Shaping Malta's Future 2021

Enabling a culture shift: Covid, FATF and an alternative outlook to GDP and beyond

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workplace
culture

Enabling a culture shift: Covid, FATF and an alternative outlook to GDP and beyond

The Gross Domestic Product Index has been the main measurement of a nation's wealth measurement since its internationalisation at the Bretton Woods conference in 1944. Despite its widespread usage for both intercountry comparison and year-to-year progress measurement, the GDP has limitations. Whilst keeping track of the value of a country's annual production and consumption in money terms adjusted for inflation, it foregoes other important factors that are significant towards peoples' wellbeing, also referred to as the people's welfare. Firstly, GDP disregards the distribution of a country's production. GDP per capita indicates the average income per person, but the reality is not so idealistic. Indeed, gradually increasing inequality has been observed globally, since the 1980s.

Furthermore, GDP is infamously known for including the consumption spent on calamities. In fact, should a country spend money to restore the damages that would have been caused by a natural disaster, like for instance a tsunami , such spending would be considered as a contribution towards the nation's wealth. GDP also ignores key factors, including environmental degradation and sustainability. Moreover, it omits any kind of measurement relating to the health of its citizens. Never has this been so significant until the recent health crisis brought about by the Covid-19 pandemic, where even the richest nations (in terms of GDP) faced hardship in order to protect their economy and its people.

Covid-19

The chaotic nature of the pandemic eroded the productivity capabilities of many regions globally. Whilst respecting the health protocols put in place, offices have been vacated and production caps sacrificed. Luckily, an alternative was found through which the shortfall was cushioned. Remote working has undoubtedly dampened the calamity that would have ensued. Malta became one of the leading forces in the adoption of this trend where 15% of the total working population opted to make use of teleworking compared to the EU-27 average of 12%. This is an impressive outcome given the fact that pre-pandemic, Malta had just 10% of workers working from home.

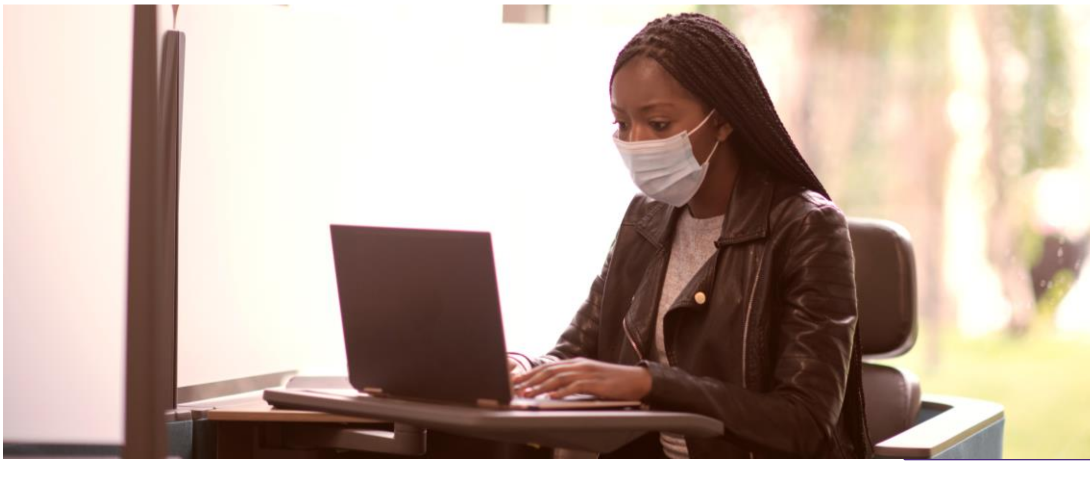
Unfortunately, this would not be a procedure without negative consequences. Humans are social beings, so it is no surprise that as much as 80% of participants in an EU wide survey agreed to having experienced socialising issues whilst teleworking during the local lockdowns. Furthermore, 62% experienced ergonomic deficiencies. Once again, due to the haste to switch from physical to remote work, it is easy to see how many individuals did not have the same equipment available in the office for a comfortable work shift. Going forward, the flexibility of remote work and the need for socialising satisfied by physical interactions point to the need for a balance between the two. The assurance of a proper work-life balance is a desirable outcome in Bhutan's Gross National Happiness (GNH) measure of its own nation's wealth. In fact, one of the 9 domains which are used to measure such GNH is the time used for a work-life balance. Furthermore, the OECD's Better Life Index (BLI) also includes 'work-life balance' as one of its parameters.

