

Bribery and corruption: ground reality in India

A survey by Fraud Investigation
& Dispute Services



EY

Building a better
working world





Bribery and corruption: ground reality in India



About the survey

This survey was conducted from March to May 2013 via an online questionnaire, which was hosted on Ernst & Young LLP's website in India. We received over 200 responses from senior executives in various business functions. The principal respondents belonged to business functions such as Internal Audit & Finance, Legal & Compliance, and Vigilance & Risk Management.

Our respondents represented a mix of Indian enterprises with domestic operations, as well as Indian and foreign multinationals in the US and the UK, whose annual incomes range from INR50 billion to INR100 billion. They operate in an extensive range of industries. The majority of our respondents were from banking and financial service institutions, and the technology, media and entertainment, and manufacturing sectors.

In order to gauge investors' perspective on the flow of investments to India, we interviewed respondents from 15 Private Equity (PE) firms through an online medium.

The survey has been supported by a secondary research conducted by our team on bribery and corruption cases reported in media from October 2011 to September 2012. The impact of some large scams, including 2G, Commonwealth Games and mining, was however outside its purview.

Note:

- ▶ Some percentages in the charts total more than 100%, since executives were allowed to make multiple selections.
- ▶ Not all the questions of the survey were answered by all respondents. Hence, all the percentage figures are derived from the total number of respondents who answered the particular question and not on the total number of overall respondents.

Some of the specific findings of our survey include:

- ▶ **Seeking fair practices:** Around 83% of the respondents felt that cases of bribery and corruption can negatively impact FDI inflows.
- ▶ **Sectors most vulnerable to corruption:** These include infrastructure & real estate, metals & mining, aerospace & defense, and power & utilities sectors.
- ▶ **Strain on ethical behavior:** Alarming, a large number of respondents appeared to be comfortable with (or were aware of) unethical business conduct, including irregular accounting to hide bribery and corruption, gifts being given to given to seek favours and third parties being used to pay bribes.
- ▶ **Taking the easy way out:** More than half of the respondents agreed that it is the lack of will to obtain licenses and approvals the "right way," which leads to bribery and corruption.
- ▶ **Need for greater enforcement of laws:** Around 89% of the respondents felt that there should be greater enforcement of laws to curb the proliferation of bribery and corruption.

We take this opportunity to express our gratitude to the people and organizations who took time to respond to our survey. The report and the findings would not have the same value without the support of these respondents and all those who made the survey successful.



Arpinder Singh
Partner and National Leader
Fraud Investigation and Dispute Services
Ernst and Young LLP



Foreword

Governance is the key to attaining global competitiveness and rapid inclusive growth. Given the state of India's economic development, good governance is absolutely critical to give us a competitive edge and sustain growth. Therefore, it is becoming increasingly evident that it is impossible to separate good governance and sustainable development.

Empirical evidence suggests that high levels of corruption are associated with lower levels of investment. Corruption invariably increases transaction costs and uncertainty in an economy while lowering efficiency by forcing entrepreneurs to divert their scarce time and money to bribery rather than production. It inhibits the development of a healthy marketplace and distorts economic and social development by distorting the rule of law and weakening the institutional foundation on which economic growth depends. Corruption is a double jeopardy for the poor, who are hardest hit by economic decline, are most reliant on the provision of public services, and are least capable of paying the extra costs associated with bribery, fraud, and the misappropriation of economic privileges.

Today, India is one of the most sought after investment destinations. Several reports place India among the top three countries globally in terms of an attractive investment destination ranked by global corporations. While several positive factors like a large and growing domestic market, favourable demographic profile and availability of a large pool of skilled manpower have brought global investors to India, in terms of 'ease of doing business' India still has a long way to go. For the year 2012, the World Bank's Doing Business Report placed India at a rank of 134 out of 183 countries that were ranked by it in terms of ease of doing business.

Clearly, to stay ahead in this competitive world, we need to improve our governance systems. Good governance in states such as Bihar, Chattisgarh, Madhya Pradesh and Uttar Pradesh is showing up in the improved growth rates.

Our government indeed, at both levels, Centre and State, in a bid to introduce governance reforms has taken various positive steps in the recent past, such as implementation of various e-governance projects; the Right to Information Act 2005, initiation of electoral funding reforms; setting up of a second Administrative Reforms Commission, 'gram nyayalayas' and performance monitoring and evaluation system (PMES) for central ministries and departments. Despite the positive steps that have been taken to bridge the gaps in governance infrastructure of the country, there exist deficiencies that continue to plague India's development.

In the year 2012, India ranked 94 out of 176 countries in the Corruption Perception Index of Transparency International. Other recent surveys also reveal that globally corruption has worsened in the last two years. Furthermore, if corruption is not contained, it will grow exponentially and we need to arrest this inimical growth which is tearing into the social fabric of our economy.

I am happy to share that FICCI in its endeavour to promote good governance has initiated a high powered Council - Inclusive Governance Council (IGC) that will act as an umbrella body to address issues of governance within the cross section of industry through our objectives of promoting integrity, Creating Shared Value, strengthening the regulatory mechanism in India and familiarising and raising awareness on laws such as the U.S. Foreign Corrupt Practices Act, UK Bribery Act and their possible implication on Indian businesses.

We are pleased to present this joint Report which identifies and analyses ground realities while also providing fresh perspectives of combating and wrestling the endemic menace of corruption in India. The results of the Survey indicate that it is extremely important that anti bribery and anti corruption be on the agenda of senior executives and a comprehensive bribery and corruption risk assessment is done before undertaking any project. On the other hand, Government must also ensure proper and impartial implementation of various anti-social regulations to take strong, deterrent, and timely legal action against the offenders. Such steps are needed to curb the menace of bribery and corruption and an atmosphere has to be created where the good come forward to serve the country with pride and honesty for the welfare of the people of India.

We hope that FICCI EY Study on Bribery and Corruption: Ground reality in India will provide useful insights to all stakeholders.



Dr Alwyn Didar Singh
Secretary General
FICCI



Message

Corruption in the country continues to loom large and tears into the fabric of governance. There is corruption in all spheres and common people get adversely affected in their day to day existence.

Corruption is growing by leaps and bounds in India. As the nation grows, the corrupt also grows to invent new methods of cheating the government and public.

More and more people, all over the world, are demanding greater transparency and accountability from public representatives. In May 2011, India ratified United Nations Convention Against Corruption (UNCAC), an instrument which legally binds all the state parties, to take appropriate punitive and preventive measures to address the problem of corruption.

As on date, there is no exclusive legislation to check corruption in the private sector in India. Existing legislative tools in India such as Prevention of Corruption Act 1988 does not expressly seek to punish corrupt acts of private parties, except to a limited extent through Sections 8 and 9 (dealing with persons accepting gratification to use their influence on a public servant in the conduct of an official act) and Section 12 (dealing with abetment, pursuant to which a person offering a bribe could be punished).

However, the sdraft Indian Penal Code (Amendments) Bill 2011 encompasses graft by an individual, firm, society, trust, association of individuals, company whether incorporated or not, which undertakes any economic, financial or commercial activity.

This report provides an in-depth study of the current scenario in the country, various forms of bribery faced by the private companies and efforts made by them towards the compliance program. It also talks about the impact of corruption on the economy, sector-wise corruption and how poor enforcement of existing laws has led to rampant corruption. What is interesting is the sharing of information in the report of the way companies manipulate finances for short-term gains.

I wish EY all success in their future endeavors and hope that they will keep publishing such reports that will hopefully be an eye-opener for the companies.



