Satyam Computer (2009)

Satyam Computer Services Ltd (Satyam) was founded in 1987 by Ramalinga Raju (Raju) and his brother Rama Raju as a private company with just 20 employees to develop software and provide consultancy services to large corporations. The company became a skyrocket success riding on the Y2K phenomenon as the end of the millennium approached. It debuted on the Bombay Stock Exchange in 1991 followed by a New York Stock Exchange listing in 2001. The company earned the distinction of 'India's one of the most remarkable and entrepreneurial companies' from the World Economic Forum. Even though public, Satyam remained a company dominated by its co-founder cum Chairman Mr. Ramalinga Raju who was conferred with the IT Man of the Year 2000 award by Dataquest.

In 2003 Satyam signed a long-term contract with the World Bank to provide IT services. In 2006, Satyam had about 23,000 employees and was reporting $1 billion in revenue. By the end of 2008, the company became fourth largest IT Company of India. It claimed to surpass $2 billion in revenue, and had about 53000 employees. In 2008, the company received "Golden Peacock Award' for excellence in corporate governance from the London based World Council for Corporate Governance. The company had in place an optimum combination of non-executive directors and executive directors, an independent audit committee, a nomination committee and remuneration committee consisting of independent directors. The company had been calling investors meet also regularly. The independent directors in company were highly acclaimed professionals ranging from the founder of the Pentium Mr. Vinod Dham, Prof. Krishna Palepu of Harvard Business School, Dean of Indian School of Business Mr. M Rammohan Rao, Mr. T.R. Prashad, former Cabinet Secretary, and other academicians.

Confession of the Fraud

In one of the biggest frauds in India's corporate history, B. Ramalinga Raju, founder and CEO of Satyam Computers, announced all of a sudden on January 7, 2009 that his company had been falsifying its accounts and doctoring the books of accounts of the company for years. The self confession "with deep regret and burden on conscience" plunged all stakeholders into deep trouble with completely dark future. As per the confessions, company's financial statements had overstated cash reserve of Rs. 5040 crores which did not exist, accrued interest of Rs. 376 crores, debtors Rs. 2160 crores, and understated liabilities of Rs. 1230 crores. Ironically, Satyam means "truth" in Sanskrit, but Raju's admission -- accompanied by his resignation -- shows the company had been *asatyam* (or untruth), at least regarding disclosure of its financial performance to the investors, shareholders, clients and employees. The scale of India's biggest corporate fraud was estimated at around Rs. 7000 crores.

Raju was compelled to admit to the fraud following an aborted attempt to have Satyam invest $1.6 billion in Maytas Properties and Maytas Infrastructure -- two firms promoted and controlled by his family members. The Board of Directors of the company on December 16, 2008, cleared the deal of acquiring 100 percent stake in Maytas Properties and 51 percent stake in Maytas Infrastructure. Following the deal, institutional investors of the company who had 61.57 percent shareholding in the company (as on Sep. 30, 2008) questioned the propriety of using the software company's cash pile to buy two infrastructure firms belonging to the promoters. The investors pummeled its stock on the New York Stock Exchange and Nasdaq. The board hurriedly reconvened the same day and the deal was aborted. The matter however didn't end there, as Raju might have hoped. In the next 48 hours, resignations streamed in from Satyam's independent directors.

Resigning as Satyam's chairman and CEO, Raju said in the confession addressed to his board, the stock exchanges and the market regulator Securities and Exchange Board of India (SEBI) that Satyam's profits were inflated over several years to "unmanageable proportions" and that it was forced to carry more assets and resources than its real operations justified. He took sole responsibility for those acts. "It was like riding a tiger, not knowing how to get off without being eaten," he said. "The aborted Maytas acquisition was the last attempt to fill the fictitious assets with real ones." Raju acknowledged that Satyam's balance sheet included Rs. 7,136 crore (nearly $1.5 billion) in non-existent cash and bank balances, accrued interest and misstatements (shown in Table 1). The company, as per the confession had also inflated its 2008 second quarter revenues by Rs. 588 crore ($122 million) to Rs. 2,700 crore ($563 million), and actual operating margins were less than a tenth of the stated Rs. 649 crore ($135 million).

