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REDEFINING CORPORATE ACCOUNTABILITY IN THE AGE OF GENERATIVE AI: A STUDY OF DISCLOSURE OBLIGATIONS AND DIRECTORS' LIABILITY IN INDIA

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Abstract:

The use of generative AI in corporate disclosure and reporting is growing rapidly by creating new opportunities but at the same time poses legal challenges as well related to corporate governance and director's liability. Companies' use AI tools increasingly in preparation of annual reports, financial statements and environmental social and governance reports(ESG) reports and regulatory filings which enables companies to process information effectively and maintain consistency in corporate reporting and disclosure. However, the use of AI in corporate reporting may also result in incorrect or incomplete disclosures raising concerns regarding transparency, investor protection and corporate accountability. This study examines the legal implications of using Generative AI in corporate disclosures specifically related to directors' responsibilities under the Companies Act, 2013. Section 134(3) and 134(5) supports your discussion on the Board's Report, the Directors' Responsibility Statement, and responsibility for financial records and internal financial controls[1]. It discusses the relevant provisions of the Act including sections 134, 166 and 149(12) to assess directors' statutory duties, standards of care and accountability for false, inaccurate or misleading AI generated informations. The study further examines legal concerns regarding insufficient human oversight, excessive dependence on AI generated outputs, determination of responsibilities between companies and AI service providers and importance of conducting proper verification and maintaining accurate records. Additionally, the research discusses about the need for strong internal control mechanisms, appropriate risk management systems, confidentiality measures and potential guidelines from the Securities and Exchange Board of India (SEBI). The study is based on doctrinal legal research to evaluate applicability of existing legal frameworks and legal

[1] Companies Act, 2013

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principles to concerns associated with AI generated corporate reporting and disclosures. It emphasises that the application of AI does not diminish the directors' statutory duties or exempt companies from complying with corporate disclosure obligations. The study concludes that responsible use of AI in corporate reporting needs adequate human supervision, careful review of information and clear accountability must be taken for any false or misleading informations or disclosures. Appropriate regulatory measures are necessary to manage legal implications of using generative AI in corporate disclosure and reporting.

Keywords: Generative Artificial Intelligence, Corporate Governance, Corporate Disclosures, Corporate Reporting, Directors' Duties, Companies Act, 2013, SEBI, Investor Protection, Corporate Accountability.

Objective of the Study:

The main objective of this study is to analyze the application of Generative Artificial Intelligence (AI) in corporate reporting and disclosures, with specific reference to corporate governance and directors' liability under the Companies Act, 2013.

In this regard, the study intends to analyze the legal provisions such as Sections 134, 166 and 149(12) to comprehend the duties of directors in relation to the generation of accurate and reliable corporate disclosures using Generative AI. In addition to that, the study will help in identifying the possible legal risks related to the use of Generative AI, which include inaccurate/ misleading data, lack of adequate human control, dependence on output of AI and difficulty in holding someone accountable for the mistakes. Also, it will provide insights about the importance of internal controls, risk management and record keeping in connection with AI-based corporate reporting. Moreover, it will highlight the importance of SEBI regulations to address the new emerging legal issues. Eventually, this study would evaluate the adequacy of the existing legal framework to deal with the legal risks related to the Generative AI based corporate disclosure process and suggest necessary measures for adoption while safeguarding corporate accountability, market integrity and invest interest.

Introduction:

Generative AI is capable of constructing words, recapitulate additional information and execute challenges which previously required human cognition. Tools like gemini, chatgpt, claudai have made these technologies extensively accessible in workplaces. Generative AI has also

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progressively being used in different corporate entities which includes accounting, finance, employee relations, financial disclosure, internal auditing, legal and corporate governance, business analysis and decision making. Hence, corporate disclosure is defined as the corporate entities which contributes to shareholders, stakeholders, analysts and the market and it can also help formulate the following information and statements. AI helps also in constructing these disclosures that are convenient, precise, accurately written and easier to formulate so that it helps to enhance communication between companies and investors. It has been noticed that in investor relations and financial reporting, the surveys demonstrate that many corporate entities are already using AI. A march 2024 survey done by National Investor Relations institute discovered that about 44% of investor relations personnel had already integrated AI into their companies IR' programs. However, another KPMG survey was also done which identified that approximately 45% of US firms were assessing generative AI in financial reporting. However there is no enough structured evidence about how corporate entities incorporate AI for corporate disclosures found out by the researchers. It is also ambiguous that whether AI generated disclosures have any effect investors and financial markets. There are certain important concerns for researchers that do investors and researchers get more relevant information from AI generated disclosures? does stock prices become more comprehensive and effective due to AI generated text? Are managers able to successfully suppress or limit the exposure of undesirable information? Can AI generatated disclosures eventually assist companies to make enhanced investment decisions? these concerns can be challenging for finding answers because there is no accurate specific evidence about how, when and how much corporate entities rely on AI for preparation of corporate disclosures and as a result of which more thorough research and evidences are required to interpret both the strengths and threats of AI generated disclosures.