Justice Kamleshwar Nath

Chairman

Transparency International India

Former: Up-Lokayukta (Karnataka),

Vice Chairman – C.A.T (Allahabad),

Judge – High Court (Lucknow &

Allahabad)







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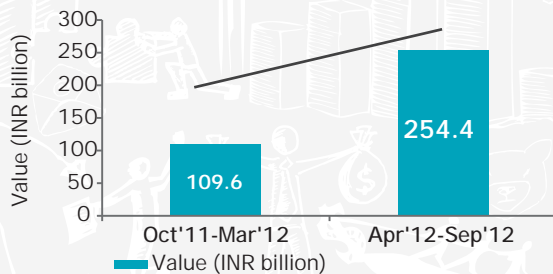
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Conclusion - Protect your business 40

Estimated loss

The potential losses suffered by the Indian economy (according to reported corruption cases in media (from October 2011 to September 2012) stands at INR364 billion³ this excludes some large scams such as 2G, Commonwealth Games and Mining.

Figure 1: Increasing magnitude of corruption



Are corporate organizations fueling corruption?

More than half of the respondents agreed that it is the lack of will of corporate enterprises to obtain licenses and approvals the "right way," which encourages bribery and corruption.

³Based on secondary research



Perceived as most corrupt sectors

1



Infrastructure
and real estate

2



Metals and Mining

3



Aerospace and defense

4



Power and utilities

Laws in India: good intentions, lacking in actions

- ▶ Two-thirds of the respondents were optimistic that new regulations such as the Companies Bill 2012 will make a difference and help in reducing fraud, bribery and corruption in the country.
- ▶ Around 89% respondents felt that there should be greater enforcement of laws to curb the proliferation of bribery and corruption.

Reality, awareness and perception


- ▶ 93% of the respondents representing PE firms indicated that accounting fraud is the most common fraudulent practice observed in India.
- ▶ With 89% of the respondents, cash continues to be the most favored form of bribe.
- ▶ 64% of the respondents were aware of companies performing irregular accounting to hide bribery and corruption.
- ▶ 44% of the respondents are in favor of legalizing facilitation payments in India.
- ▶ 31% of the respondents are unaware that making facilitation payments is illegal in India.

Facilitators

- ▶ Nearly 75% of the respondents said that it is an organization's responsibility to monitor activities managed by third parties (vendors, dealers and distributors)
- ▶ On the other hand, two third of respondents revealed that their companies do not conduct a complete due diligence on third parties or new business partners.

Are businesses willing to self-report amid lingering skepticism?

- ▶ Around 75% of the respondents were of the opinion that companies should self-report cases of bribery and corruption to the appropriate authorities. However, in reality very few cases of bribery and corruption are reported in India. In our experience, most of the companies take cognizance in India only after they are investigated at the global level.



**Perception that Managing Director
is responsible for handling
corruption-related issues**

Around 77% of the respondents think that it is the responsibility of the Managing Directors to handle the bribery and corruption related issues in the organizations.

India Inc voicing its opinion[#]

Although the representatives of companies state that they do not support corruption, they have hidden mechanisms to support corrupt practices. It is important that ethical leadership is practiced as a virtue if the private sector is to show the way.

-An Indian MNC

These days, bribery is in many cases regarded as a norm rather than an evil. This is eroding the country's very fiber. The Government will have to be proactive in handling such cases to prevent further damage to the economy and Indian citizens.

-A Foreign MNC

Automation of all procedures or processes involving interface with the Government is the ideal it needs to focus on. Doing away with person-to-person interface (to the extent feasible), especially for approvals, services, licenses, etc., would greatly reduce the scope for corruption.

-An Indian MNC

The tone at the top is extremely important to ensure awareness and compliance with anti-bribery and corruption issues. Serious action on reported instances of bribery and corruption and wide publicity of such actions across organizations are other effective deterrents.

-A UK based Foreign MNC

Bribery seeps in slowly into the culture of an organization. If it decides not to resort to bribery, it can keep its business going, but its profit will be based on its efforts.

-An Indian MNC

There should be transparency at all levels in organizations to reduce corruption. There should not be any discretionary power and every official should be made accountable for his or her omissions and commissions.

-A US based Foreign MNC

[#] Responses given by survey participants to open-ended questions

Are there adequate safeguards to protect against bribery and corruption risks?

Companies taking the first step toward compliance programs

More than 90% of the respondents reported that their companies had anti-bribery and corruption policies in place, standalone or covered under their code of conduct policy.

Lack of training making program ineffective

According to 34% of the respondents, their organizations do not conduct anti-bribery and corruption-related trainings for their employees.

Companies relying more on reporting mechanism than monitoring themselves

76% of the respondents' companies have a whistle-blowing mechanism to report corruption issues; less than 60% of the respondents' companies monitor expenses and activities of the business partners to ensure compliance with their anti-bribery programs.



How effective are vigilance setups and existing regulatory bodies for investigation of bribery and corruption cases in India?

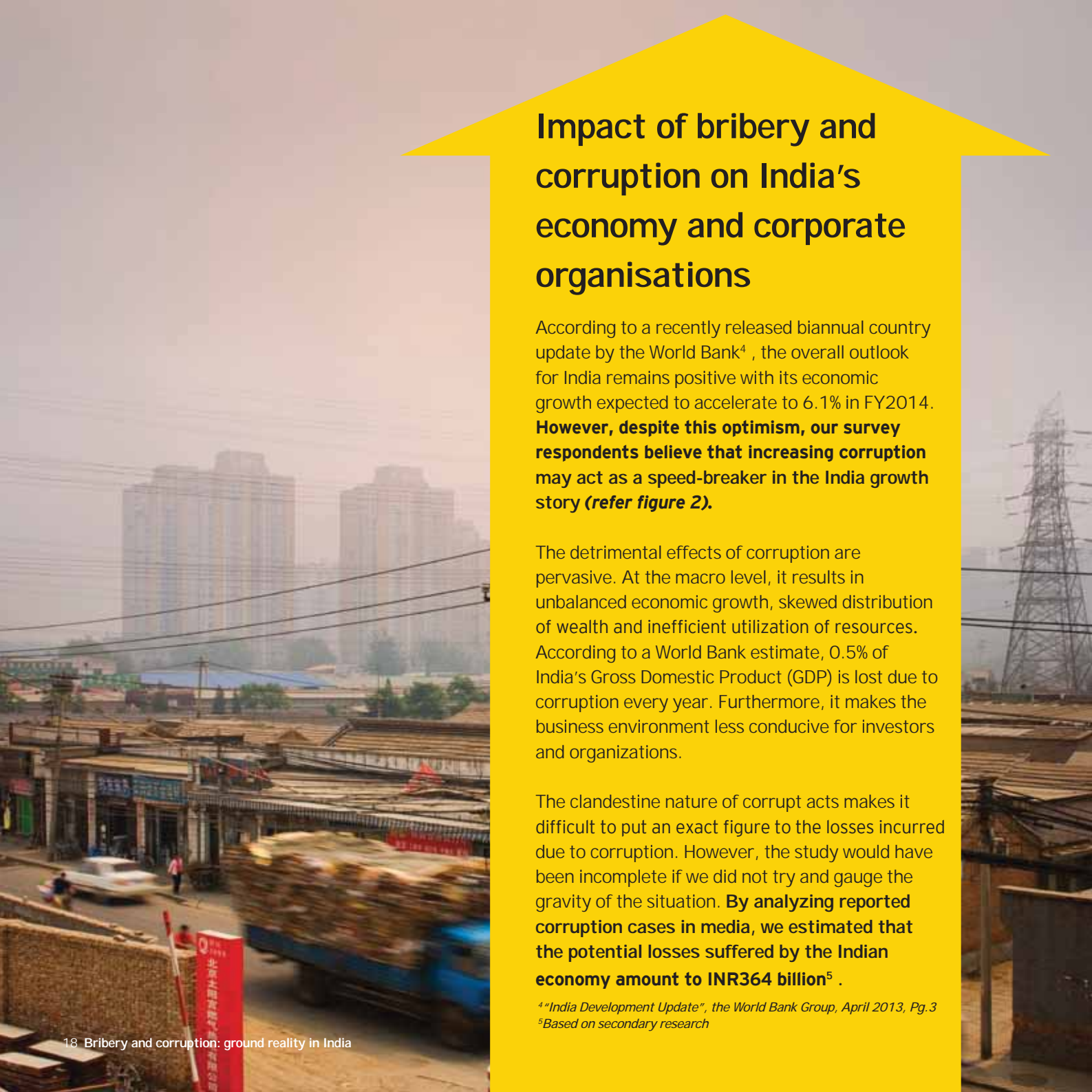
The Prevention of Corruption Act 1988 is the law governing bribery and corruption in India. It extends to the whole of the country, except in Jammu and Kashmir. And it is only applicable to public servants.

