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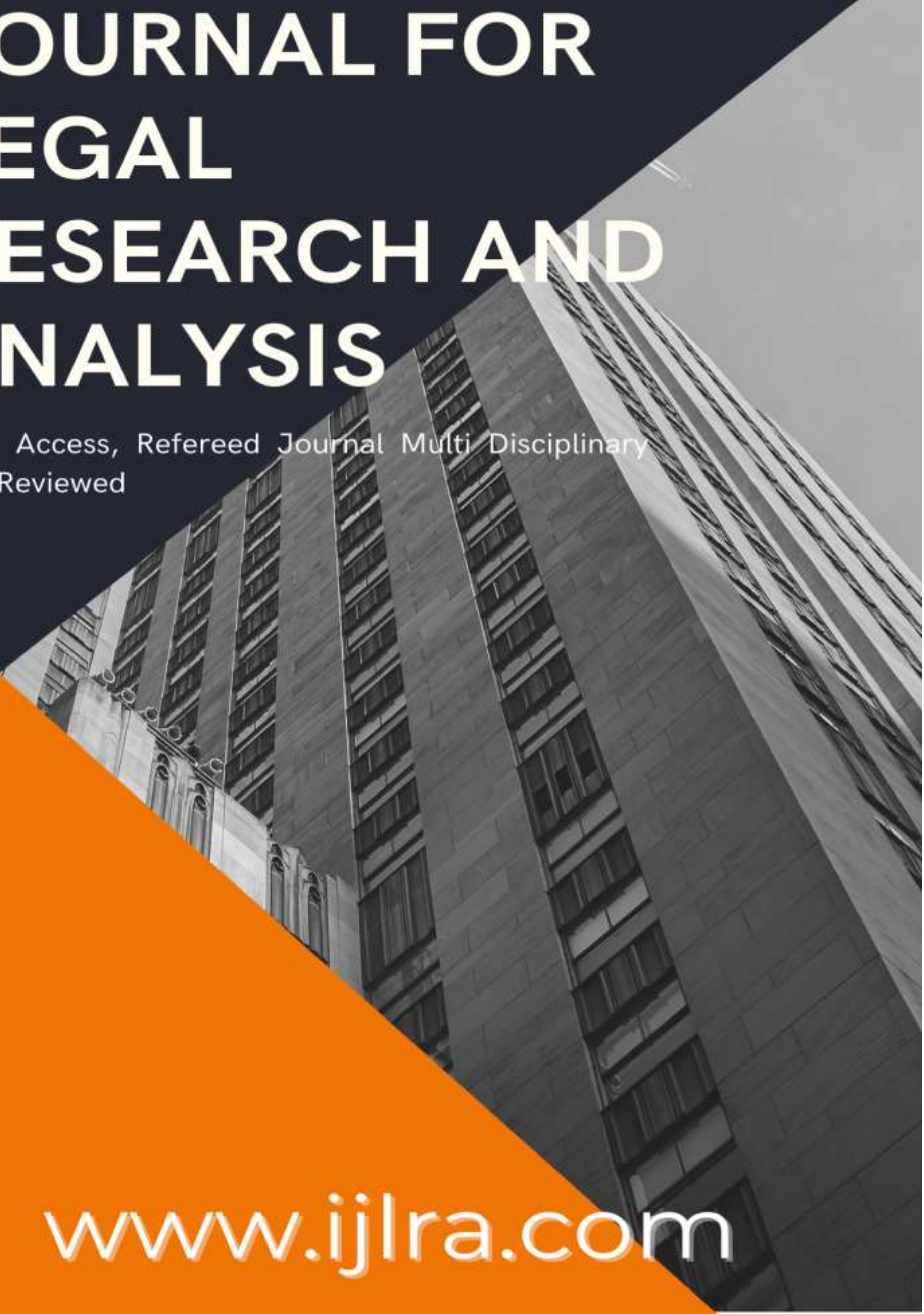

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Avinash Kumar

Avinash Kumar has completed his Ph.D. in International Investment Law from the Dept. of Law & Governance, Central University of South Bihar. His research work is on "International Investment Agreement and State's right to regulate Foreign Investment." He qualified UGC-NET and has been selected for the prestigious ICSSR Doctoral Fellowship.He is an alumnus of the Faculty of Law, University of Delhi. Formerly he has been elected as Students Union President of Law Centre-1, University of Delhi.Moreover, he completed his LL.M. from the University of Delhi (2014-16), dissertation on "Cross-border Merger & Acquisition"; LL.B. from the University of Delhi (2011-14), and B.A. (Hons.) from Maharaja Agrasen College, University of Delhi. He has also obtained P.G. Diploma in IPR from the Indian Society of International Law, New Delhi.He has qualified UGC – NET examination and has been awarded ICSSR – Doctoral Fellowship. He has published six-plus articles and presented 9 plus papers in national and international seminars/conferences. He participated in several workshops on research methodology and teaching and learning.

