

Role of Legal Mechanism in Control of Corporate Frauds

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Abstract

Today frauds are become on rise due to the many reasons. Any type of corporate fraud will be seen as a business risk due to the loss it causes. Strong regulatory mechanism is necessary to protect the business entities from occurrence of the corporate frauds. The very purpose of regulatory mechanism is protecting the interests of the investors as well as the promoters. The well defined regulatory mechanism is required to be in place.

The papers attempt to gives a glimpse upon need, purposes, and various related regulations responsible and other related facets of the regulatory mechanism in place.

Key Words: Regulatory, Corporate, Frauds

Introduction:

The basic object of providing the regulatory mechanism is mainly to keep the financial condition of the companies in good condition. Also to provide protection to the money invested by the investors and shareholders in anticipation of the better future growth. The legal frame work will helps to ensure that, the companies will remain financially sound and so can meet their obligations.

Aspects legal frame work empowers the regulatory agencies to periodically examine each of various functioning aspects of companies to check the functioning in tune to the provisions of laws.

The Government empowers to enact the applicable regulations and as well as to oversee the enforcement of the various aspects of each related law. Such laws are designed to prevent any type of unfair means & misappropriation of the funds by the management in place. Regulation of the financial and management aspects constitutes the main focus of legal frame work in the country.

India has a well developed regulatory mechanism to govern the corporate sector in a whole. Regulations have been enacted in tune to the need arises from time to time to overcome the emerged challenges in prevention & checking of the fraudulent activities in the corporate sector.

The government has to play a positive role by creating appropriate machinery for monitoring the corporate sector within the country. The government has to protect the interest of these social groups through suitable monitoring mechanism. Such mechanism is provided by the Government of India (GOI) through the various related regulations from time to time in meeting the requirements of the corporate sector. Among these regulations, the companies Act, 1956 is a comprehensive piece of legislation. Under this Act, various monitoring agencies such as, the Department of Company Affairs (DCA) and Registrar of Companies (ROC) are created.

Purposes:

Few of the following proposes have to be note it down in the context of having the legal mechanism to monitor the companies are,

- 1) The basic purpose behind the monitoring the companies is to avoid their mismanagement by the directors, officers and staff working in the companies.
- 2) Corporate sector is an important sector of the national economy.
- 3) It plays a positive role in bringing industrial and economical development and
- 4) This sector provides goods / services to people and employment to millions of people.

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These benefits will be available only when the corporate sector functions in an orderly manner. For this, the corporate sector needs effective monitoring.

Need For Monitoring Mechanism:

Monitoring mechanism through the legal framework is needed to keep effective supervision on the companies so that they will not operate in efficiently, misuse of available resources and finally exploit employees, investors and consumers through unfair trade polices and practices.⁴

The following points justify the need of machinery for monitoring the companies in India.⁵

- 1) Monitoring is needed for avoiding inefficient functioning of joint stock stock companies.
- 2) Effective monitoring is necessary for avoiding misuse of funds.
- 3) Avoiding unfair business Practices.
- 4) Avoiding Industrial sickness of the companies and
- 5) To enable proper functioning of the company.⁶

In brief, machinery monitoring companies is needed with a view to,

- i) protecting the interest of employees, share holders and creditors.
- ii) facilitating the development of corporate sector on healthy lines; and
- iii) helping the attainment of the ultimate ends of social and economic policies of the government.⁷

Changing Legal Landscape:

There is increased regulatory activism, and existing Acts are being amended and updated to address new and complex threats. Regulators are proposing more stringent standards for prevention, detection and reporting of fraud. For instance, the Government has proposed various measures to counter fraud risk in the Companies Bill 2011, which is slated to replace the Companies Act 1956.

This is in addition to many current regulations such as clause 49 of the listing agreement, Companies' (Auditor's Report) Order (CARO) 2003, which entrusts the responsibility of preventing corporate fraud to the Directors, CEO, CFO and auditors of a company.