State level: Every State has a Criminal Investigation Department (CID) for either investigating or taking over control of sensitive/special report cases registered at a police station, anywhere within the jurisdiction of the State. The economic offences wing (EOW) may be a part of the State CID or a separate wing altogether. It takes up cases of financial frauds, counterfeit currency, bribery, corruption etc. Besides this, every State has a separate Vigilance department for investigation of bribery and corruption cases against public servants.

National level: The apex/premier investigation agency at the centre is the Central Bureau of Investigation (CBI). The CBI is a nodal agency for coordinating with other central vigilance departments on vigilance matters. CBI has an Anti Corruption Division to deal with cases of corruption and fraud committed by public servants of all Central Government Departments, Central Public Sector Undertakings and Central Financial Institutions.

Central Vigilance Commission (CVC): It's an autonomous body and is free of control from any executive authority. They are charged with the power of monitoring all vigilance activity under the Central Government of India, and advising various authorities in central Government organizations in planning, executing, reviewing and reforming their vigilance work. They coordinate with the various vigilance departments involved in the public sector and also supervise CBI's work.

At the Centre, every Ministry has a vigilance cell. Similarly, all the public sector undertakings, nationalized banks etc. operating in India have their own vigilance set up.



Impact of bribery and corruption on India's economy and corporate organisations

According to a recently released biannual country update by the World Bank⁴, the overall outlook for India remains positive with its economic growth expected to accelerate to 6.1% in FY2014. **However, despite this optimism, our survey respondents believe that increasing corruption may act as a speed-breaker in the India growth story (refer figure 2).**

The detrimental effects of corruption are pervasive. At the macro level, it results in unbalanced economic growth, skewed distribution of wealth and inefficient utilization of resources. According to a World Bank estimate, 0.5% of India's Gross Domestic Product (GDP) is lost due to corruption every year. Furthermore, it makes the business environment less conducive for investors and organizations.

The clandestine nature of corrupt acts makes it difficult to put an exact figure to the losses incurred due to corruption. However, the study would have been incomplete if we did not try and gauge the gravity of the situation. **By analyzing reported corruption cases in media, we estimated that the potential losses suffered by the Indian economy amount to INR364 billion⁵.**

⁴"India Development Update", the World Bank Group, April 2013, Pg.3

⁵Based on secondary research

Figure 2: Indian economy under the strain of corruption



India Inc experiencing detrimental effect of overarching corruption

Today, businesses are operating in extremely challenging conditions. A recent Ernst & Young study, based on a fraud survey⁶, brought to the fore the fact that executives and their teams are under increasing pressure to deliver unrealistic results in difficult markets. **Three out of four Indian respondents agreed that managers in their companies are under tremendous pressure to deliver exceptional financial performance over the next fiscal year.**

Corrupt practices undermining the level playing field

An alarming number of the respondents (nearly 50%) said that their companies have lost business to their competitors due to the latter's unethical conduct.

The most worrisome aspect of this revelation is the negative impact this may have on the losing parties. Under increased pressure to "deliver," they may indulge in corrupt practices the next time to win business.

Case-study

Paying to gain unfair advantage in business

A company was alleged to have paid a government official to influence and facilitate the process of a license being issued to it in order to delay the entry of its competitors. These payments were routed through a subsidiary of the organization and the amounts were recorded by it as expenditure on service contracts for intermediaries and agents. On closure of the investigation, the company and its subsidiary had to pay a significant amount as penalty. In addition, they were also forced to incur the cost of implementation of an enhanced compliance program.

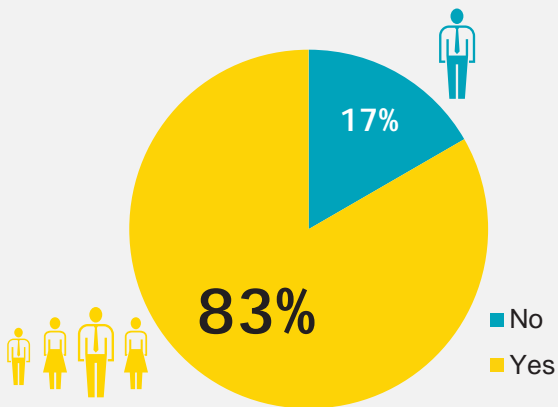
⁶Navigating today's complex business risks, Ernst & Young's EMEA Fraud Survey 2013

Bribery and corruption pose a challenge for investors

Around 83% of respondents felt that the recent spate of scams can negatively impact FDI inflows into the country (refer to figure 3)

Bribery and corruption pose a significant challenge for investors in India today and number among the most complex risks that need to be managed. The significant impact of globalization is that an MNC acquiring a company in an emerging market such as India may inherit the liabilities of the acquired company under Acts such as the Foreign Corrupt Practices Act (FCPA) and the UK Bribery Act (UKBA) for bribes the target organization may have paid. The convergence of many government regulations and increased enforcement has made investors cautious about their deals in such markets. In the case of India, global companies that are subject to such Acts may take a reverse call on investing in the country, in view of the current scenario it is witnessing of an unbroken chain of scams.

Figure 3: Keeping investors away



Corruption percolating through the sectors

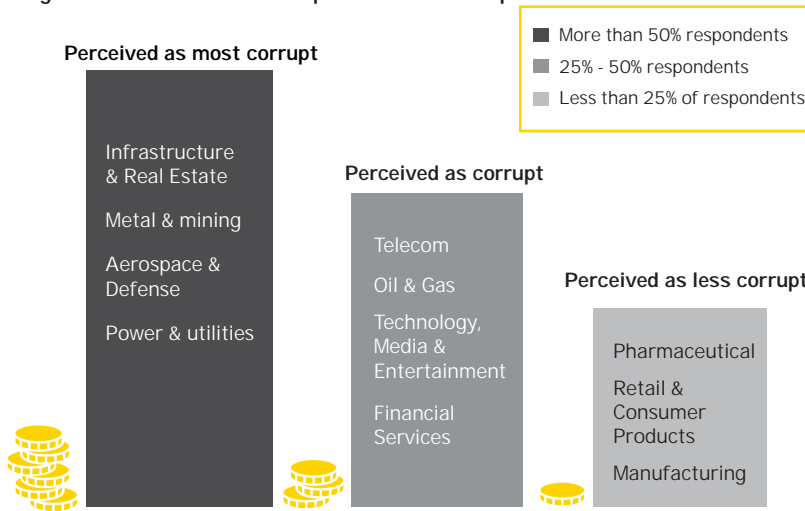
Bribery and corruption are pervasive, but some sectors tend to witness a relatively higher degree of such instances. Our respondents perceived the following sectors as the most vulnerable to corruption:

- ▶ Infrastructure & Real Estate (85%)
- ▶ Metal & mining (76%)
- ▶ Aerospace & Defense (64%)
- ▶ Power & utilities (51%)

There are a range of specific factors that make a sector more susceptible to bribery and corruption risks than others (refer Figure 4). It is imperative for MNCs to understand these factors with increasing enforcement of the FCPA by US regulators. The Securities and Exchange Commission (SEC) and Department of Justice (DOJ) have targeted industries such as oil and gas, pharmaceuticals and freight forwarding during their investigations in the past. It is observed that the regulators are sharp enough to identify red flags such as corruption schemes and use of intermediaries. Once identified, they focus on the companies that meet these criteria and can subject them to increased scrutiny.