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 ISSN: 2582-6433

CORPORATE FRAUD: ANALYSING PREVENTIVE MEASURES UNDER INDIAN LAW

AUTHORED BY - SIDDHARTHA RAI
Student of B.A.LL.B (Hons) IInd semester
University of Allahabad, Prayagraj

ABSTRACT

This paper provides an in-depth study of corporate fraud in India, its effect, and its consequences on investors and the reputation of the company involved. Also, this paper focuses on types of corporate fraud in detail and provides insight into types of corporate fraud, also this paper discusses the preventive measures of corporate fraud such as how to prevent and detect corporate fraud in companies or an organization. Also, this paper provides detailed insights about the laws and legislations existing in India to prevent corporate fraud by discussing several laws in detail also this paper mentions some major corporate fraud in India as well as the world. At the end of the paper, there are some basic recommendations based on research to prevent corporate fraud. This research is carried out to understand corporate fraud and preventive measures existing in India to prevent corporate fraud. Corporate fraud is a breach of trust & that damages business culture and goes beyond financial malfeasance. In India, corporate fraud is mainly governed by the SEBI ACT, PMLA ACT, COMPANIES ACT, PREVENTION OF CORRUPTION ACT, INDIAN CONTRACT ACT, and INFORMATION TECHNOLOGY ACT, by combining these Indian legislation provide safety and security to companies from corporate fraud.

The paper's major focus is on understanding corporate fraud, its types, & Indian legislation preventing corporate fraud.

INTRODUCTION

Corporate fraud is deceptive, illegal, or unethical activity committed by an individual, or company that is done in a dishonest or unethical manner in their capacity as an employee of the company.

Corporate fraud is so complex in nature that it is too difficult to identify, sometimes it requires an office full of forensic employees to identify cases of corporate fraud.

 ISSN: 2582-6433

It is a kind of business fraud that aims to benefit the perpetuating company or individual associated.

It goes behind the scope of the employee-stated position. Corporate fraud is often considered a white-collar crime. Corporate fraud is often perpetuated by top executives of the company which goes beyond billion dollars.

In corporate fraud victims are mostly clients, creditors, investors, and eventually the company which is the source of fraud and its employees. Companies involved in corporate fraud are upon discovery left in ruins and forced into bankruptcy.

Definition of corporate fraud

Corporate fraud is an unethical, illegal, & deceptive practice done by the company or individual holding a position in the company to gain an unfair advantage or to gain a competitive edge over other companies and also to attract investors to the company.

Key takeaways:

- When a company engages in activity that is deceptive or illegal in nature is called corporate fraud.
- There are several types of corporate fraud some of them are falsified accounting and misrepresenting products to attract investors.
- It is an example of White-collar Crime.

Preventive measures for corporate fraud

To prevent any fraud either it is corporate fraud or any general it is necessary to detect it firstly. which means to prevent any fraud it must be detect first. Now we will discuss preventive measures in to two different categories

1. **Detective measures.**
2. **Preventive measures.**

DETECTIVE MEASURES

To detect corporate fraud it must adhere to a multi-facet approach which includes Regular auditing, implementing robust internal control, running awareness program & utilizing advanced technology. Companies must install fraud detection systems & by utilizing machine learning and AI must regulate behavioral analytics and risk assessments.

 ISSN: 2582-6433

PREVENTIVE MEASURES

To prevent corporate fraud company should maintain internal control, ensure protection for fraud reporters, asses risk, Fraud detection, conduct regular audits, employee training, and fraud detection. These are the several factors by applying this company can ensure preventive measures for fraud prevention.

By detecting and preventing corporate fraud companies can prevent corporate fraud.

