KIRTANE & PANDIT

Corporate Governance and Fraud

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Corporate Governance and Fraud

In recent years, the environment in which public companies operate has become increasingly complex for business owners, board members, and shareholders alike. Increased regulatory burdens have added to the costs and complexity of overseeing and managing a business and have created new challenges from operational, regulatory and compliance perspectives. Business leaders are being challenged on their capability to practice good corporate governance and steer clear of any potential disasters.

Corporate Governance refers to the way in which companies are governed and to what purpose. It identifies who has power and accountability, and who makes decisions. It is, in essence, a toolkit that enables management and the board to deal more effectively with the challenges of running a company. Corporate governance ensures that businesses have appropriate decision-making processes and controls in place so that the interests of all stakeholders (shareholders, employees, suppliers, customers and the community) are balanced.

Governance at a corporate level includes the processes through which a company's objectives are set and pursued in the context of the social, regulatory and market environment. It is concerned with practices and procedures for trying to make sure that a company is run in such a way that it achieves its objectives, while ensuring that stakeholders can have confidence that their trust in that company is well founded.

Good governance is important as it provides the infrastructure to improve the quality of the decisions made by those who manage businesses. Good quality, ethical decision-making builds sustainable businesses and enables them to create long-term value more effectively. Corporate governance entails the areas of environmental awareness, ethical behaviour, corporate strategy, compensation, and risk management. The basic principles of corporate governance are accountability, transparency, fairness, and responsibility.

The interests of investors and other stakeholders are usually protected by a three-tier security system. At the top-level is the company's "corporate governance code," At the other end are the "reporting system," which is regulated by various public and private institutions, such as, the Securities and Exchange Commission (SEC), the Public Company Accounting Oversight Board (PCAOB), and Financial Accounting Standards Board (FASB), Securities and Exchange Board of India (SEBI), etc. These regulatory agencies require public companies to follow various accounting and disclosure standards, such as, Generally Accepted Accounting Principles (GAAP), and their auditors to audit as per Statement on Auditing Standards (SAS) like independence, ethical, and quality control standards. Linking the two extremes, however, is a company's "system of internal controls," which provides reasonable 'assurance' on the effectiveness and efficiency of operations, the 'reliability' of financial reporting, and 'compliance' with applicable laws and regulations. This system, however, seems to have been inadequate in many companies. As corporations scramble to realign their interests with those of their stakeholders, three main areas of weaknesses are emerging.

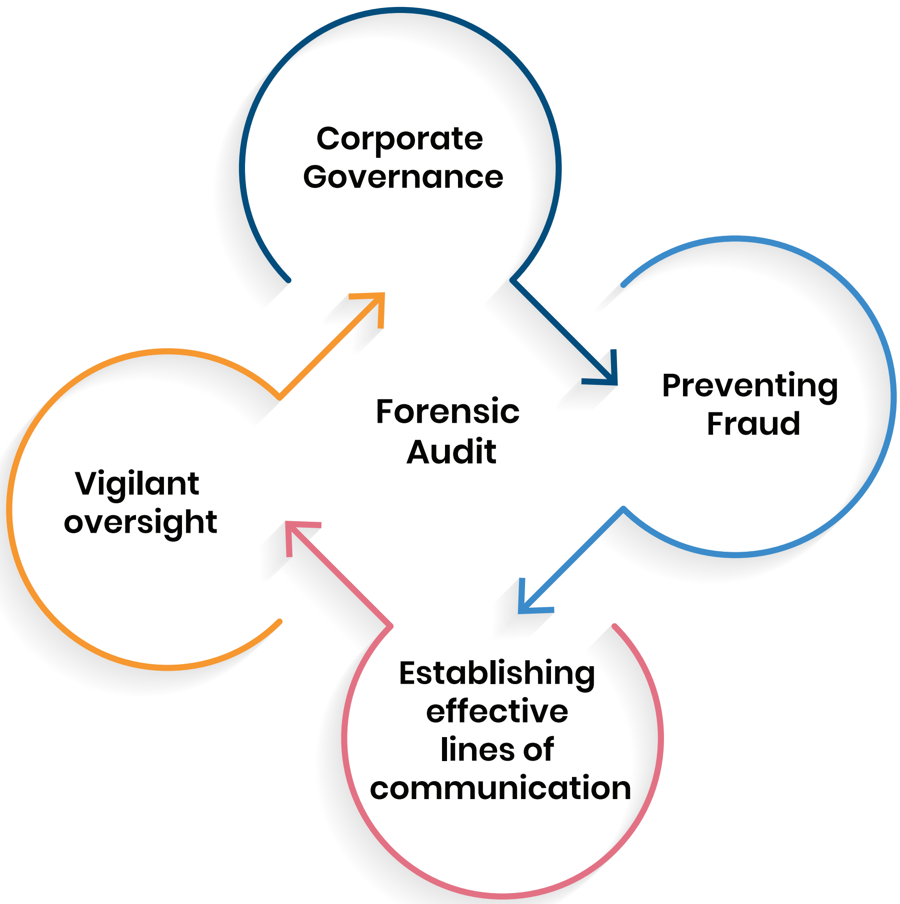
- Lack of a well-developed and Implemented Policy of Corporate Governance
- Lack of Honesty and Transparency in Reporting
- An Inefficient and Ineffective System of Internal Control

Forensic accountants can play a vital role in coordinating company efforts to achieve a cohesive policy of ethical behaviour within an organization.

What the use of fingerprints was to the 19 th Century and DNA analysis was to the 20 th Century, so financial information and forensic accounting has come to be one of today's powerful and intelligence tool available. Worldwide, we consider Sherlock Holmes to be the first detective (forensic accountant in this context). In India, 'Kautilya' was the first person to mention first forty ways of embezzlement in his book 'Arthashastra' during the ancient times. Similarly 'Birbal', scholar in the time of 'King Akbar' used various tricks to investigate various types of crimes. Some of his stories gave the fraud examiner a brief idea about the litmus test investigation.

The definition of forensic accounting is changing in response to growing needs of corporations. Forensic accounting includes the use of accounting, auditing and investigative skills to assist in legal matters. Forensic should be skilled not only in financial accounting but also in internal control systems , the law, other institutional requirements , investigative proficiency and interpersonal skills. Corporations can rely on these skills for developing a consistent system of CG, disseminating such information within and outside the company, ensuring that governance policies and objectives are interwoven into the internal control system, setting up fraud prevention systems and investigating any existing fraud.

Companies need a centralised program and an established system to measure and monitor internal controls effectiveness and alignment between CG, internal control and external reporting activities. Many are setting up governance officers or governance committees to meet the demand of corporate integrity. As part of CG committee, forensic accountants can make a significant contribution in each of the following areas:



Since the forensic auditors possess special skill and knowledge which can easily detect and prevent fraudulent activities, this definitely will be enabled the corporate governance mechanism (external auditor, audit committee and management) in carrying out their responsibility of achieving corporate goals and reducing financial fraud. Thus, the forensic auditor could be said to have impacted effectively to the corporate governance of the organization by improving the management accountability, and financial reporting system, strengthening independence of the external auditor, assisting audit committee members in their oversight functions by providing additional assurance and giving greater responsibility to the external auditor in carry out their statutory audit functions. Thus, this will definitely help to reduce corporate collapse and impoverishment of investors thereby influencing corporate growth and achievement of overall corporate objectives.

Ref: Amity Business Review; The CPA Journal; International Journal of Accounting Research

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