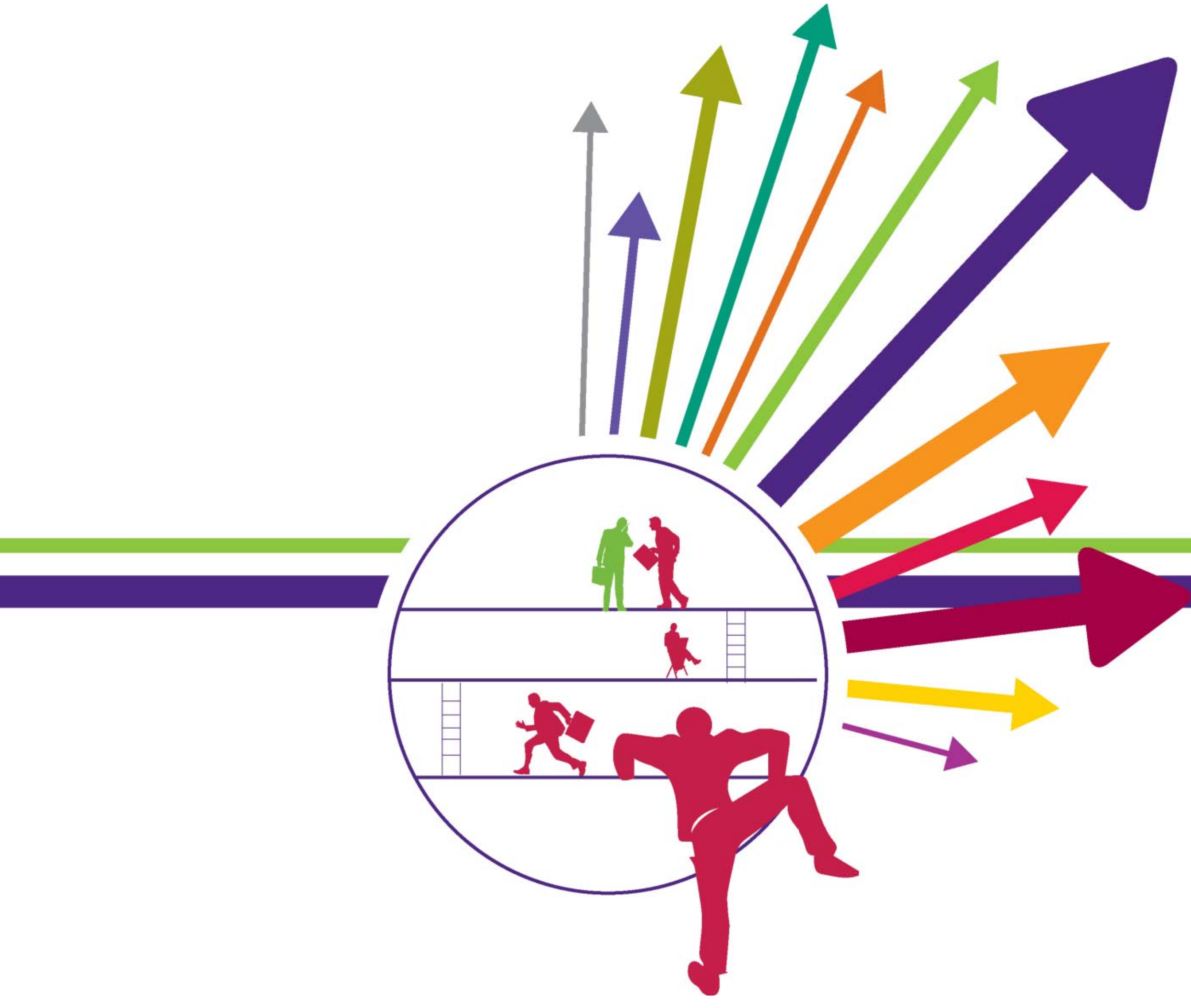
Fraud: A key governance risk

2014



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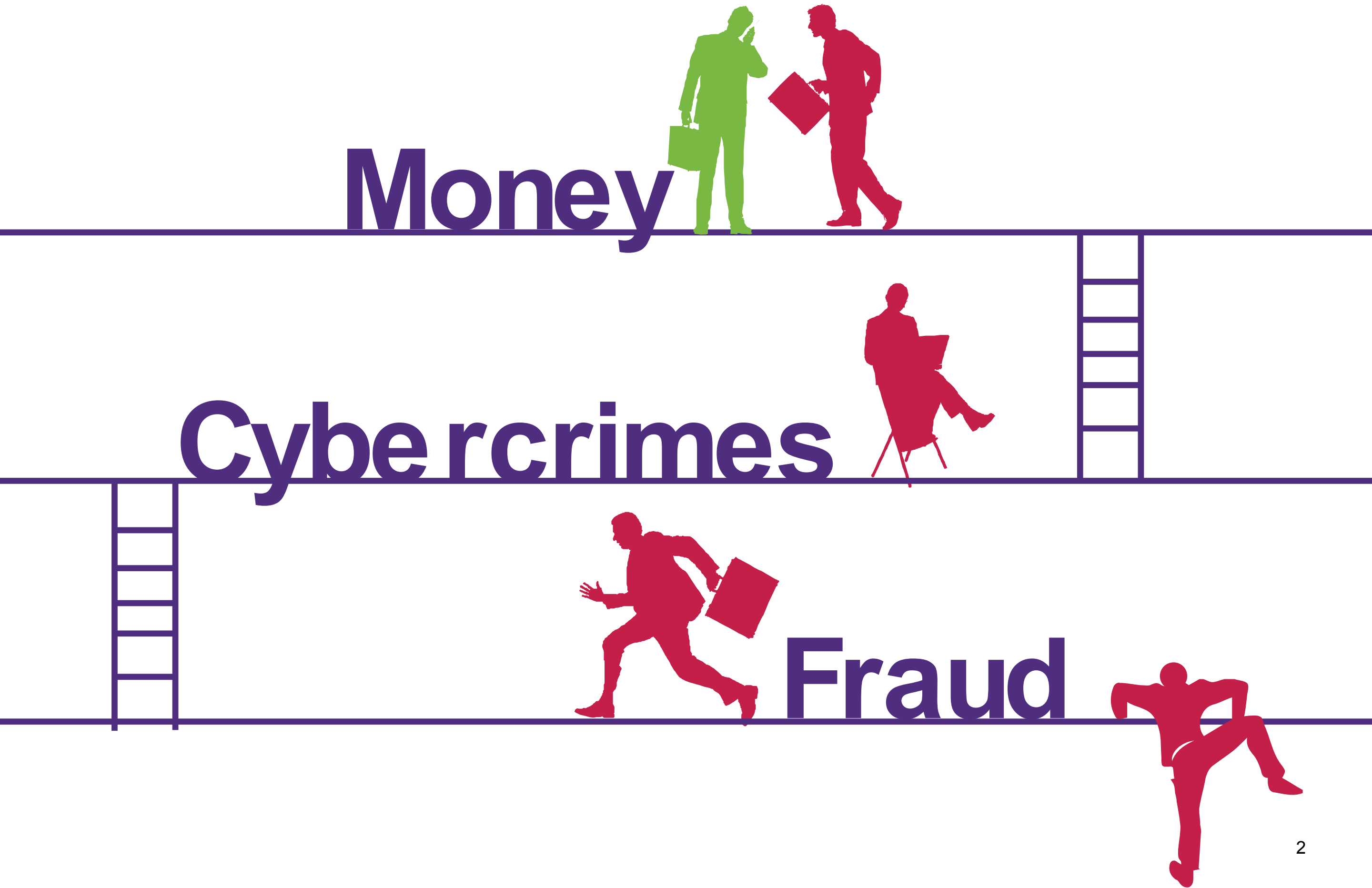


Foreword

Companies worldwide are battling to survive and grow in what has continued to be a highly adverse economic condition. In this environment, growth and ethical business conduct can sometimes appear to be competing priorities. India is an emerging country with ample opportunities. As a potential market, it is in the scheme of things for many global giants who are planning to expand their business. But these opportunities come with numerous risks and challenges such as fraud, bribery and corruption. These risks are growing concerns for Indian companies as well. A major challenge faced by the senior management of a company in addressing these risks is the lack of awareness.

