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Introduction

Welcome to the Indian Journal of Legal Affairs and Research (IJLAR), a distinguished platform dedicated to the dissemination of comprehensive legal scholarship and academic research. Our mission is to foster an environment where legal professionals, academics, and students can collaborate and contribute to the evolving discourse in the field of law. We strive to publish high-quality, peer-reviewed articles that provide insightful analysis, innovative perspectives, and practical solutions to contemporary legal challenges. The IJAR is committed to advancing legal knowledge and practice by bridging the gap between theory and practice.

Preface

The Indian Journal of Legal Affairs and Research is a testament to our unwavering commitment to excellence in legal scholarship. This volume presents a curated selection of articles that reflect the diverse and dynamic nature of legal studies today. Our contributors, ranging from esteemed legal scholars to emerging academics, bring forward a rich tapestry of insights that address critical legal issues and offer novel contributions to the field. We are grateful to our editorial board, reviewers, and authors for their dedication and hard work, which have made this publication possible. It is our hope that this journal will serve as a valuable resource for researchers, practitioners, and policymakers, and will inspire further inquiry and debate within the legal community.

Description

The Indian Journal of Legal Affairs and Research is an academic journal that publishes peer-reviewed articles on a wide range of legal topics. Each issue is designed to provide a platform for legal scholars, practitioners, and students to share their research findings, theoretical explorations, and practical insights. Our journal covers various branches of law, including but not limited to constitutional law, international law, criminal law, commercial law, human rights, and environmental law. We are dedicated to ensuring that the articles published in our journal adhere to the highest standards of academic rigor and contribute meaningfully to the understanding and development of legal theories and practices.

CORPORATE FRAUD AND REGULATORY MECHANISMS IN INDIA

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ABSTRACT

One of the biggest challenges of corporate governance and financial stability in the world has become corporate fraud. The corporate world in India is booming, and there is a rise in the integration with the global markets, which has increased the risks of fraudulent corporate practices. Scandals like the Satyam Computer Services fraud, the Punjab National Bank Nirav Modi, as well as collapse of infrastructure leasing and financial services (IL&FS) have highlighted the presence of some critical weaknesses in the regulatory and compliance environment of India. Such events not only resulted in huge losses of money but also shook the investor confidence and created concern about the efficiency of the current regulatory supervision.

This article is a critical review of the legal and institutional provisions that would help in fighting corporate fraud in India. The research is rather doctrinal, as it includes the analysis of statutory clauses, regulatory frameworks, and judicial cases, which are complemented with a case study methodology dedicated to the key cases of corporate fraud. The research aims at determining whether or not the existing regulatory environment, the Companies Act, and the securities laws and regulators are sufficiently sufficient to deter and control corporate fraud.

The article states that although India has a rather broad legal framework to control corporate misconduct, there are still large gaps in enforcing this, coordinating regulation, and in corporate governance practices. Slow implementation of the investigation process, diminished responsibility among key stakeholders, institutional inefficiency remains a weak element in the overall effectiveness of anti-frauds. The paper ends with a call to improve the enforcement practices,

enhance coordination of the regulations and structural adjustments in order to introduce much transparency and responsibility in the Indian corporate world.

INTRODUCTION

The issue of corporate fraud has become more of a serious question to the integrity and stability of the contemporary financial system. Corporate fraud in its broadest meaning is defined as illegal or unethical actions by an individual or an organization in a corporate framework with the motive of acquiring financial and personal benefit. It is usually associated with intentional misstatement, withholding of information or financial record manipulation to defraud investors, regulators and other stakeholders. Corporate fraud can be of different forms such as financial statement frauds, accounting frauds, insider trading, embezzlement, Ponzi scheme, bribery and the misuse of the shell companies to carry out illicit financial transactions¹ and thus, corporate fraud in addition to disrupting market operations, corrupts the spirit of transparency and accountability that are the pillars of corporate governance.

In India, corporate fraud has become an issue of concern because of the extensive economic and institutional impacts. The massive financial losses to investors, financial institutions as well as the economy overall have been brought about by large-scale corporate scandals. The notorious Satyam Computer Services scandal of 2009, commonly referred to as the “India so-called Enron, revealed financial statement manipulations by the company managers and brought into serious doubt the efficiency of the corporate disclosures and supervision procedures, along with the stability of the banking industry and its regulatory bodies.²

The rising rate of corporate fraud in India should be interpreted also with reference to the economic change of the nation after the economic liberalization changes in 1991.³ Liberalization exposed the Indian economy to international investment, welcome the involvement of the private sector and provide a vast number of possibilities to the white-collar crimes and financial manipulations.

¹ William K. Black, *The Best Way to Rob a Bank Is to Own One: How Corporate Executives and Politicians Looted the S&L Industry* 35–37 (Univ. of Tex. Press 2005).