Use of generative AI in corporate reporting and disclosure :

Artificial intelligence specifically generative AI is steadily used for corporate reporting and disclosure operations. Extensive amounts of financial and non-financial informations are formulated, arranged, examined and assessed with the help of AI by companies. Hence it's application can be seen in annual reports, financial statements, ESG reports and regulatory filings. AI helps companies with editing and formulating sections of annual reports such as management discussion and analysis (MD&A). It reviews information that was provided in previous reports and information accumulated from different departments of a corporate entity. AI contributes in preparing financial reports faster and more systematic by keeping the

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language and presentation standardized across annual reports. AI also strenghens accounting and financial reporting processes. AI is also used for account reconciliation, identification of discrepancies, testing of journal entries and evaluation of accounting data. AI also retrieves information from contracts, facilitates accounting operations for leases and revenues, contributes in XBRL or iXBRL tagging and make it easier for auditors to evaluate large volumes of transactions identify unusual items. AI can also be used to compile and organize ESG data such as energy consumption and green house gas emissions. AI contributes in sorting ESG data based on reporting guidelines and detecting missing or contradictory information but it may also elevate the risk of greenwashing if AI generated statements inflating sustainability performance. AI also provides erroneous data or information which may lead to false disclosures. AI usage does not relieve the management from obligation and boards from responsibility to make sure that the corporate reports are accurate.

Duties and legal liability for AI generated corporate disclosures :

Sections 134(3) and 134(5) covers board's report and directors' responsibility statement. Section 166(2) emphasizes that the directors are required to act in good faith while section 166(3) places a duty on the the directors so they exercises due care, skills, prudence and make independent decisions. Directors hold a fiduciary duty and are obligated to exercise their authority in accordance with proper objectives and for the benefit of the organization. The matter in question involved the issuance of shares undertaken to secure control of the organization[2].

However, the use of AI doesn't discharge companies from their legal liability or responsibilities. Under the Companies Act, individuals can only hold the position of directors. Hence, AI cannot take the position of a director or cannot fulfill the statutory responsibilities imposed on directors. Section 166(3) of the companies Act, 2013 states that directors must act with reasonable care and attention when monotoring corporate operations which includes use of AI in financial reporting and disclosures. Directors should not approve any information that has been generated by AI without verifying it first. They must verify material figures, statements and claims they are released.

Section 149(12) restricts the liability of independent and non-executive directors depends on their awareness of circumstances and their participation in company operations and whether they acted with due care. The conditions under which independent directors and specific non-

[2] Dale & Carrington Investment (P) Ltd. v. P.K. Prathapan, (2005) 1 SCC 212 (India)]

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executive directors may incur liability for actions or failures to act undertaken by the company[3]. Regulation 30 concerns disclosure of material events and information. Regulation 33 concerns financial results. Both are relevant when AI is used to prepare disclosures by listed companies[4]. The legal framework governing the application of these duties to specific AI related failures is still developing and hasn't been fully decided by Indian courts. Person in charge must ensure that AI generated information is consistent with financial records and original documents. Companies should develop clear rules regarding the use of AI tools in corporate disclosure. Companies should oversee any risk related to AI through their risk management and internal auditing systems. Companies should maintain systematic records of AI generated contents, modified documents, review mechanisms and final approvals.

The Directors' Responsibility Statement applies to the sufficiency and proper functioning of internal financial control mechanisms within relevant organizations[5]. Confidential information which has not been released and information that could affect share prices should be avoided from exposure to external AI tools.

Corporate Fraud, Deception and Liability in AI Generated Information :

AI technology is becoming more and more common in reporting. There are concerns about the accuracy of information and corporate accountability issues when it comes to AI generated statements, Environmental, Social and Governance (ESG) reports and regulatory filings. Even though the use of AI can make things faster there are worries about data problems, bias in the algorithms and creating misleading information. As companies are sending out information that is generated by AI this can raise concerns about activity, deception and liability issues.

Section 134 of the Companies Act, 2013, requires the Board of Directors to approve financial statements before they are signed and submitted for audit. It also provides for the Directors' Responsibility Statement, which addresses matters such as accounting standards, proper accounting records, internal financial controls, and systems for preventing and detecting fraud[6]. Section 447 of the same Act prescribes punishment for fraud, including acts, omissions, concealment of facts, or abuse of position committed with the intention to deceive, obtain an undue advantage, or injure the interests of the company, its shareholders, creditors, or other persons[7].

[3] Companies Act, 2013, No. 18 of 2013, sec 149(12) (India)
[4] SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015,
[5] Companies Act, 2013, No. 18 of 2013, & 134(5)(e) (India)
[6] https://www.incometaxindia.gov.in/w/section-134-81
[7] https://www.incometaxindia.gov.in/w/section-447-2

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Not every mistake made by AI is definitely fraudulent. This could be because of problems with the model, data sources or misreading financial facts. Whether section 447 applies depends on the law and the situation. However if the Directors or Officers intentionally approve the disclosure hide errors or try to trick investors with the AI generated information then they can be held responsible.

