

Lessons for auditors from Satyam

By
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Frauds small and BIG!

- There are no small frauds, only frauds that have not existed long enough to become big!
 - Joseph T. Wells
 - Founder and Former Chairman ACFE

White collar crime increasing!

- White collar crime, defined by criminologist Edwin Sutherland as
 - "committed by a person of respectability and high social status in the course of his occupation."
 - Is increasing !
 - In scope and numbers!

What do we know?

- No reports but bits and pieces of info. From CBI and SFIO reports which were published
- SFIO report submitted but not available:
 - 12,000 pages in 30 volumes
- CBI report submitted but not available:
 - 1532 documents
 - Statements of 433 witnesses
 - Papers packed in: 25 trunks
 - Charge sheet length: 300 pages
 - Annexures: 65000 pages
 - Investigation team size: 16
 - Scam size: Rs 7,800 cr –could be Rs 10,000 Cr
 - Front cos. Used by Raju: 327
- Restatement of accounts by KPMG (Deloitte got out) pending (given permission till Mar 10)
- Probe by ICAI is progressing- interim report submitted?
- Probe by Enforcement directorate pending
- BOB NY investigation is pending
- 32 violations of Co .law found
 - **So information is incomplete as of date and we do not still have the total picture**

What did Raju do? –bird's eye view

- Employees on bench shown as 'working'
 - For such 'working employees', 'Fictitious bills' raised
 - For such 'Fictitious bills', 'money shown as if received'
 - For "Monies shown as if received", 'fake bank statements' were created
 - With 'Fake bank statements' a 'fake reconciliation' was done
 - 'Money shown as if received' shown as 'Deposits which did not exist'
 - For 'Deposits which did not exist', 'fake bank deposit receipts and confirmations' were created
 - For 'Deposits which did not exist', 'interest shown as received';
 - For 'interest shown as received', 'TDS' shown as done!

Loading factor

- Satyam published a falsified loading factor (utilisation of staff)
- Between the second quarter of 2006-07 and that of 2008-09, the average offshore category (those working in India) loading factor was shown as 74.88 per cent, whereas the actual head count loading factor was only 62.02 per cent.
- Similarly, the company was declaring a load factor of 96.71 per cent for the onsite category (those working in customer premises abroad), while it was actually 94.86 per cent.
- Satyam's payroll was handled by its Accounts dept. The HR dept fed data on new joiners and people who resigned etc.
- The accounts dept inflated sales by generating fake invoices in the invoice management system for people who were on bench
- SAP SHINE was used by HR but not by accounts- so there was a gap
- If details of employees who quit were deleted from payroll or used to generate cash not clear

Modus operandi for billing

- Company's standard billing systems subverted to generate false invoices to show inflated sales
- 7,561 invoices found hidden in the invoice management system, worth Rs 51 billion (US\$1.01 billion).
- Concerned business circles would not be aware of the invoices, which were 'also not dispatched to the customers'.
- All the invoices that were hidden using the Super User ID in the IMS server were found to be false and fabricated.
- The value of these fake invoices were shown as receivables in the books of accounts of [Satyam] thereby dishonestly inflating the revenues of the company.

The elaborate technology set up

- Several secure networks within the company's office computers were inaccessible to all but a handful of Raju's close associates.
- Mr Raju and his cohorts had set up special password-protected 'admin login id' and 'super login id', which were used to create dodgy records of the company that could only be accessed and modified by them
- Loopholes in its accounting software left passwords unsecured to facilitate fraud; software system for managing company's financial accounting functions was deliberately made very complex for inflating profits; different departments of the company were not integrated electronically;
- The invoice management system of Satyam had a weak password protection, making the system vulnerable to misuse.
- Therefore, fake invoices could be created by unauthorised users.

How bogus billing was done?