² *Securities & Exchange Board of India v. Price Waterhouse*, (2010) SEBI Order relating to the Satyam Computer Services Fraud.

³ Ministry of Finance, Government of India, *Economic Reforms and Liberalization Policies in India* (1991).

The accelerated development of business organizations, advanced financial products, and the adoption of new technologies have challenged the regulatory oversight process, thus, putting the possibility of fraudulent transactions in business entities at high risk.

To address these issues, India has come up with a comprehensive system of laws and regulations to prevent and respond to corporate fraud. The Companies Act, 2013, the Securities and Exchange Board of India Act, 1992, and the Prevention of Money Laundering Act, 2002 are some of the statutes that have put in place corporate regulation, financial transparency, and enforcement. The presence of regulatory authorities like the Securities and Exchange Board of India (SEBI), Serious Fraud Investigation Office (SFIO), Reserve Bank of India (RBI) and Enforcement Directorate (ED) are essential in controlling the corporate practices and probe on financial anomalies. Even with the presence of these institutional mechanisms, there are still cases of corporate frauds being perpetrated at an alarming rate.

This consistent phenomenon poses a basic research question: in spite of the existence of an elaborate legal framework and various regulatory bodies, corporation fraud is a common occurrence in India. This has serious implications on the efficiency of the current regulatory enforcement frameworks and the capacity of institutions to monitor, hinder and make prosecutions of fraudulent corporate practices in an efficient and timely way.

TYPES AND NATURE OF CORPORATE FRAUD IN INDIA

Corporate fraud in India takes different forms whereby in most cases it entails advanced financial manipulation and abuse of corporate structures. As corporate operations and financial markets continue to grow, corrupt activities have equally become more intricate and challenging to the regulatory authorities and law enforcement agencies. These frauds not only affect the transparency of the market, but also lead to massive losses to the investors, financial institutions and the economy in general.

A. Accounting and Financial Statement Fraud.

One of the most common types of corporate frauds is accounting and financial statements fraud. This form of fraud entails intentional distortion or alteration of accounting books to give a distorted

image of the financial status of a company. To seek investors, loans, or artificial share price growth, corporate management is prone to inflating revenues, hiding liabilities, falsifying their assets, or manipulating accounting records.⁴

The Satyam Computer Services scandal that occurred in 2009 is one of the most notable ones in India. The company chairman and founder B. Ramalinga Raju confessed to a number of years having abused the financial statements of the company by inflating the company profits and creating billions worth of assets, which resulted into an extensive changes in the corporate regulatory framework in India.⁵

B. Banking and Loan Frauds

Another high category of corporate fraud in India is banking and loan frauds. These frauds usually include how banking systems have been misused, fraudulent borrowing, misappropriation of funds and manipulation of financial instruments in an attempt to get large amounts of money through financial institutions, the problem of non-performing assets (NPAs) is also increasing.⁶

One of the biggest banking scams in India is the Punjab national bank fraud involving jeweller Nirav Modi. The fraud case was in the form of unauthorized issuance of Letters of Undertaking (LoUs) using the SWIFT messaging system that allowed the accused to access large foreign credit facilities with no proper documentation and collateral.⁷ As per reports by the Reserve Bank of India, the internal banking controls and risk management systems have a weakness which has seen the number of banking fraud cases involving large corporate borrowers grow tremendously in the last few years.

C. Insider Trading and Securities Fraud.

Another aspect of corporate misconduct is insider trading and securities fraud. Insider trading is whereby those with unpublished price-sensitive information about a company utilize such information to trade in securities and make unfair financial benefit. These practices distort market fairness and destroy investor confidence on capital markets.

⁴ John C. Coffee Jr., *Gatekeepers: The Professions and Corporate Governance* 25–27 (Oxford Univ. Press 2006).

⁵ *Central Bureau of Investigation v. B. Ramalinga Raju*, (2015) Special CBI Court Judgment relating to the Satyam Computer Services Scam.

⁶ Reserve Bank of India, *Report on Trend and Progress of Banking in India* (2022).

⁷ *Central Bureau of Investigation v. Nirav Modi*, Case relating to Punjab National Bank Fraud (2018).

The regulatory authority in the case of insider trading and securities fraud in India is the Securities and Exchange Board of India (SEBI). Some of the cases that SEBI has been involved in have included company executives, promoters and market intermediaries who abused confidential information to gain personal profits. Regulatory provisions against the practice of insider trading; the SEBI (Prohibition of Insider Trading) Regulations have been enhanced over the last few years, yet there are still some difficulties with the detection and prosecution of the crime due to the sophistication of financial transactions.