Governments around the world have responded to corporate fraudulent activities by instituting legislative and regulatory reforms aimed at encouraging companies to become more self-governing. In India, policy-makers have taken steps to increase corporate transparency through laws and regulations including the Companies Act, 2013 and many other proposed revisions. This has strengthened the measures to fight corporate frauds, with greater accountability being placed on independent directors and auditors.

A "secure and reliable" environment is imperative for growth and successful future of all businesses.

To provide a holistic outlook along with a good understanding of the current industry scenario, regulatory viewpoints, various anti-fraud resources, tools, knowledge and best practices available, **ASSOCHAM, in partnership with Grant Thornton,** has came up with this study paper. This is an attempt to enhance the understanding and establish sound business practices for reputation enhancement and business growth by equipping companies against frauds.

I am sure this study will give rich insight and adequate knowledge to all stakeholders.

I wish the Summit a great success.

With best wishes,

D. S. Rawat
Secretary General
ASSOCHAM

Foreword

Across the globe, businesses have undergone a significant behavioural shift. Most businesses that have gone global, are increasingly dependent upon technology, which, in turn, makes them highly sensitive to any geopolitical or consumer change. This is also reflective in the way frauds are being perpetrated. Increasingly, fraud is turning into a global phenomenon with its reliance on technology and the global scale of businesses. Obviously, global regulators are finding new ways to enforce and coordinate regulatory actions across borders. Global coordinated enforcement actions cover bribery, money laundering, export controls, sanctions, etc. In response, businesses, rightly, are taking a strategic view of assessing fraud risks and an effective response to frauds. Coupled with a turbulent financial outlook, businesses are investing more and more resources in taking proactive steps because they know that each dollar spent in taking a proactive view of fraud management would go a long way in saving millions for the business in the form of either lesser leakages or avoidance of large regulatory fines.

This first edition of **"Fraud: A key governance risk"** is an initiative by Grant Thornton to analyse and reflect on the trends in fraud management in Indian businesses. A key highlight of this report is that the overall incidences of fraud are increasing in India. This also underscores the need for every company to have a multi-pronged fraud risk management strategy. Further, with increasing sophistication in the manner in which fraud is perpetrated, it is imperative that companies are ahead of the curve. This would ensure that appropriate systems and processes are designed to avoid the occurrence of frauds in the first place.

Our survey shows that corruption, money laundering and/ or bribery continue to be the biggest concerns for companies operating in India. While this could, at least in part, be attributed to the increasing media highlight on corruption issues, it is also reflective in the manner in which India is reciprocating the global trends. Globally, regulators and corporate boards have practiced zero tolerance to corruption in public and private life. This meant that Indian companies, which did not have their systems and controls geared to address such issues, lost out on potential investment and cooperation opportunities with global companies that were governed with strict anti-corruption laws.

Needless to add, fraud management cannot be a one-time affair. Monitoring the fraud management framework periodically and providing fraud awareness training to new and existing employees are essential aspects of a robust fraud management framework. With the enactment of the new Companies Act and notification of Rules thereunder, we also believe that the role of the Board would undergo a tectonic shift. The oversight role of the Board would, increasingly, involve putting in place targeted risk assessment processes, carrying out periodical evaluations of controls effectiveness, communicating topical guidance to stakeholders and clearly defining ethical and responsible business practices.

Foreword

This report has been developed by deriving the responses to an online questionnaire circulated to individuals representing some of India's leading public and private sector enterprises. We would like to thank all those who spared their precious time to contribute to this study. We would also like to express our sincere gratitude to several independent directors for expressing their candid views on the fraud and governance landscape in corporate India.

We hope that you will find this report insightful, and welcome your feedback.

Harish HV
Partner
Grant Thornton India LLP

Vidya Rajarao
Partner
Grant Thornton India LLP

Executive summary

A string of corporate scandals and frauds have rattled India Inc. in recent times, resulting in decline in investor confidence and loss of shareholder value, and in extreme cases, liquidation of business. Specific types of frauds including corruption and bribery, siphoning-off funds, information theft, theft of physical assets and internal financial fraud have increased dramatically in India. Our survey findings echo this observation, with over 41% of our respondents agreeing that the exposure of Indian corporates to fraud-related threats has increased substantially since the past several years.

Over the years, a number of specific frauds have become more common within the corporate world. Bribery, corruption, money laundering, tax evasion, window dressing, financial reporting fraud, etc. are of mounting concern for Indian corporates. In addition to this, accounting fraud is becoming increasingly significant. A common incidence is 'cooking of books' or 'fudging of accounts' by registering fake sales only to be reversed in the next accounting period, accruing future revenues as current period revenues, discarding or not applying relevant accounting principles and making lower provisions for future liabilities, etc.

Our survey findings mirror the overall situation in the country. Regulators such as the Reserve Bank of India (RBI) have levied large penalties on banks, both public and private, for not upgrading their processes and controls. As a result, companies are best advised to be vigilant and take proactive steps to stem fraud rather than reacting to an incident of fraud.

The growing menace of cyber-crimes involving data theft and identity theft pose a serious threat not only to individuals and companies across sectors, but also dents the reputation of the Information Technology-Information Technology Enabled Services (IT-ITeS) industry. Several recent incidences such as the breach of security at payment card processing companies in India have put a question mark on the outsourcing of data that requires a high degree of confidentiality.

The lurking risk of frauds has been dissuading investors from investing in India. Global Private Equity (PE) giants with a higher degree of risk appetite have been managing risks by adopting a stringent approach to sifting through minute details and digging out crucial information on their portfolio companies. In addition, more and more PE firms are periodically reviewing the books and records of investee companies to ensure that fraud does not impact their return on investments or cash flows.

The aforementioned instances are indicative that today's business landscape provides a fertile ground for misdoings, frauds and manipulations. This underscores an urgent need for companies to put in place robust controls, hold constant vigilance and identify ‘red flags’ at the earliest hint of any misdoing. With an overall awareness about frauds and the unique ways being adopted by fraudsters, expansion in the scope of fraud-mitigation programs and voluntary reconsideration of their existing governance standards, corporates can actively manage their risks. Further, stringent law enforcement and rigorous penal prosecutions by courts and regulatory agencies will usher in transparency and accountability across the Board, both in the government and corporate sectors.

Executive summary

Fraud – Key statistics

- Incidences of fraud in corporate India have increased in the past two years.
- Companies operating in the real estate and infrastructure sector are considered to be the most vulnerable to fraud-related incidences.
- More than 60% of the respondents to the survey stated that damage to their organisations' brand and market reputation was the biggest impact of fraudulent activities.
- Maintaining vigilance against corruption, money laundering and/ or bribery needs to be a key focus for Indian corporates.

Fraud prevention – Role, frequency and effectiveness

- Robust internal controls and regular testing of internal controls was cited by more than 60% of the respondents as the most effective method of fraud mitigation.
- 66% of the respondents to the survey believe that appointing compliance personnel within their organisation would help mitigate fraud.
- 29% of the respondents to the survey cited that identification and a quick response to the warning signals was the sole reason they were able to highlight fraud and misconduct in the organisation.
- 35% of the respondents to the survey believe that the fraud risk assessment and compliance controls review in their organisation was not a periodic activity.
- The survey indicated that fraud risk assessment and compliance controls review was seen as a one-time exercise by most corporates.
- Provisions in the Companies Act, 2013 are expected to improve corporate governance standards across India Inc.

The scale of corporate frauds in India:

Ground reality

The scale of corporate frauds in India: Ground reality

Globalisation and advances in technology have not only benefitted Indian businesses but have also exposed them to growing incidences of frauds that have only become more sophisticated. Greater interconnectedness of businesses and economies cause ripple effects of frauds that have far reaching consequences. Failure in identifying and mitigating fraud risks creates a huge liability pitfall for businesses in the current economic environment.

Procurement frauds, payroll frauds, asset misappropriation, financial misstatement, corruption, bribery, tax evasion, piracy, Intellectual Property (IP) fraud, kickbacks, accounting frauds, counterfeiting, white-collar crimes, etc are swiftly threatening businesses in both the private and public sectors.

Corporate wrongdoing inevitably ends up creating a vicious cycle that hurts shareholder value, damages investors' trust, leads to locking-up of capital in litigation, and ultimately causes wider financial market instability; eventually becoming part of much larger problems. Recent legislations with robust provisions are a step forward for India Inc in preventing corporate frauds. Companies and their investors have to realise that fraud prevention is not only an exercise for ensuring compliance with the laws, but it also serves as a safeguard for their return on investment.

