

# WHAT WENT WRONG WITH SATYAM?

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### INTRODUCTION

Till about two decades ago corporate governance was relatively an unknown subject. The subject came into prominence in the late 80's and early 90's when the corporate sector in many countries was surrounded with problems of questionable corporate policies or unethical practices. Junk Bond fiasco of USA and failure of Maxwell, BCCI and Polypeck in UK resulted in the beginning of codes and standards on corporate governance. The USA, UK and number of other developed countries reacted strongly to the corporate failures and codes & standards on corporate governance came to the centre stage. Enron debacle in 2001 and number of other scandals involving large US companies such as the Tyco, Quest, Global Crossings, the World.Com and the exposure of auditing lacunae, which led to the collapse of the Andersen, triggered the reform process and resulted in the passing of the Public Accounting Reform and Investor Protection Act of 2002 known as Sarbanes-Oxley (SOX) Act, 2002 in USA.

### BACKGROUND

On 24th June 1987, Satyam Computer Services Ltd (Popularly known as Satyam) was incorporated by the two brothers, B Rama Raju and B Ramalinga Raju<sup>1</sup>, as a private limited company with just 20 employees for providing software development and consultancy services to large corporations (the company got converted into public in 1991). During the year 1996, company promoted four subsidiaries including Satyam Renaissance Consulting Ltd, Satyam Enterprise Solutions Pvt. Ltd., and Satyam Infoway Pvt. Ltd. Satyam Computer Services Ltd in 1997 was selected by the Switzerland-based World Economic Forum and World Link Magazine as one of India's most remarkable and rapidly growing entrepreneurial companies. Satyam Infoway (Sify), a wholly owned subsidiary of Satyam Computer Services Ltd, was the first Indian Internet Company listed on NASDAQ. Mr. B. Ramalinga Raju, Chairman of Satyam, was awarded the IT Man of the Year 2000 Award by Dataquest. In 2001, Satyam became world's first ISO 9001:2000 company to be certified

by BVQI. In 2003, Satyam started providing IT services to World Bank and signed up a long term contract with it. IN 2005, Satyam was ranked 3rd in Corporate Governance Survey by Global Institutional Investors.

## **PROBLEMS BEGIN**

Problems in Satyam begin when on December the 16<sup>th</sup>, 2008; its chairman Mr Ramalinga Raju, in a surprise move announced a \$1.6 billion bid for two Maytas companies i.e. Maytas Infrastructure Ltd and Maytas Properties Ltd saying he wanted to deploy the cash available for the benefit of investors. The two companies have been promoted and controlled by Raju's family. The thumbs down given by investors and the market forced him to retreat within 12 hours.<sup>2</sup> Share prices plunges by 55% on concerns about Satyam's corporate governance<sup>3</sup>. In a surprise move, the World Bank announced on December 23, 2008 that Satyam has been barred from business with World Bank<sup>4</sup> for eight years for providing Bank staff with "improper benefits" and charged with data theft and bribing the staff.<sup>5</sup> Share prices fell another 14% to the lowest in over 4 years. The lone independent director since 1991, US academician Mangalam Srinivasan, announced resignation followed by the resignation of three more independent directors on December 28 i.e. Vinod K Dham (famously known as father of the Pentium and an ex Intel employee), M Rammohan Rao (Dean of the renowned Indian School of Business) and Krishna Palepu (professor at Harvard Business School)<sup>6</sup>. At last, on January 7, 2009, B. Ramalinga Raju announced confession of over Rs. 7800 crore financial fraud and he resigned as chairman of Satyam. He revealed in his letter that his attempt to buy Maytas companies was his last attempt to "fill fictitious assets with real ones". He admitted in his letter, "It was like riding a tiger without knowing how to get off without being eaten".<sup>7</sup> Satyam's promoters, two brothers B Ramalinga Raju and B Rama Raju were arrested by the State of Andhra Pradesh police and the Central government took control of the tainted company.<sup>8</sup> The Raju brothers were booked for criminal breach of trust, cheating, criminal conspiracy and forgery under the Indian Penal Code. The Central Government reconstituted Satyam's board that included three-members, HDFC Chairman Deepak Parekh, Ex Nasscom chairman and IT expert Kiran Karnik and former SEBI member C Achuthan. The Central Government added three more directors to the reconstituted Board i.e., CII chief mentor Tarun Das, former president of the Institute for Chartered Accountants (ICAI) TN Manoharan and LIC's S Balakrishnan.

A week after Satyam founder B Ramalinga Raju's scandalous confession, Satyam's auditors Price Waterhouse finally admitted that its audit report was wrong as it was based on wrong financial statements provided by the Satyam's management.<sup>9</sup> On January 22, 2009, Satyam's CFO Srinivas Vadlamani confessed to having inflated the number of employees by 10,000. He told CID officials interrogating him that this helped in drawing around Rs 20 crore per month from the related but

fictitious salary accounts. Andhra Pradesh State CB-CID raided the house of Suryanarayana Raju, the youngest sibling of Ramalinga Raju who owned 4.3 per cent in Maytas Infra, and recovered 112 sale deeds of different land purchases and development agreements.<sup>10</sup> Senior partners S Gopalakrishnan and Srinivas Talluri of the auditing firm PricewaterhouseCoopers (PwC) were arrested for their alleged role in the Satyam scandal. The State's CID police booked them, on charges of fraud (Section 420 of the IPC) and criminal conspiracy (120B).<sup>11</sup>

## **TECK MAHINDRA ACQUIRED SATYAM, RENAMED IT AS MAHINDRA SATYAM AND REPLACED ITS EXECUTIVE BOARD AND AUDITORS**

Merely four months after its founder B. Ramalinga Raju admitted to fudging the books, Satyam's government appointee six-member board managed to salvage the company despite all odds. The board, which kicked off the global competitive bidding process<sup>12</sup> in March 2009, selected Venturbay Consultants, a subsidiary of Tech Mahindra, as it emerged as the highest bidder<sup>13</sup> at rupees 58 per share. The deal got the approval of Company Law Board.<sup>14</sup> Consequently, Tech Mahindra (holding 31% stake in Satyam) bought Satyam renaming it on June 21, 2009, as 'Mahindra Satyam'<sup>15</sup> and replaced its executive Board by appointing its (Tech Mahindra) CEO and MD Vineet Nayar as Vice Chairman (who in December 2009 was promoted as Chairman), its international operations head CP Gurnani as CEO and Subramaniam Durgashankar as CFO. The executive Board appointed Deloitte Haskins & Sells as the company's statutory auditors to restate its accounts.

## **SWIFT GOVERNMENT ACTION SAVED SATYAM ULTIMATELY**

On January 7, Ramalinga Raju emailed his resignation to market regulator SEBI admitting to financial irregularities, which, in less than two hours, was forwarded to the Ministry of Corporate Affairs (MCA). The same day, the Ministry asked its two wings the Institute of Chartered Accountants of India (ICAI) and the Institute of Company Secretaries of India (ICSI) to inquire into the role of auditors and company secretaries for swift regulatory action. There was an emergency inter-ministerial meeting next day ie on 8<sup>th</sup> although it was a government holiday. Concurrently, the Ministry was drafting the petition to be filed before the Company Law Board (CLB)<sup>16</sup>. The very next day, the Ministry got the CLB order superseding the Satyam board with government appointed directors. SEBI relaxed the take-over code per se on an application by the Satyam board to meet the emergency like Satyam where government suspended the board of a company and appointed directors who act for the public good without any payment or compensation. Clearly, the Ministry of Corporate Affairs (MCA) acted swiftly and thoughtfully and saw the issue as much larger than that of an individual company. Satyam could not have been saved if there was any delay in decision-

making at the government level. Investigations also progressed as swiftly as the process of rescuing Satyam. A Satyam like situation in the US would not have allowed the government to act on behalf of the shareholders and appeal to the judicial authority concerned.<sup>17</sup>

## **MAHENDRA SATYAM AND TECH MAHINDRA TO MERGE**

The Mahindra Group, the new owner of Satyam and the largest shareholder in Tech Mahindra, is set to merge the two companies to transform the combined entity into an Information and Communication Technology (ICT). The merger can happen any time in the near future since the accounts of Satyam have been re-stated.