Coming back to India, in recent years, international businesses in sectors such as mining, construction, food and manufacturing have been sanctioned for breaches of the FCPA, often relating to awarding of licenses or payments in relation to sales contracts. It is important for businesses with government contacts, whether as customers or suppliers, to pay particular attention to their conduct in India.

Figure 4: Sector - wise corruption risk heat map



Making the sectors vulnerable

- ▶ Government-funded projects
 - ▶ High use of subcontractors and consultants/agents
 - ▶ Large contracts
 - ▶ Obtaining licenses and planning permissions
 - ▶ Procurement and sourcing of raw material
-
- ▶ Movement of personnel, equipment and goods (Visas, Customs-clearance)
 - ▶ Sales, advertising and promotional expenses
 - ▶ Use of third-parties (outsourcing)
-
- ▶ Event grants and sponsorships
 - ▶ Fee-for-service payments to health care professionals (HCPs)
 - ▶ Counterfeiting and IP theft
 - ▶ Use of distributors
 - ▶ Complex supply chain

A close look at sectors indicates that the perceived levels of corruption depend on sector specific vulnerability factors. These factors drive the depth, volume and frequency of bribery and corruption in the respective sectors. For example, stringent regulations, large value contracts and continuous govt. interaction have been instrumental in sectors like infrastructure, defense, metals and mining making them more vulnerable to bribery and corruption. On the other hand, high use of middlemen, consultants and PR agencies play a key role in making telecom, media and entertainment sector vulnerable to corruption. Also, factors like multi-layered supply chain and complex web of legislations make other sectors like pharma, retail and manufacturing vulnerable. Other factors like liaisoning activities and speed money continue to be deep rooted in majorly all the sectors.

“According to 73% of the respondents from PE firms, a company operating in a sector that is perceived as highly corrupt, may lose ground when it comes to a fair valuation of its business, as it bargains hard and factors in the cost of corruption in the sector during a transaction.”

What is making bribery and corruption rampant in the country?

Are corporate organizations fueling corruption?

The results of the survey (refer to table 1) seem to say “yes,” with the majority of respondents indicating that it is the lack of will of organizations to obtain licenses and approvals the right way that is encouraging bribery and corruption. Companies that indulge in corrupt acts weigh the cost of their actions against expected returns. With 89% of the respondents pointing to inadequate enforcement of laws, it is not surprising that companies resort to unethical conduct to make profits, at least in the short term, in the absence of deterrents.


Table 1: Top five factors facilitating bribery and corruption
(Ranks are based on the percentage of responses)

Weak law enforcement	1
Numerous government “touch points”	2
Complicated taxes and licensing system	3
Lack of will for making an effort in getting permissions the right way	4
To get unfair advantage in business	5

“Despite the fact that the Prevention of Corruption Act has established a legal framework to punish the corruption of public servants with fines and up to three years in prison, actual punishment for these offenses rarely occurs.”

- UICIFD Briefing Paper No. 7, The Current State of India's Anti-Corruption Reform: The RTI and PC (2010)





Looking toward a bright future

Two-thirds of the respondents are largely optimistic that new regulations such as the **Companies Bill 2012** will make a difference and help in reducing fraud, bribery and corruption. On 18 December 2012, the Lok Sabha passed the much-awaited Companies Bill, 2012. According to clause 177 of the Bill, every listed company has to establish a "vigil" mechanism for its directors and employees to report genuine concerns relating to bribery and corruption in the prescribed manner.

Strengthening anti-graft laws

At present there are no legal provisions to check graft in the private sector in India. Government has proposed amendments in existing acts and certain new bills for checking corruption in private sector.

Big-ticket corruption is mainly witnessed in the operations of large commercial or corporate entities. In order to prevent bribery on supply side, it is proposed that key managerial personnels of companies⁷ and also the company shall be held liable for offering bribes to gain undue benefits.

The Prevention of Money Laundering Act, 2002 provides that the properties of corrupt public servants shall be confiscated⁷. However, the Government is considering incorporating provisions for confiscation or forfeiture of the property of corrupt public servants in the Prevention of Corruption Act, 1988 to make it more self-contained and comprehensive.

A committee headed by the Chairman of Central Board of Direct Taxes (CBDT), has been constituted to examine ways to strengthen laws to curb generation of black money in India, its illegal transfer abroad and its recovery. The Committee shall examine the existing legal and administrative framework to deal with the menace of generation of black money through illegal means including inter-alia the following:

1. Declaring wealth generated illegally as national asset;
2. Enacting/ amending laws to confiscate and recover such assets; and
3. Providing for exemplary punishment against its perpetrators.

It is significant and relevant that according to information provided by the CBI, it has not unearthed any case in which a government official has benami property worth more than INR1 billion.

⁷ *Amendment in Anti-corruption Act, 1998, Press Information Bureau, Government of India, 7 September 2011, <http://pib.nic.in/newsite/erelease.aspx?relid=75745>*

“More often than not, instances of large-scale corruption in India invariably involve corporations, either as the bribe-giver or as a conduit. That being said, it remains a matter of surprise that the criminal laws in India, specifically those pertaining to anti-corruption, do not specifically cater to dealing with infractions by corporations, let alone being lackadaisical in their application as is the case with individuals. This lacunae has been taken note of by the political establishment with recent statements of the Prime Minister specifically expressing the need to amend the provisions of the Indian Penal Code and the Prevention of Corruption Act, 1988 to cover the actions of corporates. However, it remains to be seen if this would be allowed to be translated into the black-letter law and be implemented with the zealotry as shown by authorities such as the SEC and the DoJ in the US”

- Alina Arora

Partner, Luthra and Luthra Law Offices

Table 2: Proposed Bills/ Amendments

Proposed Bills/ Amendments	Salient Features
<p>Prevention of Bribery of Foreign Public Officials and Officials of Public International Organizations' Bill, 2011 (India's FCPA equivalent)⁸</p>	<p>India signed the United Nations Convention against Corruption on 9 December 2005. The Bill is required for the ratification of the convention. It provides a mechanism to deal with bribery among foreign public officials (FPOs) and those of public international organizations (OPIO). The Bill criminalizes the following acts :</p> <ul style="list-style-type: none"> ▶ Acceptance or solicitation of bribes by FPOs and OPIOs for acts or omissions in their official capacity ▶ Offering or promising to offer a bribe to any FPO and OPIO to obtain or retain business
<p>Prevention of Corruption (amendment) Bill, 2008⁹</p>	<p>To make the anti-corruption laws more effective, the recommendations of the Law Commission of India and the Committee on Civil Services Reforms (Hota Committee) formed the basis of a Bill introduced in the Lok Sabha. The salient features of the Bill include:</p> <ul style="list-style-type: none"> ▶ Forfeiture of property acquired by the holders of public office through corrupt means, by incorporating the provisions of the Criminal Law(Amendment) Ordinance 1944 in the Prevention Of Corruption Act 1988 (PC Act) ▶ Deletion of section 13(1) (d) (iii) of PC Act by observing that a commercial decision taken by an officer acting in good faith may benefit one party or another, which does not constitute grounds for prosecution of the officer who may have acted in good faith ▶ Proposal to amend section 16 of the PC Act to provide a quantum of fine for a person accused of an offence u/s 13(1) (d) so as not to exceed the pecuniary resources or value of property for which the accused person is unable to account for satisfactorily ▶ Section 19 of the PC Act to be amended to provide for obtaining sanction for prosecution, even against those who cease to be public servants, on the lines of section 197 of the Cr.P.C., 1973
<p>Public Procurement Bill 2012¹⁰</p>	<p>Up its implementation, the Bill will enable India to achieve compliance with the stipulations contained in the UNCAC. It aims to regulate public procurement with the following objectives:</p> <ul style="list-style-type: none"> ▶ Ensuring transparency, accountability and probity in the procurement process, ▶ Fair and equitable treatment of bidders ▶ Promoting competition, enhancing efficiency and economy, ▶ Maintaining integrity and public confidence in the public procurement process ▶ Matters connected therewith or incidental thereto.