Kunal Gupta
Executive Director
Grant Thornton India LLP

The scale of corporate frauds in India: Ground reality

Rising incidences of frauds

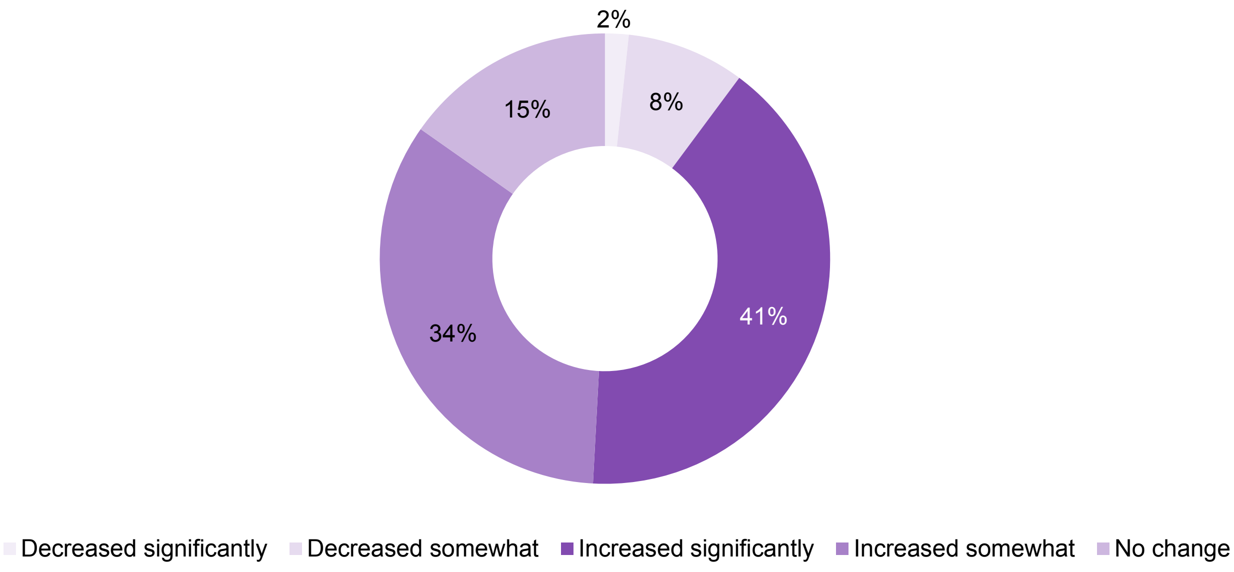
The number of companies in India witnessing incidences of frauds has increased over the past two years. Over 40% of our survey respondents agreed to witnessing a rising trend of willful defaults and frauds.

Fraud prevention

Various regulatory bodies and the government have been taking steps to overhaul the corporate oversight laws and reinforce investor confidence in the country's business practices. To tackle the growing menace of frauds in India, the Securities and Exchange Board of India (SEBI) has set up the Forensic Accounting Cell.

> Frauds are less likely to happen in family-run companies as they would be more vigilant. However, in family-run businesses, frauds are likely to be committed by family members themselves. This is because employees in such businesses are scared of committing frauds for fear of getting caught.
>
> **View of an Independent Director**

Q1 - In the last two years, incidences of fraud in corporate India have:



Increased significantly 41%

The scale of corporate frauds in India: Ground reality

The enactment of the new Companies Act, 2013 ("The Act") is aimed at making sweeping changes to strengthen corporate governance and impose checks and balances to prevent frauds. In the Act, the definition of fraud in Section 447 has been expanded, making fraud a specific concept involving deceit, conflicts of interest, corrupt practices and bribery. Any action undertaken to conceal fact, deceive, injure the interests of the company or its stakeholders, or to gain undue advantage also constitutes fraud.

Besides, the strengthening of the Serious Fraud Investigation Office (SFIO) to act as a statutory body, empowered with initiating prosecution when directed by the Central Government, is aimed at reinforcing the mechanism for detecting frauds and bringing the perpetrators to justice. The SFIO has also been vested with the power to arrest offenders for offences specified as fraud. The severity of the penalties have also been increased to include imprisonment ranging from six months to 10 years, as well as fine up to three times the sum involved in the fraud.

Under the new law, companies, audit firms, along with their partners and experts, and the officers involved in fraud have been prescribed stringent prosecution. In addition, to gear up and battle increased tax avoidance, the government has also framed guidelines for the implementation of General Anti-Avoidance Rules (GAAR), which are expected to come into force from April 2016.

The new frameworks are a definite step forward towards fraud prevention in corporate India.

Sectoral analysis

This survey shows that public sector enterprises have witnessed a rise in fraud incidences in the last few years. Weakness in related internal controls, scarcity of resources at disposal and senior management override are among the major reasons for the increased vulnerability of public sector enterprises to fraud risks. These factors create fertile ground for potential wrongdoers to carry out corruption, bribery, misappropriation of money or assets, among others.

Each year, the exchequer suffers massive losses, usually running into several crores of rupees, because of an array of frauds. As per reports from the RBI, during the period 2012-13, 29,653 cases of fraud were detected in India's nationalised banks, totalling Rs 24,828 crore.

The scale of corporate frauds in India: Ground reality

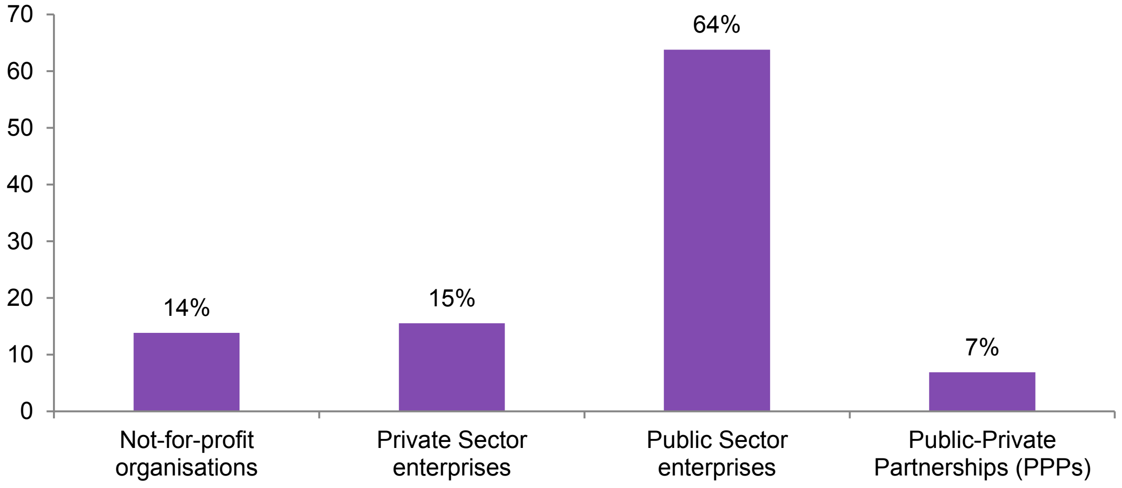
In order to assist banks in recognising and managing specific risks, the RBI has directed them to create a Special Committee of the Board and introduce a system of concurrence audit. The proposed Special Committee of the Board will be responsible for monitoring and investigating frauds amounting to Rs 1 crore and above across all Indian commercial banks.

Fraud prevention

Given the critical role of public sector enterprises to the health of the economy, concerted efforts and better coordination at operational and surveillance levels needs to become an important agenda for stakeholders of these enterprises.

Devising effective fraud prevention strategies and executing them in letter and spirit can help public sector enterprises reduce incidences of frauds. In order to ensure the effectiveness of these measures, it is also crucial to implement robust controls and maintain continued scrutiny of all expenditures.

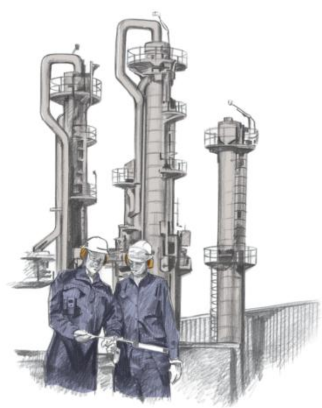
Q2 - Of the following types of corporate organisations, which do you believe, is most vulnerable to frauds?