D. Corporate Governance Manipulation.

Corporate fraud is also done by manipulating the corporate governance structures and decisions making. In most cases, the misuse of related-party transactions, diversion of company funds and the establishment of shell companies to cover up illegal business transactions are part of such frauds. In most cases, the way of controlling shareholders or promoters use their dominant position in corporate boards to pass transactions that favor them personally to the detriment of the minority shareholders.

Illicit funds have often been channeled through shell companies, which are organizations with little operational activity and are used to mainly transact financial transactions, avoid tax, or cover-up fraudulent financial deals. Analysis of such networks has grown more and more the concern of regulatory bodies who find them hard to detect because of their convoluted ownership structures.

E. New Digital Fraud by Corporates.

New types of corporate fraud have also come up with a fast pace of technological growth and digitalization of financial services. Cyber-facilitated financial manipulation, cryptocurrency-based fraud, and the misuse of digital payment systems in committing fraud are all examples of digital corporate fraud, as the anonymity and decentralization of certain digital financial platforms have made them appealing as means of hiding illegal transactions or laundering money.⁸

The Indian regulatory bodies have been aware of the increased risks of such digital fraud. According to reports of financial regulatory bodies, over the last few years there has been a consistent increase in financial frauds and cyber-payment scams associated with the use of digital

⁸ Financial Action Task Force, *Virtual Assets and Money Laundering Risks* (2021).

technologies in corporate transactions, which makes a greater importance of technological control and security architecture.

On the whole, the dynamic character of corporate fraud in India proves that the fraud does not have a specific industry or mode of operation. They are instead an indication of a dynamic trend of financial engineering that is dynamic in the face of regulatory gaps and technological advances. This would mean that, in order to curb corporate fraud, there would be need to have a sound legal framework, regulatory oversight, technological attention, and well established corporate governance systems.

LEGAL AND REGULATORY FRAMEWORK GOVERNING CORPORATE FRAUD IN INDIA

India has a well-developed legal and institutional framework on regulating corporate fraud that is meant to foster transparency, accountability and financial integrity in corporate operations. The Indian parliament and regulating bodies have over time come up with a number of statutory provisions to combat frauds committed by corporate entities as well as reinforce corporate governance. The main legislations (that can be listed as the Companies Act, 2013, the Securities and Exchange Board of India Act, 1992, the Indian Penal Code and the Prevention of Money Laundering Act, 2002) contribute to the overall effectiveness of the regulatory framework of preventing and prosecuting corporate fraud in India. Other than statutory provisions, various regulatory bodies are also very important in enforcement and investigation of compliance in the corporate sector.

A. Companies Act, 2013

The Companies Act, 2013 is one of the most remarkable legislative changes that were taken to ensure corporate governance and to fight corporate misconduct in India. The Act came up with a number of provisions that were directly aimed at identifying and penalizing fraudulent corporate activities. Section 447 of the Companies Act is the most crucial provision in this aspect and it brings punishment to the fraud⁹. In this segment, the fraud in values greater than the stipulated

⁹ Companies Act, 2013, § 447 (India).

amount may attract serious punishment, such as between six months and ten years of prison, as well as, a huge financial fine.

The other notable characteristic of the Act is the creation and empowerment of the office of Serious Fraud Investigation (SFIO). The SFIO is a specialized investigative agency under the Ministry of Corporate Affairs that has the power to investigate advanced cases of corporate frauds with large companies because of its composition of expert personnel in various fields like law, finance, accounting, and information technology.

Companies Act, 2013 also imposes a lot of responsibility on auditors to bring transparency in corporate financial reporting. The auditors have to scrutinize the financial statements and report cases of fraud or abnormalities to the relevant authorities. Section 143 of the Act also requires auditors to report suspected fraud to the Central Government, which is another step to enhance the effectiveness of auditors as an important gate-keeper of corporate governance.

The Act also presented several corporate governance mechanisms such as appointment of independent directors, formation of audit committees, disclosure requirements, and tightening of accountability of the management of the companies. These were aimed at ensuring that there is no abuse of corporate power and make financial reporting more transparent.

Nevertheless, even though the Companies Act is very comprehensive in its provisions, there remains doubt as to whether the act has been effectively applied. Although Section 447 offers harsh penalties, the reality is that the conviction rate of a corporate fraud case is very low and is usually caused by long investigations and legal delays. Then, the legislative framework might seem strong on paper, but the deterrent effect might not be very strong when the enforcement mechanisms are inefficient.

B. The Acts, Securities and Exchange Board of India Act, 1992.

The act of securities and exchange board of India that was enacted in 1992 presents the securities and exchange board of India (SEBI) as the main regulation body that oversees the securities market in India. SEBI is imperative in deterring market manipulations, insider trading and other types of securities fraud. SEBI is also trying to ensure the capital markets operate fairly and in a transparent manner through a number of regulations.

