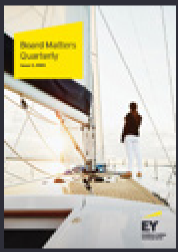
Board Matters Quarterly

Issue 3, 2021

Building a better working world

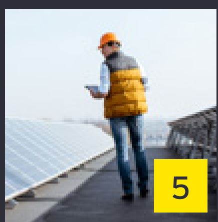
Issue 3, 2021



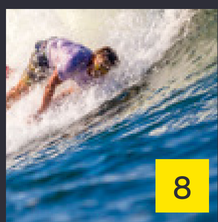
Board Matters Quarterly offers thought-provoking perspectives and insights into leadership and governance issues for boards and audit committees, supporting them to navigate the increasingly complex business environment.

The COVID-19 pandemic exacerbates new and emerging risks that organizations have struggled to contain even before the pandemic. Read more to keep updated on the latest board issues and the strategies to navigate them.

1 Why digital transformation doesn't have to be hard



5 How boards can drive more robust climate risk disclosures



8 Three ways boards can respond to rising tax risks

12 Why boards must focus on legal transformation now

16 What boards should know about overseeing corporate investigations

Why digital transformation doesn't have to be hard

Boards struggling with digital transformation should adopt a focused strategy that considers targeted M&A and plugs into the ecosystem.

By Vikram Chakravarty, Joongshik Wang and Shaurya Ahuja

The COVID-19 disruption has added a new urgency for businesses to accelerate their digital journey. In the *2020 EY-Parthenon Digital Investment Index* study, nearly two-thirds of executives agreed that organizations must radically transform their operations over the next two years. Companies are expected to commit significant investments in automation and digital collaboration tools to help them manage the disruption, while finding innovative ways to deliver products and services to customers.

Yet, many companies run the risk of doing digital rather than being digital — using technology to address specific problems rather than as part of an overall strategy. For digital transformation to truly take off, companies need to critically assess if their strategy is fit for a digital world and determine how they can address current gaps through organic investments, strategic alliances or plugging into the digital ecosystem.

Companies struggle with the major commitment of a digital transformation because the transformation journey is complex, the end results are distant and unknown, the costs are high and their primary business is often cannibalized for a lower-margin profile. This naturally raises concerns at the board and the resulting digital path is piecemeal and not holistic. Even though firms know that digital transformation is inevitable, they tend to kick the can down the road.

EY-Parthenon teams have worked with several boards to chart a calibrated digital journey that considers three key strategies.

Strategy one: Adopting a focused and strategic approach — "don't try to solve everything"

A common pitfall in digital transformation is that companies fail to take a focused and holistic approach, with different groups within the organization rolling out digital technology in silos. This easily sets them up for failure in what is a costly and challenging undertaking.

For digital transformation to succeed, the board can play a pivotal role by working with the management to provide a clear vision from the top and setting the tone for an innovative culture. These elements can then be translated into a resilient and forward-looking digital strategy. A strong board mandate with a clear digital vision can galvanize the team to challenge its traditional notions of the industry and competition and rethink established ways of allocating and prioritizing funding.

Companies should view digitalization through the lens of how it can solve real user needs. From this standpoint, how can they set themselves apart with a unique technology platform to create customer stickiness? Importantly, the board should assess if digitalization is infused into the core of the business, rather than being an add-on, if the organization were to embrace its digital strategy holistically.

Companies that succeed in doing so clearly stand to benefit. The *Digital Investment Index* found that digital leaders — firms that achieved higher returns from their digital investments — reported stronger revenue growth in the past two years and expected strong growth in the future. The research also found that digital leaders were much more likely to demonstrate clearer digital strategies, invest in the right emerging technology to execute such strategies, and devote funds to accelerate new digital products, services and business models.

> “M&As provide an effective route for acquiring the technology and talent needed to fuel digital transformation, and allow organizations to nimbly capture new opportunities ahead of the competition.

