



ROLE OF SEBI IN MANAGING CORPORATE FRAUDS AND SCANDALS SINCE 1991: A CRITICAL ANALYSIS

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Abstract

Corporate frauds or financial crimes or financial frauds can be classified as white-collar crimes, which represent the illegal acts that are characterized by deceit, concealment or violation of trust. The fraudulent exercises practiced by Enron, WorldCom and Martha Steward shook the world. Of these scandals, the Enron accounting scandal was the most infamous one. Its CEO Kenneth Lay along with a few other employees deceived the accountants by making the company appear healthy, when in reality it was in serious financial trouble. There were similar allegations against the WorldCom Company, whose CEO Bernard Ebbers hid an expenditure of \$11 bn; later this led the company to bankruptcy.

Frauds have occurred in almost every country in the world, in almost every sector, including banking, insurance, telecom, automobile industry, health, and the list is endless. Banks as well as the companies are increasingly facing the threat of financial crimes or account of both internal and external factors. Internally, the fraudulent employees who often deal with the systems and security aspects and externally the IT hackers and fraudsters can pose a significant threat of a financial crime. There are several adverse consequences of financial crimes. According to an estimate, a financial fraud in case of credit card can cause the individual great inconvenience taking up to 300 hours to rebuild his credit history. It can bring institutions down to closure and can cause employees loss of their livelihood and investors their life savings. In fact, the fraud is not as accounting problem rather it is a social phenomenon. If you strip economic crime of its multitudinous variations, these are three ways a victim can be unlawfully separated from money: by force, stealth or trickery. While the first two are on the wane, the third is not.

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Introduction

All the financial crimes, scandals and others have led to an increased focus on the development of new initiatives in ethical behavior, regulatory frame work, IT

security, etc. The aim of this paper is to examine the causes of fraud occurrence on the basis of surveys conducted by various detective agencies, and further its deterrence in the light of ethical accounting, regulatory frame work, proper internal control and audit assessment, etc.

2. Causes of Corporate Fraud Occurrence Based on Survey Reports.

I. Pricewaterhouse Coopers Survey 2005

Pricewaterhouse Coopers's Economic Crime, in association with Germany's Martin-Luther University, conducted a global survey on 2005 on organizational fraud involving 3634 companies from 34 countries, including India. According to the findings of the 2005 survey, rising economic crime poses a growing threat to companies, with more than half companies in India being victims of one or other form of fraud during the past two years. The number of companies reporting fraud increased from 24% to 54% since 2003 (approximately 125% increase). Regardless of size, no company or industry, regulated or unregulated, was immune from fraud.

II. IBM Survey 2005

The IBM survey finding are based on a total of 3002 telephonic interviews with businesses in healthcare, financial, retail and manufacturing sectors from December 2005 to January 2006. The businesses are located in the US, the UK, China, India, Russia, Poland, Czech Republic, Germany, Spain, France Argentina, Brazil, Australia, Mexico, Japan and Canada. As per the survey report, Indian firms ranked loss of revenue (75% versus 72% of global business) as the highest cost associated with cyber crime, followed by loss of market capitalization (72% versus 47% of global business). The other costs for Indian companies include damage to brand and reputation (65%), loss of current customers (64%), loss of employee productivity (60%), loss of prospective customers (57%) and the cost of restoring service (53%). Further, according to the survey report cyber crime is now a bigger threat to Indian companies than physical crime. The Indian IT executives believe more strongly than their global peers that cyber crime is more costly to their organizations than physical crime. Around 67% local Chief Information Officers (CIOs) perceive cyber crime as more costly compared to a global benchmark of 50%.

III KPMG-India Fraud Survey 2006

A survey was conducted by KPMG (known as KPMG – India Fraud Survey 2006), which pointed out that the Telecom, Media and Software sectors

have emerged as being most vulnerable to frauds in India followed by the financial sector (banking, insurance, mutual funds, asset management, non-banking finance companies and investment banks) where as the transportation, retail, consumer and food sectors are in the lower rung for fraud risk. The reasons for the occurrence of frauds in the corporate sector, as revealed by the survey presented in the following table.

