# CORPORATE FRAUDS & MONEY LAUNDERING

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- Corporate frauds/ Scams in India (or elsewhere) have effected the Indian Economy and corporates badly.
- India has one of the highest percentage of corporate frauds detected which have been close link with corruption and bribery.
- Harshad Mehta Scam, Satyam Scam, Sardha Scam, 2G Scam, Neerav Modi Scam, Mallaya Scam are few widely reported Scams

# TYPES OF CORPORATE FRAUDS





- BRIBERY AND CORRUPTION
- MISAPPROPRIATION OF ASSETS
- MANIPULATION OF FINANCIAL STATEMENTS
- PROCEDURE RELATED FRAUDS
- CORPORATE ESPIONAGE

# BRIBERY AND CORRUPTION



- CASH OR IN KIND
- PROCUREMENT FRAUD
- VENDOR FRAUD
- COLLUSION AMONG VENDORS
- COLLUSION BETWEEN EMPLOYEE AND VENDOR

# BRIBERY AND CORRUPTION

- KICKBACKS
- DIVERTING BUSINESS
- OVER INVOICING
- BID-RIGGING

# MISAPPROPRIATION OF ASSETS



- FAKE SALES
- FALSE BILLING
- MANIPULATION OF INVENTORY
- PHYSICAL PADDING

# FRAUD THROUGH MANIPULATION OF FINANCIAL STATEMENTS

- OVERSTATING REVENUE
- UNDERSTATING EXPENSES
- INADEQUATE DISCLOSURE
- OVERSTATING VALUE OF ASSETS
- UNDERSTATING VALUE OF ASSETS

# DEFINITION OF FRAUD
# INDIAN CONTRACT ACT 1872



**Section 17** of the Act defines fraud as –

**“Fraud” means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agents, with intent to deceive another party thereto his agent, or to induce him to enter into the contract.**

**Section 17 (1)** – the suggestion as to a fact of that which is not by one who does not believe it to be true –(**SUGGESTIO FALSI** or suggestion of falsehood.)

**Section 17 (2)** – the active concealment of a fact by one having the knowledge or belief of the fact (**SUPPRESIO VERI** or suppression of a fact.)

**Section 17 (3)** – a promise made without any intention of performing it. (A promise made falsely with the intention of inducing the other party to make a reciprocal promise and thereby enter into a contract.)

**Section 17 (4)** – any other Act fitted or designed to deceive.

**Section 17 (5)** – any such act or omission as the law specially declares to be fraudulent

# DEFINITION OF FRAUD
# INDIAN CONTRACT ACT 1872



**Explanation to Section 17**

This **Explanation** states a very important proposition of law. According to Explanation to Section 17 – the mere silence as to a fact likely to affect the willingness of a person to enter into a contract is not fraud. However, such silence is to be held as fraud , if the circumstances of the case that –

•It is the duty of the person keeping silence – to speak

•That his silence in itself is equivalent to speech.

# MAJOR FRAUDS

- HARSHAD MEHTA SCAM
- SATYAM SCAM
- SARDHA SCAM
- UREA SCAM
- BIHAR FODDER SCAM
- TAJ CORRIDOR SCAM

## LOSSES INCURRED BY THE BANKS DUE TO FRAUDS

According to various reports and estimates, the banks have lost very large sums due to frauds as evident from the following coverage-

i. Public sector banks lost a total of **₹ 227.43 billion** due to banking frauds between 2012 and 2016, notes an IIM-Bangalore study.

ii. Electronics and Information-Technology Minister Ravi Shankar Prasad recently told Parliament, quoting Reserve Bank of India (RBI) data, there had been **over 25,600 cases of banking fraud worth ₹ 1.79 billion reported up to December 21, 2017.**

iii. Twenty-one public sector banks (PSBs) have incurred losses totalling ₹ 25,775 crore due to banking frauds in the financial year 2017-18, a Right to Information reply has stated. The Punjab National Bank (PNB) had incurred the highest loss of ₹ 6,461.13 crore due to different cases of fraud during the fiscal that ended on March 31, 2018.