There can also be mistakes in corporate disclosure without any intention to trick people. This might include saying more money was earned than actually was putting liabilities in the category or having wrong data in an environmental report. If these mistakes are not found before sending the information to investors this can give the impression about how the company is doing and can bring attention from regulatory agencies. Corporate accountability needs controls and processes to make sure the information is correct.

The Securities and Exchange Board of India (SEBI) plays an important role in regulating disclosures by listed companies. The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, establish requirements concerning financial results and the disclosure of material events and information. Regulation 30 addresses material events and information, while Regulation 33 deals with the submission of financial results by listed entities[8]. Regulation 33 talks about the rules for listed companies to file their results. [3] These rules still apply to AI generated reports and regulatory filings. Listed companies have to share information using automated reporting tools.

Responsibility for inaccurate AI-generated disclosures may involve the company, directors, employees, auditors, and technology providers, depending on their respective duties and involvement. Section 27 of the Securities and Exchange Board of India Act, 1992, addresses offences committed by companies and the circumstances in which persons responsible for the conduct of the company's business may be held liable. It also provides for defences relating to lack of knowledge and the exercise of due diligence, subject to the statutory conditions[9]. Directors are not always to blame depending on their role what they knew, how involved they were and their responsibilities.

Looking into any actions can be hard when using AI. To find out how the wrong statement was made it is important to look at the data source the drafts made by AI the prompts any changes made by people and the checks and approvals. This can help find out if the mistake was not on purpose because of a mistake or if it was done on purpose. It is important to keep records not

[8] https://www.sebi.gov.in/legal/regulations/sep-2015/sebi-listing-obligations-and-disclosure-requirements-regulations-2015-last-amended-on-march-06-2017-_34610.html
[9] https://www.sebi.gov.in/commondata/acts.pdf

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to help regulatory agencies but also to show why the corporate information was decided on.

At the moment AI can help stop and find fraud. Auditors and regulators can spot things in financial records, odd patterns and signs of wrongdoing. However how well AI works depends on how good the data's how reliable the systems are and how much people are watching. Because of this AI should be seen as a tool to help with keeping things honest.

Challenges, New Legal Issues and Director Liability :

Using systems in corporate accounting and reporting has created problems in figuring out who is at fault for wrong or misleading information. Even though AI can make reporting faster there might be mistakes in the information that are not seen right away. If the information is in documents sent to investors or to regulators this will need to be looked into to find out who is to blame. This will include looking at the duties of Directors, Companies, Employees, Auditors and Technology Providers.

A big worry is that the people who make the information might not be held responsible. AI systems can handle a lot of data. Make reports that look official. However this might have data. When mistakes are found companies might try to blame software developers, workers or data suppliers.. Just because other people are involved doesn't mean the company won't have legal problems.

Section 166 and 134 of the Companies Act 2013 give a way to see what Directors are responsible for. Section 166 says that Directors have to be honest and use care, skill and effort. They also have to make their decisions. Section 134 has the rules for getting the Board's approval and for the Directors' Responsibility Statement. This includes accounting records and internal financial controls. These rules still apply when AI systems are used to make or check the information. There are problems when it comes to Directors understanding AI systems. Directors don't have to be experts in programming or advanced technology. They should understand the systems they use. This should include knowing the limits and the risks of using AI in reporting. If Directors just take what AI says without checking this can make the quality of Board oversight worse. Increase the chance of big mistakes.

The amount of checking should match the importance and the possible effect of the information. Financial statements, filings and important messages to investors should be checked carefully to make sure the information is right. This is important because wrong information can influence investment choices. Strong controls can be put in place by comparing the AI output with verified company data having employees check the information and getting checks when needed. This makes sure that using AI is in line with governance.

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Another problem is figuring out responsibility between Companies, Directors, Auditors and AI Technology Providers. Depending on what the Technology Provider does they might have legal responsibilities. Auditors still have to follow their duties. Contracts can help spread some of the risks and financial losses between the people involved.. Private agreements can't change legal duties.

Transparency is very important in reporting. If an AI generated disclosure is wrong the data that was put in the output that came out any changes that were made who checked the document and any clear signs of problems should be looked at. Keeping records of the AI helped writing, human checking, major changes, checking and approvals can help checks and regulator reviews. This also shows that the company had control over the reporting process.

In the future there may need to be guidance to solve problems with AI aided corporate reporting in India. SEBI could offer guidance on how the current rules for disclosure and corporate governance apply to listed companies using AI. This could include how to check the AI output, managing risks making sure there is control and keeping good records. This would give companies confidence. Help regulators keep control.

Creating rules for AI responsibility should not mean that Directors are blamed for every mistake the system makes. Who is to blame should be decided based on the rules and the facts. This includes looking at the duties of Directors what they knew, how involved they were, how likely the problem. How much control they had. This makes sure that Director responsibility is recognized but that blame is based on the facts that matter legally.