The SEBI (Prohibition of Insider Trading) Regulations are one of the most important regulatory instruments that have been implemented by SEBI and which outlaws trading in securities on the

basis of unpublished price-sensitive information. Besides insider trading laws, SEBI also has stringent disclosure laws that require listed companies to report the timely and accurate information to investors on their financial performance, the corporate governance behaviours and material developments.¹⁰

SEBI has great enforcement capabilities, with the power to levy financial fines, suspend securities futures trading, bar an individual to enter capital markets, as well as investigation in the case of suspected breach. Although such powers are widespread, there are still some difficulties in the enforcement process. SEBI in most cases does not actively pursue criminal charges but instead is mostly relying on administrative fines as a form of deterrence against the enforcement process.

Moreover, the decisions of SEBI may be appealed to the Securities Appellate Tribunal (SAT). Although it is expected that the appellate mechanism would guarantee that justice is served and that judges would exercise judicial review, the delays in adjudication process may lengthen the enforcement process and consequently lower the efficiency of the regulatory action. Such delays in the procedures at times undermine the timely resolution of corporate fraud cases in the securities market.

C. Indian Penal Code (IPC)

Another crucial role in dealing with corporate fraud is that the Indian Penal Code, 1860 also criminalizes different financial misconduct. A number of clauses in the IPC are mostly used in matters that pertain to corporate malpractice. Section 405 and Section 406 touch upon criminal breach of trust, which is a crime that consists in a person committing actions upon being entrusted with property in a foul play, to acquire or misuse property or a financial gain in a deceitful manner. In a similar vein, Section 420 of the IPC deals with the offence of cheating, where a person deceives other people or institutions to get or misuse property or a financial benefit in an unscrupulous way.

Moreover, the forgery/falsification of documents provisions in Section 463 and 468 are commonly used in situations where corporate individuals can tamper with the financial records or forgery of documents to hide fraudulent transactions.¹¹

¹⁰ Securities and Exchange Board of India, *SEBI (Prohibition of Insider Trading) Regulations*, 2015.

¹¹ Indian Penal Code, 1860, §§ 463, 468 (India).

Nonetheless, application of IPCs in corporate fraud cases overlaps with more specific corporate law like Companies Act and securitization laws in some instances. Such overlapping may lead to a complex procedure and coordination difficulties between investigative agencies and regulatory bodies.

D. Prevention of Money Laundering Act, 2002.

Prevention of Money laundering Act (PMLA), 2002 was introduced to fight laundering of proceeds of the criminal activities, such as corporate fraud. The Act gives the authorities the right to determine, probe, and seize property obtained through the unlawful financial operations. The ability of the enforcement agencies to attach and confiscate the properties which are suspected to belong to crime is one of the important features of the PMLA.¹²

The main agency that is charged with the responsibility of enforcing the provisions of the PMLA is the Enforcement Directorate (ED). The ED can investigate, call people before it and even file proceedings as a result of which assets related to money laundering can be attached. The ED often comes to rescue large-scale corporate fraud cases, where the funds acquired through illegal methods will be tracked and reinstated.

The PMLA is also a legal and political issue, although it has powerful enforcement capabilities. It has been criticized because of the wide discretionary authority given to enforcement powers and how such powers can be abused in some situations. The Act nonetheless is a very important tool of dealing with financial crimes involving corporate fraud.

E. Regulatory and Investigative Bodies.

The Indian regulatory frameworks of corporate fraud require the involvement of several institutions that have specialized functions. Capital markets are regulated by the Securities and Exchange board of India (SEBI) which oversees frauds relating to securities. The Serious Fraud Investigation Office (SFIO) is an office that investigates complicated corporate fraud issues under the Companies Act. The Reserve Bank of India (RBI) oversees the banking institutions and solves the financial anomalies in the banking industry. Corporate regulation and implementation of policies is done by the Ministry of Corporate Affairs (MCA).

¹² Prevention of Money Laundering Act, 2002, §§ 5–8 (India).

Besides these regulatory authorities, there are also investigative agencies like the Central Bureau of Investigation (CBI) and Enforcement Directorate (ED) that are also active in the investigation of the corporate fraud and other financial crime related to crimes. Although the availability of various agencies makes it possible to have expertise in a specific area, various issues arise concerning overlapping jurisdiction and coordination. In some instances, more than one agency can embark on investigating the same corporate fraud issue concurrently and this may cause procedural delays and administrative inefficiencies.

The other issue that is often brought up in the argument about corporate regulation is the chances of political or economic interests interfering with the investigations. The independence and efficacy of the regulatory institutions have occasionally been challenged as a result of the allegations of selective enforcement or slow investigation of the high profile cases within the corporate sector. The best possible remedies to these concerns are to enhance the institutional autonomy and the coordination mechanisms between the regulatory bodies.

