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Corporate Resiliency: Managing the growing risk of fraud and corruption

A holistic approach



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Foreword from FICCI Aditya Birla CSR Centre for Excellence

Increased globalisation has strengthened the civil society and has become a powerful driver of collaborative global governance initiatives through high speed communication, information dissemination, and social networking which has empowered the constituency in pushing democracy, transparency and accountability in the government as well as in business. Social networking has facilitated large consumer boycott of companies that fail to meet public standards of corporate conduct. Media campaigns, consumer boycott, and other civil society initiatives require business to comply with high social and environmental standards.

But good governance is important to realise greater transparency within the system and foster a path for strong and stable economic development in any country by making the government officials and agencies accountable to the country's citizens. It has a direct impact on the economy as it boosts private market sentiment and attracts capital inflows.

Ethics and transparency is important for sustainable business and enters into every aspect of it, such as quality standards, honest payment terms for both customers and suppliers, staff relationships and tax returns to mention only a few. Ethics is important for a business as the investors look for good governance, good quality of relationships, reputation of the companies through their policies and practices, the management of financial costs and the absence of the indulgence in corrupt practices.

The scope of operations for which companies are expected to be ethcial and transparent has increased dramatically in recent years to include not only their own performance but also that of business partners and other actors throughout the company's value chain. The mechanisms to demonstrate ethical business practices are varied and inevitably need to change and grow as the company evolves, but effective systems for increasing accountability and transparency allows a company to be inclusive, responsive and engaged with its stakeholders.

Corporate Social Responsibility (CSR) is one of the ways a company integrates social, environmental and economic concerns into their values, culture, decision making, strategy and operations in an ethical and accountable manner. It is becoming relevant today as it helps corporations achieve a balance or integration of economic, environmental, and social imperatives;

while at the same time addressing shareholder and stakeholder expectations. There are many companies around the world which are practising corporate responsibility to mitigate environmental, social impact, protecting employees and the interest of local communities.



CSR must be identified, recognised, integrated and internalised in the core business operations to a good extent.

CSR is here to stay and would slowly evolve into a mainstream business practice, and if transparent in nature with respect to the business practices, then it is definitely a sustainable practice. The more companies' factor business ethics and CSR into their purchase and investing decisions, the more responsible companies will be. Regulation can only go so far to curb corporate corruption.

The evolution of CSR will continue to create better means of managing human existence and sustainable business environment.

Dr. K K Upadhyay
Head – CSR
FICCI

Message from FICCI



FICCI values strong and ever building partnership with its members across the Indian Industry through enormous business operations. FICCI has indeed nurtured this relationship over the years.

Agreeably, this strong relationship is carried forward through immense hard work and dedication put in spreading knowledge and creating awareness about many issues in the domain of business welfare and management through ethical business practices.

FICCI advocates ethical business practices and supports all the knowledge platforms. In line with this, FICCI has constituted an inclusive Governance Council that will act as an umbrella body to address issues of governance. The council includes several business leaders, young professionals, senior government officials, representatives of key think tanks, multi-lateral organisations, NGOs etc. The aim is to look at the various governance aspects and try and create a framework for businesses, government and civil society organisations to work together in creating a fair and transparent environment that can help facilitate development and growth of the country.

I take this opportunity to express my sincere gratitude towards Deloitte for their relentless hard work in creating this paper.

It has been FICCI's endeavor to encourage and facilitate business to adopt ethical business practices. We believe that it is timely for industry and business to continuously strive and follow such practices and provide the opportunity to develop a business environment for growth that is inclusive of the community in which they operate.

Dr. A Didar Singh
Secretary General
FICCI

Message from Deloitte Touche Tohmatsu India Pvt. Ltd.

India is changing – and for the better. As a forensic professional, over the years, I have had a front row seat and have watched this change take shape. Often, I have been amazed. The change has clearly been influenced by several political and economical factors.

The perception of corruption in India – as measured by Transparency International ('TI')[1] – has deteriorated. According to TI's 2012 study, India was ranked 94th (out of 176 countries) with a CPI score of 36 on an overall score of 100. This is a low score indicating, high perception or likelihood of public sector corruption in India. This suggests that the cases of corruption and fraud in the country i.e. the Commonwealth Games, Adarsh Housing Society case, the AugustaWestland helicopter deal etc, amongst others, have had a severe impact on how the world perceives India.

This has led to a mindset that investors feel that it is impossible to do business in India without paying a bribe. But change is afoot and one of the driving forces is India's youth, which is clamouring for change and a corruption-free India.

Meanwhile, India, in order to shore-up confidence, has responded by enacting several pieces of legislations, which have been discussed in detail in this paper. Some of these legislations, of course, have been enacted in response to India's ratification of the UN Convention against Corruption (2005). However, in my view, there is one piece of legislation which stands out – the Companies Act, 2013 (the 'Act').

This piece of legislation has raised the bar of how Indian companies need to evaluate themselves. Amongst other areas, it introduces the notion of gender equality in the Boardroom. It also brings Corporate Social Responsibility ('CSR') into focus by mandating a company to invest 2% of its average net profits from the previous three years into its CSR activities. Among other ground-breaking provisions are the ones related to rotation of auditors and also the provisions for shareholders' class-action law suits.

If one was to peel the onion, one realises that the Companies Act 2013, along with other pieces of legislations, like the Prevention of Corruption Act (1988), the Whistleblower Protection Act, Prevention of Bribery of Foreign Public Officials Bill (2011), aim to increase corporate transparency.

[1] Transparency International ("TI") is the global civil society organisation leading the fight against corruption. Through more than 90 chapters worldwide and an international secretariat in Berlin, TI raises awareness of the damaging effects of corruption and works with partners in government, business and civil society to develop and implement effective measures to tackle corruption issues.

However, even with the Companies Act 2013 one needs to make careful provisions. For example, the one mandating CSR can open a can of worms, if companies use it to make inappropriate payments to NGOs that are associated with local politicians.



Historically, India has had some of the best governance policies. The issue has been in the enforcement or lack thereof. If India is to catapult into the next level of growth – read that as fuel growth and the betterment of Indians – enforcement is one area that the policy makers need to focus on.

Whilst we have taken the right steps, I do not foresee change occurring overnight. Good governance, robust enforcement and greater transparency will create a platform on which we need to work arduously to change the global mindset about doing business in India.

Rohit Mahajan
Senior Director and Head – Forensic Services
Deloitte Touche Tohmatsu India Pvt. Ltd.

1. Introduction

Corporate fraud environment – the changing face of fraud

It would be wrong to say that corporate frauds are new. The first Ponzi scheme was unraveled in the early 1900's. The most recent Ponzi scheme was that perpetrated by Bernard Madoff in 2008-09. While the underlying notion remains the same, what is different is the sophistication and of course the quantum of fraud. Much as it has always been, a weak economy simply distills out the frauds. A different way to think about it – and perhaps rightly so – is that during bad times people are more vulnerable to take steps that they would not, in the normal course.

History books and pages of business journals are dotted with cases of companies that perpetrated frauds and have since ceased to exist. Enron is a case in point. The truth is most of these companies have a rather deep impact on average people that have nothing to do with the fraud, for example, the public and investors at 'Madoff Investment Securities', who had invested their life savings in the company. When the company went bust, so did their futures. It has, therefore, become exceedingly important for policy makers and executives to address these issues. Passing of the Sarbanes Oxley Act was a direct result of some of these frauds in the early 2000's.

What these legislations do, are force companies to re-evaluate their controls and to implement fraud prevention, detection and response mechanisms. In the section below, we will discuss these aspects.

What is Corporate or Occupational Fraud?

