
Fraudulent Financial Management - A Case Study

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Ramalinga Raju, a poster boy of Indian business after setting Satyam on a path of high growth, hiring thousands of staff and bagging lucrative outsourcing contracts from overseas clients, admitted on 7th Jan (Wednesday) 2009 that the accounts were fabricated for the last several years showing exaggerated high profits.

Introduction

Raju, born in a family of farmers, a management graduate from Ohio University, moved away from agriculture to start a textile unit in 1977 and later shifted to real estate business. In 1987, he founded Satyam Computer along with his brother B Rama Raju and brother-in-law DVS. Raju, took over the company public four years later. In the same year, he won his first offshore contract from US tractor making company John Deere & Co.

Raju steered the company on a very fast track, snapping up joint ventures with GE and US defence and auto parts firm TRW Inc, which was acquired in 2002 by Northrop Grumman. He was among the first to spot the outsourcing opportunities of the turn-of-the-millennium Y2K computer problem, which saw the coming-of-age of Indian outsourcers, including Infosys Technologies and Wipro.

During the next few years he acquired six more companies, taking the firm's headcount to more than 53,000 working in software facilities in India and overseas. Under his leadership, Satyam won the prestigious "IMC Bajaj National Quality Trophy" in the year 2001. Last year in 2008, the company was awarded the Golden Peacock Global Award for the excellence in Corporate Governance by IOD.

Raju was also personally awarded, the Ernst & Young Entrepreneur of the Year in 2007 but now will be left having to watch from the sidelines rather

than calling the shots at Satyam.

Background of the company

The full legal name of the company is Satyam Computer Services Limited. Satyam was organized as a limited liability company under the Indian Companies Act on June 24, 1987. Satyam is the fourth-largest IT services company in India. It offers a range of IT services catering to verticals such as manufacturing, banking and financial services, insurance, telecom-infrastructure media-entertainment-semiconductors (TIMES), and healthcare, among others. Satyam has the largest ERP practice amongst offshore vendors, with competencies in implementation of enterprise packages such as Oracle, SAP, PeopleSoft, and JD Edwards. Satyam's presence spans 55 countries, across six continents. ERP practice contributed ~45% to Satyam's revenues in Q3FY08. The company has 598 clients across the globe and employs over 53000 professionals including its subsidiaries and joint ventures.

Financial Growth of the Company

Satyam made a spectacular growth on all the dimensions during the last 20 years. However it has been more phenomenal in the last decade with the boom in IT industry and outsourcing of various services by developed countries particularly in USA, UK, Canada etc. The recent disclosure revealed that the Satyam recorded revenue was sequentially increasing from 164.5 \$ Mil in the year 2000 to 2138.1 \$ Million in 2008. In the year 2000-01 net income was negative but 2002 onwards again there was a tremendous

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growth in Net Income i.e, 25.9 \$ Million to 481 \$ Million in 2008. The company recorded a growth in sales more than 30% in the last four years, the minimum was 33% in 2007 while it exceeded all time record of 46% in 2008. The earning per share was also as high 58% in 2008. The Book value/share has also been increasing continuously till 2007 but it suddenly dropped to 4.6% in 2008. Though Satyam didn't declare dividend in 2005 , but there is a sequential rise in dividend from

2006 to 2008 i.e., from 9.85 to 15.7%. It might be due to high sales growth in 2008 i.e., 46.3 %. The growth was broad based with manufacturing, healthcare and insurance verticals being major contributors to growth. The company also witnessed some good client additions in retail sector and has targeted it as one of the important growth areas.

THE TABLE GIVEN BELOW

Income Statement	2005	2006	2007	2008	TTM
Sales \$Million	794	1,096	1,461	2,138	2,466
Operating Income \$Million	163	220	292	409	495
Tax \$Million	25	38	31	53	55
Income \$Million	154	249	298	417	481
Earnings/Share \$	0.48	0.76	0.90	1.22	1.41
EPS (Cont Ops) \$	0.50	0.80	0.90	1.20	1.40
Dividends/Share \$	0.10	0.11	0.15	0.17	0.05
Total Shares Million	324	331	333	340	340

