

MODULE 3

Financial Frauds

Introduction

Disclosure of many companies' fraudulent practices has brought irreparable loss for financial markets and caused public distrust in many countries as India and United States; companies as WorldCom, Tyco, Global Crossing, Enron, and Adelphia and individuals as Subhjit Ghosh and Nagesh Kini are but a few to name. Many have been affected by these scandals and fraudulent practices; from the managers of big companies down to the normal people; the investors lost their competitive capacity. In a reply to the scandal of Enron, American Institute of Certified Public Accountants (AICPA) released the statement: -Our profession enjoys a sacred public trust and for more than one hundred years has served the public interest. Yet, in a short period of time, the stain from Enron's collapse has eroded our most important asset: Public Confidence.

The scandals raise the questions that how these frauds happened and to what level the future fraudulent practices can be prevented? As these questions can be answered in many different ways, and also each executed financial fraud has different particularities, this chapter is dedicated to explaining the nature of fraud, different types of financial statement frauds, background of scam frauds in India from 1990 to 2012, and how these frauds are committed. Besides presenting a comprehensive definition of fraud, this study purports to analyze different reasons of frauds, and their particularities in India.

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Meaning of Fraud

Fraud is an intentional act or failure to act to obtain an unauthorized benefit to take away a legal right or property by misrepresenting the facts. Examples of fraud include, although not limited to:

1. **Corruption:** It includes conflicts of interest, bribery, illegal gratuities and extortion.
2. **Misappropriation of Cash Asset:** It includes –larceny; skimming; check tampering; and fraudulent disbursements, including billing, payroll, and expense reimbursement schemes.⁷²
3. **Misappropriation of Non-cash Asset:** It includes –larceny; false asset requisitions; destruction, removal or inappropriate use of records and equipment; inappropriate disclosure of confidential information; and document forgery or alteration.⁷³
4. **Fraudulent Statements:** It includes –financial reporting, employment credentials, and external reporting.⁷⁴
5. **Fraudulent Practices by Customers, Vendors or other Parties:** It includes bribes or inducements, and fraudulent (rather than erroneous) invoices from a supplier or information from a customer.⁷⁵

Business Dictionary defines fraud as intentional deletion, change or concealment of a truth in order to (i) gain an illegal advantage, (ii) prompt others to part with a valuable item or give up a legal right, or (iii) cause injury in any manner. Fraud must be done willfully, and negligence and incompetency in managing a business which may even lead to the loss of a company's asset do not normally constitute fraud.⁷⁶

Financial Frauds in India

The increasing number of financial frauds in India has become a serious concern of the government. Among different types of financial frauds, accounting financial frauds are very much common in business world. In this type of fraud the auditors, executives or directors of companies modify and manipulate the financial statement of the company intentionally to deceive some party as stock market analysts or to earn a credit; some examples of these fraudulent practices in India are discussed in the following sections.

A List of Scams in India

The following section includes a list of alleged political, financial, corporate and other types of scams and scandals in India since 1990 to 2012. They are arranged based on the year in which they were first reported. Each example of the fraud will be presented in the table 1.