Table 1 Reasons for the occurrence of frauds in the corporate sector

Areas	Reasons for being Threatened by Fraud (%)
Poor Internal controls	24
Lack of ethical values	20
Collusion between vendors and employees	19
Management override of control	14
Inadequate background checks on	6
Prospective employees and/or vendors	7
Dissatisfaction among employees	10

Source : www.aicpa.org.html index06

IV Earnest and Young Global Survey 2006

The Ernst & Young Ninth Global Fraud Survey sampled about 600 companies across the American, Europe, African and Asian subcontinent and dwelt extensively on various aspects of fraud and internal controls that are in place to prevent frauds. The survey revealed that about 75% of the Multinational Corporations (MNCs) are victims of fraud that occurred in developed economies whereas only 32% were duped in emerging markets. Further, almost a quarter of the sample size confessed that they did not have proper anti-fraud measures when they want to invest as well deal in new markets.

V Ernst & Young Indian Survey 2006

According to the recent survey by Ernst & Young of Indian Corporate sector revealed that 42% of the Indian companies have responded that levels of fraud have increased acutely in the past two years. The main reasons for increasing number is large-scale recruitment combined with lack of internal audit control. The growing focus on cross-border expansion, high levels of growth with internal processes not keeping pace and large number of new employees joining the organization are making most companies vulnerable to greater fraud risk in recent times.

VI SAS Inc Survey 2006

According to a recent survey made by SAS Inc., the estimates of the cost of fraud to the UK economy were tremendously increased from \$28 bn to \$36 bn per annum. As said, some of the reasons behind the increase in fraud cases in organizations can be taken to be as follows:

- a. Organizations believe that they recruit only honest staff.
- b. They believe that customers and suppliers are also honest.
- c. They believe that their staff reports to these fraud cases in time.
- d. Some organizations even think that checking the accounts and final statements is the cheap work of auditors and, hence, they take no part in verifications.
- e. Problems surround even the lawmakers who execute it. (Mike.P 2002)

In the era of globalization and liberalization, companies have been facing a completely different set of challenges – obsolescent technology, accelerated development in industry and business, risks and complexity of information and data management. With this changed scenario, the risks faced by organizations have also increased manifold and there arises the need to manage and mitigate these risks more effectively. The increased size and impact of financial reporting standards and the related loss of billions of dollars of shareholder value have rightly focused both public and regulatory attention in all aspects of financial reporting fraud and corporate governance. We have come to know from the previous text that cyber crimes, economic crimes, ethical crimes, falsification of accounts by showing inflated profits, breach of fiduciary duty, breach of confidential information, non-disclosure of material facts etc. are causing enormous harm to the rights and interests of the society. Every such corporate fraud is a heinous crime against humanity, as it adversely affects and ruins the fortunes of large segments of innocent people.

Now, the question arises how the frauds can be deducted. The simple answer is establishing and maintaining the antifraud culture in an organization that helps in preventing fraud forever. **Ernst & Young's Ninth Global Fraud Survey :on Fraud Risk** in emerging markets indicated that anti-fraud policies that include the following elements would help in preventing fraud to a great extent.

- 1 Internal controls
- 2 Internal audit
- 3 Management reviews
- 4 Internal education of policy

- 5 Encouraging and protecting whistleblowers
- 6 Regular rotation of personnel
- 7 External audit

3 Role of SEBI in Corporate Governance

Before SEBI was formed, breach of regulations was the norm and compliance an exception. To promote the investor's confidence, it was necessary to reverse the situation. As a result, a regulatory body was constituted in the name of SEBI on April 12, 1988 to ensure the investor's protection and growth in the securities market. SEBI has extended control over the 23 stock exchanges of the country and initiated several steps to make reform in the regulations of the capital market so that investor's may be protected against the fraud. Infact, SEBI sent strong message to market participants that strict observance of regulations has been essential to meet the extending needs of capital market as well as protect the investor's against the frauds.

More over, the concept of corporate governance (initiated by the SEBI on the basis of recommendations of various committees such as Shri Kumar Mangalam Birla 2000, Naresh Chandra 2000 and Shri Naranyana Murthy 2003) hinges on complete transparency, integrity and accountability of management, which also includes the non-executive directors. The main aim of corporate governance to handle corporate frauds and scandals, and a System of making directors accountable to Shareholders for the effective management of the company and also with adequate concern for ethics and value.

4 Analysis of Scams Since 1991

The major objective for conducting this Study to evaluate the effectiveness of corporate governance against the major scams happened in India Since 1991.