Table 1: Satyam's Reconstructed Balance Sheet

Sources Of Funds	**Originally Given***	**^Raju's Statement**	**Adjusted***
Shareholders' funds	Rs/Cr	Rs/Cr	Rs/Cr
Share Capital	134.70		134.70
Share application money	2.76		2.76
Reserves & Surplus	8392.23		1255.89
Loan funds			
Secured loans	30.49		30.49
Unsecured loans	234.80	1230	1464.80
TOTAL	**8794.98**		**2888.64**
APPLICATION OF FUNDS			
Net fixed assets	1381.10		1381.10
Investments	618.64		618.64
Deferred tax	118.75		118.75
CURRENT ASSETS			
Sundry debtors	2651.36	-490	2161.36
Cash & Bank	5312.62	-5040	272.62
Other current assets**	376.34	-376.34	0.00
Loan & Advances	502.22		502.22
	8842.54		2936.20
Less: Current Liabilities			0.00
Liabilities	1669.26		1669.26
Provisions	496.79		496.79
NET CURRENT ASSETS	6676.49		770.15
TOTAL	**8794.98**		**2888.64**

**INT ACCRUED *As on 30.09.08 ^ ADJUSTMENTS

(Source: The Economic Times, New Delhi, 08-01-2009)

Table 2 summarises the sequence of events which led to unfolding of the scam by the scamster, the disgraced chairman of the company Mr. Raju.

Table 2: Sequence of Events

Date	Event
Dec 16, 2008	Satyam Computer Services announces $1.6 billion acquisition of 100% stake in Matyas properties and 51% stake in Matyas Infra, both promoted by Ramalinga Raju and sons.
Dec 17, 2008	Satyam-Matyas deal is scrapped following investors-shareholders rebellion, Raju mulls on the share buyback.
Dec 21, 2008	Govt. asks Registrar of Companies to submit the report with factual evidence on Satyam-Matyas Deal.
Dec 24, 2008	World Bank bars business with Satyam for 8 years starting September 2008.
Dec 25, 2008	Academician and independent director Mangalam Srinivasan exits from Satyam on Christmas owning moral responsibility for not voting against it.
Dec 28, 2008	Satyam Computer defers crucial board meet from Dec 28 to Jan 10.
Dec 29, 2008	Satyam appoints DSP Merill Lynch to review strategic options and assess implications of possible dilution of Ramainga Raju's stake; Non-executive director Vinod Dham resigns from board.
Dec 30, 2008	Satyam's board nearly halved as Indian School of Business dean M Rammohan Rao also quits.
Jan 2, 2009	Satyam discloses to stock exchange that Raju and his family have pledged all their shares, held in a corporate entity SRSR limited, to institutional lenders.
Jan 3, 2009	Ramalinga Raju's stake in Satyam falls to 5.13% from 8.27% as lenders sell shares.
Jan 6, 2009	Ramalinga Raju's stake falls further to 3.6% from 5.13%.
Jan 7, 2009	Chairman Ramalinga Raju and MD Rama Raju resign.

(Source: The Economic Times, New Delhi, 08-01-2009)

Aftermath

The January 7 confession of Raju emanated shock waves across the corporate sector in India, dumbfounded the regulators, and pummeled the shares of the company. The share of the company nosedived from a high of Rs.178.95 on January 6, 2009 to below Rs 40, wiping out Rs 9376 crore of investors' wealth in just one day. The Indian stock market regulator, the Securities and Exchange Board of India (SEBI) commenced investigations immediately under various SEBI regulations. The Ministry of Corporate Affairs of the Central Government separately initiated a fraud investigation through its Serious Fraud Investigation Office (SFIO). Following the January 7 letter and in accordance with the requirements under the Indian and the United States accounting standards, PricewaterhouseCoopers (PwC), Satyam's auditors, issued a letter stating that the audit reports and the opinion prepared by them for Satyam should not be relied upon. Mr. Raju, his brother (who was the Managing Director on the Board of Satyam) and the former Chief Financial Officer (CFO) were arrested. Two PwC partners were also arrested in connection with the fraud. Their bail applications were refused by the Metropolitan Magistrate's court in Hyderabad and they continue to remain in police custody. Since then, Raju and his other accomplishes have been in and out of custody, even as they continue to fight a protracted legal battle. The Institute of Chartered Accountants of India (ICAI), the body that regulates accounting firms in India, has also commenced an investigation of the auditors. The regulatory authorities in India also initiated proceedings against Maytas Infra and Maytas Properties, including seeking the removal of their respective boards and replacing them with Government nominees.

Several class action suits were filed in the District Court of the Southern District of New York, against Satyam, Mr. Raju, his brother and the CFO for violations of US federal securities laws. The members of the class have been identified as the purchasers of American Depositary Shares between 6 January 2004 and 6 January 2009.

Importantly, the Ministry of Corporate Affairs filed a petition before the Company Law Board (CLB) to prevent the existing directors from acting on the Board and to appoint new directors. On 9 January 2009, the CLB suspended the current directors of Satyam and allowed the Government to appoint up to 10 new nominee directors. The swiftness with which the Ministry of Corporate Affairs acted in superseding the board of Satyam and appointing the government nominees on the board prevented a sure liquidation of the company after the fraud of such a large magnitude had surfaced. Subsequently, the new, six-member Board appointed a Chief Executive Officer and external advisors, including the accounting firms KPMG and Deloitte to restate the accounts of Satyam.

