

A BRIEF OVERVIEW

A Joint-Research Report by Institute of Directors and Deloitte Touche Tohmatsu India LLP (DTTILLP)

Corporate Fraud and Misconduct: Role of Independent Directors



The growing focus on ethics and corporate governance within organisations has increased the importance of the role of Independent Directors (IDs) in being effective deterrents to fraud, mismanagement, and lapses in corporate governance.

The business disruption caused by the pandemic has further underscored the need to be vigilant and strengthen governance frameworks as historically, business disruptions have been accompanied by a rise in fraudulent practices. It is likely that some organisations may seek to focus on sustaining operations and on improving growth and profitability while unconsciously placing compliance on the back burner. Hence, it becomes pertinent to raise awareness on fraud, misconduct, and non-compliance amongst the ID community to help them discharge their duties effectively.

Against this background, Deloitte Touche Tohmatsu India LLP (DTTILLP), in association with the Institute of Directors (IOD), conducted a survey to understand how IDs perceive corporate fraud, their preparedness in addressing it, and the best practices to mitigate such risks.

Some of the interesting observations include:

- Around **63 percent** of the IDs responded that the current business environment induced by the pandemic can spur fraud over the next two years. Largescale remote working (**21.79 percent**) and cash flow crunch leading to business operations taking a priority over compliance (**20.09 percent**), were identified as the key factors for the expected rise in frauds



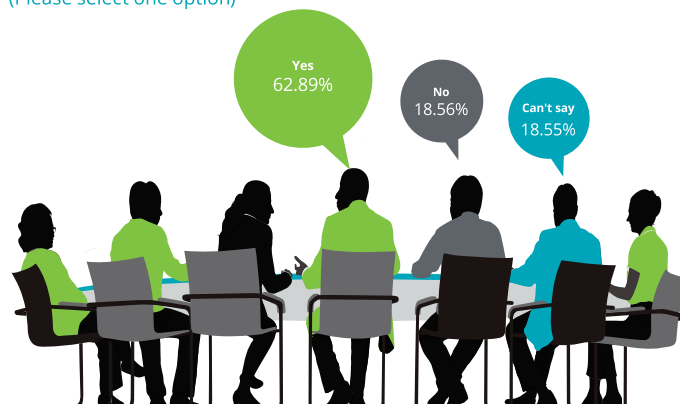
***Mr. Nikhil Bedi**
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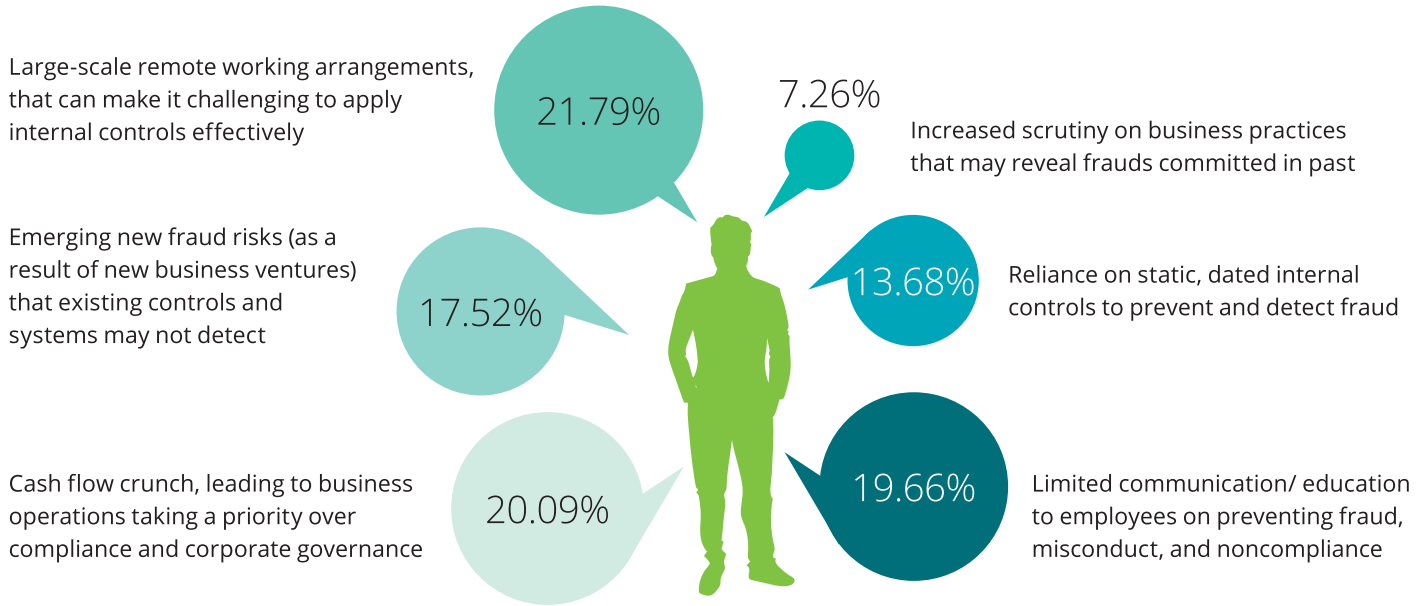
***Mr. Rohit Goel**
Partner – Forensics,
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Do you believe that the current business disruption can spur fraud over the next two years?