Strategy two: Scaling up through M&As — “buy to get a head start”

Companies can accelerate their digital journey by either building in-house capabilities or acquiring them. The above study found that nearly three-quarters of the executives surveyed were shifting to M&As and partnerships to speed up digital initiatives. Notably, digital leaders were shifting an average of five percentage points of their investment mix from building internally to M&As.

M&As provide an effective route for acquiring the technology and talent needed to fuel digital transformation, and allow organizations to nimbly capture new opportunities ahead of the competition. Having said that, acquisitions bring their own set of challenges, not least the risk of failure in post-merger integration, the difficulty of estimating the value of the firm’s technology and determining the correct price if the acquisition target is a start-up.

The success of digital M&A will depend in no small measure on executive alignment and collaboration. The goals and values of the acquiring company and those of the acquired or partner firms should be coordinated. Equally important is internal alignment — leaders from different functional groups should be on the same page on the company’s digital M&A strategy. The board should assess if the executive team is aligned on the mix of investment vehicles used by the organization. It is important that the collaboration among management teams continues during the stage of owning and directing those investments. The board should look out for and address any organizational silos and assess if the executives are playing to their individual strengths in creating a successful digital investment strategy.

All these pay off when done right. Executives in the above study who reported that partnerships and digital M&As met or exceeded expectations were significantly more likely to say that they were implemented by a combination of C-suite executives.

Strategy three: Leveraging ecosystems — “don’t try to do everything yourself”

Business models are increasingly moving toward platform-based setups that would eventually evolve to become one-stop solution platforms. With this shift, some companies may opt to build their own technology platforms, while others may prefer to forge partnerships and be part of a digital ecosystem. Joining forces can help bolster performance by allowing companies to access new opportunities to deliver products or services, and even create new assets.

Nevertheless, ecosystem partnerships are not without their hurdles. Difficulties in finding the right ecosystem partner, managing customer data privacy issues and overlaps in operations, and determining ownership of the end-user relationship are among some of the key challenges.

The board should ask the management to consider if ecosystem participation has a place in the business strategy, particularly for areas of value that are too challenging or costly to achieve with existing in-house capabilities. Before deciding to build a platform or join an existing one, carrying out a comprehensive due diligence exercise is essential. After the company starts participating in an ecosystem partnership, establishing a recurring review process will allow all parties to generate and receive value from the ecosystem.

In a post-pandemic world, companies that have transformed digitally can expect to increase efficiency, accelerate growth, create new partnerships and revamp their business models to gain a competitive edge. Boards should have a firm grasp of the strategic opportunities that digitalization creates for the company and be able to bring their expertise to bear on overseeing a large-scale digital transformation strategy. Strong board stewardship will help steer the organization toward a future-fit and digitalized business model and capture opportunities for a first-mover advantage.

Boards should consider the following questions:

- Does the organization have a clearly defined digital strategy that spells out its current and projected digital spend, technology requirements and a coherent path to execute its digital transformation?
- Does the company have a robust governance model and KPIs to oversee digital initiatives and measure returns on digital investments, while identifying potential weaknesses in its digital strategy?
- Have the sources of funding for digital investments been identified and does the organization have a long-term divestment plan, if needed?
- Is the executive team aligned on the investment mix of "build, buy, partner or corporate venture" for digital transformation? Has it developed an integrated approach to accelerate the various digital initiatives?
- Is the company making investments to build or tap into a digital ecosystem? BMQ

Vikram Chakravarty
EY Global Strategy Connected Capital Solutions Leader;
EY Asean Strategy and Transactions Leader
vikram.chakravarty@sg.ey.com
linkedin.com/in/vikram-chakravarty

Joongshik Wang
EY-Parthenon Asean Leader;
EY Asean Technology, Media & Entertainment and Telecommunications Sector Market Segment Leader
joongshik.wang@sg.ey.com
linkedin.com/in/joongshik-wang

Shaurya Ahuja
EY-Parthenon Partner, Consumer and Digital
Ernst & Young Solutions LLP
shaurya.ahuja@parthenon.ey.com
linkedin.com/in/shauryaa

How boards can drive more robust climate risk disclosures

Boards can help address gaps in the quality of climate risk disclosures by focusing on three key areas.