Globalization has added to the regulations to which companies need to adhere. Governments around the world, in an attempt to address bribery and corruption risks, have introduced anti-corruption legislation such as the US FCPA and the UK Bribery Act, which have extra-territorial jurisdiction.

More and more companies are taking cognizance of the changing regulatory scenario. We are seeing an increased focus on corporate governance. Also companies are increasingly now taking proactive measures against fraud, bribery and corruption.

In recent times, several changes have been made in various laws and regulations relating to fraud, bribery and corruption, and others are being proposed, some of these acts and proposed bills, with their changes and salient lectures, and summarized below

Related Regulations Of The Study:

The mainly applicable related regulations in the context of the study are as,

- 1) The Companies Act, 1956
- 2) The Securities and Exchange Board of India (SEBI) Act, 1992
- 3) The Chartered Accountants Act, 1949
- 4) The Company Secretaries Act, 1980.
- 5) The Information Technology Act, 2000.

Each of the selected regulation is discussed in detail in the following paragraphs.

1) The Companies Act, 1956:

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It is the most important piece of legislation. This Act is successor the previous Indian Companies Act of 1913 and is a consolidation of successive Amendments from time to time. So, the Companies Act of 1913 was repealed by the present the Companies Act of 1956.

This Act came in to effect from 1 April, 1956. It contains 658 Sections, XV Schedules, a number of Rules besides Company (Court) Rules and various types of applicable Forms. This Act is based largely on the report of the Company Law Committee, 1952 (Known as Bhabha Committee). It extends to the whole part of India with certain exceptions¹².

The Companies Act, 1956, for the first time also provided a greater of government control over formation and the management of the companies. This was considered desirable in the public interest and in order to prevent the diversion of company's funds for purpose which thwarted national economic policies of approved economic objectives.

It primarily regulates the formation, financing, functioning and winding up of companies. The Act prescribes regulatory mechanism in regarding all relevant aspects including organizational financial and managerial aspects of the companies. Regulation of the financial and management aspects constitutes the main focus of the Act. In the functioning of corporate sector, although freedom of companies is important, protection of investors and shareholders is also equally important. The Companies Act, 1956 plays balancing role between these two are competing factors.

It empowers the Central Government to inspect the books of the company, to direct special audit, to order investigation in to the affairs of a company and to launch prosecution for violation. These inspections are designed to find out whether the companies conduct their affairs in accordance with the provisions of the Act, whether any unfair practices prejudiced to the public interest are being resorted by any company and whether there is any mismanagement which may adversely affect any interest of the share holders, creditors and others. If an inspection discloses a prima facie case of fraud or cheating, action is initiated under the provisions of the Companies Act. Same is referred to the Central Bureau of Investigation (CBI). The Act has included amended provisions added from time to time.

Under Section 2(13), 254, 255, 260, 262, 265, 313 and 408 of the Act denotes the requirements regarding the various components of the Board of Directors.

Under Section 2 (26) of the Act has definition of the Managing Director and under Section 267 has the provisions in relate to the disqualification of the M D.

According to Section 2 (45) of the Act contains the provisions relating to the Company Secretary.

New Section 55 A provides the Securities and Exchange Board of India (SEBI) shall have the exclusive power to administer the provisions of the Sections 55 to 58, 57 to 819 (including 68A, 77A, 80A), 108,110,112, 113, 116 to 119, 122, 206, 206A and 207).

Under Section 205C empowers the Central Government to take measures for promotion of investor's awareness and protection.

Sections 209, 210A, 211, 212, 227 and schedule VI outline the legal frame work governing annual financial statements of the companies. Under section 211 read with schedule VI prescribes the disclosure requirements of financial statements.

Sections 224 to 233 contain provisions relating to various aspects of the company auditor.

Under section 235 and 237 empower the Central Government to order investigation in to the affairs of the company under circumstance specified

Section 269 read with Section 388 of the companies Act, 1956 empowers the central government accords the approvals for the appointments and reappointment of persons as

Managing Directors, whole time Directors or Managers of public limited or private limited company.

The Act has been amended from time to time in response to the changing requirements of the business environment. That includes in 2000, 2001, 2002, 2006 and 2008.

