

# Lessons for auditors from Satyam-part II

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# What do the results tell us

- At last we have the published results for Satyam for 2 years (Now Mahindra Satyam)
- So what are the new lessons for auditors?
- This is a sequel and an update to:
  - 3. *What happened in Satyam and lessons for auditors*

# Let us compare –Rajus’ figs and audited figs first - Rs crores

| Item                         | Raju ‘s 7.1.09 letter | Audited results   |
|------------------------------|-----------------------|---|
| Cash & bank                  | 5040                  | 5295  |
| Accrued interest             | 376                   | 376   |
| Debtors                      | 490                   | 501   |
| <b>Sub total</b>             | <b>5906</b>           | <b>6172</b>   |
| Withholding taxes            |                       | 197   |
| Advance tax                  |                       | 255   |
| Bank borrowings              |                       | 139   |
| <b>Total</b>                 | <b>5906</b>           | <b>6763</b>   |
| <i>Understated liability</i> | <i>1230</i>           | <i>1230 (Amount pending investigation suspense a/c)</i> |
| <i>Prior period errors</i>   |                       | <i>80</i>   |

## So Raju's figs were near correct!

- Just about a 5% variation in figs declared!
- At least he had kept a tab on the amounts cooked well!
- The tax part must have slipped his mind as he did not even talk about it!

# Two categories of financial irregularities

- **Fictitious entries** entered in the accounting records of the Company:
  - These primarily involved recognition of fictitious revenue and interest income, which ultimately resulted in creation of fictitious cash and bank balances and receivables.
- **Unrecorded transactions:**
  - A number of real transactions (movements into and out of the bank accounts) were omitted from the accounting records of the Company

## *Fictitious entries details -Rs mio*

|  |               |
|--|---------------|
|  |               |
| Revenue                                  | 53,528        |
| Interest income                          | 8,998         |
| Exchange gain (net)                      | 2061          |
| Salary costs                             | -2,071        |
| Others                                   | -179          |
| <i>Unrecorded transactions effecting</i> |               |
| <i>Interest on bank borrowings</i>       | 175           |
| Salary costs                             | 5,004         |
| Others                                   | 115           |
| <b>Total</b>                             | <b>67,631</b> |
|  |               |

# Investigations done by:

- Forensic accountants (KPMG)
- Central Bureau of Investigation (CBI),
- Serious Fraud Investigation Office (SFIO)
- Registrar of Companies (ROC),
- SEBI,
- Directorate of Enforcement (ED)
- Round tripping investigations by Indian authorities and SEC of USA
- The Division of Enforcement ('Division') of the SEC
- IT department etc

# Other frauds being investigated

- Remember the ‘Roach theory’?
  - Diversion of ADS proceeds \$41 Mio
  - Round tripping -29 inward remittances from tax haven entity US\$ 28Mio (of which US\$ 17 mio may have been used to set off o/s invoices)
  - Pre Apr 2002 entries which are also baffling (Rs 11221 mio)- classified as “unexplained differences suspense account (net)”
  - An ex-employee diverting co. resources through sub-contracting agencies controlled by him!
  - Legal notices from 37 cos for repayment of Rs 12304 mio
    - They have filed case as indigent persons seeking exemption from payment of court fees!



## Limitations in forensic investigations

- Certain documents and information either **unavailable** or could not be located.
- **Lack of access** to key former employees and the previous auditors of the Company.
- Erstwhile Chairman and Managing Director authorised to open bank accounts and had **sole signatory powers** , undisclosed bank accounts possible in which funds could have been diverted.
  - **five bank accounts identified** whose existence could not be confirmed by the Management.

## Limitations in forensic investigations contd.

- Company employees could have been deployed on projects that were **billed outside the accounting system** of the Company
- Discharged cheques were not available in all instances

## Confirmations- the bane of audit in India

- I still don't know how we can do an audit in India where no one sends confirmations!
- Para 13.3 states:
  - “ The responses received from the parties reflected under various captions of statement of assets and liabilities (sundry debtors, current liabilities and loans and advances) **was minimal** compared to the overall number of confirmations sent out in spite of follow-up by the Company”
- This is a major problem in India



# Internal control weaknesses

- No effective control environment at the entity level
- The risk oversight function lacked enterprise-wide coordination, senior Management commitment, and an effective approach to performing entity-wide risk assessment
- Deficiencies in internal audit
- IT general and application controls ineffective
- Unrestricted access to critical IT systems/folders
- Multiple non-integrated software platforms used for financial reporting and no process of reconciliation between various systems including payroll systems

## Internal control weaknesses contd.

- Unexplained / unreconciled differences between the sub-systems / sub-ledger and the general ledger
- No effective, timely and accurate financial closing and reporting process
- Deficiencies in the process for revenue recognition and receivables Management
- Absence of effective customer confirmation, bank balance confirmation, bank reconciliation procedures
- No physical verification of fixed assets at regular intervals and fixed assets register not updated
- Capitalisation of fixed assets done without evidence of approval by respective departments.
  - List not exhaustive!

# Audit report qualifications

- 27 qualifications
- Main qualification being:
- For FY 2008-09, inability to comment on the cash losses of the immediately preceding year {FY 2007-2008) and for FY 2009-10, inability to comment on the cash losses for the year due to various qualifications

# Some more lessons

- Certain things should always make us sit up and notice as these are **ABC of audit/accounting**:
  - IT general and application controls ineffective
  - Unrestricted access to critical IT systems/folders
  - Deficiencies in the process for revenue recognition and receivables Management
  - Multiple non-integrated software platforms
  - Unexplained / un-reconciled differences between the sub-systems / sub-ledger and the general ledger
  - Absence of bank reco.
  - Forex loss/ gain seems to be a dumping ground –as we learn here and in Wipro fraud – beware of that
- Lack of confirmations will continue to haunt auditors – hopefully there will be a law asking banks to confirm direct to

# Source

- Published results for Mar 09 and Mar 10 of Mahindra Satyam