
Different Types of Frauds

DFA – Module 1 :

Unit 6

Arijit Chakraborty
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Definition of Fraud, Scam & White collar crime

A Fraud is:

- u A representation (usually of fact)
- u About a material point
- u which is False as Truth or Correct
- u Which is believed and Acted upon by the victim
- u u Caused Damage Intentionally and knowingly so (some cases recklessly)
(Financially or otherwise)

Scam : A scheme designed with an intent to defraud a group of individuals or an enterprise(s) or a government(s) or a mix thereof, for getting some personal benefit - financial or fame, which requires violation of some law or flouting of certain established controls and involves a team work

White Collar crime : An offence which does not result in any physical injury but results in a financial loss

Corporate fraud

- Corporate fraud = illegal, deceptive actions committed either by a company or an individual who is an employee of the company.
- ¶¶ Corporate fraud schemes are highly complicated accounting schemes used to inflate a company's apparent profits and may take years to detect.
- When massive corporate fraud is eventually discovered, it can take down even huge multinational companies with billions in annual revenues.
- ¶¶ Much of the money illegally obtained through corporate fraud is often never recovered, after being spent long ago by the perpetrators

Key points

- Mistake vs Fraud (IA vs Forensic audit role)
- Forensic auditor = review Stat audit, IA & IS Audit Reports
- **Forensic audit team =**
 1. Independence
 2. Objectivity
 3. Integrity
 4. Competence & due care
 5. confidentiality
- **Forensic audit = related to 4 D**
 1. Decoy.
 2. Deception,
 3. Damage
 4. Dishonest

India Corporate Fraud Survey 2020

- About 58% of survey respondents believe incidents of fraud will rise in the next 2 years.
- The top 3 reasons for fraud include:
 - 1. *Lack of an efficient internal control/ compliance system,*
 - 2. *diminishing ethical values, and*
 - 3. *senior management override of controls*
- Top 3 fraud –prone Business process / functions:
 - 1. *Procurement (30%),*
 - 2. *vendor selection (18%), and*
 - 3. *sales and marketing (15%)*

Frauds & corruption in Industrial sector: Overall key findings - 2020

- **45% of banks** have suffered economic crime compared to only 34% across all other industries, **more than 1 in 3 organization** impacted by economic crime
- **1 in 5 internally perpetrated frauds** still involve senior management, though the majority of such fraud tends to be committed by junior staff or middle management.
- **Asset mis- appropriation** - primary type of reported economic crime
- **Cybercrime, bribery and corruption** increasingly common
- **Money laundering** remains a hot topic, *where it is almost five times more likely to occur than in other industries*
- **Whistleblowing mechanisms** appear to be more prevalent than before, **however doubts remain over their effectiveness**
- Root cause of most cyber attacks is **monetary/ financial gain**

Business Frauds types

- Internal vs external frauds
- Frauds on the company vs fraud by the company
- Management frauds – Complex, complicated challenging to detect = May go unnoticed
- Fraud by collusion / committee fraud
- Forgery, fabrication
- Conflict of interest (avoidance of conflicting roles, disclosure, safeguards , regular audits)
- bribery
- When revealed = company may be in CIRP

Reason for corporate frauds

- ❑ The Desire or Perceived need to attract or Retain Investors
- ❑ Maintain share price / PE multiples
- ❑ Managerial remuneration , bonus linked with Net profits
- ❑ Problems or defects with a Company's Products: pharma, auto
- **Major Corporate Fraud Cases in the World**
- Enron Accounting scandal = resulting in **Sarbanes-Oxley Act**, which required more transparency in companies' financial reporting and imposed significantly harsher penalties on any company
- Sec 302
- Sec 404
- PCAOB

- Boom time = BTC, Ether, Doge, Solana, Shiba Inu
- Young Indians = day trading in Crypto = after office hours = keeping busy at night
- Currently, around 10.5 crore or 7.9 % of Indians invested in Cryptocurrencies through Indian exchanges, as per CREBACO, a research firm.

Bitcoin has gained over 131% year-to-date (YTD).

- Total value of all cryptocurrency assets has just exceeded \$3 trillion, = Bloomberg News

Crypto = emerging Fraud risk ?