Public sector enterprises 64%

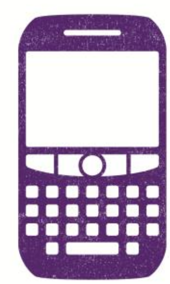
The scale of corporate frauds in India: Ground reality

Q3 - Of the following, which sectors do you believe are most vulnerable to frauds?



Real estate and infrastructure

Financial Services



Telecom

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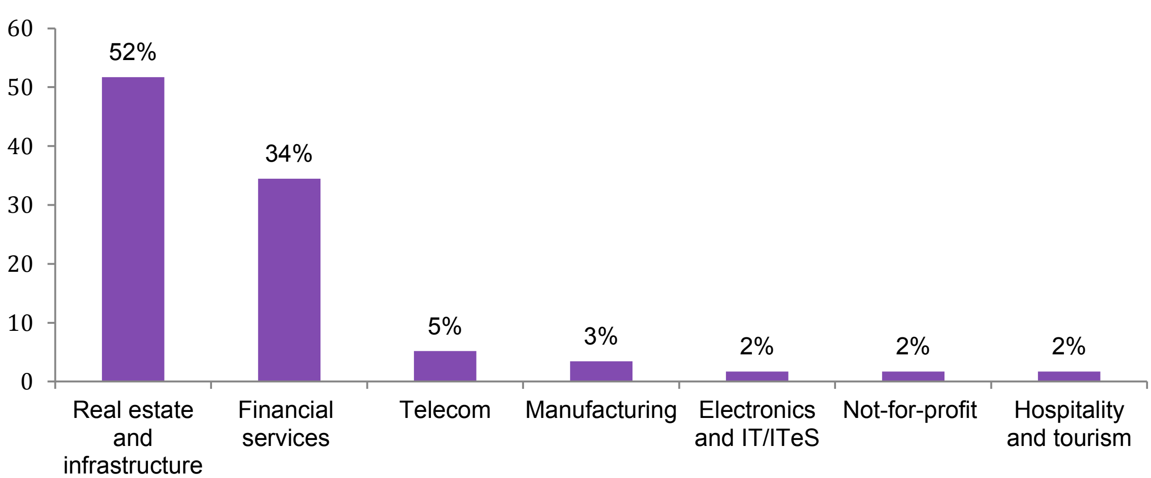


Real estate and infrastructure 52%

The scale of corporate frauds in India: Ground reality

Sectoral analysis

Highest proportion (52%) of our survey respondents feel that businesses operating in the real estate and infrastructure sector are most prone to frauds. Over the last few years, a number of frauds have been unearthed in the Indian real estate and infrastructure sector. Its heterogeneous nature and lack of robust internal controls make the real estate sector more vulnerable to frauds.

Besides, the sector also experiences a risk of revenue leakage at various levels, owing to rising cost pressures on contractors and developers, continually evolving regulations, and absence of advanced business processes and controls.

Fraud prevention

In an attempt to make the country's real estate sector more accountable and transparent, the Cabinet recently approved the Real Estate (Regulation and Development) Bill, 2012 (The Bill).

Global companies are increasingly realising that corruption is the biggest threat to do business in India. As a result, they are investing in building up controls and processes that address the direct and indirect risks of corruption and bribery in India. This means that Indian corporates that intend to do business with such global companies would have to invest significantly in ramping up their anti-corruption controls or else stand a chance to lose doing business with global companies.

Vidya Rajarao
Partner
Grant Thornton India LLP

The scale of corporate frauds in India: Ground reality

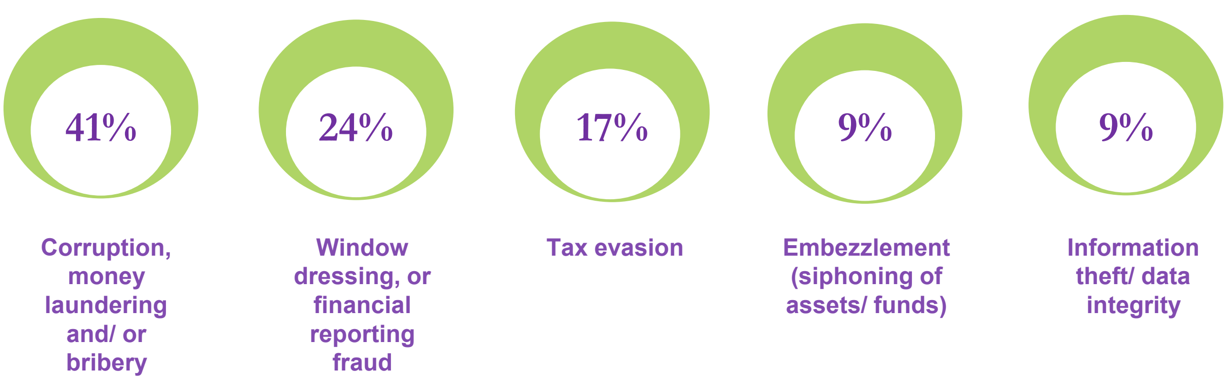
The Bill proposes to institute a uniform regulatory environment for the sector to significantly reduce frauds and delays. For ensuring greater transparency and diligence in the sector, the Bill also proposes strict penal provisions for developers deviating from the approved layout plan or defaulting on the contractual agreement. In order to protect the interest of consumers, the Bill also proposes to establish a regulatory authority at the state-level as well as an appellate tribunal.

Ranking second on our survey, the financial services industry is the next most vulnerable sector.

Fraudulent claims in the insurance sector, phishing, theft of confidential data, money laundering and tax evasion are some of issues plaguing the financial services sector, at present.

Increase in the number of fraud incidences have put pressure on the bottom-line of financial services institutions, making it necessary for them to devise and integrate holistic controls and monitoring frameworks with processes, governance, analytics and technologies. An appropriate risk management strategy can go a long way in making businesses in this sector more proactive in identifying fraudulent transactions, and taking necessary steps on time.

Q4 - Which is the most common type of fraud that Indian corporates need to vigilant about?



Corruption, money laundering and/ or bribery 41%

The scale of corporate frauds in India: Ground reality

The survey reveals that corruption, money laundering and/ or bribery is the most common type of fraud that Indian corporates need to watch out for. In India, corruption and bribery are more common in businesses that have a significant interface with public officials. Corruption and bribery are visible mostly while obtaining and retaining business, procuring routine administrative approvals, covering up for inconsistencies in documentation and quality of work, etc.

The amended draft Indian Penal Code Bill, 2011 would cover graft by firm, society, trust, individual, association of individuals, and. or company, whether incorporated or not, which undertakes any economic or financial or commercial activity. Tightening domestic regulatory framework will force Indian corporates to reevaluate how they conduct their own business and collaborate with others.

According to the survey, tax evasion is also swiftly becoming rampant in India. A plethora of tax evasion techniques are being adopted by corporates in recent times, with individuals evading tax on passive income such as interest, capital gains and dividends, and multinational companies shifting profits from high-tax to low-tax jurisdictions artificially. In order to curb instances of tax evasion, the Finance Ministry has decided to tighten the regulatory oversight on sectors and industries prone to chronic service tax evasion, such as real estate, mining, IT, consultancy, transport operators, storage and warehouse, advertising, security, and manpower and recruitment services.

The scale of corporate frauds in India: Ground reality

Window dressing/ financial reporting frauds is another serious concern for Indian corporates. Financial misstatement and manipulation of accounting data are among the main concerns for investors and other capital market stakeholders.

Financial reporting frauds are often initiated for concealing the company's poor performance, bolstering the financial position of the company to cover up misappropriated assets, attract potential investors, etc.

Comparatively, only a minute proportion of our survey respondents are concerned about embezzlement and theft of information and intellectual assets.

Deterring the occurrences of embezzlement of funds or assets and the theft of data is of utmost importance for any business to mitigate its reputational and business risks. Not only adequate attention needs to be given to preventive and detective controls framework, but the Boards and executive management must also effectively communicate values and set the right culture. This succeeds more by setting examples than by setting rules. When ethical behavior is ingrained into the way of life in any organisation, the risks of fraud significantly reduce.