By Simon Yeo

Climate risks are moving up the boardroom agenda as companies face increasing pressure to tackle climate change more proactively. Investors are increasingly interested in how organizations plan to contribute to a decarbonized economy and would reconsider or even walk away from investments based on climate risk. Likewise, employees, customers and other stakeholders expect corporate leaders to lead the way in addressing climate change.

With the fast-growing urgency of climate action, businesses must understand their climate risks and opportunities, speed up their implementation of climate strategies and communicate their performance. Amid this shift, companies continue to make progress in both the quality and coverage of their climate-related financial disclosures, according to the June 2021 EY *Global Climate Risk Disclosure Barometer*. The research draws on companies' public disclosures – such as in annual reports, sustainability reports and CDP responses – on the uptake of the Task Force on Climate-related Financial Disclosures (TCFD) recommendations and covers more than 1,100 companies across 42 countries.

But the quality of these disclosures still lags behind coverage of the TCFD recommendations, and Singapore is no exception. An analysis of more than 90 listed and non-listed companies across 11 sectors in Singapore found that while the companies' disclosures covered 45% of the TCFD recommendations on average, the average quality score across the organizations was only 18% of the maximum quality score across the 11 recommendations. These findings suggest that companies in Singapore still find it challenging to come to grips with their exposure to climate risks and act on it.

> With the fast-growing urgency of climate action, businesses must understand their climate risks and opportunities, speed up their implementation of climate strategies and communicate their performance.

Clearly, businesses need to widen their view of both physical and transition climate risks, and the opportunities that may arise from responding to these risks. Board leadership is critical for guiding organizations in decarbonizing their business models and supply chains. There are three ways in which boards can drive more robust climate risk disclosures and position the company to better navigate climate risks and leverage opportunities.

Connect climate reporting more directly with risks and opportunities

The research found that many organizations still lacked reporting on metrics directly connected to risks. While disclosing the company's Scope 1 and 2 emissions (i.e., direct emissions from controlled sources and indirect emissions from purchased electricity respectively) is critical, it is equally important to disclose metrics used to assess its exposure to physical risks. An example is the weighted average carbon intensity metric, which measures exposure to carbon-intensive companies. A more rigorous assessment may be required to develop the climate-related financial disclosures that drive behavioral change. Boards should assess whether sufficient coverage is given to both the risks and opportunities in the company's climate reporting to allow the business to better assess the potential impact on the corporate strategy.

Another common pitfall is that companies may be limiting climate risk assessments to certain parts of the business and only including qualitative analyses. Clearly, there is a need to widen the scope of assessment as physical and transition risks from climate change can have an impact on products and services, supply chains and operations across the organization, materially affecting operating costs and revenues.

Review climate risks and opportunities across the value chain

Companies should look beyond their internal operations when assessing climate risks and opportunities. In fact, the upstream and downstream emissions in most organizations' value chains (Scope 3) are much higher than those from their own operations (Scope 1 and Scope 2). Boards should evaluate if the executive team has reviewed the value chain holistically to identify material climate risks and opportunities, and whether suppliers are actively involved in their decarbonization process.

This won't be a straightforward task as many businesses currently have opaque supply chains. But with increasing stakeholder scrutiny on value chain emissions, particularly in carbon-intensive and consumer-facing industries, the board needs to work with the management to actively pursue decarbonization strategies throughout the company's value chain.

Analyze climate scenarios for robust risk assessment

Scenario analysis is important for companies to understand how future climate risks can potentially impact their business and supply chain activities, and should inform risk assessment, strategy formulation and investment decisions. Yet, only 17.2% of the organizations in Singapore assessed in the study are conducting scenario analysis. This is of concern, given that scenario analysis is perhaps the most critical aspect of the TCFD framework as it helps turn theories into tangible strategies.

Boards should mandate climate-related financial disclosures to be included in mainstream financial filings. Climate risk information should also be included in financial statement estimates and assumptions, including asset impairment models or asset depreciation models. So far, companies have had limited progress on this front.