I. HARSHAD SHANTILAL MEHTA'S SCAM 1992

Harshad Shantilal Mehta was born in a Gujarati Jain family of modest means. Mehta first started working as a dispatch clerk in the New India Assurance Company. Over the years, he got interested in the stock markets and started investing heavily in the stock market. Mehta gradually rose to become a stockbroker on the Bombay Stock Exchange, who did very well for himself. The crucial mechanism through which the scam was affected was the **Ready Forward (RF) Deal** and **Bank Receipt (BR)**. The deal is in essence a secured short-terms loan from one bank to another. The bank lends against government securities. The borrowing bank actually sells the securities to the lending bank and buys them

back at the end of the period of the loan, typically at a slightly higher price. It was this RF deal that Harshad Mehta and his associates used with great success to channel money from the banking system. A typically ready forward deal involved two banks brought together by a broker in lieu of a commission. The broker handles neither the cash nor the securities, though that wasn't the case in the lead-up to the scam. In this settlement process, delivery of securities and payments were made through the broker. That's the seller handed over the securities to the broker, who passed them to the buyer while the buyer gave the cheque to the broker, who then made the payment to the seller. This the brokers could manage primarily because by now they had become market makers and had started trading on their account. To keep up a semblance of legality, they pretended to be the undertakers of the transactions on behalf of a bank.

Another instrument used in a big way was the bank receipt (BR). In a ready forward deal, securities were not moved back and forth in actuality. Instead, the borrower, i.e. the seller of securities, gave the buyer of the securities a BR. A BR confirms the sale of securities. It acts as receipts for the money received by the selling bank. It promises to deliver the securities to the buyer. It also states that in the mean time, the seller holds the securities in trust of the buyer. Having figured this out, Mehta needed banks, which could issue fake BRs. Two small and little known banks – **the Bank of Karad (BOK)** and the **Metropolitan Co-operative Bank (MCB)** came in forward for this purpose. Once the fake BRs were issued, they were passed to other banks and the banks in turn gave money to Mehta. This money was used to drive up the prices of stocks in the stock market. When time came to return the money, the shares were sold for a profit and the BR was retired. The money due to the bank was returned. The game went on as long as the stock prices going up and no one had a clue about Mehta's modus operandi. Once the scam was exposed, through, a lot of banks were left holding BRs **which did not have any value and the banking system had been swindled of a whopping Rs. 4000 crore.**

II IPO SCAM (2003-2007)

IPO scam took place in the market between 2003-2007, which was much more refined and organized in terms of operations. It involved manipulation of the primary market i.e. applying in the initial **public offering (IPOs)** by financiers and market players by using fictitious or benami demat accounts. The scamsters led by Roopalben Panchal, Sugandh Estates, Purshottam Budhwani, Manojdev Seksaria and a few others, opened thousands of fictitious/benami demat accounts with common last names such as **Patel, Gandhi, Rathod, Pandya,**

Desai, Pathak, Bhatt, Trivedi, etc. The bank accounts were opened with **Bharat Overseas Bank, HDFC Bank, Vijaya Bank, Indian Overseas Bank, Yes Bank** and demat accounts are opened with **Karvy Depository participant and Pratik Stock Vision Depository Participant**. To open the benami/fictitious accounts, the scamsters used photographs of thousands of people who have nothing to do with the scam. The scamsters reportedly lured these people by giving advertisements in some local dailies in Gujarat offering free passport size photographs to promote a studio. Thousands of people turned up to get themselves photographed and while they got two or three copies of their photographs at free of cost as promised. They also unknowingly provided the scamsters with their photographs to open the fictitious bank and demat accounts. Over a period of time, the scamsters built a library of over one-lakh photographs using the free photo scheme. After getting their photographs, these scamsters gave names of their choice to these people. As for furnishing addresses of these people on the bank and demat application forms, the scamsters provided addresses of premises owned/leased by others as show in **Table 1 and 2**.

Table - 1

Surnames that have been used in Fictitious Applications			
Surnames	No. Of Times Used	Surnames	No. Of Times Used
Barot	1,000	Rathi	999
Bhatt	977	Rathod	987
Desai	1,000	Trivedi	995
Gandhi	991	Vala	999
Pandya	1,000	Vania	976
Pathak	975	Verma	1,000
Patel	976	Zaia	996
Ranka	936	Total	14,807

SOURCE:<http://capital market scams,94,index/link>

Table - 2

No. Of Demat Accounts opened with Karvy Depository having Identical Addresses			
Date	No. Of Accounts	Date	No. Of Accounts
20/06/03	125	18/02/04	58
27/06/03	196	16/08/04	2729
06/11/03	575	17/08/04	195

