



Shipping sector

Sailing through troubled water
of frauds and disputes

An Ernst & Young Fraud Investigation &
Dispute Services (FIDS) perspective

Sector overview

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India's shipping sector has grown over the years in terms of its physical and financial assets, human resources, knowledge base, operating processes and support infrastructure. In 2008, the country ranked sixteenth globally by deadweight tonnage (DWT), accounting for 1.5% of the total global DWT. Indian flag vessels cumulatively accounted for the ninth-largest DWT in the world. However, foreign fleets dominated the country's maritime trade and accounted for approximately 70% of the traffic.

Shipping tonnage

India's shipping tonnage has grown tremendously from a mere 0.19 million gross registered tonnage (GRT), with 59 vessels in 1947 to 9.6 million GRT with 967 vessels as of 1 April 2010. Of these 967 vessels, 323 are engaged in overseas trade, while the rest operate on inland routes.

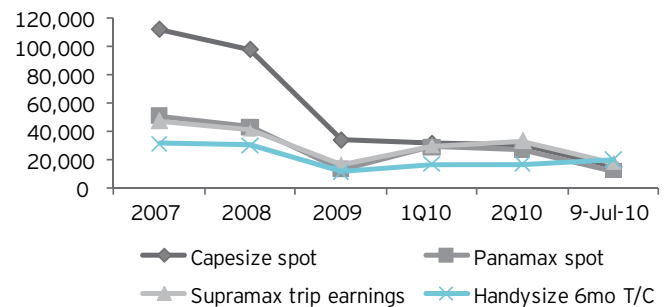
Fleet composition

In the case of overseas vessels, bulk carriers and oil tankers constitute approximately 92% of their total capacity (with oil tankers accounting for around 60%). Container ships account for only 2% of the total Indian overseas shipping fleet, compared with 15% of the world's fleet. In the case of coastal vessels, bulk carriers and offshore vessels collectively constitute approximately 56% of the former's total capacity; oil tankers and dredgers cumulatively constitute 21.9%.

Freight rates

Freight rates across shipping segments witnessed a sharp decline in 2009 due to a decrease in demand as a result of the economic slowdown. In 2010, the shipping market exhibited signs of recovery led by economic revival. However, rates continue to be volatile due to several reasons, including fluctuating demand from developed nations, a substantial order book for certain classes of ships, delays in new deliveries and the scrapping of old vessels.

