Speech of the Director, CBI
on
“Corporate Frauds-Risk & Prevention under Changing Paradigm”

(May 13, 2014 at New Delhi)

Ladies and Gentleman!

It is my pleasure to be here this morning to deliver the special address at the 8th Annual Summit on Corporate Frauds.

The corporate frauds, of late, have been a cause of concern across the globe. These frauds have been gaining new dimensions with the pace of advanced technology requiring attention of all stakeholders.

The most common reasons of the infamous corporate frauds in the world were identified as the greed of the promoters / top management, to sustain the investor pressure, luring of innocent investors, failure of the over sight mechanisms and other regulators, inadequate laws and in some cases, unhealthy incentive / bonus mechanisms.

India is seen an emerging country with a plethora of opportunities and also seen as a potential market where many global giants are planning to expand business. However, these opportunities also carry with them, risks and challenges by way of fraud, bribery and corruption.

In recent years India has also witnessed a marked increase in the number of scams that have surfaced both in public and private sectors. The scale and size of Corporate Frauds in India has zoomed in the last 15 years with majority of the cases of fraud involving siphoning off funds by promoters /top management and defrauding the lenders/investors.

Let us have a look at the way a fraud has been defined in Indian context.

Fraud is generally described as an intentional and deliberate act to deprive another person or institution of property or money by deception or other unfair means. It is further defined with respect to financial reporting, as an intentional act that results in a material mis-statement in the financial statements. Though, sections 17 of Indian Contract Act, 1872 has a definition of fraud, the same has undergone a change in the recent times. Series of Corporate Frauds of unimaginable magnitude like the Satyam scam have led to a relook on the provisions. The new Companies Act 2013 has come out with several clauses which cover wider area under ‘Fraud’ including new definition and penal provisions. I am happy to note that there is a Technical Session planned on this and you will be deliberating on this issue at length.

However, I would like to draw your attention to the common categories of Fraud which continue to be the modus operandi adopted by Corporates for availing huge limits from financial sector**.** Most of the corporate frauds fall under asset mis-appropriation and submission of fraudulent statements like Concealment of liabilities, Improper asset valuation, Fictitious revenues, Improper disclosures, etc. It is these practices which are causing severe damage to our financial system. The quantum of its impact is evident from the fact that the total number of frauds reported by the commercial banks as on March 31, 2013 were 1.69 lacs involving amount to the tune of Rs. 29910 crores. The Public Sector Banks have cumulatively lost a massive sum of Rs. 22743 crores due to cheating and forgery in the three years ending March 2013.

At the same time, there has been a sharp rise in the NPAs of commercial banks. The gross NPAs of the Public Sector Banks were Rs.164462 crores in March 2013 comprising 3.6% of gross advances and are estimated to have grown further as on March 2014.

Though, all the NPAs cannot be classified as frauds, the rise in the gross NPAs and the volume of cases being increasingly referred to the **Corporate Debt Restructuring (**CDR) mechanism indicates towards increasing incidents of siphoning /diversion of funds by the corporates/ promoters.

The normal question to ask would be why frauds are happening?

To me, corporate frauds are manifestation of the failure of corporate governance mechanism. It is manifestation of a culture of competition which spurs and motivates rule breaking as the power of business concern expands and misuse of executive power, also involving personal gains. It seems that, a short term objective of good results instead of long term sustainability is leading to growing fraudulent practices.

These frauds are also occurring due to collective failure of the regulatory oversight mechanisms like the statutory auditors, the independent Directors, the Board, the shareholders and other regulators. This is, where a lot of correction, is required.

To add to the list of causes are the systemic errors. As per RBI analysis, majority of the credit related frauds are on account of weak appraisal system, laxity in post-disbursement supervision and non- compliance with terms of sanction. Lack of coordination among the lender banks on sharing of information further aggravates the problem. In order to project better indicators about Non Performing Assets by the banks, majority of the fraud cases come to light only during the recovery process initiated after the accounts have been classified as NPA.

Very often during recovery process, banks are confronted with the fact that the title deeds are not genuine or the borrower has availed multiple finance against the same property which clearly indicates that the basic safeguards are not taken by the banks while disbursing the loans. Dependence on the professionals/ consultants like Chartered Accountants, Valuers and Advocates involved in the credit dispensation process have been leading to the increased instances of corporate frauds as some of these professionals are colluding with the corporates to generate inflated financials, overvaluation of securities, defective title deeds of properties mortgaged.