This information is intended to only provide a general outline of the subjects covered. It should neither be regarded as comprehensive nor sufficient for making decisions and taking legal action, nor should it be used in place of professional or legal advice.

⁸Bill No. 26 of 2011, the Prevention of Bribery of Foreign Public Officials and Officials of Public International Organizations Bill, 2011.

⁹Bill No. 70 of 2008, The Prevention of Corruption (amendment) Bill, 2008

¹⁰"India: Probity in Public Procurement," United Nations Office on Drugs and Crime (UNODC) Report, 2013, p. 22 and 23

How is India Inc. complying with the provisions of various anti-graft laws?

Bribery and corruption continue to pose a major challenge in India. The 2012 Transparency International Corruption Perceptions and Bribe Payers Indices rank India 94 (out of 176) and 19 (out of 28), respectively, indicating the severity of the issue.

Around 28% of the Indian respondents to Ernst & Young's 12th Global Fraud Survey were willing to make cash payments to win or retain business, compared with 15% of respondents globally¹¹. Corruption is perceived as being acceptable in business dealings as a means of avoiding administrative bottlenecks. Low public sector wages increase the risk of bribery being accepted for quick favors or to ignore wrongdoing.

According to the Ministry of Finance's white paper¹² on "black money," the "corrupt" component of this money could stem from bribery received and theft by those holding public office, e.g., by grant of business, leakages from government social spending programs, "speed" money to circumvent or fast-track procedures, black marketing of price-controlled services and altering land use by regularizing unauthorized construction.

¹¹ 12th Global Fraud Survey, Ernst & Young 2012

¹² Ministry of Finance's White Paper on Black Money, May 2012

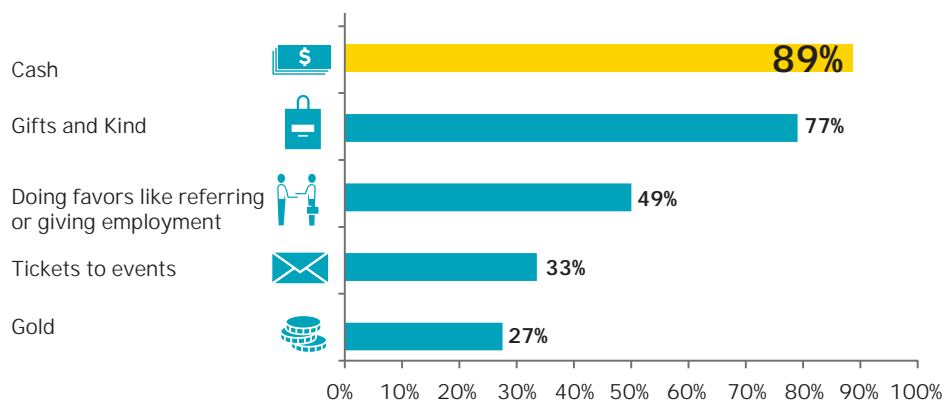
Bribery with cash reigning supreme

Cash continues to be the most preferred mode of paying bribes – 89% of the respondents selected it from the long list of possible modes (refer to figure 5).

According to the annual report of the CBI in 2012, 213 cases were registered for bribes being demanded by public servants for grant of official favors and 67 cases were filed for possession of assets disproportionate to known sources of income. This is the demand side of corruption.

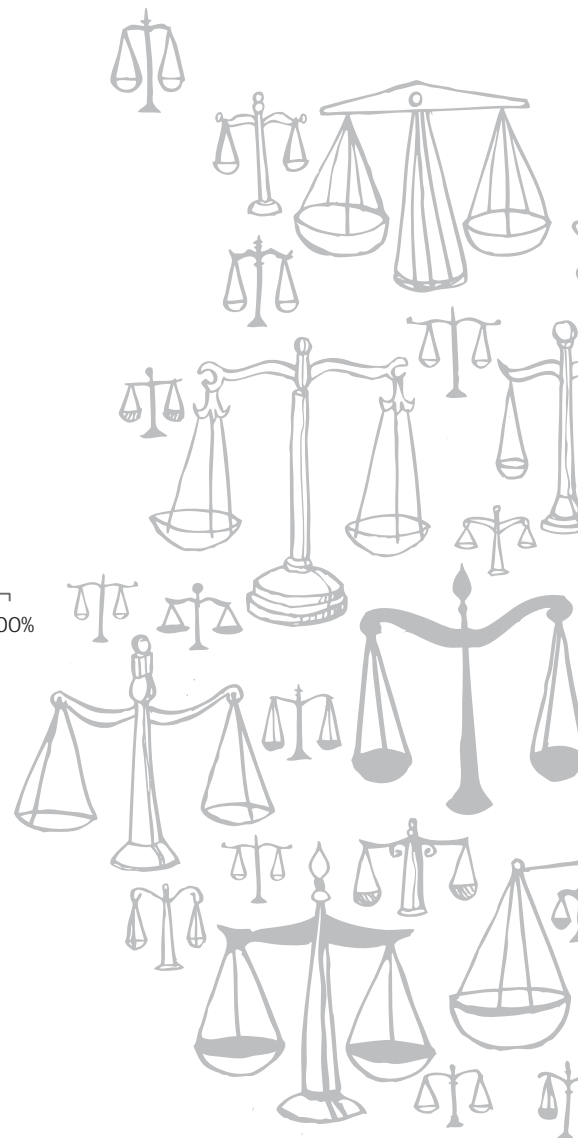
What about the supply side? Alarmingly, a large number of respondents appear to be comfortable with or are aware of unethical conduct. This includes irregular accounting to hide bribery and corruption, gifts being given to seek favours or using agents and third parties to pay bribes.

Figure 5: Businesses cashing in on 'cash' bribes



Innovative ways of paying bribes

- ▶ Paying high salaries to selected employees with an understanding that the excess amount will be used to make improper payments
- ▶ Routing improper payments through payment facilitators (existing vendors or material suppliers), who pass on the cash to liaising agents, keeping themselves out of the loop
- ▶ Paying a periodic performance bonus to vendors assisting in procurement of licenses
- ▶ Presenting gift cards (prepaid cash cards issued by banks) to government officials with whom organizations frequently interact



Some contagious issues in emerging markets that can expose companies to bribery and corruption risks

Corporate hospitality: Established norms in some countries may be extravagant and at risk of being perceived as intended to have a direct impact on decision-making. The key issue here is when does influence become inducement? A simple rule a company in doubt can follow is to stay away from giving gifts or offering entertainment at the time of negotiating a contract.

Facilitation payments: Such payments, also known as “grease payment,” are allowed under the FCPA, but are prohibited under the UKBA. In fact, many payments that meet the FCPA’s narrow definition of “facilitating payments” may be illegal in the country in which they are made, e.g., such payments are prohibited under the PC act in India.

Third-party risk: In a new market, a company must work with multiple suppliers, intermediaries and agents, who may themselves depend on a web of second-tier third parties. This creates a complex network to manage. The UK Bribery Act states that where a bribe is paid by an “associated person,” i.e., an employee, agent or subsidiary (as defined in Section 8 of the Act), with the intention of benefitting the company, the organization will automatically be guilty of a criminal offence. In short, a business may be held responsible for the actions of persons employed by or associated with it. It has also become increasingly clear that ignorance of laws does not absolve senior management of their liabilities for the activities of their local subsidiaries and agents.





Rules governing government officials

According to the rules of conduct governing government servants¹³, they are not to accept or permit members of their families (or other persons acting on their behalf) to accept gifts. The expression “gift” includes free transport, boarding, lodging or other services, or any other pecuniary advantage provided by any person other than a near relative or personal friend with no official dealings with the civil servant. Acceptance of gifts needs to be well regulated on occasions such as weddings, anniversaries, funerals, religious functions, transfer and retirement when presentation of gifts (including gifts from their own staff) is in conformity with prevailing religious and social practices. A report should be submitted to the Government by the civil servant if the value of such gifts exceeds the laid down limits defined on the basis of the grade of post of the person.

