

Corporate Governance as A Mechanism for Fraud Prevention in Indian Companies: A Legal and Regulatory Analysis

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Abstract- The need for Corporate Governance as a mechanism that can provide an enabling legal system for transparency, accountability, and integrity within corporate organizations has become imperative, especially in emerging economies like India. The importance of CG as a means for preventing frauds, financial statements, and other types of corporate governance failures cannot be overstated in the wake of such incidences being increasingly witnessed among corporates. This research seeks to explore the effectiveness of CG mechanisms in India, considering their capability to prevent, detect, and handle any cases of frauds. It will evaluate the relationship between legal mechanisms, such as the Companies Act, 2013, and regulations from bodies such as SEBI, towards ensuring strong corporate governance. The research examines how important elements of governance, like independent directors, audit committee members, internal control systems, and whistleblowers, contribute to fraud prevention. The research analyzes landmark cases involving corporate fraud in India in order to understand how corporate governance failure and weaknesses contribute to corporate fraud. Some of the issues that the study will address include the problem of regulation and enforcement of corporate governance regulations, the problem of regulatory arbitrage, and the challenge posed by the changing landscape of financial crimes with the emergence of digital finance.

Keywords: *Corporate Governance, Corporate Frauds, Companies Act*

I. INTRODUCTION

The concept of corporate governance in India has emerged as an important tool for ensuring that corporations run their businesses in an accountable and responsible manner. Corporate governance, essentially, is about the way in which corporations are governed. This includes rules, principles, and procedures that help balance the needs and interests of various stakeholders including shareholders, management, customers, and regulatory agencies. The

complexity and international nature of contemporary businesses make it extremely difficult to protect against fraudulent activities unless there is adequate corporate governance. Corporate governance in India is regulated through laws like the Companies Act, 2013, which makes provisions for governance-related matters like board composition, disclosure obligations, and duties of directors. In addition, corporate governance norms in India have been made mandatory for listed firms under regulations like LODR.¹

The history of CG reforms in India is highly associated with large-scale corporate fraud cases, which shed light on deficiencies in corporate governance and risk management. In one such case, the PNB fraud scandal brought to light several weaknesses in the governance structure of banks. Such scandals have led to the introduction of reforms in governance regulations, stressing the importance of having independent directors, better audit practices, and better disclosure procedures. The introduction of Section 177, which makes the establishment of an audit committee mandatory, and Section 245, which facilitates class-action lawsuits, are some instances of such reform efforts.²

II. STATEMENT OF THE PROBLEM

Although there are adequate legislative frameworks in the Indian corporate environment in terms of corporate governance, the effective implementation of actions to tackle corporate frauds has not been possible. This means that although there exists a sound legal framework to govern corporate governance, yet the mechanism itself lacks effectiveness in terms of preventing frauds. There are drawbacks in the entire process of CG, thus making fraud prevention very difficult. The complexity of the situation arises when

one looks at the underlying issues that have come about as a result of inadequacies in the structure and institutions themselves. These issues include promoter-dominated CG, lack of freedom of the board and auditors, overlapping of jurisdictions between different regulatory agencies like SEBI, MCA, RBI, and SFIO. Besides, inadequate enforcement, delays in investigation and the absence of whistleblower protection contribute to making the laws of corporate governance inadequate.

III. LITERATURE REVIEW

Gupta & Gupta (2025)³ points out that corporate frauds are the major issue in India, which is only revealed at the last moment when the organization is on the verge of collapse, thereby creating distrust among the investors, decreasing income generation, and losing valuable resources. These types of fraud are generally not known until the individuals in the companies utilize the loopholes in the company and financial systems for their personal gain. The Indian government has developed a complex regulatory system that consists of different government departments, statutory bodies, and investigation agencies like CDD, ED, CBI, and other organizations to tackle economic crimes. Nonetheless, due to the fragmentation of the investigative organizations, they become inefficient unless there is an effective coordination among them.

Bhattacharya (2022)⁴ explores the link between corporate governance practices and financial scandals among publicly held companies in India, particularly the role played by corporate governance issues affecting earnings management and reporting. The study highlights that lack of board independence, ineffectiveness of the audit committee, and promoter dominance have been noted as some of the factors making organizations susceptible to fraud. In addition, the study underscores the importance of institutional arrangements such as LODR regulations enacted by SEBI.

