



## Managing corruption risks in India



### Growing US business trade and investments in India

In the past few years, India has emerged as one of the most promising destinations for investments. Its democratic government and large economy in terms of purchase power parity, highly skilled workforce, growing domestic market and sizeable English-speaking population, has resulted in an increasing number of global investors. According to a recent survey conducted by United Nations Conference on Trade and Development (UNCTAD), India has been ranked as the third most attractive destination for investments by transnational companies.<sup>1</sup> In addition, the United States is one of India's largest investment and trade partners and both countries are currently negotiating a bilateral investment treaty as part of their effort to strengthen their mutual economic ties and enhance investor confidence.

While India presents increasing investment opportunities, foreign companies in India face some unique challenges. This article focuses mainly on the corruption landscape in India, several associated risks and the need for implementing an effective anti-corruption compliance program in India.

### Corruption risk landscape in India

According to the World Economic Forum, corruption is the second most challenging factor in doing business in India. Transparency International's Corruption Perception Index (CPI) ranked India at 94 (out of 176 countries) in 2013, with a CPI score of 36 based on an overall potential score of 100 (100 being the least corrupt).

Conducting business in India is often complicated by burdensome regulatory requirements and procedures. Factors such as a bottom-heavy bureaucracy, widespread red tape, a higher tolerance to corruption and lax anti-bribery enforcement can increase the risk of operating in India. For example, organizations need to obtain and/or renew a large number of licenses and permits on an ongoing basis from multiple government agencies that often require bribes, along with official fees.<sup>2</sup> Additionally, various aspects of the Indian economy are controlled by governmental bodies at both central and state levels. More than 240 corporations (called Public Sector Undertakings

— PSUs) across different industries and several nationalized banks, insurance companies and financial institutions are either fully or partially owned by the government or their agencies. A large number of these organizations are dominant players in their respective industries. Internal controls and procedures at many government organizations and agencies involving the tendering, bidding, allocation and/or procurement processes have been criticized in various reports by the Comptroller and Auditor General of India, High Level Committee involving Commonwealth Games and India's Central Vigilance Commission.

### Regulatory framework

There are several laws and statutes in India that address corruption. The primary law governing corruption of public officials is the Prevention of Corruption Act (PCA). However, a number of other statutes such as the Indian Penal Code, The Right to Information Act and Prevention of Money Laundering Act also address corruption-related activities.

Unlike the U.S. Foreign Corrupt Practices Act (FCPA), which is focused on the bribe-giver, the prime focus of the PCA is on the bribe-taker (recipient). The PCA prohibits receiving of any gratification by public officials in India and related acts. A brief comparison between the FCPA and the PCA is summarized in Table 1.

There are a number of Indian law enforcement agencies that investigate corruption-related matters. Among them, the chief investigation agency is the Central Bureau of Investigation (CBI). Other enforcement agencies such the Criminal Investigation Department (CID), Economic Offences Wing (EOW) and vigilance departments of government departments, PSUs and nationalized banks also investigate corruption-related matters. India has set up an autonomous body, the Central Vigilance Commission (CVC) that is free of control from any executive authority. While the CVC does not have power to prosecute individuals for violations, it monitors the work of various central vigilance departments and also supervises CBI's work.

In recent years, Indian government and authorities have stepped up their anti-corruption enforcement efforts, and, in 2011 ratified the United Nations Convention Against Corruption. Moreover, it appears that the CBI is aggressively investigating corruption cases, and several PSUs have signed Transparency International's

1 <http://ibnlive.in.com/news/india-is-the-worlds-third-most-attractive-fdi-destination-survey/402169-7.html>

2 <http://www.reuters.com/article/2013/05/06/india-retail-idUSL3N0DN01720130506>

Integrity Pact<sup>3</sup> to reduce corruption. Currently, there are two important bills pending approval from the Indian Parliament — the Whistle Blower Protection Bill and the Prevention of Bribery of Foreign Public Officials and Officials of Public International Organizations Bill (FPO). The FPO is similar to the FCPA and seeks to criminalize the act of bribing foreign public officials and officials of public international organizations.