Knowing your employee means detecting behavioral traits that are often displayed by fraud perpetrators by knowing the employee the fraud can be prevented.

Setting up a reporting system will instill fear in the mind of the perpetrator that upon commission of fraud it will be detected and with this fear fraud can be prevented.

Hiring trustworthy experts who are certified fraud experts or certified fraud forensic experts in a company can prevent corporate fraud.

SCOPE AND OBJECTIVE OF RESEARCH

This research is conducted to understand the corporate fraud, its nature and preventive measures along with the consequences of corporate fraud and to get the detail insight of its type and legal provisions involves in the case of corporate fraud in Indian legal system. and will discuss about the challenges and limitation that are faced by companies or government in preventing corporate fraud. The objective of the research is understanding corporate fraud and analyzing the preventive measures in context of Indian legal system.

TYPES OF CORPORATE FRAUD

Corporate can be done in various ways, It frequently performed by utilizing the sensitive data or by taking advantage of confidential information and using those assets for gain. This fraud is often hidden behind legitimate business practice. For e.g., A company financial record altered to present high profit and good revenue to attract potential investors.

<u>CORPORATE FRAUD CAN BE OF SEVERAL TYPES SUCH AS</u>:

1. **Financial Statement Fraud.**
2. **Asset Misappropriation.**
3. **Insider Trading.**
4. **Bribery and Corruption.**
5. **Embezzlement and Tax evasion.**

 ISSN: 2582-6433

6. **Cyber crime and Data Theft.**

1. **<u>FINANCIAL STATEMENT FRAUD</u>:**

Financial statement fraud is a white-collar crime usually perpetrated by management insiders to represent the company in a more favorable fiscal light.

This fraud is a deliberate misrepresentation of a company's financial statements, whether through omission or exaggeration, to create a more positive impression of the company's financial position, performance, and cash flow.

It is usually done by senior management of the company with the purpose of personal gain, to keep business afloat, and to maintain status as a leader in the field.

Financial statement fraud causes damage to current & potential investors and shareholders of the company also it causes reputational damage to the company.

In short, financial statement fraud is committed when a person with access to financial documents and information manipulates data to appear a company more successful.

2. **<u>ASSETS MISAPPROPRIATION</u>:**

In the fraud of asset misappropriation, there is the involvement of a third party or employee of an organization who abuses their power or position to steal from it. This type of fraud can be called Insider fraud.

Members involved in fraud misappropriation can be company directors employees or anyone else who is entrusted to hold and manage the company properties.

Stolen assets can be cash, cash equivalent, or intellectual property as well as company data. Stealing assets doesn't mean stealing direct companies' assets such as stationary or other physically present assets.

One of the major examples of assets misappropriation is **false expense claims.**

3. **<u>INSIDER TRADING:</u>**

It is malpractice, where the trade of companies' security is undertaken by people who have access to non-public information which is crucial for decision-making regarding investment. This access to information is by virtue of their work or position in a company.

When insiders, have information of non-public data or strategic information of the company, by utilizing this information in trade and investment in company stocks and securities.

Then it is called Insider trading. But in the case when information is made public then it is not called insider trading, in the case of insider trading the other investor suffers the loss or is at

 ISSN: 2582-6433

disadvantage.

4. BRIBERY AND CORRUPTION:

Bribery and corruption are defined as giving money, gifts, or some other valuable items to influence the work or decision of others or to get special treatment or favor. It is an illegal and unethical practice. Whereas corruption is defined as using power or authority for personal gain. It is an illegal and unethical practice. Corruption is the most common problem in government institutions & organizations.

Corruption can occur by **commission as well as omission.**

Corruption and bribery can affect the judgment and justification of corrupt actors in government officials holding positions.

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Corruption are of several types such as:

- Demand-side corruption.
- Conventional corruption.
- Petty corruption.
- Grand corruption.
- Unconventional corruption.

5. EMBEZZLEMENT AND TAX EVASION:

Embezzlement and tax evasion both are different concepts but almost similar in cases, embezzlement is a white–collar crime.

In which an individual, or employee of a company or an organization misappropriates the assets entrusted to them for their personal gains. Embezzlement is an intentional act, it is not a mistake. For embezzlement, a key element is the existing fiduciary relationship.

Tax evasion is intentionally and illegally avoiding the payment by an individual or an organization of its true tax liability.