16/12/03	517	18/08/04	59
17/12/03	753	19/07/05	1001
05/01/04	1088	20/07/05	1525
06/01/04	1135	21/07/05	758
16/02/04	1543		

SOURCE:<http://capital market scams,94,index/link>

III Dinesh Dalmia's Scam 2001

Dinesh Dalmia was the managing director of DSQ Software Limited when the Central Bureau of Investigation arrested him for his involvement in a stocks scam of Rs. 595 crore (Rs. 5.95 billion). Dalima's group included **DSQ Holdings Ltd, Hulda Properties and Trades Ltd and Power Holding and Trading Pvt. Ltd.** Dalmia resorted to illegal ways to make money through the partly paid shares of DSQ Software Ltd, in the name of New Vision Investment Ltd, UK, and unallotted shares in the name of Dinesh Dalmia Technology Trust.

SEBI's findings regarding involvement of promoters/associated entities of the company in the scam are as follows.

1. Unauthorized allotment of one crore shares was made by the company in October/December 2000 out of which **60 lakh shares were allotted to Dinesh Dalmia Technology Trust and 40 lakh shares to Dr. Suryanil Ghosh Trustee Software Corporation.** These shares were allotted without any resolution passed by the company and without receipt of any funds and also without following any procedure under the Company Law. These shares were finally transferred to entities connected with promoters i.e **DSQ Holding Ltd, DSQ Industries Ltd, Holda Trades and properties Ltd.** and were sold to various brokers. The entities with promoters were indulging in circular traders and fictitious trades with a view to create an artificial market in the scrip.
2. SEBI also revealed that on 30.12.99, the company made a preferential allotment of **1 crore shares of DSQ Software to FII's, OCB's etc. and two entities of Ketan Parekh e.g. Classic Credit Ltd. and Saimangal Investrade Ltd. were allotted 9 lakh shares each @ Rs. 275 per share** The preferential allotment was made at a discount of almost 67% to prevailing market price of the share. **Classic Credit Ltd.** sold all the 9 lakh shares allotted to it within 4 months of allotment. The net benefit accrued to Classic Credit Ltd. as a result of sales of 9 lakh shares is approximately to the tune of **Rs. 144.5 cr.** Out of 9 lakh shares allotted to **Saimangal Investrade 5,45,000 shares were bought back by DSQ Holdings Ltd** at market rate (a

- promoter group) company in off-market transactions.
3. Finding also show on that further **42, 50,000 shares of DSQ Biotech were given by DSQ group/associated entities to Ketan Parekh**. The market value of these shares is approximately **Rs. 74.35 cr.** Thus, funds to the tune of approximately **Rs. 75 cr. Of DSQ Biotech and shares worth Rs. 400 crores** have been given by DSQ group earlier to Ketan Parekh entities approximately who is also indulge in unfair practices to increase the prices of the shares of DSQ ltd. Thus ,the funds to the tune of **Rs 475 crores** have been manipulated by the promoters.
 4. Investigation clearly revealed that there was an abnormal spurt in prices and volume of DSQ Software. The prices of Scrip rose from Rs. 250 to 2631 during October 1999 to March 2000 and fell to Re 58 in June 2001 as shown in following chart.

Table – 3

Share Price of DSQ Software Ltd. During 2000-2001

Date	Share Price
20.03.2000	2631
28.11.2000	412.90
31.01.01	362.75
28.02.01	264.00
31.03.2001	129.85
28.04.2001	92.55
28.05.2001	81.10
30.06.01	54.00

Source: Compiled from various sources

IV Ketan Parekh’s Scam 2002

Ketan Parekh (KP) was a chartered accountant by profession and used to manage a family business. He was known as the “**Bombay Bull**” and had connections with movies stars, politicians and even leading international entrepreneurs like Australian media tycoon Kerry Packer, who partnered Ketan Parekh in KPV ventures, a \$250 million venture capital fund that invested in new economy companies. Over the years, KP builds a network of companies, mainly in Mumbai, involved in stock market operations. Ketan also formed a network of brokers from smaller exchanges like the Allahabad Stock Exchange and the Calcutta Stock Exchange. Ketan also used benami or share purchase in the name of poor people living in the slum towns of Mumbai. Ketan’s rise to fame occurred at

the same time as the worldwide dot-com boom (1999-2000) and he relied primarily on the shares of ten companies for his dealings (known famously as the **K-10 scrips**). Further, Ketan had large borrowings from **Global Trust Bank amounted to Rs. 250 crores and 1,000 crores from the Madhavpura Mercantile Co-operative Bank** despite the fact was that RBI regulation which clearly ruled that the maximum a broker could have got a loan of Rs. 15 crores only.