## **MAHINDRA SATYAM HAS BRIGHT FUTURE**

Given that Tech Mahindra has only 25,429 employees, the acquisition of a company bigger than itself may have its own challenges. While combined employee strength 85,167 of Tech Mahindra and Mahindra Satyam may make Tech Mahindra next only to India's third largest IT services provider Wipro, managing the integration may not be easy. It is going to be an uphill task for Mahindra and Mahindra group to clean up Satyam and make it run profitably again, given all liabilities and reputation issues. The table 1 clearly reveals the position of "Mahindra Satyam" (formerly Satyam) amongst the prominent IT companies in the country.<sup>18</sup>

**Table 1-Mahindra Satyam has Bright Future**

<b>Company</b>	<b>Employees (2009-10)</b>	<b>Revenue (2009-10)</b>	<b>Net Profit (2009-10)</b>
TCS	1,74,417	23,044	5,619
Infosys	1,14,822	21,140	5803
Wipro	1,08,071	23,178	4,898
Cognizant	95,600	15,859	25,88
HCL	70,218	5,079	1057
Patni	13,995	1,751	543
IGATE	8,278	934	138
<b>Patni+IGATE</b>	<b>22,273</b>	<b>2685</b>	<b>681</b>

Tech Mahendra	33,524	4,484	743
Mahendra Satyam	51,643	5,101	-71
<b>Tech Mah+Mahendra Satyam</b>	<b>85,167 (5<sup>th</sup>)</b>	<b>9,584 (5<sup>th</sup>)</b>	<b>672 (6<sup>th</sup>)</b>

Source: Updated version of figures given in the India Today, April 27, 2009, p 47.

Following a sharp rally seen in its share price, “Mahindra Satyam“ (formerly Satyam) capitalization has grown quit substantially, placing it among the 100 most-valued firms in IndiaSatyam (now Mahindra Satyam), which, prior to its fall, was India’s 4rth most-valued IT firm after Infosys, TCS and Wipro, now ranks at the 6<sup>th</sup> position among IT companies after TCS, Infosys, Wipro, HCL Tech, Oracle and Tech Mahindra and at the 97<sup>th</sup> spot among the top 100 companies.<sup>19</sup>

Mahindra Satyam recorded profit for the first time in the first and second quarter of the fiscal year 2011 after being hit by the country’s largest corporate fraud. Thus, company, once ranked the country’s fourth largest IT firm, is on the path to recovery. For the second quarter ended September 30, 2010, Mahindra Satyam recorded revenues of Rs 1242.4 crore while the profit stood at Rs 23.3 crore. This was lower than the first quarter of financial year 2011 when it registered a profit of Rs 97.5 crore on sales of Rs 1248 crore. This fall in profit may be mainly on account of wage hike and forex fluctuations.<sup>20</sup> Mahindra Satyam had earlier declared a net loss of Rs 8176.8 crore for FY 2008-09, when the company was under Satyam founder B. Ramalinga Raju and shown a much lower net loss of Rs 124.6 crore for the FY 2009-10.<sup>21</sup>

## CHALLENGES AHEAD

A year after Raju's shocking confessions, Satyam (now Mahindra Satyam) is back in business, but a host of financial, legal and customer or pricing challenges continue to trouble the company that was once the fourth largest IT player in India. In the first few months after the takeover, the new management in Mahindra Satyam spent its energy on traveling, meeting key customers, and reassuring them that it was business as usual at Satyam. A few customers like State Farm Insurance had moved to rivals even before the new owner and management came on board. Others, shaken by the scam, decided to de-risk and move. One of the most high-profile losses was that of British Petroleum’s \$1-billion contract, which moved to TCS and Wipro. British Petroleum used to outsource projects worth \$50m annually to Satyam. A few big names such as GE, a top customer, and GSK stayed on but extracted their pound of flesh. In July last year, GSK signed a five-year multi-million dollar SAP contract with Mahindra Satyam, and in September, GE extended its multi-

million dollar contract for the next three years. They asked for 15-20% rate cuts across the vendor base, and Mahindra Satyam was no exception.<sup>22</sup>

## **PROGRESS OF INVESTIGATIONS**

A lot has changed for Satyam ever since the founder chairman Ramalinga Raju confessed the Rs 7000 crore fraud; new owner, a brand new board, new CEO and CFO; new auditors, and the investigations into the scam are on full swing. Succeeding paragraphs provide the status of investigations.

### **SFIO INVESTIGATIONS**

The Serious Fraud Investigation Office (SFIO),<sup>23</sup> a multi-disciplinary investigating arm of the Ministry of Corporate Affairs, set up in 2003 with officials from various law enforcement agencies, was asked to investigate the fudging of accounts as admitted by B. Ramalinga Raju. It submitted its preliminary report on April 13, 2009 that runs into 29 volumes contained in 14 thousand pages. On November 30, it filed case<sup>24</sup> against Satyam promoter B Ramalinga Raju, his brother B Rama Raju, ex-CFO Vadlamani Srinivas, senior finance manager D. Venkatapathy Raju and finance manager C. Srisailan, along-with company's former statutory auditors S Gopalakrishna and Srinivas Talluri<sup>25</sup> under various provisions of the Indian Penal Code, Companies Act and IT Act. The SFIO report believed the confession was not out of Raju's call of conscience; rather it was deliberately painting a distressing face to keep the legal and public dealings with a light hand. According to SFIO report, Satyam founders B Ramalinga Raju, B Rama Raju and ex-CFO Vadlamani Srinivas, and ex-vice-president (finance) G Ramakrishna, together hatched a conspiracy to artificially increase the revenues and profits in the books. The report highlights that the falsification was done by deliberately leaving loopholes in the Computerized Accounting System which uses ERP modules. The high-level application landscape of Satyam internal applications has many links between various systems where either there was no integration or there was weak integration. These loopholes were deliberately left to insert fictitious invoices and fictitious bank statements to balance them without being detected. Very smartly fictitious invoices were created in the invoice management system using regular login ids, falsely intimating that any of the employees could be involved in this. In order to cover up these fictitious entries, the receipts were first accounted with Bank of Baroda, New York branch, (account no- 120559) and they then were relocated as fixed deposits in other accounts. With such artificial entries started giving a blooming picture of the company, the management decided to put the surging profits in better investments. Unfortunately, Raju was now forced to make

investments from the non-existing investments. But fate had something else in store. After raising money, Raju disembarked them in losing propositions. As the company was constantly losing money, Raju decided to venture into brand building to avoid bad circumstances. It was then the promoter-directors of the company started commissioning on these inflated profits, which is again an offence under IPC. The SFIO probe also takes a call on the account statements of the company with the Bank of Baroda highlighting jacking up of the books ever since 2001-02. The report also clarifies that the company had booked false fixed deposits and interests in five banks namely, ICICI, HSBC, HDFC, BNP Paribas and Citi Bank. On the reconciliation of these statements the company books showed major gaps with the actual existing deposits. The SFIO has also booked this offence under various sections of IPC and the Companies Act. The investigation also throws light on the company's paying excess taxes on the non-existing assets and also indulging in forging current account balance statements. This helped the company forge quarterly details of outstanding balances of fixed deposits and interest earned on them. The report says that by showing a rosy picture of the company, the promoters were jacking up the share price and simultaneously selling off their holdings raking in handsome money. The company, apart from this, is also believed to have issued American Depository Shares worth \$ 15.2 crore out of which only \$ 5.25 crore were brought in to the country. After detailed investigation, the company was unable to convince the SFIO on the false amount. The allocation of this amount is now considered to be under the Enforcement Directorate. Thus, the report unveils the entire scam with proofs of all false claims.<sup>26</sup>

The SFIO investigations also throws light on the company's desperate attempt to acquire Maytas Infrastructure (MIL) and Maytas Properties (MPL), an act done under the pressure from external investors who were pressing for better use of liquid asset shown in the balance sheet. The report states that the promoters Ramalinga Raju, Rama Raju and the CFO Srinivas Vadlamani were fully aware of the precarious financial position of the company and the large number of fake fixed deposit and fake bank balances created in the books since 2000-2001 onwards. "A facade was created in the form of proposed acquisition of MIL and MPL to replace fictitious assets of Satyam with real assets with intent to deceive the shareholders of MIL and MPL and to fraudulently induce them to deliver their shares to Satyam," the SFIO report states. The Report further states "in the meeting that took place on December 16, 2008 to discuss the acquisition of MIL and MPL, B Ramalinga Raju was present, but abstained from discussion and voting of these proposals. V Srinivasan, ex-CFO informed the members that the evaluation of Maytas Infra was based on SEBI (Substantial Acquisition and Takeovers) Regulations, 1997 and for Maytas Properties, based on evaluation done by Ernst & Young. Further, the consent of the board was unanimously accorded after which Raju proposed the merger of MIL and MPL to the shareholders, which came in for stiff resistant, and issue of corporate governance was raised." A couple of weeks later, Ramalinga Raju dropped a bombshell by sending a letter of admission to SEBI and the board of directors that he had fudged the accounts

of Satyam and that the balance sheet as on September 30, 2008 carried an inflated (non-existent) cash and bank balances of Rs 5040 crore, non-existent interest of Rs 376 crore and understated liability of Rs 1230 crore<sup>27</sup> as has been highlighted in table 2.