Vinamra Shastri
Partner
Grant Thornton India LLP

The big picture:

Cost of fraud

The big picture: Cost of fraud

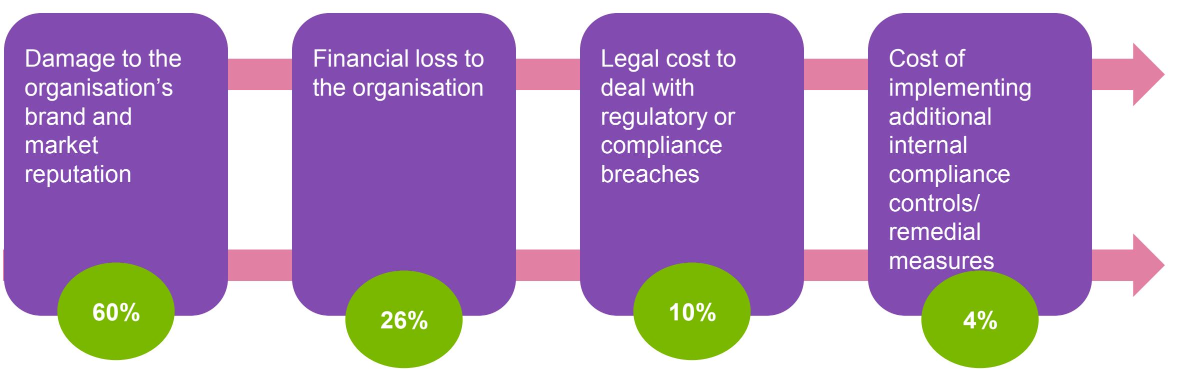
Besides the financial losses, businesses that are victims of fraud also suffer long-term negative impact on their brand and reputation.

60% of the survey respondents highlighted their concerns about the impact of frauds on their brand and market reputation. In recent times, market reputation of some of the large organisations have been mauled by a series of instances relating to frauds including corruption and bribery.

Further, 26% of our respondents were concerned about the financial losses that businesses suffer as a result of frauds. Intentional fraudulent financial reporting, information manipulation, theft of inventory, etc are among the common types of misconducts that can result in financial losses for companies.

Further, the cost of implementing additional internal compliance controls/ remedial measures to combat frauds is provided the least weightage by the respondents. This shows that irrespective of the impact of frauds on businesses, a number of organisations remain averse to implementing a comprehensive anti-fraud system to diagnose, detect, prevent and remediate fraud risks.

Q5 - What is the biggest impact on an organisation that falls prey to fraudulent activities?



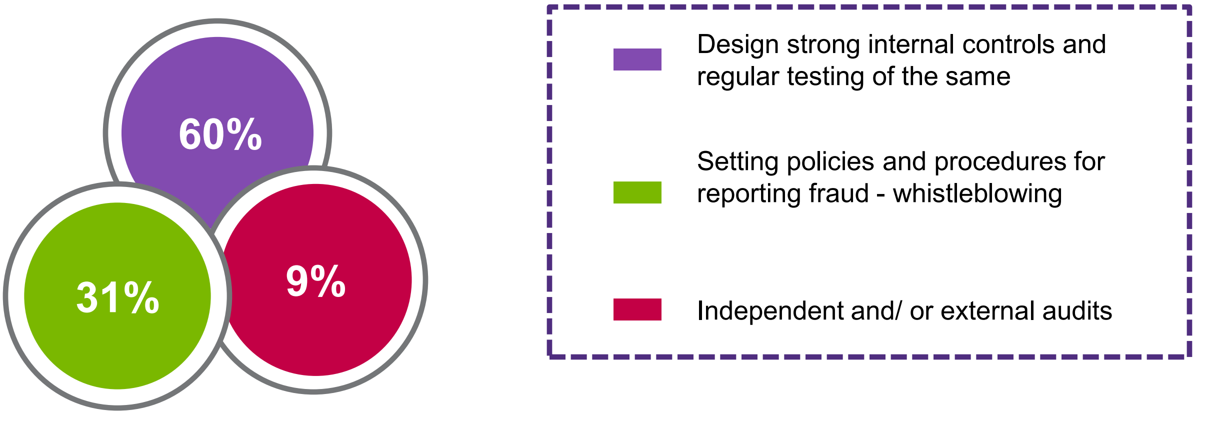
Damage to the organisation’s brand and market reputation 60%

A macro perspective:

Identifying and mitigating frauds

A macro perspective: Identifying and mitigating frauds

Q6 - Which is the most effective method for fraud mitigation in an organisation?



Design strong internal controls and regular testing of the same

60%

A majority of the respondents (60%) consider strong internal controls as the most effective mitigation strategy for managing operational and financial risks related to frauds. By designing and implementing effective internal controls, corporates can detect frauds in a timely manner, while also limiting the damage. Internal audit is one of the most commonly used control mechanism deployed by corporates to address fraud risks. Besides, the following internal control measures are also adopted by businesses to limit their exposure to frauds and embezzlement:

- proper segregation of financial duties among the accounting staff
- maintaining optimal personal oversight of the business' finances
- putting in place a mechanism for employees to report suspicious activities that could be linked to possible fraud
- developing an ethical work culture in the organisation

However, instituting proper internal controls regime is often not enough for an organisation to manage fraud risks. What is also needed is regular assessment of controls and compliance programs, both to evaluate the design and to test its effectiveness.

Specific controls can also be designed to prevent, deter, and detect fraud risks occurring due to a company's chosen industry, market and geography, as well as the general economic conditions. For instance, process-specific fraud risk controls can help businesses identify 'red flags' and mitigate occurrence of procurement fraud such as false invoicing, inventory theft, procurement of substandard goods, bribery and kickback schemes.

A macro perspective: Identifying and mitigating frauds

Our survey further indicates that whistleblowing is perceived as the next most effective mechanism in the timely detection of frauds.

In sharp contrast to the US laws which encourage employees to report misconducts and reap handsome rewards once their forewarnings are proved correct, India Inc, until recently, lacked a formal whistleblower policy. Previously, the whistleblower policy in India was mostly an organisation's internal guidance that governed how the cases of wrongdoings would be notified to the senior management.

Taking cue from jurisdictions such as the US and UK, which empower citizens to report suspicious activities and offer protection to whistleblowers, the Indian government recently introduced the Public Interest Disclosure and Protection to Persons Making the Disclosures Bill, 2010. The Bill was renamed as the Whistleblowers Protection Bill, 2011 and was subsequently passed in the Lok Sabha. The Bill proposes suitable safeguards against victimisation of any individual providing disclosers on any potential instances of misconducts or illegal practices within an organisation.

The Companies Act, 1956 required audit committees to put in place a vigil/ whistleblower mechanism for reporting frauds. The law required every organisation to disclose its whistleblower policy in the corporate governance section of its annual report.

While the disclosure in the annual report was mandatory, framing a vigil mechanism was not a requisite for Indian corporates under the law.

The recently enacted Companies Act, 2013 has gone a step further to strengthen the whistleblower policy. The Act bolsters transparency in corporate governance by directing listed companies and certain class of companies, including entities accepting deposits from the public and those which have borrowed more than Rs 50 crores from banks and public financial institutions, to institute mandatory vigil mechanism for directors and employees to report their genuine concerns.

Independent directors can only insist on laying down proper systems and take a view on each fraud with reference to an approved system. Whistleblowers are a must in any organisation and all reports from whistleblowers must be seen at the highest level in the organisation. The recent case of sacking of a top executive of the IT department in a large private sector bank was based on the whistleblower's report. If only the bank had a system of calling for asset-liability statement from all employees, the misdemeanour could have come to light a couple of years back. Such an annual statement of the CEO and senior executives must be placed before the Board.