Companies should also stress test their business models against the different climate scenarios. Depending on the level of climate risk disclosure, boards can then guide their organizations to move toward operating models, revenue streams and markets that are better positioned for a decarbonized economy, and wind down operations with high climate risk exposure.

With growing political will and public opinion pressuring businesses to tackle climate change urgently, a strong uptick in climate-related financial disclosures looks likely. Companies will be expected to assess and fully disclose the physical and financial risks that climate change poses to their assets. They will need to demonstrate a robust strategy that protects value and makes commercial sense in a decarbonized economy. Boards that can guide their organizations to respond nimbly in this way will help the business improve its operational resilience, expand its customer base, and maintain access to institutional capital.

Boards should ask the following questions:

- What are the organization's risks and opportunities as a result of climate change in the short, medium and long term?
- What are the current processes used by the organization to identify, assess and manage climate-related risks and to what extent are these processes integrated into the company's risk management framework?
- What are the top emission reduction levers in the company's value chain and how can the business work with its supply chain partners more closely to involve them in its decarbonization journey?
- What internal governance structures are in place to foster deeper engagement with the senior management on climate-related issues?
- Are the organization's disclosures robust enough to address the needs of stakeholders and provide "decision-useful", forward-looking information? BMQ

Simon Yeo
EY Asean Climate Change and Sustainability Services Leader;
Partner, Assurance
Ernst & Young LLP
simon.yeo@sg.ey.com

Three ways boards can respond to rising tax risks

Even as tax may sit firmly on company agendas, more proactive management of tax controversy is needed.

By Luis Coronado

Organizations are facing an increased risk of tax controversy as a result of the staggering pace of legislative and regulatory changes in the global tax environment. According to the *2021 EY Tax Risk and Controversy Survey*, 53% of tax leaders expect greater enforcement in the next three years, particularly as governments begin to address budgetary pressures stemming from the COVID-19 pandemic responses. If not managed properly, tax controversy can cause severe disruption to an organization, including financial exposure, brand and reputational risk, and possibly even criminal sanctions against those with ultimate responsibility for corporate decision-making.

This uncertain environment has prompted boards and business leaders to assess whether their organization is managing evolving tax risks and controversies in an effective manner. In fact, two-thirds of respondents in the abovementioned survey said that C-suite executives, particularly those leading cross-border businesses across various jurisdictions, have become more involved in managing their organization's tax profile in the last three years. Yet, despite the greater C-suite interest, many organizations are still unprepared to respond to higher tax enforcement. Only 24% of respondents have full global visibility of all their tax audits, disputes and litigation, while just 35% have a proactive strategy to secure advance pricing agreements — a common dispute prevention tool to help mitigate transfer pricing risks.

For post-pandemic recovery, risk management must be a top priority for boards as they seek to build the organization's resilience against increasingly severe business disruptions. Tax risks constitute a critical area that needs close attention. The board has a crucial role in overseeing how the company is monitoring and managing current and emerging tax risks as well as mandating the management to continually refresh its tax risk and controversy management strategy — effectively building their "tax controversy department of the future".

To address tax risks more robustly and methodically, boards should focus on three areas: assessing potential tax risks; managing such risks if and when they arise; and managing tax audits, disputes and litigation when they occur.

Assessing tax risks

Many organizations tend to focus on managing tax disputes, but overlook the opportunity to reduce the likelihood of tax risks turning into tax disputes earlier in the life cycle. There are merits to adopting a dispute prevention approach and actively managing risks. The aim is to do everything possible to stop tax controversy before it occurs. Being proactive is key and this starts with assessing the company's full range of tax risks — globally and in real time. This also helps companies decide how to deploy their resources in resolving these risks by considering the potential financial and reputational impact should they materialize.

The top sources of tax risks cited by the survey respondents include transfer pricing, challenges related to the tax impact of the COVID-19 pandemic, issues associated with the Organisation for Economic Co-operation and Development's Base Erosion and Profit Shifting project and interpretations of tax issues that differ dramatically from international standards. Consequently, the volume of cross-border tax controversies is expected to increase by a larger extent and at a faster pace. High-profile tax disputes also pose reputational risks to organizations.