Case-study

Prosecution for presentation of expensive gifts

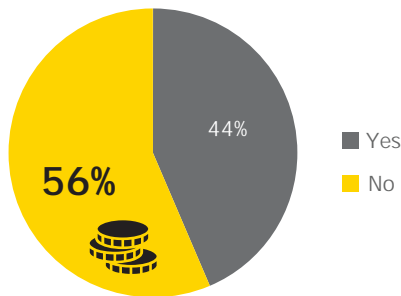
A large multinational company was prosecuted by the regulator for violating transnational bribery laws by presenting expensive gifts and offering extravagant hospitality to secure the sale of its products. These expenses were improperly recorded by its subsidiaries and joint ventures, which paid for these. In addition, the subsidiaries also made payments to vendors for fictitious services to create a “slush” fund for providing lavish entertainment to government officials to secure contracts. The company was charged with violating the laws and was fined for a significant amount as penalty.

¹³Central Civil Services (Conduct) Rules, 1964

Facilitating or expediting payments are illegal in India

31% of respondents are unaware that giving facilitation payment is illegal in India. As per Prevention of Corruption Act, 1988 facilitation payments are considered as an act of bribery and therefore punishable under the act.

Figure 6: Legalizing facilitation payment



“The FCPA’s prohibition of bribery comprises a narrow exception for “facilitating or expediting payments” made in furtherance of “routine governmental action” that involves non-discretionary acts.”

- A Resource Guide to the U.S.
Foreign Corrupt Practices Act

44% of respondents are in favor of legalizing facilitation payments in India (refer figure 6)

While 44% of the respondents were in favor of legalizing facilitation payment under Indian laws, similar to the FCPA, the Organization of Economic Cooperation and Development (OECD) has a different view¹⁴.

In view of the corrosive effect of small facilitation payments, OECD recommends following to the countries:

- ▶ Undertaking a periodic review of their policies and approach on small facilitation payments to effectively combat the phenomenon.
- ▶ Encouraging companies to prohibit or discourage the use of small facilitation payments in internal company controls, ethics and compliance programs or measures, recognizing that such payments are generally illegal in the countries in which they are made, and must in all cases be accurately accounted for in such companies’ books and financial records.
- ▶ Urging all countries to raise the awareness of their public officials on their domestic bribery and solicitation laws with a view to stop solicitation and acceptance of small facilitation payments.

¹⁴Convention on combating bribery of foreign public officials in international business transactions, OECD 2011, p.22



Case-study

Arrest for small payments made

There are no degrees in bribery and corruption – a small bribe may expose you to risk. There are reported instances of government officers being arrested for accepting bribes as small as INR 1000. For instance, a forest officer was arrested for accepting a bribe of INR1000 from two people. He had demanded this bribe to not charge them for illegal collection of firewood, since they had been found by him in a forest. In another instance, an officer of a state electricity department was arrested for accepting a bribe of INR1000 for processing a request to replace a damaged transformer.

What happens if an executive pays bribe out of his pocket ?

The regional head of a multinational company was suspended for paying INR 1000 in cash to an Electricity Board official. There was sudden electricity outage. The regional head rushed to the site and immediately paid the amount from his personal funds. He paid the amount to restore continuous electricity supply and save the diesel cost of running the generators. He did not claim the amount as reimbursement. However, as soon as the company came to know of this event, he was immediately suspended.

The anti-bribery enforcement actions of DOJs and SECs have been focusing on small payments and gifts when these are part of a systemic or long-standing course of conduct that provides evidence of a scheme to make illegal payments to foreign officials to obtain or retain business.

- A Resource Guide to the U.S. Foreign Corrupt Practices Act

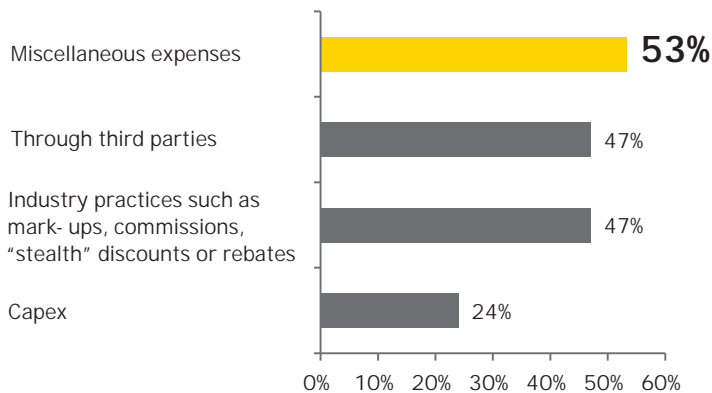


Hiding it in books

Hiding the bribes paid as promotion expenses, payment made to sales agents, expenditure on gifts and entertainment and payment of agents' commission are some practices.

When we questioned respondents on what they had to say about companies performing irregular accounting to hide bribery and corruption, around 64% of them mentioned that they were aware of companies performing irregular accounting to hide bribery and corruption (*refer figure 7, to see how companies are doing it?*)

Figure 7: How companies are doing it?



“Around 93% of the respondents representing PE firms indicated that accounting fraud is the most common fraudulent practice observed in India. ”

In such circumstances senior management should ask tough questions about the following:

- ▶ High levels of travel, entertainment and gifts; Inadequate supporting documentation; no clear business purpose; attendees not identified, etc
- ▶ Unclear and varying wording of distributor contracts
- ▶ Fixed fee or percentage contracts with unclear scope and deliverables
- ▶ Lack of clear explanations regarding the services of hired agents or consultants
- ▶ Excess fees paid to agents to obtain licenses as compared to nominal government fees
- ▶ Distributor commission higher than industry standards

Innovative ways of hiding bribes

- ▶ Capitalizing bribes paid to set up a factory, offices, shop, etc.
- ▶ Bribes paid in cash and recorded fictitiously under repairs and maintenance
- ▶ Bribes paid through dealers and distributors and recorded as annual performance bonus payments
- ▶ Amount spent on giving gifts or sponsoring massages recorded under reimbursement for meals, refreshments or travel
- ▶ Funds spent on liaising with government offices recorded as retainer fees

Too good to be true?

Businesses have good reason to look critically at what is being reported to headquarters from other jurisdictions and ask the question: do these results add up? As getting more for less becomes more challenging, some managers may look at an alternate option like meeting targets by misrepresenting performance.

According to our *EMEIA Fraud Survey 2013* more than 50% of respondents said that they have seen financial manipulation of some kind occurring in their own company (refer figure 8).

Figure 8: Unethical conduct by a organisations

	India	Developed	Rapid - growth	All respondents
Revenues recorded before they should be to meet short term financial targets	37 %	7	13	9
Under -reporting of costs incurred to meet short - term financial budgets	26 %	6	9	8
Customer required to buy unnecessary stock to meet short - term sales targets	21 %	4	10	6
Have heard of at least one of these happening at our company	59 %	13	26	20

The survey results serve as a warning for multinational companies with subsidiaries in rapid growth markets like India where 54% think financial performance is often exaggerated. Unfortunately, a major financial statement fraud by the local management of a multinational company which was exposed last year in India reiterates this result.

