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CORPORATE FRAUD AND CORPORATE ETHICS

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Any essay on corporate fraud and its links with corporate ethics needs to start with the definition offraud, ethics, and the links between them. Fraud is a criminal offense apart from being a moral turpitude. Fraud consists of an intention to manipulate, falsifyimplicate, deliberate misrepresentation, evil intentionto exploit the trust, and making a deliberate effort to cause a wrongful gain to self and the wrongful loss to the other person. The deliberate intention is towards active deception of the victim for tangible personal gain to the perpetrator or to cause tangible personal loss to the victim.The fraudulent miss presentation is a minute deliberate misinformationor concealment of factual information to create a falsified impression masquerading and non-truth as the truth.The concept of fraud starts with the deliberate belief on the part of the victim regarding the truthfulness of the claim and hence the victim walks into the scheme of the fraud. In other words, the exploitation of basic trust and faith is built in the act of fraud.Fraud does not exist in a vacuum and hence it has to create either a financial gain to the perpetrator or a financial loss to the victim or both.Fraud will be dealt in this essay both from the points of view of American Law and Indian law.

In the United States of America, different states have different definitions under different contexts for any act that is termed as fraud. However, broadly speaking, as a concept of legal significance, fraud essentially has the following specific elements, namely, deliberate misrepresentation or statement of falsehood, deliberate intention to deceive, deliberate reasonable reliance of the victim on the information that was known to be false to the perpetrator, suffering of the victim of some form of damage or part or harm or financial loss as a result of the fraudulent misdemeanor. The following five categories of fraud arebroadly recognized in the United States of America. There are as follows.

1. Electronic mail and electronic wire-related frauds.
2. Corporate securities-related frauds.
3. Banking-related frauds.
4. Insurance and healthcare-related frauds.
5. Consumer activist and consumer protection-related frauds.
6. Ponzi schemes and investment-related frauds.
7. Falsify display /sales promotion frauds.

The responses from the enforcing authorities depend on the specific situation and the specific area of commission of the offense. The penal consequences may include laying of the fines, decree of restitution, liability in civil matters, and in certain specific cases if required and if valid prosecution of combined criminal offenses which may ultimately lead to the imposition of jail/imprisonment.

Fraud,the definition according to the US Constitution and India:

The US Constitution defines fraud in different formations according to the needs of corporations as well as individuals in different parts of the USA. There are as follows.

1. Wire fraud and mail fraud which mention the use of electronic mail radio location or television communication to cheat others.

2. Frauds related to security transactions which involve manipulation of information related to markets and resorting to insider trading to defraud others.

3. Frauds related to banking transactions that involve the deliberate production of four statements in obtaining loans or suppression of information to be mandatorily submitted to the bank authorities.

4. Frauds related to healthcare in which false information is deliberately submitted to obtain insurance claims.

5. Debit card and credit card frauds in which activities related to credit card and debit card transactions are deliberately falsified to cause wrongful loss to the servicing industries.

6. Frauds related to filing of tax returns in which the tax being paid to different agencies is manipulated or avoided or evaded through a process of deliberate misrepresentation of facts.

7. Frauds related to claims of damages and insurance receivables in which either life insurance or property insurance is deliberately done to fraud right from the beginning.

Normally in the USA, fraud is a criminal wrong and individuals committing fraud can be sent to prison sentences through penalty. If any damage is by default scene, an additional amount of fine will be added as a part of a civil remedy to compensate the victim and also to pay for the lawsuit. This above description is general in nature and according to the situation, jurisdiction, and type of activity, the definition of fraud changes in the USA. In India, the following is the situation.

The definition of fraud in India varies according to the situation and according to the law that is being applied to a particular transaction. In general, the following points are important.

1. The Indian Penal Code (IPC) specifically deals with and defines fraud with particular sections and also specifically provides for punishment under different conditions and situations. Section 420 of the Indian penal code defines cheating and dishonest actions related to delivery and transactions in property in wrongful loss or wrongful gain to the victim and to self respectively. This option is the main ingredient of such a transaction

which ultimately results in the exchange of property by a dishonest inducement in another person to voluntarily deliver the property, or valuable document or any property which is movable or documents related to immovable property et cetera.

