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ACCOUNTING FRAUD IN CORPORATE: CASE STUDY ON SATYAM COMPUTERS LIMITED.

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Abstract: In the modern globalized and liberalized era, the firms are facing stiff competition and are under pressure to show the good financial results through financial reporting. In such an environment, they start using the creative accounting practices, especially in unsuitable situation to boost up the profit or manipulate the assets and liabilities to report to the stakeholders the image that is better than the actual image. Corporate accounting fraud is a major problem that is increasing both in its frequency and severity. Research evidence has shown that growing number of frauds have undermined the integrity of financial reports, contributed to substantial economic losses, and eroded investor's confidence regarding the usefulness and reliability of financial statements.

An attempt is made in this paper to examine in-depth and analyse India's Enron, Satyam Computer's "creative-accounting" scandal. Satyam was brought to its knee due to 'tunnelling' effect. The Satyam scandal highlights the importance of securities laws and Corporate Governance in emerging markets. Their scandal/fraud has put a big question mark on the entire corporate governance system in India. Indeed, Satyam fraud "spurred the government of India to tighten the CG norms to prevent recurrence of similar frauds in future. Thus, major financial reporting frauds need to be studied for "lessons-learned" and "strategies-to-follow" to reduce the incidents of such frauds in the future. Thus this paper is devoted to the case study of Satyam, its creative accounting scandal and the effect of it on the global market.

Keywords: Corporate Accounting Frauds, Satyam Computers, Case Study, effect on India and global market, Corporate Governance.

'Doing the right thing doesn't automatically bring success. But compromising ethics almost always leads to failure'

What is Fraud?

Fraud is a worldwide phenomenon that affects all continents and all sectors of the economy. Fraud encompasses a widerange of illicit practices and illegal acts involving intentional deception or misrepresentation. According to the Association of Certified Fraud Examiners (ACFE, 2010), fraud is "a deception or misrepresentation that an individual

or entity makes knowing that misrepresentation could result in some unauthorized benefit to the individual or to the entity or some other party." In other words, mistakes are not fraud. Indeed, in fraud, groups of unscrupulous individuals manipulate, or influence the activities of a target business with the intention of making money, or obtaining goods through illegal or unfair means. Fraud cheats the target organization of its legitimate income and results in a loss of goods, money, and even goodwill and reputation. Fraud often employs illegal and immoral, or unfair means. It is essential that organizations build processes, procedures and controls that do not needlessly put employees in a position to commit fraud and that effectively detect fraudulent activity if it occurs.

Satyam Scam

Satyam Systems, a global IT company based in India, has just been added to a notorious list of companies involved in fraudulent financial activities, one that includes such names as Enron, WorldCom, Society General, Parmalat, Ahold, Allied Irish, Bearings and Kidder Peabody. Satyam's CEO, Ramalingam Raju, took responsibility for broad accounting improprieties that overstated the company's revenues and profits and reported a cash holding of approximately \$1.04 billion that simply did not exist. This leads one Creative accounting practices at Satyam computers limited. How does this keep happening? In his letter to his board, Satyam's Raju shows the markers of this pathology. He states that, "What started as a marginal gap between actual operating profits and ones reflected in the books of accounts continued to grow over the years. It has attained unmanageable proportions." Later, he describes the process as "like riding a tiger, not knowing how to get off without being eaten." To be able to compare what happened at Enron and Satyam, one needs to look into the basic functioning of both companies. The outcome at Satyam is, undoubtedly, better than Enron. It is quite obvious that the crucial difference was the presence of an agency in Satyam, the government of India to spearhead a damage control exercise and keep the company afloat. After all Enron, like Satyam, had its business and assets namely, power plants and the marketing, commercial, and administrative infrastructure intact. Power, which was Enron's product and an essential utility, had an assured market. Despite these positives, Enron was simply allowed to collapse, causing pain all around. Comparing the results with Enron, the



merits of the method tried in Satyam are quite clear. But the position is reversed when we look at how the wrongdoers in the two companies have been treated in the respective countries India and the US (Vasudev,2010). In this, the much-bemoaned inefficacy of the Indian legal system and the comparative efficiency of the American system are evident. The events also provide a measure of the ethical values, and that delicate thing called sense of honour, prevailing in the two societies.