*Source: 'Navigating today's complex business risks', Ernst & Young's EMEIA Fraud Survey 2013

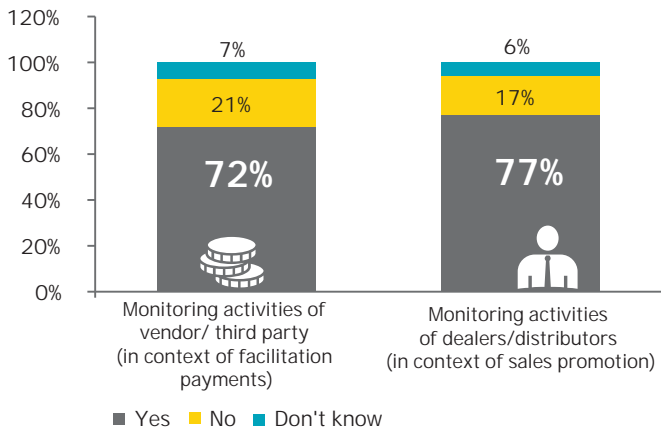


Asking questions, demanding answers

According to nearly 75% of the respondents, it is an organization's responsibility to monitor activities managed by third parties including vendors, dealers and distributors (refer to figure 9).

In today's business environment, the risks faced by global companies relating to business associates, including customers, vendors and outsourced business relationships, are greater than ever before. The rise in fraud risk and awareness, originating from the economic crisis, along with strong governmental enforcement activity and an increased focus on enterprise risk are resulting in global corporations and their audit committees taking a closer look at how they manage their vendor and customer-compliance relations.

Figure 9: Keeping an eye



Are business partners really as good as they seem?

Our survey revealed that two-third of the respondents' organizations do not conduct a complete due diligence on third parties or new business partners.

Any due diligence is incomplete without the following checks:

- ▶ Information collected on company ownership and key personnel
- ▶ Facts and figures collated on the business history, activities and operations of enterprises
- ▶ Data gathered on market reputation and credentials
- ▶ Information collected on background, reputation and ethical track record of business partners
- ▶ Relevant data garnered on associations or relationships of potential concern (government connections, political exposure, etc)
- ▶ Red flag coverage on the company and personnel on sources such as sanction and watch list, local and international ,media, litigation's database, etc

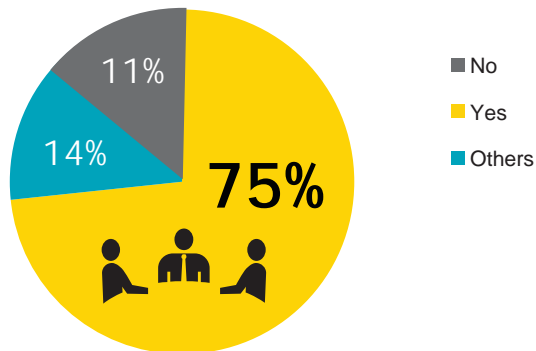


Businesses willing to self-report amid lingering skepticism

According to around 75% of the respondents, companies should self-report cases of bribery and corruption to the appropriate authorities (refer to figure 10).

The question is, “What is the right thing to do and what happens in reality?” Some of the reasons why organizations do not self-report include lack of trust in the system, fear of a backlash, victimization, etc.

Figure 10: Own the problem



Case-study

Exemplary case of a company self-reporting

In a recent case, the SEC signed a non-prosecution agreement for violation of the Foreign Corrupt Practices Act due to a company's prompt self-reporting of violations, the completeness of the information it provided and its extensive, thorough and real-time cooperation during the SEC's investigation. However, although the SEC wants to set this up as an example for companies who want to self-report, companies are still hesitant to do so.


Investors throwing caution to the wind

The survey revealed that 73% of PE respondents' organizations do not conduct anti-bribery and corruption due diligence before investing in enterprises.

Investing in another business is fraught with various risks. This is further compounded by aggressive enforcement of anti-graft laws such as the US FCPA Act. PE firms that do not conduct due diligences are doing so at their own peril and are overlooking specific risks¹⁵ such as the following:

- ▶ Impaired value of an acquired company in the event of its value being based on revenues generated by paying bribes
- ▶ Significant expenses incurred in conducting an internal investigation, responding to regulatory inquiries, and paying significant fines and penalties for issues identified after closure of the transaction and related litigation costs
- ▶ Loss of expected revenue due to inherited segment-specific operations in the area where the problem is concentrated
- ▶ Successor liability for PE firm and directors due to violating activity performed by the portfolio company, even before its ownership by the PE firm
- ▶ Liability exposure for directors, fund managers, executives and other associated individuals with management or guidance responsibilities over the portfolio company

¹⁵Anti-corruption considerations for private equity firms, Ernst & Young, 2012



Are there adequate safeguards to protect against bribery and corruption risks?

Multinational organizations are under increasing pressure to improve their anti-bribery and anti-corruption compliance programs as jurisdictions around the world increase their enforcement of laws and regulations to combat bribery and corruption. Executives need to be acutely aware of the liability they personally face for the actions of their employees and business partners.

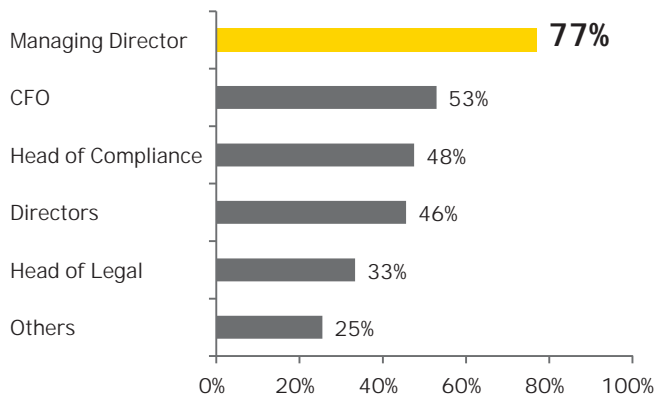
Perception that Managing Director is responsible for handling corruption-related issues

“The MD should be made responsible for combating bribery and corruption. He must ensure strict adherence to the laid down code of ethics, fraud risk management systems and close supervision, surveillance and monitoring on a need basis. However, he can't be held responsible for an individual aberration on an equal footing as the person having committed the offence. Here, the MD'S role should be gauged by the seriousness with which the fraud was inquired into and the punitive action taken by him.”

- **Shri Uday Shankar Dutt, IPS (Retd)**

Member, Advisory Board on Bank, Commercial and Financial Frauds, Reserve Bank of India
Advisor, Ernst and Young LLP

Figure 11: Questioning the tone at the top



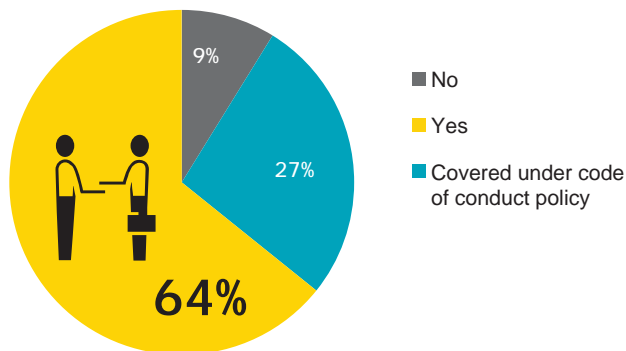
“77% think Managing Director is responsible for bribery and corruption issues in a company.”

Compliance programs – always more to do

According to the UNODC's recent report¹⁶, organizations are realizing that preventing corruption makes good business sense. Many companies have learnt from their own experiences or through the experiences of others that complicity can make them vulnerable to repeated illegal demands, result in cost escalation and compel them to commit economic offences, including fraud and forgery, for unaccounted cash flows. Even worse, as has been witnessed of late, the unethical practices of some large and formerly reputed companies have led to their economic collapse (and loss of reputation) in the market as well as among their competitors and customers.

Companies are taking their first steps toward implementing compliance programs. More than 90% of the respondents reported that their companies have anti-bribery and corruption policies that are standalone or covered under their code of conduct policies (*refer to figure 12*).