- Various systems Satyam had:
 - Regular Satyam bills created by a computer application called 'Operational Real Time Management (OPTIMA)', which created and maintained information on company projects.
 - The 'Satyam Project Repository (SRP)' system then generated project IDs;
 - An 'Ontime' application for entering the hours worked by Satyam employees;
 - A 'Project Bill Management System (PBMS)' for billing.
 - An 'Invoice Management System (IMS)' generated the final invoices.

How bogus billing was done?

- This system structure bypassed by the abuse of an emergency '**Excel Porting**' system, which allowed 'invoices [to] be generated directly in IMS...by porting the data into the IMS.'
- This system was subverted by the creation of a user ID called '**Super User**' with 'the power to hide/unhide the invoices generated in IMS'.
- By 'logging in a Super User, the accused were hiding some of the invoices that were generated through Excel Porting.
- Once an invoice is hidden the same will not be visible to the other divisions within the company but will only be visible to the company's finance division sales team'
- Some of the 600 odd customers' sales were doubled and shown.

Who did it ?

- 33 year old assistant manager (finance) Srisailam "got created the 7561 falsified sales invoices ..(and) hid them from business divisions.. got the data fed into the systems."
- These invoices were "exported to Oracle Financials from where annual financial statements were generated."

Collection of these fake invoices!

- In order to balance the collections against these fictitious invoices, they were first shown as 'receipts' in the current account maintained with the Bank of Baroda, New York Branch and subsequently they were shown to be transferred to other bank accounts as fixed deposits
- They made false bank statements to show receipts of these fake invoices
- Now the bank statement had to be reconciled!
- Venkatapathi Raju, senior manager (finance) of Satyam, **"handed over forged monthly statement of banks (that he received from bosses) to Srisailam for making reconciliation and entries into Oracle Financials."**
- Also teeming and lading was done
- V.Raju was responsible for handling the cheques of Satyam Computers. " He received cheques totalling Rs 1,425 crores during 2006-08 from 37 companies and deposited them in the accounts of Satyam but failed to reflect the same in the books of accounts of the company.
- Instead he got them reflected wrongly as if these monies were received through sales proceeds from Bank of Baroda, New York branch."

Fake deposit receipts

- Investments shown as fixed deposit receipts (FDRs) worth crores of rupees were fake and printed from Ramalinga Raju's personal device
- Ramalinga Raju regularly generated fake quarterly balance confirmation letters showing the amounts of fixed deposits and the interest accrued on them.
- The fake FDRs showed huge amounts, and the interest on these deposits was projected to be over Rs 375 crore, as against the actual interest income of Rs 7.42 lakh only.
- VP finance Ramakrishna oversaw the process of perpetration of fraud and was custodian of forged FD receipts.

Destroying of records

- Ramakrishna got his laptop reformatted one day before the confession by Ramalinga Raju and instructed juniors to delete records from the computers.
- He also got the forged FD receipts destroyed.
- Further Srisailam - in the wake of the aborted Satyam-Maytas deal - also got **electronic records deleted and reversed certain entries in the Oracle Financials**
 - **So if the auditor does not have copies in his files the records won't be found anywhere!**

Share sale proceeds missing

- Rs 760 crore raised by scam-tainted Satyam Computer through share sales in 2001 in the US referred by SFIO to the Enforcement Directorate for further inquiry, after they failed to trace the amount.
- Satyam promoters have showed that the money was parked with Citibank, but no such accounts were found with the said bank
- Unanswered questions:
 - How could such a huge sum just vanish?
 - How can Citi bank “show their inability to provide this information on the plea that all such transfers are routed through Citibank's system account No. 10996665 Citibank, N. A. Bahrain.”
 - What is special about Bahrain that Citi itself does not know what happened after Bahrain?
 - How did company disclose utilisation of proceeds?
 - ?????!!!!