In addition, in some high profile corruption matters, such as the 2G telecom scam, the Indian judiciary has taken an active role in directing law enforcement agencies to conduct investigations and is monitoring the investigations. In 2012, India's Supreme Court cancelled 122 2G telecom licenses held by Indian and international telecom companies, worth billions of dollars, as a result of the ongoing investigations.<sup>4</sup>

#### High risk areas

Multinational companies doing business in India are likely to have frequent interaction with all levels of the government, PSUs and other government agencies, either directly or via third party intermediaries. Some of the key high risk areas include:

- Sale to government customers
- Obtaining licenses and permits
- Inspections
- Land acquisition
- Setting up plants and operations
- Customs and taxes
- Lower level judiciary

Multinational companies in India generally rely on third party intermediaries such as agents, consultants, lawyers, dealers, distributors and customs agents to deal with government agencies and officials. Some intermediaries specialize only in government business and may focus on working with specific government departments, customers and/or officials. These relationships may have developed over years and can lead to a familiarity and course of dealing through which improper payments and/or benefits

to government officials can be routed, adding complexity that makes detection challenging.

A number of recent corruption-related matters involved one or more of the above high risk areas. For example, the Coal scam involves allegations surrounding the improper issue of coal blocks/permits. The Commonwealth Games investigation involved allegations of tender manipulation and sale to government agencies at significantly inflated prices. A number of FCPA matters covering India also involved sales to government customers by a number of companies.

#### High risk sectors

Some of the key high-risk sectors include:

- Hospitality and tourism
- Defense contracting
- Mining
- Infrastructure and energy
- Media and entertainment
- Life sciences
- Retailers

#### Some common corruption schemes

Some of the common corruption schemes in India include:

- Using slush funds and making payments in cash
- Creating fictitious documents (e.g., invoices)
- Providing lavish, gifts, trips, benefits and entertainment
- Awarding lucrative contracts or dealerships to relatives of public officials and/or based on recommendations of public officials
- Inflating contract values and excessive payments to third party intermediaries (in the form of commissions, margins, fees, expense reimbursements, etc.)
- Making charitable contributions to organizations recommended by government officials
- Collusion with distributors and dealers for sale of samples and free goods in the black market in order to generate funds for making improper payments

Another corruption scheme, though not as common, involves giving minority ownership or shares to relatives of government officials at discounted value.

<sup>3</sup> Under the Integrity Pact, PSUs, their vendors and all bidders for public contracts agree not to take, offer or accept bribes or collude with competitors to get a business advantage.

<sup>4</sup> [http://articles.timesofindia.indiatimes.com/2012-02-02/india/31016262\\_1\\_spectrum-licences-2g-spectrum-allotment-case](http://articles.timesofindia.indiatimes.com/2012-02-02/india/31016262_1_spectrum-licences-2g-spectrum-allotment-case)

### Implementing and monitoring an FCPA compliance program in India

Recognizing FCPA and corruption-related risks, many US companies with operations in India have designed and implemented FCPA compliance programs or are in the process of doing so. Given the risk environment in India, it is important for companies to remember that anti-corruption compliance programs should be tailored and proportionate to the risks faced by the organization in India and not simply part of a “one size fits all” program.

The starting point for an “India-tailored” compliance program should be a holistic risk assessment that incorporates an assessment of country corruption exposures, local operational risks, accounts with higher perceived levels of risk, the complexity or non-transparency of the local regulatory framework, and whether its products or services present any unique risks through more frequent contacts with government officials. The approach should also strike a balance between establishing policies and procedures that effectively monitor corruption risk with business necessities. For instance, cash is still a common and preferred method of payment, particularly in rural India. A company policy having an absolute restriction on use of petty cash may lead to an inability to do business in India.

While India has a significant English speaking population, vast differences in culture, ways of doing business, social behavior and etiquette can oftentimes lead to misinterpretations and confusion. The compliance team should involve individuals who not only understand global compliance requirements but are also sensitive to local culture and industry practices so that risks are properly identified and subsequent mitigating steps are effective, practical and reasonable.

Indian senior management should join global senior management in demonstrating and communicating the organization’s commitment against corruption. This helps set the appropriate “tone of the middle.” It is also important to identify specific areas in the company’s code of conduct and policies that need to be customized for Indian operations. While all relevant employees and high risk third parties should receive some form of anti-corruption compliance awareness and/or training, local compliance and finance teams should be trained to detect improper schemes and payments.