(Please select one option)

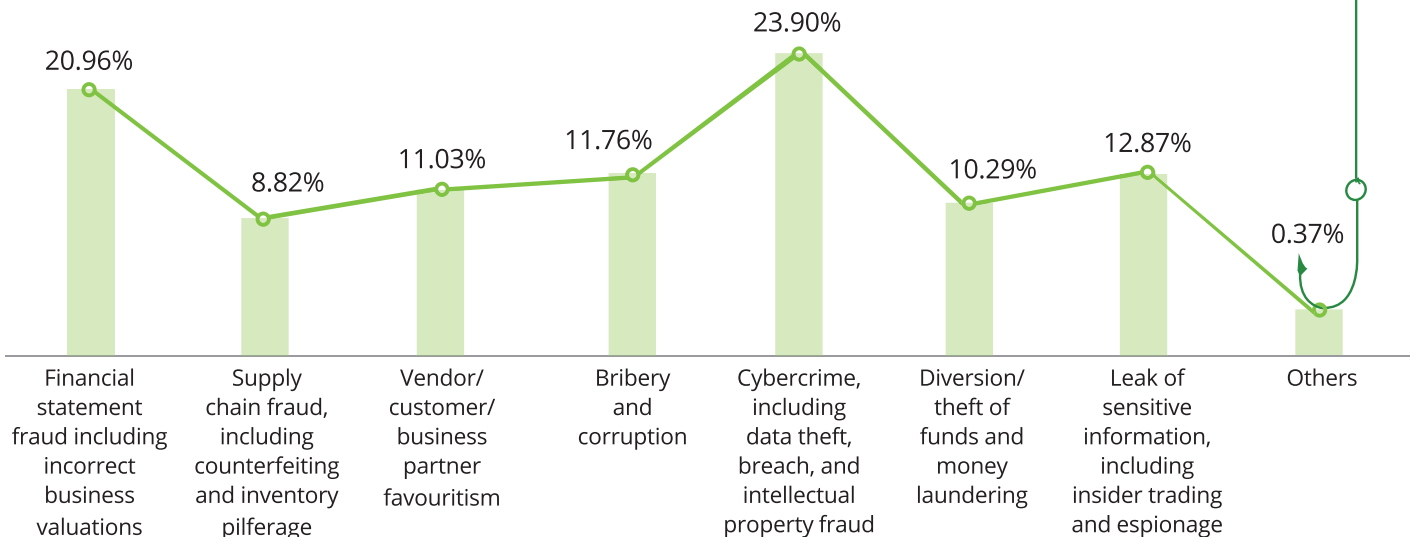


What do you feel are some of the factors/ pressures that can contribute to frauds in the future?



