



PROFESSIONAL ETHICS PROJECT

REPORT

PRIVILEGED & CONFIDENTIAL

Financial Scams in India – The Satyam Computers Scam



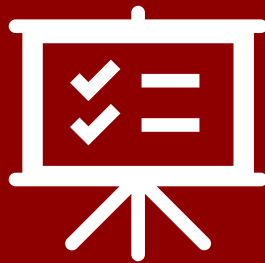
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INTRODUCTION



Before getting into the crux of the project, it is crucial to have a clear understanding of the topic and defining the objectives to be achieved. Throughout the process, these serve as a reminder of what the final learning goal that we hope to achieve is. Not only that, but they also help us evaluate our performance once the project is completed. So, let us get some context first.

Financial scams or frauds, at a company level, are ethical malpractices where shareholders are deprived of financial benefits or misguided by falsified reports. Financial frauds harm the financial health of the company and can sometimes even lead to bankruptcy. The world has witnessed a plethora of financial frauds which include the infamous Enron scam, the Harshad Mehta scam and many more. The unearthing of such scams has led to stricter controls, better reporting standards and an increased active regulatory overlook. While there is no sure shot way to curb financial frauds, one can always learn from past incidents and fill gaps and loopholes existing in the systems to prevent their recurrence. One such financial fraud that we are going to learn about in this report is the **Satyam Computers Scam**.

The Satyam Computers Scam is a classic case of how the top management of a company cooked books with the assistance of auditors. In the first section, we will get ourselves acquainted with the facts and figures of the scam. We will follow this up with the legal actions that were taken against the fraudsters and where they stand at the time of drafting this report. In the third section, we will become aware of the major reforms that were enforced post the era of the scandal. Lastly, we will look at the author's analysis of the scam and some suggestions that could have prevented the scam and that could prevent similar scams in the future.

Let us commence and understand the Satyam Computers Scam!





CASE FACTS AND FIGURES



The Conspirators

- Byrraju Ramalinga Raju (Chairman, Satyam)
- Vadlamani Srinivas (Chief Financial Officer)
- Subramani Gopalakrishnan (PWC auditor)
- T Srinivas (PWC auditor)

Background

In 1987, B. Ramalinga Raju (previously a cotton businessman) and his brother started Satyam Computers – Hyderabad based IT company. After a few years of exceptional performance, Satyam Computers got listed on the Bombay Stock Exchange in 1991-92. Satyam Computers, one of the fastest growing Indian companies expanded their reach across the globe and started operations overseas, including major economies like USA, Canada, Japan, and Australia. Owing to this booming growth, Satyam Computers become a part of the biggest stock exchange in the world - New York Stock Exchange! Satyam Computers and B. Ramalinga Raju received several accolades for their exceptional performance.

During this period, the real estate market was witnessing a surge. This marked the downfall of the company and the beginning of what is known to be called the ‘Enron scam of India’ – the Satyam Computers Scam.

Beginning of the downfall

The boom in the real estate market and surging prices in Hyderabad caught B. Ramalinga Raju’s attention. Instead of running his IT company, B. Ramalinga Raju shifted his focus on acquiring land and properties in and around Hyderabad. B. Ramalinga Raju did not stop here. He aggressively acquired more real estate in the name of himself, his family members and other owned companies such as Maytas Infrastructure and Maytas Properties.

The Scam

B. Ramalinga Raju’s buying spree came to a temporary halt due to monetary constraints. B. Ramalinga Raju needed resources to acquire more properties and was actively looking for ways fund his acquisitions. B. Ramalinga Raju crossed all limits and started manipulating Satyam Computers’ financial statements. For example, if Satyam Computers made a profit of 3 crores in a financial year, B. Ramalinga Raju along with the assistance of the other conspirators mentioned hereinabove inflated the profit and misrepresented it as 300 crores before the shareholders! To show increased sales, B. Ramalinga Raju started creating fake invoices. Creation of fake invoices was half the battle won, but where was the profit? B. Ramalinga Raju, with the assistance of bank officials substantiated the exorbitant profit by false bank statements. Basically, he misguided the investors by showing cash reserves that never actually existed! This unethical practice was increasing at breakneck speed and the cooked ‘strong’ financial results of Satyam Computers garnered attention from Dalal Street.