The pertinent question here is how were these companies able to misrepresent their assets to such a proportion without the knowledge of anyone within their organizations? Was it loyalty or fear or both that kept employees in these organizations from blowing the whistle on the wrongdoers? While the result of both frauds was an initial rise in stock price and although the scam in Satyam Computers Services Limited is being called “The Indian Enron,” there are some differences (like corporate culture, route followed by management to falsify the information etc.) between these two episodes. Even as Raju is widely blamed for unleashing “India’s Enron,” Chaudhuri points to a major difference between Enron and Satyam. “At Enron, the CEO stonewalled, while whistle-blowers came out with the truth,” he says. “At Satyam, there were no whistle-blowers. The CEO blew the whistle on himself.” In that sense, Raju did ultimately tell the truth and perhaps live up to the “Satyam” name. Unfortunately for him, the company, and India’s IT industry, by then it was much too late. Useem draws a parallel between what occurred at Satyam with the scandals at WorldCom and Tyco, rather than at Enron. “At WorldCom, the CFO and the CEO were knowingly misstating the accounting and financials of the firm; at Tyco, the CEO and the CFO were knowingly taking money from the company for personal purposes,” he says. “Satyam’s disaster has a parallel to these acts of malfeasance.” Satyam scam has been the greatest scam in the history of the corporate world of the India. The case of Satyam accounting fraud has been dubbed by the media as “India’s Enron”. In order to evaluate and understand the severity of Satyam fraud, it is important to understand the factors that contributed to the ‘unethical’ decisions made by the company’s executives. Therefore, it is necessary to examine in detail the rise of Satyam as a competitor within the global IT services market-place. In addition, it is also helpful to evaluate the driving-forces behind Satyam’s decisions under the leadership of Ramalinga Raju (Chairman). Finally, attempt may be made to draw some broad conclusions and to learn some ‘lessons’ from Satyam fraud. Ironically, Satyam means “truth” in the ancient Indian language “Sanskrit”. Satyam won the “Golden Peacock Award” for the best governed company in 2007 and in 2009. From being India’s IT “crown jewel” and the country’s “fourth largest” company with high-profile customers, the outsourcing firm Satyam Computers has become embroiled in the nation’s biggest corporate scam in living memory.

Mr. Ramalinga Raju (Chairman and Founder of Satyam; henceforth called ‘Raju’), who has been arrested and has confessed to a \$1.47 billion (or Rs. 7,800 crore) fraud, admitted that he had made up profits for years. According to reports, Raju and his brother, B. Rama Raju, who was the Managing Director, “hid the deception from the company’s board, senior managers, and auditors.” The case of Satyam’s accounting fraud has been dubbed as “India’s Enron”. In order to evaluate and understand the severity of Satyam’s fraud, it is important to understand factors that contributed to the ‘unethical’ decisions made by the company’s executives. First, it is necessary to detail the rise of Satyam as a competitor within the global IT services market-place. Second, it is helpful to evaluate the driving-forces behind Satyam’s decisions: Ramalinga Raju. Finally, attempt to learn some ‘lessons’ from Satyam fraud for the future.

Factors affecting to Fraud – Auditors role

Global auditing firm, PricewaterhouseCoopers (PwC), audited Satyam’s books from June 2000 until the discovery of the fraud in 2009. Several commentators criticized PwC harshly for failing to detect the fraud. Indeed, PwC signed Satyam’s financial statements and was responsible for the numbers under the Indian law. One particularly troubling item concerned the \$1.04 billion that Satyam claimed to have on its balance sheet in “non-interest bearing” deposits. According to accounting professionals, “any reasonable company would have either invested the money into an interest-bearing account, or returned the excess cash to the shareholders. The large amount of cash thus should have been a ‘red-flag’ for the auditors that further verification and testing was necessary. Furthermore, it appears that the auditors did not independently verify with the banks in which Satyam claimed to have deposits” Additionally, the Satyam fraud went on for a number of years and involved both the manipulation of balance sheets and income statements. Whenever Satyam needed more income to meet analyst estimates, it simply created “fictitious” sources and it did so numerous times, without the auditors ever discovering the fraud. Suspiciously, Satyam also paid PwC twice what other firms would charge for the audit, which raises questions about whether PwC was complicit in the fraud. Furthermore, PwC audited the company for nearly 9 years and did not uncover the fraud, whereas Merrill Lynch discovered the fraud as part of its due diligence in merely 10 days. Missing these “red-flags” implied either that the auditors were grossly inept or in collusion with the company in committing the fraud. PwC initially asserted that it performed all of the company’s audits in accordance with applicable auditing standards. Numerous factors contributed to the Satyam fraud. The independent board members of Satyam, the institutional investor community, the SEBI, retail investors, and the external auditor—none of them, including professional investors with detailed information and models available to them, detected the

malfeasance. The following is a list of factors that contributed to the fraud: greed, ambitious corporate growth, deceptive reporting practices—lack of transparency, excessive interest in maintaining stock prices, executive incentives, stock market expectations, nature of accounting rules, ESOPs issued to those who prepared fake bills, high

risk deals that went sour, audit failures (internal and external), aggressiveness of investment and commercial banks, rating agencies and investors, weak independent directors and audit committee, and whistleblower policy not being effective.