Turmoil was also inflicted on the capital markets as uncertainty consumed the world's economy. In many industries, therefore, investment fell. One notable exception was the ever-growing Distributed Ledger Technology (DLT) which attracted global investment of €5.63 billion as of April 2021. This trend is not incongruous to Malta with Commercial Bank Blockchains & peer-to-peer applications taking place.

The pandemic has caused various disruptions in the functions of companies, including the way in which companies analyse and assess internal controls. Companies had to increase their risk assessments, whilst auditors might have had difficulties in testing and getting assessments due to various challenges that such organisations faced during the pandemic, including the increase in fraud risk and physical difficulties such as not being able to be present in physical walkthrough, due to Covid-19 restrictions.

Many factors have contributed to this increase in fraud risk. The pressure caused by the pandemic led management to reduce the level of oversight required from their end. Because of this, anti-fraud measures and rules might have been overridden or even downgraded. Given that many employees were working remotely during the pandemic, the controls which protect the assets of organisations, were more subject to vulnerability to both internal as well as external fraudsters.

Furthermore, remote working also increased the risk of confidentiality leaks and the risk of social engineering, which is a method used by fraudsters to acquire organisations' sensitive data or even attempt to wire money. During this pandemic, many organisations had to purchase devices, tools, and software to equip their employees with the necessary products to work safely from home. However, given the situation, such purchases were often made under pressure and, thus organisations were more susceptible to fraudulent risks especially related to the purchase of software.



Grey listing

Although the pressures caused by the Covid-19 pandemic might incentivise management and employees to commit fraudulent activities, this was not representative in the local scene as Malta showed a decrease in fraud related cases between 2019 and 2020. In fact, as evidenced in the 2019 and 2020 FIAU reports, the total fraud related cases in 2020 amounted to 29% of all suspected predicate offences, a fall of 10 percentage points from the previous year. Notwithstanding this, fraud remained one of the most prominent suspected predicate offences up until 2020.

Additionally, internal control weaknesses might also contribute to the increase in fraud risk. As evidenced in the 2020 'Report to the Nations', a global study on occupational fraud and abuse, the most prevalent internal control weakness was eventually the lack of it, attributable to 32% of all the different types of occupational fraud and abuses.

It also stemmed from the report that organisations lose 5% of their revenue due to fraud each year. In fact, the cost of crime can be quantified by using the Genuine Progress Indicator (GPI) which is an indicator created as an alternative to GDP. Ozone depletion and lost leisure time are also factors considered in this indicator, though it has only been adopted by some U.S. states.

Taking the aforementioned factors into account, for organisations to be able to curtail occupational fraud and mitigate their risks, it is of utmost importance to implement the required anti-fraud controls. According to the 'Report to the Nations', the most common anti-fraud control adopted by almost 90% of organisations participating in the study in 2020, was the external audit of financial statements. This was followed by other anti-fraud controls, such as applying a code of conduct, management reviews and creating an internal audit department

For organisations to detect and mitigate possible errors, fraud or misstatements, effective internal controls are required. The segregation of duties at a workplace is an effective preventive control against both fraud and abuse. The whole operation of an organisation business must be split into smaller tasks and performed by different employees. By implementing this, organisations would ensure that those employees who have access to assets, do not also have access to their records.

Furthermore, an organisation should ensure the upkeep of both physical and IT controls which would minimize the chances of confidentiality breaches and cooking the books; such as the withholding of data in secure locations whilst limiting employees' data access.