Satyam Computers soon become the apple of investors' eyes. Both, retail and institutional investors invested heavily in the shares of Satyam Computers, and, owing to this, within a short span of time, Satyam Computers' share price skyrocketed. B. Ramalinga Raju, his brother and other family members who were majority stakeholders in Satyam Computers either sold or pledged their shares as collateral and acquired properties using the funds. From the records, it was discovered that in 1997, the promoter shareholding was 24% which came down to as low as 2% by 2007-08. B. Ramalinga Raju went to the extent that he created over 350 dummy corporations and bought properties in the name of the directors of these corporations. It is believed that gardeners working at B. Ramalinga Raju's farm, who earned a meagre income of 4000-5000 per month, were directors of these dummy corporations and owned properties worth crores! In fact, Metro Man, Mr. E Sreedharan, alleged that B. Ramalinga Raju had access to the proposed Hyderabad metro rail route and started acquiring properties in the vicinity with the expectation of price appreciation. B. Ramalinga Raju had planned that a pie of the profit that he would earn from real estate would be invested back in Satyam Computers to correct the discrepancy of fake and actual profit. However, the rampant malpractice which was cooking for almost 13 years had made the gap between fake and actual figures too wide to be filled.

The Fault in B. Ramalinga Raju's Stars

The year 2008 witnessed a global recession and real estate prices across all economies plunged. B Ramalinga Raju's plan of selling the properties at high prices and making up for the difference between actual and fake figures failed. However, B Ramalinga Raju did not give up and thought of another malicious masterplan. According to this plan, Satyam Computers would acquire 51% and 100% stake in Maytas Infrastructure and Maytas Properties (which were owned by the family members of B Ramalinga Raju) respectively. B Ramalinga Raju thought that he could use this acquisition to justify the discrepancy between the actual and fake figures of Satyam Computers. On 16th Decembers 2008, the Board of Directors at Satyam Computers approved this plan and B Ramalinga Raju sanctioned this deal without seeking the approval of the shareholders. This decision, however, did not go well with the investors of Satyam Computers, especially the institutional investors. To protest the deal, one of the investors in the US filed a lawsuit against Satyam Computers and within a couple of days, the share price of the company of the New York Stock Exchange plunged by a whopping 55%! Due to the constant pressure and uproar amongst the investor community, B Ramalinga Raju decided to cancel the transaction. Following this fiasco, a couple of Independent Directors resigned from the Board of Satyam Computers as well.

The Admission

B Ramalinga Raju had used all the tricks in the book but to no avail! Finally, on 7th January 2009, B Ramalinga Raju publicly confessed that Satyam Computers has been manipulating financial statements since many years. B Ramalinga Raju stated that the difference between the actual and fake figures of Satyam Computers was over Rs. 7,000 crores! Investors started questioning the independent directors and PricewaterhouseCoopers (Satyam Computers' auditors) for their neglect and ignorance on this misrepresentation for so many years and even alleged that this was done on purpose with malicious intent. Various regulatory and legal authorities came cracking down heavily on Satyam Computers and all the conspirators involved after the admission of B Ramalinga Raju. Let us understand the consequences and the verdict of the scam in the upcoming section!