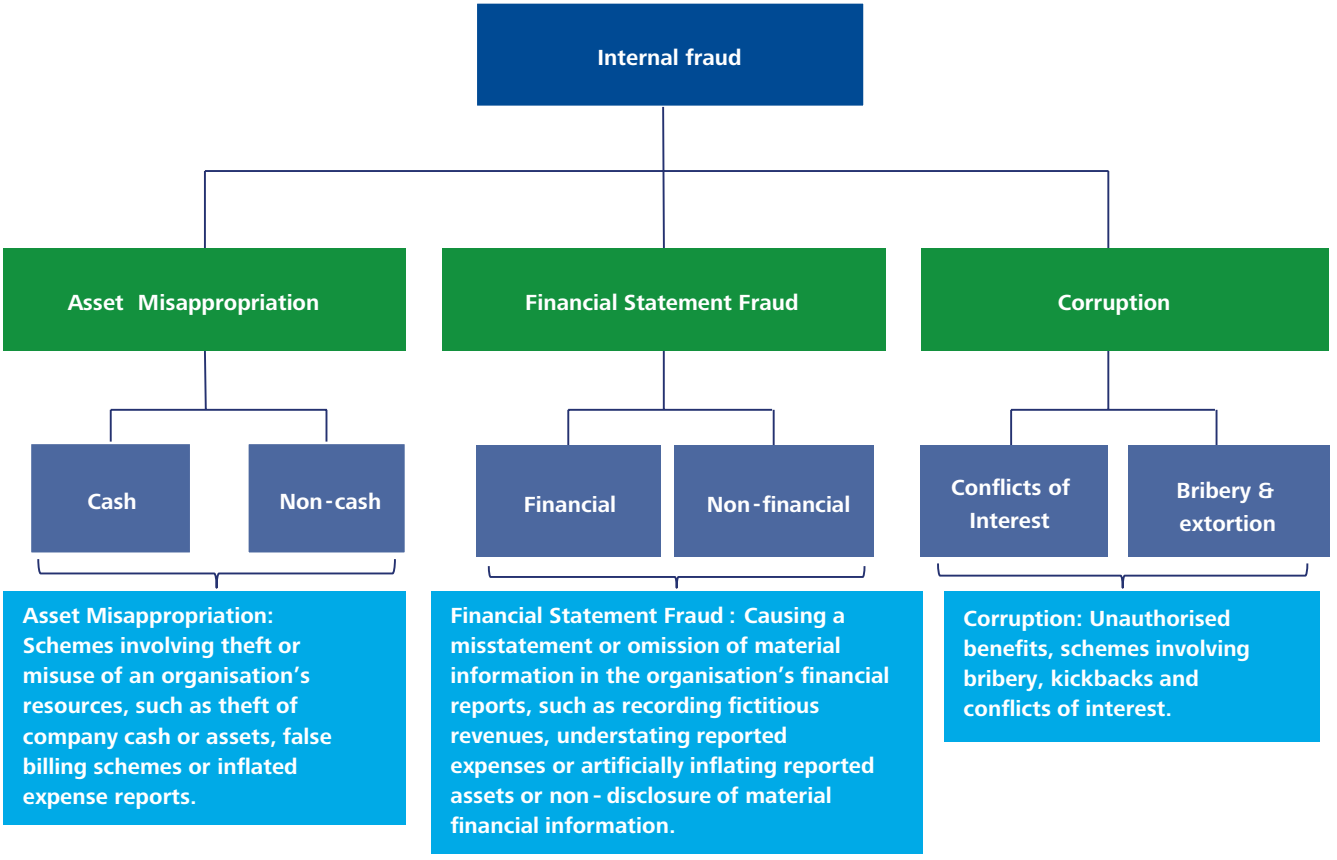
Corporate or occupational fraud and abuse are known by many other names, including internal fraud (described in greater detail below), employee fraud, employee theft, and embezzlement. The phrases "occupational fraud" or "internal fraud" are often used when discussing corporate fraud because they apply to a range of employee misconducts, while the other terms are a bit more restrictive.

In a lay person's terms, "corporate fraud" is when:

- An employee violates ones fiduciary duties towards the organisation
- Is done in secret and is concealed
- Is done for a direct or indirect benefit to the perpetrator
- Costs the organisation, its assets, revenue, or opportunities

Fraud perpetrated involving collusion of two or more persons becomes more complex, involving schemes that are, at times, more difficult to detect. Such collusive fraud, is essentially an agreement between two or more persons to defraud the victim(s) of their rights. It involves conspiracy or concert of action between two or more persons for fraudulent or deceitful purpose.

Internal fraud in a corporate organisation encompasses the following types or categories of frauds:



Why does fraud and corruption occur?

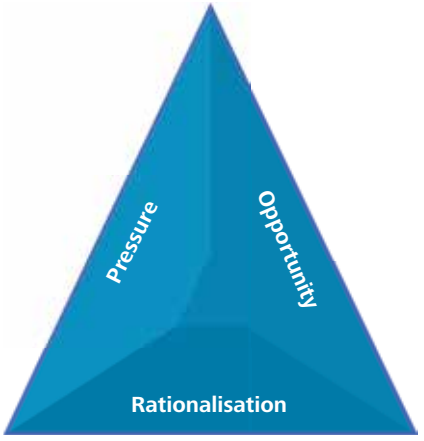
One of the basic concepts in the field of fraud examination originated by the famous criminologist, Donald R. Cressey relates to the three key elements present in every fraud that is: pressure/motivation, opportunity, and rationalisation. The occurrence of fraud, therefore, is typically a result of these three factors:

- **Pressure/Incentive** to commit fraud, which can be attributed to factors like, sustaining growth or profitability in a volatile economic environment, increasing competition, meeting stock market/ analysts' expectations, financial need, job performance, etc.
- **Opportunity** to seize resulting from ineffective or lack of controls, management override of controls, insufficient monitoring or ineffective segregation of duties, etc.
- **Rationalisation/Justification** by the perpetrator of fraud as, "it's for the company's good", "it's a small amount to the company", "I deserve it", "just this once", etc.

The cost of fraud is not restricted to financial loss alone. The impact of fraud also includes:

- Reputation loss
- Cultural loss, involving loss of trust, insecurity or anxiety, low productivity or team morale
- Loss of customer relationships

Further, the prospects of recovery of monetary proceeds from fraud are remote. Out of the few victims who have attempted recovery of financial loss due to fraud, have recovered just 25% or less of the misappropriated funds from the fraudster on an average and majority of victims have recovered nothing[2].



Fraud Triangle

Various studies have consistently reported that frauds are primarily committed by people within the organisation i.e., employees, senior management personnel or other company representatives. Frauds committed by the senior management or executives tend to cost the organisation the most, in terms of

[2] Source: ACFE Report 2012 (statistics related to recovery of fraud losses)

monetary loss. Studies also show that the frauds committed by people who are most trusted or have been with the organisation for several years tend to be of a higher value. Increasingly, fraud is being perpetrated by company insiders and the biggest threat comes 'from within', thus calling for robust anti-fraud strategies to be implemented and an ongoing monitoring and review of anti-fraud measures.

Responding to the challenge

It is a well-known fact that "to think, we know and understand all risks around us is misleading, to think we can manage all of them, if they hit us, is an illusion and to turn a blind eye to them is sheer foolishness". Therefore, the need of the hour is to respond to this ever-increasing challenge and adopt anti-fraud measures in an effective and a proactive manner. It is possible for an organisation of any size to manage the growing risk of fraud and corruption by embedding values of fraud prevention and detection within their culture, and developing suitable policies towards establishing an effective fraud response management program - which would in turn work as a fraud deterrent.

Some components of effective fraud prevention include:

- Conducting periodic fraud risk assessment to assess effectiveness of internal controls
- Conducting employee and vendor, supplier or business partner due diligence
- Providing effective fraud awareness training
- Implementing an effective whistleblowing system

Fraud detection involves the early identification of anomalies that may be indicators of fraudulent activity. Unfortunately, many such fraud symptoms go unnoticed, and in some cases, signals that are recognised are not vigorously pursued. The symptoms could be related to internal control weaknesses, accounting anomalies, analytical symptoms, life style symptoms, behavioural changes and tips or complaints - these need to be addressed promptly in order to prevent any fraud in the future as well as identifying a fraud that might occur. If anomalies are not detected early, they become the norm. For example, a manufacturing company experienced an increase in cost of goods sold due to increase in the price of one component. Further inquiry indicated that the price increase corresponded to a change in vendor. This anomaly may indicate that the purchase officer of a manufacturing firm might be receiving kickbacks, which needs to be potentially investigated.

A key element of an effective fraud response management program is to allow the organisation to react to various types of fraud and misconduct allegations in a measured and consistent manner.

The overreaching goal of a fraud response program is to respond to an incident of fraud promptly and effectively in order to protect the organisation from the economic, reputational and legal risks associated with the fraud and corruption allegation. At the same time the program should also ensure that suitable anti-fraud controls are implemented and strict disciplinary action is taken against the perpetrator(s) of fraud.

All the aforesaid anti-fraud measures would collectively act as fraud deterrents. Other important deterrents include a strong tone at the top, clear policies regarding fraud and unethical behaviour and consistent enforcement of strict disciplinary action against the fraud perpetrators of reported incidents.

It is human psychology to act out if you believe you can get away with it without being punished but if you know there will be consequences, such as, being fired, imprisoned, made to pay a hefty fine, or reprimanded by any other strict action – then, you are less likely to act on an opportunity. This is what deterrence is all about.

