

Nangia Andersen LLP

INVESTIGATION AS A TOOL OF CORPORATE GOVERNANCE

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CORPORATE GOVERNANCE

UNDERSTANDING CORPORATE GOVERNANCE

MEANING: The term corporate governance refers to a corporation's government. The term is broadly used to describe the oversight responsibilities of different parties for an organization's direction, operations and performance.

DEFINITION of Corporate Governance by the Organization for Economic Co-operation and Development (OECD):

“

The procedures and processes according to which an organization is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organization –such as the board, managers shareholders and other stakeholders- and lays down the rules and procedures for decision making.

”



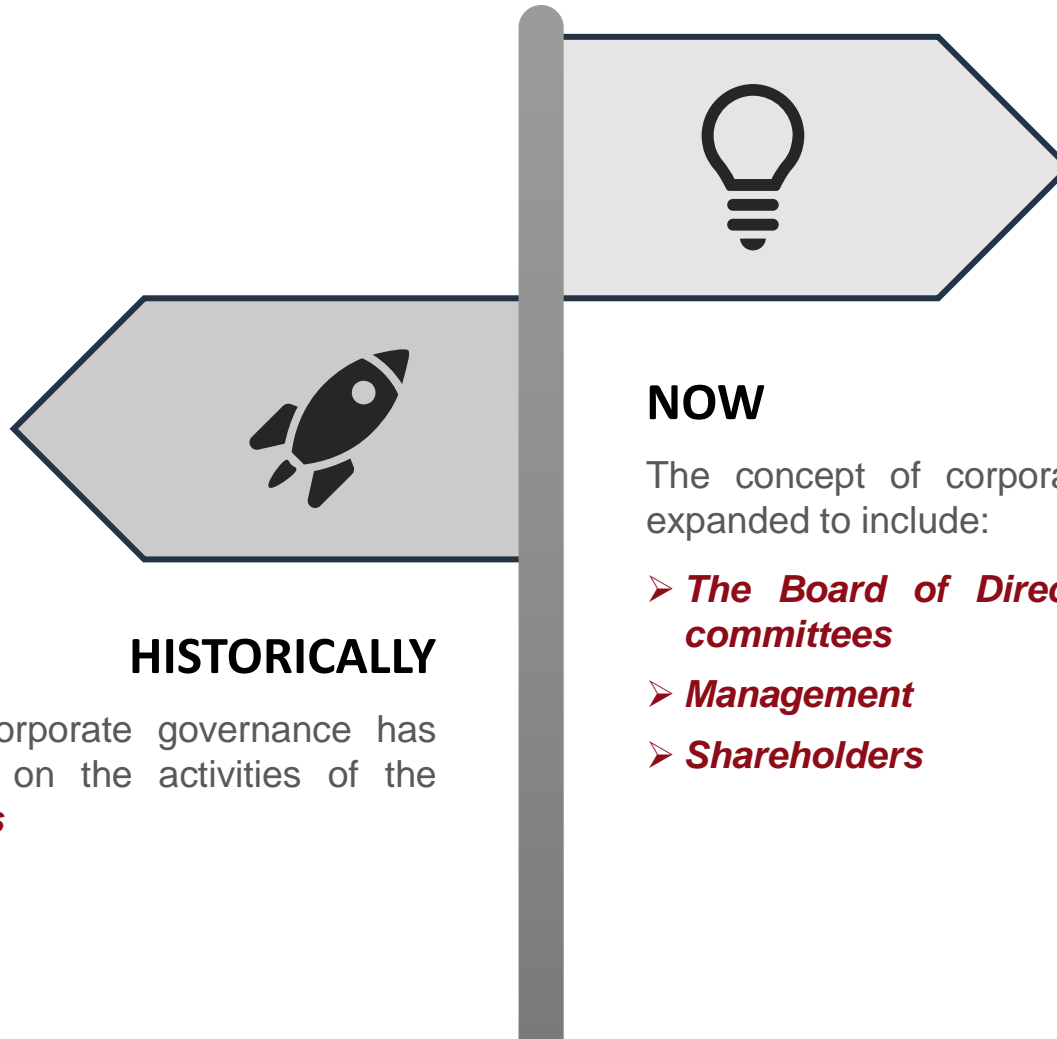
UNDERSTANDING CORPORATE GOVERNANCE

MAIN FUNCTIONS OF CORPORATE GOVERNANCE :



UNDERSTANDING CORPORATE GOVERNANCE

WHO IS INVOLVED IN CORPORATE GOVERNANCE :



HISTORICALLY

The concept of corporate governance has centered primarily on the activities of the ***Board of Directors***

NOW

The concept of corporate governance has expanded to include:

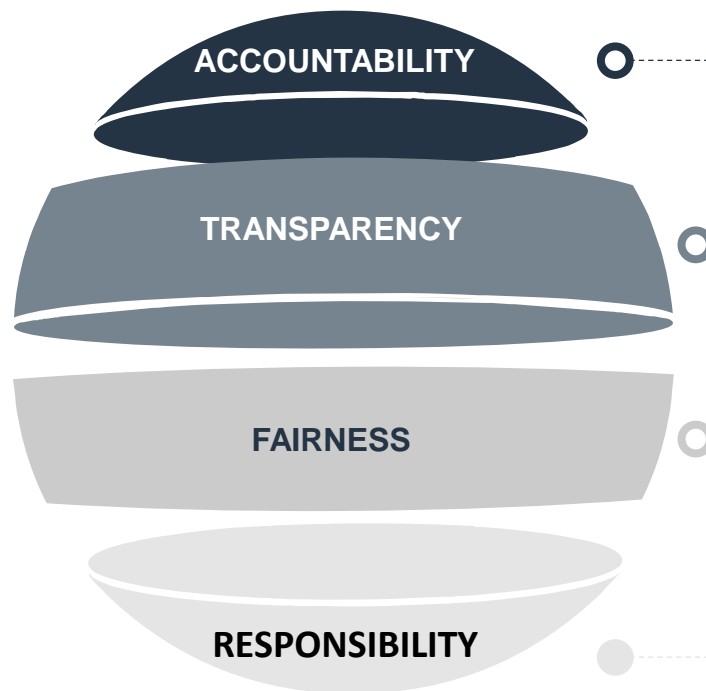
- ***The Board of Directors and its sub-committees***
- ***Management***
- ***Shareholders***



PRINCIPLES OF CORPORATE GOVERNANCE

PRINCIPLES OF CORPORATE GOVERNANCE

Most Systems of corporate governance are focused on several core principles or values, which include the following:



ACCOUNTABILITY:

To make sure that the organization operates effectively and efficiently, there must be mechanisms in place to ensure that management is accountable to the board and that the board is accountable to the shareholders

TRANSPARENCY:

In the context of corporate governance, transparency refers to the clarity, accuracy, completeness, and timeliness of the financial statements and other information provided by management to shareholders

FAIRNESS:

Ensures that all stakeholders are treated equitably and given just and appropriate consideration

RESPONSIBILITY:

Applies both to the duty of internal parties to act in the best interest of the organization and to the duty of the organization as a whole to act in society's best interest.

G20/ OECD PRINCIPLES OF CORPORATE GOVERNANCE



Is a publication by the Organization for Economic Co-operation and Development



It is regarded as one of the hallmark sources of guidance for corporate governance practices for organizations throughout the world



The principles are non-binding, as their implementation must be adapted to different legal, economic and cultural circumstances



According to OECD, the principles “are intended to help policymakers evaluate and improve the legal, regulatory and institutional framework for corporate governance with a view to support economic efficiency , sustainable growth and financial stability.



By agreeing on the principles, OECD governments have established a benchmark for high standards of corporate governance

G20/ OECD PRINCIPLES OF CORPORATE GOVERNANCE

The principles cover six main areas. Following are the main provisions of the principles:

Ensuring the basis for an effective corporate governance

The Corporate governance framework should promote transparent and fair markets and the efficient allocation of resources.

The Rights and equitable treatment of shareholders and key ownership functions

The Corporate governance framework should protect and facilitate the exercise of shareholders' rights and ensure the equitable treatment of all shareholders, including minority and foreign shareholders.

Institutional Investors, Stock Markets and Other Intermediaries

The Corporate governance framework should provide sound incentives throughout the investment chain and provide for stock markets to function in a way that contributes to good corporate governance .



The role of Stakeholders in Corporate Governance

The Corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

Disclosure and Transparency

The Corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation , including the financial situation, performance, ownership and governance of the company.