- RBI Governor sounded alarm on cryptocurrencies, cautioning investors on the potential pitfalls of the digital currency.
- After Hon'ble SC overturned RBI's order, which effectively lifted the ban on cryptocurrency trading in India, craze in India has grown at a furious rate.
- The Union Government not yet enacted a law on cryptocurrencies
- Consultation on with industry experts
- After several rounds of caution, Govt may largely want to set severe limits on the trading of cryptocurrencies in India in the larger public interest
- Cryptocurrencies are a very serious concern from a macro economic and financial stability point of view ... Numbers on crypto market participants highly exaggerated:
 - - RBI Governor , 10th November 2021 (Source = media reports)

SATYAM FIASCO



Business Transformation. Together.

“SINKING SHIP OR TIP OF
ICEBERG”



"It was like riding a tiger, not knowing how to get off without being eaten."

B. Ramalinga Raju

The Satyam scandal has shocked India.

It is being called India's Enron. Satyam is a Sanskrit word whose meaning is 'truth'. Satyam Computer Services Ltd. which was a few weeks back one of the top 5 IT companies of India.

So what went wrong with Satyam?

- On 7th January 2009, the company Chairman Ramalinga Raju resigned after notifying its board members and the SEBI that he had falsified accounts.
- Total direct scam amount = Rs 7136 crore
- Fall in stock market
- Loss of investments, M-Cap
- Loss in FII confidence
- Job cuts, economic impact

INTRODUCTION

1987

- Satyam computers was founded by Ramalinga Raju
- He started the Satyam computers with 20 employees

1991

- Converted into Public Ltd Co. and listed in BSE, NSE
- First Indian company to be listed in three international exchanges NYSE, DOWJONES & EURONEXT

2000

- Declared one of the 100 most pioneering technology companies by World Economic Forum

2007

- Become the 1st Asian company to features in the training magazine's list of top 125 companies for learning

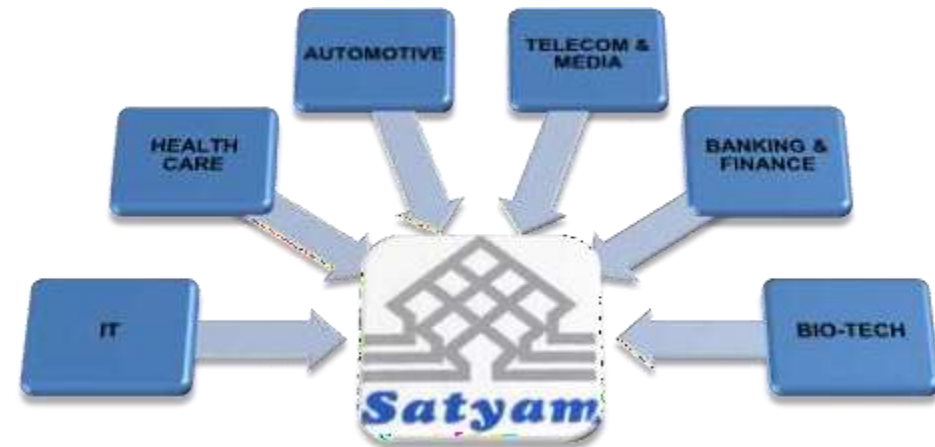
2008

- 4th fastest growing IT company in India
- Satyam network covers 66 countries and 53,000 employees across the globe

BUSINESS OPERATIONS

- Satyam computers = Indian multinational provider of **Information Technology (IT)**, **Networking Technology Solutions** and **Business Support Services (BPO)** to the telecommunications industry. It is Headquartered at **Mumbai**, India
- Employees more than 40,000 in India
- 4th largest IT Outsourcing Company of India
- Offered services to more than 550 MNC's
- High Global reputation
- The company offered consulting and information technology services spanning various sectors like software development, outsourcing, CRM & consulting

OPERATIONS



MAJOR CLIENTS



Details of Scam

7th Jan 2009 = news came in the market of Satyam scandal.

Mr. Ramalinga Raju confessed about manipulating FS of the company. 5-page letter given by

Mr. Ramalinga Raju to Board of Directors

The revenue made by the company were overstated.

Motive Behind the Scam:

- To maintain the pace of growth
- To please investors and shareholders
- To justify the inflated P/E multiples.

Inflated (non-existent) Cash and Bank balance of Rs. 5,040 crores (as against INR 5361 crore reflected in the books).

- An accrued interest of Rs. 376 crore which is non-existent.
- An understated liability of Rs. 1,230 crore.
- An overstated debtors position of Rs. 2161 crore (as against 2651 reflected in the books).

Actual number of employees = 40,000 and not 53,000 and Mr. Raju had been allegedly withdrawing INR 20 crore rupees every month for paying these 13,000 non-existent employees.