A robust tax risk assessment framework is key to effective tax risk management and delivered via top-down governance, systems and processes that enhance monitoring, compliance and dispute prevention efforts. This should be a continual process and the board should encourage the management to establish tax risk management frameworks that are updated periodically to reflect the changing tax environment. Integral to an effective tax risk assessment framework is the use of tax technology. This could include globally accessible platforms that allow tax and finance personnel anywhere to log their touchpoints with tax authorities or a comprehensive system that prioritizes the disputes to be closed and allows efficient and effective communication with tax authorities.

Boards leading the way in this area are not only showing more interest in tax issues and oversight of them, but also demanding more significant, regular updates on tax developments. They also require the management to keep the tax department fully apprised of all business decisions — something that only 4 in 10 respondents confirm occurred.

“

Many organizations tend to focus on managing tax disputes, but overlook the opportunity to reduce the likelihood of tax risks turning into tax disputes earlier in the life cycle.

Managing tax risks

The board should also assess whether the organization is managing its tax risks in an effective and consistent manner. A primary tool in this regard is the tax control framework, a major part of any company's internal controls to assure the accuracy and completeness of tax returns and disclosures. Such approaches are currently used by 50% of respondents, while an increasing number of countries are now requiring companies to both document their frameworks and demonstrate that they work.

Another area for consideration is whether the business executes a comprehensive strategy to utilize various dispute prevention and resolution tools and certainty programs made available by tax administrations. While many such programs may require up-front investment, the benefits of greater tax certainty — including the potential release of financial reserves, the ability to focus on more value-adding activity, and the reduction of reputational risks — are often tangible.

Robust tax documentation is becoming more important than ever in managing tax risks. Against a backdrop of more forensic, granular and whole-of-value-chain tax audits, leading practices include proactively building and maintaining substance as well as business activities-based tax documentation that include background documents, opinions, functional interview notes, meeting and call minutes, and emails. Technology can support these documentation activities in no small measure, and boards should be asking whether there is scope to expand the use of technology beyond its current deployment level.

Managing tax audits, disputes and litigation

When tax disputes occur, the aim is to secure a quick and effective resolution. Companies that manage tax disputes effectively tend to take a consistent approach in handling the various steps of a tax audit, dispute or litigation, efficiently managing tax authority enquiries and clearly assigning who will be responsible for, consulted on and informed about a wide range of individual steps, including audit preparation, information provision, position formulation, dispute negotiation, dispute settlement and post-dispute tasks.

The board may want the management to develop clear protocols to determine the appropriate dispute resolution strategies for different circumstances. For instance, when should the organization employ a litigation-focused strategy, rather than use alternative dispute resolution options, such as arbitration or mutual agreement procedures? Given that the reputational implications, outcomes, costs and timelines may differ depending on the route taken, having a considered approach would allow different stakeholders to better anticipate the financial implications.

Looking ahead, the global tax controversy environment is likely to see an upward trend in more varied and complex disputes. Companies will increasingly need to manage disputes in multiple jurisdictions concurrently. Those with a clearly defined global tax controversy strategy will be well-placed to navigate this disruption and boards are critical in setting the tone for developing and implementing a robust and agile strategy.

Boards should consider the following questions:

- Does the company monitor ongoing tax policy and administrative developments and have an action plan to address them? To what extent is the board apprised of these developments?
- Is the board confident that the company's tax risk management approach is commensurate with the overall tax risk appetite for the organization? Is the board aware of where the company's current disputes are occurring and what the potential financial exposure of each might be?
- What is the company's current level of investment in technology tools to assess and manage tax risks and deal with tax audits, disputes and litigation? What further investments are needed to enhance the technological capabilities to manage tax risks in an effective way?
- What is the company's current approach to tax risk management and dispute resolution? Is the approach proactive and preventive, or a reactive one focusing on resolution?
- Has the company developed a tax risk management framework and how does it deploy its controls to monitor this framework? Does the company proactively utilize all relevant dispute prevention and resolution programs to mitigate its tax risks? BMQ

Luis Coronado
EY Global Tax Controversy Leader
luis.coronado@sg.ey.com
linkedin.com/in/luis-coronado-ey

Why boards must focus on legal transformation now

Boards must help legal departments transform quickly to effectively address fast-evolving risks and support recovery from the pandemic.