Cash Flow \$MSI

Fiscal year-end: 3	TTM = Trailing 12 Months			
	2006	2007	2008	TTM
Operating Cash Flow	163	262	339	512
- Capital Spending	54	82	97	128
= Free Cash Flow	109	180	242	384

Assets	\$Million	Liabilities and Equity	\$Million
Cash	1,147.0	Current Liabilities	500.0
Other Current Assets	770.0	Long-Term Liabilities	62.9
Long-Term Assets	466.0	Shareholders' Equity	1,820.1
Total	2,383.0	Total	2,383.0

Growth Table

Fiscal year-end: 3	2005	2006	2007	2008
Sales %	40.1	38.1	33.3	46.3
Earnings/Share %	33.3	58.3	18.4	35.6
Book Value/Share %	19.9	26.9	34.1	4.6
Dividends/Share %	—	9.8	33.0	15.7

RAJU HAS A GREAT FALL

Everything in Satyam was moving on a fast track till 6th Jan 2009 and suddenly the balloon burst. The morning news on 7th Jan 2009 gave a great shock and surprise to every one in the nation and the abroad when the Chairman of Satyam Computer admitted in his resignation letter sent to Board of Directors as on 7th Jan 2009 that there was fudging of the company's account books to the tune of at least Rs. 7,136 crore, over a period of "several years"

- " HE ALSO CONFESSED THAT THIS FRAUD WAS DONE TO SAVE THE COMPANY FROM THE SCAM IN SATYAM BOOKS WHICH WAS DONE OVER MANY YEARS. " .

The confession and the magnitude of the accounting irregularities point out to serious lapses in

the corporate governance and also raise questions about the role of Satyam's external auditor Price Waterhouse and of the Board and especially the independent directors of the company.

Today Satyam India's fourth largest IT company having more than 53,000 employees, has come under the dark clouds and a complete stage of uncertainty. It's share value gone rock. Some of ***the striking facts about the fraud on various financial aspects are as below:-***

- The Balance Sheet for the period till 30th September 2008, carried inflated (non-existent) cash & bank balances of Rs. 5,040 crore (as against Rs.5,361 crore reflected in the books).
- Interest earned on this money, Rs. 376 crore which is non-existent.
- The liability was understated to the tune of Rs.

1,230 crore.

- An overstatement of money owed to the tune of Rs. 490 crore.
- For the quarter ending to 30 september, Satyam reported a revenue of Rs. 2,700 crore and an operating margin of Rs. 649 crore (24 % of revenue) as against actual revenue of Rs. 2,112 crore and an actual operating margin of Rs. 61 crore (3% of revenue). This resulted in artificial cash & bank balances rising by Rs. 588 crore in the fiscal second quarter alone.

CONCLUSION

This is a typical case of financial fraudulency. The ERP, net income share value etc have been increasing but unfortunately by manipulating the figures for several years. Incidentally it has not been checked or detected by any agency including SEBI, auditing agency as well as other financial institutions viz LIC, HDFC, ICICI etc which have invested heavily in Satyam Computers. It provides a living case of non-ethical corporate governance. Satyam has not only damaged its own future but has also tarnished the image of India Inc. It has shaken the trust of the investors in the country as well as abroad. Most of the foreign institutions would think twice before investing money in India. The economy, which is already on the down slide may further fall and create a serious financial crisis. Besides, it is a great tragedy, especially for the 53000+ employees who have worked very hard with full dedication and commitment for years with the company and now have an uncertain future this for no fault of theirs.

A multi pronged startegy needs to be formulated to check the recurrence of such financial embezzlements by any company in future.

The Issues are ?

- What should be the role of the SEBI in all such cases ?
- What should be done to detect such kind of scams ?
- What should be the role & responsibilities of the Auditing & Consulting Firms ?
- What should be the role & responsibilities of Board of Directors ?
- What can be preventive checks & measures

to control such scams in other corporates ?

- What will be the responsibilities of Financial Institutions like ICICI, LIC, HDFC etc ?
- What are the control measures available with Ministry of Corporate Affairs & Reserve bank of India ?
- What are the provision of punishment for the person (s)/ Companies indulging in such types of high level financial scams ?
- In such cases the shareholders are the worst victims, Who are going to support them and take care of their interest ?

These are the some of the questions which need to be addressed by the financial experts, government officials, legal expert and business corporates.

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