Generally speaking, India has a comprehensive legal and regulatory system that is designed to combat corporate fraud, but the success of these mechanisms only relies on the regular enforcement, coordination among the various institutions, and prompt resolution of fraud cases.

LANDMARK CORPORATE FRAUD CASE STUDIES

The fact that a number of high profile corporate frauds in India have occurred has been instrumental in exposing structural flaws in corporate governance systems and regulatory enforcement mechanisms. An analysis of big frauds would assist in the way corporate frauds are committed, the loopholes that enable such frauds to continue and the regulatory reaction to the frauds. Some of the most controversial corporate fraud incidents in India include the Satyam Computer Services scam, the Infrastructure Leasing and Financial Services (IL&FS) scam and the Punjab National Bank (PNB)-Nirav Modi scam. All these incidents revealed various aspects of corporate fraud and also indicated severe vices in regulation.

A. Satyam Computer Services Scam (2009)

It is generally considered that one of the biggest corporate frauds in India was the Satyam Computer Services scandal that was discovered in January 2009. This fraud was revealed when B.

Ramalinga Raju, the founder and chairman of Satyam had come out publicly to admit that he had been manipulating the company financial statements over the years. His own confession shows that the company had falsified accounts by inflating revenues, overstating profits, and fabricating non-existent assets and bank balances valued in the billions of rupees to give the impression that it was financially stable and growing.

Another major factor in the scandal was the involvement of the external auditors of the company PricewaterhouseCoopers (PwC). As statutory auditors, PwC was meant to check the authenticity of the financial statements of Satyam. The auditors however did not notice the accounting irregularities of large scale that had been going on over a few years. Investigations later showed that there were gross lapses on the auditing procedure such as failure to check the bank balances by themselves, or use of documents handed over by the company management.³ This raised serious concerns on the accountability and effectiveness of external auditors in ensuring corporate transparency.

After the fraud was disclosed, the regulatory bodies took several measures. The SEBI board of directors investigated and fined the people who participated in the fraud. Criminal charges were also pressed against some of the company officials by the Central Bureau of Investigation (CBI). The government also stepped in by disbanding the current board of directors and replacing them with a new board to bring about sanity to operations of the company and also through the Companies Act, 2013 as far as auditor functions and role, board oversight as well as fraud reporting mechanisms are concerned, it will bring significant reforms in the corporate governance rules.

In a critical view, the Satyam scandal proved that even such big publicly listed companies could act offensively and alter financial disclosures over a long period of time before being detected. It also pointed to severe weaknesses in auditing regulations, monitoring of regulations and supervision at board level. Despite regulatory reforms following the scandal, the case highlights a need to have more accountability of the auditors and more active regulatory controls.

B. The IL&FS Financial Crisis

Another significant corporate governance and financial management failure was the collapse of Infrastructure Leasing & Financial services (IL&FS) in 2018. IL&FS was a massive infrastructure financing and development firm which contributed greatly to financing of infrastructure in India. The firm had over time accumulated huge debts in form of convoluted financial structures and

borrowing. Nevertheless, its actual financial plight was mostly kept under wraps until the company started to miss its debt payments in 2018.¹³

The financial system of India was severely put at risk by the crisis as IL&FS had a vast financial connection with banks, mutual funds, insurance firms, and other financial institutions. It caused panic in the financial markets when it defaulted and questioned the stability of the non-banking financial companies (NBFCs). Further inquiries exposed some grave corporate governance flaws, among others, such as misappropriation of money, inadequate transparency in financial reporting and the ineffectiveness of the board of directors to check the company financial status.

Regulatory authorities were also blamed as they did not realize the worsening financial state of the company on time. Regulators and credit rating agencies failed to respond to warning signs despite the magnitude of the IL &FS operations and debt exposure. This was later to be changed by the Government of India that came in to replace the existing board of directors with a new board to administer the company and put its financial status back into order.¹⁴ Investigations were also launched by the various regulatory organs to find out the accountability of the financial irregularities.

Critically, the IL&FS crisis showed how risky regulatory procrastination and poor financial oversight can be. The case revealed that big financial institutions may acquire unsustainable amount of debt without the early intervention of regulators. It also revealed vulnerabilities in the corporate governance practices, risk assessment mechanisms and operations of credit rating agencies in the financial system of India.

C. Punjab National Bank -Nirav Modi Fraud.

The Punjab National Bank (PNB) scam in which businessman Nirav Modi was discovered in 2018 is one of the biggest banking scams in India. The fraud was related to the illegal issuance of Letters of Undertaking (LoUs) by some of the officials of the PNB branch in Mumbai. These LoUs were sent to foreign banks by use of SWIFT messaging system, where companies related to Nirav Modi were able to get huge credit facilities without due authorization or security.