**Table 2: Two Versions of Satyam's Accounts**

<b>TWO VERSIONS OF SATYAM'S ACCOUNTS</b>		
<b>(I) SOURCES OF FUNDS</b>	<b>BEFORE CONFESSION</b>	<b>AFTER CONFESSION</b>
<b>(1) Shareholders Funds</b>		
a) Share capital	134.70	134.70
b) Share application money, pending allotment	2.76	2.76
c) Reserves and surplus	8392.23	(415.47)
	<u>8529.69</u>	(278.01)
<b>(2) Loan Funds</b>		
a) Secured loans	30.49	30.49
b) Unsecured loans- others	<u>234.80</u>	<u>1464.80</u>
	8794.98	1217.28
<b>(I) APPLICATION OF FUNDS</b>		
<b>(1) Fixed Assets</b>		
<b>(2) Investment</b>		
<b>(3) Deferred Tax Assets (net)</b>		
<b>(4) Current Assets, Loans and Advances</b>		
a) Sundry debtors	1381.10	1381.10
b) Cash and bank balances	618.64	618.64
c) Interest accrued on fixed deposits	118.75	118.75
d) Loans and advances	<u>2651.36</u>	<u>490.00</u>
	<u>5312.62</u>	<u>272.62</u>
	<u>376.34</u>	<u>0</u>
	<u>502.22</u>	<u>502.22</u>
	8842.54	1264.84
Less: current liabilities and provisions		
a) Liabilities	1669.26	1669.26
b) Provisions	<u>496.79</u>	<u>496.79</u>
	2166.05	2166.05
<b>Net Current Assets</b>	<u>6676.49</u>	<u>(901.21)</u>
	8794.98	1217.28

*Understated liability Rs. 1230 crore*

*Debtors overstated*

*Gap of Rs. 5040 crores in cash*

*Interest not existing*

Source: The Business Today, February 8, 2009, p50.

## CBI INVESTIGATIONS

Central Bureau of Investigations (CBI) in February 2009 registered a case of cheating, forgery and criminal conspiracy against Ramalinga Raju and several other directors and auditors who worked with the company.<sup>28</sup> The FIR mentions several Indian Penal Code (IPC) sections including 120B (criminal conspiracy), 409 (criminal breach of trust), 420 (cheating), 467 (forgery of valuable security, will), 468 (forgery for cheating, 471(using forged documents as genuine) and 477-A (falsification of accounts).<sup>29</sup> The CBI, investigating diversion of Satyam funds abroad, have identified three suspicious foreign bank accounts in the US, which are held in the name of three different individuals. About rupees 60 crore belonging to Satyam were channelized into the accounts that stand in the

name of these three non-Indian persons. The CBI did not find these transactions reflected in Satyam's books.<sup>30</sup>

On April 7, 2009, the CBI had filed a charge sheet against Ramalinga Raju and eight others under various sections of the Indian Penal Code for cheating and forgery and submitted 1532 original documents of bank transactions and 65,000 pages of other documents, which included the statements of 432 witnesses in the case along with the charge sheet.<sup>31</sup> In a 200 page supplementary charge sheet filed on November 24, CBI charged the accused of forging board resolutions and unauthorisedly obtaining loans worth rupees 1220 crore from banks as well as inflating Satyam revenues to the tune of rupees 430 crore by creating fake customers and generating fake invoices. The rupees 1220 crore unauthorized loan detailed by the CBI are not reflected in the company's books and are over and above the rupees 1230 crore that Ramalinga Raju confessed to Satyam having received from various family owned companies including Mytas Infra and Mytas Properties. The charge sheet also identifies 1065 properties with a documented value of rupees 350 crore that were acquired by the Rajus with the spoils of the fraud. These include 6000 acres of land, 40,000 sq yd of housing plots and 90,000 sq ft of built up property. The CBI on November 21 arrested Satyam's internal audit head VS Prabhakar Gupta making him the 10<sup>th</sup> accused.<sup>32</sup>

The CBI on January 7, 2010 filed a 3<sup>rd</sup> charge-sheet against six persons in the Satyam scam. The charges were filed before the Additional Chief Metropolitan Magistrate, Nampally, Hyderabad after completion of investigations. Besides Satyam's former chairman B Ramalinga Raju, the others who have been charged are then managing director and Raju's brother B Rama Raju, then chief financial officer (CFO) Vadlamani Srinivas, then vice-president (finance) G Ramakrishna and two auditors of Bangalore based private company PriceWaterhouse Coopers (PwC) S Gopalakrishnan and Srinivas Talluri. The 30-page charge-sheet contains 32 documents and cites 26 witnesses. The documentation runs into 3,552 pages. In the fresh charge-sheet, the CBI has brought out evidence against the accused on the allegations of filing false Income Tax (IT) returns with fraudulent and dishonest intentions of cheating the shareholders and thereby causing wrongful loss to Satyam. According to the charge-sheet, the accused persons squandered the money in violation of the trust bestowed on them by the shareholders of the company in order to conceal their fraudulent and dishonest deeds of inflating income on account of fictitious sales and interest on non-existent fixed deposits by violating the law and corporate ethics made Satyam to suffer an estimated loss of Rs 126.57 crore. Further, the accused had inflated the revenue of the company by infusing false and fictitious sales invoices and shown the amount received and deposited as fixed deposits in various scheduled banks. Due to this inflated revenue and the inflated income in the form of interest on the non-existent fixed deposits, an additional tax liability to the tune of Rs 526.37 crore was created on the company. Subsequently, the charge sheet says, by taking recourse to the provisions of section

90 and 91 of the IT Act, the accused in furtherance of the conspiracy showed higher tax remittances in foreign countries to get relief from the tax chargeable in India. Thus, they achieved by showing income on the non-existent revenue as part of the income of the overseas branches of Satyam while filing IT returns in India.<sup>33</sup>

A whistleblower (Hyderabadi origin UK National settled in London) who contacted CBI at his own has told the investigating agency that six bank accounts and fictitious firms that the founder Ramalinga Raju had floated in London had served their purpose and were liquidated long before the scam came to light. The six companies and bank accounts which were operated from London were started in 1999 and closed down just before the listing of Satyam's ADRs on New York Stock Exchange in May 2001. These accounts and fictitious firms were clearly part of Raju's modus operandi to divert Satyam's funds.<sup>34</sup>

## **ENFORCEMENT DIRECTORATE PROBE**

Enforcement Directorate (ED) has attached in all 347 properties so far worth over Rs. 1000 crore of Ramalinga Raju, his relatives and others on the charge of money laundering. In August 2010 ED has taken possession of 4000 acres belonging to Raju family in Loyapalli village near Ibrahimpatnam of Ranga Reddy district in the State of Andhra Pradesh. The Property in Loyapalli is one among 347 properties attached is the single largest. Taking physical possession includes installing a board that property belongs to Government.<sup>35</sup> ED issued provisional attachment order attaching three flats that were lying in the names of spouses of Raju brothers-Nandini Raju, Radha and Jhansi Rani, in Bangalore's prestigious Omega Towers spread over 4800 square feet each, the purchase value of these three flats is shown at rupees 81 lakh each. Apart from this ED authorities also attached agricultural plots acquired in Chennai and other areas.<sup>36</sup> An interesting fact that ED investigations have brought to light is that several gardeners, truck drivers and others, who were working in the mango gardens and orchards belonging to Raju family for meagre salaries of Rs 4000 to Rs 5000 per month, have been found to possess more than 50 acres of land worth crores of rupees. Majority of these lands are situated in a single village (called Loyapalli). Raju brothers had purchased as much as 4200 acres of land in this village alone in 2006 valuing at present over 4000 crores of rupees (though official records state that the entire land was purchased for a mere Rs 30 crore). When the ED sleuths interrogated the gardeners on their source of income, they revealed that the land was purchased by the Raju brothers through SRSR Holdings Company and the sale deeds and other papers were lying with them. Later, these workers were made directors of several fictitious companies floated by Ramalinga Raju.<sup>37</sup>

## **SEC INVESTIGATIONS**

A team of American capital market regulator Securities & Exchange Commission (SEC) came to India following filing of a dozen of class action lawsuits<sup>38</sup> in US against promoters and management of Satyam on behalf of investors who purchased ADRs of the Co. The SEC has completed its probe in India into the multi-crore rupee Satyam fraud, especially the role of external auditors. The SEC team has conducted detailed discussions with CBI and other investigating agencies.<sup>39</sup> Since the renamed company Mahindra Satyam has now settled most of the claims filed in US, SEC has not much role to play now.

