

Making India Inc. Accountable

ANDREW BEATO CITED IN ARTICLE THAT STATES, "IT IS NOT THE RESPONSIBILITY OF THE GOVERNMENT ALONE TO ACT IN ORDER TO CURB CORRUPTION; CORPORATE FIRMS NEED TO BE PROACTIVE AS WELL IN CHECKING FRAUDULENT FINANCIAL PRACTICES"

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The winter session of Parliament witnessed a noisy debate on the black money controversy. Governments of all hues have disappointed the Indian janata on the issue of black money and the failure is often associated with a perceived nexus between politicians and big business, weak laws and poor enforcement. At the G20 summit in Brisbane, Prime Minister Narendra Modi had made statements regarding getting international cooperation to bring the unaccounted wealth of Indian individuals and organisations back from global tax havens, but back home these have not inspired much confidence.

A recent report from the Organisation for Economic Cooperation and Development (OECD) hints at multinational companies using internal loans and complex financial structures as a strategy for tax evasion. The OECD report raises several concerns relating to the erosion of the tax base in countries due to multinational companies adopting such practices.

The Global Financial Integrity Report, released in December 2013, shows that 60 per cent of black money generated in developing countries such as India happens because of corporate tax evasion. In this report, India figures among the six Asian countries that are in the top 15 exporters of illicit capital, mostly due to trade-based money laundering. The report further says real GDP growth is significantly related to driving the flow of illicit money.

What that means is that greater economic growth and greater international trade is only likely to increase illicit capital flows out of the country. A 2012 White Paper on Black Money brought out by the Finance Ministry had observed that in India, more than 60 per cent of global trade is carried out by associated enterprises of multinational enterprises, with shifting of taxable income from high-tax to low-tax jurisdictions in these enterprises being a favoured method for minimising tax liability.

While the current discourse has largely focussed on the question of bringing back illicit money that has already been transferred discreetly to Swiss banks, there is also need for concentrating attention closer home and looking at ways to strengthen vigil mechanisms that will ensure the accountability of corporate firms in India.

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Supply side of corruption

Corruption, which includes concerns pertaining to black money, has a supply side to it as well. The moment we take cognisance of this, it would become evident why checking corruption at the source is crucial for addressing present concerns. It is not the responsibility of the government alone to act in order to curb corruption; corporate firms need to be proactive as well in checking such practices.

The 2014 Global Fraud Survey conducted by Ernst & Young's (EY) Fraud Investigation and Dispute Services (FIDS) wing shows that "unethical behaviour" persists among Indian businesses with practices to win/retain businesses ranging from offering entertainment, making cash payments, giving personal gifts and misstating company's financial performance. A whopping 71 per cent of participants in the survey said at least one of these practices for winning/retaining businesses was "justified" in India. Further, to the question whether bribery/corruption happens widely in businesses in India, 68 per cent of the participants answered in the affirmative. The report further shows that 71 per cent of Indian participants had not received any anti-corruption training and 53 per cent also reported the absence of whistle-blowing hotlines for monitoring compliance with anti-corruption laws in India. In another 2014 survey by EY FIDS on the compliance with the whistle-blowing framework provided under the Companies Act, 2013, only 13 per cent of the respondents indicated that their whistle-blowing frameworks were fully compliant with what was required by law.

The survey also stated that only 22 per cent of the respondents had implemented the framework because they considered the structured mechanism integral to their business operations. The principal respondents of this survey comprised senior executives in business functions, including internal audit and legal compliance, representing Indian enterprises with domestic operations as well as Indian subsidiaries of MNCs.

Arpinder Singh, Partner and National Leader at EY FIDS, who oversaw the surveys, said, "While many organisations had a whistle-blower policy in place, half of the respondents offered only one channel for reporting of complaints — which is more a 'tick in the box' approach than actually reaping the real benefits of a whistle-blowing framework. This shows that while organisations are taking the initial steps to be compliant, they still have a long way to go in establishing a robust whistle-blowing framework."

What we can infer from this is there is not enough incentive for reporting of financial malpractice among Indian enterprises at present. Since its revision, the Companies Act 2013 has introduced a provision for mandatory vigil mechanism to monitor fraudulent practices, and also ensured the appointment of independent directors, who must "ascertain and ensure" that the company has an "adequate and functional" vigil mechanism and that the interests of the person using this mechanism are protected.

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Whistle-blowing frameworks within companies cannot be an answer for addressing ongoing black money-related concerns since the matter largely falls within the realm of banking and taxation. But they help in pressuring companies to comply with anti-fraud mechanisms mandated by law.

Speaking from a Companies Act perspective, Mr. Singh said that specific revisions as well as additional guidance focussed on vulnerable industries such as gems and jewellery, real estate, NGOs, etc., which are currently unregulated from an anti-money laundering perspective, call for strengthening compliance to the monitoring framework. Having a reporting mechanism to an independent body such as the Financial Intelligence Unit (FIU), under the Ministry of Finance, could also be considered as a good starting point, he added.

Lessons from the U.S.

The anti-fraud mechanisms available in the United States have saved millions of dollars of losses to the government there. These offer valuable lessons for India. Andrew Beato, chair, False Claims Act and Whistleblower Practice Group at Stein Mitchell Muse Cipollone & Beato LLP, said the False Claims Act in the U.S. allows citizens to report instances of abuse of public money for personal gain. "For every dollar that the U.S. government invests in implementing this law, they earn back 20 dollars," he said. To cover tax frauds, the U.S. Internal Revenue Service runs a separate whistle-blower programme. He cited the example of Bradley Birkenfeld, the whistle-blower in the tax evasion case involving Swiss global financial services company UBS AG in which cross-border fraud by American citizens to the tune of \$780 million was exposed. The IRS whistle-blower programme helped Mr. Birkenfeld win \$104 million from the tax authorities in return for his services. Mr. Beato, who had represented the case of the Ranbaxy whistle-blower Dinesh Thakur in the U.S. courts, said that the absence of a comparable mechanism in India to safely report corporate fraud compelled Indian citizens to turn to the U.S. to report such practices.

In an interview published in The Hindu on December 3, Switzerland's envoy to India Linus von Castelmur had remarked that India must show proof of fraud before seeking information from them on the illegal wealth of Indians held in their banks. The envoy's comments draw attention to the perils of not having a healthy monitoring mechanism to curb fraudulent financial transactions in India. The hard lesson for India remains that curbing financial fraud, like charity, has to begin at home.

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