Dry bulk segment in US\$ kpd/day*

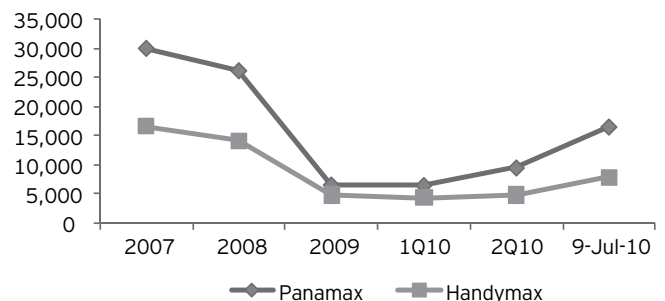


*USD/\$ thousand per day

Tanker segment in US\$ kpd/day

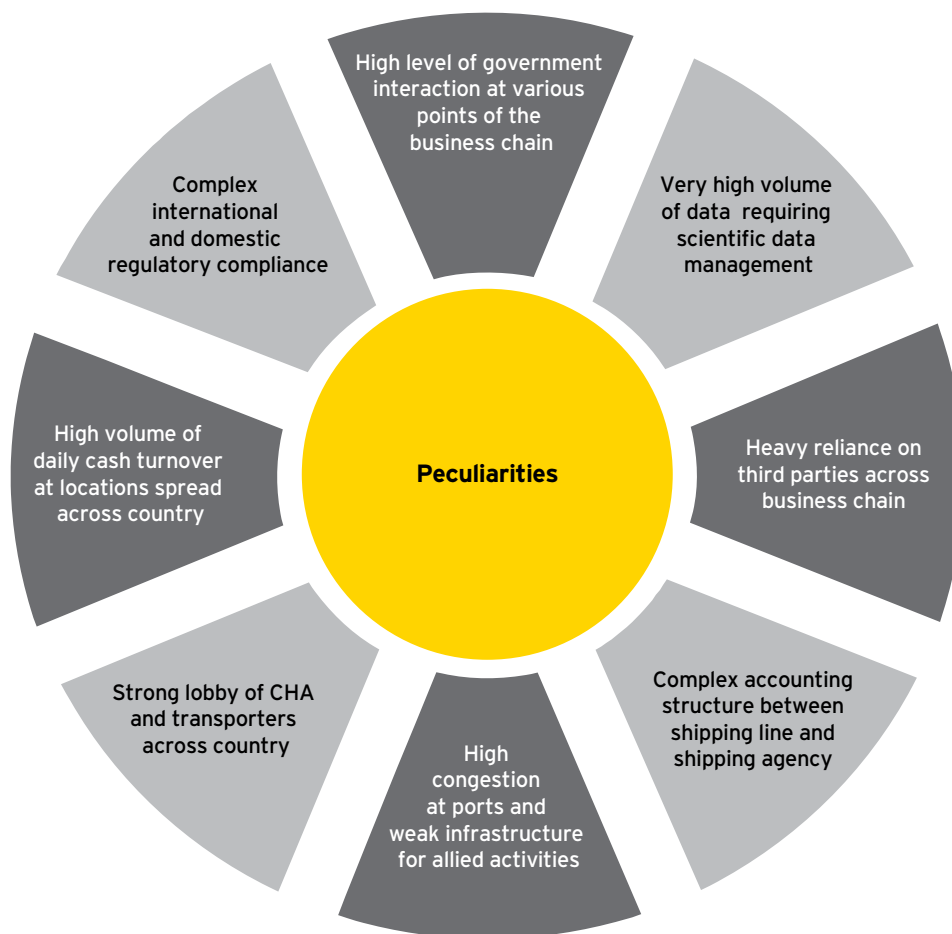


Container segment in US\$ kpd/day



Source: The Indian ports and shipping sector: breaking boundaries, tapping potential, August 2010
Ernst & Young-FICCI

Sector peculiarities



The Government of India (GoI) has taken several initiatives to develop key shipping infrastructure and formulate a competent maritime policy:

- ▶ Collaboration with international maritime entities
- ▶ Introduction of tonnage tax
- ▶ Proposal for exemption from service tax
- ▶ Implementation of the International Ship & Port Facility Security Code (ISPS)
- ▶ Liberalization of ship acquisition
- ▶ Shipping modernization fund

Fraud and dispute scenarios

Key functions of shipping sector affected by fraud and disputes.



Revenue leakage & Sales Frauds

Sales revenue: Difference between actual cargo shipped and cargo billed, which can lead to revenue loss.

Sales revenue: Sales channel may apply incorrect sales rates or discounts to customers, thereby causing revenue losses.

Detention revenue: Leakages in detention revenue due to the misstatement of containers' inward/outward movement dates.

Detention revenue: Incorrect waivers and discount may be granted to customers on detention charges.

Customers may perform intentional defaults in connivance with employees.

Sales figures may be inflated, especially toward period ends initiated by employees to meet targets.

Non collection of various documentation charges (NOC fee, IGM Amendment Fee, etc)

Non collection of detention charges due to auctioning of cargo leading to low recovery

Senior employees may float front-company vendors to garner business.

Direct sales may be made to customers routed from fictitious agents or brokers firms that are floated by sales employees to garner commission by defrauding the shipping company.

Kickbacks being paid to sales employees by agents and brokers to obtain relatively large pieces of vessel capacity

Kickbacks received by employees for providing lower freight rates and waivers to customers

Purchase/expenses fraud

Vendors such as stevedores, transporters, crane operators, CHA and surveyors can inflate expenses either individually or in collusion with employees.

Conflict of interest in purchases of services and/or consumables

Kickbacks received by employees in vendor appointments process, such as surveyors, CHA, Transporter, etc.

Vendor may charge for services that have not been rendered in collusion with employees.

Vendors and/or customers may inflate or manipulate container-damage expenses either individually or in collusion with employees - - inflation of invoices by vendor, underreporting of damages by customer and sub-standard repairs to equipments,


Cash bank and treasury frauds

Shipping industry deals with a significant amount of cash collections from customers, which is spread across the country. This makes it susceptible to cash-defalcation schemes used by company employees.

Employees can create fake or duplicate invoices for various services with the aim of misappropriating cash.

The decentralization of the shipping industry needs several employees across locations, which can lead to fraudulent disbursements such as ghost employees, fictitious vendors, pay & return schemes and over-billing.

Manipulations of bank reconciliations statements and accounting records to siphon off funds



Sales and marketing

Line/branch
operations Management

Accounting manipulations

Tax can be evaded by manipulating transactions, specifically in cross-border shipping by underreporting

Financial statements may be reported incorrectly. For example, revenue recognitions may be in contravention to accounting standards.