BOB NY branch

- The SFIO has recommended an investigation into Bank of Baroda's role in the Satyam scam.
- Satyam account, numbered 120559, in New York was used by the company to camouflage fictitious collections — when the cash did not exist — and that the account statements were falsified and so was the quarterly 'balance sheet' with regard to this account.
- Satyam would show the fictitious balance in the account and would later show the money being diverted and being shown as fixed deposits with other banks.
- SFIO says prima-facie evidence suggests involvement of some of the bank officials and has recommended an enquiry on the part of the Ministry of Corporate Affairs

Fraud/forgery is not new at Satyam

- A Satyam subsidiary had worked on developing software for mobile prepaid technology for Upaid.
- To obtain the patent, Upaid required the signature of 20 Satyam employees and Upaid received the signatures from Satyam and the patent in due course.
- Upaid then sued Verizon and Qualcomm for using patented technology; and Upaid got a rude shock.
- An ex-Satyam employee, who had worked on the prepaid mobile technology, now a Verizon employee, pointed out that his signature which was on the patent application, was forged.
- Upaid then sued Satyam for \$1 billion.

Other angles to investigation

- ED looking afresh into involvement of Satyam in Ketan Parekh securities scam
- CBI approaching US, Mauritius and European countries to seek details of bank accounts incl. Bank of Baroda's New York branch
- CBI has located suspicious foreign bank a/cs in USA held in the name of non Indians- Rs 60 cr channelled into these a/cs. As these are foreign banks a/cs CBI has to rely on Interpol to unravel the details
- CBI looking at expenses to see if there have been misappropriation of funds
- The Union home ministry's Government Examiner of Questioned Documents (GEQD) has confirmed the forgery committed by Raju

Other angles of investigation

- The CBI, which suspects that land was bought with money siphoned away from Satyam, has now sent special teams to identify and freeze all these land assets.

"We are now preparing a dossier on what can be called the **Satyam-Raju land bank**. Most of the pieces of land in the control of Raju are in the sizes of five to six acre plot each."

- The CAG has mentioned in the report, 2009-2010, that "Satyam Computer Services Ltd, in Hyderabad II Commissionerate, engaged in rendering of consulting engineers services, manpower recruitment agency services, etc, took **wrong credit of Rs 4.15 crore** during the period between February 2006 and July 2007, of the service tax paid on health insurance services obtained from insurance companies for the welfare of their employees

Other angles to investigation

- The United States Securities and Exchange Commission (SEC), the federal agency to regulate the securities industry in the United States, has sought India's permission to probe the Satyam fraud case
- A highly placed source in the CBI confirmed the hawala trail of money from Satyam Computers traced by the agency.
 - The accused persons in the multi-crore scam allegedly routed some Rs 12 crore every month through hawala channels outside India since 2002 till the scam was unearthed. The money was illegally sent out of the country every month leading to the loss of some Rs 1,008 crores since 2002 till 2008.
- CBI counsel Balla Ravindranath argued that the accounts of Rajus in HDFC Bank were suspected to contain funds diverted by Satyam.

Moneys lent

- Ramalinga Raju's brother Suryanarayana Raju has staked a claim to Rs 1230 crore
- There is no evidence that Raju lent Rs 1230 cr to Satyam as he had claimed.
- Recently Maytas has made a demand for Rs 600 crores said to have been paid to Satyam (Rs 380 cr in one company and Rs 220 cr in another as ICDs)
 - Which promptly has been denied by Mahindra Satyam

Restatement will take time

- The re-statement of accounts will take a long time as they have to go back to six years.
- Many documents are not available in the company, many have been torn or misplaced and some confiscated by investigating authorities.
 - Deepak Parekh
- Expected in Mar 2010

