CORPORATE FRAUD

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"FRAUS OMNIA VITIATE"

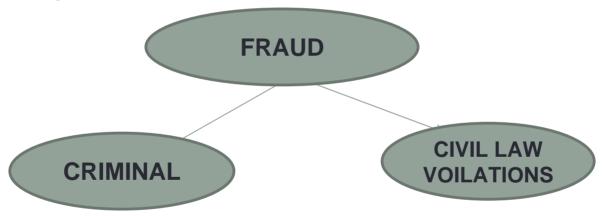
Fraud Vitiates Everything

First Principles

- The Biggest Fraud is to cheat oneself
- Rather fail with honor than succeed by Fraud.
- For the most part Fraud in the end secures for its companions repentance and shame.

Definition

 In the broadest sense, a fraud is an intentional deception made for personal gain or to damage another person/entity



 Wrongful or criminal deception intended to result in financial or personal gain

Indian Law

Indian Contract Act, 1872

Section 17 of the Act defines "Fraud" as

"Fraud" means and include any of the following acts committed by a party to a contract, or with his connivance, or by his agents, with intent to deceive another party thereto his agent, or to induce him to enter into a contract.

- the suggestion as a fact, of that which is not true, by one who does not believe it to be true;
- > the active concealment of a fact by one having knowledge or belief of the fact;
- > a promise made without any intention of performing it;
- > any other act fitted to deceive;
- > any such act or omission as the law specially declares to be fraudulent.



Contd.

Indian Penal Code, 1860

Section 25 of IPC defines "Fraudulently" as:

A person is said to do a thing fraudulently if he does that thing with intent to defraud but not otherwise.

Regulatory Legislations

Anti Fraud Legislations/Regulations/Guidance - Examples

INDIA

- Indian Contract Act 1872
- Indian Penal Code
- Prevention of Corruption Act
- Prevention of Money Laundering Act
- The Companies Act 1956
- Clause 49 of Listing Agreement
- **CARO 2003**

USA/EUROPE

- Sarbanes Oxley Act
- Foreign Corrupt Practices Act
- Patriot Act
- OECD Guidelines
- IIA Guidance

Increase in regulators/stakeholders expectation from Management & Auditors towards Prevention, Detection, Investigation & Reporting of Fraud

Types of Fraud

- Fraudulent Financial Statements
- Employee Fraud
- Vendor Fraud
- Customer Fraud
- Investment Scams
- Bankruptcy Frauds
- Miscellaneous

The common element is deceit or trickery!



Financial Statement Frauds

East India Company Fraud
Mudhra Scam
Enron Fiasco
Satyam – Enron of India
Harshad Mehta Scam





East India Company Fraud

- Fraudulent Financial reporting and corrupt business practices having its existence since the era of footprints of Public corporation.
- It was the first multinational corporation in the world and the first company to issue stock.
- In the late 1700s Edmund Burke had Robert Clive, "the founder of the empire" and Warren Hastings, India's Governor-General, brought up on impeachment charges laden with corruption issues. Though the trials failed to convict anybody.
- The Company was subsequently wound up under the East India Company Stock Redemption Act, 1874.

Mundhra Scam- First Scam of Independent India

- First successful trial of a financial scandal in Independent India.
- Haridas Mundhra, a industrialist & stock speculator sold fictitious shares to LIC and thereby defrauding LIC by Rs. 125 crores.
- Mr. Jawahar Lal Nehru, set up a one-man commission headed by Justice Chagla to investigate.
- Justice Chagla concluded the matter; Haridas was found guilty and was sentenced to imprisonment for 22 years.
- T.T. Krishnamachari, the then Finance Minister, resigned from his position.

Enron Fiasco

February 2000

Fortune magazine chooses Enron as it's "Best Managed and *Most Innovative* company"

- August 2000: Stock at \$73 billion
- March 2001: FY2000 revenues at \$100 billion
- Sep 16, 2001: "Buy more shares"
- October 2001: Enron pays its regular dividend

Enron

• October 16, 2001

\$618 million 3rd Qtr Loss

- \$1.2 billion reduction in shareholder equity
- October 31, 2001

SEC upgrades inquiry into a

formal investigation

• December 2, 2001

Enron files for bankruptcy 4,000 employees fired

- 20,000 workers lose their jobs
- \$73 billion in stock value gone

Enron - Reactions

Enron Wasn't Just Enron

- Enron Corporation
- Arthur Andersen
- Enron's Law firm
- Investment bankers
- Countries with Enron operations

Argentina, Mozambique, India, Poland

Companies in other countries

Shell, BP, Mobil

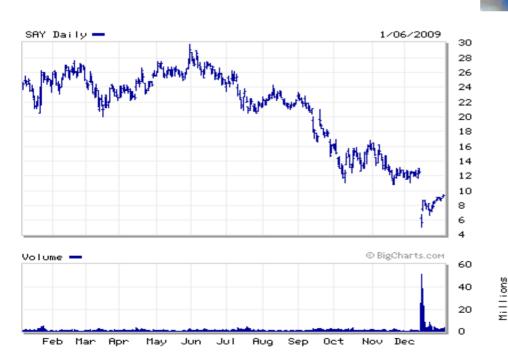
Reasons behind Enron Fiasco

- Enron Senior Management used complex and murky accounting schemes
- to reduce Enron's tax payments;
- to inflate Enron's income and profits;
- to inflate Enron's stock price and credit rating;
- to hide losses in off-balance-sheet subsidiaries;
- •to engineer off-balance-sheet schemes to *funnel money* to themselves, friends, and family;
- •to fraudulently misrepresent Enron's financial condition in public reports.