- Cybercrimes (**23.90 percent**), financial statement frauds (**20.96 percent**) and leakage of sensitive information including insider trading (**12.87 percent**) are most likely frauds to be experienced in the near future

From the list below, identify the top three frauds and malpractices that you believe can expose the company to significant monetary, regulatory, and reputational loss.





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We help you identify and surmount the barriers impeding your Board's effectiveness. Our well recognized and industry leading evaluation programmes can be tailored to suit your objectives and are known to impact performance positively. You can also count on us to streamline your existing evaluation procedures by facilitating the use of industry benchmarked assessment tools.

Key Areas Evaluated

- Board Structure, Diversity and Skill matrix
- Board's compliance with its legal, regulatory and fiduciary responsibilities
- Stakeholders Relationship Management
- Risk Management & Internal Controls
- Board Dynamics & Functioning
- Board Committees - Structure, Functioning & Effectiveness
- Oversight of Management Performance, Compensation & Succession planning
- Corporate Governance Framework, Compliance Status and Disclosures

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Board & Directors' Performance Evaluation



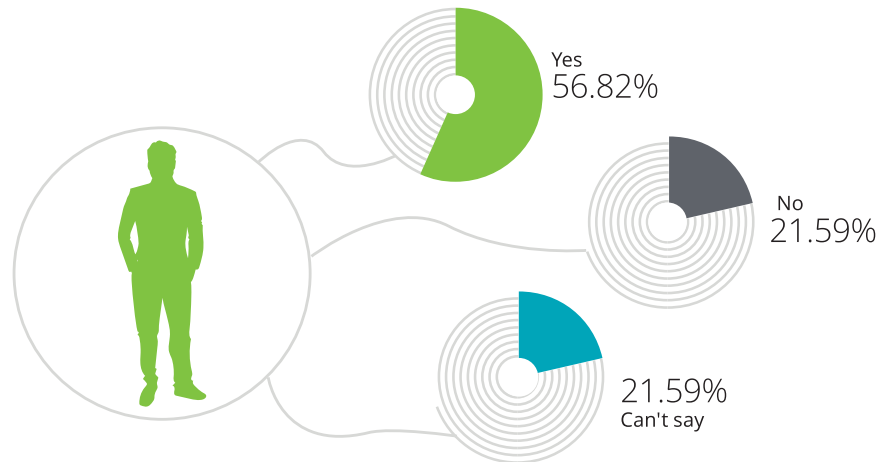
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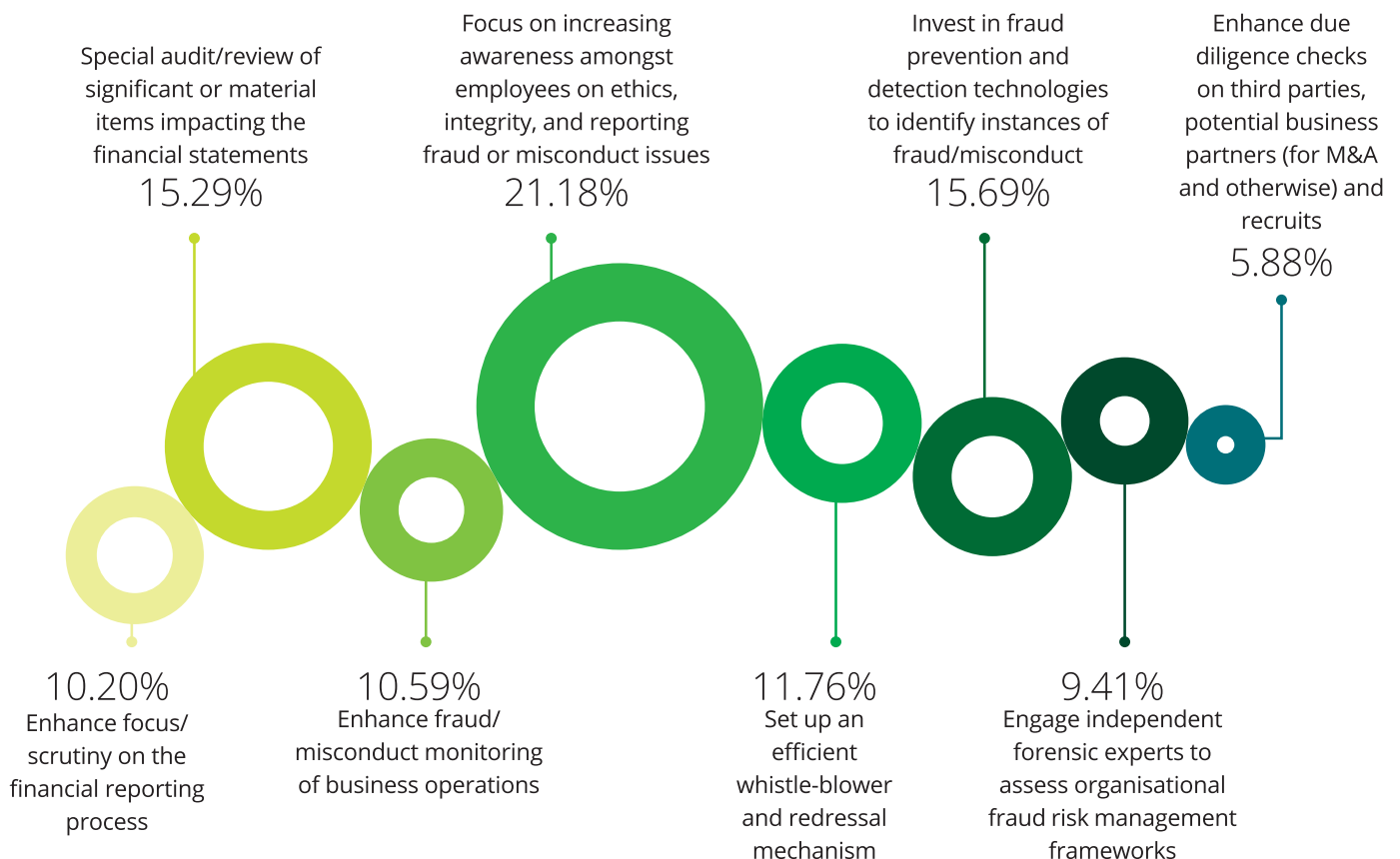
- While around **57 percent** IDs indicated that their board had established an effective Fraud Risk Management (FRM) framework, around **22 percent** IDs indicated the need to