Charges against PW

- 135 “control deficiencies” identified in the integrated audit conducted in accordance with the standards of the Public Company Accounting Oversight Board. Auditors “did not bring these controlled deficiencies to the notice of audit committee and thereby, facilitated the continuance of the fraudulent practices unabated.”
- Information technology report stated: IT systems in Satyam were subject to manipulation. It was also suggested that, given these deficiencies, substantial and elaborate examination of financials should be done.
- Auditors “deliberately did not make any extensive changes in the audit plan, which clearly establishes his motives and intentions in allowing the fraudulent practices to continue.”
- Auditors received certificates of deposit from Satyam’s banks that were in “great variance with the figures provided by the company’s management” but signed off the fudged accounts
- Auditors compensated through “exorbitant audit fee” of Rs 3.67 crore in 2006-07 and Rs 3.73 crore in 2007-08. In comparison, the audit fee paid by Wipro and Infosys in 2007-08 was Rs 1.1 crore and Rs 83 lakh, respectively

Another possible charge against PwC global

- Was PwC a strategic partner with Satyam- a blog says quoting a Gartner report:
 - Did the strategic importance of Satyam as a systems integration partner and technical resource cause global PwC leadership to overlook, look the other way, or not take action on reports of poor quality or lack of independence by Price Waterhouse India partners and others?
 - Did PwC leadership - US, global, and Indian- enable and perhaps promote complicity in the fraud called "India's Enron" for the sake of their consulting business strategy?
- PwC says: We have read the Gartner report in detail and find no justification for the comment that “the Gartner report indicates that PwC was in a strategic partnership with Satyam”.
- In a rejoinder Ritwik Mukherjee replies: The Gartner report that we quoted said the opposite of what Price Waterhouse now contends!
 - Only an investigation will reveal who is right.

SEBI on PW

- Sebi has found “grave professional lapses on the part of the auditors”, which are “directly tied into and inseparably a part of the fraud perpetrated in the capital market”
 - Satyam BS was in fact audited by Lovelock and Lewes and not PW (*Then how did they sign as PW?*)
 - Audit fees though deposited in PW Bangalore was transferred to Lovelock and Lewes!
 - It is from L&L that Gopalakrishnan and Talluri withdrew moneys!
 - The partners of PW denied any association with PW Bangalore
 - Gopalakrishnan and Talluri were not authorized to sign any BS on behalf of PW!
 - The auditors wrongly signed as PW and outsourced work to L&L
 - Entire audit team is from L&L
 - Rajan who is also a partner of PW Bangalore said “PW had no manpower and as part of internal arrangement outsources work to L&L’
- Next day news:
- “Satyam Computer Services was audited by Price Waterhouse Bangalore,” the global auditing firm PWC said in an email to PTI.
- Confusion prevails here also!

Recommendations of SFIO

- Auditors be rotated every five years,
- Auditors' appointment as well as remuneration be handled by an independent agency
- Extend the scope of peer review to include audit processes as well as audit plans.
- Disciplinary proceedings against statutory auditors be handled by an independent oversight board
- Bank statements- "All credit transactions in the accounts (of banks) that are generated through clearing must reveal the details of credit as is done in the case of debit clearing transactions."
- Need to adopt a uniform practice by all the commercial banks/foreign banks while issuing balance confirmation certificates to their customers

Regulators

- Banking and market regulators are considering a proposal authorising auditors to directly verify financial information of their clients with banks where they hold accounts
- Fin-min going hi-tech-will use computer aided tools to detect frauds. (CAIT) ;
 - IT dept will use it to identify duplicate values, check sequencing and detect gaps, summarise fields etc. List of purchasers who give fictitious entries for others to inflate purchases and tool will be used to detect such purchases based on name, ph no. VST no. etc -First testing at **Hyderabad**

Regulators-SEBI

- The Securities and Exchange Board of India (Sebi), which is probing the accounting scam at Satyam Computer Services Ltd, seems to favour prohibiting Price Waterhouse and its arrested partners S. Gopalakrishnan and Srinivas Talluri from auditing any listed Indian firm or intermediary for a “certain period”

ICAI

- The Financial Reporting Review Board appointed a Panel of Reviewers to review five years' general purpose financial statements of Satyam Computer Services Ltd. The Panel has already held six meetings and is presently considering the general purpose financial statement of the company.
- High Powered Committee has so far written letters to 94 firms of Chartered Accountants, which are known to have affiliation with international entities

Back to basics audit

- Emile Woolf a famous auditing expert says: “Getting back to basic checks may be the only way for accounting firms to avoid flawed audits
- Uday Chitale and Murtuza Vaijihi point out in a BCAJ article from their case book :.. had the auditors merely opened the company’s private cash book , they would have seen columns blatantly recording the finance director’s (FD) substantial personal expenditure and illicit loans to finance dept personnel. Instead they relied on ‘high level IT systems reviews’ in which FD obligingly collaborated.