## **SUPREME COURT CANCELS RAMALINGA RAJU'S BAIL**

Prime accused Ramalinga Raju moved the Supreme Court for bail in March, 2010 on health ground. But, the apex court rejected his bail application on the apprehensions that he might influence the witnesses.

## **GOVERNANCE FLAWS NOTICED**

Following are the common governance problems, which have been noticed in the collapse of Satyam:

### **UNETHICAL CONDUCT**

In Satyam's case, for its founder B. Ramalinga Raju, honesty was not something that he wanted to pursue as hard as profits. He wanted to make money any which way by avoiding paying taxes, cooking books, and pay offs.<sup>40</sup> Ironically, the word 'Satyam' means 'truth' in Sanskrit language, but Raju's admission accompanied by his resignation shows the company had been feeding investors, shareholders, clients and employees a steady diet of 'asatyam' (or untruth), at least on its financial front. Did Satyam's Boss B. Ramalinga Raju while leading the company followed the spirit behind its name, certainly not? He on January 7, 2009 revealed some alarming truths that he was concealing for a long period by confessing to a fraud of Rs 7800 crores (\$1.47 billion) on Satyam's balance sheet. He and his brother B. Rama Raju who was Satyam's managing director, had disguised all this from the company's board, senior managers and auditors for several years. The unfolding of the story behind the confession reveals the fraudulent and unethical character of a man who till very recently bagged number of awards on good corporate governance.

There was no explicit or implicit code of ethics surrounding Satyam's corporate culture; bribery, corruption, and exchange of favors, within and outside the company, appear to have occurred with frequency at various levels. It was too late when World Bank in the 3<sup>rd</sup> week of December, 2008 publicized Satyam's unethical work culture by announcing Satyam being imposed with charges of data theft and bribing the staff and was barred from business with World Bank for eight years for providing Bank staff with "improper benefits". Ethical standards thus in the company were poor.

Both the CEO and CFO have been charged putting self-interests ahead of the company's interests. They were actively selling large portions of their shareholdings in the company a few months before the confession of scandalous fraud. The company's most senior executives behaved unethically and there was no evidence of basic moral conduct or behavior at the top executives' level that exploited the company's resources for personal gain for several years. The internal controls appear not to have detected the fraudulent activities for an extended period of time. Satyam received the World Council for Corporate Governance's Golden Peacock Award for excellence<sup>41</sup> in corporate governance, indeed; there is a strong case for World Council for Corporate Governance to assess its own methodology in selecting the winner for their awards. Withdrawing the 2002 award today after the blunder has been done does not protect the Council's reputation.

## **A CASE OF INSIDER TRADING**

Investigations into Satyam scam by the Crime Investigation Department (CID) of the State Police and Central agencies have established that the promoters indulged in nastiest kind of insider trading of the company's shares to raise money for building a large land bank. The funds collected by the former chairman B. Ramalinga Raju, his brother Rama Raju and their relatives were used to purchase lands in the names of 330 companies and about 30 individuals. All of them had equity participation in these entities, of which 327 were linked to the family. They have been charged to use money earned by offloading their shares in Satyam to purchase lands.<sup>42</sup> According to the SFIO findings, promoters of Satyam and their family members during April 2000 to January 7, 2009 sold almost 3.9 crore shares collecting in Rs 3029.67 crore as is revealed in the table 3. The promoters on the basis of the inflated books posed a healthy financial state of the company in the market. As the brand built strong amongst the peers, the share price started shooting up. During this course of time, the promoters kept their objective straight of offloading their shares at frequent intervals. Thus, the promoters not only manipulated share prices to make personal gains but also cheated the other shareholders and investors. SFIO report also states how the promoters during this time traded through 15 brokers, sub-brokers and investment companies in the market, some considered market leaders, namely, the DBS Cholamandalam Securities Ltd, DSP Merrill Lynch Ltd and BNP Paribas equity India Pvt Ltd.<sup>43</sup> During this course, the founder ex-chairman Ramalinga Raju sold 98 lakh

shares collecting in Rs 773.42 crores, whereas, his brother Rama Raju, sold 1.1 crore shares pocketing Rs 894.32 crores. Table 3 provides details of sale of shares by the promoters and their family:

**Table 3-Stake Sale by Promoters**

<b>Name of Promoter</b>	<b>No of Shares Sold</b>	<b>Money Earnd Rs (in crore)</b>
B. Ramalinga Raju	98,25,000	773.42
B. Rama Raju	1,13,18,500	894.32
B. Suryanarayana Raju	1,11,000	12.81
B. Nandini Raju	40,47,000	327.59
B. Radha	38,73,500	313.55
B. Jhansi Rani	1,00,000	11.25
B. Pritam Teja	9,42,250	49.01
B. Rama Raju (Jr)	9,34,250	48.59
Maytas Infra Ltd (Satyam Construction Ltd)	0	0.00
B. Satyanarayana Raju	0	0.00
B. Appal Anarsamma	0	0.00
Elem Investments Pvt Ltd	25,47,708	181.29
Fincity Investments Pvt Ltd	25,30,400	180.41
Highgrace Investments Pvt Ltd	25,30,332	170.83
Veeyes Investments Pvt Ltd	57,500	71.79
Other individuals connected to investment cos	68,000	515.58
Offmarket transfers by investments cos in the year 2001(value estimated)	1,90,000	78.29
<b>Promoters Group Total</b>	<b>3,90,75,440</b>	<b>3,029.67</b>

Source: SFIO Report published in the Pioneer (New Delhi), May 4, 2009, p 10

It was in February 2000 that the Satyam scrip saw a high of Rs 7081 with the software boom and as the markets plunged in 2001 it touched a low of Rs114 (September 2001). With the scrip keeping a low in the markets, it was in October 2006 that the company came up with a bonus issue to boost the sentiments. It was only after this that the scrip started surging between Rs 400 and Rs 520 till September 2008. The SFIO findings clears that all the promoters except the Raju brothers along

with their wives Nandani Raju and Radha Raju exhausted all their shareholding by September 2005. Market regulator SEBI and the SFIO are also probing the sale of over 3.6 lakhs shares by senior company executives ahead of founder Raju's confession and the sale of 4.3 crore shares in December quarter of 2008 by financial institutions which were pledged by Raju and his family as collateral for loans from these institutions. Satyam's senior executives' en-cashed employee stock options (Esops) shares in the December quarter when the scrip was trading at Rs 264-150. Probing agencies are baffled as these deals were struck when the scrip was ruling far below its May peak of Rs 500. Soon after Raju's confession, the price fell to an all-time low of Rs 6.30.<sup>44</sup> Although the positions of chairman and CEO/CFO in Satyam were separated but the findings of SFIO reveals that the chairman (Ramalinga Raju) and the CFO (Srinivas Vadlamani) were working in collusion to defraud the stakeholders for their personal gain. In the first half of September 2008, four months prior to the scandalous confession made by Raju, Srinivas Vadlamani <sup>45</sup>suddenly offloaded 92,358 shares of Satyam in the stock market. This proves he had an inkling that the bubble could burst and hence sold off his ESOP holdings in a hurry. Now potentially liable to be charged for insider trading amongst other things, Vadlamani had become enormously rich in his long tenure at the company.<sup>46</sup> The findings of the investigations make it clear that Vadlamani was not only aware of the happenings in the company but was an equal partner in perpetrating the fraud. Incidentally Ram Mynampati, the new interim CEO (prior to company being taken over by Tech Mahindra) also sold off shares of Satyam during that time.