Confessions Made

- *‘Neither myself, nor the managing Director (including our spouses) sold any shares in the last eight years-excepting for a small portion declared and sold for philanthropic purpose.*
- *That neither me, nor the Managing Director took even one rupee / dollar from the company and have benefitted in financial terms on account of the inflated results.*
- *Non of the board members, past or present, have any knowledge of the situation in which the company is placed. None of my or Managing Director’s immediate or extended family members has any idea about these issues. ‘*

Violation of the Companies Act

- Violation of Section 372A of Companies Act.
 - Acquiring shares in another corporate for an amount not exceeding 60% of the acquiring company's share capital & free reserves.
 - Passing resolution through a postal ballot & giving advance intimation to the RoC (Hyderabad)
- Violation of Section 293 of Companies Act.
 - Failed to pass resolution regarding the proposed acquisition of stakes in Matyas Infra. & Matyas Properties.

Satyam's path to disaster

- Chronological summary of the events which send IT major Satyam Computer Services, founded in 1987, to disaster:
 1. **December 16:** Satyam gets board's approval for acquisition of Maytas Infrastructure and Maytas Properties for \$1.6 billion
 2. **December 18:** British mobile solution provider Upaid files a suit against Satyam in a district Court in the US over Maytas deal.
 3. **December 25:** Mangalam Srinivasan, non-executive and independent director resigns from board.
 4. **December 27:** Promoters disclose that their entire holding in Satyam pledged with institutional lenders since 2006.
 5. **January 1:** Satyam-Upaid case hearing over the Maytas deal in Texas court on January 7.

- 7. January 2:** Promoter holding in Satyam drops to 5.31 per cent from 8.27 per cent after sale of pledged shares by lenders.
- 8. January 6:** Raju family holding in Satyam falls to 3.16 per cent after sale of pledged share by lenders
- 9. January 7:** Satyam Chairman Ramalinga Raju sends letter to board tendering his resignation and admitting to fraud in accounting books.
- 10. January 7:** Satyam Managing Director B Rama Raju also resigns
- 11. January 7:** DSP Merrill Lynch terminated its advisory engagement with company

Items Rs. in crore	Actual	Reported	Difference
Cash and Bank Balances	321	5361	5040
Accrued Interest on Bank Fixed Deposits	Nil	376.5	376
Understated Liability	1230	None	1230
Overstated Debtors	2161	2651	490
Total	Nil	Nil	7136
Revenues (Q2 FY 2009)	2112	2700	588
Operating Profits	61	649	588

IMMEDIATE MARKET REACTION

Immediate Market Reaction:

- Sensex stock index dropped 7.3%
- Satyam shares fell nearly 78%



Historic Graph 01-01-2009 to 16-03-2009

IMPACT ON STAYAM

SHARE PRICES PLUNGES



IMPACT ON STOCK MARKET:

- ✓ shares fell to 6.00 rupees on 10 January 2009, compared to a high of 544 rupees in 2008.
- ✓ The sensex fell from its closing peak of 20,837 on January 8, 2008 to less than 10,000 by October 17, 2008.
- ✓ NSE announced that it will remove Satyam from its S&P CNX Nifty 50-share index on January 12 and added Sun Pharma
- ✓ In New York Stock Exchange Satyam shares peaked in 2008 at US\$ 29.10; by March 2009 they were trading around US \$1.80.
- ✓ The New York Stock Exchange halted trading in Satyam stock as of 7 January 2009.
- ✓ Withdrawal of FII of actual \$66.5 billion at the beginning of 2008 to pull out of \$ 11.1 billion during the first nine and a half months of 2008 triggered a collapse in the stock market.
- ✓ Withdrawals in FII also led to sharp depreciation in rupees.

Regulators in action:

- Department of Company Affairs(DCA): Scanned for further misappropriations in the balance sheet.
- CLB(Company Law Board): Looking into violations of the Securities Act.
- SEBI: Investigating matters relating to trading of shares.
- Enforcement Directorate: Looking into possible violations of rules governing foreign exchange transactions.
- CID/CBI: Investigated the criminal aspects of the fraud.



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Satyam – impact on profession

- The audits were conducted by auditor *“in accordance with applicable auditing standards”* – questions from Regulators
- Ties between the company management and auditors = Audit rotation
- SEBI, called for peer reviews of audits among the companies that are part of the Nifty and Sensex indices.
- Role of Independent Directors
- Regulation and transparency can only serve to lower the incidences of fraud.
- Companies Act 2013 – sec 447
- Emergence of Forensic Audit