

# Accounting Fraud with Reference of Satyam Company

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**Abstract:** *Accounting Fraud means misrepresentation or alteration of accounting record regarding sales, revenue, expenses and other factors for a profit motive such as inflating company stock values, obtaining more favorable financing or avoiding debt obligations. In this research paper we analyzed the accounting fraud with case study of Satyam Company is classic example, 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. Mr. Ramalinga Raju (Chairman and Founder of Satyam), who has been arrested and has confessed to a \$1.47 billion (or Rs. 7800 crore) fraud, admitted that he had made up profits for years. The Auditors Role and Factors Contributing to Fraud Global auditing firm, Price water house Coopers (PwC), who had 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. 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. Thus, investors lost \$2.82 billion in Satyam. Unfortunately, Satyam significantly inflated its earnings and assets for years and rolling down Indian stock markets and throwing the industry into turmoil. Criminal charges were brought against Mr. Raju, including: criminal conspiracy, breach of trust, and forgery.*

**Keywords:** Accounting Fraud, Satyam Scam

## I. MEANING OF ACCOUNTING FRAUD

The international misrepresentation or alteration of accounting record regarding sales, revenue, expenses and other factors for a profit motive such as inflating company stock values, obtaining more favourable financing or avoiding debt obligations. Employees who commit accounting fraud at the request of their employers are subject to personal criminal prosecution.

### 1.1 Case Study on Corporate Accounting Scandal at Satyam Computer Services Limited

A Case Study of Indian history of accounting scam is Satyam Computer services Ltd. Satyam means "truth" in the ancient Indian language "Sanskrit". Satyam had 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 involved in the nation's biggest corporate scam in living memory. The main culprit was 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. 7800 crore) fraud, admitted that he had made up profits for years. Mr. Raju and his brother, B. Rama Raju, who was the Managing Director, "hid the deception from the company's board, senior managers, and auditors".

In order to evaluate and understand the cruelty of Satyam's fraud, it is important to understand factors that contributed to the "unethical" decisions made by the company's executives.

### A. Emergence of Satyam Computer Services Limited

Satyam Computer Services Limited was a "rising-star" in the Indian "outsourced" IT-services industry. The company was formed in 1987 in Hyderabad (India) by Mr. Ramalinga Raju. The firm began with 20 employees and grew rapidly

as a “global” business. It offered IT and business process outsourcing services spanning various sectors. Satyam was as an example of “India’s growing success”. Satyam won numerous awards for innovation, governance, and corporate accountability.

From 2003-2008, in nearly all financial metrics of interest to investors, the company grew measurably. Satyam generated USD \$467 million in total sales. By March 2008, the company had grown to USD \$2.1 billion. The company demonstrated “an annual compound growth rate of 35% over that period”. Operating profits averaged 21%. Finally, beginning in January 2003, at a share price of 138.08 INR, Satyam’s stock would peak at 526.25 INR- 300% improvement in share price after nearly five years. Satyam clearly generated significant corporate growth and shareholder value. The company was a leading star and a recognizable name in a global IT marketplace. The external environment in which Satyam operated was indeed beneficial to the company’s growth.

### **B. Satyam Scandal**

Mr. Ramalinga Raju and the Satyam Scandal on January 7, 2009, Mr. Raju disclosed in a letter to Satyam Computers Limited Board of Directors that “he had been manipulating the company’s accounting numbers for years”. Mr. Raju claimed that he overstated assets on Satyam’s balance sheet by \$1.47 billion. Nearly \$1.04 billion in bank loans and cash that the company claimed to own was non-existent. Satyam also underreported liabilities on its balance sheet. Satyam overstated income nearly every quarter over the course of several years in order to meet analyst expectations. For example, the results announced on October 17, 2009 overstated quarterly revenues by 75 percent and profits by 97 percent.

Mr. Raju and the company’s global head of internal audit used a number of different techniques to perpetrate the fraud. “Using his personal computer, Mr. Raju created numerous bank statements to advance the fraud. Mr. Raju falsified the bank accounts to inflate the balance sheet with balances that did not exist. He inflated the income statement by claiming interest income from the fake bank accounts. Mr. Raju also revealed that he created 6000 fake salary accounts over the past few years and appropriated the money after the company deposited it. The company’s global head of internal audit created fake customer identities and generated fake invoices against their names to inflate revenue. The global head of internal audit also forged board resolutions and illegally obtained loans for the company”. It also appeared that the cash that the company raised through American Depository Receipts in the United States never made it to the balance sheets. Greed for money, power, competition, success and prestige compelled Mr. Raju to “ride the tiger”, which led to violation of all duties imposed on them as fiduciaries—the duty of care, the duty of negligence, the duty of loyalty, the duty of disclosure towards the stakeholders.