Moreover, organisations should also provide their employees with the necessary tailor-made training so that they would be in a better position to be able to detect possible fraud, abuse and errors that might hinder the reputation and profitability of the organisation. The internal audit team should report to an independent director, who is external to the company and should have the required and appropriate resources ready and available for implementation. The independence and objectivity of internal auditors is important to create trust in the process and ensure effective whistleblowing, which is an essential feature for good corporate governance since it reveals organisations' vulnerabilities such as fraud, corruption, bribery, and negligence.

Corporate Governance

Furthermore, internal control measures not only reduce the risk of fraud but also assist organisations in maintaining steady corporate governance. Nevertheless, governance issues, namely fraud and corruption, continue to persist in most industries.

Subsequently, companies can integrate DLT into their operations to enhance transparency with stakeholders by providing them with real-time information. Hence, any act of fraud or corruption within the organisation is more likely to be apprehended. Additionally, the present bureaucratic means by which shareholders vote requires too much effort to be efficiently exercised by all eligible voters, resulting in these individuals either relinquishing their power to others or not voting at all. However, DLT could also aid shareholder voting by allocating digital identities to shareholders which allows them to participate on a remote basis. In such way, the organisation would be facilitating the entire process whilst assuring that there is a fair shareholder representation within its decision making.

As mentioned above, remote working was the ideal solution that prevented the pandemic from causing total disruption. However, teleworking also gave rise to some governance issues, due to the technological shift that it requires. In fact, the latest 'Flash Eurobarometer' survey on SMEs, which was published in 2020, showed that 62% of EU SMEs respondents face barriers to digitalisation. Specifically, 20% of the surveyed companies stated that they find 'lack of skills' and 'IT security issues', as some of the barriers to making a sustainable teleworking system. Furthermore, uncertainty about future digital standards, as well as lack of financial resources, were other barriers which were highlighted by 24% and 23% of the surveyed companies, respectively. Moreover, 70% of the respondents stated that they face at least one obstacle which prevents their enterprise from becoming sustainable.

Nevertheless, such problems could be mitigated through adequate employee training, recruiting employees who are competent in IT and the provision of the required support to companies, specifically SMEs, to make them more sustainable.

In fact, the EU implemented several digital governance strategies to help drive business sustainability. Moreover, the World Economic Forum also launched the EDISON Alliance, to help cultivate partnerships between the government and the private industry, in order to enhance rapid digital development, which was a crucial factor to allow the shift of several employees, to start working remotely during the pandemic.

At a broader level, a pertinent issue in the realm of corporate governance has been the lack of harmonization of both the definition and measurement of sustainability. Three related but distinct regulations, set out by the Malta Financial Services Authority (MFSA) are in the process of implementation and these may prove to be pivotal in achieving greater synchronization and transparency across organisations. The Taxonomy Regulation indicates which type of activities fall in the sustainable category and it also highlights what it means to not do any significant harm. Then there is the Disclosure Regulation, which aims to prevent the problem of 'greenwashing'. That is, when firms exaggerate their environmental commitments and would provide a false impression of their products or services, to be environmentally sound. However, since it is now easier to compare firms' commitments, where for instance, financial-market participants (FMPs) must publish information about their policies on the integration of sustainability risks on their websites, the problem of 'greenwashing' will be greatly monitored. Lastly, the third regulation is the Benchmark Regulation, which aims to reinforce the rules of benchmark creation and use.

Firms are increasingly compelling their own efforts to be more sustainably led, reflected in the fact that the number of firms not reporting on sustainable activities has been decreasing with just 50 firms of the S&P 500 not reporting as of 2019. Be that as it may, enterprises have also cracked down on their supply chains since most of a company's environmental impact stems from them.

Conclusion

Considering all the above, one ends up back to the inadequacy of GDP to serve as a comprehensive indicator of a country's wealth and wellbeing. The GNH, BLI, and GNI have already been encountered as possible alternatives to the GDP standard, with several more having been created and proposed. For instance, the Human Development Index (HDI), which is a part of the United Nations Programme, focuses on opportunity and capability. Human development holds a long and healthy life, being knowledgeable, and having a decent standard of living as key dimensions.