The responsibilities of the board

The Corporate governance framework should ensure the strategic guidance of the company , the effective monitoring of management by the board, and the board's accountability to the company and the shareholders

INVESTIGATIONS

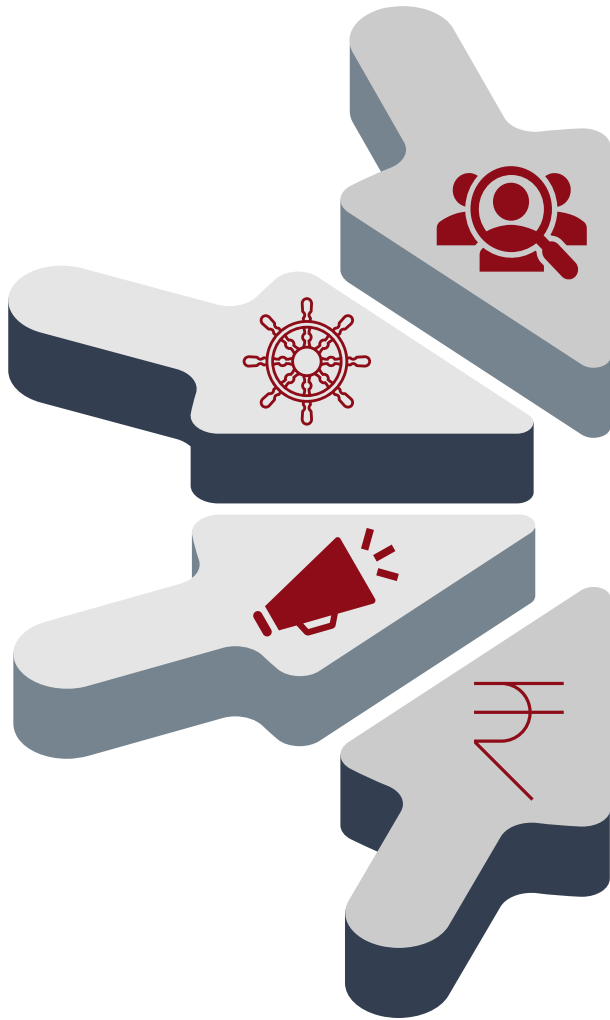
There can be many reason for conducting an investigation in an organisation. The following are the more common ones.



SOURCE: Report to the Nations, 2020 Global Study on Occupational Fraud and Abuse (ACFE)

INVESTIGATIONS

A KEY TO ACHIEVE THE PRINCIPLES OF CORPORATE GOVERNANCE



CORPORATE GOVERNANCE

- Identifying improper conduct
- Identifying the persons responsible for improper conduct
- Sending a message throughout the organization that fraud will not be tolerated
- Determining the extent of potential liabilities or losses that might exist
- Helping Facilitate recovery of losses
- Stopping future losses
- Stopping Fraud
- Mitigating other potential consequences
- Strengthening internal control weakness



CORPORATE GOVERNANCE AND MANAGEMENT'S RESPONSIBILITY

CORPORATE GOVERNANCE CODES AND GUIDANCE

COUNTRY SPECIFIC CORPORATE GOVERNANCE GUIDELINES



- Legislators, regulators and other bodies in location around the world have issued corporate governance guidance specific to their jurisdictions
- Companies should be familiar with the existing guidance specific to all the regions in which they operate and those charged with governance should consult the laws and regulations governing their organizations.

TREADWAY COMMISSION



- The National Commission on Fraudulent Financial Reporting (*the Treadway Commission*) was formed in the United States in 1985.
- The purpose was to define the auditor's responsibility in preventing and detecting fraud.
- Five Predominant Professional Accounting Organizations at the time; AICPA, IIA, AAA, FEI, IMA* established the Treadway commission

* AICPA- the American Institute of Certified Public Accountants
IIA- the Institute of Internal Auditors
AAA- the American Accounting Association
FEI- Financial Executives International
IMA- Institute of Management Accountants

COUNTRY SPECIFIC CORPORATE GOVERNANCE GUIDELINES

SEBI (Listing and Disclosure) Regulations, 2015

INTRODUCTION :

- SEBI, on September 2, 2015 issued SEBI (Listing and Disclosure) Regulations, 2015
- Considering the dynamism brought in by globalization and uncertainties arising from recent events like the COVID-19 pandemic, the exposure of risk to organizations has increased.
- Market Regulator SEBI has published the SEBI (LODR) (second amendments) on May 5, 2021. These set of norms incorporate the **corporate governance principles and emphasize the need of improving corporate governance standards, especially with respect to listed entities.**

APPLICABILITY :

A **listed entity** which has listed its specified securities shall comply with the corporate governance provisions as specified in chapter IV. Such provisions shall be implemented in a manner so as to achieve the objectives of the principles as mentioned below:

- The Rights of shareholders
- Timely Information
- Equitable treatment
- Role of stakeholders in Corporate Governance
- Disclosure and Transparency
- Responsibilities of the Board of Directors

CORPORATE GOVERNANCE REPORT | COMPLIANCE SPECIFIED BY THE REGULATION:

The corporate governance compliance report is to be filed within **15 days from the close of each quarter**

TREADWAY COMMISSION

- To curb fraudulent financial reporting, the Treadway Commission offered the following four recommendations that, in combination with other measures, are designed to reduce the probability of fraud in financial reports.
- These recommendations are addressed to the board of directors' audit committee.



- **Mandatory Independent Audit Committee :**

The Board of Directors oversees management's conduct. The treadway commission recommended that each Board of Director have an audit committee composed of *outside* director.

- **Written Charter :**

The treadway commission also suggested that companies develop a written charter setting forth the *audit committee's duties and responsibilities*. The Board of Directors should periodically review, modify and approve this written charter.

- **Resources and Authority :**

According to the treadway commission, in addition to the existence of an audit committee and the written charter, the committee also must have adequate resources and authority to carry out its responsibilities.

- **Informed, Vigilant and Effective audit committee members :**

The audit committee should be composed of members who are informed, vigilant and effective.

MANAGEMENT'S FRAUD RELATED RESPONSIBILITY



Vicarious/ Imputed Liability

- The specific legal terms and extent of the organization's liability vary by jurisdiction
- However, corporations and other organisations might also be held liable for the criminal acts of their employees if those acts are done in the course and scope of their employment and for the ostensible purpose of benefitting the corporation



Internal controls

- It is Management's job to ensure that proper internal controls are in place to prevent fraud, as well as to detect it
- Management is also responsible for monitoring and remediating internal controls to ensure they are effectively designed and operating to prevent and detect fraud.



Compliance & Ethic Program

- The Organizational Guidelines promulgated by U.S Sentencing guidelines for organizations are designed to provide incentives for organisations to maintain internal mechanisms for preventing, detecting and reporting criminal conduct.
- Certain factors that each organization must consider while designing a program:
Applicable Size and Industry
Size of the organization
Recurrence of similar misconduct



FRAUD PREVENTION PROGRAMS

FRAUD PREVENTION PROGRAMS

Need for implementing fraud prevention programs

- The most cost-effective way to limit fraud losses is to prevent fraud from occurring
- The possibility of being caught serves as a deterrent to potential fraudsters
- Thus, the existence of a thorough control system is essential to fraud prevention



FRAUD PREVENTION requires a system of policies and procedures that can,



Maximise
Detection of fraudulent activity

Minimize
Likelihood of fraud occurring



FRAUD PREVENTION PROGRAMS

PROCEDURES TO PREVENT FRAUD



FRAUD PREVENTION PROGRAMS

Anti-Fraud Policy

INTRODUCTION :

- An Important element of an overall fraud prevention program is a written anti-fraud policy that specifically spells out who in an organization handles varying fraud matters under differing circumstances
- Instituting a separate, formal anti-fraud policy sends a strong message to employees about the organization's intolerance for employee fraud.

ELEMENTS OF ANTI-FRAUD POLICY :

- Components of an anti-fraud policy differ from company to company.
- Many anti-fraud policies have some of the following elements:
 - Policy Statement
 - Scope of Policy
 - Responsibility for fraud prevention and detection
 - Non-Fraud Irregularities
 - Reporting Procedures
 - Investigation Responsibilities
 - Authorization for Investigation
 - Confidentiality
 - Disciplinary Action



COMMUNICATING THE ANTI-FRAUD POLICY :

- Management must periodically and appropriately communicate the company's anti-fraud policy to all employees and third parties.
- The goals of distributing and communicating the policy are to make it easily accessible and memorable.
- Communication regarding the policy can be accomplished in several ways:
 - Orientation/ Annual Training
 - Memoranda
 - Posters
 - Quizzes/ Games





FRAUD RISK ASSESSMENTS

FACTORS IMPACTING FRAUD RISK



The Operating Environment of the business:

- Impacts the vulnerability of organisation
- Businesses with physical presence have a different risk profile than purely internet based business



The Nature of the business:

- Risk involved is directly connected to the nature of business
- Inherent fraud impacting a business varies from industry to industry. Each business is vulnerable in its own way.



