Free governance failure at satyam case study example

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According to the Wharton research, when an executive is overconfident and thinks that his organization is just facing the bad luck otherwise it is in best concern of all stakeholders. These stakeholders include customers, shareholders, management, creditors, and employees. The executive to cover up the problem takes short routes that do not allow the executive to understand the poor performance of the organization as a future threat. An overconfident manager does not consider the flaws and search for gray areas to manage earnings that led them to fraudulent behavior (Wharton, 2008).

If the case of Satyam is considered, then the case presents the same facts. Because Raju (chairman of Satyam) his statement mentioned that " every attempt made to eliminate the gap failed." This statement explains that the chairman of Satyam to reduce the gap that exist between actual operating profit and reflected in the book drove the company towards fraudulent activities. Due to his overconfidence, he could not realize the alarming situation and in the result, the organization had to face poor performance that exposed the gap.

Through analysis, it has been determined that sometimes managers to meet the quarterly expectations, improperly recognize the revenues. Then because of such actions, organizations have to face difficulties in meeting the expectations. Even sometimes, it becomes impossible without fraudulent and manipulating accounting practices. Companies that are involved in earning management through doing fraudulent activities require more sophisticated and complex techniques of account to make sure that the expectations of the analysis are being met. Ultimately, companies have to be involved in activities that are more fraudulent (Magrath & Weld, 2002). It has happened as well in Satyam that to reduce the gap and meet the expectations the chairman of the company falsify the financial documents. The weak corporate governance mechanism contributed in fraudulent activities; the role of independent directs was doubtful because they could not realize the fraudulent activities and immense manipulation in accounting activities. They supposed to keep the company answerable for maintaining such vast quantity of cash. Even the internal and external auditors could not catch up the irregularities, which means failure of auditors is another reason that contributed to fraudulent activities.

Evaluation of the corporate governance practices adopted by Satyam

The role of internal controls in the prevention of fraud

Internal control is check and control system that is instituted by different management's levels. These management levels can be interdependent and independent and are integrated into non-financial and financial operations and activities of the business to make sure that the process are being conducted effectively and efficiently. It is made sure that the report of all sort of result gathered from all business aspects is reliable to ensure the well based management decision making. Moreover, such gathering of results is helpful to assure that all regulation and relevant laws are complied with decision making (Trenerry, 1999). It has been determined that the company was lacking severely in internal control management due to with the fraudulent activities continued. Board of directors is the most important and influential body in any organization. At satyam, the team of board of directors was based on nine members from which 5 were independent directors. The board of directors did not have a deliberate and dedicated focus on risk assessment. Board of directors could play a significant role in fighting fraud. Board of directors count formal design process and could consider the financial statements critically. Effective internal control is a base of risk management. Oversight activities of risk management by observable and dedicated board enhance the ethical image of the firm and set the stable stage for the culture of internal antifraud (McNeal, 2011). Internal auditors can also prevent the organization from fraud through having proper compliance with the code of conduct and maintaining the auditing standards. The internal auditor is liable to analyze the fairness and truth of financial statements, but internal auditor could not extract the fraud. The bank could also prevent the organization from fraud by taking proactive measures for fraud deduction. However, the chairman of the group created several fake bank accounts to leverage the fraud and bank could not deduct the fraud.

Discuss ownership structure of Satyam, board composition, board committee.

Among several factors, that influence corporate governance the one factor is ownership structure. It is critical to the success of the organization that how the organization is controlled and managed. The ownership structure of the company can be separate from institutional and individual shareholders. The ownership structure of the organization has been divided into three categories that include promoter’s holding, non-promoters, and others. Non-promoters that are institutional investors such as banks and foreign investors acquire a major share of holdings. 22. 99 shares are held by private corporate bodies, Indian individuals, NRIs and others collectively. However, only 20. 74 percent shares are owned by Indian promoters. Over all the major holdings were in the hand of foreign investors and Indian promoters.

The structure of the organization board along with ownership structure of the organization has a significant impact on control and management system of the company. The compliance of board of directors with rules and regulation is essential because they are immensely liable for corporate governance. Board of Directors is responsible to formulate board policies, corporate objectives and to select executives to lead the organization with set objective and policies. Before the crisis of Satyam the board was composed of 9 members from which 5 were independent directors, 2 were family members, 1 was an internal employee and one was a consultant to the organization. This composition of the board of directors was in compliance with set Indian rules and regulations. However, after the crisis composition of the board includes six board of directors in which 5 were independent, and one was a non-executive director. The reason for enhancing the number of independent directors is that they can work without having the pressure from internal directors. They can detect the fraud and take actions without bias that will encourage the antifraud culture and prevent the organization from further fraudulent activities.

If the audit and compensation committee is considered then, it includes four members, and all four members were independent. The compensation committee was used to meet thrice in a year while audit committee used to meet eight times on annual basis. The composition of these committees was also according to the rules and regulations of India.

Failure of three-layers of financial auditing

Satyam is the worst case unfolded numerous reasons behind the collapse of the organization from which one was the failure of management in realizing the fraud. The reason due to which the immense collapsed happened was the lack of dedication of internal and external auditors. The auditors avoided their responsibilities and did not check the irregularities. For example, when Satyam financial statements were showing significant amount of cash, auditors must review the facts that either the cash in hand that has been reported in statements is available or not. They should have done physical verification of this matter. Secondly PwC did not perform its duties appropriately and avoid following the set standards and code of conduct (SEC, 2011). Auditors have not applied proper auditing tools to check the truthiness and fairness of financial statements. The responsibility of auditors was to verify that every financial document of the company presents fair and correct information.

The responsibility of an external auditor team is to assure consumers that the organization is trustworthy, but from the analysis of the case it has been realized that the external auditor. Such as PwC has been given, higher fees for performing auditing activities to PwC that arises the concern that the audit organization may leverage the satyam in irregularities deliberately. Because cash audit is the easiest audit as it can be confirmed through banks.

The declined commitment of bank was another reason that contributed to the failure of auditors to analyze the fraud. The audit team should be free of any pressure so it can work best for the organization, but at satyam the chief financial officer headed the team. In this case, numerous layers were involved, but rather to take responsibility all indulge in passing the blames on other.

Conclusion:

The company showed healthy balance sheet in eight years of its life, and the significance increase in turnover was taking place as well in financials. Event profit after taxation also posed significant gains with 10 to 20 percent gain in net profit. All the data is committed to showing growth, but the crisis appeared when the company exposed the acquisition of 50 percent stake of Maytas Infra. The acquisition required $300 million borrowing. Investors were not happy with the acquisition and ADRs of satyam declined by 55 percent in the result. Satyam, to obtain profitable contracts, was offering bribes to the staff of world bank in effect world bank suspended the company to do business itself for eight years that resulted in falling share prices. Further infrastructure leasing and financial services trust sold an immense amount of the company’s share that the reduced the share of family and Raju to 5. 13 percent from 8. 65 percent. In just two weeks, 40 percent of market capitalization got down. During this crisis, the fraud was exposed to board members by the former senior executive. He confirmed that the company does not cater enough liquid assets. Circumstances drove the organization towards fraudulent activities include overconfidence of chairman, pressure to meet the quarterly expectations, and the improper recognition of revenues.

References

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