The Thriving Places Index (TPI) is appropriate to assess the performance of local communities with prioritization given to sustainability, equality, and local conditions. As of yet, it has only been operated within the UK and its main criticism is related to the inclusion of subjective input. This arises because the TPI is not only based on quantitative data but also on subjective wellbeing measures, specifically life satisfaction questions. Thus, many question the reliability of this methodology since one's opinion could change in a short time due to mood, for instance. Another indicator which has, as yet, not spread in popularity, is the Green GDP. This modified GDP monetizes environmental damage and has only been applied by the Chinese government for a very small period.

A final, curious substitute for GDP is the Happy Planet Index (HPI) which bases its score on four factors, namely: wellbeing, life expectancy, inequality of outcomes, and ecological footprint. The fact of the matter is that the presence of a ludicrously high ecological footprint often results in western nations, which rank amongst the best using GDP, scoring and ranking poorly. This is because of the environmental costs of how such countries' economy is run. Furthermore, the rates of depression within such Western countries is on the rise amongst all age groups. So are the trends of drug abuse, suicidal behaviour, and crime, amongst the younger generation. The top spots of such index are then occupied by Latin American and Asia Pacific countries, with the number one rank awarded to Costa Rica, as of 2016.

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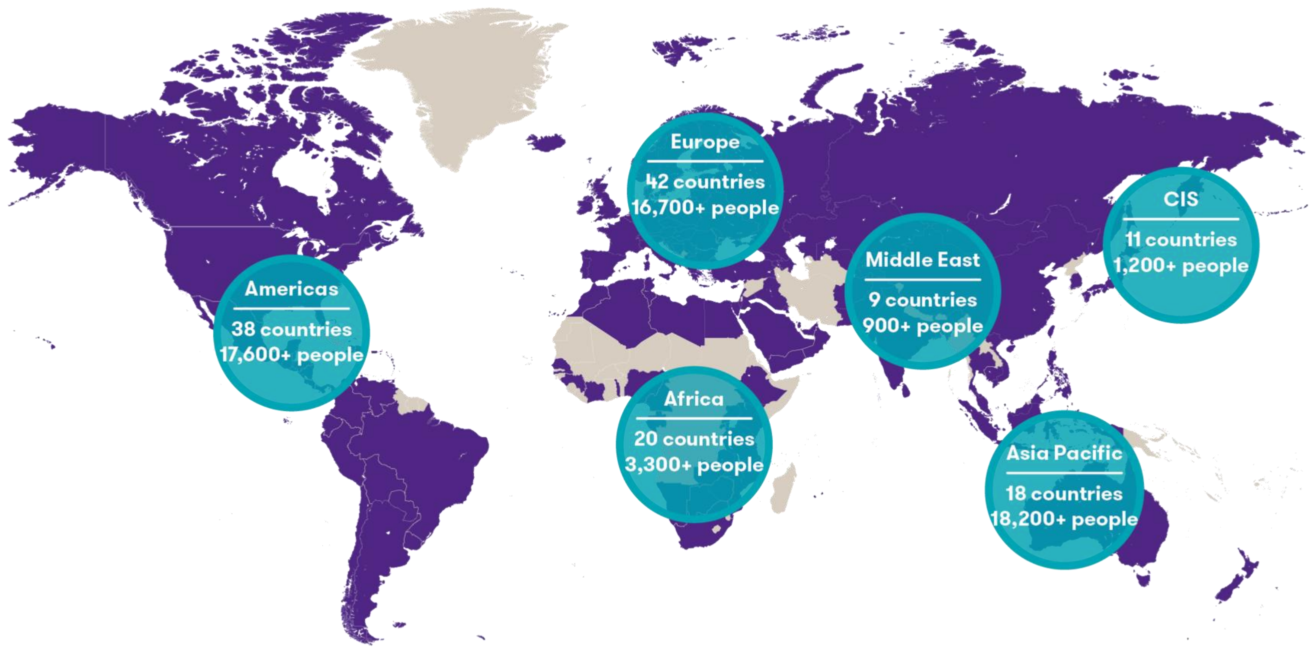

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- statistics and data analytics
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- tool kit using research techniques

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- human resource consultancy

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