CURRENT VERDICT OF THE CASE



The Consequences

The scam entailed severe consequences for the conspirators. Following the announcement, B Ramalinga Raju and his brother were arrested by Andhra Pradesh Police's Crime Investigation Department on 9th January 2009 and charged with criminal conspiracy, breach of trust and forgery under relevant sections of the Indian Penal Code for inflating invoices and incomes, account falsification, faking fixed deposits, besides allegedly falsifying returns through violation of various Income Tax laws. In February 2009, the Central Bureau of Investigation ("CBI") took over and filed three partial charge sheets which were later merged into one. The CBI also raided the house of the youngest sibling of the Raju family where they found 112 sales deeds to different land purchases. The CBI also found 13,000 fake employee records created in the company. In the year 2014, B Ramalinga Raju's wife – Ms. Nandini Raju and sons – Teja Raju and Rama Raju and 18 other relatives were convicted by a Special Court for Economic Offences here for default in Income Tax payment. Later that year, B Ramalinga Raju, Rama Raju, Vadlamani Srinivas and former director Ram Mynampati were sentenced to six months jail term and fined by the Special Court for Economic Offences in connection with complaints filed by Serious Fraud Investigation Office for violation of various provisions of the Companies Act. On 9th April 2015, after a marathon 6-year long trial, a special court convicted B Ramalinga Raju and 9 other members comprising of Satyam Computers' former Managing Director B Rama Raju, former Chief Financial Officer Vadlamani Srinivas, former PricewaterhouseCoopers auditors Subramani Gopalakrishnan and T Srinivas, B Ramalinga Raju's another brother B Suryanarayana Raju, former employees G Ramakrishna, D Venkatpathi Raju and Ch Srisailam and the company's former internal chief auditor VS Prabhakar Gupta, and ordered 7 years of rigorous imprisonment. Amidst all this, on 15th July 2014, the Securities and Exchange Board of India barred B Ramalinga Raju and 4 others from accessing the securities market and ordered them to repay Rs. 1,849 crores with 12% interest within 45 days!

While PricewaterhouseCoopers initially claimed that their inability to catch the discrepancy was due to the information provided to them by the management of Satyam Computers, it was later found that PricewaterhouseCoopers had been looking the other way all along as they received twice the fees (as compared to industry standards) for the services rendered. The Indian arm of PricewaterhouseCoopers was fined \$6 million by the US Securities and Exchange Commission for not adhering to the code of conduct and auditing standards in the performance of their duties while auditing the accounts of Satyam Computers. In 2018, the Securities and Exchange Board of India barred PricewaterhouseCoopers from auditing any listed company in India for 2 years and ordered disgorgement of over Rs. 13 crores wrongful gains from the firm and their 2 auditors involved. This resulted in the stock prices of companies being audited by PricewaterhouseCoopers fall by 5-15%!

Investors had lost confidence, there was panic at Dalal Street and the stock market was in a turmoil following the scam. The stock markets around the world were down in the dumps already due to the Global Recession, and to make matters worse, the Indian stock exchange was taken aback by the Satyam Computers' scam. The Indian Government realised that before matters get out of hand, intervention was essential. A new Board was appointed at Satyam with an aim to sell the company within 100 days. The Board in turn appointed Goldman Sachs and Avendus Capital to facilitate the deal. While several companies bid on 13th April 2009, the winning bid was placed by Tech Mahindra. The value of the bid is pegged to be at 1/3 of Satyam Computers' value before the scam.

Tech Mahindra acquired 51% (controlling) stake in Satyam Computers and rebranded it as Mahindra Satyam. Later in June 2013, Mahindra Satyam merged with Tech Mahindra.

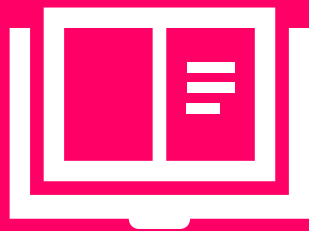
The impact of the scam on the investor community was severely detrimental. Following the confession of B Ramalinga Raju, the share price of Satyam Computers plummeted from Rs. 170 to Rs. 6.50 within 3 days. Due to this, it is believed that the investors of Satyam Computers incurred a loss of over 15,000 crores! Life Insurance Corporation, majority institutional investor in Satyam Computers alone lost over 950 crores!

The Satyam Computers Scam is believed to be the largest corporate fraud of India. Right from the middle-class retail investor to the Prime Minister of the country were shaken from the core by this scam. This called for revolutionary reforms in laws and regulations to prevent such scams from reoccurring. We will familiarize ourselves with these reforms in the upcoming section.





MAJOR REFORMS IN POST-SATYAM ERA



Safeguarding the Future

The Satyam scandal sent shock waves amongst the legal and regulatory bodies of the country. What is believed to be the biggest corporate scandal of the country clearly exploited the loopholes of the Indian corporate governance system - unethical conduct, fraudulent accounting, insider trading, oversight by auditors, ineffectiveness of Board, failure of independent directors and non-disclosure of material facts to the stakeholders. It made investors, bureaucrats, politicians, and lawmakers realize the dire need of reforms that would prevent such scams from being orchestrated again. The wake of Satyam scam altered the corporate governance landscape in India permanently.