Frauds & manipulations by a Branch in accounting & reconciliation of transactions with the line operations

Overcharging of expenses to the shipping line and discrepancies in GSA account between Branch and Line operations

Disputes

Disputes with customers may arise due to absence of/informal agreements with respect to various categories of rates and charges, ambiguity in Service Level Agreements & Key Performance Indicators, etc.

Commercial disputes may arise in the nature of sharing commercial charges with various agents and yard operators, service contractors, etc.

Disputes with Port Authorities, Customs Department with respect to commercial aspects of shipping operations, may arise.

Bribery and corruption

Payment of bribes and facilitation payments to concerned authorities/agencies

Potential violations may emerge, resulting in fines and/or strictures by anti bribery & FCPA regulators.

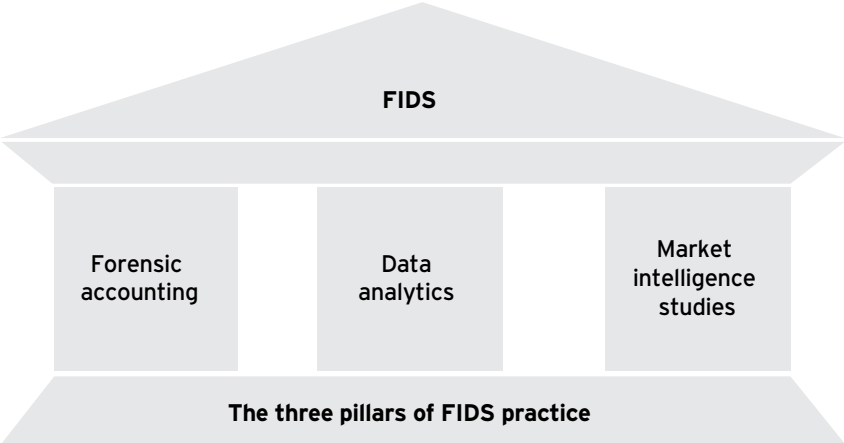
Physical security

Cargo theft: Cargos are vulnerable to theft/pilferages during transportation or storage at yards.

Container damages: Containers may be damaged due to mishandling by yards, transporters or customers

Theft or adulteration or misappropriation of fuel and other consumables may occur.

Customized service offerings for the shipping sector



<p>Background check</p> <ul style="list-style-type: none"> ▶ Level 1 background check: This is based on information available in the public domain. ▶ Level 2 background check: This includes site visits and interviews. ▶ Level 3 background check: This is a full-fledged investigation. 	<p>On employees responsible for critical activities such as appointing vendors or approving business transactions and on vendors supposedly indulging in suspicious transactions</p> <p>On vendors/surveyors/yard operators/CHA/transporters handling critical functions of the company to ascertain malpractices if any</p>
<p>Fraud risk-vulnerability assessment</p> <ul style="list-style-type: none"> ▶ Conduct fraud risk assessment of the current state of vulnerable processes. ▶ Develop a continuous monitoring mechanism for high-risk areas. ▶ Create an anti-fraud policy and a fraud-response plan. 	<p>Of critical areas such as sales commissions, import detention revenue, damage and repair expenses, yard expenses, and invoicing and collections</p>
<p>Investigation</p> <ul style="list-style-type: none"> ▶ Conduct whistleblower allegation investigations and reporting. ▶ Manage an ethics hotline for reporting concerns. 	<p>On specific cases so as to ascertain:</p> <ul style="list-style-type: none"> ▶ How did the fraud occur? ▶ Who is involved? ▶ What is the extent of loss? ▶ How was it perpetuated? ▶ What are preventions?



Anti-bribery and anti-corruption assistance

- ▶ Monitor compliance with global anti-corruption and operating guidelines.
- ▶ Perform forensic due diligence into target companies and business partners.

Of key expenses incurred around government-related work such as payments to port authorities, customs and other authorities

Data analytics

- ▶ Perform complex analytics over high-volume data to achieve specific results on predetermined parameters.
- ▶ Perform the trending or modeling of data to identify revenue-leakage areas or fraud patterns.
- ▶ Create dashboards for continuous monitoring of critical parameters

On volume of transactions to ascertain trends in sales and expenditures, exceptions in transactions, red flag and scenario indicators

Regulatory compliance assistance

- ▶ Create a code of ethics by centralizing responsibility at the board level.
- ▶ Conduct regulatory compliance reviews.
- ▶ Provide solutions on record-risk management.

Regulatory compliance review over key acts to review compliance framework, critical non-compliances, documentation standards, etc.

Why Ernst & Young?

Our FIDS team has specific domain knowledge, along with wide industry experience.