The proposed Companies Bill, 2011 has been introduced in parliament with many reforms in the existing law, clause. 132 of the bill defines the expression independent directors and also stipulates minimum number at 1/3rd of the total number of directors.

2) The Securities Exchange Board of India (SEBI) Act, 1992:

An Act to protect the interests of investors in securities and to promote the development of and to regulate, the securities market in whole. The SEBI was subsequently upgraded as a fully autonomous body with statutory powers in the year 1992 by passing the SEBI Act. It is a statutory, autonomous regulatory board with defined responsibilities to both development and regulation of the securities market and listed companies.

More particularly, under Section 11 (2A) of the SEBI Act, 1992, the Board may take measures to undertake inspection of any book, or register, or other document or record of any listed public company or a public company which intends to get its securities listed on any recognized stock exchange where the Board (SEBI) has reasonable grounds to believe the such company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market. Further, Board (SEBI) has powers (equivalent to that of a civil court under the Code of Civil Procedure, 1908) to inspect any book, or register, or other document or record of the company¹⁶.

Clause 49 of the listings agreement covers all major components of a company and its board, including board's composition, audits committee, certification of accounts, basis of related party transactions, and disclosure of accounting treatment and details about subsidiary companies. This clause covers all major function of a company. As this clause is mandatory in practice for all the listed companies on the stock exchanges.

3) The Chartered Accountants Act, 1949:

With the growth and importance of accountant profession, The Chartered Accountants Act, 1949 was passed. Previously, the auditor's qualifications and other related aspects were governed by the Auditor's Certificate Rules, 1932 of the Central Government. The objective of present Act is to make provision for the regulation of the profession of Chartered Accounts in India. The enforcement of the provisions of the Act vests with the Institute of Chartered Accountants of India (ICAI), an apex body empowered by the Central Government to promote and conduct of profession of Chartered Accountants in India. The provisions of the Act included the amended provisions from time to time by the government.

Chapter -V of the Act has special description of the provisions for the disciplinary action against any of the audit professional, who found in misconduct on part of exercising the professional duties. The Act has been amended in 2006 to make provisions for newer clauses.

4) The Company Secretaries Act, 1980:

An Act to regulate the Company Secretary's profession in India by the enactment of the Company Secretaries Act in 1980 by the Central Government. Under this Act, the Institute of Company Secretaries of India (ICSI), an autonomous body was formed and empowered to regulate the company secretaries' education and other allied aspects relating to the profession.

5) The Information Technology Act, 2000:

On the topic of awareness of Indian laws on Information Technology and related data, the level of awareness was found to be below the global standards.

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The first step toward regulating electronic commerce was taken by the Government of India in May 2000, when the Information Technology Act 2000 was passed. It broadly covered the following aspects'

- Legal recognition of electronic documents
- Legal recognition of digital signatures
- Offenses and contraventions
- Justice dispensation systems for cybercrimes

Further to this, amendments were made in the Act to cover data privacy and Information Technology (Amendment) Act. 2008 came into being. This Act mandates companies to implement "reasonable security practices" for protecting "sensitive personal Information" of any Individual failing which they are liable to pay damages to the aggrieved person.

Indian businesses today are leveraging contemporary technologies to deliver world class services and products, both in domestic and International markets and the revised Act provides a promotional legal framework to address the technology risks and to enhance business growth. The Act ensures legal recognition to electronic records and digital signatures and categorizes

Conclusion:

The basic aspect of the legal frame work in respect with the corporate is to safe guard the interest of the investors as well as to the related aspects of the corporate, which paves the way for growth of financial soundness in healthy manner of the companies.

Providing legal frame work for the corporate houses has gained importance today in view of growing risk of fraud due to the huge investments by investors in modern business establishments. The legal control of corporate frauds is a modern institute of law, which is fast developing to the growth of corporate sector in security environment.

The prevalence and increase in risk of frauds in corporate sector is to such an extent created the need for reforms in existing laws regulating the corporate. As this is evident in the growth of case of frauds even after in place of developed legal control system in India.

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