This reasoning is supported by the findings at CBI. Investigation of cases of fraud has revealed that, fraudulent documentation, multiple funding, over-valuation/non-existence of collateral and siphoning off funds are some of the areas in which banks have witnessed major incidents of fraud. Another emerging trend in the banking sector is that after getting the money the borrower escapes causing huge losses to the bank in the absence of adequate collaterals and tracking of proceeds of crime.

A related issue in this context is the considerable delay in identification, classification and reporting of frauds by the financial sector. Delay in reporting helps the corporates / borrowers to defraud the banking system and also leading to loss of time enabling the fraudster to dispose the available assets making task of investigative agencies difficult.

This brings me to raise the question of corporate responsibility.

Good corporate governance serves as a very important factor in control of fraudulent activities. RBI has clearly indicated that fraud risk management, fraud monitoring and fraud investigation function must be owned by the bank's CEO. Similar analogy can be extended to corporate sector. An appropriate system of governance is symbolized by a structure, which is adaptable and flexible according to the company's growth. Setting the right tone at the top, intolerance towards unethical behavior coupled with strong internal audit mechanism, accountability and performance management are some of the key elements of Corporate Governance.

While it may be true that Fraud itself cannot be eliminated, but fraud and corruption risks can be managed and controlled like other business risks. A right blend of corporate governance that sets and monitors behavioral expectations intends to deter the fraudster.

Today, our country is facing a different kind of challenge. The growing number of scams involving thousands of crores highlight a nexus which if not checked could have a far reaching impact. Part of this could be attributed to the willingness of the private sector to pay bribes to get their work done. On one hand we haveprofit-seeking companies trying to influence policy makers, regulator etc. and on the other the companies that evade taxes or indulge in irregularities adversely affecting the shareholders, customers and the public at large. The occurrence of such scams and revelations of frauds rightfully draw our attention to the inadequacies in the legal, institutional and regulatory framework for corporate governance in India.

So what is the Road Map Ahead?

1. There is inherent risk in banking business and corporate sector in today's economy thereby underlying the importance of old saying "prevention is better than cure".

   To prevent the corporate frauds from insiders as well as from outsiders, surveillance and detection of frauds is important by taking proactive steps to prevent the frauds.

Poor corporate governance standards and lack of firm resolve by the top Management are often seen as important obstacles in fighting this menace. An important ingredient is to strengthen internal vigilance mechanism. Oversight by Board of Directors through the audit processes and the internal systems and control must be able to identify weak areas, raise concerns timely and plug gaps in early stages in an efficient manner.

Another effective way for detecting fraud and corruption can be through implementation of a robust whistle-blowing mechanism.

In the scenario where complexities involved in the financial and banking regulation are on the rise, new financial products and regulations are being introduced much frequently than ever before, the necessity to have requisite expertise to detect such white collar crimes with the latest audit tools of forensic audit cannot be overstated. It will not be out of place to stress that the advantages of technology need to be utilized to contain menace of frauds.

2. Close liaison needs to be maintained among regulators and investigating agencies to ensure timely completion of investigations and closure of cases to ensure that officials not found guilty are allowed to work in an independent manner. The regulatory bodies and the investigative agencies like SFIO, SEBI, CBI, the ED, along with the Registrar of Companies and the Ministry of Corporate Affairs need to interact more frequently at various levels to share the intelligence and the outcome of the respective investigations to ensure desired corporate governance and also to avoid repetition by way of multiple investigations on the same set of allegations by various investigative agencies.

3. There is also a need for institutional mechanism for information sharing and use of common database by all the regulatory as well as investigating agencies in the country to achieve better results.

However, all our efforts may fall short of expectations unless higher integrity standards are followed by the corporate sector and punitive action is taken against the culprits without delay.

I will conclude with a quote of Frederick W. Robertson that "There are three things in the world that deserve no mercy, hypocrisy, **fraud**, and tyranny."

Finally, I thank ASSOCHAM for inviting me to this session of the conference and wish the conference deliberations a grand success.

Thank you.

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