On December 16, 2008, the Satyam board, including its five independent directors had approved the founder’s proposal to buy the stake in Maytas Infrastructure and all of Maytas Properties, which were owned by family members of Satyam’s Chairman, Ramalinga Raju, as fully owned subsidiary for \$1.6 billion. Without shareholder approval, the directors went ahead with the management’s decision. The decision of acquisition was, however, reversed twelve hours after investors sold Satyam’s stock and threatened action against the management. This was followed by the law-suits filed in the US contesting Maytas deal. Investment bank DSP Merrill Lynch, which was appointed by Satyam to look for a partner or buyer for the company, ultimately blew the whistle and terminated its engagement with the company soon after it found financial irregularities.

On 7 January 2009, Satyam’s Chairman, Ramalinga Raju, resigned after notifying board members and the Securities and Exchange Board of India (SEBI) that Satyam’s accounts had been falsified. Raju confessed that Satyam’s balance sheet of September 30, 2008, contained the following irregularities: “He faked figures to the extent of Rs. 5040 crore of non-existent cash and bank balances as against Rs. 5361 crore in the books, accrued interest of Rs. 376 crore (non-existent), understated liability of Rs. 1230 crore on account of funds raised by Raju, and an overstated debtor’s position of Rs. 490 crore. He accepted that Satyam had reported revenue of Rs. 2700 crore and an operating margin of Rs. 649 crore, while the actual revenue was Rs. 2112 crore and the margin was Rs. 61 crore”. In other words, Raju claimed in the same letter that “neither he nor the managing director had benefited financially from the inflated revenues, and none of the board members had any knowledge of the situation in which the company was placed”. The fraud took place to divert company funds into real-estate investment, keep high earnings per share, raise executive compensation, and make huge profits by selling stake at inflated price. The gap in the balance sheet had arisen purely on account of inflated profits over a period that lasted several years starting in April 1999.

### **C. The Auditors Role and Factors Contributing to Fraud Global Auditing Firm**

Price water house Coopers (PwC) was 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".

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.

### **D. Outcome 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 PricewaterhouseCoopers (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. 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.

Criminal charges were brought against Mr. Raju, including: criminal conspiracy, breach of trust, and falsification. After the Satyam fiasco and the role played by PwC, investors became wary of those companies who are clients of PwC, which resulted in fall in share prices of around 100 companies varying between 5% - 15%. Immediately after Raju's revelation about the accounting fraud, "new" board members were appointed and they started working towards a solution that would prevent the total collapse of the firm.

Indian officials acted quickly to try to save Satyam from the same fate that met Enron and WorldCom, when they experienced large accounting scandals. The government appointed a "new" board of directors for Satyam to try to save the company. The Board's goal was "to sell the company within 100 days". To devise a plan of sale, the board met with bankers, accountants, lawyers, and government officials immediately. It worked diligently to bring stability and confidence back to the company to ensure the sale of the company within the 100-day time frame. To accomplish the sale, the board hired Goldman Sachs and Avendus Capital and charged them with selling the company in the shortest time possible. By mid-March 2009, several major players in the IT field had gained enough confidence in Satyam's operations to participate in an auction process for Satyam. The Securities and Exchange Board of India (SEBI) appointed a retired Supreme Court Justice, Justice Bharucha, to oversee the process and instill confidence in the transaction.

### **E. Investigation Criminal and Civil Charges**

The investigation that followed the revelation of the fraud has led to charges against several different groups of people involved with Satyam. Indian authorities arrested Mr. Raju, Mr. Raju's brother, B. Ramu Raju, its former managing director, Srinivas Vdlamani, the company's head of internal audit, and its CFO on criminal charges of fraud. Indian authorities also arrested and charged several of the company's auditors (PwC) with fraud. The Institute of Chartered Accountants of India ruled that "the CFO and the auditor were guilty of professional misconduct".

The CBI is also in the course of investigating the CEO's overseas assets. There were also several civil charges filed in the US against Satyam by the holders of its ADRs. The investigation also implicated several Indian politicians. Both civil and criminal litigation cases continue in India and civil litigation continues in the United States. Some of the main victims were: employees, clients, shareholders, bankers and Indian government. In the aftermath of Satyam, India's markets recovered and Satyam now lives on. Civil litigation and criminal charges continue against Satyam. Tech Mahindra purchased 51% of Satyam on April 16, 2009, successfully saving the firm from a complete collapse. With the right changes, India can minimize the rate and size of accounting fraud in the Indian capital markets.

## II. LESSONS LEARNED FROM SATYAM SCAM

### 2.1 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. Dividing responsibilities across a team of people makes it easier to detect irregularities or misappropriated fund.

### 2.2 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 IT sector of India. 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.

### 2.3 Corporate Governance Needs to Be Stronger

The Satyam case is just another example supporting the need for stronger Corporate Governance. 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.

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