View of an Independent Director

A macro perspective: Identifying and mitigating frauds

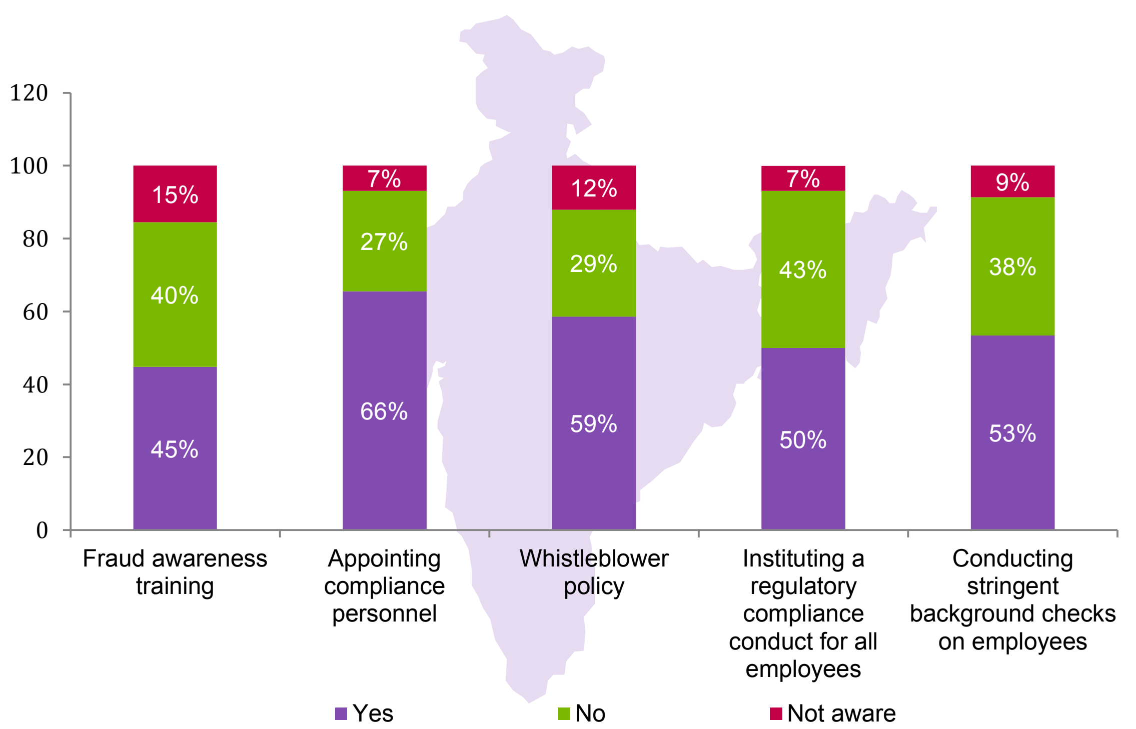
Further, in order to ensure that this policy is not abused, the Companies Act, 2013 states that 'repeated frivolous complaints' by a director or an employee would invite strict action against them.

Different companies put in place different measures to deal with frauds. Most frauds are committed by people at the senior level. It is important, therefore, to have comparable quotes, well-policed purchase function, and timely job rotation to ensure that frauds are prevented.

If the company has strong operating procedures, systems and adequate internal controls, then frauds won't happen in any case. In such instances, a fraud risk assessment might not be of great help.

View of an Independent Director

Q7 - As a preventive measure against frauds, has your organisation considered any of the following?



A macro perspective: Identifying and mitigating frauds

India ranks 94 among 177 nations on Transparency International Corruption Perception Index (CPI) for 2013. It is particularly worrisome to note that India ranked lower on the index than three of its BRICS peers - China (80th), Brazil and South Africa (both ranked 72nd).

Considering the growing economic clout of emerging markets and rising influence of India in markets globally, it has become crucial for Indian businesses to assess their standards of ethics and transparency, intensify their fraud mitigation efforts and set new benchmarks for legal and regulatory standards.

A staggering 40% of our survey respondents have pointed to the lack of penetration of employee awareness programs in their organisations. Besides, over 15% respondents are unaware of such a training that could help detect warning signs.

The highest proportion of our respondents (66%) believe that appointing a compliance personnel within their organisations would help mitigate frauds. This strategy to combat frauds and misdoings is more preferred than having a whistleblower policy, with over 58% of survey respondents reporting that development of formal policies for whistleblowers can help address rising incidences of frauds.

Although awareness about the effectiveness of having a compliance personnel and a whistleblower policy is high, the level of implementation by organisations is still low. A large proportion of our respondents are yet to implement whistleblower policy and appoint compliance personnel to respond to fraud risks.

Prevention is always better than cure. In order to ensure that an organisation's fraud risk management strategies are adept at preventing instances of misconduct and wrongdoing, these need to be reinforced with regular training and a clearly communicated zero tolerance policy. An effective fraud awareness program serves as the bedrock to detect and prevent frauds in corporates. Our survey findings echo this fact, with over 45% of respondents rating fraud awareness training as the most effective measure considered by their organisations to mitigate fraud risks.

Anil Roy
Partner
Grant Thornton India LLP

A macro perspective: Identifying and mitigating frauds

Further, 50% of the survey respondents agree that a strong approach to instituting a regulatory compliance framework for all employees can help build a climate of integrity and an ethical culture across the organisation. Instituting such policies increases the desired conduct and supports overall compliance with relevant codes, guidelines and laws, while also meeting the requisite expectations of transparency, probity and accountability. Remarkably, most organisations fail to see value in establishing compliance programs for their employees, a point echoed by over 43% of our respondents.

Conducting stringent background checks on employees is another effective measure being adopted by organisations. Undertaking staff monitoring as part of the hiring process can help overcome negative attitudes that may arise in employees from excessive supervision or controls. In order to detect and mitigate potential risks associated with employee-related misconduct, it is recommended to supplement pre-employment background checks with a screening strategy as well as periodic checks on a random sample of the existing employee population.

There must be a constant review of systems within an organisation. The department should report only to the CEO. Most large pharmaceutical companies have pharmcological-vigilance teams which are deeply involved in pre-approval of new drugs. Moreover, they also examine feedback after a drug is launched in the market.

The CEO should never approve/ compromise on the systems-based standards but may review the systems thoroughly for any change. Cutting the corners becomes habitual after some time, which then provides fertile ground for frauds. It is well-known how some of the leading rating agencies compromised on 'independent' research of companies, which eventually led to the financial disaster of 2008, from which the world is yet to recover.

View of an Independent Director

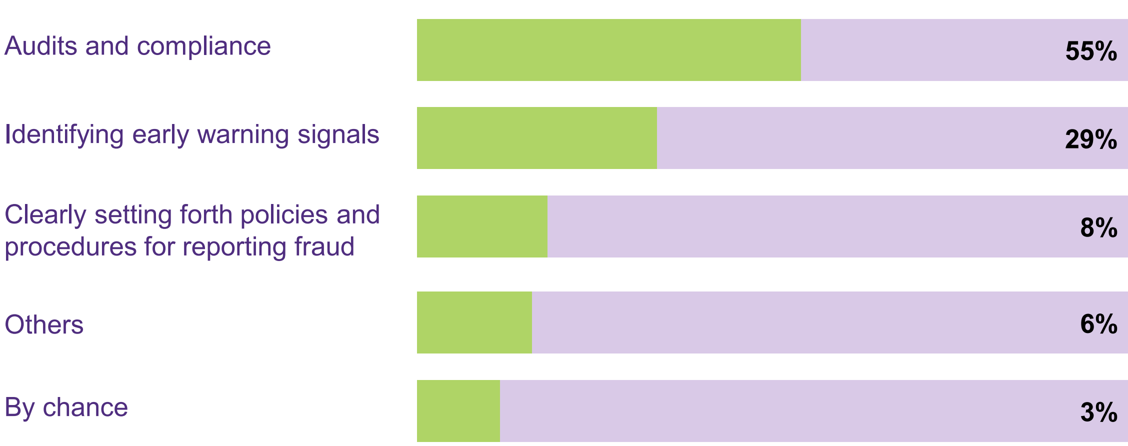
A macro perspective: Identifying and mitigating frauds

Remaining proactive in identifying transactions that indicate heightened risk of fraud or a fraudulent activity is critical for every organisation. Putting in place effective tests for frauds, seeking out fraud indicators in the day-to-day operations of the business, and establishing whistleblower hotlines and internal controls are some of the effective measures for fraud detection. By adopting a more hands-on approach to fraud detection and prevention, organisations can contain financial and collateral damage.

Businesses are increasingly seeing value in compliance and audits in establishing a critical line of defence against the threat of frauds and misdoings, a fact echoed by majority of our respondents (55%).

Spotting early warning signs and 'red flags' can help organisations unearth an array of irregularities and illegal acts that can eventually dent an organisation's reputation and dampen employee morale. Bypassing and ignoring early warning signs often becomes a potential lost opportunity to detect and prevent frauds and misconducts.

Q8 – What has been the most effective method for uncovering fraud in your organisation?



Audits and compliance 55%

A macro perspective: Identifying and mitigating frauds

29% of survey respondents agreed that frauds and misconducts in their organisations came to light solely by identifying and acting quickly on the warning signs.