## A CASE OF FALSE BOOKS AND BOGUS ACCOUNTING

According to the findings of SFIO, Satyam's balance sheet as on September 7, 2008 carried an accrued interest of Rs. 376 crore, which was non-existent. These figures of accrued interest were shown in balance sheets in order to suppress the detection of such non-existent fixed deposits on account of inflated profits. The investigations also detailed that the company had deliberately paid taxes of about 186.91 crores on account of the non-existent accrued interests of Rs 376 crores, which was a considerable loss for the company. As is revealed in the table 4, the SFIO report clearly states that the company had created a false impression about its fixed deposits summing to be about Rs 3318.37 crore while they actually held FDRs of just about Rs 9.96 crores.<sup>47</sup>

**Table 4-Falsification of Fixed Deposits Accounts**  
(Rupees in crore)

<b>Financial Yr</b>	<b>Amount as per Balance Sheet/Trial Balance</b>	<b>Amount as per Bank Confirmation</b>	<b>Amount Falsified</b>

2001-02	1243.15	5.43	7000.00
2002-03	1252.37	0.00	1252.37
2003-04	1465.33	1.89	1446.46
2004-05	1801.47	5.97	1795.50
2005-06	1906.47	1.11	1795.50
2006-07	3364.93	5.65	3308.41
2007-08	3316.94	8.53	3308.41
September 2008	3318.37	9.96	3308.41

Source: SFIO Report published in the Pioneer (New Delhi), May 4, 2009, p 10

The SFIO report affirmed that the falsification of current account deposits was done mainly through Bank of Baroda, New York Branch and various other banks in India, namely Citi Bank, HDFC and HSBC. While Bank of Baroda, New York Branch in a reply to the investigative team said that the closing balance as on September 30, 2008 was \$1.08 crore as against \$37.9 crore stated by Satyam. The bank also said the stationary used by Satyam for the account statement, was not sent by their branch. Proving with the fact, the stationary used was discontinued since June 2005 with the change in bank's logo. The promoters regularly used to generate monthly bank statements to be fed into the bankbooks. Similarly, they also used to generate confirmations of bank balances at the end of every quarter against non-existent fixed deposit and interest thereon. The SFIO report clarifies that Satyam has shown huge amount of current account balances for several years. (See table 4). The report also scrutinized the account no. 120559 of Bank of Baroda, New York branch maintained by Satyam, which was the main collection account for most of the exchanges received before being transferred to other accounts for meeting various expenditures.<sup>48</sup>

According to the Report, from August 20, 2007 till May 2, 2008, Satyam also received Rs 1425 crore from various front companies in its current account without reporting in the books of accounts. However, it is highlighted that from October 6, 2008 to November 25, 2008, a sum of Rs 194.60 crore were paid to these companies through high value cheques of Citibank and HDFC bank signed by Ramalinga Raju and his brother Rama Raju. Thus, a net sum of Rs 1230.40 crore came to the account of Satyam which was not accounted for in their book of accounts. "On examination of fixed deposit statements obtained from the various scheduled banks and those stated by Satyam, it was found that a large number of fixed deposits did not exist as per the bank records," the report added. Falsification of fixed deposit was done, by mainly using five banks, namely, ICICI bank, HDFC bank, HSBC bank, BNP Paribas Bank and Citi bank. Falsification with regards to fixed deposit have been done since 2001-02 till 2007-08 and also for the quarter ended June 2008 and September 2008. All the misleading actions of window dressing and camouflaging created a larger than life picturesque

image year after year in the minds of millions of gullible investors whose fate underwent a depressive spin.<sup>49</sup> One of the biggest sources of defalcation at Satyam was the inflation of the number of employees. Founder chairman Raju claimed that the company had 53,000 employees on its payroll. But according to the Criminal Investigation Department of the Andhra Pradesh police, the real number was just over 40,000. This closely matches the number of Satyam employees registered for provident fund payments, a little over 43,000.<sup>50</sup> The fictitious number could be fabricated only because payment to the remaining 10,000 employees was faked year after year - an operation that evidently involved the creation of bogus companies with a large number of employees.

## **LAX BOARD**

The Satyam Board was composed of 'chairman-friendly' directors who failed to question management's strategy and use of leverage in recasting the company; they were also extremely slow to act when it was already clear that the company was in financial distress. The glue that held the board members together was Ramalinga Raju. Each of the board members were there on his personal invitation and (that) made them ineffective. As individuals, they were all solid bricks. But they don't make for a solid wall because the mortar that held them together (Raju) was weak.<sup>51</sup> The Board ignored, or failed to act on, critical information related to financial wrongdoings before the company ultimately collapsed. It was only when Ramalinga Raju in the December, 2008 announced a \$1.6 billion bid for two Maytas companies<sup>52</sup> i.e. Maytas Infra and Maytas Properties, and while the share market reacted very strongly against the bid and prices plunged by 55 % on concerns about Satyam's corporate governance, that some of the independent directors came into action by announcing their withdrawal from the Board, by then it was too late. Satyam board's investment decision to invest 1.6 billion dollars to acquire a 100 percent stake in Maytas Properties and in 51 percent stake in Maytas Infrastructure, the two real estate firms promoted by Raju's sons, was in gross violation of the Companies Act 1956, under which no company is allowed without shareholder's approval to acquire directly or indirectly any other corporate entity that is valued at over 60 percent of its paid-up capital. Yet, Satyam's directors went along with the decision, raising only technical and procedural questions about SEBI's guidelines and the valuation of the Maytas companies. They did not even refer to the conflict of interest in buying companies in a completely unrelated business, floated by the chairman's relatives. Indeed, one of the independent directors, Krishna Palepu, a professor at Harvard Business School, praised the merits of real estate investment on Satyam's part. Palepu was earlier an independent director on the Global Trust Bank, which collapsed in 2003.

## **UNCONVINCED ROLE OF INDEPENDENT DIRECTORS**

The Satyam episode has brought out the failure of the present corporate governance structure that hinges on the independent directors,<sup>53</sup> who are supposed to bring objectivity to the oversight function of the board and improve its effectiveness. They serve as watchdogs over management, which involves keeping their eyes and ears open at Board deliberations with critical eye raising queries when decisions scent wrong. Stakeholders place high expectations on them but the Satyam's case reveals such expectations are misplaced. Six of the nine directors on Satyam's Board were independent directors including US academician Mangalam Srinivasan (the independent director since 1991), Vinod K. Dham (famously known as father of the Pentium and an ex Intel employee), M Rammohan Rao (Dean of Indian School of Business), US Raju (former director of IIT Delhi), T.R. Prasad (former Cabinet Secretary) and Krishna Palepu (professor at Harvard Business School). They were men of standing & reputation.

It is amazing that seven out of the nine directors were present at the board meeting where the unanimous decision to acquire Maytas Infra and Maytas Properties was taken. To avoid any controversy, the two founder directors did not participate in the decision making process for the reason that the provisions of the Companies Act and SEBI regulations mandate presence of only disinterested directors in board meeting where the agenda of such a nature is discussed. This naturally causes suspicion on the role performed by the independent directors present in that meeting. What concerns everyone is that those independent directors allowed themselves to be party to the mysterious designs of the promoter directors. It is hard to believe that such eminent and experienced personalities could not discover the well-planned massive fraud and manipulations.

The independent directors should have questioned why the company was sitting on such a huge pile of cash (as shown in the cooked books). The facts of the Satyam's case make it clear in spite of knowing the truth they did not raise their voice against such malpractices. They kept watching the wrongdoing for so many years even when it was detrimental to the interest of shareholders and other stakeholders. They although met the standards set by the NYSE<sup>54</sup> (on which Satyam's securities were listed) and Clause 49 of SEBI, but they did not ask hard questions.

## **QUESTIONABLE ROLE OF AUDIT COMMITTEE**

The true role of audit committee in précis is to ensure transparency in the company, that financial disclosures and financial statements provide a correct, sufficient and creditable picture and that, cases of frauds, irregularities, failure of internal control system within the organization, were minimized, which the committee failed to carry out. The timely action on the information supplied by

a whistleblower to the chairman and members of the audit committee (an e-mail dated December 18, 2008 by Jose Abraham), could serve as an SOS to the company, but, they chose to keep silent and did not report the matter to the shareholders or the regulatory authorities. The Board members on audit committee who failed to perform their duties alertly be therefore tried out under the provisions of the Securities Contracts (Regulation) Act, 1956 (an unimaginable fine extendable to rupees 25 crore by also including imprisonment for a term, which may extent to 10 years).

## **DUBIOUS ROLE OF RATING AGENCIES**

Credit rating agencies have been consistently accused of their lax attitude in assessing issuers and giving misleading ratings without thorough analysis, as has been the case of Enron and now in Satyam, they failed to warn market participants about the deteriorating condition of company. On December 2, 2001, Enron Corporation, the USA's 7th largest corporation declared bankruptcy when it was rated investment grade by all the credit rating agencies even four days before its bankruptcy. None of the watchdogs barked, including the credit rating agencies, which had greater access to Enron's books.<sup>55</sup> In the case of Satyam, credit rating agencies have been heavily criticized as regards their role and for the accuracy of their ratings. The rating agencies were allowed to look into company's books for making assessments but they never investigated the financial condition of Satyam. The rating agencies displayed lack of due diligence in their coverage and assessment of Satyam. They based their analysis on fraudulently prepared and audited financial statements and thereby failed to warn investors about Satyam's deteriorating condition.