Technology – leveraging transaction monitoring and data mining

Global media, and the internet enable news to travel faster and reach a wider audience than ever before. The nature of business becoming more global and growing collaboration amongst regulators worldwide can expose companies to a greater number of regulatory regimes. These factors increase the requirement for companies to improve their compliance to prevent both, the likelihood and the potential impact of the alleged non-compliance on a company's reputation and shareholder value. Audit committee members need to consider how their company manages the risks of fraud and corruption and whether today's risk environment merits a more proactive approach.

In today's automated world, many business processes depend on the use of technology. This allows people to commit fraud by exploiting weaknesses in security, controls or oversight in business applications to perpetrate their crimes. The 'new age' frauds coming to light are confidential information or data theft/ loss, insider trading and conflicts of interest situations leading to financial and reputational damage. However, the brighter side is that technology can also be a means of combating fraud. Leveraging technology by using data analytics tools to implement continuous fraud prevention programs can help safeguard organisations from the risk of fraud and reduce the time it takes to uncover fraudulent activity. This can help uncover a fraudulent activity faster as well as reduce the impact that an incident of fraud can have on an organisation.

The impact of the U.S. Foreign Corrupt Practices Act, 1977 (FCPA) and the UK Bribery Act, 2010 (UKBA) is growing, pushing companies to take steps



to improve their compliance. The key question to address is whether companies have implemented computer-assisted transactions monitoring and data analysis, targeted at its key fraud and corruption risk areas? These tools are especially valuable in entities with a large volume of transactions and potentially high-impact fraud and corruption risk areas. Today's technology, combined with skilled evaluation of anomalies, can enhance detection and deterrence capabilities in this area significantly.

In the ensuing sections of this paper we will further elaborate on:
(1) Corporate social responsibility and transparency – a foundation for ethical business practices
(2) Regulatory regime in India for tackling fraud and corruption
(3) Responsibilities of stakeholders – internal and external to tackle this menace
(4) Provide a practical approach to what companies need to do to mitigate fraud and corruption risks
(5) How organisations can respond to the incidents of fraud and corruption in an efficient and effective manner

2. Corporate social responsibility and transparency – a foundation for ethical business practices



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Corporate Social Responsibility ("CSR") is understood to be the way firms integrate social, environmental and economic concerns into their values, culture, decision-making, strategy and operations in a transparent and accountable manner and thereby establish better practices within the firm, create wealth and improve society.

At the heart of responsible and ethical business behaviour lies the leadership and management intent of building trust. Trust can be gained through improved transparency, a robust system of checks and balances and programs that build and foster integrity of the business character.

Corporate slip-ups / blunders have created a customer mentality of "guilty until proven innocent". Someone receives a higher-than-expected phone bill and immediately thinks, "The carrier is trying to rip me off!" Toys are coated in lead paint and parents assume the manufacturer was trying to cut costs. Companies are beginning to recognise that transparency is the counterweight to public skepticism. Allegations of corruption, bribery and improper practices have seen the share prices of such companies plummet. Poor community relations have delayed multibillion-dollar projects for years. The reverse is also true. In almost every sector, companies that have delivered the best long-term returns are those that have taken their environmental, social and governance responsibilities most to heart.

Corruption is not a peripheral social concern that corporations can ignore or passively address — it is a bottom-line business issue that directly affects companies' ability to compete. Widespread in emerging markets, corruption is becoming an increasingly important issue for business to address.

Just as top corporations have ventured out proactive positions on other social issues, such as child labour and the environment, it's time for anti-corruption to become part of companies' CSR missions. Now, it's a high priority mandate for businesses to embrace anti-corruption values as a strategic CSR mission by moving beyond risk mitigation towards proactively solving social problems critical to the business.

As someone said, "Corruption is authority, plus monopoly, minus transparency." Corruption can only happen when there is space under the table.

Transparency is considered to be a crucial element in CSR, as it sanctifies the incorporation and reporting of CSR in the organisation. However, there are many different strategies that firms need to apply to enforce transparency. Transparency has become a popular word. It is also used in various contexts, including monetary policy, economic policy, enterprise and association. It seems as though the word 'transparency' has recently become the lip-service of every business guru, consultant, reporter, government official and/or analyst, as an outlet to share his opinion.

Nevertheless, transparency is first of all a 'need of the hour', due to growing complexity of society, increasing globalisation of businessess and an element of the process of democratisation.

Today, organisations are being encouraged by both, their internal and external stakeholders to demonstrate transparency and accountability in their business operations and their impact on society and environment. Given the current state of growing distrust between society and business firms, corporate claims of good behaviour are being met with suspicion. However, there is a need to back these claims by comprehensive and verifiable information.

Although, one can observe the progress in reporting CSR initiatives, disclosing of lobbying practices and being transparent on sensitive issues, is still playing a minor role for many corporations. As a part of being the oldest apex chambers of commerce, FICCI has screened quite a few CSR reports and has concluded that only the minority give relevant information on subjects like human rights, fair trade practices, etc. There is a huge discrepancy between claims of companies and the reality, which proves the fact that having CSR or corporate governance in a company is incomplete, until there is trust on the transparency of the company.

Beyond this, transparency is vital to effectively tackle issues such as, communication gaps, etc., which are underlying reasons for fraud and corruption in the society.

Introduction to Ethics in Business

Business ethics go beyond choosing "to do the right thing" in day-to-day operations and business decisions. It is a core principle of good management and sustainability. Without good management, strong corporate governance and open and transparent relationships with customers, business partners and stakeholders, sustainability issues, policies and goals can go nowhere. Today, every citizen of the world is assaulted by daily news about corporations and individuals who have committed fraud and betrayed the trust of their clients, customers and investors.

Ethics enters into every aspect of sustainable business, such as quality standards, honest payment terms for both customers and suppliers, staff relationships, tax, etc. Regardless of your position in a company, ethics should be the foundation of your job. Despite their importance, ethics are often forgotten, pushed aside or taken for granted. Most companies have some set of ethics and management code of conduct in place, by which the company stands, but many employees just assume that their company is properly managing

ethical issues. Thus, senior management play an important role in ensuring that ethical standards are upheld and practised in promoting sustainability principles throughout their work place.

The subject of corporate governance always looks into creating strong control systems in organisations. The Organisation for Economic Cooperation and Development (OECD) defines corporate governance, as the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as shareholders, board members, managers, employees and other stakeholders and spells out the rules and procedures for making decisions on corporate affairs.

The 21st century technology-driven knowledge economy has created a new business model, which is beyond nation/state boundaries and is required to serve and address the demands of a faster-moving and frequently relocating population. Simultaneously it impacts the ways in which business is conducted – be it sales, manufacturing operations or customer services. In many instances, the composition of the workforce has now increasingly become multicultural with presence of offices in several countries, further leading to an increased mobility of the workforce. The outcomes of the change in business processes is creating greater opportunities in the global marketplace by increasing opportunities for entrepreneurship and creating new jobs and more choices for the customer. But at the same time, bringing along with it is the greater responsibility for business entities to indulge in fair and transparent business practices, respecting human rights, and the need to comply with environmental policies and code of business conduct. These behaviour expectations have always been there and have had a significant impact worldwide. But, the importance and significance of it is increasing in this digitalised economy due to one major factor – empowered Stakeholders. An ethical company is more likely to build a good reputation, which is more likely to bring financial rewards over the long term.

The backbone of any business is 'Trust'. If trust is broken, a business cannot succeed. Greed kills the consciousness and corruption is the greatest dilemma in the world. That's what we saw with the financial crisis. So, how does one determine what is ethically acceptable and unacceptable behaviour? This is the dilemma that many employees and business-owners are facing every day. Everyone is faced with a decision that involves ethical behaviour. Therefore, companies put in place a code of business conduct and ethics policy, which provides guidance to employees and business partners for conducting business with integrity, fairness and in compliance with the applicable laws and regulations. This needs to be further supplemented with ethical dillema workshops and training to employees.

Fairness, transparency and righteousness are complex issues, especially when business involves myriad pressure points such as, maximising profits, cutting operating cost, etc. An individual can make either a right or wrong decision, depending on how it will affect his work and life status. In view of the fact that ethics are moral issues, every individual's beliefs and values are often put to test. Hence, it is essential that companies conduct workshops for employees, involving various practical situations related to ethical dilemma that they would face in their day-to-day business activities, and how they should respond to those situations. This would ensure that the employees clearly understand the organisation's code of business conduct and ethics policy and comply with the same, in spirit and action.

Drivers of Ethics in Business

Business ethics can be defined as the study of business situations, activities and decisions where issues of right or wrong are addressed. When it comes to potential ethical responsibilities in an organisation, one can draw from a vast literature on moral theory to establish or determine appropriate ethical or moral standards. A range of approaches can be used to propagate ethical business practices. However, the two prominent ones are coined as 'Corporate Social Responsibility' and 'Transparency'.