We have a qualified and experienced mix of certified fraud examiners, CIAs, CAs, CISAs, engineers, MBAs and computer forensic professionals.

We use sophisticated tools and established forensic techniques to find the right solution for individual client challenges.

We have a significant repository of thought leadership reports and white papers.

Several of our team members have been trained on international engagements to get global exposure on fraud scenarios.

We have dedicated field professionals, specifically experienced and trained in corporate intelligence, capable of conducting extensive market intelligence and background studies on various subjects, industries, company and people.

About Ernst & Young's Fraud Investigation & Dispute Services

Dealing with complex issues of fraud, regulatory compliance and business disputes can detract you from your efforts to achieve your company's potential. Better management of fraud risk and compliance exposure is a critical business priority – no matter what the industry sector. With more than 1,000 fraud investigation and dispute professionals across the globe, we assemble the right multidisciplinary and culturally aligned team to work with you and your legal advisors. And we work to give you the benefit of our broad sector experience, our deep subject matter knowledge and the latest insights from our work worldwide. It's how Ernst & Young makes a difference.





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EY offices

Ahmedabad

2nd Floor, Shivalik Ishaan
Near CN Vidhyalaya
Ambawadi
Ahmedabad - 380 015
Tel: +91 79 6608 3800
Fax: +91 79 6608 3900

Bengaluru

"UB City", Canberra Block
12th & 13th floor
No.24, Vittal Mallya Road
Bengaluru - 560 001
Tel: +91 80 4027 5000
+91 80 6727 5000
Fax: +91 80 2210 6000 (12th Floor)
+91 80 2224 0695 (13th Floor)

Chennai

TPL House, 2nd floor
No 3, Cenotaph Road
Teynampet
Chennai - 600 018
Tel: +91 44 4219 4400
+91 44 6632 8400
Fax: +91 44 2431 1450

Hyderabad

205, 2nd floor
Ashoka Bhoopal Chambers
Sardar Patel Road
Secunderabad - 500 003
Tel: +91 40 6627 4000
Fax: +91 40 2789 8851

Oval Office

18, iLabs Centre
Hitech City, Madhapur
Hyderabad - 500 081
Tel: +91 40 6736 2000
Fax: +91 40 6736 2200

Kochi

9th Floor, Abad Nucleus
NH-49, Maradu PO
Kochi, Kerala 682304, India
Tel: +91 484 3044000
Fax: +91 484 2705393

Kolkata

22, Camac Street
Block 'C', 3rd floor
Kolkata - 700 016
Tel: +91 33 6615 3400
Fax: +91 33 2281 7750

Mumbai

6th floor & 18th floor
Express Towers, Nariman Point
Mumbai - 400 021
Tel: +91 22 6657 9200 (6th floor)
Fax: +91 22 2287 6401
Tel: +91 22 6665 5000 (18th floor)
Fax: +91 22 2282 6000

The Ruby

29 Senapati Bapat Marg,
Dadar (W), Mumbai 400028
Tel: +91 22 61920000
Fax: +91 22 61921000

Block B-2, 5th floor
Nirlon Knowledge Park
Off Western Express Highway, Goregaon (E)
Mumbai - 400 063
Tel: +91 22 6749 8000
Fax: +91 22 6749 8200

NCR

Golf View Corporate Tower - B
Near DLF Golf Course, Sector 42
Gurgaon - 122 002
Tel: +91 124 464 4000
Fax: +91 124 464 4050

6th floor, HT House
18-20 Kasturba Gandhi Marg
New Delhi - 110 001
Tel: +91 11 4363 3000
Fax: +91 11 4363 3200

4th & 5th Floor, Plot No 2B, Tower 2,
Sector 126, NOIDA - 201 304
Gautam Budh Nagar, U.P. India
Tel: +91 120 671 7000
Fax: +91 120 671 7171

Pune

C-401, 4th floor
Panchshil Tech Park
Yerwada (Near Don Bosco School)
Pune - 411 006
Tel: +91 20 6603 6000
Fax: +91 20 6601 5900

Fraud investigation and dispute services

For further information please contact:

Arpinder Singh
Partner and National Director
arpinder.singh@in.ey.com
Tel (M): +91 986 728 3313

Yogen Vaidya
Associate Director
yogen.vaidya@in.ey.com
Tel (M): +91 982 042 6709

Sandeep Baldava
Partner
sandeep.baldava@in.ey.com
Tel (M): +91 98490 15347

Ajay Upadhyay
Senior Manager
ajay.upadhyay@in.ey.com
Tel (M): +91 932 454 5101

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