Satyam – Enron of India

- The biggest corporate scam in India has come from one of the respected business family.
- Satyam Fourth largest Indian IT Company listed in India & US.
- Over US \$ 2 billion annual revenue size co.
- Established in mid 1980s, grown to 53,000 employees.
- 600 plus customers including 185 fortune 500 Cos.
- Operations in 66 countries across the globe.
- Financial advisor: Merrill Lynch (now Bank of America).
- Auditors: Price Water House Coopers.
- Bankers: Citi bank; BNP Paribas, HSBC & HDFC.





Mr. Ramalinga Raju resigned as Chairman from Satyam after admitting to cooking up the account books.

Cause behind Satyam

- Fudging of Accounts.
- Over stated Assets of Rs. 490 crore.
- Fake cash balances over Rs. 5,000 crore in the Balance Sheet.
- Interest component of Rs. 376 crore which never flowed into the company's coffers.
- Understated Liabilities of Rs. 1,230 crore.

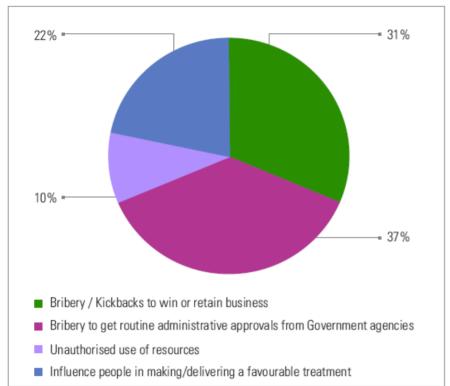
Aftermath Effect

- Investors- Panicked as Stock plummeted.
- Employees stranded in many ways- morally, financially, legally and socially.
- The incident resulted in immeasurable and unjustifiable damage to Brand India and Brand IT in particular.
- Chairman, MD and CEO, CFO, Key associates arrested.
- Partners of Audit Firm were also arrested.
- People lost a staggering Rs 100 billion in Satyam in market capitalisation as investors reacted sharply and dumped shares, pushing down the scrip by 78 per cent to Rs. 39.95 on BSE.

Harshad Mehta – What happened

- Mehta obtained fake Bank Receipts from small banks.
- The said Bank Receipts were further passed on to other banks as security to obtain cash.
- This money was used to drive up the prices of stocks in the stock market.
- Bubble of stock market manipulation and fake BRs busted.
- Drastically impacted the Stock Market, Economy and progress of the Country.
- Banking system was swindled of a whopping of Rs. 4,000 crore.
- Even, the Chairman of one of the Bank committed suicide.

Survey on Fraud in India -2010



- As per The World Bank estimate
 - bribes paid globally aggregates to over USD 1 trillion per annum
- Key reasons in India
 - Obtaining routine administrative approvals
 - Attempts to win / retain business

Common Types of Fraud

Financial Frauds

- Manipulation, falsification, alteration of accounting records
- Misrepresentation or intentional omission of amounts
- Misapplication of accounting principles
- Intentionally false, misleading or omitted disclosures

Misappropriation of Assets

*Theft of tangible assets by internal or external parties

Sales of proprietary information

Causing improper payments

Corruption

Making or receiving improper payments

- *Offering bribes to public or private officials
- Receiving bribes, kickbacks or other payments
- *Aiding and abetting fraud by others

Common Perpetrator

- Male 85%
- Average Tenure < 5 Years 57%
- College Educated 38%
- Company Manager 52%
- Age 31 to 50 72%

Rationale for doing Fraud

- Everyone else was doing it
- They can afford it
- I needed the money
- It was just a loan...I would have repaid it
- I felt used and wanted revenge
- I meant no harm and did no harm
- I did it to keep the business afloat
- Bribery is the norm in this type of business
- What I did was entirely appropriate for someone in my position
- My employer didn't compensate me well enough, so I took what was due to me

Who is Responsible?

- Board of Directors
- •CEO
- •CFO
- Senior Management
- Internal Audit
- •IT Department
- Middle Management
- Operational Management

How Management Encourages Fraud

- Responsibility, accountability and authority not established or documented
- Goals and objectives neither established nor monitored for success
- No written policies or procedures
 - low priority for the establishment of internal controls
 - no separation of duties
 - inadequate cash controls documents
 - inadequate physical security for assets and records
 - no independent inventory of assets
- Inconsistent application of policies or procedures may result in unfair
- treatment of employees favoritism low morale

What an Organization can do

- Tone at the top; create an ethical environment
- Lead by Example
- Corporate Code of Conduct
- Call in Services for reporting unethical practices
- Reliable Internal Controls

What an Organization can do.. contd.

- Training Courses on
 - Ethics Training
 - Internal Controls
 - Fraud Prevention
 - Technological and business changes
 - Special training for monitors
- Reference Checks on New Employees
- Code of Sanction for Suppliers/Contractors

Adopt Anti Corruption & Anti Bribery practices as a process

- Assessment of specific corruption risks of the business.
- Development of detailed anti corruption and bribery policies .
- Implementation of the policies.
- Self monitoring of the effective implementation of the policies.
- Reporting on the policies and related programmes.
- Independent assurance of the effectiveness of these efforts.

Developing Code of Governance

Working together with civil societies, government and private sector to develop and disseminate anti corruption messages.

Regional and international initiatives provide a forum for private sector, public sector, and civil society to come together with a common goal of reducing vulnerability to corruption .

Finally, attitudinal change is necessary.

By changing our thoughts, we can change our attitude and thereby change our behavior, which can change our lives. The quality of our thoughts equals the quality of our lives. Let us all work towards changing our attitude towards corruption.

Lets say No to corruption

Prevent - Fraud

Strong Ethical value in Organization flowing from the top

Recruitment process ; Selection of right people at appointment

Reference Check and verification

Defined Policies and Guidelines

> Clear Roles and responsibility

Internal Control System

Transparency

Common sense



Thank you!