The Effectiveness of Internal Controls:

- Preventive and Detective controls can reduce an organisation's exposure to fraud
- No system of internal controls can *eliminate* the risk of fraud, but well designed and implemented controls can help reduce the vulnerability



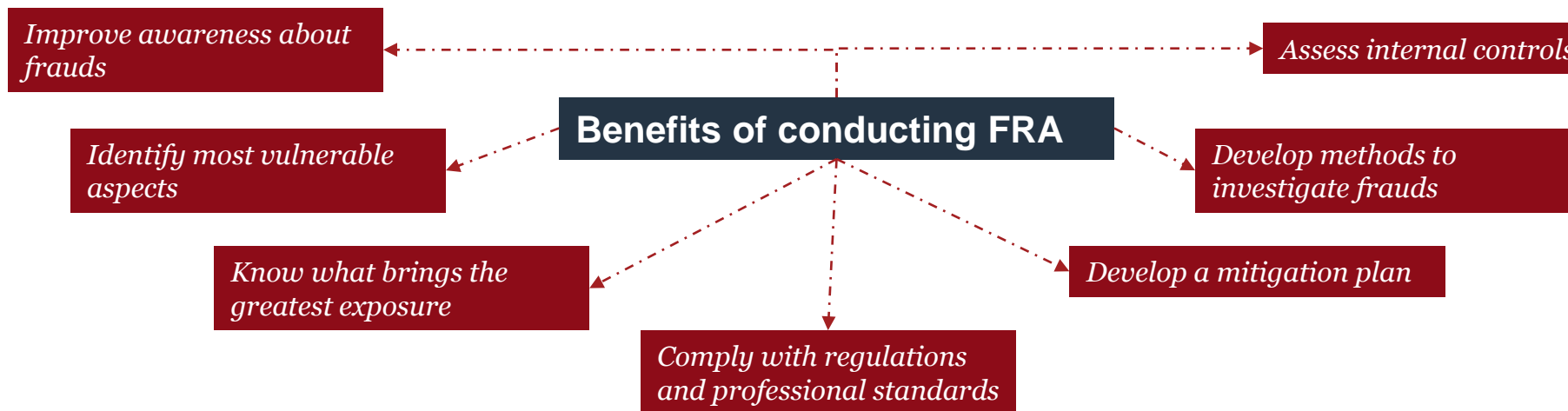
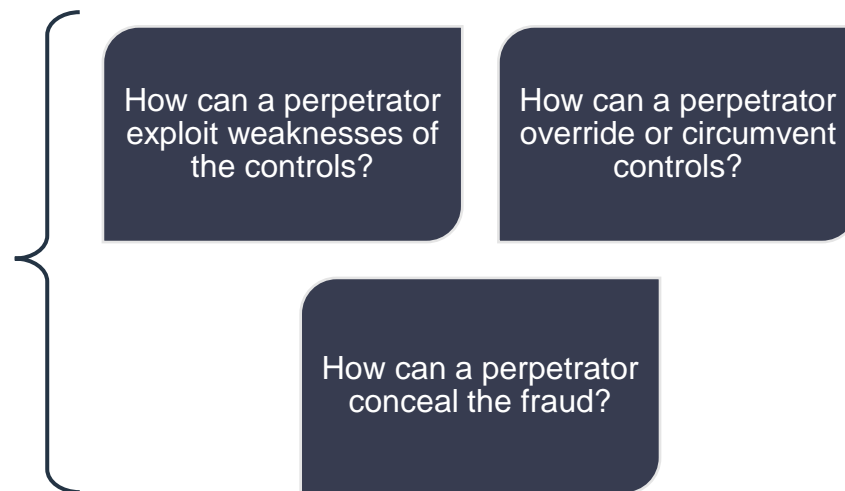
The Ethics & Values of the company

- When the ethics and value of the individuals are not aligned with those of the company, the fraud risks increase.
- Codes of conduct often a grey area between acceptable and unacceptable behaviours

FRAUD RISK ASSESSMENT

FRA is a process proactively aimed to identifying and addressing vulnerabilities to both **internal and external fraud**. What gets evaluated and how is tailored to the needs of each organisation.

An FRA exercise starts with an identification and prioritisation of fraud risks that exist in the organisation. The process evolves as newer risks emerge.



FRAUD RISK ASSESSMENT

Analyse and Assess

Analyse activities performed and associated gaps if any;

Define additional fraud risks basis the gaps identified and identify/ map control activities if any.

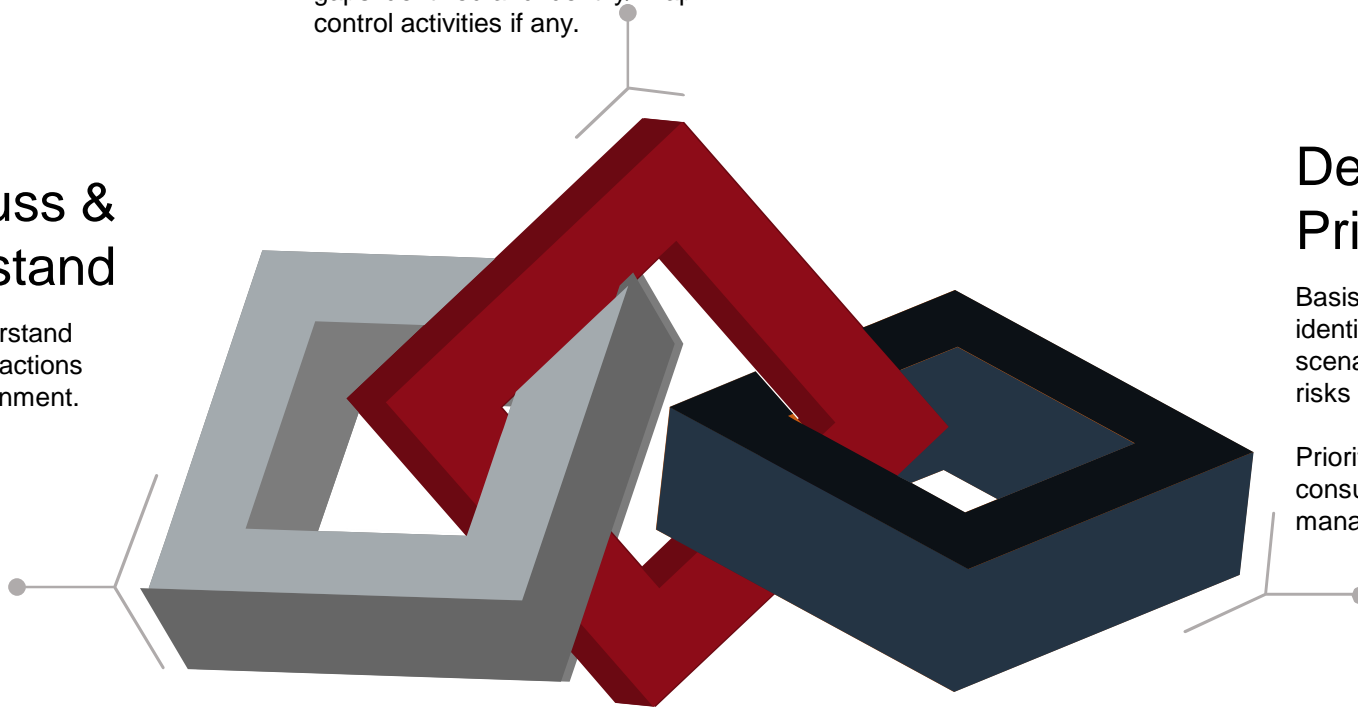
Discuss & Understand

Discuss and understand the process, transactions and control environment.

Define & Prioritize

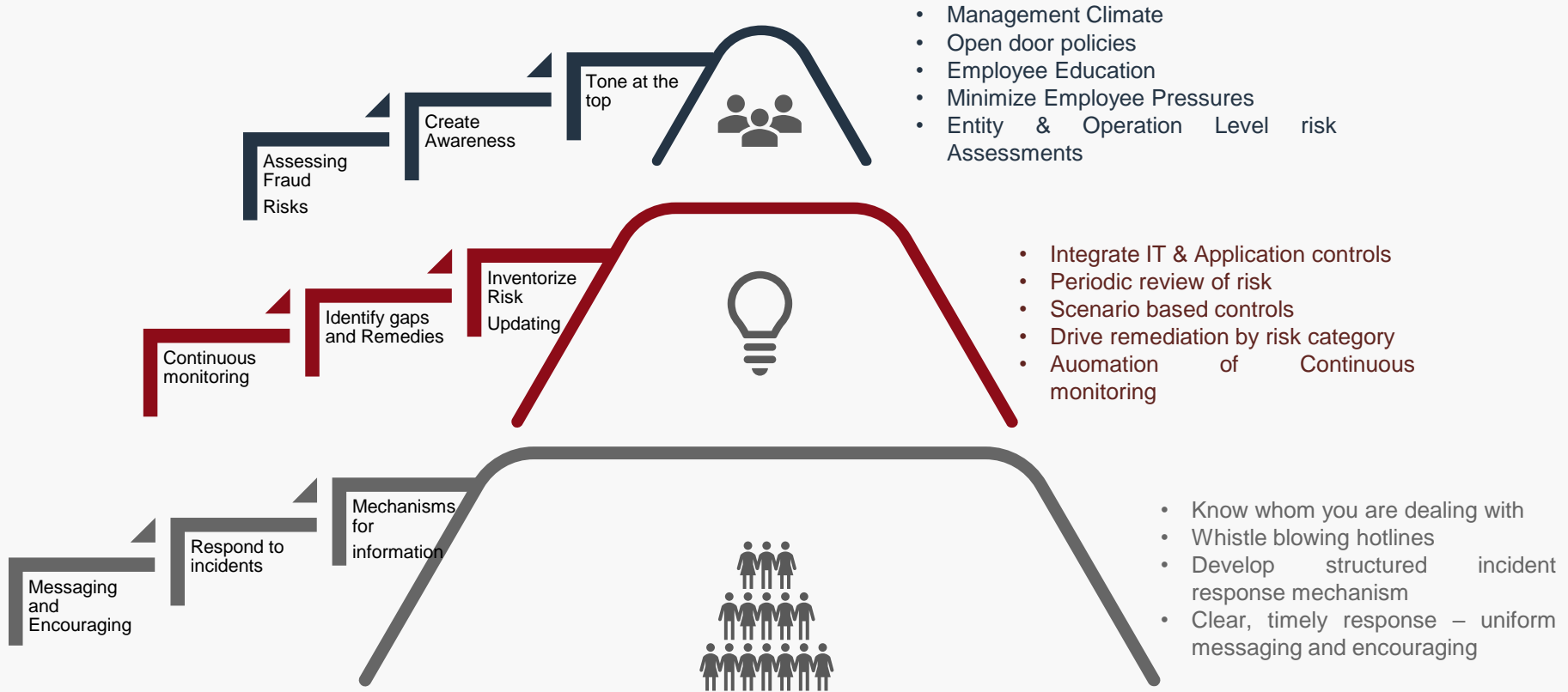
Basis the control gaps identified, define fraud scenarios towards the risks prioritised;