Corporate social responsibility ("CSR"), also called corporate conscience, corporate citizenship, social performance, or sustainable responsible business is a form of corporate self-regulation integrated into a business model. It is an important component of corporate governance. The requirement now, is for corporates to move from beyond just generating shareholder value to contributing to the overall growth of the nation by undertaking community and social welfare development initiatives.

CSR policy functions as a built-in, self-regulating mechanism, whereby a business monitors and ensures its active compliance with the spirit of the law, ethical standards, and international norms. CSR is meant to aid an organisation's mission as well as guide what the company stands for and will uphold to its consumers. CSR is an essential ethical business practice, which is focused on concerned values, objectives and decisions based on sustainable inclusive development of business rather than mere pursuit of profit. CSR is concerned with a business's obligation to all stakeholders in its core and augmented network.

The second important factor to help lay the foundation of ethics in business is 'Transparency'. This term holds a lot of importance to any ethical company with or without the adoption of CSR. Transparency is hard to

define, as it's far more than the obligation to disclose basic financial information. Various stakeholders who interact with companies regularly are gaining unprecedented access to all sorts of information about corporate behaviour, operations, performance, organisational structure etc. Instances of being partially ethical or good, yet communicating only a good picture has been a corporate trend for long. Lobbying, unsustainable use of natural resources, poor labour laws, faulty annual reports, superfluous environmental friendly claims are often found to occur in the corporate world.

Socially responsible companies are lauded for their involvement in the welfare of all the stakeholders, the community and the environment. There is a general acceptance that the government alone cannot manage the multifarious needs of the modern global society. Public-private partnerships have to be the order of the day to balance the interest of the stakeholders with profit requirements of the shareholders.

The Companies Act, 2013 which will overhaul the old Companies Act, 1956 received the President's assent on 29 August 2013. The Act has brought the subject of CSR to the forefront. The new law will make it mandatory for companies (above certain thresholds) to spend 2% of their average net profit during three preceding years on CSR activities with appropriate disclosures of the spend and be answerable for the amounts set aside for CSR activities that are not spent by the company. This would require companies to focus, plan and structure their CSR initiatives for effective use of the funds mandatorily required to be spent on CSR activities.

In an optimistic view towards the future, it would become imperative for companies to come forward and share the responsibilities for distributive justice and inclusive growth. Simultaneously, companies would strive to achieve rapid growth in order to raise the standards of living of the people. Hence, the future of CSR appears extremely bright. There is already a trend in place to create more consensus on preparing acceptable codes of CSR conduct. Consolidation of the various standards of measuring CSR would be undertaken at a global level. This should lead to clarity for the future generations to follow CSR more effortlessly, as there would be standardisation of processes and practices. The evolution of CSR will continue to create better means of managing human existence. Despite the difference in views about social impact and the degree of corporate commitment, the general view is that CSR is here to stay, and would slowly evolve into a mainstream business practice. Thus, CSR and transparency are the two pillars to the foundation for ethical business practices.

3. Regulatory regime in India for tackling fraud and corruption

Volatile economic conditions and increasing business and technological complexities have led to increased incidents of fraud. Diminishing ethical values and failure on the part of managers to act against deviations from established policies and processes are some of the reasons for increase in frauds. The increasing amount of white-collar crimes is symptomatic of the status of India's regulatory environment, whistle-blowing mechanisms and law enforcement in the corporate sector.

In recent times, there has been an increased focus on anti-corruption and anti-bribery laws across the world. Laws and regulations are also starting to have a very wide application, criminalising not just the bribe-giver, but the bribe-taker; not just bribery to public officials but corporate officials. Several anti-corruption laws have wide, extra-territorial applications and potentially include within their ambit, the conduct of individuals and corporations around the world. Law enforcers are seeking to implement these laws very seriously and multilateral organisations are seeking to bar applicants based on evidence of having breached such anti-corruption laws. Regulators are also requiring that regulated entities have appropriate procedures and controls in place to deal with exposure to bribery and corruption risks.

The scope of such laws range from criminal statutes to laws that require accurate books, records and accounts to be maintained. In this background, it is important to understand the existing and proposed regulations around addressing corporate frauds in general, and the scope and consequences of some of the more important anti-corruption laws in India in order to gauge the risks to corporations on account of violation of these laws and devise relevant risk mitigating measures.



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Key Highlights of existing and changing regulations dealing with issues of corporate fraud and corruption

Sr. No.	Existing Laws and Proposed Bills/ Acts	Key highlights – on dealing with corporate fraud and corruption
1.	Erstwhile Companies Act, 1956	• The Erstwhile Companies Act, 1956 (the "Companies Act") imposes obligations on companies to maintain true and fair accounts, which represent an accurate picture of payments made by the company. • Section 628 of the Companies Act, 1956 deals with penalties and imprisonment for false statements. Under the section, where any person knowingly makes a materially false statement or knowingly omits a material fact from a return, report, certificate, balance sheet, prospectus, statement or other document required under the Companies Act, will be punishable with imprisonment and will also be liable to pay a fine. This is not a compoundable offence. • Under Section 234 of the Companies Act, if the Registrar of Companies ("Registrar") is of the opinion that the business of the company is being carried out for a fraudulent or unlawful purpose or if the Registrar is of the opinion that the information or books and papers disclosed by the company do not represent a full and fair statement the Registrar may report the same to the Central Government, who may appoint officials for investigation of the affairs of the company. • Ministry of Company Affairs ("MCA") has set up a regulatory authority, the Serious Fraud Investigation Office ("SFIO"), which is invested with the powers of detecting, investigating and prosecuting white-collar crimes and frauds with multi-disciplinary ramifications or public interest elements where improvements in the system, laws and procedures are possible. While the SFIO primarily investigates matters received from the MCA, it also has the authority to take-up cases on its own. SFIO till date has been involved in matters relating to stock market frauds. SFIO had investigated the affairs of Satyam Computer Services Limited ("Satyam") following revelations by its managing director that Satyam's accounts depicted inflated profits and had also initiated criminal proceedings against the directors of Satyam.

		• As regards the liability of directors for offences under the Companies Act, the MCA has recently issued a circular dated March 25, 2011 (the "Circular") setting out certain guidelines, which the Registrar of Companies is required to adhere to while exercising its discretion to prosecute directors of a company for violations of the Companies Act. The Circular requires the Registrar to take into account certain factors inter-alia including, the time when the offence was committed, whether the offence was committed with the consent, responsibility attributable to the neglect of the director etc., especially where the director is a non-executive or independent director.
2	Companies Act, 2013 (the 'Act')[1]	• "Fraud" and "Wrongful gain" have been defined for the first time, apart from penalties; punishment for fraud involving imprisonment, which is now introduced in many cases. • The Act makes companies and its officers more accountable and brings new concepts to better regulate companies. From shareholders' rights (class action suits) to greater duties of independent directors in scrutiny of related party transactions and its disclosures (Board now has to justify them), from rotation of auditors (with maximum tenure of five years for an auditor) to mandatory formation of vigil mechanism (whistleblowing mechanism), by listed companies and introduction of stringent penal provisions for fraud or wrongful acts or contravention of any provisions in the law are some of the highlights of the Act. • Auditors (including, Cost Accountants for Cost Audit and Company Secretary in Practice for Secretarial Audit), during the course of performance of its duties, are required to immediately report to the Central Government, any offence involving fraud that is being or has been committed against the company by its officers or employees. • The legislation also grants statutory powers to SFIO to tackle corporate frauds. The SFIO will get a big fillip, now that the Act has come into force.

[1] The Companies Act, 2013 (the 'Act') seeks to revise and modify the erstwhile company law, in consonance with changes in national and international economic environment. The Act was passed by the Lok Sabha on 18 December 2012, further by the Rajya Sabha on 8 August 2013 and received the President's assent on 29 August 2013, soon to replace the erstwhile Companies Act, 1956. The Act is divided into 29 chapters and contains 470 clauses and 7 schedules.