¹³ Reserve Bank of India, *Report on Trend and Progress of Banking in India* (2019).

¹⁴ Ministry of Corporate Affairs, Government of India, *Order Superseding the Board of IL&FS* (2018).

The second important aspect of the fraud was the abuse of the SWIFT messaging system that had not been embedded in the core banking system of the bank. This ensured that the fraudulent transactions went unnoticed over a few years since it was not documented in the internal accounting system of the bank. Through this, huge financial debts were formed in the sense that they were not under reasonable check or control. It was found later through investigations that internal controls of the bank were overcome with the help of some bank officials.

After the fraud was uncovered, several investigative agencies such as the Central Bureau of Investigation (CBI) and the Enforcement Directorate (ED) began prosecution of the accused persons. The case also led the reserve bank of India to develop more stringent provisions in respect to issuing Letters of Undertaking and also enhanced the supervision mechanisms applied to the banking sector.¹⁵

The PNB Nirav Modi fraud, through the lenses of critical thought, revealed significant flaws in internal controls within a bank, technology integration, and risk management systems. The fact that fraudulent transactions could go on to last a few years without raising concerns was a grave fault of the internal monitoring mechanisms. The case also highlighted the importance of having a tighter technological control and better coordination between the financial institutions and the regulatory authorities.

All these milestone cases prove that corporate fraud in India is frequently a combination of the poor internal controls alongside insufficient regulatory oversight and corporate governance architecture failures. Although the regulatory bodies have acted in response to such cases by introducing reforms and taking enforcement measures, the fact that such cases have been occurring where frauds are of a significant scale means that there are still structural issues in the Indian regulatory framework.

CRITICAL ANALYSIS: LAPSES IN REGULATORY MECHANISMS.

Even though the Indian legal framework has been quite extensive to prevent and deal with corporate fraud, there are still a few structural and institutional loopholes that negatively affect the efficiency of regulatory frameworks. Although laws like the Companies Act, 2013, the Securities and Exchange Board of India Act, 1992, and the Prevention of Money Laundering Act, 2002 entail

¹⁵ Reserve Bank of India, *Statement on Developmental and Regulatory Policies* (2018).

a lot of regulatory power, the continued occurrence of huge scale corporate fraud implies that this is not a matter of regulation enforcement effectiveness.

Among the most prominent issues in the regulatory framework of India, the matter of enforcement delays should be mentioned. Complex cases of corporate frauds are usually more likely to end up being investigated over a number of years, mainly because of the inefficiency in the procedural aspects, and due to the overall backlog at the judicial system. Corporate fraud cases are normally associated with complex financial dealings, cross-border money trails, and various stakeholders and need expert investigative skills and considerable time. Nevertheless, the deterrent effect of regulatory action is diminished by the delay in the investigation and prosecution.¹⁶ As an example, legal investigations into the consequences of such big scandals as the Satyam fraud, in addition to undermining the effectiveness of enforcement efforts, also expose the inability of investigative agencies to obtain evidence in time and convict perpetrators.

The other gap that is critical is the overlap of regulations and institutional fragmentation between the different enforcement bodies. In India, corporate fraud is examined and controlled by several agencies, such as the Securities and Exchange Board of India (SEBI), Serious Fraud Investigation Office (SFIO), the reserve bank of India (RBI), the Enforcement Directorate (ED), and the central bureau of investigation (CBI). Although the existence of a variety of regulators is theoretically beneficial in terms of strengthening the oversight, in reality it can cause inconsistency in investigations, delays in information exchanges, and inefficiency of enforcement.¹⁷ To illustrate this, in a number of high-profile fraud cases, various regulatory bodies started a parallel investigation without an apparent institutional coordination, thus making the accountability process difficult. This fragmentation points to the necessity of a more coordinated form of regulation based on which the collaboration between the enforcement agencies can work efficiently.

Another weakness is that the corporate governance culture in most corporate in India is poor. Internal controls against fraud are supposed to be internal controls such as the presence of independent directors, in-house audit systems and board checking and balancing. Nonetheless,

¹⁶ Ministry of Corporate Affairs, Government of India, *Report on Corporate Frauds and Investigations in India* (2012).

¹⁷ Umakanth Varottil, *Corporate Governance in India: Challenges and Prospects*, 27 Nat'l L. Sch. India Rev. 45 (2015).

these mechanisms have not worked well in a number of cases of corporate frauds. The passive nature of independent directors in corporate decision-making has been frequently criticized; in most situations, independent directors do not have enough autonomy, access to information, and knowledge to oppose management decisions.¹⁸ As a result, boards in corporations are not always able to identify or avert fraud at its initial stages.