*http://www.rediff.com/business/report/psu-banks-lost-rs-227-bn-to-frauds-in-5-years/20180215.htm*

*https://www.financialexpress.com/industry/banking-finance/21-psu-banks-lost-rs-25775-crore-in-bank-frauds-in-financial-year-2017-2018-reveals-rti/1183434/*

**WHAT IS A BANK FRAUD?**

However, the **Reserve Bank of India**, the Central Regulators for all the banks in the country does defines **Bank fraud** as-
**" A deliberate act of omission or commission by any person, carried out in the course of a banking transaction or in the Books of accounts maintained manually or under computer system in banks, resulting into wrongful gain to any person for a temporary period or otherwise, with or without any monetary loss to the bank."**

Coming to the legal aspect of bank fraud, we find that the **Indian Penal Code,** 1860 does not define the act of fraud even though it defines specific terms connoting fraudulent misconduct like wrongful gain and wrongful loss (Section 23); dishonestly (Section 24); fraudulently (Section 25); cheating (Section 415); conspiracy (Section 120A). Similarly, certain types of misconduct by public servants have been constituted in to offences under **the Prevention of Corruption Act, 1988 (as amended),** like-

*7. Offences relating to public servant being bribed.*

*7A. Taking undue advantage to influence public servant by corrupt or illegal means or by exercise of personal influence.*

*8. Offences relating to bribing of a public servant.*

*9. Offences relating to bribing a public servant by a commercial organisation.*

*10. Person in charge of commercial organisation to be guilty of offence.*

*11. Public servant obtaining valuable thing, without consideration from person concerned in proceeding or business transacted by such public servant; and*

*13. Criminal misconduct by a public servant.*

*It is to be noted that the Bank employees are PUBLIC SERVANTS under Section 21 of the IPC,1860, the Prevention of Corruption Act, 1988, and the Banking Regulations Act,1949(section 46A). Hence any bank employee indulging in criminal misconduct in his capacity as a Bank employee would be liable to be proceeded against for the offences constituted under IPC, the Prevention of Corruption Act and other extant special laws.*

# The Companies Act, 2013





**Section 447(1) defines fraud as follows:**

"fraud" in relation to affairs of a company or any corporate, includes

(a) any act,

(b) omission,

(c) concealment of any fact or

(d) 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;
"wrongful gain" means the gain by unlawful means of property to which the person gaining is not legally entitled;
"wrongful loss" means the loss by unlawful means of property to which the person losing is legally entitled.

## STATUTORY PROVISIONS OF FRAUD UNDER THE COMPANIES ACT, 2013

**PUNISHMENT FOR FRAUD (SECTION 447):**Any person who is found guilty of fraud shall be punishable with imprisonment for a term which shall not be less than six (06) months but which may extend to ten (10) 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 (03) times the amount involved in the fraud. Where the fraud in question involves public interest, the term of imprisonment shall not be less than three (03) years

**PUNISHMENT FOR FALSE STATEMENT (SECTION 448):**If in any return, report, certificate, financial statement, prospectus, statement or other document required by, or for, the purposes of any of the provisions of this Act or the rules made thereunder, any person makes a statement,—
which is false in any material particulars, knowing it to be false; or
which omits any material fact, knowing it to be material
he shall be liable under section 447.

**PUNISHMENT FOR FALSE EVIDENCE (SECTION 449):**

If any person intentionally gives false evidence –

a.upon any examination on oath or solemn affirmation; or

b.in any affidavit, deposition or solemn affirmation in or about winding up of any company under this Act, or otherwise in or about any matter arising under this Act,

he shall be punishable with imprisonment for a term which shall not be less than three (03) years but which may extend to seven years (07) and with fine which may extend to ten lakh rupees (Rs. 10 Lacs).

**PUNISHMENT WHERE NO SPECIFIC PENALTY OR PUNISHMENT IS PROVIDED (SECTION 450):**

If a company or any officer of a company or any other person contravenes any of the provisions of this Act or the rules made thereunder and for which no penalty or punishment is provided elsewhere in the Act, they shall be punishable with fine which may extend to ten thousand rupees (Rs. 10,000) and where the contravention is continuing one, with a further fine which may extend to one thousand rupees (Rs. 1,000) for every day after the first during which the contravention continues.