Prioritise key fraud risks in consultation with the management.



FRAUD RISK ASSESSMENT APPROACH

Fraud risk assessment involves multiple stakeholders and should have a top-down approach. The top management should express concern and seriousness about raising and resolving issues related to fraud in an organisation.





ETHICAL DILEMMAS

ETHICAL DILEMMAS



Ethics, in the words of Sir Potter Stewart, “*Ethics is knowing the difference between what you have a right to do and what is right to do*”



Resolving ethical dilemmas is an important concern for corporate governance. Those charged with management need to ensure that employees facing such dilemmas are able to **resolve them** or **escalate them**. **Fraud awareness** and **fraud reporting** within the organisation are important tools to resolution of ethical dilemmas.

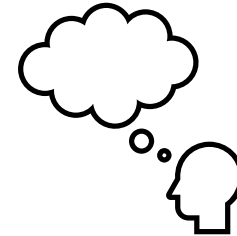
There can be many different types of ethical dilemmas faced by employees at **various levels**. The strategy defining dilemmas of senior management can be addressed by setting out a **clear mission statement**, whereas lower level employees usually might have dilemmas emanating from **observing frauds or malpractices** which they have observed.

ETHICAL DILEMMAS

 RIGHT	WRONG 
Difficult	Convenient

- A right versus wrong dilemma is not so easy to resolve. It often involves an **apparent conflict** between moral imperatives.
- An ethical dilemma involves a situation that **makes a person question** what is the 'right' or 'wrong' thing to do. They make individuals think about their obligations, duties or responsibilities
- Easier dilemmas involve a 'right' versus 'wrong' answer; whereas, **complex ethical dilemmas** involve a decision between a **right and another right choice**.

RESOLVING AN ETHICAL DILEMMA



Considering the options available

Considering the consequences

Analyzing Actions

Decision making and Commitment

Evaluating Systems

ETHICAL DILEMMAS

SIGHTING THE FREQUENTLY FACED ETHICAL QUESTIONS

In many cases, ethical dilemmas are challenging to work through because the risk and the reward aren't as clear-cut as other types of decisions. Following are some frequently faced ethical dilemmas in business :

01. Supporting other businesses

Sometimes businesses have to choose between reducing costs especially in recession prone economies.

02. Compromising On Product Quality

Reducing the quality (and sometimes quantity) of the product is a common method of creating surplus.

03. Offshoring your Manufacturing

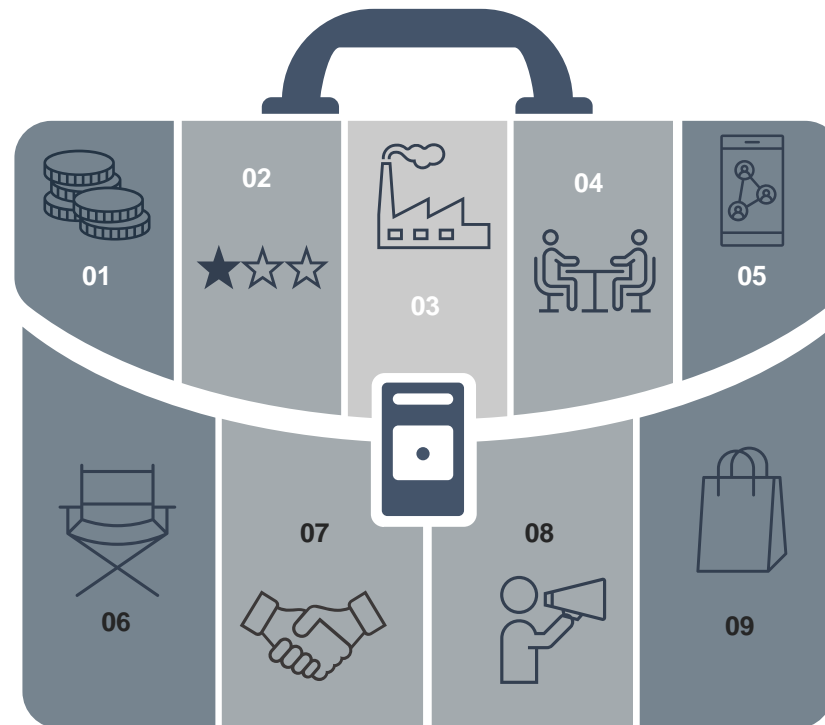
Moving production to offshore locations often involves domestic staff cuts and reduction of other costs.

04. Letting clients go

Walking away from toxic clients can be a common ethical dilemma.

05. Responding To Employee Social Media Behavior

It's entirely justifiable to fire an employee over poor behavior on their personal social media accounts, but it's sometimes tricky to determine exactly when that line is crossed



06. Keeping Employees Because Of Seniority

Choosing to keep loyal old timers at the cost of team efficiency and firing old staff is a dilemma often faced by business with advancement in tech.

07. Accepting Job Applicants From Competitors

Is poaching staff ethical? What is the line between creating a new team and bringing in teams from competitors to weaken them.

08. Creating Honest Marketing

How much information is too much? And how accurate can you make the message balancing the complexities of your product.

09. Ethical Sourcing

While sourcing raw materials from some organizations may be cheap and convenient, it is the duty of a business owner to consider the ethical environment at the supplier's end too. Sanction restrictions also need a careful consideration in such cases.

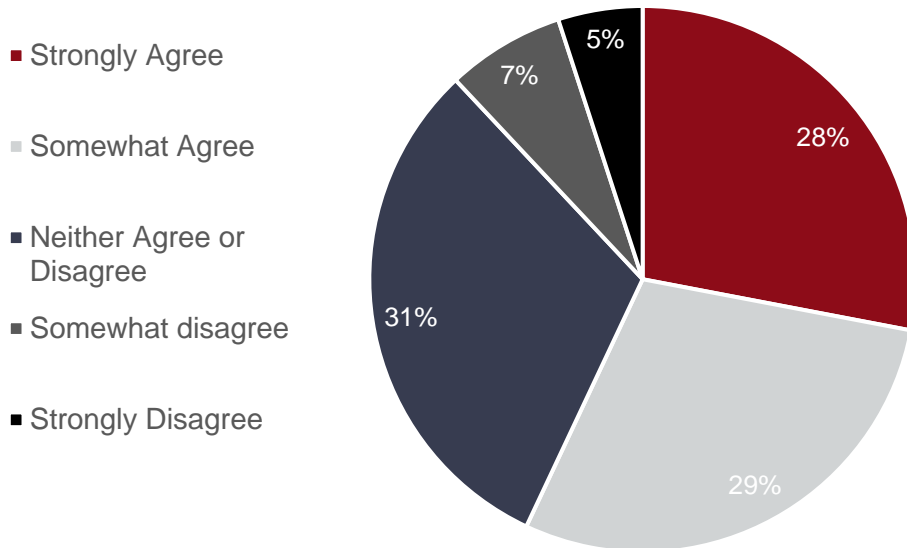


WHISTLE BLOWING AND FRAUD AWARENESS

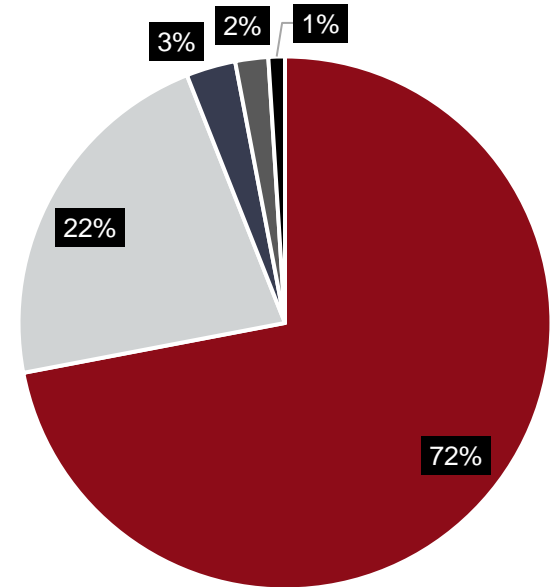
FRAUD AWARENESS IN ORGANISATIONS

One of the most important components of any effective anti-fraud program is fraud awareness training for an organization's employees, officers and directors. Effective fraud awareness training can help an organization better mitigate general, organizational or industry-specific fraud risks, increase the effectiveness of other anti-fraud controls, and ensure that anti-fraud policies and reporting protocols are followed. ACFE survey on Fraud Awareness Training (2021) showed that majority of respondents agree that **fraud awareness trainings increase information** and **generate more tips**.