The question of auditor accountability is closely associated with the problem of governance failures. External audit is also important in ensuring that the financial statements by corporations are accurate and that there is transparency in financial reporting. Nonetheless, the major corporate scandals have shown that the auditors were not capable of identifying or reporting a financial anomaly. An example of such issues was the Satyam scandal that revealed that major lapses existed in the auditing process and that auditing firms overseeing corporate accounts should be more stringent and tougher on professional misconduct, a point of controversy in the effectiveness of such measures.

Political and economic power is also a big challenge towards effective enforcement of regulations. In other instances, giant corporate citizens can have intimate relations with the political arena or have significant economic muscle, which can influence the regulatory agency autonomy. This kind of influence may lead to selective enforcement or delayed investigations, or regulatory leniency in cases of large corporate actors. The sense that some corporations can avoid the stringent regulations is a blow to the confidence of the people in the regulatory authorities as well as undermining the viability of corporate governance systems.

The other significant issue is the comparatively low conviction rate of a case of corporate fraud. Despite the fact that the investigation agencies can institute inquiries and press charges on corporate criminals, the intricacy of financial crimes, procedural time hangs, and technical financial facts, often make prosecution exceptionally difficult. Consequently, even high-profile cases can take years to achieve a legal resolution of the case, which will reduce the deterrence effect of regulatory enforcement.

Lastly, the gap between the requirements of compliance and the reality of compliance in the corporate world is also very wide. Most organizations comply with the regulatory standards with an aim of meeting the procedural demands and not to promote actual transparency and

¹⁸ Companies Act, 2013, § 149 (India).

accountability.¹⁹ No one takes the areas of Corporate Governance disclosures, compliance reports and regulatory filings as serious mechanisms of control, instead, it has been embraced as a culture of box-ticking compliance and it is not accurate that the mere presence of rules will inevitably lead to ethical corporate conduct and responsible management practices.

Based on these, it can be seen that the issue of corporate fraud in India cannot simply be reduced to the failure to provide adequate legislation, but in fact due to structural inefficiency in enforcement mechanisms, institutional coordination and corporate governance culture. To deal with these gaps, the formulation of stricter regulatory provisions is not enough but also the development of better provision of institutional capacity, increased transparency and accountability of the regulatory institutions and corporate organization. The current regulatory framework might still fail to achieve success in preventing and managing corporate fraud in India, unless there are meaningful reforms to enforce them and improve their regulatory mechanisms.

RECOMMENDATIONS AND REFORMS

The fact that corporate fraud prevails in India is an indication that simply the presence of legal provisions is not enough without the appropriate enforcement mechanism as well as institutional efficiency. Although the existing regulatory system has various protection mechanisms via legislations like the Companies Act, 2013 and the SEBI Act, 1992, there is need to overhaul the entire system to create more protection avenues towards curbing fraud. The subsequent proposals are meant to improve the efficiency of Indian corporate regulatory system and ensure that the corporate sector is more transparent and accountable.

The autonomy and capacity to operate itself of the Serious Fraud Investigation Office (SFIO) is one of the most needed reforms. The SFIO was founded in the Companies Act, 2013 and is the key agency which investigates the complex corporate fraud. Nevertheless, it has been noted to have a small number of resources, have a tendency to rely on the administration and take a long time to conduct an investigation. Greater functional independence, larger investigative force, and heightened technical skills of the SFIO would greatly assist its capability in making timely and effective investigations. Furthermore, the organization of special training on the subject of

¹⁹ OECD, *Corporate Governance and Disclosure Practices in Emerging Economies* (2019).

financial and forensic investigation should help the agency to cope with the more advanced corporate fraud schemes.

The other reform that must be put in place is the creation of fast-track courts that are specifically meant to deal with corporate and financial fraud cases. Corporate fraud cases and indictments are usually associated with complicated wire transfer and significant amounts of documentary evidence which contributes to the extreme duration of the judicial process. The reduction of deterrence and the lack of trust in the enforcement system by the population are caused by delays in adjudication. The establishment of financial crime courts equipped with trained judicial officers who would be able to deal with the crime would further speed up the trials process and also make enforcing corporate accountability more effective.²⁰

It is also necessary to enhance mechanisms of protection of whistleblowers to lead to the detection of corporate fraud early. Workers and internal auditors are usually equipped with key details regarding fraud in organizations but they fear victimization and thus do not seek to report fraud. Though the Companies Act, 2013 provides the provisions concerning the vigil mechanisms and protection of the whistleblower, their application has not been extensive. Providing greater statutory protection to whistleblowers, a guarantee of confidentiality, and providing explicit legal protection against victimization would promote more reporting of corporate misconduct.

The other potential area that needs reform is in the accountability of auditors. Auditors are a key factor that keeps financial transparency and ensures that the corporate financial statements are accurate. But a number of big corporate fraud cases have exposed cases in which the auditors have either not detected anomalies or they have not acted in good faith. The audit quality can be improved by increasing the auditor liability provisions, punitive actions against professional negligence, and increasing the supervisory powers of regulating bodies like the National Financial Reporting Authority (NFRA).

