



Whistleblower Allegations on Financial Fraud

Should independent directors (“IDs”) for publicly listed companies conduct an independent investigation or accept management’s response?

When a financial fraud allegation is raised against a publicly listed company, independent directors are often faced with the question of whether to conduct an independent investigation or accept management’s response to the allegations. The advantages of the latter include cost effectiveness, time saving and being able to provide a direct response to the allegation. *Is this really the case though?*

Management’s Response

Management’s remuneration is often pegged to certain key indicators of the company’s performance. Hence, having management respond to a financial fraud allegation, which may potentially affect their performance, reduces the independence of their responses.

IDs are bound not just ethically, but also by relevant local rules, regulations and laws to address the crux of the issue: *Did management know about the fraud and what actions did they take to prevent and remediate the situation?*

In this article, FTI Consulting walks through an investigation process to understand the IDs’ obligations when they receive a financial fraud allegation.

Receiving a Whistleblower Allegation on Financial Fraud

A whistleblower alleges the company’s management were involved in falsifying the financial statements and potentially channeling company funds to themselves (undisclosed related party transactions).

What should the IDs do next?



Step 1 :

Returning confidence back to key stakeholders

At this point, key stakeholders, such as the local regulators, shareholders, external auditors and the public at large, may react to the allegation, especially if made publicly available.

Having management respond with an announcement creates the perception of a reduced independent explanation and may set off a series of chain reactions that include:

- Regulators investigating on their own and request for more information relating to the transactions to form their own opinion;
- Shareholders demanding further responses through social media subjecting the reputation of the company to public scrutiny;
- If the trading of shares is not suspended, the share price may be affected due to the reaction to the news of the allegation and management's response; and
- The statutory auditors may not be comfortable with their audit opinion on the company's past years' financial statements and expect the company to provide an independent response to the allegation.

Instilling confidence with key stakeholders is a crucial step as failing to do so may have an adverse impact on the listed company.



Step 2 : Obligations of IDs as an individual

The second consideration is the relevant rules, regulations and laws which are applicable to the IDs as individuals if they mishandle the fraud allegation.

In Singapore, these requirements include the Singapore Companies Act (Chapter 50), the Securities and Futures Act, the Singapore Exchange Securities Trading Limited Listing Manual and the Singapore Code of Corporate Governance.

A breach in the statutory laws of Singapore and the country where the company has operations may result in an imprisonment, fine or both for the IDs¹.

The practice of IDs allowing and accepting management's responses to the allegations, is *essentially having the IDs place their individual legal obligations on the trust they have on management.*

Trust, in the world of fraud, is often manipulated by fraudsters to commit wrong-doing.



Step 3: Commissioning an independent investigation

To limit IDs' potential exposure to legal obligations and control the uniformity of responses to key stakeholders, IDs should consider forming an Independent Committee to conduct an investigation.

The key success factors for these financial fraud investigations include IDs knowing what to expect during the process, limiting any blind spots and handling of potentially confrontational situations from the management, regulators or public.

External advisers, such as counsels, forensic investigators and public relations experts with corporate investigations experience, assist the Independent Committee by driving the investigation and providing practical advice.

Working as a team, the lawyers are able to advise the IDs on their legal obligations and the implications of the results, while the forensic investigators (including accountants, computer forensics technicians, data technologists and corporate intelligence specialists) focus on performing a financial review of the company's books and records. Public relations experts would typically assist the Independent Committee in drafting the information and messages to inform the key stakeholders.

Essentially, the external advisers will enable the Independent Committee to handle the investigation expeditiously, smoothly and with confidence as key stakeholders will undoubtedly be anxious to know the results of the investigation.



Step 4 : Concluding an independent investigation

At the end of the investigation, the Independent Committee will have a factual account of the matter, which will address:

- Was the financial fraud allegation substantially proven?
- How did the fraud happen?
- What was the financial loss?
- Who was involved; more importantly, was management involved in the fraud?
- Are the perpetrators still with the company?
- Are there any other similar fraudulent transactions?

¹ For Singapore listed Chinese companies, the Chinese Criminal law and Anti-Unfair Competition law may also be applicable to IDs as individuals.

The factual account provides the IDs a basis on whether to terminate any business relationships with business partners and/or employees, including management, and put in place measures to remediate the issues at hand. At this stage, the Independent Committee should also consider working with their public relations team on sharing the results of the investigation to key stakeholders.

Conclusion

As mentioned, IDs often have to weigh up the cost benefits of conducting an independent investigation, or accepting management's response to a financial fraud allegation.

The above scenario presents reasons why conducting an independent investigation is not only beneficial for the company, but also to the IDs as individuals.

Even if the investigation does not produce any hard evidence of fraud, it sends a message to the employees, management and key stakeholders that the IDs hold corporate integrity and reputation, arguably one of the most prized assets of a listed company.

Without such commitment from IDs to uphold the company's reputation, who else can stand firm and vouch for the integrity of the business and management's response to financial fraud allegations? Will you?

After all, there is no smoke without fire.



Benjamin Ee
Managing Director
Risk Advisory & Investigations
+65 6831 7820
benjamin.ee@fticonsulting.com

The views expressed herein are those of the author(s) and not necessarily the views of FTI Consulting, Inc., its management, its subsidiaries, its affiliates, or its other professionals



EXPERTS WITH IMPACT

About FTI Consulting

FTI Consulting is an independent global business advisory firm dedicated to helping organisations manage change, mitigate risk and resolve disputes: financial, legal, operational, political & regulatory, reputational and transactional. FTI Consulting professionals, located in all major business centres throughout the world, work closely with clients to anticipate, illuminate and overcome complex business challenges and opportunities.

The views expressed in this article are those of the author(s) and not necessarily the views of FTI Consulting, its management, its subsidiaries, its affiliates, or its other professionals.