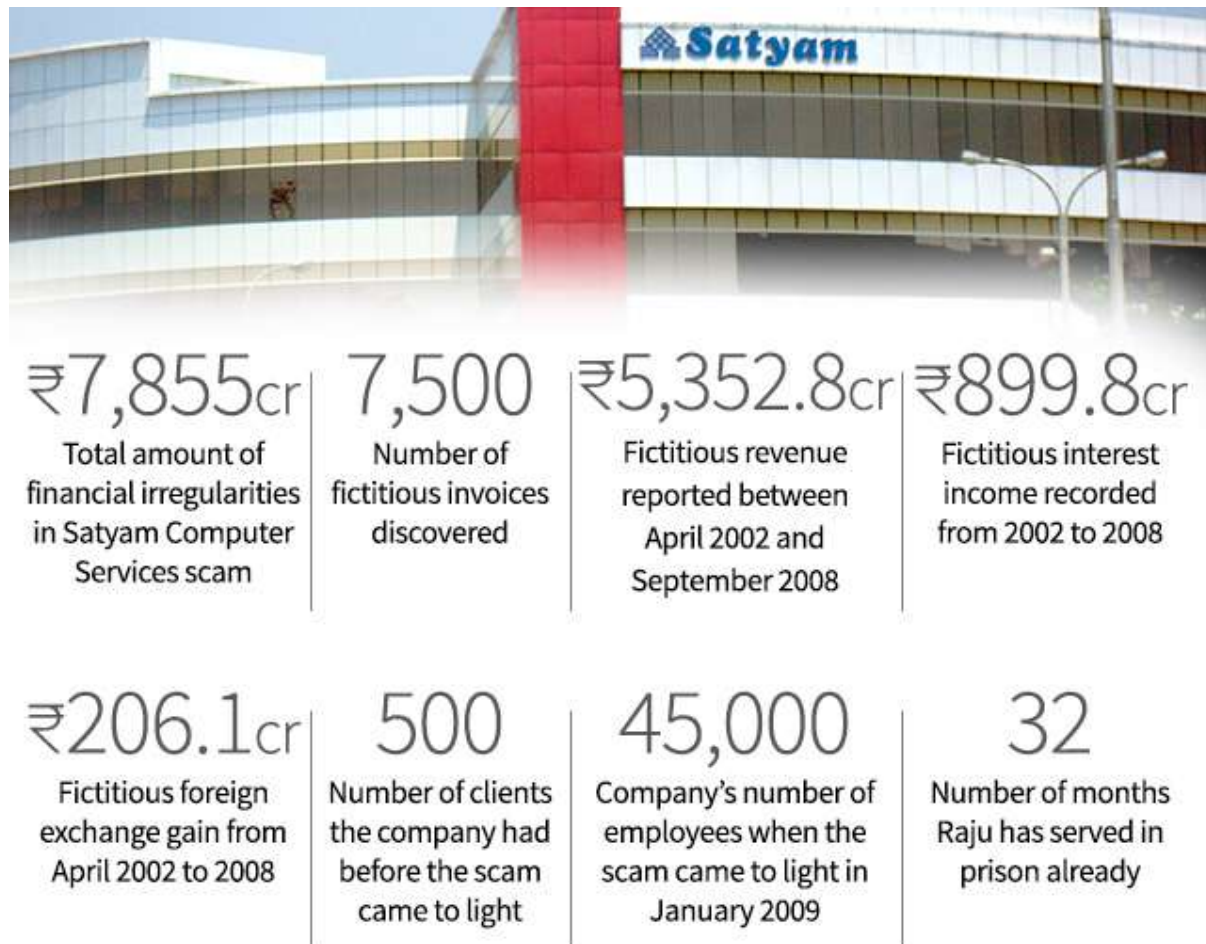


Figure 1: figures of the scam

After effects of Satyam Scandal

Immediately following the news of the fraud, Merrill Lynch terminated its engagement with Satyam, Credit Suisse suspended its coverage of Satyam, and Price water house Coopers (PwC) came under intense scrutiny and its license to operate was revoked. Coveted awards won by Satyam and its executive management were stripped from the company (Agarwal and Sharma, 2009). At its peak market capitalization, Satyam was valued at Rs. 36,600 crores in 2008. Just a year later, the scam-hit Satyam was snapped up by Tech Mahindra for a mere Rs. 58 per share a market cap of a mere Rs. 5600 crores. The stock that hit its all-time high of Rs. 542 in 2008 crashed to an unimaginable Rs. 6.30 on the day Raju confessed on January 9, 2009. Satyam's