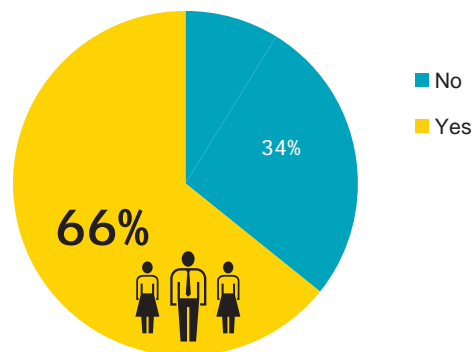
Figure 12: Foundation for effective compliance program



Organizations falling behind in training employees on risks

Around 34% of the respondents reported that their organizations do not conduct anti-bribery and corruption training for their employees (refer to figure 13). This is a clear indication that these organizations underestimate the threat posed by their own employees. According to an EY study¹⁷, employees are involved in one-third of all reported bribery and corruption cases in enterprises.

Figure 13: Lack of training



“There is a strong need to enhance training and awareness for government sector officials, since it is often seen that they do not fully understand the workings of the private sector, and vice-versa, making a way for vulnerability to corruption in this sector.”

- Probity in Public Procurement, UNODC Report on India, 2013

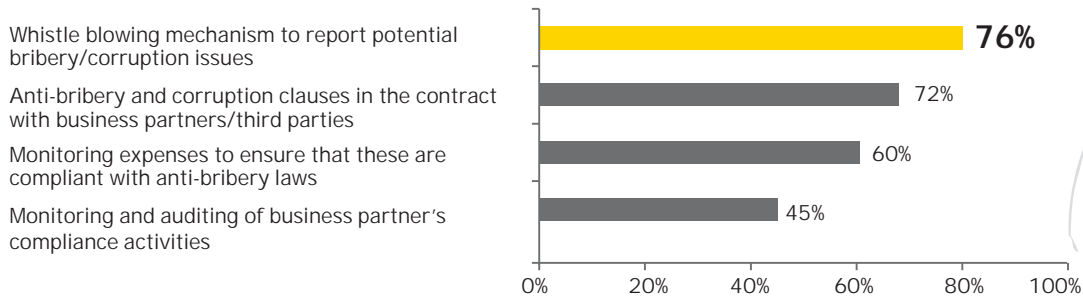
¹⁶ “Corporate Integrity”, UNODC Report, 2013

¹⁷ Based on secondary research

Companies relying more on reporting mechanism than on monitoring themselves

While it is a positive factor that 76% of the respondents' companies have whistle-blowing mechanisms to report corruption issues, less than 60% of their organizations monitor their own activities to ensure that these comply with anti-bribery laws (refer to figure 14).

Figure 14: Methods used to mitigate risks



How are PEs monitoring their portfolio companies?

The majority of the respondents indicated that their companies use management information and accounting systems to monitor their portfolio companies (refer to table 3).

Table 3: Keeping track of investments
(Ranks are based on the percentage of responses)

Management information and accounting systems	1
Independence of board and board functioning	2
Strengthening internal audit function	3
Regular compliance monitoring	4
Change in statutory auditors	5

“The change will only come about when the problem of corruption is handled collectively. Introducing strong processes in place is only the first step. Ensuring that people build the conviction for adhering to those processes is the bigger challenge. The leadership of every organisation needs to play an important role in this. By putting things right, Siemens is in a better position today than before. Our company would not like to reap profits in the present by jeopardizing the future”

- Neville K Gandhi, Regional Compliance Officer, Siemens Ltd

Conclusion - Protect your business

Acknowledge: There are diverse risks for different divisions and geographies and the one size fits all approach is not effective.

Be alert: Constant updating is required on current bribery risks in a country, sector, transaction, business opportunity and business partnership.

Take the right approach: Action taken on policies and procedures should be proportionate to the risks faced and the complexity of the nature, location and scale of commercial activities.

Define “zero tolerance”: Clearly communicate what this means for the business.

Do not be ambiguous: Provide clear guidance on gifts, hospitality, political and charitable donations, and demands for facilitation payments.

Perform due diligence: Carry out systematic risk assessment of third parties, undertake site visits, perform information searches in the public domain and conduct local interviews to collect information on identified vendors.

Conduct tailor-made training: A continual and relevant training process need to be in place on day-to-day issues employees are likely to face, to guide them effectively on addressing these effectively.

Employ a dynamic approach: Make required adjustments as business risks change.

Lastly, ensure that “speak up” channels such as hotlines are available for your employees. Businesses need to consider how they incentivize employees to act ethically. As they focus more closely on driving ethical growth for shareholder value, the absence of mechanisms to recognize ethical behavior seems a missed opportunity.

Disclaimer: The information in this report is intended to only provide a general outline of the subjects covered. It should neither be regarded as comprehensive nor sufficient for making decisions, nor should it be used in place of professional advice.



About Ernst & Young's Fraud Investigation & Dispute Services (FIDS)

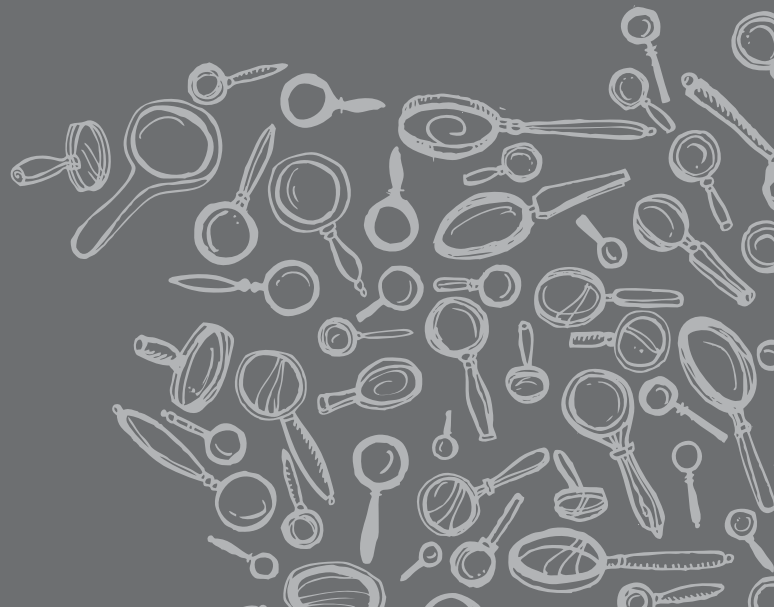
Dealing with complex issues of fraud, regulatory compliance and business disputes can detract from your efforts to achieve your company's potential. Enhanced management of fraud risk and compliance is a critical business priority – whatever the industry sector. With our more than 2000 fraud investigation and dispute professionals around the world, we will assemble the right multi-disciplinary and culturally aligned team to work with you and your legal advisors. In addition, we will provide you the benefit of our broad sector experience, our deep subject matter knowledge and the latest insights from our global activities.

FIDS India

- ▶ **Deep competencies:** Our FIDS team has specific domain knowledge along with wide industry experience.
- ▶ **Forensic technology:** We use sophisticated tools and established forensic techniques to provide requisite services to address individual client challenges.
- ▶ **Global exposure:** Our team members have been trained on international engagements and have had global exposure to fraud scenarios.
- ▶ **Market intelligence:** We have dedicated field professionals, who are specifically experienced and trained in corporate intelligence, and are capable of conducting extensive market intelligence and background studies on various subjects, industries, companies and people.
- ▶ **Thought leadership:** We serve a variety of leading clients, which gives us deep insight into a wide range of issues affecting our clients and business globally.
- ▶ **Qualified professionals:** We have a qualified and experienced mix of chartered accountants, certified fraud examiners, lawyers, CIAs, CISAs, engineers, MBAs and forensic computer professionals.

Our services:

- ▶ Anti-bribery program
- ▶ Anti-fraud and fraud risk assessment
- ▶ Fraud, bribery and corruption investigation
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- ▶ Forensic technology and discovery services
- ▶ Regulatory compliance
- ▶ Brand protection and IP risk
- ▶ Ethics and integrity due diligence
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- ▶ Whistle-blowing services
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EYIN1307-048
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