2. The Indian Contract Act, 1872, defines fraud as follows "As per section 17 of the Indian Contract Act, 1872, Fraud means and includes any one of the following acts committed by a party to a contract, or with his connivance, or by his agent, with intent to deceive another party thereof or his agent, or to induce him to enter into the contract."There are frauds related to bankruptcy, security transactions, and credit card/debit card management. Fraud according to the above definition can be done, by an individual, by a group of individuals, by a small Corporation or even biased multinational corporation. There are frauds of intellectual property which includes plagiarism, financial frauds which include tax fraud credit card fraud mortgage fraud consumer affairs fraud, dictionary ten years of additionally attributable that they said the corruption, asset misappropriation, insurance and also banking frauds. The pre-text of help right of satellites of sonography eliminates of ng and using the helplessness and vulnerability of a readily available victim is the cornerstone of a professional fraudulent criminal. Cyber frauds often look for senior citizens who are not equipped with the knowledge related to technical or technological transactions. Cyber frauds also include false information on false websites and false promises. Normally, detection becomes belated when the siphoning of the money of innocent persons takes place.

3. The Information Technology Act, 2000 discusses cyber crimes and elaborate provisions are made regarding fraudulent activities which include hacking and illegal access to computers and passwords. Section 65 to section 74 of the act specifically provides for different crimes related to manipulated of data of electronic origin and systems of computer processors.

4. Frauds Related to Banking: The RBA Act provides for banking transactions both for individuals and also among the banks and it is the main regulator insofar as banking activity in India is concerned. The specific act that relates to fraudulent activities Is called the Banking Regulation Act, 1949 and the Prevention of Money Laundering Act, 2002.

5. SECURITIES and EXCHANGE BOARD of INDIA (EDDIE) ACT, 1992: the board regulates the stock market in the country. It is empowered with the responsibility to inquire and investigate and also to chargesheet and argue for a conviction in the court of law for penalising any fraudulent activities related to stock markets.

6. INSURANCE REGULATORY and DEVELOPMENT AUTHORITY of INDIA (IRDAI) ACT, 1999: the explosion of the industry requires insurance is a Harper to me e and banking as support logistics and hence regulation of the insurance sector is important, and this act looks into that aspect. Its main duty is to regulate and to give guidance for the insurance activities of both the government as well as the non-government corporations.

7.CONSUMER PROTECTION ACT, 2019: the main purpose of this act is to protect customers and consumers from illegal trade practices and dishonest/fraudulent/cheating activities by business houses or their agents.

8. GOODS and SERVICES and TAX (GST) frauds: By removing many cascading effects of different access in different states, the Parliament of India took the initiative to introduce one single tax namely, GST, GOODS and SERVICES TAX. There are provisions in this act to prevent possible fraud and this activity required a new infrastructure.Hence, modifications were made to the income tax as well as excise tax departments of the Finance Ministry, Government of India.

CORPORATE FRAUDS:

When frauds are committed, not by individuals but in the corporate arena, the damage to society is intensified than a single transaction of fraud committed by an individual. The legitimacy of the criminal justice system is in question. The delay in investigation, due to many unforeseeable reasons, may make a dent in the efficacy of the concept of the rule of law in the eyes of not only the victims of corporate fraud but also of other stakeholders. A fewhistorical examples will explain the repeated occurrence of corporate fraud in different parts of the world at different points in time. In the current century, the Enron scam, the WorldCom scandal, the Tyco International scandal, the Satyam computer services scandal, the Volkswagen emissions scandal, the Wells Fargo unauthorized account scandal, the 1Malaysia development Berar hard scandal, and the collapse of Lehman Bros are some of the scandals that rocked the corporate world in general. Historically, the South Sea Bubble scandal in 1720, the Ponzi Scheme of 1920, the Lockheed bribery scandal of 1970, and the collapse of the Barings bank in 1995 are some of the major scams in the previous centuries.

The common point in the above occurrences is the collapse of the systems of regulatory agencies in checking the occurrences and also the absence of values like transparency, accountability, and corporate governance within the management of the corporations. Lessons are hardly learned in the follow-up action through proper regulatory agencies and hence the recurrence of corporate fraud continues in newer forms. Embezzlement and misappropriation of public funds, misrepresentation and deliberate falsification of accounts, deliberate diversion of the funds to private accounts, and extravagant payments to the commission agents and the so-called consultants are some of the major reasons. The professional failure of the auditing agencies, meant exactly for detecting the fraud in the first place is the major reason for the recurrence of the corporate frauds. Analysis of the failures are attributed to scant attention given to ethical values in corporate governance.

