

BDO joined Assocham as knowledge partner for a seminar on “National Conclave on Corporate Governance - Voluntary Guidelines – 2009”.

Date and Venue :July 30, 2010 in New Delhi.



Chief guest for the event was Shri Salman Khurshid, Minister, Ministry of Corporate Affairs and other key members/ speakers were:

- Mr. R. Bandyopadhyay, Secretary, Ministry of Corporate Affairs
- Ms Preeti Malhotra, Chairperson, ASSOCHAM National Committee on Corporate Governance
- Mr. U Venkataraman, Executive Director, MCX Stock Exchange
- Mr. B.D. Narang, Former CMD, Oriental Bank of Commerce
- Mr. Jitesh Khosla, IAS, Additional Secretary to Government of India
- Mr. B.G.Daga, Former Chairman, CDSL

The event was a great success and was attended by over 75 guests and our key clients at Delhi were invited as BDO invitees for the seminar. **From BDO, Huzeifa Unwala spoke on the panel "Audit Committees and Auditors" and Vijay Sachdeva spoke on the panel "Mechanism for Whistle Blowing"**

In the paper released by Assocham on the event, BDO Governance publication paper on role of audit committee chair was included.

In a separate meeting with the Shri Salman Khurshid BDO profile and paper on role of audit committee chair was presented to the minister and Mr. Bandyopadhyay, Secretary-Ministry of Corporate Affairs.

Appended are the photographs from the event and presentations made on the panel by BDO members.











National Conclave on Corporate Governance - Voluntary Guidelines 2009

Huzeifa I. Unwala
30 July 2010





Topics

1. COSO Study on Fraudulent Financial Reporting
2. Key Considerations



Fraudulent Financial Reporting

Source - COSO Study on Fraudulent Financial Reporting

COSO sponsored this study, *Fraudulent Financial Reporting: 1998-2007*, to provide a comprehensive analysis of fraudulent financial reporting occurrences investigated by the U.S. Securities and Exchange Commission (SEC) between January 1998 and December 2007. This study updates our understanding of fraud since COSO's 1999 issuance of *Fraudulent Financial Reporting: 1987-1997*. Some of the more critical findings of the present study are:

- There were **347** alleged cases of public company fraudulent financial reporting from 1998 to 2007, versus 294 cases from 1987 to 1997. Consistent with the high-profile frauds at Enron, WorldCom, etc., the **dollar magnitude of fraudulent financial reporting soared in the last decade**, with total cumulative misstatement or **misappropriation of nearly \$120 billion** across 300 fraud cases with available information (mean of nearly \$400 million per case).
- The companies allegedly engaging in financial statement fraud had median assets and revenues just under \$100 million. These companies were much larger than fraud companies in the 1999 COSO study, which had median assets and revenues under \$16 million.



Fraudulent Financial Reporting

Source - COSO Study on Fraudulent Financial Reporting

- The SEC named the *CEO and/or CFO for some level of involvement in 89 percent of the fraud cases*, up from 83 percent of cases in 1987-1997. Within two years of the completion of the SEC's investigation, about 20 percent of CEOs/CFOs had been indicted and over 60 percent of those indicted were convicted.
- The *most common fraud technique involved improper revenue recognition, followed by the overstatement of existing assets or capitalization of expenses*. Revenue frauds accounted for over 60 percent of the cases, versus 50 percent in 1987-1997.
- *Relatively few differences in board of director characteristics existed between firms engaging in fraud and similar firms not engaging in fraud*. Also, in some instances, noted differences were in directions opposite of what might be expected. These results suggest the importance of research on governance processes and the interaction of various governance mechanisms.



Fraudulent Financial Reporting

Source - COSO Study on Fraudulent Financial Reporting

- Twenty-six percent of the fraud firms changed auditors between the last clean financial statements and the last fraudulent financial statements, whereas only 12 percent of no-fraud firms switched auditors during that same time. Sixty percent of the fraud firms that changed auditors did so during the fraud period, while the remaining 40 percent changed in the fiscal period just before the fraud began.
- Initial news in the press of an alleged fraud resulted in an average 16.7 percent abnormal stock price decline in the two days surrounding the news announcement. In addition, news of an SEC or Department of Justice investigation resulted in an average 7.3 percent abnormal stock price decline.
- Long-term negative consequences of fraud were apparent. Companies engaged in fraud often experienced bankruptcy, delisting from a stock exchange, or material asset sales following discovery of fraud - at rates much higher than those experienced by no-fraud firms.



Key Considerations

- Enhanced scepticism when companies are experiencing financial stress may be warranted for key governance participants, including the board of directors, auditors and regulators.
- In companies that have a dominant leader or owner, other investors must be even more vigilant that the Code is effectively implemented to ensure proper checks and balances, both in the governance structure (especially in the independence and experience of the Audit Committee) and in the processes adopted. It is important that there is a very clear separation between the Chairman and the CEO.
- Composition of Audit Committee: Independent directors should be truly independent. Any relationships with "controlling" family members or promoters should be disclosed.
- Pre-approval or disclosure of all related party transactions
- Role of the Chair of the Audit Committee
- Review the functioning of the whistle blower policy
- Review the usage of funds (public issue, large borrowings)
- Review the reasons for substantial defaults to depositors, debenture holders, etc



Key Considerations

- Ethics the first line of defense for auditees - Investigative due diligence.
- Self-interest, self-review, familiarity and intimidation threats to the audit profession.
- Companies need an effective and, ideally, independent Internal Audit. Internal Audit should not report to and should not be answerable to CFO and CEO, but the Audit Committee. There are many advantages in it being conducted by an independent firm.
- Joint Audits: Audit Committees may choose to recommend Joint Auditors. Clearly, having two auditors can add a further layer of assurance. However, there are some significant disadvantages - they can increase cost to the company and impact the quality of audit as the lines of responsibility can be blurred.
- ICAI prescription on engagement partner rotation (7 years), services that create self-interest situations such as Valuations, Litigation support and Implementation of IT financial accounting systems.
- ICAI recommendation on the recommendation of qualified staff to unqualified staff ratio.



