

HOW CAN THE BOARD OF DIRECTORS WALK THE ANTI-FRAUD AND COMPLIANCE TALK?



*Vidya Rajarao



Background

Since the global financial meltdown more than a decade ago, organisations have come far in rethinking, deliberating and correcting priority areas to tackle risks better. Similarly, accountability and responsiveness of companies and their boards have occupied centre stage since some of the biggest scandals rocked the corporate world. Simultaneously, the propensity of risks has intensified equally (if not more). Frauds have continued to transpire and, unfortunately, will do because they are primarily an outcome of human behaviour.

The question, therefore, is: How can the board of directors, to whom concerns are often raised in case of a fraud or a governance fallout, fulfil their responsibilities in walking the anti-fraud and compliance talk of the organisation?



Fraud risks galore, and governance must match up

The business environment world over is plagued with uncertainty and disruption. The arc of vulnerabilities is expanding every second and, worse, frauds are assuming the shape of organised crime. The World Economic Forum, in its 2018 Global Risks Report, cited data theft amongst the top five risks by likelihood. Evidently, risks which in the past were not considered have emerged (or need to appear) high on the risk framework. Mounting expectations and heightened public scrutiny from stakeholders including clients, employees, shareholders, and regulatory authorities have only increased manifold. And so has the need for organisations to operate ever more responsibly.

Further, globally and in India, whistle-blowing mechanisms are assuming a significant role in uncovering frauds at companies. Such whistle-blower complaints land at the feet of the board, who must be adept in sifting through them, confirming their veracity or otherwise and taking swift and effective remedial actions. Boards that are unable to do so swiftly and competently face the peril of such complaints being leaked to the media or shared with regulators, thus leading to greater scrutiny and reputational impact.

Finally, activist shareholders, including lending institutions, private equity firms, institutional investors etc., demand greater accountability from board members. Hence, the board must be clear, decisive and consistent in dealing with fraud.



Reactive Role, next steps for the Board when a fraud incident is discovered

Board of Directors impart a critical role when a fraud is discovered or reported to them. Collective board experience guides the CEO (or management) during testing times. An ideal approach in response requires clearly assigned roles of individual directors and their oversight (depending on their subject expertise and prior experience of having dealt with a similar state) as well as a plan of action for damage control, especially in response to reputation risk.

Responding to a fraud: Immediate action items for the board

- Constitute a committee
- Develop and institutionalise the process for investigation, taking account of who to call, what data to collect, who to interview, and how and what evidence to gather
- Decide on the actions to be taken based on such investigation
- Ensure consistency irrespective of level and hierarchy of the person involved based on an independent investigation
- Do not jump to any conclusion; hold judgment till the investigation is complete

Corporate governance must go a notch higher in times like these, and assessment of the governance framework be an ongoing process. The board must not be hesitant in calling upon independent guidance from the organisation on legal, financial or associated issues. Finally, lessons learnt from missteps in the past when incorporated to detect such incidents early on can save substantial cost, financial and otherwise, in the future.



The big picture: Board's proactive role in risk oversight, fraud risk management and compliance

While a well-thought-out approach in response to a fraud incident is useful, it is not sufficient.

A proactive approach to mitigating such risk is imperative and fulfilled with a comprehensive fraud risk management framework. The responsibility of managing fraud risk is not only with the board of directors, but with senior executives, and, as a matter of fact, with the entire personnel in the organisation.

However, the board of directors is expected to fulfil their organisational obligation to manage fraud risks.

An able board understands the risk environment after carefully considering external and internal factors like the operating industry, its size and the level of investment required in risk management. Accordingly, the fraud risk management programme spells out clearly existing internal controls and their effectiveness, process to investigate fraud, corrective action, policies to deter and detect fraud, reporting mechanisms etc. To establish an all-inclusive policy, the board must seek necessary inputs as required from relevant stakeholders like legal counsel, external auditors or management. This is especially required

because directors may not have specific compliance, ethics or fraud risk expertise.

While the board provides strategic oversight, the responsibility to design and implement a formal programme rests with the senior management. The board must, nonetheless, continue its supervisory role to review, assess and guide on providing appropriate oversight to fraud strategy. Allocating sufficient time to monitor the success and roadblocks, if any, is fundamental. Participation of the board of directors should not be restricted to discussions during the annual general meetings but considered as fundamental to the firm's growth as its financial performance.

Directors must engage with the management by asking the right questions

1. Are fraud risks being relooked at with the advent of newer vulnerabilities or are existing controls keeping pace with rising complexities of business environment?
2. Is the organisation embracing data analytics or other technologies to deter fraud?
3. Is sufficient financial support being injected into the programme?
4. Are anti-fraud policies and procedures communicated to all levels in the organisation, including reporting mechanisms like the whistle-blower policy?
5. Are all personnel (including the senior management) conscious of the fact that being a part of, or privy to, any fraudulent act would be a ticket out the door?



Walk the ethics and compliance talk

Walking the compliance talk is the only validation of top-level commitment to the organisation's ethics and compliance programme. The Association of Certified Fraud Examiners (ACFE) 2018 Report to the Nations suggests tips as the most common initial detection method of occupational fraud, with 40% of cases in the study supporting the finding. This only echoes the significance of keeping in place effective incident-reporting like a whistle-blower framework. Director oversight and clear understanding on elements of the existing reporting mechanism including its design (hotline or email) access, effectiveness, independence, functionality and extent of participation of senior management in the programme will allow the board to better understand how and whether the mechanism is working.