By Rishi Ballakhan

As companies prepare for post-pandemic recovery, corporate leaders will focus on enabling growth and transforming risk management. Legal departments will be expected to deliver on these priorities and align with the corporate strategy. Maximizing the legal function's value to the organization will therefore be critical.

Yet, are legal departments ready to think and act differently to support the wider business? Heightened risks, rising workloads and low morale from voluminous low-value work are among factors holding legal functions back from being a strategic partner to the business, according to the *2021 EY Law Survey*. The study, conducted in collaboration with the Harvard Law School Center on the Legal Profession, found that workloads are expected to rise by 21% for legal departments in Singapore over the next three years, while headcounts are expected to rise by just 3%, as budgets continue to face increased scrutiny.

The board and management need to put legal transformation on their agenda for the legal function to manage fast-evolving regulatory, cyber and operational risks in an agile manner. If legal departments fail to transform, or don't pivot fast enough, there will be significant implications for the organization's risk management, growth and operational efficiency.

Hindrances to risk management and business partnering abilities

Risk management is the area that CEOs expect to implement the most changes over the next three years.[1] Yet, the aforementioned law survey found that a large proportion of general counsels lack confidence in their department's ability to identify, measure and handle the risks faced by their organization. More than half of the organizations report a lack of access to accurate and up-to-date information on their legal entities. This lack of transparency reduces the legal department's visibility of the tax and corporate governance risks that its organization may be facing. Almost two-thirds say they do not have all the data and technology needed to respond to a data breach, highlighting exposure to cybersecurity, compliance and data privacy risks.

Furthermore, 92% of Singapore respondents in the law survey say they do not systematically track contractual obligations. Standardization in the contract creation process and monitoring of contracts for deviations from standard terms are also not the norm. Such process management gaps and the underuse of technology may limit the organization's risk oversight and potentially create a wide range of risks that permeate corporate supply chains and client relationships.

As the prolonged effects of the pandemic continue to impact the global economy, a strong focus on enabling growth and eliminating any inefficiencies and barriers that may hinder revenue recognition or business opportunities is imperative. The law survey suggests there are opportunities for improvement in this area – an overwhelming 99% of business

1 "CEO Imperative Study," EY website, www.ey.com/en_sg/ceo-imperative-study, accessed 24 September 2021.

> If legal departments fail to transform, or don't pivot fast enough, there will be significant implications for the organization's risk management, growth and operational efficiency.

development leaders in Singapore note that inefficiencies in the contracting process have slowed revenue recognition, and a third report that these inefficiencies have actually resulted in lost business opportunities.

To support revenue growth, legal departments need to be aligned with their business partners. However, only 58% of general counsels in the law survey report that their department's day-to-day work is aligned with the broader business strategy and 35% say their department is effective in adding value to the business. These findings, combined with those suggesting increasing workloads and time spent on routine tasks, reveal that many legal departments lack the bandwidth to support their business partners strategically because of day-to-day responsibilities.

These shortfalls in data, risk management and business partnering capabilities may result in a lack of requisite information for the board to effectively fulfill its risk oversight and governance responsibilities over strategic business decisions.

Need for technology and the right sourcing mix

Greater use of technologies, such as machine learning, artificial intelligence and automation, can help improve productivity and accuracy for legal departments, saving considerable time and cost. However, the law survey found that only half of legal departments have increased technology use over the past 12 months. While many reasons, including a lack of access and capabilities, account for why legal departments struggle to implement new technologies, one stands out. Ninety-seven percent of general counsels say the inability to get buy-in from the C-suite has made it challenging to secure budgets for investments in legal technology.

Besides technology, organizations can also benefit from analyzing, refining and optimizing processes. Yet, the law survey suggests organizations are struggling – 88% of legal departments in Singapore struggle with the adoption of new processes and only 25% say they have the data needed to optimize the department.