Ministry of Corporate Affairs Voluntary Guidelines on Corporate Governance 2009

Audit Committee - Enabling Powers:

The Audit Committee should have the power to -

- have independent back office support and other resources from the company;
- have access to information contained in the records of the company; and
- obtain professional advice from external sources

The Audit Committee should also have the facility of separate discussions with both internal and external auditors as well as the management.

Audit Committee - Role and Responsibilities

The Audit Committee should have the responsibility to -

- monitor the integrity of the financial statements of the company;
- review the company's internal financial controls, internal audit function and risk management systems;
- make recommendations in relation to the appointment, reappointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor

Audit committees have been empowered with roles and responsibilities by the regulators as they are regarded as the only independent governance body. The changed global economic and business environment calls for increased participation of the audit committee to address emerging risks, and to steer the governance ecosystem to the next stage of maturity. *The Audit Chair plays a leadership role in discharging these responsibilities to meet the stakeholders' expectations.*

The views expressed in this presentation are personal views of the speaker.



**Assocham - National Conclave on
“Corporate Governance - Voluntary Guidelines - 2009”**

Mechanism for Whistle Blowing

July 30, 2010

What is whistle blowing?

The term “whistle-blowing” originates from the practice of British policemen who blew their whistles whenever they observed commission of a crime.

Whistle-blowing refers to “disclosure by organization members (former or current) of illegal, immoral, or illegitimate practices under the control of their employers, to persons or organizations that may be able to effect action”

Whistle-blowers can be:

External: Lawyers, mass media, law enforcement, or watchdog agencies

internal: Designated officer, employees or superiors in the same organization

Types of misconduct whistle blowers can report:

- Illegal or unlawful conduct
- Unprocedural conduct
- Unethical conduct
- Wasteful conduct

Benefits:

- Increases safety and well-being of organization
- Reinforces organization’s code of ethics
- Reduces organizational waste and mismanagement
- Improves employee morale



Mechanism for Whistle Blower as per C49

Clause 49 recommends companies to establish a mechanism for employees. Mechanism which is adopted by organization for whistle blower:

- Communicating the existence of a whistle-blowing policy to employees
- Adoption and encouragement of the policy (for all listed companies)
- Assigning Ombudsmen, providing special telephone numbers and email IDs
- Providing high degree of protection to whistleblowers
- Procedure for whistle blowing



To Prevent Whistleblowing, Encourage Whistleblowing..

The **OBJECTIVES** of an internal whistleblowing program should be:

- To **encourage** employees to bring ethical and legal violations they are aware of
- To **minimize organization's exposure** to the damage that can occur when employees circumvent internal mechanisms
- To let employees know the **organization is serious** about adherence to codes of conduct

BARRIERS to a successful internal whistleblowing program could be:

- Lack of trust in the internal system
- Unwillingness of employees
- Misguided union solidarity
- Belief that management is not held to the same standard
- Fear of retaliation or alienation from peers



Steps for Creating a Whistle-blowing Culture

- I. Create a Policy**
- II. Get Endorsement From Top Management**
- III. Publicize the Organization's Commitment**
- IV. Investigate and Follow Up**
- V. Assess the Organization's Internal Whistleblowing System**

Organizations will have to institute rigorous policies to allow employees to bring unethical and illegal practices to the forefront. Companies will have to train managers and executives on how to encourage openness. Putting processes in place will not be quick, but it is certainly necessary given the increased public scrutiny of corporate behavior



Mechanism for Whistle Blower - How to implement?

- Designating an ombudsperson for overseeing and managing compliance issues within the organization
- Mode of communication of compliant is defined in the policy (such as mail, call, hotline numbers)
- Ombudsperson formulates an investigation process for the breach of:
 - Code of Ethical Business Conduct
 - Accounting
 - Internal Accounting Controls
 - Auditing matters and applicable national and international laws including statutory/ regulatory rules and regulations.
- Redressal committee consisting of experts formed to conduct investigation process
- Confidential clause for non-disclosure of information will form part of policy to safeguard whistle blower
- A whistle blower need to communicate the complaint with sufficient evidences orally or written form
- Ombudsperson presents quarterly update or report to Board of Directors



Safeguards of whistleblowers

Potential whistle-blowers will not report internally if they **fear reprisals** within organization or **suspect** that the management condoned or approved the illegal activity. To encourage whistle-blowing, whistle-blowers must be protected:

- Genuine whistle-blowers must be adequately protected to encourage them to report wrongdoing in the organization
- Whistleblowers who make false allegations should be punished
- As whistle-blowers face retaliation, ostracism, dismissal or death threats, their organizations must make it safe for them to blow the whistle

The internal accountability of a organization can be enhanced by adopting three-pronged strategy:

- *Provision of ethics training for all its staff*
- *Punishing staff who violate its code of ethics*
- *Establishing an internal whistle-blowing mechanism with safeguards to protect whistle-blowers*



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Thank You

The views expressed in this presentation are personal views of the speaker.