### Third party intermediaries present significant risk

Of note, every action brought by the U.S. Department of Justice and U.S. Securities and Exchange Commission in both 2011 and 2012 involved the use of third-party intermediaries. As such, a key element of an effective compliance program in India should include protocols for performing third party due diligence. Third party-related forms and questionnaires may need to be customized depending on the service being performed and how it may expose the company to potential violations. Relevant company personnel should be trained to identify “red-flags” when dealing with third parties, such as requests for payments in advance of the rendering of services, or payment to a different third party. The due diligence exercise should consider including third party verification, obtaining representations, warranties and certifications that all services will be performed in compliance with laws, regulations and company policies, and ensuring that services are clearly described and payments are reasonable for the type of service performed. For higher risk third parties, due diligence could be expanded to include public information databases, media in local language, public record searches at government buildings and/or discreet inquiries made by experienced former law enforcement agents. In India, limited financial information may be available in public databases for third parties that are proprietary concerns or partnerships. Contracts with third parties may also include audit rights and termination rights for non-compliance to help ensure companies can check compliance with its standards and the law, and take meaningful action in the event they are not comfortable with a third party’s actions..

### Internal controls are critical to an effective anti-corruption program

Companies must also understand that putting policies and procedures into place is not enough if the program is not implemented effectively. They must establish internal controls that monitor approval levels for certain types of third party retention and remuneration, as well as consistency between contract terms and payments. Maintaining supporting documentation should be a key component of the program, as the failure to do so will likely be viewed as a control failure and subject the company to liability under anti-corruption laws regardless of whether the unsupported transaction was part of a

bribe scheme or not. Lastly, companies should strongly consider performing internal audits at operations that are new, are located in higher risk countries, have recently been acquired, or if they present other indicators of potential risk of non-compliance with anti-corruption laws or policies.

A tailored and robust anti-corruption compliance program that incorporates local risk factors helps to detect, prevent and remediate corrupt activity and is one of the first steps a company should take to protect itself from the potentially devastating legal, reputational and financial consequences of a violation.

#### Conclusion

Companies seeking to do business in India must recognize and react to the potential corruption risks they may face in the course of their dealings with commercial or government entities. While India is taking strong legislative and enforcement action to combat bribery and corruption, these efforts will likely not result in quick fixes to endemic problems. Assessing risk and taking a measured and firm approach to mitigating those risks through (1) an understanding of local practices and customs, (2) training relevant personnel who will be in a position to identify the “red flags” of potentially improper payments and relationships, (3) implementing internal controls that will serve to prevent, monitor and detect potential violations, and, perhaps most importantly, instituting a clear “tone at the top” and “tone at the middle” through which company leadership and management consistently reinforce their companies’ policy against paying or receiving improper and/or illegal payments and benefits, can help a company establish an effective and defensible anti-corruption program. With a well-designed effective anti-corruption compliance program, and strong commitment to compliance, global companies can protect themselves against risks inherent in doing business in India.

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**Table 1: Comparison of the U.S. Foreign Corrupt Practice Act (FCPA) and the Indian Prevention of Corruption Act (PCA)**

Particulars	FCPA, USA	PCA, India
Jurisdiction	Global — US concerns & foreign companies with securities registered/filing reports with the SEC or any person acting	It extends to the whole of India except the State of Jammu and Kashmir.
Activity considered as an offence	Payment of bribes or offering benefits to foreign government officials	Receipt of bribes by government officials/servants and/or related abetment
Underlying condition to above activity	To obtain or retain business or obtain improper advantage	None
Facilitation payments	Permitted	Not permitted
Payments allowable under local law	Payments that are considered lawful as per written local law are considered as affirmative defenses	No reference
Knowledge that the payment will be used for	Enough for prosecution	Insufficient for prosecution
<b>Liability Under The Act</b>		
Liability for the acts of third party	Exists	Does not exist
Liability for failure to maintain adequate internal controls	Strict liability	Not defined
Type of enforcement	Civil & Criminal	Criminal
Prosecution	Only the bribe payer	Primarily bribe receiver. Bribe payer can also be prosecuted for abetment
Punishment & Penalty for offenses	<b>Type</b>	<b>Criminal/Civil Penalty</b>
	Entity	Criminal Up to USD 2 million and Civil Up to USD 10 K
	Individual	Criminal Up to USD 1 million with / without imprisonment up to 5 years and Civil Up to USD 10 k
		Imprisonment between 6 months to 5 yrs. 2 years to 7 years in-case of habitual offenders.
		Imprisonment up to 3 years if found guilty of attempting to commit an offense.
		Amount of penalty not quantified. It is dependent on the value of the property obtained by the accused by committing the offense.

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