shares fell to 11.50 rupees on January 10, 2009, their lowest level since March 1998, compared to a high of 544 rupees in 2008. In the New York Stock Exchange, Satyam shares peaked in 2008 at US\$ 29.10; by March 2009 they were trading around US \$1.80. Thus, investors lost \$2.82 billion in Satyam (BBC News, 2009). Unfortunately, Satyam significantly inflated its earnings and assets for years and rolling down Indian stock markets and throwing the industry into turmoil (Timmons and Wassener, 2009). Criminal charges were brought against Mr. Raju, including: criminal conspiracy, breach of trust, and forgery. After the Satyam fiasco and the role played by PwC, investors became wary of those companies who are clients of PwC (Blakely), which resulted in fall in share prices of around 100 companies

varying between 5-15%. The news of the scandal (quickly compared with the collapse of Enron) sent jitters through the Indian stock market, and the benchmark Sensex index fell more than 5%. Shares in Satyam fell more than 70%. The

graph “Fall from Grace,” shown in figure:2 depicts the Satyam’s stock decline between December 2008 and January 2009.



Figure 2: Satyam stock decline between December 2008 and January 2009

Corporate Governance Issues at Satyam

On a quarterly basis, Satyam earnings grew. Mr. Raju admitted that the fraud which he committed amounted to nearly \$276 million. In the process, Satyam grossly violated all rules of corporate governance. The Satyam scam had been the example for following “poor” CG practices. It had failed to show good relation with the shareholders and employees. CG issue at Satyam arose because of non-fulfilment of obligation of the company towards the various stakeholders. Of specific interest are the following: distinguishing the roles of board and management; separation of the roles of the CEO and chairman; appointment to the board; directors and executive compensation; protection of shareholder’s rights and their executives.

Influence of Satyam scam on Indian Economy

- Although several companies are trying to have a bite into Satyam computers, according to Gartner study the company is likely to exist in its current form. It is expected to discontinue some of its businesses, service lines or cease to exist in certain geographies.
- Huge losses to investors aside, Satyam scandal has caused several damage to India Inc’s reputation as well as the country’s regulatory authorities outside.
- The government certainly cannot remain aloof and allow Satyam to die off especially when it provides occupation to 53,000 odd people and indirectly supports more than a million Indians.

- The Satyam scam effect has started its infectious presence. U.S listed stocks of other Indian companies have started taken a severe beating.
- Indian firms are looking into methods to avoid scenarios of such scams within their companies.

Messages Learned from Satyam Scam

The 2009 Satyam scandal in India highlighted the nefarious potential of an improperly governed corporate leader. As the fallout continues, and the effects were felt throughout the global economy, the prevailing hope is that some good can come from the scandal in terms of lessons learned [35]. Here are some lessons learned from the Satyam Scandal:

- **Investigate All Inaccuracies:** The fraud scheme at Satyam started very small, eventually growing into \$276 million white-elephant in the room. Indeed, a lot of fraud schemes initially start out small, with the perpetrator thinking that small changes here and there would not make a big difference, and is less likely to be detected. This sends a message to a lot of companies: if your accounts are not balancing, or if something seems inaccurate (even just a tiny bit), it is worth investigating. Dividing responsibilities across a team of people makes it easier to detect irregularities or misappropriated funds.
- **Ruined Reputations:** Fraud does not just look bad on a company; it looks bad on the whole industry and a country. “India’s biggest corporate scandal in memory threatens future foreign investment flows into Asia’s third largest economy and casts a cloud over growth in



its once-booming outsourcing sector. The news sent Indian equity markets into a tail-spin, with Bombay's main benchmark index tumbling 7.3% and the Indian rupee fell". Now, because of the Satyam scandal, Indian rivals will come under greater scrutiny by the regulators, investors and customers.

- **Corporate Governance Needs to Be Stronger:** The Satyam case is just another example supporting the need for stronger CG. All public-companies must be careful when selecting executives and top-level managers. These are the people who set the tone for the company: if there is corruption at the top, it is bound to trickle-down. Also, separate the role of CEO and Chairman of the Board. Splitting up the roles, thus, helps avoid situations like the one at Satyam. The Satyam Computer Services' scandal brought to light the importance of ethics and its relevance to corporate culture. The fraud committed by the founders of Satyam is a testament to the fact that "the science of conduct" is swayed in large by human greed, ambition, and hunger for power, money, fame and glory.

CONCLUSION

A transformed organizational culture, which pays highest attention to ethical conduct and moral values, will strengthen sustainable roots of the company. Transparency and effective auditing and regulatory checks, through internal and external auditors and monitoring agencies, will also help to establish long-lasting credibility for a company. Companies must take a step-back when presented with challenging decisions and individuals must listen to "the little voice in their head in complying with the 'law' and to their heart in dealing with 'people'." Transparency in financial reporting, as a moral duty and ethical code of conduct, are also very important for companies to adhere to in order to uphold ethical standards.

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