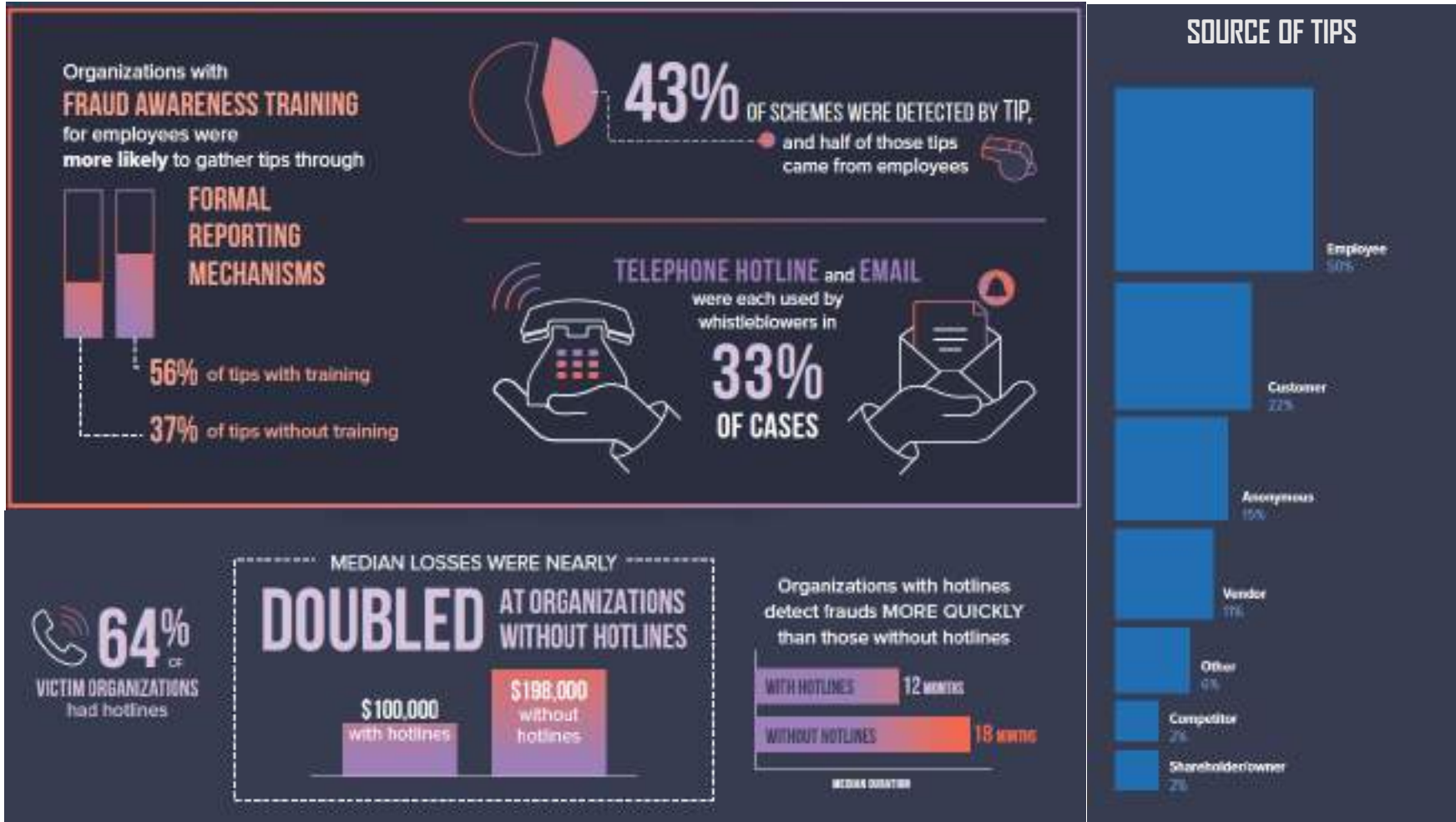
Increase in Tips Received



Informs employees about general fraud issues and risks



NEED FOR WHISTLE-BLOWER MECHANISM



SOURCE: Report to the Nations, 2020 Global Study on Occupational Fraud and Abuse (ACFE)

CRITICAL SUCCESS FACTORS FOR A WHISTLE-BLOWER SYSTEM

Legally Compliant

In India SEBI and Companies Act 2013, mandate the rules which apply to whistleblower systems.



Secure & Anonymous

Whistleblower system contain highly confidential data. The information gathered must be channeld on secure systems which ensure anonymity for the whistleblower.



Easy to Use

Whistleblower systems should be neutral devices which are accessible to all employees. Often whistleblowers will be persons closely associated to the scene of fraud so taking the next step to report fraud should be fairly simple.

Trustworthy

Whistleblowers should be assured that no harm will come to them from reporting fraud. The fear of employer retaliation is major factor why tips are not reported.



Integrated

Whistleblower system should be integrated in the fraud awareness mechanism of an organization. It should not appear as an additional or an external part of the anti – fraud culture in an organization.

ESSENTIALS FOR IN-HOUSE FRAUD UNITS

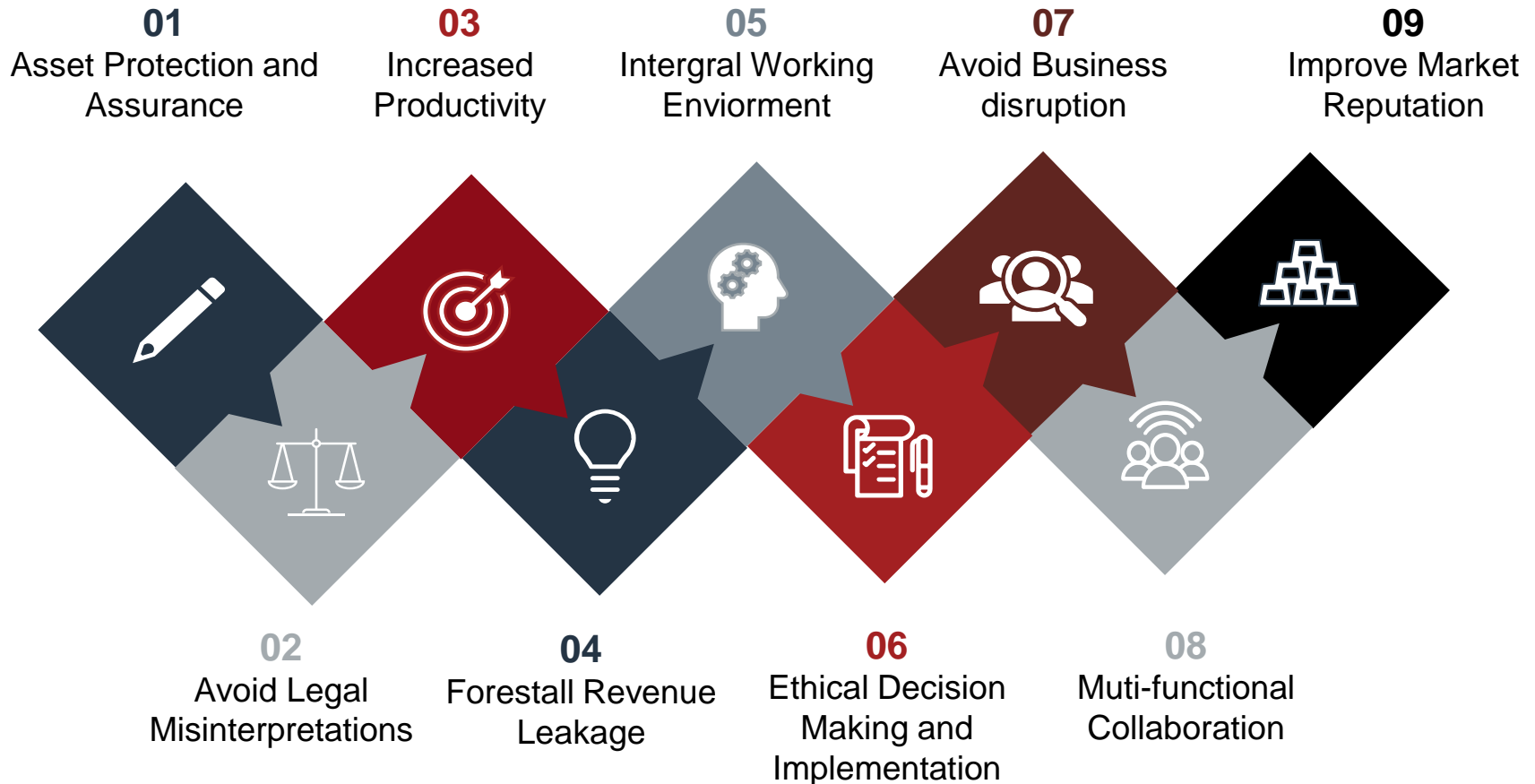
COMPETENCES & SKILLS OF FORENSIC AUDITORS

Given rise in complications of fraud scheme and digital platforms adopted by Fraudsters, the competences and skills of the members of in-house Anti-fraud Units should be honed.



