Satyam Scandal

Company's Background

The company Satyam Computer Services was founded in 1987 by Ramalinga Raju. Satyam's core services included software development, engineering design, software integration into systems, ERP solutions, consultation, IT outsourcing, electronic commerce, customer relationship management, and system maintenance. The company operated in 45 countries across the world and provided information technology services to more than 270 companies in different parts of the world.

The expertise of Satyam's employee had led to partnership deals with 76 Fortune 500 companies, hence, its rapid expansion into a top IT company in India. Satyam's rapid growth was based on core organizational values that included belief in people, customer orientation, the pursuit of excellence, and entrepreneurship. In 2003, Satyam signed a partnership deal with the World Health Organization (WHO) to provide IT services. Two years later, the company was ranked highly by Global Institutional Investors for its exceptional corporate governance. In 2008, Satyam was awarded the "Global Peacock Award" by the World Council for Corporate Governance. Satyam's corporate accountability award was ironic because a few months later, India's biggest scandal erupted and revealed the company's unethical corporate governance .

Scandal: In Brief

According to the Central Bureau of Investigation (CBI), the scandal began in 1999 when Satyam embarked on a plan to multiply its annual growth. The main growth strategy involved the manipulation of financial statements. The purpose of altering financial accounts was twofold. First, the chairman wanted to keep the company's share price high in the various stock exchanges that it was listed. A high share price was an indication that the company was doing well financially. On the other hand, it was a strategy to increase investors' confidence in the company. Second, Raju wanted to boost the company's market capitalization in order to attract more investors.

This strategy worked because Satyam was awarded by many organizations for its remarkable growth and corporate governance. The scandal was made public in 2009 when the company's chairman, Ramalinga Raju, revealed that he had manipulated financial accounts to the tune of US$1.47 billion. Raju stated that the fraud began as a marginal gap between the company's actual operating profit and the numbers that appeared in the account books. Between 2003 and 2008, the company created false clients, projects, and invoices in order to falsify the company's financial performance, improve its profile in the IT sector, and attract more customers. In 2009, Satyam falsified its sales and recorded Rs. 5200 crore instead of the real Rs 4100 crore. In addition, profits were inflated from 3% to 24%.

The financial results announced in 2009 were highly inflated. For instance, quarterly revenues were inflated by 75%, while operating profits were inflated by 97 percent. The marginal gap widened over the years, and when it was too wide to hide, the chairman confessed to engaging in illegal accounting practices. According to Raju, the manipulation was done because of the fear that the company's performance would lead to a hostile takeover. The company's promoters held a small percentage of equity that was not enough to boost the company's financial performance. As the company grew, the marginal gaps grew so big that the chairman could no longer hide the company's poor financial performance.

On 16 December 2008, Raju announced that the company was planning to purchase two companies belonging to Maytas i.e. Maytas Infrastructure Limited and Maytas Properties Limited. Satyam's investors rejected the proposal because the two companies were operated by Raju's family. Investors were dissatisfied with Raju's leadership style as well as the company's corporate governance. The World Bank surprised Satyam by cancelling all business transactions between them and imposing a suspension. The bank accused Satyam of bribing employees and providing staff members with unauthorized benefits that raised suspicion of unethical corporate governance. In addition, the company was accused of stealing data that is used to improve its business operations.

The suspension caused a further 14% decline in share price, which was the lowest Satyam had experienced in over 4 years. The plunges in share price exposed the company's poor financial situation. As a result, Raju, revealed the financial fraud, and stepped down as the chairman. He disclosed that buying the two Maytas companies was his last attempt at altering the company's financial accounts by replacing fictitious assets with real assets. He was trying to cover up his unethical practices. After the fraud's disclosure, the government took over control of the company and began investigations into the scandal.

Seven days after Raju admitted to manipulating financial accounts, PriceWaterhouseCoopers revealed that its auditors presented a falsified audit report. The auditors had used manipulated financial statements provided by Satyam's management team. The auditors played a key role in the fraud because Satyam's head of global audit fabricated customer identities, created fake invoices to inflate the company's earnings, and falsified board resolutions and secured loans without following legal procedures. The money acquired through American Depository Receipts in the United States was misappropriated because it was always excluded from Satyam's balance sheet.

The company's promoters played a significant role in the fraud as well. For example, they sold their shares at inflated prices and took advantage of unsuspecting investors. The stake of the promoters in the company declined from 25.6% in 2001 to 8.74 in 2008 (as shown in table). This decline in ownership revealed that the fraud was premeditated and that the participants planned to steal money from investors.

As on	**Promoter's stake in Satyam (%)**
March 2001	25.6
2002	22.26
2003	20.74
2004	17.35
2005	15.67
2006	14.02
2007	8.79
2008	8.74
Dec 2008	2.18

A large percentage of the cash raised by the company was used to buy land in order to take advantage of the realty market that was blooming. The land was then put under the management of two companies owned by Raju's family, namely Maytas Properties and

Maytas Infrastructure. These lucrative purchases left little money that Saytam could use to fund its day-to-day operations. The company was destined for failure because a large percentage of the money and bank balances are shown in the balance sheet were non-existent.

According to the Serious Fraud Investigation Office, Satyam paid Rs. 186.91 crores as a tax within a period of seven years for fictitious fixed deposit accounts that top executives had created to siphon money from the company. The company’s software developers and system administrators also played a minor role in the fraud. For example, details of Satyam’s financial accounts were stored in two different Internet Protocol (IP) addresses. The company’s IT specialists participated in the fraud because they created fake invoices and bills for inclusion in the balance sheet. They used advanced software programs to create fictitious invoices and bills.

The role of the auditors was to ensure that Satyam did not engage in unethical accounting practices. However, their contribution was critical because, for the many years that they audited the company’s accounts, they never identified any unethical dealings. After the fraud’s discovery, they confessed that they only relied on the financial statements they received from Satyam’s management. Their lack of vigilance was appalling.

Conclusion

The Satyam accounting fraud is the largest fraud scandal to happen in the history of India. It was conducted over a period of about 10 years by the company’s chairman and other top executives. It is evident from the foregoing discussion that Satyam’s management did not honor the code of ethics and standards that govern the accounting profession. They inflated their financial accounts in order to present a false image of their company’s financial performance. The scandal was exposed by Merrill Lynch after discovering financial inconsistencies in the financial statements of Satyam. The chairman and other top executives resigned, the company’s share price fell drastically, investors lost $2.2 billion, and the government appointed a board to handle the situation. The company was sold to Tech Mahindra, and the two entities merged to form Mahindra Satyam. The Satyam accounting fraud occurred due to many years of financial manipulation of accounts that was intended to fool investors and the public into believing that Satyam was performing well financially. Such occurrences can be avoided by adhering to accounting ethics, honoring business ethics, and by promoting transparency and accountability within organizations.