

Corporate Fraud, Investigation and Preventions - Today's Challenges

India is an emerging country with a plethora of opportunities. As a potential market, it is in the blueprint of many global giants who are planning to expand business. But these **opportunities come fraught with numerous risks and challenges like fraud, bribery and corruption**. These risks are growing concerns for Indian companies as well. A major challenge faced by the senior management of a company in addressing these risks is the lack of awareness. Also, there are some common myths that prevent companies from taking suitable measures.

Some of the common myths are -

- ▶ "Our people would not commit fraud."
The fact is that it is impossible to vouch for all of your employees.

- ▶ "Fraud could not happen to us – we are a stable organization."
You may have the requisite internal controls, but you may be exposed to an external vulnerability which is outside your influence.

- ▶ "We would know if fraud occurred – we watch vulnerable areas."
The reality is that no system can be 100% fraud proof, and the fraud prevention activities often are not aligned with the risks that really matter

- ▶ "If fraud occurred, it would be discovered quickly."
The individual fraud detection mechanisms often work in isolation and have limited impact

- ▶ "Damage would not be significant – we can deal with it."
The fact is that the impact of fraud cascades. There can be a collateral damage like loss of reputation, which is far more consequential than the monetary loss.

- ▶ "We are covered on fraud through SOX compliance."
Sarbanes-Oxley projects address only financial reporting risks

Regulatory scenario

In addition, the recent scams have resulted in increased regulatory activism. Existing acts are being amended and updated to address the new and complex threats. Regulators are proposing more stringent standards for fraud prevention, detection and reporting.

For instance, various measures proposed in the Companies bill 2011 which is slated to replace The Companies Act 1956. **One of the proposed measures is formation of a financial reporting body “National Financial Reporting Authority (NFRA)” for better monitoring of corporate financial management.** This body will have quasi-judicial powers to order investigation, levy penalty and bar professionals from practice in case of their indulgence in professional or other misconduct. Such authority will have the mandate to ensure scrutiny and compliance of accounting and auditing standards. It will also ascertain the quality of service of professionals associated with compliance. **The new bill seeks to provide more teeth to Serious Fraud Investigation office (SFIO).** It is proposed that SFIO will be a statutory body with enforcement powers, including arrest, focus on protection of investors with recognition of class action suits and provision for nomination of directors by small shareholders and stricter role for auditors including rotation. The investigation report of SFIO, filed with the court for framing of charges, would be treated as a report from a police officer.

Currently under various regulations like **Clause 49 of the listing agreement**, the CEO and CFO of a company, in their certification have to confirm that there are, to the best of their knowledge and belief, no fraudulent /illegal transactions entered into by the company during the year. Also, as per **Companies (Auditor’s Report) Order (CARO) 2003**, the auditor has to report whether any fraud by or on the company was noticed or reported along with its nature and amount.

Enhanced globalization has added to the list of regulations that companies have to adhere to. **Governments around the world, in an attempt to address bribery and corruption risks, have introduced anti-corruption legislations like US FCPA and UK bribery act which have extra-territorial jurisdiction.** Bribery and corruption continue to be some of the biggest challenges for companies, and the risk is compounded by increasing enforcements and stricter penalties.

Some risk prone and vulnerable areas

- ▶ Employees of a company have access to the company’s and its customer’s confidential and sensitive information, which can be misused by an unscrupulous current or ex employee
- ▶ Vendor initiated frauds to deceive company by way of overcharging or under delivery
- ▶ Payables and Receivables mismanagement leading to financial loss to company
- ▶ Funds and inventory defalcation or theft by employees / vendors
- ▶ Expenses misappropriation / overcharging by employees and third party vendors
- ▶ Theft of sensitive information related to customers, tenders, contracts, acquisitions, and IP
- ▶ Misuse of schemes and rebates
- ▶ Bribery and inappropriate treatment of government officials and other parties

A strategic move: proactive fraud risk management

The first step a company should take in its quest to address fraud, bribery and corruption risks is to do a fraud risk assessment. This will help in identifying the vulnerable areas and indicate the key red flags. These findings will then become foundation for a comprehensive and effective fraud risk management plan. Most important element, required for making any such plan a success, lies in the hands of the senior management. Hence, **setting the “tone at the top” is essential to bring about the change.**

We have seen a considerable increase in the number of companies opting to undertake proactive fraud risk management compared the previous year. This is an encouraging sign which indicates a better future for corporate governance in India.

This paper is authored by Arpinder Singh, Partner & National Director – Fraud Investigation & Dispute Services, Ernst & Young India. The opinions expressed in this article are the author's own and do not reflect firms view.

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