ESSENTIALS FOR IN-HOUSE FRAUD UNITS

KEY BENEFITS OF ETHICS AND COMPLIANCE TRAINING



ESSENTIALS FOR IN-HOUSE FRAUD UNITS

ETHICS AND COMPLIANCE TRAINING IS CRITICAL

In today's rapidly changing landscape, informed approach to the business strategy complying with all the applicable laws and policies is getting more important than ever. Compliance failure typically occurs due to lack of knowledge and understanding, that is exactly why companies shall treat compliance training as critical.

Employee Awareness means employee Engagement

Employees are trustworthy stewards of corporate values. Though employee needs incentive to engage, Compliance training can give them this by leveraging their content, knowledge and understanding of good conduct expectations.

Avoid criminal Act “of omission”

Any organization which is aware of a potential violation and does not report to the appropriate authority considered as criminal act. **Ethical training** makes the employees and an organization understand the value of detection of ethical issues and discussed & reported.



Approach to Risk Management

Compliance training for awareness can offer inspiring results for executive boards who wish to **promote social responsibility**, and employee integrity. Practical rule-based approach to risk management helps to steer organizations to future longevity and success.

Mitigation of reputation risk is Key

Organization takes the burnt of public scrutiny and criticism when events leading to **reputational risk occur**. Compliance training helps the employees and the organization to understand the importance of noticing the unethical behavior/s when they see it.

Effective governance relies on clarity and dialogue

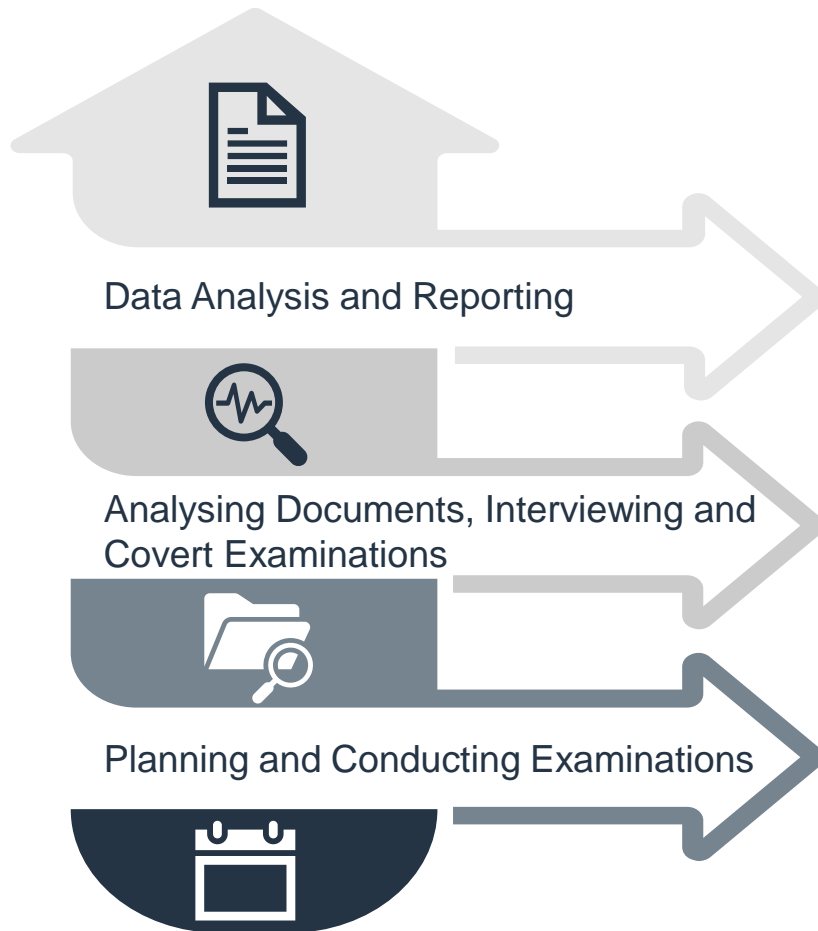
Boards can decide upon the most carefully designed architecture for corporate governance, but if **individuals do not know** what they should do in order to be accord with policies and regulations, they are not prepared to succeed in making the right choices. An effective training can do so.



CONDUCTING INVESTIGATIONS – SPECIAL FOCUS ON REMOTE WORKING

CONDUCTING INVESTIGATIONS

– SPECIAL FOCUS ON REMOTE WORKING



INTRODUCTION:

- Companies are facing significant challenges due to the COVID-19 pandemic.
- Although, the “work from home” model is the new normal, conducting investigations in a remote working environment is a challenge.
- However, companies will have to find their way to productively initiate and conduct investigations in this environment.

DAUNTING CHALLENGES WITH REMOTE WORKING

- Investigation Planning and Scope review
- Collating and Reviewing data
- Assessing Document authenticity
- Storing Data
- Conducting Interviews
- Adequate Technology
- Reporting
- Data privacy

SPECIAL FOCUS ON REMOTE WORKING| CHALLENGES

Investigation Planning and Scope Review

- In a remote working environment Investigation Planning demands additional thought and brainstorming by teams to incorporate the nuances posed by the remote environment.
- The traditional scope needs to be extended to combat the newer challenges faced in planning and execution.

Collating and reviewing data

- Need for a disciplined approach for collating data and clear guidance on maintaining data confidentiality.
- Availing necessary equipments for collating and reviewing data is a herculean task considering limited access to logistic services due to the COVID-19 state or nation wide lockdowns.

Data storage

- To incorporate large amounts of confidential data being stored without any data loss, the key challenge is scalability of storage systems.

Reporting

- Document authenticity should be considered when data or reports are being shared via emails.
- Reports and ancillary confidential data must reach the intended recipients only.

Data Privacy

- The new-age devices make theft and infringements easier for fraudsters. Keeping a strict control over data access is difficult where thousands of employees work all around the globe.



Conducting Interviews

- Social Distancing requirements making face-to-face interactions impossible
- Inability to make unannounced visits reduces the efficacy of interviews
- There is a tendency to ask fewer questions in an online set-up
- Presence of unconnected people cannot be detected and many-a-times cannot be avoided
- In a “WFH” environment, suspects can be in their comfort zones. The interviewers cannot have physical control over the set-up for interrogations to avoid distractions.
- Safe storage of interview recordings is very crucial. The key challenge here is having a secure communication line. Also the legal provisions for recording such meetings needs to be considered.

Enabling Technology

- Special technologies and skill sets are required to conduct E-Discovery procedures online.
- Availability of high internet speed and imaging softwares which can conduct online imaging is a challenge
- Maintaining the sanctity of data and chain of custody through the process of imaging needs careful consideration.

CONDUCTING INVESTIGATIONS

– SPECIAL FOCUS ON REMOTE WORKING | RISING UP



Additional Time and effort in the planning and scoping phase



Special monitoring for authenticity breaches where data is accessed remotely.



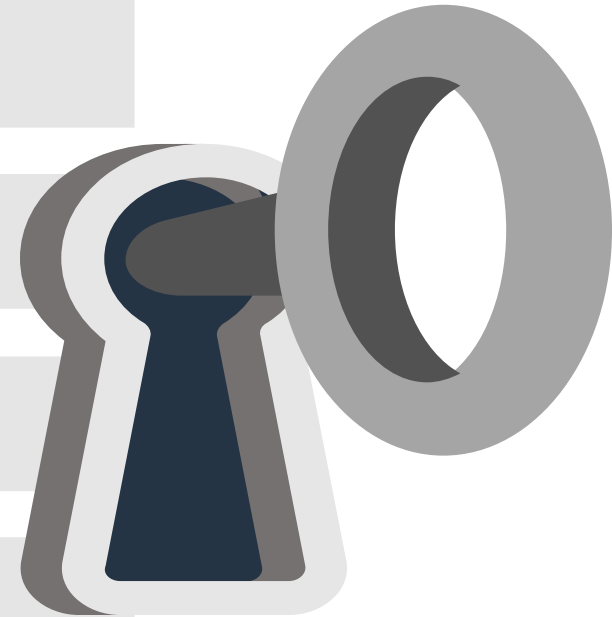
Use of technology solution for bridging the gaps created by remote working



Strict, clear and formally documented guidelines with respect to data collection, review, storage and conducting interviews