Organisations are now understanding the value of establishing a formal corporate fraud and ethics policy to encourage the reporting of any irregularity, or suspected irregularity involving employees and other stakeholders. The formal guidelines are often also meant to ensure that allegations of fraud and corruption are adequately and instantly addressed.

However, a mere 8% of respondents have chosen this option for detection of fraud, misappropriations, and other irregularities, which shows that its awareness about this method of fraud prevention among Indian corporates is still not widespread.

Of the total number of respondents, 6% agreed to using other strategic approaches for detecting fraud-related problems in their organisations Putting in place whistleblower hotlines, data analytics and internal controls are some other tools that help expose misconducts in an organisation.

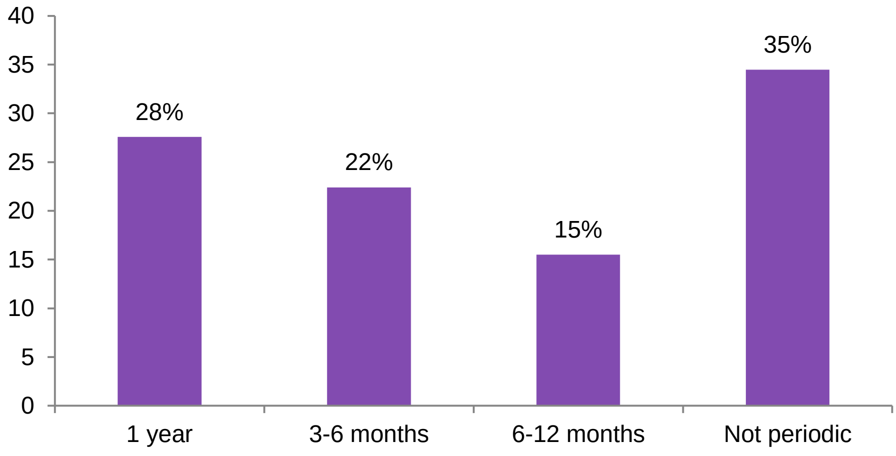
External tip-offs, accident or chance can often supplement the various strategies available for the detection of fraud. A total of 3% of the respondents have relied on luck or chance to unearth fraudulent incidences in their organisations.

Corruption fines by the regulators are getting significant by the day. In addition, there are significant incentives for the whistleblowers in India to report to the regulators in the US. As a result, Indian corporates with global ambitions, are best advised to put in place an effective whistleblower mechanism in addition to fraud prevention controls, so that the companies get to know of the wrongdoing and are able to address it before it becomes public knowledge, and mars the reputation of the company.

Vidya Rajarao
Partner
Grant Thornton India LLP

A macro perspective: Identifying and mitigating frauds

Q9 - What is the frequency of fraud risk assessment and compliance controls review in your organisation?



Not periodic **35%**

Although incidences of fraud are widespread, frequency of fraud risk assessment and compliance controls review in Indian corporates remains a cause of concern. The highest proportion of our respondents do not have formal processes and systems in place for periodic fraud risk assessment and compliance controls review.

A macro perspective: Identifying and mitigating frauds

Highest proportion of the respondents (35%) have assessed the design and operational effectiveness of controls and fraud mitigation programs on a non-periodic basis.

Further, a total of 28% of the respondents conduct fraud risk assessment and compliance controls review on an annual basis.

The efficacy of fraud prevention lies in how responsive is it to the changes in the manner frauds are perpetrated. Hence, it is important that companies conduct periodic assessments to identify risks that may threaten an organisation's operational, financial and brand stability.

Kunal Gupta
Executive Director
Grant Thornton India LLP

A macro perspective: Identifying and mitigating frauds

Q10 - In your experience, after identifying a 'fraud', what is the average time lapse before corrective measures are taken?

< 3 months 43%

Our survey results indicate that remedying the damage caused from frauds and misconduct, as well as taking corrective action takes centre-stage for corporates in India. Most of our respondents (43%) agree to putting in place response controls within 3 months of uncovering fraud incidents.

Although there remains a difference in the specific action undertaken by organisations in response to frauds, nevertheless, most organisations adopt a proactive approach to resolve the outcomes of fraudulent activities.

Reporting incidents to law enforcement agencies, conducting internal and external investigations, outright dismissing the involved parties, etc form some of the common responses adopted by the management after identifying a fraud.

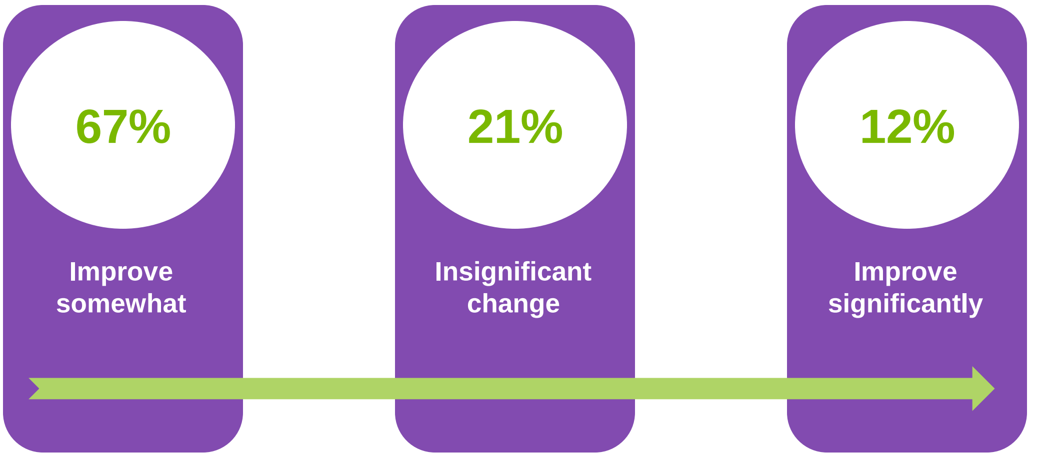
Establishing fraud hotlines for reporting suspicious behaviours and fraud allegations is another effective mechanism adopted by organisations to safeguard their profits, operating efficiencies, and reputation from future instances of fraudulent activities.

Notably, 16% of respondents have never encountered any incidences of frauds in their respective organisations.

Role of corporate governance in mitigating frauds

Role of Corporate Governance in mitigating frauds

Q11 - Provisions in the Companies Act, 2013 will have the following impact on corporate governance:



Improve somewhat 67%

Most of the survey respondents are optimistic that provisions in the Companies Act, 2013 will improve corporate governance across Indian businesses. The Act is expected to bring in stringent framework of accountability in corporate boardrooms. A majority of respondents agreed that the new law will help improve the conduct of the Board, paving the way for better corporate governance and business environment. Further, 12% of the respondents are of the opinion that the new legislation will significantly strengthen corporate governance systems.

On the other hand, 21% of the respondents said that the Companies Act, 2013 will fail to bring in more transparency and accountability in Indian businesses.

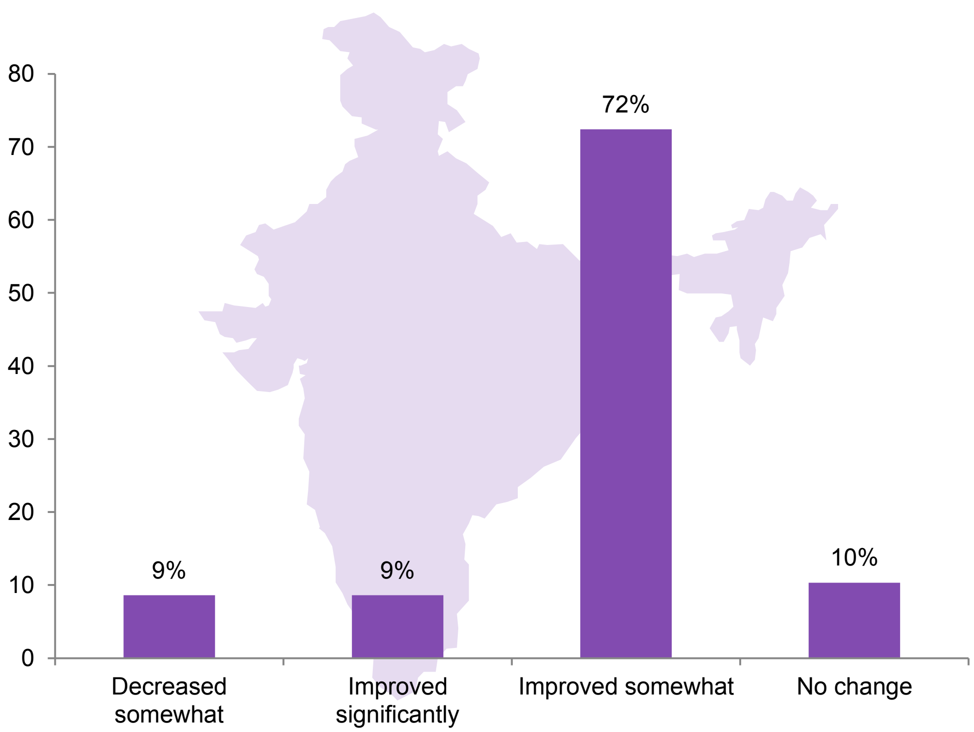
Role of Corporate Governance in mitigating frauds

The Companies Act, 2013 is a historic piece of legislation aimed at improving transparency and accountability in India's corporate sector. With its notification in the Union Gazette, the comprehensive law, with its 470 sections spread over 29 chapters and 7 schedules, has replaced the Companies Act, 1956.