increase awareness amongst employees on ethics, integrity, and reporting fraud or misconduct issues to improve the FRM framework

Has the Audit Committee of your board established an effective anti-fraud (including Financial Statement Frauds) and misconduct detection mechanism?



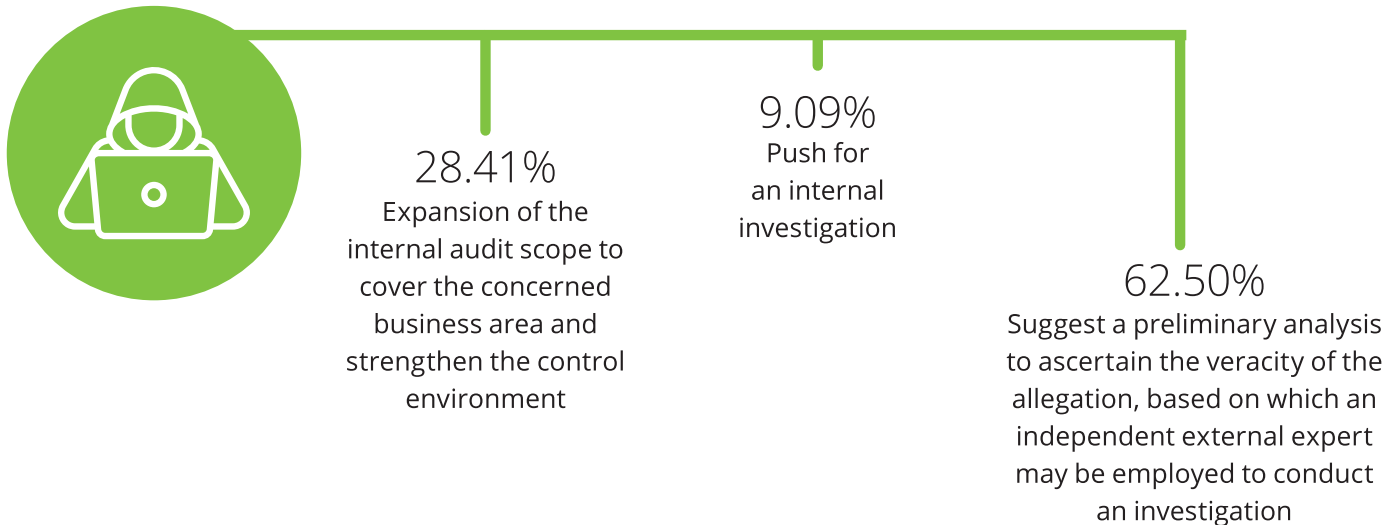
Given the long-term impact of the current business disruption, what are the best practices that organisations can focus on to improve their fraud risk management practices? (Please select top three)



- After receiving suspicious activity reports, around **63 percent** IDs responded that they would suggest a preliminary analysis to ascertain the veracity of the

allegation and may consider the appointment of an independent expert to conduct an investigation

What would you typically suggest upon receiving suspicious activity reports?



Fraud risk management is a dynamic phenomenon as the environment, be it internal or external, is constantly evolving. While the large organizations have generally set up fraud risk management frameworks relevant in their context, however the changed environment could have challenged the efficacy of existing frameworks both from a design and implementation perspective. A structured approach to fraud risk management will help the ones charged with ensuring corporate governance to think in the right direction and ask the right questions. A robust fraud risk management program – addressing the requirements of people, process and technology improvements – is the need of the hour.

In our view, IDs have a greater responsibility in financial matters, as they make up two-thirds of a board's audit committee under the Listing Obligations and Disclosure Requirements (LODR), including the chairmanship, and oversee the integrity of financial information, risk management and a company's vigil mechanism more particularly from a fraud prevention and detection perspective.

The role of the board of directors in overseeing the effectiveness of an organisation's fraud risk management efforts has become increasingly challenging as expectations for board engagement are increasing. The corporate governance norms have been strengthened by the Companies Act, 2013, and the regulations

of the Securities Exchange Board of India (SEBI) for listed companies' where key emphasis is given to frauds by recognizing them as a key risk and has placed the accountability of effective risk management on the board of directors and the senior management.

In the case of listed entities, there is additional fencing by the 'Audit Committee', necessitating IDs to have necessary checks and taking pro-active measures for risk mitigation. IDs should equip themselves with the knowledge of the development/changes in the fraud risk landscape and latest tools and technologies that are being used to protect the organisation from fraud risks.

Interestingly, in our survey report we have witnessed a split response on the existence of effective anti-fraud and misconduct detection frameworks, where on one hand, around 57 percent IDs responded that the audit committee of the board that they represent have established an effective anti-fraud and misconduct detection mechanism, however approximately 43 percent IDs either did not agree or could not confirm the effectiveness of the existing anti-fraud framework.

Amidst the rapidly changing environment, it is essential for organisations to revisit the effectiveness of existing fraud risk management frameworks and ensure that organisations have robust fraud response protocols.