## **QUESTIONABLE ROLE OF BANKS**

The ICAI Probe Panel has hit out at banks for not doing due diligence on Satyam Software Services Ltd before giving it loans. While sanctioning short term loans why not the banks posed any question as to why the company which was supposedly cash rich as per the financial statements was taking loans from them. The Panel wondered why the government put Deepak Parikh on its Board despite his HDFC group being a major creditor to the company. The banks that gave loans to Satyam during 2000-08 despite the company claiming huze surpluses were HDFC Bank (Rs 530 Crore, Citibank (223.87 Crore), Citicorp Finance (Rs222.28 Crore), ICICI Bank (Rs 40 Crore), and BNP Paribas (Rs 20 Crore) totaling Rs 122.161 Crore.<sup>56</sup>

## FAKE AUDIT

PricewaterhouseCoopers (PwC)'s audit firm, Price Waterhouse, was in the auditor for Satyam and have been auditing their accounts since 2000-01. The fraudulent role played by the PricewaterhouseCoopers (PwC) in the failure of Satyam matches the role played by Arthur Anderson in the collapse of Enron. S Goplakrishnan and S Talluri, partners of PwC according to the SFIO findings, had admitted they did not come across any case or instance of fraud by the company. However, Ramalinga Raju admission of having fudged the accounts for several years put the role of these statutory auditors on the dock. The SFIO report stated that the statutory auditors instead of using an independent testing mechanism used Satyam's investigative tools and thereby compromised on reporting standards. The last straw of deficiencies in statutory standards was despite having observed control deficiencies in the Information Systems and the risk of exposure to frauds, PwC chose to keep silent and did not report the matter to the shareholders. In an admission before the SFIO, VSP Gupta, Global Head Internal audit had said that even though the coverage and resources of internal audit was not commensurate with the size of the business, PwC ignored this fact and certified the company. PwC did not check even one per cent of the invoices, neither did they pay enough attention to verification of sundry debtors, which according to Ramalinga Raju's confession was overstated by 23 per cent (SFIO report says it was overstated by almost 50 per cent).<sup>57</sup> The Statutory auditors also failed in discharging their duty when it came to independently verifying cash and bank balances, both current account and fixed deposits. Ideally, if the company claims it has cash on its hand, that should be enough signal for auditors to check whether that cash in hand is available or not; whether bank balance has been invested properly or not; whether internal control mechanisms are in place. There needs to be a physical verification of assets owned by the company rather than simply relying on the books prepared by the company. Hence, it was required that the auditors (PwC) independently checked with the banks on the existence of fixed deposits, but this was not done for as large as a sum of Rs. 5040 crore. Thus, the statutory auditors on whom the general public relied on for accurate information not only failed in their job but themselves played a part in perpetrating fraud by preparing a clean audit report for fudged, manipulated and cooked books. Another development that came under investigators lens was that between 2003- 2008, audit fee from Satyam had increased three times. Price Waterhouse received an annual fee of 4.3 crore for financial year 2007-2008, which is almost twice as what Satyam peers i.e. TCS, Infosys, Wipro, on an average pay their auditors. This shows that the auditors were being lured by a monetary incentive to certify the cooked and manipulated financial statements. Events of such nature raise doubts about statutory auditors' discharging their duty independently and consequently on 24<sup>th</sup> January 2009, senior partners of PwC, S Gopalakrishna (was due for retirement by March 09) and Srinivas Talluri were booked by Andhra Pradesh CID police on charges of fraud (section 420 of IPC) and criminal conspiracy (120B).<sup>58</sup> The PwC has suspended the two partners, who signed on

Satyam's balance sheet and are currently in prison. The SFIO report also states that PwC outsourced the audit function to some audit firm, Lovelock and Lewis, without the approval of Satyam.

## **FALSE DISCLOSURES**

The SFIO findings reveal that the company was also involved in making false disclosures to the Stock Exchanges. The company used the name of Chintalapati Srinivasa amongst its directors, friends and relatives list till December 31, 2008 at the Stock Exchanges, who in fact was a director from 1990 till Jan 23, 2003 and held the post of executive director only till 31 August 2000. Further, the company, in its annual reports for the year 2002-03, had reported certain extra ordinary items, which on a deduction would have brought the company under losses. Additionally, Satyam preferring to indulge in the fraudulent activities displayed an EPS of Rs 9.77 per share, which on correction stands at (-) 1.93 per share. As EPS is one of the major factors leading the prices of the company in the stock markets, the false fundamentals kept the scrip moving in tandem with the market sentiments.

## **NO ACTION ON WHISTLEBLOWER'S INFORMATION**

According to the SFIO findings, it was in December 2008 that one Jose Abraham, an ex-senior executive of the company, blew the whistle on the Satyam scam. In an e-mail dated December 18, 2008, Jose Abraham sent his findings to KG Palepu, an independent director in the company, who then forwarded the mail to M Rammohan Rao, the chairman of the audit committee of the company. M Rammohan in turn forwarded the same to other members of the audit committee, the statutory auditor S Gopalakrishna, and also to B Ramalinga Raju, the chairman. Realising that the beans were already spilt, Raju, fearing regulatory actions, confessed the fraud ultimately.<sup>59</sup>

## **PROMOTER'S PLEDGING OF SHARES**

According to the SFIO findings, when the company started feeling a credit crunch, they had to resort to share pledging to raise funds. To cover such an act, the promoters transferred their individual shareholding to SRSR Holdings Private Limited (SRSRHP) and pledged shares as a security for the loans obtained from various Private limited entities. These were later transferred to it by the founder B. Ramalinga Raju and his wife and the money for the same were brought to Satyam as a liability which was not recorded in the books of account of Satyam. It was in September 2008 that the global crises made the existence of the company further stringent. Due to a drop in the valuation of the

shares the promoters had to additionally pledge 3.61 crore shares of Maytas Infra Ltd to meet the margins. In the last attempt to cover up the frauds, Raju tried to make an acquisition of Maytas Properties and Maytas Infra Ltd, which led to the entire fall out.<sup>60</sup>

## **POLITICAL CONTRIBUTIONS GENERATED OFF THE BOOKS**

Politics in India that is the world's largest democracy is an expensive affair<sup>61</sup>, running to several hundred thousand crore rupees every year. The bulk of this money comes from companies, generated off the books. Do all industrial houses disclose every paisa of what they contribute? Do they reveal even 10% of what they donate? Will those who receive these donations permit them to reveal that money has changed hands? After all, a significant portion of political contributions end up with individual leaders rather than with their parties. All these companies making these payments have employed internal and external auditors, to comply with regulatory requirements. Reputed audit firms routinely sign off on books they perfectly know to be cooked in assorted ways. They have no choice but to collude. After all, they have to work in this country and with its business as it is.<sup>62</sup> Indians have collectively been closing their eyes to this malaise and Satyam was no exception to this kind of malaise prevalent in the country.

## **FLAWED OWNERSHIP MODEL**

Satyam ownership model was flawed from the perspective of good corporate governance. There may be three factors responsible for this. The factors are not the causes of global and colossal fraud, but they provide an enabling environment for abuse and delusion.

1. First, being a publicly owned company, Satyam could raise capital inexpensively if its existing shareholders assigned it a high value. Hence, in order to attract capital from public, it was under pressure to overstate profits to keep the company's bonds and equities in high esteem.
2. Second, the promoter of the company, Mr. B. Ramalinga Raju, owned a very small fraction of the ownership stock. He diluted his holding from 25.6 % in 2001 to 3.6 % in 2009. He could overstate profits with the objective of influencing other shareholders. The overstatement never hurt him because his own share of the real profits remained very small. Consider, Wipro, a peer of Satyam, where its founder and principal owner, Mr Azim Premji, owns a very large part of its equity. The compulsion to overstate profits does not arise since Mr. Premji would be deluding himself.
3. Third important factor for flawed ownership model may be, Satyam could preserve its fictitious profits without having to pay big taxes because its profits were protected significantly from the normal tax laws. They do not pay taxes on fictitious revenues and

profits. There are no penalties. The belief that exempting firms such as Satyam from service tax and corporate income tax will make them competitive is a little ridiculous. Satyam would not have overstated its revenues and profits if it had to back both with real cash. A big part of the blame for the colossal fraud thus belongs to India's trade and fiscal policy makers<sup>63</sup>.

