Financial Statement Fraud & cases
DFA – Module 1 :
Unit 8 & 12

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FS Fraud

- Financial statement fraud = manipulation of the information used to prepare FS released to the public and financial institutions.
- Manipulating FS allows = business to portray a better but false financial picture, or to hide a disbursement of money, liabilities or assets
- Management = responsibility for IFC

Financial Statements manipulation

- Accounting standards non compliance
- Alteration of accounting records, docs & registers
- Intentional omission of key facts / misrepresentation
- Showing CL as contingent liability
- Under / overstatement of provision
- **Clause 49 – Listing agreement = CEO-CFO Certification**
- 1. no materially untrue disclosure, or omission of facts
- 2. no fraudulent / illegal activity / transactions during the FY
- 3. IFC – design & TOC
- 4. BOD to disclose to auditor & audit committee –
- - IC changes
- - changes in Accoutering Policies
- - instances of significant fraud

Motive

- To show that some financial target, sales or budget projections have been fulfilled.
- either to increase share prices of publicly listed companies,
- or obtain finance on more favourable conditions that would have otherwise been available.
- results may be manipulated to show a lower taxable income in order to reduce a tax liability

Techniques

- **Manipulating Timing**
- **1. Early Recognition of Revenues & false booking**
- Recording a sale <u>when there are still items or services </u>to be provided;
- iii. Recording a <u>sale before the sale contract has been </u>finalized and before shipment to customers:
- iv. Recording a <u>sale when items are sent on consignment, on approval, or with a right of return</u>;
- v. <u>Issuing invoices for non-existent sales </u>and recording the transaction

- **Postponing Expenses**
- postponing the <u>recording of expenses until the next period</u>
- may only record expenses <u>after the invoice arrives </u>from the supplier
- Expenses may be recorded <u>when the expense is finally paid</u>
- **Fictitious revenues: Fictitious revenues can be created by:**
- a) Inventing sales transactions; or
- b) Classifying other incomes or gains as sales.

Manipulating liabilities and expenses

- Moving a short-term liability to long term liability improves the working capital figures on the balance sheet.
- Capitalizing expenses and writing them off slowly creates an asset that does not exist and reduces the expenses in the current period.
- These capitalized expenses can then be written off over an extended period spreading the expense.
- Not writing-off assets when appropriate-usually debtors that become uncollectible, or investments, stock or other assets that will depreciate or fluctuate in value – keeps an ‘asset’ in the balance sheet when it has no or little worth.

Valuing Assets

- Value the inventory at a higher price than appropriate (at an inflated selling or cost price) and count the correct amount.
- b) Value the inventory at the correct amount and inflate the number of items.
- c) Do both.

✓ Gaining extra inventory for stock takes is done by either counting empty boxes stacked high on shelves,

✓ moving inventory between warehouses so that it is counted multiple times,

✓ obtaining inventory from a supplier on consignment or

✓ under some right of return, or

✓ borrowing inventory from a friendly supplier

Accounts Receivable

- Creating debtors and sales is a simple credit sales / debit debtors' entry. This has the same effect.
- Creating false sales will usually have the effect of increasing debtors
- Writing off good debtors at the end of a period creates an expense and lowers profits. Simply write them back on when collected
- Bill and Holds
- Overstated tangible & Intangible assets
- **Other Schemes**

✓ failure to disclose certain transactions with related parties,

✓ material asset impairments, unrecorded liabilities

✓ or accounting practices that violate Indian GAAP.

Forensic Audit Approach – ARP , ISA 520

Audit techniques

- Compare current-period financial information to prior-period financial information, budgets, and forecasts.
- Examine relationships among financial information. Ex: COGS expected to vary directly in relation to sales.
- Study relationships of financial information with related non-financial information. Ex: department store sales are expected to vary with the square footage of the sales floor.
- Compare information to that of other organizational units or the industry
- **Review : trends, ratio (directly proportional)**

✓ Assets Versus Liabilities

✓ Sales Versus Cost of Goods Sold

✓ Sales Versus Accounts Receivable

✓ Sales Versus Inventory

✓ Profit Margins (GPM, NPM)

SARADHA GROUP FINANCIAL SCAM

- Saradha Group financial scam was a major financial scam and alleged political upheaval caused by the collapse of a Ponzi scheme run by Saradha Group, a consortium of over 200 private companies believed to be running collective investment schemes popularly referred to as chit funds in Eastern India.
- In the early 2000s, businessman Sudipto Sen set up the Saradha Group, and launched what the securities market regulator SEBI later categorised as a collective investment scheme.
- The Saradha Group used a consortium of companies to tap small investors, promising them very high returns

SEBI Scanner

- Like in a classic Ponzi scheme, money was collected through a wide network of agents, who were paid commissions of over 25%.
- In a few years, Saradha's raised about ₹.2,500 crore. It built its brand through:
- film star endorsements,
- investments in popular football clubs,
- ownership of multiple media outlets, and
- sponsorship of cultural events such as Durga Pujas.
- The scheme expanded to Odisha, Assam, and Tripura, and the number of investors reached close to 17 lakhs.
- In 2012, SEBI, which was already watching the Group, asked it to stop accepting money from investors until it got the regulator's permission.
- Alarm bells started to ring in January 2013, when for the first time, the Group's cash inflow was lower than its outflow-another classic event in a Ponzi scheme.

Beginning of the fall

- By April 2013, the scheme had collapsed, and investors and agents lodged hundreds of complaints with the Bidhannagar Police. Sudipto Sen fled West Bengal after writing an 18-page letter, in which he accused several politicians of arm-twisting him into making investments that led the company to collapse.
- An FIR was registered, Sen was arrested along with his associate Debjani Mukherjee in Sonmarg on April 20, 2013
- Investigations found the company had laundered investments in locations such as Dubai, South Africa and Singapore.
- Government set up a Special Investigation Team (SIT) to probe the case after clubbing all the FIRs.
- CBI began investigations in Assam after the state government handed over the probe to it.
- Based on state police FIRs, Enforcement Directorate registered cases of alleged money laundering, and arrested several people

SFIO action

- SFIO clearly pointed out alleged violation of some provisions of the Companies Act by key Saradha outfits - Saradha Realty, Saradha Construction Company, Saradha Tours and Travels and Bengal Media.
- SFIO has specifically pointed out 8 such violations through which Saradha Group has allegedly siphoned off over Rs 150 crore (based on a report of ROC)
- Auditor questioned

SFIO

- Has been constituted u/s 211 of the Companies Act, 2013.
- It is a multidisciplinary Investigating Agency, wherein experts from diverse sectors like banking, capital markets regulation, corporate regulation, law, forensic audit, taxation, information technology, etc. work together to unravel corporate frauds.
- It is headed by a Director, in the rank of Joint Secretary to the Government of India, SFIO.
- The Head Office of SFIO is in Delhi and 5 Regional Offices are presently functional i.e. at New Delhi, Chennai, Mumbai, Hyderabad, and Kolkata.