In the year of the scam, the Confederation of Indian Industries set up a task force headed by former cabinet secretary Mr. Naresh Chandra to suggest reforms. Based on the task force's suggestions, in 2009, the Ministry of Corporate Affairs issued 'Voluntary Guidelines for Corporate Governance'. The National Association of Software and Services Companies established a corporate governance and ethics committee. This committee suggestions were focused on audit committees, shareholder rights, and whistle-blower policy.

In 2013, The Companies Act, 1956 was repealed with the new Companies Act, 2013. The new act introduced several measures to safeguard the interest of the larger stakeholder community. One of the most major addition to the new act was the provision which recognized corporate fraud as a criminal offence. To detect and report instances of fraud and other irregularities, the act provides for all listed companies to have a vigil mechanism and mandates a Directors' Responsibility Statement to be a part of the report of Board of Directors. It provides for compulsory rotation of individual auditors after five years and audit firms after ten years to rule out malpractices and financial oversight and ensure independence of auditors. The auditors are also obligated now to report instances of fraud noticed by them during the performance of their duties. The Institute of Chartered Accountants of India came out with a Guidance Note on Reporting on Fraud (ICAI Guidance Note, 2016). The act also puts forth a stringent framework for related party transactions. The highlight of the new act was the introduction of Serious Fraud Investigation Office. Under the new, the Serious Fraud Investigation Office has statutory status and has recently been conferred the power and authority to arrest. The Serious Fraud Investigation Office is also actively involved in investigating cases related to corporate fraud.

In April 2014, the Securities and Exchange Board of India amended the listing agreement to include provisions relating to establishment of a vigil mechanism, role of audit committees in cases of suspected fraud or irregularity, and the role of the Chief Executive Officer and the Chief Financial Officer pertaining to financial reporting and disclosure to the audit committee. In 2015, SEBI framed the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 applicable to all listed companies, and provided for stringent guidelines relating to reporting / disclosure of material events and actual and suspected fraud.

In the years since the Satyam scam broke out, substantial changes have been made with respect to corporate governance in India. The use of criminal sanctions by the Parliament to regulate corporate conduct has been on the rise. The regulators and the investigative bodies are more vigilant.

In the next section, the author has written his analysis of the Satyam scandal. Let us dive right into it!





ANALYSIS OF THE SATYAM COMPUTERS SCAM



Author's Analysis

The Satyam Computers Scandal is the biggest corporate fraud of India. In my opinion, it is equivalent to the Enron Scandal that took place in United States. In effect, the Satyam Computers Scandal is an accounting fraud. Various accounting and financial statements were manipulated and forged by intentional omissions, inadequate disclosures and by intentional misapplication of accounting policies. In addition to this, assets were overstated than actual, and fictitious deposits and interest were shown in the banks. The Satyam Computers Scam is a classic example of bad and dishonest governance with an intent to siphon public funds from the company with the assistance of auditors for personal interests and gains.

As mentioned hereinabove, the conspirators of the scam were B Ramalinga Raju and 9 other members comprising of Satyam Computers' former Managing Director B Rama Raju, former Chief Financial Officer Vadlamani Srinivas, former PricewaterhouseCoopers auditors Subramani Gopalakrishnan and T Srinivas, B Ramalinga Raju's another brother B Suryanarayana Raju, former employees G Ramakrishna, D Venkatpathi Raju and Ch Srisailam and the company's former internal chief auditor VS Prabhakar Gupta.

In my personal opinion, the single most factor behind the motivation of the scam was **GREED!** B Ramalinga Raju and his brother (prime conspirators) were engulfed with immense greed that they failed to foresee the consequences. In an attempt to amass huge wealth illegally, B Ramalinga Raju and his brother dug their own grave – one that was so deep that it was impossible to get out of without ringing alarm bells. Another factor behind the scam was the lack of focus. Instead of focusing on the operations and growth of his IT company, B Ramalinga Raju and family dabbled in acquisition of real estate. They used public resources as means to further their own interests and ended up inflicting damage to crores of individuals. Little to no vigilance system aided the prime conspirators to collude with the auditors and carry out the malpractices for over a decade. Had there been stricter rules and regulations set in place by the regulators, the scam would not have been successful. B Ramalinga Raju and team were aware of these systematic loopholes and exploited them to their advantage. In my opinion, one of the major factors that is overlooked by many is the assistance that the conspirators received from government officials. How was it possible that Raju and his family members were able to acquire so many properties at low costs? How was it possible that B Ramalinga Raju created over 300 corporations without any proper due diligence? Of course, the officials and bureaucrats were paid handsomely.