## **UNWARRANTED ACQUISITIONS PROVED HEAVY**

What started as a marginal gap between actual operating profit and the one reflected in the books of accounts continued to grow over the years. It attained unmanageable proportions as the size of company's operations grew significantly leading to depiction of huge cash and bank balances in the balance sheets published over the years before the scam of falsification of accounts came to purview. Due to the pressures proffered by the investors to invest the surplus money shown in balance sheet, the company resorted to various acquisitions in India and abroad. Most of the acquisitions were not carefully planned and executed and hence turned out to be losing propositions in the long run, the SFIO report stated. Some major acquisitions so done were; Securities Subscription Agreement (SSA) having Satyam and its subsidiary Nipuna Service Ltd. on one end and Olympus BPO Holding Ltd. and Intel Capital on the other; incorporation of the Satyam Infoways Ltd.; Acquisition of S&V; purchase of SAP license, to name a few. In the tie up of Satyam BPO with Olympus BPO Holding Ltd and Intel Capital, Satyam received a sum of Rs. 91.10 crores in lieu of which it had to make a payment of Rs.233.26 crore to the same either through redemption of shares or purchase of shares either through Satyam or through its subsidiary, thus the management incurred losses to the tune of over Rs.142 crores. Satyam Infoways Ltd. proved to be yet another fruitless attempt in the chronology of acquisitions done by Satyam. Initially, the company had gross investments of over Rs. 749.65 crores and Rs. 763.47 crores as in March 2001 and March 2002, respectively. Investments were majorly plunked in three firms viz M/s Indiaworld Communications Pvt. Ltd. (Rs.501 crores), M/s India Plaza.com Inc (Rs.35.76 crores) and M/s Cricinfo Ltd (Rs.168.25 crores), which turned to zero in March 2004, March 2002 and March 2003, respectively. Even after earning heavy losses in above ventures, Satyam went for acquiring S&V consultancy through Nitor Global Solutions Ltd. at a consideration of Rs.141.50 crores on April 21, 2008, Bridge Strategy Group LLC, a strategy and general management consulting firm, Citisoft, a highly specialized European business and systems consulting firm; and Knowledge Dynamics, a high-end consulting solutions provider in Business Intelligence. For SAP license, Satyam invested Rs.44 crores knowing the fact that company was in financial crunch and the expenditure required for implementation of the SAP-ERP package (meant for learning solutions, e-recruiting etc.) would be huge. Thus, B Ramalinga Raju (ex-chairman) and B. Rama Raju (ex-M.D.) who were legally bound to protect the interests of the stakeholders and the company allegedly concealed the true financial position of the Company and hoodwinked the attention of stakeholders and close associates by its acquisitions.<sup>64</sup>

## **DESIRED POLICY ACTIONS TO PREVENT ANOTHER SATYAM**

Some of the steps which could be taken to strengthen corporate governance are: have in all listed companies a code on ethics; independent regulatory body on the lines of the Public Company Accounting Oversight Board (PCAOB) of USA; rotation of external auditors in non-financial institutions; Reform Audit Education; split offices of chairman and CEO; encourage competent directors; abolish practice of nominating independent directors, exempt independent directors from vicarious liability; provide insurance cover to them; review the definition of independent director given in clause 49 of listing agreement; close supervision of rating agencies; superior Board practices, improve remuneration policy; legislative sanction to insider trading laws; introduce new audit standards; make audit committee strictly independent; prohibit political funding; install whistleblower system; introduce class action suit & compensation; make CSR compliance a mandatory provision; have in place permanent PPP system, and enhance criminal and civil penalties.

### ***CONCLUSION***

The Satyam fraud has shattered the dreams of different categories of investors, shocked the government and regulators alike and led to questioning the accounting practices of statutory auditors and corporate governance norms in India. Severe corporate governance problems emerge out of the above-mentioned corporate wreckage. Many of these governance problems were noticed in several other such corporate failures in USA, UK and Europe. These countries reacted strongly to the corporate failures and codes & standards on corporate governance came to the centre stage. Corporate scandals especially in the United States triggered reforms in corporate governance, accounting practices and disclosures the world over. Enron debacle in 2001 and number of other scandals involving large US companies around that period set in motion the corporate governance reform process and resulted in the passing of the Sarbanes-Oxley Act, 2002. The main objective of the Oxley Act is to repose investor's confidence by preventing corporate frauds and ensuring transparency and disclosures. Similar kinds of corporate governance reforms are needed in India too. There is need to reform corporate governance in India by taking harsh policy measures. Even though corporate governance mechanisms cannot prevent unethical activity by top management completely, but they can at least act as a means of detecting such activity before it is too late. When an apple is rotten there is no cure, but at least the rotten apple can be removed before the infection spreads and infects the whole basket.<sup>65</sup> This is really what effective governance is about.

## End Notes

<sup>1</sup> India Today (New Delhi), January 26, 2009, p 43

<sup>2</sup> The Pioneer (New Delhi), January 11, 2009, p1

<sup>3</sup> India Today (New Delhi), January 26, 2009, p 43

<sup>4</sup> The World Bank is now having a relook at the ban imposed on the Mahindra Satyam when it was under the Rajus family. Mahindra Satyam requested for lifting the ban. (Economic Times, New Delhi, May 06, 2010, Page 21).

<sup>5</sup> Economic Times (New Delhi), December 24, 2009, p1

<sup>6</sup> Economic Times (New Delhi), December 30, 2009, p1

<sup>7</sup> Economic Times (New Delhi), January 8, 2009, p1.

<sup>8</sup> [http://economictimes.indiatimes.com/Satyams\\_Raju\\_brothers\\_arrested\\_by\\_AP\\_Police/rssarticleshow/3957655.cms](http://economictimes.indiatimes.com/Satyams_Raju_brothers_arrested_by_AP_Police/rssarticleshow/3957655.cms)

<sup>9</sup> Times of India (New Delhi), January 25, 2009, p1

<sup>10</sup> <http://economictimes.indiatimes.com/articleshow/4084919.cms>

<sup>11</sup> Times Of India (Delhi), January 25, 2009, p1

<sup>12</sup> On February 19, 2009, the Company Law Board (CLB) had given nod to Satyam board to get a new owner through the process of open auction and authorized it to make a preferential allotment of shares at par or at premium without the need of calling an AGM. (Pioneer, February 20, 2009, p 10)

<sup>13</sup> The marquee list of bidders included engineering firm L&T, billionaire investor Wilbur Ross, IT services firm Tech Mahindra, B.K.Modi promoted Spice Group and IT services firm Cognizant Technologies. (Economic Times (New Delhi), August 31, 2009, p 6)

<sup>14</sup> India Today, April 27, 2009, p 46

<sup>15</sup> Mahindra Satyam is the new name given to Satyam Computer Services Ltd having its registered office at 1<sup>st</sup> floor Mayfair Centre, S.P. Road, Secunderabad, Hyderabad, India.

<sup>16</sup> Central Government U/S 388 B to E has power to remove board members on the recommendation of CLB/Tribunal, if satisfied that board members are:

1. Guilty of fraud, misfeasance or breach of trust, or
2. Business not conducted with sound principles, or
3. Conducted in a manner, likely to cause serious injury or damage to the interest of trade, industry or business, or
4. Conducted to defraud creditors, members, or for fraudulent purposes
5. As a consequences of this action removed person shall not hold office of a director in the company for 5 years, and no compensation is payable to the removed director, Central Government may appoint another person/s to that office.

