

The reasons behind the largest corporate scandal of india accounting essay



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' Satyam' means ' Truth' and the truth was revealed very late in case of India's one of the largest IT company, Satyam Computers Services Limited. By the time, Satyam fraud came to public light, Ramalinga Raju, the chairman of the company, had already committed India's largest corporate fraud ever. The first section of essay will discuss the reasons behind the largest corporate scandal of India. It will discuss why people with billions in banks go corrupt. In this section, it will argue on the negligence and violation of duty by various elements involved in the wrongdoing. Then, the next section of essay will state some recommendations to avoid further frauds or scams.

In the first section, we will discuss why big businessmen or rich people who are very famous and known to the world, sometimes, step out of line of honesty. By doing this, they break the trust of people and lose all their reputation and name that they had gained by working hard in their lives. The first reason for their divergence from honesty to dishonesty is sense of ownership. If a person is the only owner or founder of the company, then he finds it easy to do what he wants with his business. He thinks that it is his business and money. Security of getting away with any wrongdoing makes him comfortable. He becomes unaware of the consequences and keeps on doing wrong things again and again.

The owners and founders of companies, sometimes, don't like outer interference in their business and they do only what, they think is best in their interest. Hence, this sense of ownership, somehow, leads to greed.

They don't think of other people who put their money in business. They justify themselves that they are permitted to do what they want with that

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money because it is their business. They just ignore the rights of other stakeholders who are involved in business too (Kaur and Mishra, 2010). Hence their unethical behaviour cost them a lot at the end because one day everybody comes to know about crime.

In Satyam case, ownership structure of Indian companies is also responsible to some extent. The popularity of family owned businesses in India led to concentrated business control. In this system, independent directors agree to act in interest of family group. They just ignore the interests of the company and minority shareholders and act in the way that is best for their benefit.

Some corporations are generally structured in a pyramid structure. The pyramid structure comprises of some separate business lines. Different businesses are considered as one entity and are controlled by one group at the top. Thus, they can transfer money from one entity to another as required (Winkler, 2010). Hence, it can lead to ' tunneling'. Tunneling is a process in which a control group moves money from one company to another company, where they possess bigger share. Also, in pyramid structure, it is hard for outside shareholders to check inner performance of business entities (Winkler, 2010).

Because of pyramid structure and consolidated control of the business, board of directors of Satyam didn't do their duty independently. They approved the purchase of family owned company of Chairman Mr. Raju, Maytas properties and Maytas Infrastructure. It was not an IT company and Mr. Raju had larger shares in Maytas than in Satyam. Thus, ownership

structure of business impacted the performance of directors in another way (Winkler, 2010).

Another reason for the professional misconduct of billionaire businessmen is the desire to do something different. Sometimes they think that they have achieved everything in their life, so what is next exciting job for them. Thus, the thrill of danger involved gives them the drive to do something unusual. So, they tend to try new things in their jobs to gain more advantage out of their business. Thus, gradually, this tendency leads to their deviation from right to wrong and they can't step back because they merge themselves in the offence to that extent that they fear to get exposed to the public. So they keep on doing that without expecting to get caught one day.

Sometimes, people start their offence with small misconduct. To get benefit, they just try a mischief by manipulating the account books by little difference. They think that is very easy as they didn't get caught. So, next year they again do that to cover last year's gap. Then, they feel uneasy to stop that as they don't know how to get out of this. Hence, they commit that mistake again and again until that mistake gets transformed to a blunder and then to a largest fraud. In case of Satyam, Ramalinga Raju had to overstate the income every quarter to cover the last gaps. When he finally disclosed the fraud, he mentioned, " It was like riding a tiger, not knowing how to get off without being eaten" (Winkler, 2010 pg 5). Thus, a small mistake led him to the edge, where he didn't know how to get back and he became convicted of the scam of billions.

In a competitive corporate world, billionaires become prone to be more successful than their rivals. They become habitual of winning. So, when they perceive that next situation is not going to be in their favour, it hurts their sense of pride. Thus, they become ready to do anything to maintain their status and repute. They just forget that by choosing wrong way to success, their pride will sustain for short term. For the long term, they will have to pay for every wrong deed.

