a direct or indirect impact on the company. It has got a great potential to cause impending effects in the financial markets which may even amount to unemployment crisis in the society. For this strict regulations are required. But before discussing them, let's take a look into some of the famous corporate frauds that took place in India.

Firstly, it is the **Harshad Mehta case**. It was the first Corporate Fraud case reported in India in the year 1992. The CBI arrested Mehta and his brothers on November 9, 1992, for allegedly misappropriating more than 2.8 million shares of about 90 companies using fraudulent share transfer documents. The misuse of shares totalled ₹250 crore (equivalent to ₹19 billion or US$230 million in 2023).[2] This was considered as the major reason for the enactment of SEBI Act, 1992.

[2] HARSHAD MEHTA –THE GUARDIAN : https://www.theguardian.com/news/2002/jan/15/guardianobituaries1 [last visited6/6/2024]

Then secondly we have **Ketan Prekh Scam** in the year 2001 where he cheated along with the banks by misrepresenting facts, falsifying accounts, ripping off the stock market prices and exploiting investors' decisions, mishandling public money, bribing company directors to enable him to do insider trading.

Then we have the famous **Satyam Scandal in the year 2009**, in which the founder and chairman of Satyam Computer Services, Ramalinga Raju, confessed to manipulating the company's accounts and inflated the profits for years. The scam was estimated to be worth around Rs. 14,000 crore [3]and it completely shook the confidence and trust that investors, shareholders, and stakeholders had in the Indian corporate sector.

In the year 2010, **the Commonwealth Games Scam** took place in which, the Commonwealth Games were hampered by fraud and poor management, and it completely damaged India's image and represented India as a country plagued by widespread fraud and abuse. It is considered as one of the largest frauds in Indian history involving the rounding off of Rs. 70,000 crores[4].

The **Nirav Modi's Punjab National Bank scam** is also one among the many controversial issues. In the year 2015, Nirav Modi received his first fake guarantee from PNB on March 10, 2011, and was able to obtain 1,212 more such guarantees over the next 74 months. The Enforcement Directorate (ED) seized bank token devices from international sham firms used by a fugitive diamond trader to transfer illegal cash. In the case the PNB employees misused the SWIFT network to transmit messages. PNB lodged a FIR with CBI stating that fraudulent LOU's worth Rs. 2.8 billion [280.7crore]. [5]Finally in the year 2020, the Yes Bank crisis also took place in which, its founder Rana Kapoor was the culprit of financial mismanagement which led to bank's financial instability. That's major impact after the case was a restructure or reformation in the banking operations.

Kingfisher Airlines Scam . The Vijay Mallya escaped to the UK in March 2016, is sought in India for defaulting on a Rs 9,000 crore loan to Kingfisher Airlines from multiple banks. In order to operate his aircraft company. Vijay Mallya continued to borrow funds via banks to fund aircraft. He obtained 9000 cores from 17 banks, and despite SBI reporting him penniless, several banks proceeded to grant him credit. Company was forced into bankruptcy after failing to pay wages to its employees. Kingfisher had to cease its services in 2012 due to lack of

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[3] Satyam Scandal-Discover what really happened / https://www.linkedin.com/pulse/satyam-scam-discover-what-exactly-happened-case-manshu-garg/ [last visited: 6/6/24]

[4] Commonwealth Scams [CWG]: Political Games/ https://insider.finology.in/juicy-scams/commonwealth-games-scam#:~:text=In%202010%2C%20India%20was%20voted,the%20country%20in%20every%20aspect. /[last visited:6/6/2024]

[5] PNB Scam Source: https://www.business-standard.com/about/what-is-pnb-scam /[last visited-6/6/24]

funding to continue services. In addition, Vijay Mallya stopped repaying his debts. Government charged him with fraud and money laundering.

III. Legislation

In India, Corporate Fraud has been mentioned in many legislations. They are Indian Penal Code [IPC], Companies Act 2013, Securities and Exchange Board of India SEBI Act 1992, Prevention of Corruption Act, 1988, Prevention of Money Laundering Act 2002. Let's take a look into legislations and its provisions in depth.

Sec 405 of Indian Penal Code has stated that, *"Whoever commits criminal breach of trust shall be punished with imprisonment of either description for a term which may extend to three years, or with fine, or with both."*

Sec. 406 has prescribed the punishment for Criminal Breach of Trust.

Sec. 415 has explained about cheating. It states that *"Whoever, by deceiving any person, fraudulently or dishonestly induces the person so deceived to deliver any property to any person, or to consent that any person shall retain any property, or intentionally induces the person so deceived to do or omit to do anything which he would not do or omit if he were not so deceived, and which act or omission causes or is likely to cause damage or harm to that person in body, mind, reputation or property, is said to 'cheat' "*.

At the same time Sec. 420 states the punishment for cheating.

Companies Act of 2013, Sec.447 has stated the punishment for fraud for the individuals in the corporate sector including Directors and officers. Imprisonment and fines are the punishment that have been mentioned in it particularly.

Sec.448 of the Companies Act, 2013 aims to deter individuals from making or circulating false statements, reports, or accounts in connection with a company, thereby ensuring transparency and integrity in financial reporting and dealings.

Sec. 449 [false evidence] mentions the punishment for providing false evidence.

Securities and Exchange Board of India Act, 1992 in Sec.24 prescribes offenses relating to securities fraud.

Then comes, the Prevention of Money Laundering Act, 2002, Sec. 3 states that, *Whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money laundering*.

Basically money laundering is an illegal activity of creating money through criminal activities and Sec.4 of the Prevention of Money Laundering Act, 2002 also states the punishment for money laundering.

Therefore we can state that to extent the above mentioned comprehensive legislations could prosecute corporate fraud in India.

To summarize, corporate fraud is a major issue in the business world, impacting businesses of all sizes and industries. Such fraudulent operations have far-reaching consequences, not only causing financial losses but also eroding shareholder trust, hurting reputations, and threatening general economic stability. Corporations must develop strong internal controls, foster an ethical culture, and maintain vigilance via ongoing monitoring and auditing methods. Furthermore, regulatory organizations must impose strict restrictions and punishments to discourage fraudulent activity. Businesses that prioritize openness, accountability, and honesty may protect their interests while also contributing to a healthy economic climate. Finally, the battle against corporate fraud is a communal endeavour that involves dedication and cooperation from all levels of a business.

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