If an individual or an organization willfully fails to pay the tax can attract criminal charges against the person, it is a crime defined under **the Internal Revenue Service's (IRS) tax code**. Tax evasion can be either non-payment or underpayment of taxes.

Generally, someone is not considered to be guilty of tax evasion until and unless they are proven to be intentional.

6. **CYBER CRIME AND DATA THEFT:**

Cybercrime is an offense that is done by using a computer and the internet, such as hacking, data theft, malware attacks, and financial fraud. Cybercrime increases due to heavy reliance on digital platforms. **In 2023 alone cyber crime costs over $8 trillion in damages.**

Data theft is a kind of cybercrime, data theft is illegally copying, removing, and stealing confidential, sensitive, or valuable information of an individual or business without their knowledge or consent is called data theft. In this type of theft, a person gets threatened with getting their password, personal information, banking, or financial information getting stolen. While, companies get threatened with getting their client data, source code, and corporate trade secret getting stolen.

Data theft is an offence, which is governed by IT ACT 2000.

INDIAN LAWS AND REGULATIONS

Corporate fraud is a very serious white-collar crime in which billions of dollars is on stake. Due to very high level of seriousness of matter it requires proper laws and regulation for its control. The web illegal financial transaction poses serious threat to corporation and individuals. To address this threat there are several different laws and regulation addressing corporate fraud.

Different laws governing corporate fraud are:

- Indian Contract Act,1873
- Companies Act 2013
- Securities And Exchange Board Of India (SEBI) Act,1992
- Prevention Of Corruption Act,1988
- Information Technology Act,2000

These are the several laws that govern or address the corporate fraud in INDIA. we will discuss each and every laws in details about corporate fraud.

1. **INDIAN CONTRACT ACT, 1873**

Section 17 of Indian Contract Act defines the fraud which say that *Fraud' means and includes any 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 thereto or his agent, or to induce him to enter into the contract:—*

 ISSN: 2582-6433

1) *the suggestion, as a fact, of that which is not true, by one who does not believe it to be true;*
2) *the active concealment of a fact by one having knowledge or belief of the fact;*
3) *a promise made without any intention of performing it;*
4) *any other act fitted to deceive;*
5) *any such act or omission as the law specially declares to be fraudulent.*

This section of Indian Contract Act defines fraud, and corporate fraud is a subset of fraud which is a bigger term which includes corporate fraud inside it. ICA, 1873 deals with corporate fraud by providing legal framework for investigation, prosecution and punishments.

2. <u>COMPANIES ACT, 2013</u>

Under Companies Act, 2013 Part XXIX, Section 447 to 454A talks about the corporate fraud and punishments of various types of fraud committed.

- 447A- Punishment for false statement
- 448,49,50- Punishment for forgery
- 542- Liability for fraudulent conduct of business

As per Companies Act, 2013 fraud is defined as:

i. *"fraud", in relation to affairs of a company or anybody corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss;*

ii. *"wrongful gain" means the gain by unlawful means of property to which the person gaining is not legally entitled;*

iii. *"wrongful loss" means the loss by unlawful means of property to which the person losing is legally entitled.*

There are punishment defined under section 447. Punishment shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

ISSN: 2582-6433

3. SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI) ACT, 1992:

The Security and Exchange Board of India monitor and regulate the Fraud. The corporation Finance investigation department carries out the detail scrutiny on irregularities such as Fraud, diversion, material misstatement, fraudulent party transaction suspected diversion of funds etc.

Key function of SEBI includes monitoring and regulating and safeguarding interest of Indian investors as well as guiding them about securities market and intermediaries.

SECTION 12A – This section prohibits the manipulative and deceptive devices, insider trading, and acquisition of security and control. It says that no person shall directly or indirectly indulge in employing device that are manipulative in nature or engaging in insider trading etc.

SECTION 15E- this section imposes penalties for failure to observe rules and regulation by an asset management company. This section explains that where any assets management company of mutual fund registered under this Act fails to comply any restriction on the activity of asset management, then such company shall be liable for penalty.

4. PREVENTION OF CORRUPTION ACT, 1988:

Prevention of corruption act plays crucial role in tackling the corporate fraud in company by addressing corrupt practices and holding official liable for their actions. It provides legal provisions for investigating, and prosecuting corruption related crimes including those done by individual as well as company. The prevention of corruption act deals mainly with the public sector but it covers corporate fraud in matter related to bribery and corruption etc.