Thus, all the above mentioned reasons together give an example of weak corporate governance of India. Personal greed of the chairman and negligence of duty by board of directors and the audit committee resulted in a worst scandal in Indian history.

Now, the second section of essay will provide some implications to prevent these types of corporate frauds in future. After Satyam scandal, Indian regulators started working for the improvement in corporate governance of India. The Securities and Exchange Board of India (SEBI) is a main regulatory authority for India's stock market (Afsharipour, 2009). It proposed some regulations that should be strictly followed by all companies to maintain good governance standards. But, still it is difficult for the corporate government of India to make changes in their standards in short period of time to prevent further frauds. Still, it can be achieved by facilitating strict enforcement of their rules.

First of all, government should take initiative by being strict in its laws and regulations. Government can initiate this from the roots of crime, that is, bribery. They should punish the bribe givers and bribe takers. The persons,

who give or take bribe for their own interests and grab the rights of other people involved in the business, deserve punishment. It will help to prevent further corruption as people will avoid it for the fear of strict punishment. If still any person is involved in any kind of fraud or scam, they should be sent to prison and their assets should be seized. They should make suffer hard so that in future nobody will feel secure or easy to get away with a crime.

Also, there are some duties of companies towards their employees.

Employees should be encouraged to whistle blowing. Whistleblowing helps to avoid and eliminate evil and to decrease the probability of misconduct and dishonesty in an organisation (Grace & Cohen 2010). All the employees should be aware of the means that how can they disclose unethical behaviour of board member or any other person in the company without getting affected. This would create a strict and honest environment in the companies as everybody will be afraid of getting caught if they would chose to be corrupt. Also, to make this step successful, whistle blowers should firstly, provide full protection. That will encourage them to follow the moral behaviour and stand against evil. This practice will play an important role in the prevention of corruption and frauds. Moreover, to get best out of their workforce companies can encourage employees to buy some shares from the company. If employees have some shares in the company, they are working; they will work for the best interest of the company. They will not favour any bribery and stand against evil in firm. Hence, it will lead to best corporate results.

To avoid unethical behaviours in companies, business should be run on the concept of Corporate Social Responsibility. Under this concept, businesses
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become committed to behave ethically. In the companies, duties are performed morally towards contribution to economic development, while considering the interests of employees, all stakeholders and society as a whole (Ferrar, 2008). CSR works in long term interest of the company and it also increases company's reputation. Hence, a company working on the concept of CSR will have good quality workforce who will focus on the interests of all the people attached to the business.

In corporations, there are two audit committees. First is internal audit committee that is comprised of independent directors of the company. They scan all the operations in the firm including income statements. They make sure that no unreliable and false information regarding financial report would be given to the shareholders (Solomon, 2007). They are responsible for the internal audit system. Hence they ensure the accuracy of all the operations inside the firm. External auditors are the auditors from outside the company. They review the performance of internal auditors, that is, they check internal audit functions. They scan company's whole financial reporting process (Afsharipour, 2009).

In India, there is need for more clear functions of audit committees. There is need for more independence and better composition of internal auditors. More frequent meetings of audit committees should be encouraged. It will help in more effective internal control. Also, more meetings will help in effective judgement and decision making (Al-Mudhaki and Joshi, 2004).

Moreover, an audit committee should not work with a company for more than five years. They should be changed after every five years, otherwise, they will get lazy working with same company and they might get involved <https://assignbuster.com/the-reasons-behind-the-largest-corporate-scandal-of-india-accounting-essay/>

with some people of company. That can affect their performance as auditors because their job needs total unbiasedness. Final check of the financial reports should be done by anonymous external auditors so that directors will not find any opportunity to bribe them. Hence, effective role of auditors is very necessary to avoid corporate failures.

In India, corporate governance has been put into practice through clauses of Companies' act 1956 (Farias, 2001). Companies Act in India has been drawn a lot from UK Companies Act 1948 (Afsharipour, 2009). But, still Indian Companies Act doesn't put more stress on the independence and qualification of board of directors and investor protection. In India, lack of independent and qualified directors leads to weak corporate governance. Most independent directors are the university professors or government officials. They show least interest in their duties and monitoring the performance of management. According to Zhang and Rajagopalan (2008), to ensure unbiasedness and quality of boardroom, foreign directors can be appointed. Also, India can open its market for foreign investors. Hence, independence of directors will ensure right and unbiased decision making and avoidance of any influence from anybody.