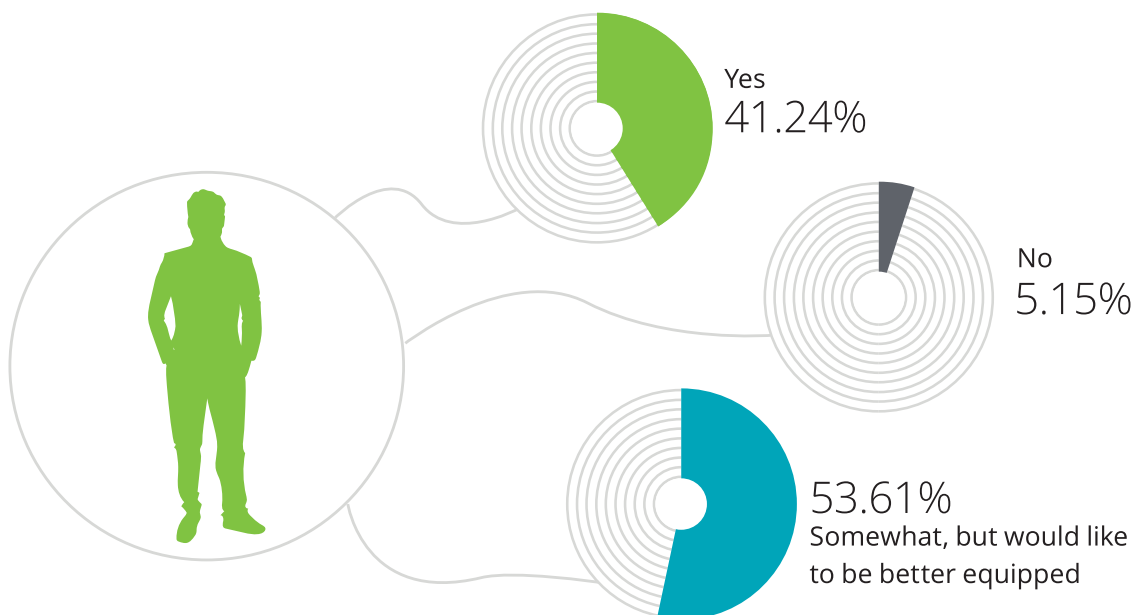
As per the survey, approximately **75 percent** IDs agreed that they could play a significant role in preventing, detecting and responding to fraud. This is quite encouraging as there is growing realisation within the community to strengthen fraud

risk management. However, close to **54 percent** of IDs expressed they need to be better equipped to fulfil their fiduciary responsibilities.

Do you believe independent directors can play a significant role in preventing, detecting and responding to fraud?



Do you believe you are well equipped to discharge your regulatory and fiduciary responsibilities towards fraud prevention and detection? (Select one option in the appropriate category)



Further majority of the IDs indicated specific training on fraud risk management, understanding the organisation's fraud risk profile, independent screening of high-risk areas and increased visibility on the review and continuous monitoring mechanisms (put in place by the organisations for timely detection of unusual activities) will empower them to discharge their responsibilities better.

Although there are multiple priorities for IDs, in our view, there is a need for IDs to push senior management to enhance the organisation's anti-fraud controls framework and continuous monitoring efforts. At the end of the day, these should be integrated within the organisation's corporate governance framework to help safeguard the interests of all stakeholders and fulfilling their fiduciary responsibility.

**Mr. Nikhil Bedi is a Partner and Head of the Deloitte Forensic practice in India. He holds over two decades of professional experience of which he has spent over ten years advising varied clients including corporates, financial institutions, hedge funds and private equity funds on a wide range of Forensic services.*

**Mr. Rohit Goel is a Partner in the Forensic Services practice, and the subject matter expert on Independent Directors at Deloitte India.*

This brief report is based on a jointly-conducted research survey by the Institute of Directors and Deloitte Touche Tohmatsu India LLP, on the role of Independent Directors in addressing Corporate Fraud and Misconduct, which was released during the 'Annual Directors' Conclave 2021'. ■



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Wednesday, December 08, 2021



1045 - 1845 hrs (IST)

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