3	Prevention of Money Laundering Act, 2002 ("PMLA")	• The Prevention of Money Laundering Act, 2002, ("PMLA") together with the rules issued thereunder the Prevention of Money Laundering (Maintenance of Records of the Nature and Value of Transactions, the Procedure and Manner of Maintaining and Time for Furnishing Information and Verification and Maintenance of Records of the Identity of the Clients of the Banking Companies, Financial Institutions and Intermediaries) Rules, 2005, (the "PML Rules") set out the process to be adopted by banks, financial institutions and financial intermediaries for identifying and verifying their clients prior to commencing a business relationship with them. • The PML Rules also prescribe exhaustive requirements for banks, financial institutions and intermediaries to establish and verify the identity of any client at the time of operating an account, executing a transaction, including prescribing the documents that the bank, financial institution or intermediary should seek from a client and maintain on record. • Every intermediary is required to maintain a record of all transactions, prescribed under the regulations, including transactions above specified thresholds and all cash transactions where counterfeit currency notes or bank notes have been used as genuine; and all "suspicious transactions", which include transactions, including attempted transactions, whether or not made in cash, which to a person acting in good faith or transactions which give rise to a reasonable ground of suspicion that it may involve proceeds of an offence specified in the schedule to the PMLA, regardless of the value involved; or appears to be made in circumstances of unusual or unjustified complexity; or appears to have no economic rationale or bonafide purpose. • These records are required to be maintained for a period of ten years from the date of transactions with the relevant client. Further, the records are required to be maintained using the procedure and in the manner specified by the PML Rules.

		• Banks, financial institutions and intermediaries are required to maintain such records as are sufficient to permit reconstruction of individual transactions (including the amounts and types of currencies involved, if any) so as to provide, if necessary, evidence for prosecution of criminal behaviour. Should there be any suspected drug related or other laundered money or terrorist property, the competent investigating authorities may need to trace through the audit trail for reconstructing a financial profile of the suspect account. • Banks, financial institutions and intermediaries are required to ensure that all client and transaction records and information are available on a timely basis to the competent investigating authorities. Where required by the investigating authority, they should retain certain records, e.g. client identification, account files and business correspondence, for periods, which may exceed those required under the Banking Regulation Act, 1949; Reserve Bank of India Act, 1934; Securities and Exchange Board of India Act, 1992 rules and regulations framed under each of the aforesaid (Guidelines); PML Act; and other relevant legislations, rules and regulations or exchange bye-laws or circulars.
4	The Prevention of Money Laundering (Amendment) Act, 2012 ("PMLA Amendment Act")[2]	• Certain new definitions have been incorporated in section 2 of the Act (PMLA). They are namely, "beneficial owner", "client, dealer", "precious metal", "precious stone", "real estate agent". • The PMLA Amendment Act has additional provisions for strengthening Know Your Customers ("KYC") and reporting obligation, record keeping and measures for effective compliance. • The PMLA Amendment Act brings the following new reporting entities (apart from banks, financial institution and intermediaries): Department of Posts, Commodity Exchanges and brokers, Stock Exchanges, Entities registered with Pension Fund Regulatory and Development Authority ("PFRDA"), entities who can be included, when notified by the Government, such as, Real estate agents, Sub-registrars (registering property), Dealers in precious metals/ stones, high value goods and safe deposit keepers.

[2] The Prevention of Money Laundering (Amendment) Act, 2012 has recently been notified in the official Gazette by the Government of India.

5	Income Tax Act 1961 ("Income Tax Act")	• Section 277 of the Income Tax Act, 1961 ("Income Tax Act") dealing with false statements in verification etc., states that if any person makes a statement in any verification under the Income Tax Act or any rule made thereunder, or delivers an account or statement, which is false, and which he either knows or believes to be false, or does not believe to be true, shall be punished with rigorous imprisonment and fine, as prescribed in the said provisions. • Section 277A of the Income Tax Act stipulates that if any person willfully and with intent to enable any other person to evade any tax or interest or penalty chargeable and imposable under the Income Tax Act, makes or causes to be made any entry or statement, which is false and which the first person either knows to be false or does not believe to be true, in any books of accounts or other document relevant to or useful in any proceedings against the first person or the second person, under this Act, the first person shall be punished with rigorous imprisonment and with fine, as prescribed in the said provisions. • Further, Section 278B (2) of Income Tax Act also provides that where an offence has been committed by the company and it is proved that the offence was committed with the consent or connivance of or is attributable to any neglect on the part of any director then such director shall be deemed to be guilty of the offence and shall be liable to be punished and proceeded against. However, it is not provided that the directors of such companies will be personally liable for the payment of tax. • Section 179 of the Income Tax Act, provides that in case of a private company, if the income-tax liability cannot be recovered from the company, the directors of such private company will be personally, jointly and severally responsible for the tax liability. A director can escape liability only if he proves that non-recovery was not due to his neglect, misfeasance or breach of duty. Thus, a vicarious liability is imposed on directors of a private company, even when a private limited company is a separate legal entity. The directors cannot be held liable unless the Assessing Officer gives a clear finding that the tax could not be recovered from the company. • Under the Income Tax Act, books of a company can be reopened by the Assessing Officer under the Income Tax Act, for a period of six assessment years, after the relevant assessment year.

6	Prevention of Corruption Act, 1988 ("PCA")	• The Prevention of Corruption Act, 1988 ("PCA") is the primary law relating to the prevention of corruption and matters connected therewith. • The PCA prohibits public servants from (a) taking gratification other than their legal remuneration in respect of an official act; and (b) accepting a valuable thing without paying for it, or paying inadequately for it, from a person with whom the public servant is involved in a business transaction in his official capacity. • The PCA also prohibits anyone from (a) accepting or obtaining any gratification as a motive or reward for inducing, by corrupt or illegal means, any public servant to do or forbear to do any official act; and (b) accepting or obtaining any gratification as a motive or reward for inducing, by the exercise of personal influence, any public servant to do or to forbear to do any official act. • It is significant to note that in terms of the PCA and its judicial interpretation, payments made to get even lawful things done promptly are also prohibited. Any "speed money', "grease" and "facilitation payments" are also not permitted under the PCA. • The PCA also criminalises the act of a private individual offering gratification to a public servant. Although, the PCA refers to the aforesaid offence by private individuals (bribe giver) as abetting a public servant, it is an independent, distinct and substantive offence. • The PCA does not contain any provision that deals with offences committed by corporations. In the absence of such a specific provision in the PCA, the question of whether the directors of a corporation can be prosecuted for offences under the PCA may be addressed by referring to certain decisions of the Supreme Court in the context of criminal liability of directors for offences by a corporation generally, and not with specific reference to the PCA.

		• In terms of the PCA, the intention of the bribe giver is what is important and a mere offer with the objective to offer gratification to a public servant is sufficient to constitute an offence by a private individual even if no money or other compensation is produced. This is the case irrespective of whether: (i) the public servant has or does not have the authority to do the favour or the public servant refuses to; or (ii) the public servant accepts or refuses to accept the bribe. If it is proved that any gratification was given or offered to be given or attempted to be given by a private individual, it shall be presumed that such person gave or attempted to give such gratification for the purposes of the public servant favouring or dis-favouring or doing or forbearing to do an official act. • The Central Bureau of Investigation ("CBI"), India's federal investigation agency is the "investigating agency" currently prosecuting officials of companies, including directors who are alleged to have bribed public servants, in what is popularly known in India as the "2G Spectrum Licenses" Scam.
7.	Central Vigilance Commission Act, 2003 ("CVC Act")	• The Central Government has constituted the Central Vigilance Commission ("CVC") pursuant to the Central Vigilance Commission Act 2003. CVC is required to operate impartially and free of executive control. • CVC is the primary agency to inquire or cause inquiry to be conducted into offences, alleged to have been committed under the PCA. • CVC is also responsible for advising, planning, executing, reviewing and reforming vigilance operations in the central government organisations.

8.	Lok Ayuktas	• In addition to the CVC, several state governments have established statutory functionaries known as "Lok Ayuktas" who are responsible for investigating complaints against the functioning of the state government machinery, including complaints related to bribery and corruption punishable under the PCA. • Both, the CVC and the offices of the Lok Ayuktas are assisted in the investigation of matters and the enforcement of the PCA by the police. • In recent times, there have been several controversies in states surrounding the appointment of Lok Ayuktas. India is in the midst of a prolonged political battle to enact a new anti-corruption law (the "Lokpal Bill") that sets out the roles and responsibilities of state level Lok Ayuktas.
9.	Amendments to the Indian Penal Code, 1860 ("IPC") to introduce provisions relating to criminalising private sector bribery	• The Indian Penal Code, 1860 ("IPC") is proposed to be amended to add provisions to criminalise corruption in the private sector. These amendments are intended as part of India's efforts to comply with the United Nations Convention against Corruption ("UNCAC"), which India has ratified in May 2011. • The UNCAC requires member states to address the "supply side" of corruption and corrupt practices within the private sector. The final form of the proposed amendments to the IPC is not in the public domain as yet.