India corporate governance needs to put great emphasis on transparency and disclosure. Transparency and disclosure are very necessary to eliminate corruption and to ensure precision of all the operations performed in a business (Zhang and Rajagopalan (2008). Corporations should not hide anything from the public. They should be transparent and clear in their operations and disclose their annual agendas every year. They should state clearly in the beginning of financial year what they are going to do and how

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they are going to use the shareholders' money. Companies should work in favour of more voluntary disclosure. They should disclose their balance sheet position more than once a year, perhaps twice. This will help to avoid mismanagement of account books. If there would any falsification in the statements of balance sheet then it will be prevented on time. Hence, transparency and disclosure in business adds up to the value and quality of operations in the business. Companies will be more honest and true in their approaches leading to achievement of good corporate governance standards.

Reaction of American government to Enron scandal resulted in Sarbanes-Oxley Act (SOA) in 2002 which holds lots of reforms in corporate governance in America. SOA put great emphasis on certification system in corporations. According to this act, each quarterly and annual report must be certified by CEO and CFO of the company (Pinto & Branson, 2009). They should review the financial reports themselves and should take responsibility. This law has been adopted by Indian Companies Act in Clause 49 but it doesn't put criminal liability in case of fake or wrong statement (Afsharipour, 2009). So, absence of criminal liability means there will not be any fear of law in people and they can easily alter the financial statements. There is no benefit in implementing a regulation with no strict criminal law on the violation of that regulation. Hence, if any law is implemented by the regulators, it should be strengthened with penalties, in case if somebody dares to break those laws. It will help to install fear of law in minds of people so that they won't even think to go against laws in a corporation.

Failure of Indian Judicial System to settle corporate conflicts is another reason for weak corporate governance in India (Afsharipour, 2009). Delays in making decisions in judiciary process often led to ignorance of issues. Hence, judiciary processes in India are strongly criticised because of their negligence of judicial system. Thus, more steps should be taken towards the reforms in Judiciary System. This will help in timely resolving of corporate disputes and ensure the effective corporate governance standards.

Ministry of Company Affairs (MCA) is government regulatory body and Securities Exchange Board of India (SEBI) is independent securities regulator. Since creation of SEBI in 1992, there have been continuous conflicts between SEBI and MCA. (Afsharipour, 2009). Simultaneous exercise of all legislative responsibilities by both regulatory bodies is increasing tension between SEBI and MCA. This conflict and competition between two groups is putting hindrance on the way of corporate governance reforms. SEBI adopted most of the legislative regulations but implemented few of them. Both of the groups have least focus on corporate governance regulations and more focus on undermining each other. So, authorisation of SEBI and MCA on the regulations in the companies should be managed effectively so as to resolve conflict between both groups. Both of the groups should work in harmony for the strict implementation of all the regulations and thus, it will further help to achieve better standards for the corporate governance.

Apart from these reforms, one thing that builds the foundation of the corporate governance is the ethics of people. So, it should be reformed from the roots. That is, students should be taught ethics in schools (Kaur and Mishra, 2010). Especially in a country like India, there is need for the honest <https://assignbuster.com/the-reasons-behind-the-largest-corporate-scandal-of-india-accounting-essay/>

and ethical people. Introduction of ethical education in schools would strengthen the roots of corporate governance.

In conclusion, there is an urgent need to take revolutionary steps for the governance reforms to prevent corporate failures due to scandals. Hence, as no business can operate in a vacuum, directors have some fiduciary responsibilities towards stakeholders. If directors step out of line of honesty, they should be punished. The first part of essay identified some reasons for convergence in behaviour of billionaires that leads to large corporate frauds. The second part of essay provided some recommendations for corporate governance reforms which would help to prevent frauds in companies. After analysing all the points, this essay puts great emphasis on the implementation of strict laws against corruption. This would mark the prevention of debacles like Satyam for a longer time in the future.

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