Corporate governance must go a notch higher in times like these, and assessment of the governance framework be an ongoing process. The board must not be hesitant in calling upon independent guidance from the organisation on legal, financial or associated issues. Finally, lessons learnt from missteps in the past when incorporated to detect such incidents early on can save substantial cost, financial and otherwise, in the future.

The big picture: Board's proactive role in risk oversight, fraud risk management and compliance

While a well-thought-out approach in response to a fraud incident is useful, it is not sufficient.

A proactive approach to mitigating such risk is imperative and fulfilled with a comprehensive fraud risk management framework. The responsibility of managing fraud risk is not only with the board of directors, but with senior executives, and, as a matter of fact, with the entire personnel in the organisation.

However, the board of directors is expected to fulfil their organisational obligation to manage fraud risks.

An able board understands the risk environment after carefully considering external and internal factors like the operating industry, its size and the level of investment required in risk management. Accordingly, the fraud risk management programme spells out clearly existing internal controls and their effectiveness, process to investigate fraud, corrective action, policies to deter and detect fraud, reporting mechanisms etc. To establish an all-inclusive policy, the board must seek necessary inputs as required from relevant stakeholders like legal counsel, external auditors or management. This is especially required because directors may not have specific compliance, ethics or fraud risk expertise.

While the board provides strategic oversight, the responsibility to design and implement a formal programme rests with the senior management. The board must, nonetheless, continue its supervisory role to review, assess and guide on providing appropriate oversight to fraud strategy. Allocating sufficient time to monitor the success and roadblocks, if any, is fundamental. Participation of the board of directors should not be restricted to discussions during the annual general meetings but considered as fundamental to the firm's growth as its financial performance.

Setting the right tone and building an ethical framework is augmented with an independent review of company's compliance programme, and, driven by an effective Compliance Committee.

Highlights of Corporate Governance Research Reports of Grant Thornton International

- a. Determining the right composition of the board is one of the key considerations for stakeholder engagement.
- b. The board should have enough experience and expertise to manage the spectrum of risks facing the business, including digital diversity in the board.
- c. Research carried out in the UK found that more than half of the 73% companies that report IT and technology risks do not disclose having technology expertise represented on their board.
- d. Boards worldwide are thinking about the culture of their customers and their suppliers when they do business with them, which illustrates a recognition that those external stakeholders you deal with can affect your brand and reputation.
- e. Understanding how the leaders that the board oversees, articulate the culture of the organisation in their own words is, important. Developing strong relationship with the senior management can help the board understand how leaders perceive the culture

The committee can support the management in effectively running the compliance programme, and assume a broader role in exercising effective corporate governance. Ideally, it constitutes majority of independent directors to provide a neutral view on the company's compliance framework. As independent directors represent different groups and are guardians of shareholder welfare, their role in preventing favouritism by the board towards specific shareholder groups is critical. Appointing within the board one director with compliance expertise and experience is important, and ultimately what matters the most is the time allocated by this Committee to providing meaningful, functional and actionable reporting on the organisation's compliance and ethics activity. Therefore, at least quarterly meetings must be held for the Committee to fulfil its objective.

One of the primary deterrents for directors in performing compliance and ethics oversight is lack of adequate and timely information and training. Boards must ask for appropriate information on metrics including training data, hotline reports, results of culture surveys, compliance audits or other ethics initiatives within the organisation. They can use this data to deliberate on the adequacy of the existing compliance and ethics framework, techniques like bench marking or assessment tools (if any) to track the progress and periodic review of the

compliance and ethics training programme. Organisations can include training on ethics and oversight responsibilities during board members' induction and on boarding program. Similarly, direct access to the Chief Compliance Officer can better equip the board to oversee the implementation of a reasonable reporting system and ethical culture.

The Board of directors' role in compliance is only growing. By being well-informed, attentive and responsive, they can ensure appropriate and strict vigilance to keep in check fraud and non-compliance in today's volatile risk environment.

References

Engagement beyond the boardroom: What do your stakeholders expect? www.grantthornton.global, 2018

Corporate Governance Review 2017, www.grantthornton.co.uk - October 2017

Beyond Compliance, the building blocks of a strong corporate culture, www.granthornton.in, 2017

Beyond Compliance, the building blocks of a strong corporate culture, www.granthornton.in, 2017

* *Vidya Rajarao, Partner, Grant Thornton India LLP* ■



Assessors Invited

Would you like to be an assessor of these most prestigious awards

We are constantly on the lookout for volunteers, professionals or quality people nominated by their organisations who can become certified examiners for **Golden Peacock Awards**

GOLDEN PEACOCK AWARDS SECRETARIAT

invites for specialists in the areas of

Corporate Governance & Sustainability

A most rewarding and rich learning experience



Golden Peacock Awards®
A Strategic Tool to Lead the Competition

Please send your CV at info@goldenpeacockaward.com

Golden Peacock Awards Secretariat

M-56 A, Greater Kailash Part - II (Market), New Delhi-110048, India.

Tel: 011 - 41636717, 41636294, 41008704, Email: info@goldenpeacockaward.com

www.goldenpeacockaward.com