As per the new law, the role of independent directors have been provided statutory recognition, which was previously only defined for listed companies through the Listing Agreement.

In addition, the new law also describes the code of conduct for the roles, responsibilities and functions of independent directors. Section 149 details out the various criteria for a person to be appointed as an independent director, as well as his/ her remuneration, tenure and the set of comprehensive guidelines to be followed by them. Section 149 (12) of the Act has transformed the concept of liability of independent directors, making them prima facie guilty if they had knowledge of the matter and consented, connived or showed lack of diligence.

Q12 - In the last two years, governance standards amongst organisations in India have:



Improved somewhat 72%

Role of Corporate Governance in mitigating frauds

In absolute compliance with the requirement of Clause 49 of the Listing Agreement, every listed public company, under Section 149 of The Act is required to have at least one-third of the total number of directors in the Board as independent directors. This provision is a milestone as far as corporate governance norms are concerned.

Providing additional powers to the SFIO, a multi-disciplinary organisation under the Ministry of Corporate Affairs (MCA), is yet another landmark development in strengthening the enforcement powers of the regulatory bodies.

Further, accepting certain recommendations of the policy document on corporate governance, formulated by a committee constituted by the MCA and headed by Adi Godrej, SEBI also plans to transform corporate governance norms in listing pacts.

The market regulator is likely to bring in a new regulation to incorporate various provisions detailed in The Act and revamp the current norms pertaining to remuneration of top management, class action suits, whistleblowers, audit committees, independent directorships, corporate social responsibility (CSR) spends, related-party transactions, among others.

The efficiency of reforms and regulatory oversights is mirrored by responses to the survey as well, with 72% respondents agreeing that the governance standards amongst organisations in India has shown an improvement over the past two years. 10% of the respondents feel that governance standards among businesses has not changed at all over the past few years, which creates an urgent need for corporate India to streamline its fraud prevention strategies.

Another major step taken by the government is the setting up of an anti-graft ombudsman to check corruption, with the Presidential assent being accorded to the Lokpal Bill that was passed by the Parliament in December last year.

The job of the independent directors is that the systems and procedures laid out by the company are followed. If they are not being followed, then why not. The independent directors must ensure that the Board acts transparently and everything is well documented.

View of an Independent Director

Role of Corporate Governance in mitigating frauds

Q13 - Change in governance standards amongst Indian corporates is primarily driven by:

53%
Regulatory/ compliance regime

26%
Internal or voluntary initiatives

21%
Activism amongst non-promoter stakeholders (private equity investors, analysts, etc)

Regulatory/compliance regime driven

53%

The highest proportion (53%) of the respondents are of the opinion that the evolving regulatory and compliance regime is driving the move towards stricter corporate governance norms. In India, SEBI and the MCA are entrusted with channeling various corporate governance reforms in the business landscape.

On the other hand, just 26% of the survey respondents believe that internal/ voluntary initiatives encourage Indian businesses to evaluate their existing corporate governance practices and strengthen their policy framework.

Role of Corporate Governance in mitigating frauds

Addressing contemporary corporate governance issues often requires businesses to complement the forces outside the company such as market and/ or regulator with a participatory approach from the Board and the management. It is disconcerting to note the lack of value currently being seen by Indian businesses in voluntary adoption of better practices and corporate governance guidelines.

The MCA recently released the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business ("the Guidelines"), a refinement over the Corporate Social Responsibility Voluntary Guidelines, 2009. Intended to provide a framework for all businesses, irrespective of the size, market and locations, for responsible action, the Guidelines contain clauses, to be chosen and adopted by organisations voluntarily as per their own preference.

Activism amongst non-promoter stakeholders (private equity investors, analysts, etc) is considered to contribute the least towards adopting improvements in governance standards by Indian corporates, the survey results point out.

Activism through a range of activities such as whistleblowing, active participation at general meetings, press campaigns, etc from institutional investors has only recently started gaining traction and is now being seen as an effective tool for bringing-in transparency.

The aforementioned results are indicative that Indian businesses are waking up to the importance and relevance of good business ethics, compliance with codes and adherence with environmental and societal interests.

Investing in fraud controls for the sake of regulatory compliance is only one aspect but can never be the sole motivation of putting in place an effective fraud risk management framework. Companies and their investors should look at fraud and leakages emanating from fraud issues in a wholesome perspective. From our experience, each dollar spent in fraud prevention yields greater rewards in the long run.

Lav Goyal
Partner
Grant Thornton India LLP

About ASSOCHAM

The Associated Chambers of Commerce and Industry of India (ASSOCHAM), India's premier apex chamber, covers a membership of over 4 lakh companies and professionals across the country. ASSOCHAM, which started in 1920, is one of the oldest Chambers of Commerce. ASSOCHAM is known as the "knowledge chamber" for its ability to gather and disseminate knowledge. Its vision is to empower the industry with knowledge so that they become strong and powerful global competitors with world-class management, technology and quality standards.

ASSOCHAM is also a "pillar of democracy" as it reflects diverse views and sometimes opposing ideas in industry group. This important facet puts us ahead of countries like China and will strengthen our foundations of a democratic debate and better solution for the future. ASSOCHAM is also the "voice of industry" – it reflects the "pain" of industry as well as its "success" to the government. The Chamber is a "change agent" that helps to create the environment for positive and constructive policy changes and solutions by the government for the progress of India.

As an apex industry body, ASSOCHAM represents the interests of industry and trade, interfaces with Government on policy issues and interacts with counterpart international organisations to promote bilateral economic issues. ASSOCHAM is represented on all national and local bodies and is, thus, able to proactively convey industry viewpoints, and also communicate and debate issues relating to public-private partnerships for economic development.

The road is long. It has many hills and valleys – yet the vision before us of a new resurgent India is strong and powerful. The light of knowledge and banishment of ignorance and poverty beckons us, calling each member of the Chamber to serve the nation and make a difference.

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About Grant Thornton India LLP

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About Fraud and Investigations Services

At Grant Thornton, we are committed to helping our clients navigate through the maze of business issues and disputes, while mitigating the risk and impact of fraud for their organisations. We utilise our high level of technical prowess and comprehensive understanding of statutory regulations to proactively advise our clients in addressing and mitigating the unprecedented systemic fraud risks affecting the control environment of their business. Our range of services include:

- Fraud investigations
- Fraud risk management
  - fraud risk assessment
  - fraud risk awareness workshops
- Dispute resolution/ litigation support
- Corporate intelligence
- Brand protection services
- Pre-employment background checks
- Asset tracing

About Governance Advisory Services

Companies need to understand the emerging governance regulatory environment and also how to put the right corporate governance framework in place. As organisations seek to give stakeholders greater confidence, they face ever increasing pressure to demonstrate good corporate governance practices. We work with audit committee and board of directors, as well as the management team, to develop bespoke solutions that strengthen the governance structures, which will underpin corporate performance as well as ensure regulatory compliance. Our suite of governance advisory services include:

- Clause 49 readiness
- CxO advisory
- Audit committee support
- Whistleblowing mechanism
- Ethics review
- Compliance risk

For more information on our services, please visit us at: **www.grantthornton.in/services**

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