While the role of B Ramalinga Raju in the scam is pivotal, one cannot ignore the role of the company's external auditor – PricewaterhouseCoopers. Auditors are the eyes of the shareholders. Their most important responsibility is to check the reliability and accuracy of the financial statements of the company. PricewaterhouseCoopers initially claimed that they were not aware of the scam and relied on the information provided by the Board of the company. However, how is it possible that so many fake invoices and bank statements were generated but the auditor failed to check their accuracy? Auditors, in one way, are the representatives of the shareholders. However, unfortunately in this case, the auditor failed to perform their duties and cheated the investors.

What can be done to plug the existing loopholes to ensure that such scams do not repeat? Let us look at a few recommendations in the following section!





**AUTHOR'S
RECOMMENDATIONS TO
PREVENT SCAMS**



Author's Recommendations

This report has introduced the readers with the facts of the Satyam Computers Scam, its status, reforms in laws and regulations following it and a lucid analysis. Scams of such magnitude have the potential to cause a systematic failure. Thus, all stakeholders of the economy have to be vary and take collective responsibility to ensure that scams akin to the Satyam Computers Scam are prevented altogether. As someone who has researched in and out about the Satyam Scandal, this section covers the recommendations of the author.

- The most basic recommendation to prevent scams is to understand the motivation behind them. Regulators and lawmakers need to initially study the behaviour of fraudsters to be able to effectively set in place rules and regulations to discourage them
- Adopting and implementing effective internal controls. This will help auditors and management personnel identify the fraud at an early stage and curb them
- In the Satyam Scam we saw how detrimental leadership can create a catastrophe. Thus, the most important recommendation would be to have a responsible leader at the helm. A leadership with integrity will set an example and steer the organization in the right direction
- At times, even if an employee detects a fraud in the company records or system, he is bullied or discouraged into reporting it due to pressure from the higher authorities. To prevent this and make a safe environment for employees to report issues, an effective whistle-blower program must be cultivated. Encouraging this behaviour will create a valuable contribution and create a workplace based on values. The automatic and direct submission to the audit committee, of all complaints involving senior management is essential
- Establishing an effective and broad information and feedback network
- An organization must also have an internal Code of Conduct that every stakeholder of the company must adhere to. Internal auditors or independent directors must periodically review the adherence of the code and ensure that at all levels the opportunity or motivation to commit a fraud is eradicated
- The audit committee should be routinely furnished with the results of any surveys of employees regarding corporate behavior and similar information obtained from external parties
- The organization must also ensure that stringent action is taken against violators
- In this case study, the auditor and consulator of the company was the same – PricewaterhouseCoopers. This made it simpler for the conspirators to collude with PricewaterhouseCoopers. Thus, an organization must also ensure that their auditor and consulator are two independent and different firms
- In the instance of Satyam, the independent directors were oblivious to the manipulation taking place within the organization. The independent directors are the representatives of the shareholders. Thus, they must play an active role in ensuring that scams harming the investor community are prevented

While the aforementioned recommendations are not exhaustive, they do plug a majority of loopholes which were exploited during the Satyam Scandal. Finally, we move on to the concluding section of the report.





CONCLUSION AND SOURCES



Concluding Remarks

In Sanskrit, 'sat' means 'truth' and 'yam' means 'to hold'. The name of the company collectively means an organization that is run on trust. However, the actions taken by the scamsters were completely opposite. Not only did the scam weaken the investors' confidence in the Indian investment ecosystem, but also shattered the life savings of crores of retail investors.

Fast forward to 2021, while there are stricter laws and controls set in place, Indian yet witnesses financial frauds. It is that the scamsters are aided by individuals in higher places? Maybe. Or is it that no matter what rules and regulations we implement, people with a fraudulent intent are always going to find a way to defraud others? Food for thought...

Sources

The following sources were referred to while constructing this report:

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**THANK
YOU!**