**PUNISHMENT IN CASE OF REPEATED DEFAULT (SECTION 451):**

If a company or an officer of a company commits an offence punishable either with fine or with imprisonment and where the same offence is committed for the second or subsequent occasions within a period of three (03) years, then, that company and every officer thereof who is in default shall be punishable with twice the amount of fine for such offence in addition to any imprisonment provided for that offence.

This section is not applicable to the offence repeated after a period of three (03) years from the commitment of first offence.

**ADJUDICATION OF PENALTIES (SECTION 454):**

The Central Government may by an order published in the official gazette appoint adjudicating officers for adjudicating penalty under this Act. The Central Government shall also specify their jurisdiction. The adjudicating officer may, by an order impose the penalties on the company and the officer who is in default, stating any non – compliance of default under the relevant provision of the Act. Any person aggrieved by an order made by the adjudicating officer may prefer an appeal to the regional director having jurisdiction in the matter.

**OFFENCE OF FRAUD NON- COMPOUNDABLE**

As the punishment for Fraud is both imprisonment and fine, it is considered a non-compoundable offence. It shows that, the commission of Fraud has become a serious offence in the eyes of law. The Act has provided punishment for fraud under section 447 and around 20 sections of the Act talk about fraud committed by the directors, key managerial personnel, auditors and/or officers of company. Thus, the new Act goes beyond professional liability for fraud and extends to personal liability, if a company contravenes such provisions. Here, the contravention of the provisions of the Act with an intention to deceive are also considered as fraud, to name a few acts amounting to fraud:-

1. Furnishing of false information at the time of incorporation of company by promoters, first directors or any other person – Sec 7(5)&(6)
2. Managing the affairs of the non-profit company fraudulently – Sec 8(11)
3. Misrepresenting any material information in prospectus – Sec 34
4. Inducing any person fraudulently to invest money – Sec 36
5. Making of applications for acquisition of any securities in fictitious names – Sec 38(1)
6. Issue of duplicate shares of company with intent to defraud or deceive – Sec 46(5)
7. Transfer of any shares by depository or depository participant with an intent to defraud, deceive any person – Sec 56(7)
8. Concealment of name or misrepresenting the amount of claim knowingly of any creditor – Sec 66(10)
9. Failure to repay deposit with intent to defraud depositor -Sec 75(1)
10. Furnishing of false statement, mutilation, destruction of secretarial documents – Sec 229
11. Conducting business to defraud its creditors, members or any other person – Sec 213 (proviso)

**VII. FRAUD REPORTING UNDER THE COMPANIES ACT, 2013**

Section 143(12) to 143(15) of the Act contain provisions relating to reporting of Fraud, where the statutory auditor (who is appointed as per Section 139 of the Act), cost auditor who is appointed as per Section 148 of the Act) and the secretarial auditor (who is appointed as per Section 204 of the Act) are responsible to detect Fraud. In the event of detection of any Fraud, they have to first inform the Board of Directors and then to the Central government.

**Fraud Reporting** is defined in Section 143 (12) of the Act as "notwithstanding anything contained in this section, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within such time and in such manner as prescribed under the Companies (Audit & Auditors), Rules , 2014."

**Section 143 (13) :** No duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred to in sub-section (12) of Section 143 of the Act if it is done in good faith.

**Section 143(14)**: The provisions of this section shall *mutatis mutandis* apply to—

a.the cost accountant in practice conducting cost audit under section 148; or

b.the company secretary in practice conducting secretarial audit under section 204.

## COMMON CATEGORIES OF BANK FRAUDS

One thing is certain that each and every bank fraud, barring some rare exceptions, involves the culpable role of one or more bank personnel dealing with the transaction. With the rise in crime in cyber-space and increased digitisation of the banks, the contributory role of the account holder cheated also comes to light that is attributable to his negligent conduct by way of sharing vital details of his bank account, Credit/Debit card to the unauthorised persons. Different types of frauds that have become known during all these years are summarised in following slides:

**STOLEN CHEQUES FRAUD**

It involves stealing cheques and getting credit of the same by depositing in an assumed name (the beneficiary of the cheques) by opening an account in some bank.