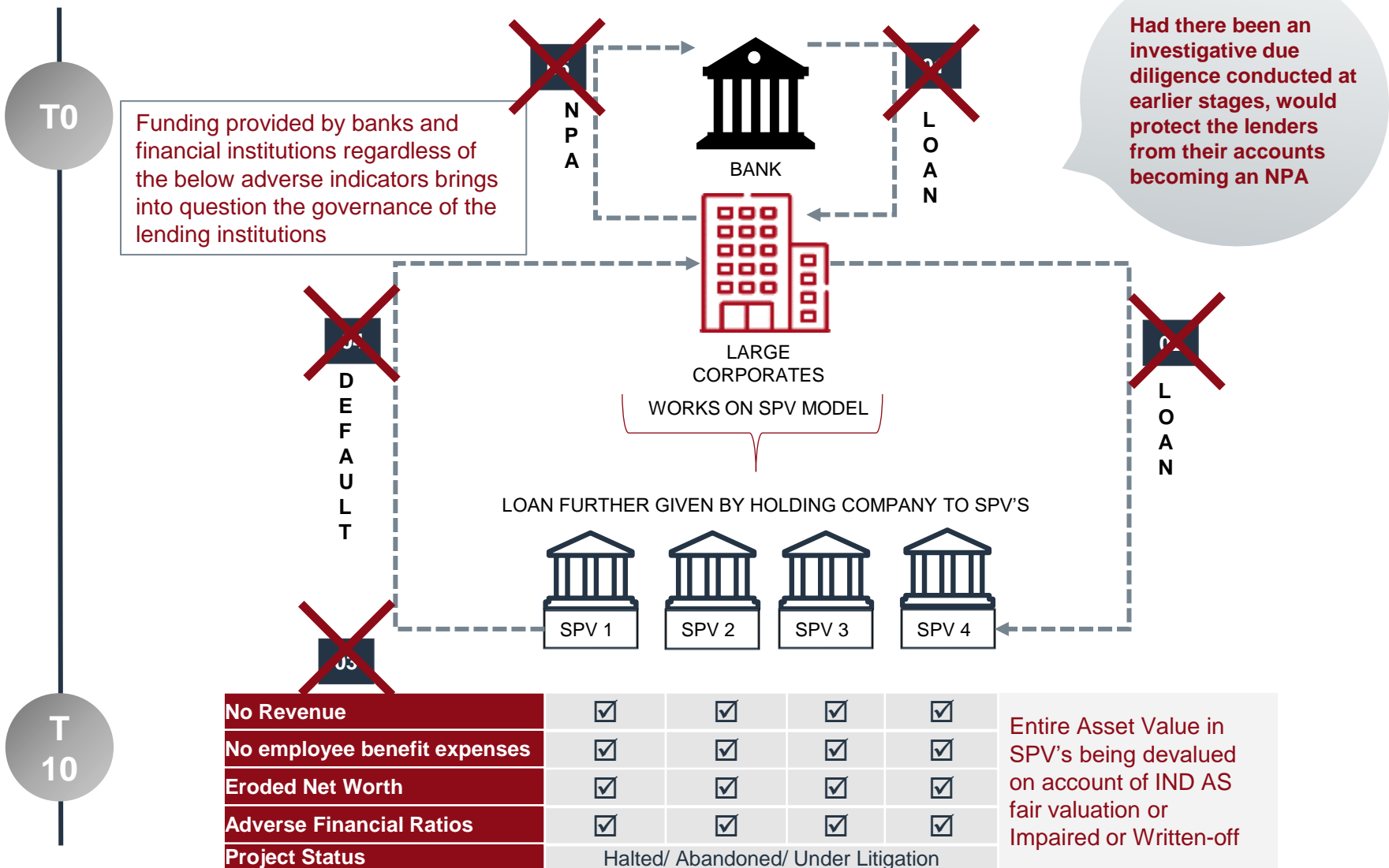
Use of secure communication lines for collating, storing and accessing data





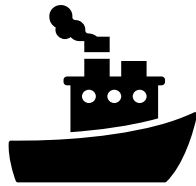
CASE STUDIES

CASE STUDY 1 | MISGOVERNANCE AT LENDING INSTITUTIONS



CASE STUDY 2 | VENDOR FAVOURITISM

01 PROBLEMS FACED BY COMPANY'S SENIOR MANAGEMENT



- Repeated year-on-year increasing ship repair cost
- Increasing losses



Leading ship repair company -----> Vendor Company

SENIOR MANAGEMENT SIGHT THE NEED FOR AN INVESTIGATION

02



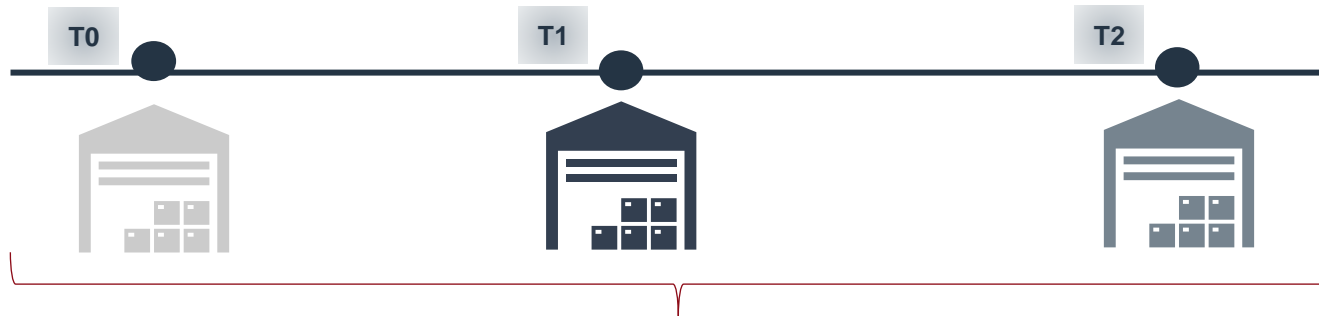
- To spot the person in-charge (custodian) for managing and running the cost centre
- Covert investigations into the official communications of alleged employees by using technologies like desktop imaging

03 INVESTIGATION ON SELECT CUSTODIANS REVEALED THAT :

- Standard operating procedures for appointment of vendor on panel not followed
- Repeated violation of Company's policies
- New vendor preferred over loyal and trusted vendors already on the panel
- Selection of L2 vendor bidder over L1 vendor bidder without any business rationale
- Vendor Favouritism.
- Facilitation of kick-backs from favoured vendors by purchase department officials in form of cash, expensive gift items or arrangement of offshore travel for family and friends.
- Collection of commission in personal bank account directly from favoured vendors by officials on panel of vendor selection



CASE STUDY 3 | UNJUSTIFIABLE BUSINESS RATIONALE



Issues faced by management -
Frequent change of warehouses and increasing costs

- Insufficient storage space
- Theft and Inventory Mismatch
- Delay in dispatch
- High penalties

T3



T4

Management sight a need for an investigation

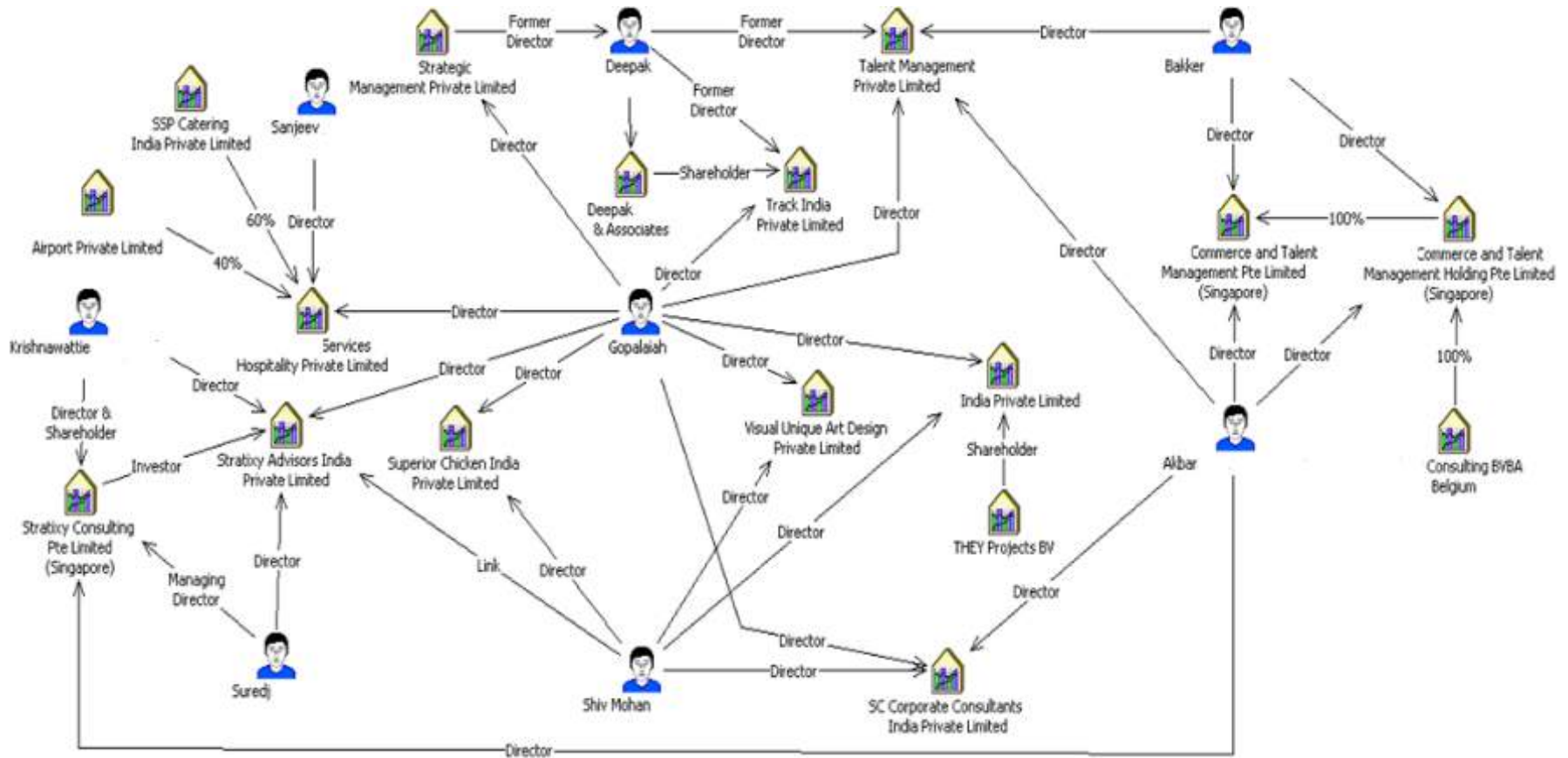
- Even after changing the warehousing contract with a different vendor, problems encountered in the past remained.
- Increasing storage costs, subsequent losses and frequent change in warehousing contracts invited the attention of senior management.