Finding the right sourcing mix of external counsels, insourcing, technology and co-sourcing is important. As legal departments encounter challenges with traditional delivery methods, such as managing external counsels and insourcing, many are looking to new solutions. Notably, there is a growing appetite for co-sourcing strategies using alternative legal service providers. Eighty-five percent of general counsels in the law survey say their department uses such services – up from 54% of respondents in 2019.

Legal departments that use legal managed services report being significantly more confident in managing complex risks, according to an EY report in 2020, *Realizing the benefits of legal managed services*. Their in-house counsels are able to focus on higher-value work as selected high-volume work is moved to legal managed services providers. This in turn improves morale and appears to help in recruiting and retaining talent.

Those that leverage alternative legal service providers enjoy extensive use of process management and technology, which, among other benefits, allows risks to be managed more granularly. They also gain greater access to data and transparency over processes, which enables them to identify and manage risks in new ways. Unsurprisingly, the aforementioned legal managed services report noted that legal departments already using alternative legal service providers are seeking to expand their use.

In the post-pandemic business environment, legal departments that boldly transform risk management, leverage technology and revise sourcing strategies will stand out for aligning with the overall business strategy and helping their organization grow. At the same time, boards must understand the challenges faced by their legal departments and provide them with the support to transform and operate efficiently.

Boards should consider the following questions:

- In what ways may the legal function be perceived as a bottleneck for the company's revenue growth? How can it support business growth more robustly?
- What higher-value activities can the legal function own versus high-volume ones that can be co-sourced or automated?
- Is the legal function providing robust reporting and insights on risks faced by the organization?
- Are lawyers embedded into the leadership team at the business unit or operating company level?
- Are there ongoing digital transformation initiatives within the organization that can benefit or integrate the needs of the legal function? BMQ

Rishi Ballakhan
EY Asean Legal Operations Leader
rishi.ballakhan1@sg.ey.com
linkedin.com/in/rishi-ballakhan

What boards must watch for in corporate investigations

Boards must be able to navigate complex corporate investigations as part of a robust crisis management framework when adverse events occur.

By Ramesh Moosa

The board's ability to manage crises has become more critical than ever during this time of COVID-19 disruption. According to the *EY Global Integrity Report 2020*, 90% of respondents believe that the pandemic poses a risk to ethical business conduct at their organization. Similarly, a recent survey by the Association of Certified Fraud Examiners found that as of August 2020, 77% of respondents had seen an increase in fraud cases since the start of the pandemic and they expect this trend to continue.[1]

While it is imperative that a strong integrity culture is established within the organization to reduce the likelihood of adverse events, crises may still occur despite best efforts. Boards should see that a sound crisis management framework is in place to guide themselves and the organization in handling significant incidents, with the aim of minimizing impact and securing stakeholders' trust.

Overseeing a corporate investigation – such as a short-seller attack, a whistle-blower complaint that calls into question the integrity of senior leaders or a sophisticated cyber attack – is often complex and time-consuming. Failure in oversight can carry personal risks for directors. Board members are personally liable for failure to exercise reasonable diligence in the discharge of their duties as company directors. The board should therefore understand the key steps involved in the investigative process, including the common pitfalls at each stage.

1 "The Second Edition of the COVID-19 Benchmarking Report Is Here," ACFE Insights website, www.acfeinsights.com/acfe-insights/the-second-edition-of-the-covid-19-benchmarking-report-is-here, accessed 30 September 2021.

Triggering crisis management

At the onset of the incident, a dedicated crisis management team comprising cross-functional business unit leaders that reports to the board should be assembled. A preliminary assessment should be conducted on the allegations or issues to determine the response strategy, including the use of appropriate incident response playbooks that the management team prepared. At this point, the board should also identify key intervention actions, which may include the suspension of senior executives named in the allegations as well as mitigation and contingency plans.

Robust communication strategies, both internal and external, are key to protecting confidential and sensitive information. Legal professional privilege protocols may be adopted to protect attorney and client privilege over confidential information, such as situation analyses, mitigation plans and strategies.