Audit failures andcausative factors of corporate frauds:

Many factors contributeto audit failure isas corporate scams/corporate frauds both in the USA and in other countries. They are first, nonoptimal assessment of risk, second, lack of concentration, and lack of skepticism-oriented doubt, third, connived or corrupted independence, and lastly criminal collusion between the auditors and the perpetrators of corporate fraud from the corporations themselves. In the case of the United States of America, there were many scandals, and notable among them was the Enron scandal in the year 2001. Auditors, Arthur Andersen was engaged by Enron authorities and there was a proven case of connivance and criminality as a result of which, Arthur Andersen lost its license to practice auditing in the USA and was banned permanently by the security/regulatory agencies of the USA. This massive scam shook the US economy, causing the passing of the new act calledthe Sarbanes-Oxley act with the purpose of enhancing the corporate governance mechanism and enforcing auditor accountability on a continuous basis. In the case of emerging economies like India, the Satyam Computer Services scandal in the year 2009 was a notorious example of deliberate audit connivance and criminality causing a massive fraud that shook the image of India as a competent computer services provider to the world. The auditors, PricewaterhouseCoopers (PwC) per portion for their incompetency in allowing some of their colleagues to manipulatethe financial statements of the company at the behest of the owner/CEO of the company. This corporate fraud was impactful in contributing to the decision to make a new Companies Act, in the year 2013. The lessons learned included the emphasis on continuous scrutiny reforming the regulatory authorities and making enough scope for greater transparency in the financial reporting and auditing practices in all the corporations including the government-controlled public Sector undertakings of the country.

REGULATORY FAILURES and CORPORATE FRAUDS:

Public policy experts and legal authorities often mention the failure of the regulatory authorities as the main reason behind the financial crisis of the year 2008 inthe USA. Many regulatory agencies under the Department of Justice, including the Securities and Exchange Commission were found to be faltering and were also found to be indulging in such practices that ultimately led to the crisis.The main failure of the regulatory agencies was a casual approach towards the functioning of the financial institutions and loving the deceptive practices despite whistleblowing knowledge and despite having enough time to prevent the same.

In an emerging economy like India, the famous Nirav Modi-PNB scam was a case in point in that a known fraudster who runs a jewel export company defrauded the government-owned Punjab National Bank through the cooperation/connivance of a section of the banking staff in overlooking the correctness of the letters of undertaking issuance process. This criminal act of banking fraud coupled with corporate fraud was allowed to go unpunished despite notices for obvious reasons for years together. The non-performing assets of the bank namely the Punjab National Bankwere increased by huge proportions.

GOVERNANCE FAILURE and CORPORATE FRAUDS in the USA and India :

The Wells Fargo scandal of the year 2016 was a notorious example of the failure of corporate governance visually in the banks that contributed to a preventable corporate fraud incident. The modus operandi in this scandal was very simple in that, if you thousand employees were encouraged to create unauthorized accounts of existing customers without their consent and use the same for manipulating the banking records as well a submission to the taxing authorities. This is a clear case of deception, cheating, fraud, and a non-ethical and criminal practice at the same time. The board of directors was aware of this activity and yet their silence was explained by the reasons of their selfishness and incompetency bordering on criminality. This scam highlighted the necessary intervention on the part of the Government Authorities in creating and enforcing strong systems of and also establishing such structures in corporate governance that cannot be manipulated or attempted to be destroyed by the fraudsters. The purpose was also to establish systems for the prevention of unethical behaviour and practices within banking initiations and mortgage finance-related corporations because the main victims happen to be innocent non-suspecting ordinary citizens.

In the emerging economy of India, the Infrastructure Leasing and Financial and Services (IL& FS) is a case in point in that there was a massive failure on the part of the board of directors who were mandated for efficient implementation of the principles of corporate governance. I

L& FS was a major infrastructure development and finance company and the collapse of this corporation resulted in major economic distress in the Sector. Criminal negligence on the part of the enforcing authorities as well as criminality displayed by members of the board who subsequently placed the enquiry from the Central Bureau of Investigation of India was a contributory factor towards the failure of the principles of corporate governance and also for the existence of nonoptimal management of risk systems. A total lack of crisis management awareness and timely response on the part of the so-called Board of Directorswas yet another contributory factor.