<sup>17</sup> Interview of the Secretary in the Ministry of Corporate Affairs Mr Anurag Goyal given to Mr KG Narendranath carried by the Economic Times (New Delhi), May 5, 2009, p 13

<sup>18</sup> India Today, April 27, 2009, p 47

<sup>19</sup> Times of India (New Delhi), June 15, 2009, p 17

<sup>20</sup> The Economic Times (New Delhi), November 16, 2010, p 12

<sup>21</sup> Times of India (New Delhi), November 16, 2010, p 19

<sup>22</sup> 'It's baby steps still, but in right direction', Economic Times (New Delhi), December 14, 2009, p 17

<sup>23</sup> A 31 member Parliamentary Standing Committee on Finance, the report of which was tabled in the Parliament in December 2009, has recommended that the Ministry of Corporate Affairs should take steps to implement the suggestions of the Vepa Kamesan Committee that has recommended granting statutory status to SFIO. Vepa Kamesan Committee was constituted in 2006 to provide suggestions to the Government to review and decide on future course of action of the SFIO. (Economic Times (New Delhi), December 7, 2009, p 10)

<sup>24</sup> Economic Times (New Delhi), December 01, 2009, p 5

<sup>25</sup> Almost a year after it was rattled by the Satyam scam, auditing firm PricewaterhouseCoopers (PwC) on December 07, announced a sudden change of leadership of India operations as its chairman Ramesh Rajan stepped down prematurely to make way for Gautam Banerjee, who has taken over from Singapore. Rajan, who has been at the helm of PwC India since 2007, was also summoned by CBI to Hyderabad for questioning after the scam broke. (Times of India (New Delhi), December 8, 2009, p 21)

<sup>26</sup> The Pioneer (New Delhi), May 4, 2009, front page, [www.dailypioneer.com](http://www.dailypioneer.com)

<sup>27</sup> The Pioneer (New Delhi), May 4, 2009, p 10 [www.dailypioneer.com](http://www.dailypioneer.com)

<sup>28</sup> Times of India (New Delhi), February 21, 2009, p 25

<sup>29</sup> Times of India (New Delhi), February 21, 2009, p 25

<sup>30</sup> Times of India (New Delhi), June 25, 2009, p 17

<sup>31</sup> Times of India (New Delhi), October 19, 2009, p 17

<sup>32</sup> Times of India (New Delhi), November 25, 2009, p 27

<sup>33</sup> The Pioneer (New Delhi), January 8, 2010, p 5 [www.dailypioneer.com](http://www.dailypioneer.com), 'Satyam Scam: CBI Files 3rd Charge- sheet'

<sup>34</sup> Times of India (New Delhi), March 28, 2010, p 8

<sup>35</sup> Times of India (New Delhi), August 28, 2010, p 14

<sup>36</sup> Times of India (New Delhi), December 01, 2009, p 21

<sup>37</sup> Times of India (New Delhi), January 2, 2010, p 19

<sup>38</sup> With lessons from the Satyam fraud, government has included the concept of class action suits in the new Companies Bill, 2009 to help retail and small investors in fighting for their rights. Class action suit is one brought by one party on behalf of a group of individuals to file for claims against erring companies in a court of law, mainly because it would be too expensive for each individual shareholder to launch her/his own law suit and claim damages. Following the confession of Raju, US based law firms, on behalf of Satyam's ADR holders and securities and anti-trust firms, filed class action suits against the IT company in America. 12 such class action suits in US courts were filed for which Mahindra Satyam (earlier Satyam) appointed Wachtell, Lipton, Rosen & Katz as lawyers to contest the cases. (The Pioneer (New Delhi), July 10, 2009)

<sup>39</sup> Economic Times (New Delhi), August 31, p 6

<sup>40</sup> Economic Times (New Delhi), April 20, 2009, p 5

<sup>41</sup> It was during the concluding address at the 10th International Conference on Corporate Governance in October 2009 that the president, World Council for Corporate Governance got around to explaining how Satyam ended up winning the UK based institute's prestigious Golden Peacock Award for Excellence in Corporate Governance in 2008. "Because the 60-page Satyam document on corporate governance was simply the best. On paper, the Satyam board was truly top-notch with luminaries like Harvard management maven G Krishna Palepu, Silicon Valley superstar Vinod K Dham, ISB's Dean Mendu Rammohan Rao, among others. And that eminent board coupled with creative accounting, snazzy documentation, and an elaborate cover-up strategy that included even paying taxes on non-existent revenues managed to dupe the council into believing that the charlatan was a knight in shining armour. ('Satyam no wake-up call: Governance given go-by', Economic Times (New Delhi), December 14, 2009, p 16).

<sup>42</sup> The Hindu, Hyderabad, February 01, 2009, p 7

<sup>43</sup> Brokers and sub-brokers include-Gandhi Securities and Investments Pvt Ltd; Unifi Wealth Management Pvt Ltd; Indsec Securities and Finance Ltd; OFL Securities Ltd (now Gulita Securities Ltd); Advani Share Brokers Pvt Ltd (now Centrum Broking Pvt Ltd); Mittal Securities Ltd; Spark Capital Advisors (India) Pvt Ltd; Essen Swastik Securities; Nihar Securities; Limra Securities Ltd; Navia Markets Ltd; Anand Laxmi Securities Ltd; DBS Cholamandlam Securities Ltd; BNP Paribas Equity India Pvt Ltd; and DSP Merrill Lynch Ltd. (Source: The Pioneer (New Delhi), May 4, 2009, p 10).

<sup>44</sup> Economic Times (New Delhi), February 5, 2009, front page.

<sup>45</sup> Though not on the board of Satyam, Vadlamani used to exercise tremendous clout in the company matters and had total grip on the finance function. So he was one man who knew the insides of the company.

<sup>46</sup> Times of India (New Delhi), January 10, 2009 p 23

<sup>47</sup> The Pioneer (New Delhi), May 4, 2009, p 10

<sup>48</sup> The Pioneer (New Delhi), May 4, 2009, p 10

<sup>49</sup> The Pioneer (New Delhi), May 4, 2009, p 10

<sup>50</sup> www.timesofindia.com

<sup>51</sup> 'Boards need to select members, not invite them', Economic Times (New Delhi), December 14, 2009, p 17

<sup>52</sup> CLB approved ouster of Raju Family from Mytas. IL&FS group on January 13, 2011 acquired a controlling stake in Mytas Properties by holding 80% of the total equity in it. Rest 20% will be held by Raju family through their Rs 5 lakh equity. Mytas Properties is a privately held real estate company promoted by Raju family. The board of Mytas Properties have been reconstituted with the IL&FS Group appointing its directors, while those from Raju family Rama Raju, D. Gopal Krishnana Raju, and D. Venkata Satya Raju submitting their resignations ending their representations. IL&FS will appoint four new directors to the board, while government will continue to have its nominee directors for two years. The CLB has granted new directors immunity from any act of omission or commission in respect of past acts of erstwhile promoters/directors. IL&FS had already taken over Mytas Infra (another company of Raju family)

<sup>53</sup> The expression 'independent director' as per the clause 49 of the listing agreement means a non-executive director of the company who: a) Apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiaries and associates which may affect independence of the director; b) Is not related to promoters or persons occupying management positions at the board level or at one level below the board; c) Has not been an executive of the company in the immediately preceding three financial years; d) Is not a partner or an executive or was not partner or an executive during the preceding three years, of any of the following: The statutory audit firm or the internal audit firm that is associated with the company, and The legal firm(s) and consulting firm(s) that have a material association with the company; e) Is not a material supplier, service provider or customer or a lesser or lessee of the company, which may affect independence of the director; and f) Is not a substantial shareholder of the company i.e. owning two percent or more of the block of voting shares?.

<sup>54</sup> NYSE Listed Company Manual's criteria for independence of directors is similar to those specified in the SEBI Clause 49 save that SEBI Clause 49 does not place any numerical limit on independence director's remuneration. In the NYSE Listed Company Manual, 120,000 US dollar is annual compensation limit for independent directors.

<sup>55</sup> "Rating the raters, Enron and the Credit Rating Agencies", Hearings before the Senate Committee on Government al Affairs, 107<sup>th</sup> Congress, March 2002, available at <http://www.access.gpo.gov/congress/senate/senate12sh107.html#4>

<sup>56</sup> Times of India (New Delhi), April 5, 2010, p 20

<sup>57</sup> The Pioneer (New Delhi), May 4, 2009, p 10

<sup>58</sup> Times of India (New Delhi), January 25, 2009, p 1

<sup>59</sup> The Pioneer (New Delhi), May 4, 2009, front page

<sup>60</sup> The Pioneer (New Delhi), May 4, 2009, p 10

<sup>61</sup> According to the Centre for Media Studies estimates, the country spent rupees 10,000 crores on the 2009 Lok Sabha polls one-fourth of which was going to be in the form of unofficial money.

<sup>62</sup> Economic Times (New Delhi), January 29, 2009, p17

<sup>63</sup> The Hindu Business Line, January 9, 2009, p8

<sup>64</sup> The Pioneer (New Delhi), May 4, 2009, p 10

<sup>65</sup> Jim Solomon and Aris Solomon (2004), "Corporate Governance and Accountability", John Wiley & Sons Ltd, England, page 42 (303 pages)