Conducting the investigation

To convene an investigation, the board must clearly establish the objective, scope, investigative actions and timelines. Where the allegations are directed at the senior management's integrity over matters like financial reporting irregularities or other fraud-related matters, such personnel must not be in the chain of command in the investigation.

The board must also assess the need to engage external forensic investigators and legal counsels to conduct the investigation independently without undue influence. For serious allegations, it is worthwhile

“

Acting swiftly to identify and remediate risks and control weaknesses, as opposed to waiting for the investigations to complete, will go a long way in restoring the confidence of regulators and other stakeholders.

engaging independent forensic investigators who report directly to a committee comprising independent non-executive directors. Engaging external counsels may also be useful, particularly for matters involving multiple jurisdictions.

Once the board has convened the investigation, steps must be taken quickly to preserve all potentially relevant documents. A document preservation notice must be issued to all relevant employees to preserve both electronic and paper records. Equally important is preventing the overwriting and deletion of electronic data that occur as part of business-as-usual activities, such as system audit logs, recycling of data backups or purging of emails as part of regular housekeeping when mail size quotas are exceeded. Failure to preserve documentary evidence could impede a thorough investigation and seriously compromise the company’s legal position with regulators or in any ensuing litigation.

The board must also decide how and when to disclose the investigation findings to stakeholders, statutory auditors, regulators and other impacted third parties. Although there are no hard-and-fast rules governing the timing for reporting the preliminary or final findings of an investigation, the board must consider the potential impact of the disclosures on the company’s financial statements as well as criminal and civil liabilities that may arise from the investigation results. Communications regarding the investigation must therefore be conducted on a careful and “need to know” basis.

Taking decisive mitigation and remediation actions

Companies need not wait until the investigation is completed before taking decisive mitigation or remediation actions. When an incident happens, regulators will often question whether other risks may be present in the organization or whether similar issues may occur in other territories where the organization operates.

Regulators are increasingly sharing information with their counterparts in other jurisdictions. An example is the payment of bribes to government officials. Many anti-bribery and corruption regulations are extraterritorial, including Singapore’s Prevention of Corruption Act, the Malaysian Anti-Corruption Commission Act, the US Foreign Corrupt Practices Act and the UK Bribery Act. An incident impacting an organization in one territory can quickly escalate and impact its operations in other key markets.

The board should conduct risk and controls assessments as soon as practicable and in parallel with the investigation, but without impeding it. Acting swiftly to identify and remediate risks and control weaknesses, as opposed to waiting for the investigations to complete, will go a long way in restoring the confidence of regulators and other stakeholders.

Importantly, as part of remediation measures, companies need to establish an effective fraud risk management framework to strengthen proactive fraud prevention, detection and monitoring controls. Having a whistle-blowing hotline may not be sufficient – the program needs to be tested for effectiveness. The adoption of fraud detection systems, case management and workflow solutions to enable the compliance function to anticipate and detect risks more effectively is also crucial. This will provide greater assurance to regulators and other key stakeholders that adequate measures are implemented to prevent similar issues from reoccurring.

By staying vigilant and proactively directing the management to establish a crisis management framework, the board will enhance its effectiveness in overseeing adverse events and safeguarding stakeholders' trust. The board should consider the following questions:

- What are the crisis management plans or playbooks in place to help the board and management deal with adverse events?
- How will the board directors discharge their fiduciary duties in the conduct of a complex corporate investigation where the ethics and integrity of the senior management have been called into question?
- Does the board have the ability to quickly draw upon the experience of independent forensic and legal experts at its disposal to avoid common pitfalls, address issues swiftly and secure stakeholders' trust?
- Has the board implemented effective monitoring of financial transactions using technology and data to identify and investigate fraud indicators?
- How often is the fraud risk management program, including the whistle-blowing program, tested to confirm that it is effective?
- Is the board able to justify that the management has established adequate controls and procedures to prevent and detect fraud? BMQ

Ramesh Moosa
EY Asean and Singapore Forensic & Integrity Services Leader
ramesh.moosa@sg.ey.com
linkedin.com/in/rameshmoosa

APAC no. 12002671
ED None.