ETHICAL FAILURE and CORPORATE FRAUD:

Ethical failure happens when scant attention is given to the systems of values throughout the body corporate of corporations. Ethical failure doesn't only confine itself to the top management but spreads across the entire corporate structure. While governance failure can happen at the top without the knowledge ofthe managerial staff in the middle or lower level, ethical failure normally happens with a sense of depression and giving up on the part of all those stakeholders for mainly the reasons of survival and hence ethical failure is more dangerous than the corporate governance failure.

In the case of the USA, the emissions scandal and pollution-related contribution of the company Volkswagen of the year 2015 is often quoted as an example of the failure of ethics contributing to corporate fraud. This software system and the vehicles were manipulated to hoodwink not only the customers but also the regulators and it was admitted by the Volkswagen management ultimately after investigation. Without the connivance of managerial staff at different levels this would not have been possible and that is why this incident falls within the failure of ethical standards of the entire corporation called the Volkswagen. The admission of the guilt and the punishment awarded was no compensation for the de-legitimacy of the entire industry of the automotive Sector faced in the world.

In the case of the emerging economy of India, in the month of November, 2023, Mr. Subroto Roy of the in-famous Sahara Financial Services died after a prolonged illness of self as well as an investigation of his fraudulent company. The size of this financial fraud was so massive that the victims were more than the population of many European countries put together. The failure of the regulatory agencies was visible despite the complaints given to them by the victims. However, the ethical failure on the part of the corporation and many employees at every level is visible in that this one scam created such huge dent in the legitimacy of the Indian financial markets in the eyes of its citizens. The ethical failure was not confined only to the Sahara mafia but also to the conniving mafia of a section of the government employees of a section of the government regulatory agencies. Scandals of Sahara type were neither the first nor unfortunately the last. In the state of West Bengal, India, there was another massive scam called,the Sharada scam. Some of the victims of this latest scam committed suicide because of a lack of faith in the investigating agencies as well as the section of the government agencies to get back their money.

CONCLUSION:

The above discussion on the origins of fraud, the application of fraudulent practices in corporations, the nature of corporate fraud, the impact of corporate fraud on the stakeholders, and the main contributory factors towards corporate fraud--- all point out the preventable aspects through powerful regulatory agencies. No agency can be powerful if it is not allowed to function systematically, without interference, and with full financial/technical assistance from the law-enforcing policy makers. The functioning of the criminal justice system without any delay and the application of the latest technology through artificial intelligence and machine learningare important in strengthening the hands of the investigators of the enforcing/regulatory agencies. In some emerging economies like India, the artificial division of the provincial and the union investigating agencies' differentiation of powers and responsibilities needs to be looked at afresh to control the possibility of the fraudsters escaping through the loopholes in the name of federalism. Corporate crime does not follow the tenets of political federalism and hence the need of the hour for countries like India is to benchmark the best practices of the USA in creating robust systems for non-prevention of scams and frauds. Legitimacy starts with the faith in the enforcing agencies of the stakeholders within the country first and then the investors abroad. There is also a need for cooperation between the enforcing authorities of the USA and emerging economies like India since the fraudsters also do not recognize international borders.

ABSTRACT:

Corporate Fraud and Scams do not occur in a vacuum. There are known contributory factors and, when unchecked, they follow a knownrepeatable pattern. Enforcement agencies cannot afford to function in a lackadaisical manner and cannot afford to lose the trust/ faithof the stakeholders in their efficiency. Many contributory factors can be controlled by the timely intervention of the enforcing agencies provided there is capability and willpower on the part of the enforcing agencies. Ethical issues and governance issues need attention from the corporations within and enforcement issues require attention from the government agencies. There is a need for international cooperation and internal cooperation among corporations and the government to prevent fraud. This is in the interest of not only the corporations but the legitimacy of the countries themselves as signatories of the principles of the Rule of Law.

KEYWORDS: Corporate Fraud, ethics, legitimacy, board of directors, and corporate governance.

Reference:

Section 17 of the Indian Contract Act, 1872.

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