Sharma and Mehta (2020)⁵ investigate the efficacy of the regulatory structure in combating corporate fraud using governance mechanisms in India. The paper examines the importance of important legislation, including the Companies Act, 2013, SEBI

Regulations, and the PMLA. It explains how all of these laws have been designed to ensure accountability and transparency. However, the research concludes that while the legal system has been established effectively, there have been inconsistencies in its implementation. This is mainly because of bureaucratic delays and a lack of coordination among regulatory agencies. Moreover, corporate frauds usually take advantage of deficiencies in the monitoring and reporting processes.

Khari and Sharma (2025)⁶ The effectiveness of CG mechanisms in relation to the provisions of the Companies Act, 2013 and LODR regulations may be assessed based on the capability of these mechanisms to control financial statement fraud among organizations operating in India. According to the researchers, although there is a quite strong set of laws related to corporate governance, financial fraud continues to occur owing to poor enforcement, regulation, as well as collusion among auditors and the management of the organization. In other words, it could be said that CG mechanism, including board of directors and disclosures, represent vital instruments that would enable companies to become transparent and accountable; yet, their efficiency is conditional upon the extent of compliance and symbolical meaning.

IV. OBJECTIVES OF THE STUDY

- To study the use of Companies Act 2013 and other relevant laws in the creation of mechanisms for fraud prevention in Indian companies through corporate governance.
- To analyze how effective regulatory authorities like SEBI and SFIO have been in the detection, investigation, and control of corporate frauds.
- To examine the challenges faced in executing CG norms to prevent fraud and provide suggestions for improvement in the existing system.

V. CORPORATE GOVERNANCE
MECHANISMS FOR FRAUD
PREVENTION IN INDIA

The Companies Act, 2013

The Companies Act, 2013 is the foundation of corporate governance and fraud prevention in India. This law was enacted to supersede obsolete legislation and aims to create a regime of transparency and accountability through strict enforcement mechanisms. It combines the concepts of governance with penalties such that corporations are not just bound by the ethics of corporate governance, but they also have a legal obligation to ensure compliance. Through definitions of fraud, obligations of the board, and regulation by authorities, a system has been created to combat corporate fraud.

Another important provision of the Act is the detailed coverage of fraud provided under Section 447. According to this section, fraud is described in wide terms as an act, omission, concealment of fact, or misuse of position made in a way to cause deception, wrongful gain, or damage to the interests of stakeholders. The penalty for committing fraud is tough, as it includes imprisonment for between six months and ten years, and a fine which could run into thrice the sum involved in the fraud. In cases of fraud where the interests of the general public are involved, at least three years' imprisonment must be imposed. In addition, Section 448 deals with false representations on financial documents, which are penalized as per Section 447.⁷

Board Accountability and Responsibility : Corporate governance starts from the top, and Section 134 makes directors responsible for it in their “Board’s Responsibility Statement.” Directors have to certify that the financial statements show a true and fair picture of the company’s affairs; they comply with accounting standards; and internal financial controls are adequate. In addition, they must ensure compliance with all relevant laws. This section encourages corporate leaders to act ethically and be responsible for their decisions.⁸

Audit, Accounts & Internal Control Mechanisms: The Act also encourages financial discipline by including sections such as sections 128 & 129 that compel

companies to keep accurate records and ensure that their financial statements give a factual and fair picture of their financial situation. Auditors’ obligations are laid out in section 143, which compels them to report any instance of frauds to the union government. In this way, auditors become very important observers within the corporate world.

Audit Committees and Whistleblower Protection : For improvement in corporate governance internally, section 177 provides that there should be an Audit Committee in every listed company, and a specific category of public companies. The functions of this committee include accounting matters, internal controls, and auditing matters. Most significantly, this provision insists upon having a “vigil mechanism” which is popularly known as a whistleblowing mechanism.