10.	The Prevention of Bribery of Foreign Public Officials and Officials of Public Interest Organisations Bill, 2011 ("PBFPO Bill")	• The Central Government has, on 26 March 2011, tabled a bill titled the 'The Prevention of Bribery of Foreign Public Officials and Officials of Public Interest Organisations Bill, 2011' ("PBFPO Bill") in the lower house of the Parliament (Lok Sabha). • The PBFPO Bill seeks to criminalise the act of bribing foreign public officials and officials of public international organisations. • The PBFPO Bill defines a foreign public official widely and includes: any person exercising a public function for a foreign country; and any official or agent of a public international organisation. • The PBFPO Bill seeks to penalise any foreign public official who accepts or obtains or agrees to accept or obtain, either for himself or for any other person, any undue advantage other than his legal remuneration, as a motive or reward for doing or forbearing to do an official act. • Further, the PBFPO Bill penalises any person who, in the conduct of international business, offers or promises any undue advantage to any foreign public official, in order to obtain or retain any business. • The abetment of any offence under the proposed PBFPO bill would also constitute a criminal offence, punishable with imprisonment. • The Cabinet has recently approved certain amendments to the PBFPO Bill, including relating to extradition of accused officials, empowering the government to enter into information sharing agreements with foreign governments with regard to offences under the PBFPO Bill. .
11.	The Public Interest Disclosure and Protection to Persons Making the Disclosure Bill, 2010 ("Whistle-blower Bill")	• The Central Government has, on 26 August 2010, tabled a bill titled The Public Interest Disclosure and Protection to Persons Making the Disclosure Bill, 2010 ("Whistle-blower Bill") in the lower house of the Parliament (Lok Sabha), which seeks to protect persons making a public interest disclosure related to an act of corruption, misuse of power, or criminal offence committed by a public servant. • The Whistle-blower Bill does not presently apply to private sector companies.

12.	Right to Information Act 2005 ("RTI Act")	• The Right to Information Act 2005 ("RTI Act") is a law aiming, inter alia, at transparent governance and prevention of corruption. It prescribes a procedure by which an Indian citizen can apply for and obtain information held by any public authority, subject to certain defined exceptions in respect of national interest, legislative privilege and right to privacy. • The term 'public authority' is widely defined to mean any authority, body or institution of self-government created under statute or by government order, and includes entities owned, controlled or substantially financed, directly or indirectly, by the government. • All public authorities are required, in terms of the RTI Act, to make public a variety of information, including statements of what information and documents they hold their budget and their rules and regulations. The RTI Act has displayed itself as a powerful tool against corruption.

4. Responsibilities of stakeholders – internal and external to tackle the menace of fraud

Companies must stay vigilant, as today's fraudsters are increasingly using sophisticated techniques in structuring their crimes and the tactics deployed to prevent detection. The ultimate impact of a fraud is financial loss to an organisation, as the perpetrator of the fraud gains directly or indirectly from the misconduct or wrongdoing. The perception of the society and investors in general is that the management and the auditors are expected to have prevented and detected the incidents of fraud from occurring. However, these expectations have to be dealt with by the management by being more proactive in implementing robust anti-fraud measures and acting immediately to investigate issues of fraud and corruption, whenever it surfaces. Management should thus be able to demonstrate a "Zero tolerance" to the issues of fraud and corruption. Whilst the auditors would need to bring in a high level of professional skepticisim in performing their audit procedures, which can address potential fraud risks.

Directors' and Management's responsibilities

Generally, an internal and external audit are considered as the first line of defence against fraud and probably the only defence against fraud. In reality, a vibrant corporate governance system, effective risk management practices and an internal control framework are essential components of what comprises the first and the most effective defense to a fraud. These measures primarily aim at preventing, detecting and deterring frauds. The responsibility for the said measures vests with the Management, and the Board of Directors, who are ultimately responsible for oversight and monitoring of business operations on behalf of the shareholders. As such, the company's management comprising of those charged with governance and board of directors have the primary responsibility to ensure that robust anti-fraud mechanisms are put in place to prevent and detect potential frauds.

The key responsibilities of the Management in this regard are:

- Setting a "tone at the top" that communicates an expectation of exceptional moral and ethical behaviour, intolerance for unethical actions and the need for transparent, accurate and timely financial reporting.
- Promptly investigating and remediating unethical and fraudulent events and violations to corporate policies and procedures, if any, as and when they come to the notice of the management.
- Maintaining the internal and statutory audit functions independent of management's influence.
- Ensuring transparency in the flow of critical information to the board and other stakeholders, as necessary.

In order to effectively prevent and detect fraud, in addition to the internal and external audits, management and audit committees should consider undertaking independent fraud risk assessment and the implementation of a comprehensive fraud prevention program. Implementation of policies,



procedures, prevention and detection of frauds is the primary responsibility of the management. The Board of Directors and the Audit Committee are also responsible for prevention and detection of frauds. Now, participation of independent directors in fraud risk management has increased with the introduction of new corporate governance requirements.

The Code of Independent directors set forth in Schedule IV of the new Companies Act, 2013 (the 'Act'), is a guide to professional conduct for independent directors. As per the said Schedule, independent directors are required to assist the company in implementing the best corporate governance practices. One of the key roles and functions also sets out to satisfy themselves on the integrity of financial information and that financial control and the systems of risk management are robust and defensible. It is also the duty of independent directors to ascertain and ensure that the company has an adequate and functional vigil mechanism and to ensure that the interests of a person or a whistleblower is protected; and to report concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy.

Aligning and measuring audit expectations

An optimised internal audit function can provide a balance between protecting and enhancing enterprise value by taking a holistic approach to risk management across the enterprise and providing independent and objective assurance with value-added advice. As risks and opportunities constantly emerge, it is important for internal audit charter, risk assessment process and audit plan to be dynamic enough to allow internal audit to take a proactive and forward-thinking approach.

It has become increasingly important for the audit committees to assess, whether internal audit is performing the appropriate activities, has adequate resources, and is proactively identifying risks and monitoring critical controls. The specific expectations for internal audit functions vary by organisation, but audit committees can facilitate a mutually beneficial relationship by setting high expectations, clearly communicating these expectations, and holding internal audit accountable for meeting them. By performing a periodic assessment of the internal audit function, audit committees can help align expectations with other key stakeholders. This assessment can help the audit committee to confirm that internal audit meets the needs of the organisation, both today and in the future.

The duties, which have been cast on an 'Auditor' in the Act, applies to both, Cost Accountants for Cost Audit and Company Secretary in Practice for Secretarial Audit, apart from the Statutory Auditors of a company. The Act has conferred auditors with greater responsibility. Auditors, during the course of performance of its duties, are required to immediately report to the Central Government, within such time and in such manner as may be prescribed, any offence involving fraud that is being or has been committed against the company by its officers or employees. If it is ascertained that a partner of the audit firm has acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to or by, the company or its directors or officers, the liability for such an act, whether civil or criminal, as provided in this legislation or in any other law for the time being in force, shall be joint and shared by several of the partner or partners concerned of the audit firm and the firm.

Punishment for fraud under Clause 447 of the Act provides that any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term, which shall not be less than six months, but which may extend to ten years and shall also be liable to a fine, which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud. Provided that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years. A company or any officer of a company or any other person in case of wrongful acts, such as, making false statement and giving false evidence will be subjected to stringent penal provisions set forth in the Act.

Corporate set-ups with global operations need to also meet compliance obligations across various regions such as, Africa, South East Asia, USA and Europe, which have become more stringent now. This means considering the implications of the U.S. Foreign Corrupt Practices Act (FCPA) and the UK Bribery Act, wherever these companies operate needs to be evaluated. Management needs to be fully aware of the risks in various markets and needs to ensure that proper controls and accountability are in place.

5. What companies need to do to mitigate fraud and corruption risks



An appropriate system of governance is symbolised by a structure, which is adaptable and flexible according to the company's growth. Setting and monitoring objectives, tone at the top, policies, risk appetite, accountability and performance management are some of the key elements of Corporate Governance. Corporate Goverance includes some of the so-called 'high level controls'. That is, controls, which span across the organisation rather than being specific to a particular function and process. These controls include attitudes, delegations of authority and controls that communicate to all constituencies, including senior management, that fraud will not be tolerated. It further communicates that compliance with laws, ethical business practices, accounting principles and corporate policies are to be followed and it is the responsibility of all employees, including senior management that any attempted or actual fraud, is expected to be disclosed by those who know or suspect that the fraud has occurred.

Fraud itself cannot be eliminated, but fraud and corruption risks can be managed and controlled like other business risks. Fraud and corruption risk management strategies can help companies avoid potential frauds and assist in reducing the impact of frauds that occur. Resilient corporations focus more on strategies, not tactics, for managing fraud and corruption risks intelligently. In short, corporate governance is an entire culture that sets and monitors behavioural expectations intended to deter the fraudster. Today, changes in business are being driven

by increased stakeholder demands, heightened public scrutiny, and new performance expectations.