5. INFORMATION AND TECHNOLOGY ACT, 2000

The Information and Technology Act, 2000 played a crucial role in tackling the corporate fraud by its 2 major section that addresses the corporate fraud.

SECTION 43 - This section criminalizes unauthorized access to computer systems, including hacking, data theft, and manipulation of information. It also covers actions that cause damage to computer systems, data, or networks.

SECTION 66 - This section prescribes punishment for individuals who commit offenses under Section 43 with dishonest or fraudulent intent. This means if someone engages in the actions

 ISSN: 2582-6433

outlined in Section 43 with the intention of deceiving or gaining an unfair advantage, they can be penalized.

Through these 2 sections Information Technology Act, 2000 deals with matters related to corporate fraud and providing safeguard.

These are the few legal provisions in India which regulates and monitors matters related to corporate and provides punishment by holding both individuals or employee of the company liable for their act and provides punishments according to the provisions mentioned. These are the few basics laws governing the corporate fraud and ensuring security and safety to the interest of the investors.

PREVENTIVE MEASURES

No company can ever eradicate fraud completely but it can be prevented by adapting some preventive measures, such as:

- **Good Practices**
- **Company Culture And Control**
- **Training**
- **Robust Security System**
- **Regular Audit And Assessment Of Fraud Risk**

By utilizing all these measures company can detect fraud faster.
With evolving nature of corporate companies nowadays software are also performing well in detecting fraud , by installing certain software that can keep a close look on data security, financial transaction and detect suspicious activity companies can detect fraud.

Also, there are certain preventive measures such as :

1. Corporate Governance Best Practice
2. Internal Control And Auditing
3. Whistle Blower Policies
4. Regulatory Compliance

 ISSN: 2582-6433

1. **Corporate Governance Best Practices:**

   Corporate governance best practices focuses on ensuring a company is directed and controlled in such a way that maximize value for stakeholder while adhering to ethical and legal standards. The main elements of corporate governance best practices are accountability, transparency, fairness, responsibility, and risk management.

2. **Internal Control And Auditing:**

   In a company, internal control can be defined as a process and security measures set up for reaching a certain goal. It aims to identify the potential risks linked to non-compliance of your internal process. It plays a crucial role in preventing and detecting corporate fraud.

   Internal controls, like segregation of duties and reconciliation of accounts, help prevent fraud by limiting opportunities for fraud and identifying discrepancies. Auditing, including internal and external audits, provides an independent check on internal controls and financial reporting, helping to uncover fraud.

3. **Whistle Blower Policies:**

   Whistle blower policies in corporation aim to establish a framework for employee to report suspected fraud and unethical behavior, ensuring a safe and secure process for reporting & protecting whistle blowers.

   Key elements include; safe reporting channel, protection, proper investigation, confidentiality, and regular review.

4. **Regulatory Compliance:**

   Regulatory compliance is defined as an action taken by an organization to comply with those rule and policies as part of its operation. When it comes to the matter related to data then there are rules of handling sensitive information to be in specific framework companies make an internal process to keep data safe and protected.

   Due to the increasing number of regulations and need for operational transparency, organizations are increasingly adopting the use of consolidated and harmonized sets of compliance controls. This approach is used to ensure that all necessary governance requirements can be met without the unnecessary duplication of effort and activity from resources.

CHALLENGES AND LIMITATION

Implementing preventive measures faces several challenges like difficulty of adapting to evolving fraud technique, balancing fraud prevention with customer experience, and managing resource constrain. Lack of awareness, inadequate internal control, and complex organizational structure can also hinder successful implementation. Although global law enforcement authorities along with companies' stakeholder are taking drastic step to counter crime, also there are several challenges that faces by digital sector right now.

There are several other challenges faces in implementing preventive measures such as :

- **ENFORCEMENT ISSUE**
  These challenges are due to lack of proper communication of policies and maintaining a culture of compliance and utilizing robust internal control. Also there is issue arises like policy dissemination, improper training and awareness, and policy attestation.

- **COMPLEXITY OF CORPORATE STRUCTURE**
  This is one of the several reason of challenges in implementing preventive measures due to complex structure of corporate companies. Corporate companies involves multiple layers of ownership, control, and legal entities, making it difficult to determine the ultimate beneficial owners (UBOs) and the actual control mechanisms within the company which causes challenges in implementing preventive measures.