Investigation Powers : The law also has effective mechanisms of enforcing compliance via Sections 206, 210, and 212 that enable the government to carry out inspection, inquiry, and investigation into the business dealings of companies. In extreme cases, the issue is referred to the SFIO, a special body competent to deal with corporate fraud cases. Other sections like Section 7(5) make it an offense to submit false information when incorporating a company, and Section 245 enables members to sue directors for fraudulent behavior.

Prevention Of Money Laundering Act, 2002

According to the Act, the use or possession of any property or process involving the use or possession of any property obtained through criminal activity amounts to the crime under Section 3 (PMLA). Under Section 4 , an offender found guilty of committing offences under Sections 3 and 5 will be liable to imprisonment of 3-7 years, which may extend upto 7 years, in addition to fines. One of the important sections from the governance perspective is Section 12. According to Section 12, all reporting entities, such as banks and financial institutions, need to maintain proper transactional records and KYC documentation for the customers. At the same time, they must report suspicious transactions to FIU-IND. This particular section establishes an instant connection among CG and provisions made by the PMLA.⁹

Section 17 and 18 grant the investigative agencies the right to conduct searches, seizures, and investigations in the event that there is any doubt about money laundering. Section 50 grants the investigative agencies the right to summon any person along with documents, as well as to administer oaths with respect to the statements of such persons. Thus, the powers granted to the investigative agencies are quite substantial.

VI. JUDICIAL APPROACH

Union of India v. IL&FS 10 From the governance perspective, the IL&FS case emphasized the significance of effective risk management systems, proper oversight by an independent board of directors, and early warning signals. It was important to tighten the regulatory regime for financial entities and monitor group transactions more strictly. This particular case became a catalyst for many governance reforms for non-banking financial companies.

Tata Sons v. Cyrus Investments 11 The Supreme Court held that courts should not interfere in the internal management of companies unless there is clear evidence of oppression or mismanagement under S. 241 and 242. The Court emphasized the principle of majority rule in CG while also acknowledging the importance of protecting minority shareholder interests. It clarified that business decisions taken in good faith by the board cannot be questioned by courts merely on grounds of fairness.

SEBI v. Reliance Industries Ltd. 12 The Court has decided upon the necessary evidence that would be required for the conviction of insider trading. The Court has made it abundantly clear that it is not sufficient merely to have a hunch or an anomaly in the dealings. There should be an established link between the possession of UPSI and the execution of such dealings.

UOI v. Devas Multimedia 13 The ruling has huge relevance in CG because it helps to widen the area of judicial interventions in cases of fraud within a corporation. It should be understood from the ruling that the court can disregard the corporate personality when the corporation engages itself in criminal activities. With respect to the steps taken to avoid

fraud, it supports them because it shows that there is a need to practice CG within the bounds of the law as well as the needs of the people, otherwise the corporation faces severe consequences.

VII. CONCLUSION

In India, corporate governance has developed as a well-defined system which helps in preventing fraud as a result of legislation like the Companies Act, 2013 and the regulations issued by the SEBI along with the complementary laws. The system incorporates a combination of prevention, detection, and punishment measures through board accountability, strict disclosure standards, audits, and rigorous enforcement measures including Section 447. Other organizations like the SFIO and other agencies like the SEBI help in strengthening the process through proper oversight and enforcement measures. Though there have been many developments in the legal structure, the recurrence of corporate frauds suggests that corporate governance failures occur due to poor enforcement, absence of corporate ethics, and lack of monitoring.

In order to make corporate governance an effective method for preventing fraud, it becomes essential to ensure proper enforcement of the system through active monitoring. This can be achieved through the adoption of technological measures such as data analysis and forensic auditing. In this regard, the independence, appropriate training, and accountability of independent director and audit committees need to be enhanced. Further, more stringent punishment for violations of norms of corporate governance along with timely legal proceedings can deter fraudulent activities from taking place.

Another key aspect which needs to be emphasized is the establishment of a moral culture in companies, not merely complying with the letter of law. For this purpose, robust internal controls and risk management mechanisms need to be established, along with an appropriate mechanism for protecting whistleblowers. Ethical and corporate governance training programs can sensitize employees and management about the risks of frauds. Ultimately, CG shall prove to be effective in combating frauds when there are adequate provisions of laws supplemented by ethical governance practices.

FOOTNOTES

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