Today organisations are not only faced with the risk of traditional frauds, but also substantial risks from new age technology frauds. All organisations are exposed to the risk of fraud, bribery and corruption, but it depends on management philosophy, willingness, and the tone at the top on how various complex situations are dealt with. Although it is rare to have a foolproof system or process, timely preventive measures can, however, help to combat frauds and can be a good safeguard. Robust policies and procedures, strong internal control environment (both preventive and detective controls), effective implementation techniques, continuous monitoring at transaction level, ethical culture of "zero tolerance" towards fraud, corruption and bribery, conducting fraud awareness training programs, implementing a whistle blowing mechanism, together with timely disciplinary action are few essential pre-requisites of any plan to effectively mitigate fraud and corruption risks.

Mitigation of fraud and corruption risks

Mitigation of fraud and corruption risk is a collective effort of board of directors, employees, business partners, regulators, society and government. In this regard, the role of the government can be significant because weak law enforcement is one of the key reasons for high levels of bribery and corruption in a country. A holistic and integrated approach is required to expect desired results from any fraud and corruption risk mitigation initiative. It should not remain on paper as a 'tick-in-the-box' approach or recommendatory compliance. Companies that focus on developing practical strategies, workable frameworks and robust processes for preventing fraud, detecting fraud when it occurs, and responding appropriately to minimise the impact of fraud after it has occurred are considered to employ strategies that allow them to be resilient. The four elements of fraud and corruption risk management are assessment, prevention, detection, and response.

Fraud Risk Assessment

Performing a competent fraud and corruption risk assessment is the key first-step to fraud risk management. Before putting preventive or detective strategies in place, it is necessary to identify, categorise, and assess risks, on the one hand, and to determine which risks require mitigation and what mitigation strategies are to be used, on the other. Therefore, undertaking periodic fraud risk assessments is one of the pre-requisites to mitigating the risk of bribery and corruption. A fraud risk assessment should be performed periodically to identify potential schemes and events that need to be mitigated. An effective fraud risk assessment should identify where fraud may occur and who the perpetrators might be. Therefore, controls around key processes should always consider both the fraud scheme and the individuals within and outside the organisation who could be the perpetrators of such fraud schemes. If the scheme involves collusion, preventive controls should be augmented

by detective controls, as collusion negates the control effectiveness of segregation of duties. As a part of the assessment, organisations need to look at the control environment and information technology, as both have a significant effect on fraud risk for most functions. The fraud risk assessment should also anticipate the behaviour of a potential fraud perpetrator. It is important to design fraud detection procedures that a perpetrator may not expect - this requires a skeptical mindset and involves asking questions such as:

- How might a fraud perpetrator exploit weaknesses in the system of controls?
- How could a perpetrator override or circumvent controls?
- What could a perpetrator do to conceal the fraud?

Organisations should apply a framework to document their fraud risk assessment. A fraud risk assessment generally includes three key elements:

- Identify fraud risks
- Assess likelihood and significance of fraud risks
- Respond to significant and those frauds likely to occur

Prevention Mechanism

Internal Polices, Procedures, and Training

A key aspect of the fraud and corruption risk assessment is, putting in place preventive strategies. There are a number of them, ranging from enterprise-wide, non-fraud-specific strategies, such as starting with corporate ethics policies, to highly targeted controls designed to prevent specific fraud schemes.

Organisations should have their own code of business conduct and ethics policy. This should be further supported with a detailed guidance to employees, through the Fraud control policy and Anti-bribery and corruption policy, in order to prevent fraud, bribery and corruption. These policies should be approved by the Board of Directors and the Audit Committee, which should be implemented by the management, along with its compliance status being monitored regularly. Creating awareness of policies and procedures amongst employees should be done by way of conducting ethical dilemma workshops. Training to employees should include various possible scenarios of fraud, bribery and corruption and how an employee needs to deal with and respond to such situations. Provision for disciplinary action against persons for any non-compliance of policies should also be in place.

Third Party/Business Partner Due Diligence

The measures against fraud, bribery and corruption are applicable not only to employees of any organisation, but also to all the business partners, such as, vendors, customers, agents, third party intermediaries, etc. As a preventive measure, a thorough background check of the business partner should be conducted, before entering into a business relationship with any third party. The company should undertake a third party due diligence to assess the integrity and reputation of the party's current business activities, their affiliations with political parties, pending legal cases and their image in the society and business community.



Transaction-level controls are next in the cycle. These are accounting and financial controls designed to help ensure that only valid, authorised, and legitimate transactions occur and to safeguard corporate assets from loss due to theft or other fraudulent activities. These procedures are preventive because they may actively block or prevent a fraudulent transaction from occurring. Such systems, however, are not foolproof, and fraudsters frequently take advantage of the loopholes, inconsistencies, or other vulnerabilities in the existing system. Also, dishonest employees may engage in a variety of deceptive practices to defeat or deceive such controls. Anti–money laundering procedures employed by financial institutions are a good example of a proactive process designed to deter fraudulent transactions from taking place through a financial institution. Another example is the policy relating to the review and approval of documentation in support of disbursements.

Detection strategies are meant both to deter frauds, due to employees knowing they are in place, and to uncover those that occur.

Detection Mechanism

Whistleblowing mechanism/system

One of the effective ways for detecting fraud and corruption can be implementing a robust whistleblowing mechanism or a system within the organisation. Recent forensic investigations have also indicated that many frauds were detected due to tip-offs or complaints through the whistleblowing mechanism. A whistleblowing system is also recommended under Clause 49 of the listing agreement. However, this mechanism is not in place in many Indian companies, unlike Multi-National companies. Anonymity is one of the pre-requisites for this mechanism. Employees generally have a fear of being exposed and are thus reluctant to disclose any fraudulent or corrupt activity through this mechanism. It is important to therefore, increase awareness about anonymity and provide assurance to the employee of protecting their identity and to prevent unfair treatment or harassment. A well-structured committee should also be capable enough to hear and resolve cases received through this mechanism.

A vigil mechanism (Whistleblowing mechanism) has been made mandatory in the Companies Act, 2013 for listed companies and such class or classes of companies, as would be prescribed in the rules. Whistleblowing mechanism is one of the effective ways of detecting fraud, which can help put in place preventive controls in an organisation sooner than later in the current dynamic business environment.

Continuous monitoring and review of system and processes

It is important to constitute some internal mechanism like internal audit for continuous monitoring and review of systems and processes for timely identification of control gaps. If such gaps are not corrected on time, they may be used by fraudsters to perpetrate any kind of fraud. Process-specific fraud controls need to be identified. Significant gaps should be reported to the Board of Directors and the Audit Committee for their recommendations. Immediate corrective actions should be taken. It is also necessary to carry out a follow-up exercise, where it should be ensured that the control gaps identified are resolved on a timely basis. Instances of technology-based fraud have increased in recent times due to the growing dependence on technology. Fraudsters also use advanced tools for perpetrating fraud. Data or information theft or IP infringement are some such examples. Hence, IT audit, access controls testing and assessment of application system controls are gaining importance. Detection strategies, which vary from periodic auditing to continuous monitoring of transactions and relationships, can selectively be put in place depending on the fraud risks identified by the company.

Use of Data Analytics to identify unusual patterns and anomalies in transactions

Today technology is an important pillar for any organisation irrespective of its size or nature. Spreadsheet usage is highly vulnerable to manipulation and data integrity is questionable. Although, use of technology has brought in lot of efficiencies, at the same time tech savvy fraudsters are finding different ways of perpetrating frauds. A technology-based framework to prevent and detect fraud is the need of the hour. Periodically analysing high risk transactions using Forensic Data Analytics is a very effective tool for detecting fraud. Vast and complex data can be analysed using this tool and red flags or anomalous or unusual patterns can be identified efficiently in a relatively short time span and at the right juncture.

There are also certain other tools for continuous monitoring of business transactions. Computer forensic tools can be used for monitoring business communications by using key word searches. Computer forensic tools are very effective mechanisms used for investigations, where an electronic device is used by the suspect. These devices can be imaged and analysed to find evidence related to a fraud or corruption issue under investigation.

Fraud Response Management

Timely investigation of suspected, alleged, or actual frauds and thereafter, taking immediate disciplinary action can act as a deterrent for other employees in the organisation from engaging in any dishonest act in the future. This allows a clear message to be disbursed, that the top management believes in a 'zero tolerance' approach to fraud and corruption issues.