The new Board of Satyam met numerous times since it was constituted in January 2009. The priority of the new board was to sell a portion of the company to a strategic investor through a bidding process. It was not an easy task as the key issues facing a potential bidder was the lack of clarity on the financial statements of Satyam, the ability to continue with existing client contracts (which are critical for a services company) and the outcome of various legal proceedings against the company, including the class action law suits in the United States. Finally in April 2009, Mahindra group beat Larsen & Toubro in the bidding process to acquire the company. Satyam has been rebranded as Mahindra Satyam and is attempting to regain its past glory.

As the various investigative agencies in India- CBI, SFIO, ED, SEBI are investigating and prosecuting the offenders in the Indian courts, the Securities Exchange Commission (SEC) of the USA released two documents in April 2011 unfolding the modus operandi of the scam involving inflating of the revenues of Satyam by the top management by $1.1 billion. The fraud flourished as under (as per the SEC):

Step1: 'Super User' Log in

The then-senior management allowed certain employees to have a 'super user' login password to access the company's billing system. Those employees, under directions from the then-senior management created fake invoices for services not provided and, in some cases, non-existent customers.

Step 2: Fake Invoices

After accessing the billing system, fake invoices were entered into the billing system. A total of 6,603 fake invoices were created in that five-year period. On an average, 100 to 200 fake invoices were being created in a month. Their number peaked in 2007-08, at about 2,500. Heads of business units might not have known about them at the time of their creation, but they should have noticed the mismatch in numbers when the company declared its quarterly results.

Step3: Boost Revenues and Profits

Data from the fake invoices entered the company's financial statements. This action, which carried out by the senior management "knowingly and intentionally", added $1.1 billion to the financial statements filed by the company from fiscal 2004 through the second quarter of fiscal 2009. For the last two quarters of 2008-09 and the first quarter of 2008-09, a loss was converted to a profit.

Step 4a: Falsified Bank Statements

After creating fake invoices and generating false revenues, the next step was to show these as cash receipts. To ensure that, the senior-management falsified bank statements that showed higher bank balances than what was actually.

Step 4b: Falsified Interest Income Earned From Deposits

It is not enough to falsify bank statements, as investors could question how much such deposits were earning. So, the next level of fraud was to falsify interest on fixed deposit receipts to show that fictitious bank balances were earning interest income, thus completing the circle. The deposits were held at five banks; BNP Paribas, Citibank, HDFC Bank, HSBC and ICICI Bank.

The scam was crafted and operated by the disgraced chairman by incorporating 40 front companies, maintaining fictitious bank accounts on behalf of such companies, raising bogus invoices, forging board's resolution to borrow, and employing 'ghost' employees. As per the CBI investigations, a regular flow of applications like Operational Real Time Management (OPTIMA), Satyam Project Repository (SRP), Project Bill Management System (PBMS), Invoice Management System (IMS) and Excel porting were used to create inflated data in the account of Satyam Computers. The OPTIMA were used for creating and maintaining the projects, SRP for generating the project ID, PBMS for generating bills, and IMS for generating invoices were used for purporting the fraud; while Excel Porting were used for directly accessing company's account and hiding the invoices. 7561 invoices were found to be hidden in the IMS. These 7561 invoices were worth Rs 5,117 crores. Investigators discovered that the accused had already entered 6603 out of these false and fabricated invoices amounting to Rs 4,746 crores into their books of accounts thereby inflating the revenues of the company to this tune. CBI found that the guilty were also extremely smart, they tabulated balance sheets using computers that could not be tracked. Office data showed that a few officers would make entries late in the night, toward the last quarter of the month. The manipulated balance sheets were thus created.

The Satyam fraud is a total failure of corporate governance. It provides evidence that despite sound norms of corporate governance unscrupulous persons have ways to circumvent the law. The Satyam fraud has also highlighted the multiplicity of regulators, courts and regulations involved in a serious offence by a listed company in India. Some of the regulators investigating Satyam include: the Ministry of Corporate Affairs (Government of India) including the Serious Fraud Investigation Office, the Registrar of Companies in Hyderabad, the Company Law Board; the Central Bureau of Investigation; Income Tax Department; the Enforcement Directorate; the Provident Fund authorities; the Securities and Exchange Board of India; and the Institute of Chartered Accountants of India. The impact of several parallel investigations on the successful prosecution of the accused is unclear. The wheels of justice grind slowly in India. It will be interesting to see the outcome of the investigations in India against professionals such as auditors and whether any proceedings are initiated against the former independent directors or other employees of Satyam.