- **EMERGING RISKS:**
  Implementing corporate fraud includes several emerging risk such as involvement of technological advancement, and continuous change of regulatory landscape.
  Also this risk includes, Data theft, cyber fraud, regulatory crackdown, due to all these limitation there is difficulty in tackling corporate fraud issue.
  These are the several challenges and limitation of implementation of corporate fraud preventive measures.

SOME MAJOR CORPORATE FRAUD CASES

- ***SATYAM COMPUTERS SCAM 2009:***
  The Satyam scam is one of the biggest accounting scams in India. Done by Company Satyam Computers. Chairman of Satyam Computer Service admitted to exaggerating

 ISSN: 2582-6433

sales, earnings, cash balances, and personnel numbers in the company's books. He also acknowledged siphoning off money from the firm for his personal use. The Satyam fraud was considered worth Rs. 7800 crores and was formerly regarded as India's largest business scandal. This scam highlighted the lack of corporate governance, auditing standards, and regulatory monitoring in India's one of the leading IT firms. The founder and chairman of Satyam Computer Services admitted to falsifying the company's accounting for many years in 2009.

This disclosure surprised investors, workers, and regulators, ruining Satyam's and the Indian business community's image.

The Satyam scam was a methodically planned effort to defraud stakeholders. Raju and a small group of accomplices increased sales, earnings, and cash levels, providing a false sense of financial accomplishment. Forging bank statements, faking invoices, and inflating customer numbers were all part of the fraudulent operations. Auditors tasked with protecting shareholders' interests failed to discover the anomalies, showing the failure of corporate governance processes.

- ***ENRON SCANDAL:***

  Enron scandal, a series of events that led to bankruptcy of the US energy commodities and Service Company Enron Corporation in 2001 and the dissolution of Arthur Andersen LLP, which had been one of the largest auditing and accounting companies in the world. The collapse of Enron, which held more than $60 billion in assets, involved one of the biggest bankruptcy filings in the history of the United States, and it generated much debate as well as legislation designed to improve accounting standards and practices, with long- lasting repercussions in the financial world.

- ***NIRAV MODI-PNB BANK SCAM 2018:***

  The Nirav Modi-PNB scam was a massive financial fraud case involving diamond jeweler Nirav Modi and Punjab National Bank (PNB), one of India's largest public sector banks. Nirav Modi and his associates secured fraudulent letters of undertaking (LoUs) from PNB, enabling them to access substantial funds without collateral. The scam's total value was estimated at nearly $2 billion.

  These are the few major corporate fraud in India as well as around the world.

  These are few notable cases in India that serve as reminders of the importance of effective regulatory oversight, corporate governance and transparency. They have also led to reforms in various sectors and increased awareness of the need for robust measures to prevent and address corporate fraud.

Addressing it is not only crucial for investor protection but also for maintaining India's reputation as a destination for business and investment.

RECOMMENDATIONS AND CONCLUSION

As per based on above Research work there are following recommendation to prevent corporate fraud and enhance preventive measures:

- STRENGTHENING REGULATORY FRAMEWORKS.
- ENHANCING CORPORATE GOVERNANCE.
- FUTURE DIRECTIONS FOR RESEARCH AND POLICY.
- STRENGTHENING BOARD OVERSIGHT
- IMPROVING INTERNAL CONTROL.
- PROMOTING TRANSPARENCY AND ACCOUNTABILITY
- LEVARAGING TECHNOLOGY

Corporate frauds are rising globally as well as in India, fraudster see financial institution as a series of process that they need to overcome, but once speared, the reward can be magnanimous.

Corporate fraud is a breach of trust and which damages business culture and goes beyond financial malfeasances. It damage culture of business, hinders the trust of stakeholder and damages the reputation of the organizations. The main reason behind fraud cases is due to intense competition in the market creating an environment for unethical practices.

In India corporate fraud is mainly governed by SEBI ACT, PMLA and Companies ACT to prevent corporate fraud.

Corporate frauds in India are not merely financial transgression; they are societal challenges that demand collective action. While regulatory bodies, auditors, and technology can play pivotal role in fraud detection and prevention, its ethical fabric of corporate culture that will ultimately determine the fate of INDIA.

 ISSN: 2582-6433

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