**ACCOUNTING FRAUD**

It involves fudging of the accounts of the company running in losses, in order to show it in profit, and then borrowing from the bank against such manipulated records of account.

**FORGERY AND ALTERED CHEQUES FRAUDS**

The fraudster tinkers with the particulars mentioned in the cheque and thereby gets credit in his account dishonestly.

**DEMAND DRAFT FRAUD**

It involves use of certain leaves of the Demand Draft book from the bank with the connivance of bank employee(s), and then being issued to some distant bank branch for the benefit of the fraudster.

**UNINSURED DEPOSITS FRAUD**

Certain bank without license to raise funds from the public may resort to raise deposits for the bank that will be uninsured as well. The misapplication of funds so raised to the detriment of depositors is covered under this head.

**FRAUDULENT LOANS**

Here a company promoted by some person in connivance with some bank official(s) is advanced loan on the strength of papers of doubtful documents, and the accused then declares bankruptcy and vanishes with the borrowed amount.

**FRAUDULENT LOAN APPLICATIONS**

The borrowing company prepares loan application with untrue credit history rendering them unworthy of loan sanction. However, in collusion with bank employees such tainted applications are processed successfully resulting into sanction of the loan applied for. The same is not repaid because the company in first place was ineligible for loan and had neither the capacity nor any intention to pay the same either.

**CHEQUE KITING FRAUD**

Here the *modus operandi* is to exploit the ''FLOAT'' system prevalent in the banking industry that permits reflecting credit of the cheque amount in two accounts simultaneously during the transit period of cheque processing and credit/debit entries being given effect to. The fraudster is able to take credit of the cheque proceeds from the receiving branch in connivance with bank employees even though the cheque should have bounced for want of sufficient funds from the issuing account.

**REMOTELY CREATED CHEQUE FRAUDS**

This *modus operandi* involves issue of pay orders that are authorised by the drawer remotely on phone and internet without the cheque being actually signed by the drawer. The time lag involved in processing such transactions at both end facilitates fraud by some unscrupulous persons.

**WIRE TRANSFER FRAUDS**

These frauds cover interbank transfer using the international SWIFT INTERBANK FUND TRANSFER system. Despite lots of checks in place against its misuse, still certain entities are able to commit fraud running into huge amount with the collusion of the bank officials on either side or both sides.

**DISCOUNTING FRAUD BILL**

It involves winning the trust of the bank by the accused entity by having the bank collect payments from its customers, also part of the racket. In due course, the bank is induced to start making payment to the accused upfront for bills it will collect from the customers later. The trust gained by the accused person is used to siphon off huge sums as upfront payments without sufficient balance in the account. Thereafter the erring company disappears along with ill-gotten funds.

**PAYMENT CARD FRAUDS**

It assumes number of *avtaars* that enables the cardholder to spend from his card or that of other dishonestly. Booster Cheques, essentially bad cheque used to enhance the limit of credit card; use of duplication or skimming of card information; stolen payment cards; and identity thefts, are some of the illustrative modus operandi used to commit frauds under this category.

**CYBER FRAUDS**

With new age banking systems, having gone digital, the criminals are hacking, tampering with data stored in bank servers, even from remote locations, are gain unauthorised access to customer data and then transferring money to their accounts, sometimes even maintained in tax havens.

**PHISHING AND INTERNET FRAUDS**

It involves luring a customer by online exchange of mails into sharing his vital bank account particulars and this information is then used to draw money from his account on the basis of identity theft or online auction fraud. The trend to dupe the credulous customers online to obtain their bank particulars by the fraudsters have seen very significant rise during the recent years all over the world. The weakness to succumb to making extra money as promised by the online fraudster coupled with his inadequate grasp over computer operation, also account for such type of frauds to a significant extent.