Companies can develop response strategies designed to minimise the impact of frauds that occur, or are discovered, and come to the attention of the company, authorities and other interested parties. The response strategies include the capability to conduct sound investigations. A fraud response management program may encompass:

- the procedures and processes through which an organisation is alerted to allegations of potential fraud and misconduct;
- the manner in which those allegations are initially and subsequently communicated within the organisation;
- the assignment of responsibility and accountability for handling those allegations;
- decision making authority;
- the methods and procedures by which allegations are investigated;
- consideration of legal implications, documentation and evidentiary procedures;
- reporting of investigation results within the organisation;
- remedial recommendations; and
- procedures for dealing with outside parties.

A fraud response management programme, when effectively designed and implemented, can become one of the most critical elements of an organisation's anti-fraud program.

Entities that suspect or experience a fraud should undertake a series of steps to credibly maintain and demonstrate good corporate governance practices.

Investigative findings often form the basis for both internal actions, such as, suspension or dismissal and external actions against the guilty parties or restatement of previously issued financial statements. An investigation should also form the basis for remediating control procedures. Investigations should lead to actions commensurate with the size and seriousness of the impropriety or fraud, no matter whether it is found to be a minor infraction of corporate policy or a major scheme to create fraudulent financial statements or misappropriate significant assets.

Deploying all the four elements of fraud and corruption risk management collectively, that is, assessment, prevention, detection, and response can put companies on the path of being resilient to the threat of fraud and corruption.

6. Responding to incidents of fraud and corruption

The processes for an effective fraud response management program, as mentioned in the previous section 5, when effectively designed and implemented, can become one of the most critical elements of an organisation's anti-fraud program. These steps, however, should be tailored to fit the organisation. Failing to implement an effective fraud response management program as part of your organisation's overall anti-fraud programs and controls may put your organisation at significant risk. Fraud happens and will likely continue to plague organisations and world markets for some time. Being prepared is thus part of the solution.

Some important considerations when designing an effective fraud response management program can include:

- monitoring compliance with applicable legal and regulatory standards;
- confirming that the complaint intake system provides for anonymous reporting;
- defining roles and responsibilities for those involved in the fraud response management process;
- establishing clear and meaningful investigative protocols to include interviewing, evidence collection, computer forensic examinations, and analysis;
- identifying competent fraud investigation resources, especially global response teams, before a crisis situation
- utilising a case management system that allows the organisation to efficiently track and log the progress and resolution of fraud allegations;
- establishing consistent reporting within and outside the organisation; and
- identifying processes and control improvements enterprise-wide to help gain efficiencies and prevent recurrences.

As organisations expand their global presence, it can be useful to have a well devised Fraud Response Management program in place that allows timely and an appropriate response to allegations of fraud and misconduct. This can be especially important in light of the world economic conditions because the risk of fraud can increase in an economic downturn. The economic downturn can also create the added challenge of compelling organisations to be more efficient with their resources, including those utilised for responding to and managing fraud allegations.

When an allegation of fraud surfaces, the organisation decides how to proceed and to what extent it may investigate. In some instances, outside counsel is retained to conduct an investigation.



Part of the response phase is to recover monetary losses due to a fraud. The amount can, not only be significant but difficult to recover. The latter is true because most often, the perpetrator has spent or hidden all or most of the ill-gotten gain, and there is little to recover from the fraudster.

Once the need for an investigation arises, it should be conducted in a timely and thorough manner. Timely investigations can be viewed positively by regulators and prosecutors and generally produce more precise results because witness recollections are fresh and documents are more likely to be available. The investigation should gather, in a lawful manner, sufficient data and evidence in support of any potential litigation or inquiries from regulatory entities. Generally, the investigation process should also seek to identify control weaknesses and management missteps that may have impacted the timely prevention or detection of the incident.

7. Conclusion



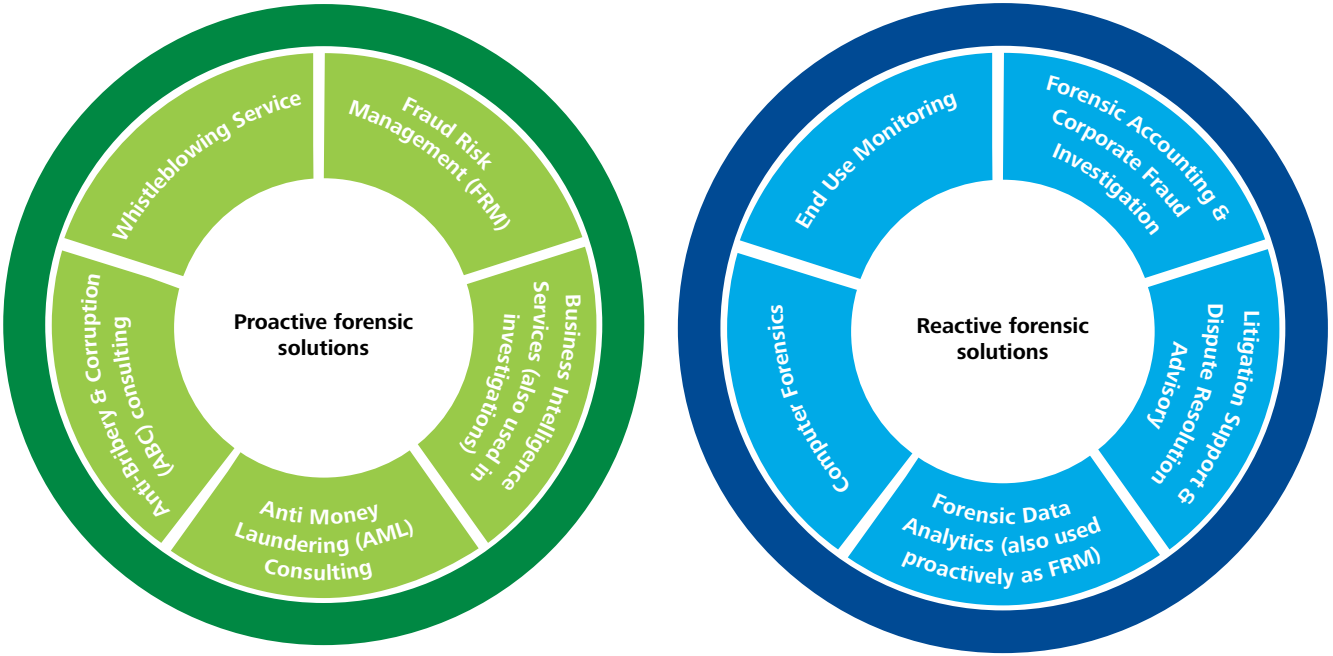
India Inc. is on the verge of the next quantum leap. Recent fraud cases like the AugustaWestland deal have cast a shadow of doubt on India Inc. This is exemplified by the drop in the perception the world has on India. Fortunately, this has been recognised by all and more so by the youth of the country, which is clamouring for change and action.

Policy makers have taken their first step to increase corporate transparency by writing several pieces of legislations, including the Companies Act 2013 and the proposed revision(s) to the Prevention of Corruption Act, amongst others.

It is now India Inc.'s opportunity to step-up to the plate. The need of the hour for corporate organisations is thus to invest in right anti-fraud measures, such as, employee background screening, business partner or third party due diligence, effective and well-understood whistleblowing systems and well-tested fraud risk management systems, which would help reduce losses on account of fraud and corruption.

About Deloitte Forensic

Deloitte Forensic helps clients react quickly and confidently in a crisis, investigation or dispute. We use our global network, deep industry experience and advanced analytical technology to understand and resolve issues. And we deliver the proactive advice clients need to reduce the risk of future problems.



About FICCI Aditya Birla CSR Centre for Excellence

FICCI Aditya Birla CSR Centre For Excellence has evolved in consonance with Mahatma Gandhi's dream: ethics-based business practices leading to improvement in the quality of life for the common people. The centre envisions- To incubate, nurture and accelerate a paradigm of sustainable and inclusive CSR in India and across the globe, thereby raising the Human Development Index through poverty alleviation.

The Centre for Excellence is a joint endeavor of Federation of Indian Chambers of Commerce & Industry (FICCI), a rallying point for free enterprise in India since 1927 and the Aditya Birla Group - a prominent business group with a mission to deliver superior value to customers, shareholders, employees and society at large.

As a resource centre, the Centre for Excellence shall provide strategic direction to the development of inclusive and holistic CSR practices; create synergy by providing platform to various stakeholders to share their experiences, learn, exchange ideas and support partnerships that add value to business and recognise and reward business enterprises contributing towards sustainable and inclusive development.

Goals of the Centre for Excellence are:

- Provide an enabling environment for business to pursue their CSR goals.
- Generate awareness about holistic CSR practices and sustainable development
- Create synergy amongst CSR stakeholders for exchange of ideas and shared learning
- Support capacity building of enterprises, civil society organisations and other stakeholders

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