Besides the legal changes, implementation of technological innovations like artificial intelligence and data analytics may greatly increase the ability to detect fraud. The present day business fraud cases are usually associated with sophisticated financial frameworks and online dealings that are hard to track using conventional surveillance systems. Advanced data analytics tools can help regulatory bodies and other financial institutions detect suspicious patterns of transactions, track

²⁰ Law Commission of India, *Report No. 213: Fast Track Courts for Financial Offences* (2008).

financial anomalies, and identify red flags of possible fraud. The fact that AI-based monitoring systems are integrated into regulatory frameworks would thus enhance preventive oversight and minimize chances of corporate-sized frauds.²¹

Another area of critical reforms is the improvement of the coordination between control and investigative bodies. In India, there are various agencies, such as the SEBI, the SFIO, the reserve bank of India (RBI), the Enforcement Directorate (ED) and the Ministry of corporate affairs, which are involved in the regulation of corporate behavior. Nevertheless, in many instances, enforcement gaps are provided by a lack of jurisdiction and disjointed mechanisms of information-sharing. Implementation of a coordinated system of information sharing and inter-agency investigations would increase efficiency in regulations and guarantee faster reactions to possible cases of fraud. Lastly, the establishment of mandatory forensic audits on large corporations and high-risk industries could help improve the system of fraud prevention to a greater extent. The conventional financial audits are mainly aimed at ensuring that the required standards of financial reporting and accounting standards are met. By contrast, forensic audits encompass a more thorough review of financial records in order to identify fraud, financial manipulation and suspicious transactions. Ensuring that large publicly listed companies and corporations that are involved in sensitive sectors like the banking, infrastructure and finance sector should make it a requirement to have periodic forensic audit as a way of strong deterrent against corporate fraud.

To sum up, corporate fraud in India should be solved through institutional fortification, legal reform, technological advancement, and better regulatory coordination. With these reforms, India will be able to improve the efficiency of its corporate regulatory regime and encourage the culture of transparency, accountability, and responsible corporate governance.

CONCLUSION

One of the most topical issues of current corporate governance and financial regulation is corporate fraud. The current research attempted to test the hypothesis of whether the current regulatory frameworks in India are adequate to prevent and regulate fraudulent corporate activities. In spite of the existence of a comprehensive legal framework and several regulatory bodies, cases of

²¹ Financial Action Task Force, *Opportunities and Challenges of New Technologies for AML/CFT* (2021).

corporate fraud are getting reported in an alarming rate. This is a major issue over the effectiveness of regulation enforcement and institutional control in the Indian corporate sector.

The overview conducted in this paper shows that India has a comparatively elaborate law framework that is supposed to deal with corporate fraud. The laws, including Companies Act, 2013, the Securities and Exchange Board of India Act, 1992 and the Prevention of Money Laundering Act, 2002 give statutory force to control corporate behaviour and financial disclosure. Secondly, the regulatory bodies like the Securities and Exchange Board of India (SEBI), the Serious Fraud Investigation Office (SFIO) and the Reserve Bank of India (RBI) have been given immense powers to keep a check on the company operations and to probe into financial anomalies.¹ Nevertheless, the fact that major corporate frauds, such as the Satyam scandal, the Punjab National Bank -Nirav Modi financial fraud, as well as the failure of Infrastructure Leasing and Financial Services (IL&FS) still took place, is indicative of the fact that the legal provisions in question were only slightly helpful in deterring corporate misconduct, as there are in fact a number of structural shortcomings in the regulatory system, such as sluggish investigations, lack of coordination between law enforcement agencies, ineffective corporate governance practices, and a lack of accountability measures. The infliction of corporate fraud is complicated by the fact that in most instances, the intricacy of the financial transactions and the jurisdictional overlap between the regulatory authorities make it even more difficult to detect and prosecute the perpetrators in time. The results of this paper do indicate that the biggest problem facing the anti-fraud regulatory regime is not the lack of laws in India but the constraints of the implementation and enforcement of the laws. The improvement of the effectiveness of the regulatory framework should include strengthening the institutional power of regulatory authorities, to a larger extent their coordination with the investigative agencies as well as the responsibility of the corporate management and auditors. Furthermore, the implementation of more effective whistleblower protection, use of modern technological means of fraud detection, and the creation of special fast-track courts to deal with financial crimes may substantially increase the overall effectiveness of the process of corporate fraud.

To sum up, although India has been successful in formulating a legal structure to govern corporate malpractices, one would need to work continuously to close the divide between intent and actual implementation of the law. The future of the Indian corporate economy is not just the ample legislation, but also the integrity of regulations, and their strict implementation.