Red flags highlighted through Investigation



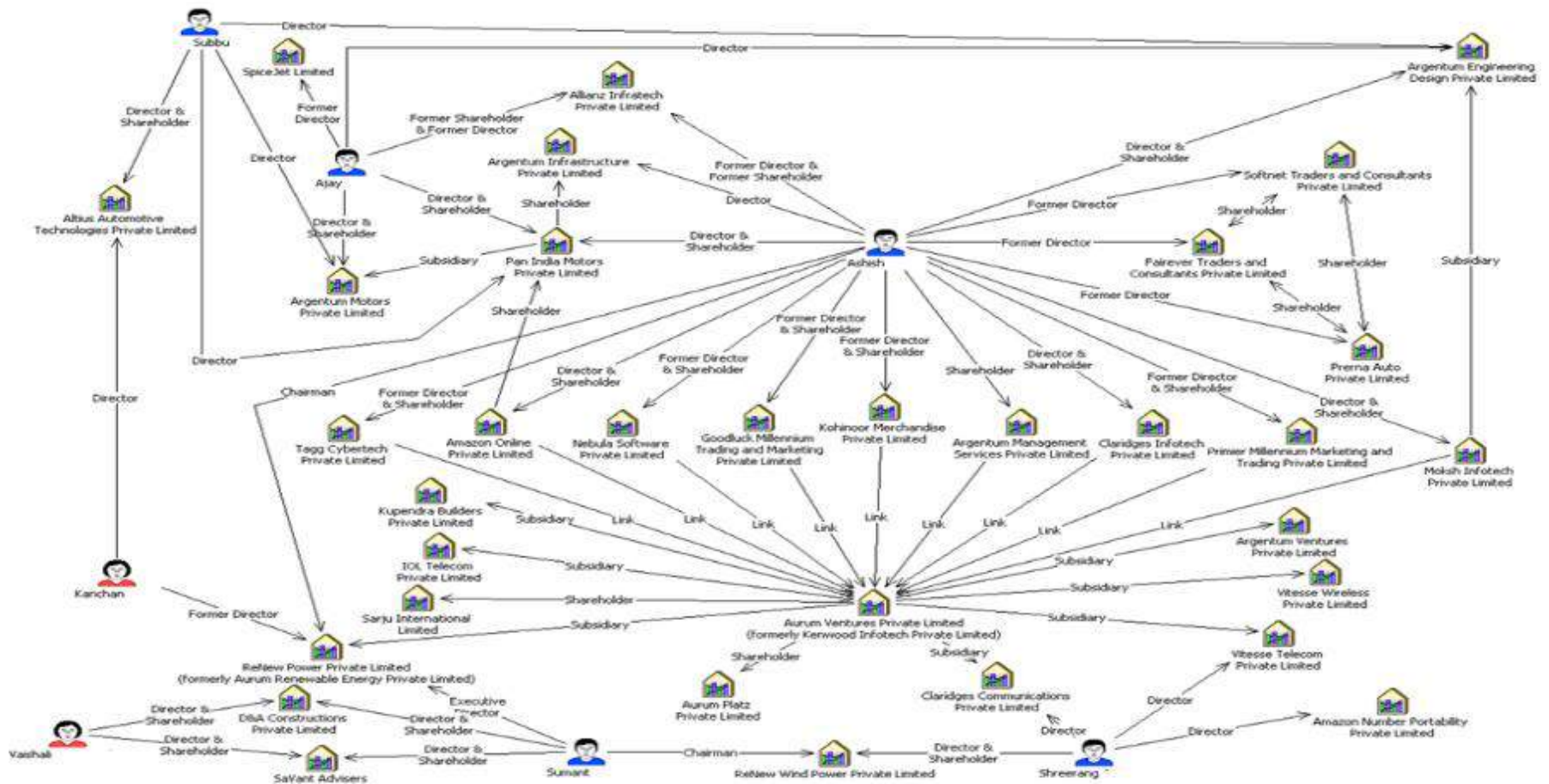
- No standard operating procedures in place
- Circumvention of control by senior staff and abuse of position
- Senior management not involved in decision making
- No periodical reporting to senior management by staff
- Links of management with vendor entities from past employment
- Facilitation of kick-backs
- Vendor Favoritism

CASE STUDY 4 – CONFLICT OF INTEREST (1/2)



**The names of entities/individuals is fictitious in nature.*

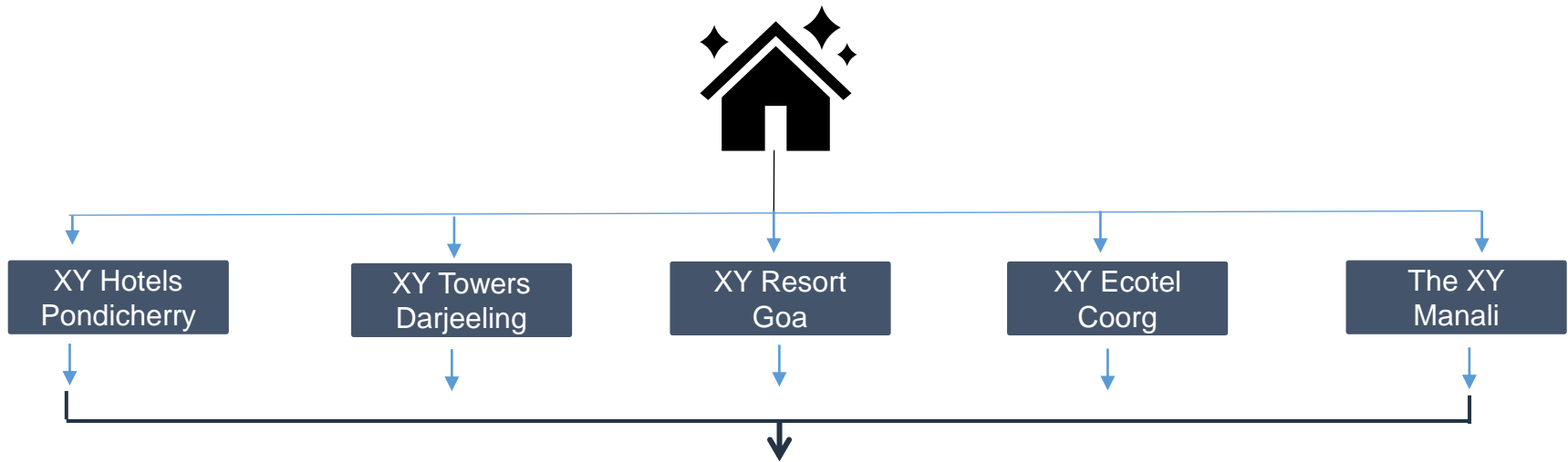
CASE STUDY 4 – CONFLICT OF INTEREST (2/2)



**The names of entities/individuals is fictitious in nature.*

CASE STUDY 5 – FINANCIAL MISAPPROPRIATION (1/1)

XYZ Group of Hotels



Summary of Consolidated Financial Data

Average Balance Sheet value = INR 100 crores

Average Annual Revenue (last two years) = INR 5 crores

Value of towels purchased in the last 2 years = INR 35 crore

Is this a red flag?

Thank You