Importance of computer systems

- Ernst & Young study has said that more than half of the companies surveyed do not take into account risk of frauds in their annual audit plans.
- Though many companies have increased their internal audit budgets, the survey said that 44 per cent companies confirmed that fraud-detection procedures are not included in the work plan for most audits, while 36 per cent of them said they do not account IT risk assessments in their annual audit plans.
- Though IT systems are backbone of operations in most companies, the India Internal Audit Survey 2009 showed that there is a dearth of IT auditors and a low percentage of firms perform an IT risk assessment before finalising their internal audit plans.

Could it have been located earlier?

- My iris says:
 - It is amazing that three key items, Gross Margin, Revenue and Cost of Goods Sold, each have the same growth rate of 13% in 2005, 18% in 2006, 24% in 2007 and 35% in 2008!
- Do we need better tools like BI to locate such things and give us early warning?!

Living in opulence then and NOW!

- Then:
 - The offices of Mr. Raju and his brother today are empty on the top floor of the company's Hyderabad headquarters.
 - The penthouse has showers, bedrooms and a Japanese garden, (but an expert in vastu -- India's version of feng shui -- has declared its design a disaster!)
- Now undertrial number 882, Chanchalguda Central Prison, Hyderabad:
 - separate kitchen and fresh cooked food
 - shuttle court
 - cell phone /laptop usage
 - mineral water and fruit juices to drink, a clean bed, an independent toilet, water cooler, radio, television, newspapers and magazines (*can it be true?!)*
 - Their consultant Venkateshwara Rao of Krishi Co-op bank arrested for Rs 40cr bank fraud
 - **N.B: These apply to Raju's and not the auditors who must really be undergoing hell**

The dozen lessons of Satyam

- Thou shalt not:
 - Overlook computer system weaknesses and complex systems
 - Overlook 'super user id's' and loose password controls or fail to study logs for super user id's
 - Accept confirmations provided by Company- go the direct route
 - Overlook differences in confirmations
 - Overlook the 'roach theory' -if there are small differences /errors/frauds bigger ones could be hiding
 - Forget that anyone of any stature could act with monumental recklessness, selfishness and self destructiveness as Ramalinga Raju has proved - that all the awards mean nothing
 - Fail to rotate the key staff and partners in audits -familiarity breeds complacency
 - Forget that anything can be faked in this modern technology oriented world or underestimate the fraudster
 - Forget that there is nothing like good old fashioned audit where one looks at files, papers, check book entries with source documents etc.
 - Forget to bring to the attention of audit committee all material internal control weaknesses esp. computer system weaknesses
 - Take fees which are very high compared to peer group company audits
 - Audit work papers must be taken and preserved carefully as Company can destroy all its records- it is our only saviour

The most important lesson

- Learn to say 'no' when you should
- Ex CFO of Health south who now realises (too late) that he should have said no.
- He now mows lawns for a living and gives lectures on his story to students!

The last word

- “Due to the efficient manner in which our Ministry of Corporate Affairs (MCA) functioned, not a single stakeholder suffered, and in quite an understated way, in a public-private partnership initiative which had few parallels, the company was rescued.”
- Sudhakar V. Balachandran, an assistant professor of accounting at Columbia Business School, said the United States could learn a lot from India’s rapid response to Satyam
- The Government did a very swift and good job
- The world acknowledges that!

Source

- Various news papers
- Various journals
- Various websites and blogs
 - From Jan 09 to Aug 09