Thus, Ketan modus operandi was clearly to ramp up shares of select firms such as **Global Trust bank, Zee Telefilms, HFCL, Lupin Laboratories, Aftak Infosys and Padmini Polymer**. Ketan's endgame, now with the prices of select shares constantly going up thanks largely to this rigging, innocent investors who bought such shares thinking the market as genuine, were at loss. Soon after discovery of this scam, the prices of these stocks came down to the fraction of the values at which they were bought. The Global Trust bank and the Madhavpura Cooperative went bust because the money they had lent to Ketan had sunk with his K-10 stocks.

5. Satyam Scam 2008-09

The recent scam of satyam, which is also known as India's largest ever-corporate fraud of Rs 9600 crores has shocked everyone. The details of the frauds are given as below.

S. No.	Particular / Area	Amount involved
1.	Operating Margin	Rs. 649 crores (24 per cent of the revenue but actually it was Rs. 61 crores only 3 per cent of the revenue). As a result, the inflated profits over the years will keep up, and ultimately stock prices will up.
2.	Understated liabilities	Certain liabilities and contingencies that amounted to Rs. 1,230 crores are not recorded and warranty costs are omitted.
3.	Showing cash where none was generated and, therefore, it did not exist.	Amounted to Rs. 5,300 crores. In fact, the speculation which the promoters were doing in order to acquire equity of two companies of real estate of their own sons.
4.	Sensex	Sensex slipped by 7.3 per cent to 9587 whereas BSE reality index crashed by 17 per cent to 1965. As a result, Rs. 94,000

		crores of investor's wealth was lost.
5.	Fake Invoices and Forget Documents	The investigation agency revealed that 7000 fake invoices and forget documents were used to manipulate Rs. 4500 crores.
6.	Fake Fixed Deposit Receipt.	To the tune of Rs. 3300 crores.
7.	Manipulated Bank Guarantee.	Promoters manipulated bank guarantee to show balance in bank accounts as Rs. 1800 crores.
8.	Share Prices	Share Prices fell from Rs. 237.50 in December 2008 to Rs. 21.60 in January 2009.

Source: Compiled from various sources

Table - 4

Share Prices of the Satyam (December 2008 to January 2009)

Dates	Share Price (in Rs.)
8/12/08	239.70
14/12/08	225.55
25/12/08	212.10
31/12/08	168.42
01/01/09	118.10
06/01/09	178.95
010/01/09	39.25
15/01/09	22.30
20/01/09	21.60

This fraud clearly shows that the auditions internal as well as external have been known requesting the scam. Internal auditors can be hand in glove with the management but what happened to the external auditors as to why they did not suspect something wrong. In this the case the external auditors were **PEC** or Price Water House Coppers that means PWC knew about the fraud all along or they **did not do proper auditing**. In fact they were paid much than what other Indian IT companies paid their auditors.

6 . 2 G Spectrum Fraud 2010

A classic example of collusion between politicians , industrialists and media with high powered brokers which fraud of Rs 1.76 lakh crores. India is

now witnessing not mere corruption but national plunder.

7 Common Wealth Games 2010

A common proverb is true in case of Common Wealth Games 2010 i.e. A fish rots from head down when the head is putrid, the body politic cannot be healthy .In Common Wealth Games 2010, 90 % of infrastructure cost were looted and Rs 900 crore bills were sanctioned for just Rs 85 crore of actual spending.

5. Concluding Remarks.

From the above analysis it is clear that in spite of SEBI and norms of corporate governance the scams have happened in India, which affect the interest and confidence of small investors. These scams show that the regulatory bodies have not worked effectively. There are various loopholes in the financial market, which lead to these types of scams. Some of the major loopholes are.

1. Circular trading is common in the market, which leads to manipulate the share prices by artificial increase or decrease in the share prices. It is one of the main causes of the scam in stock market. Like in case of in Dinesh Dalmia which indulge in the circular trading.
2. No proper regulation of ICWA was followed by the auditors, which lead to major scam. As in case of Satyam, the PWC (Price Water House Coopers) did not properly auditing the Satyam Company, which led to the major scam.
3. DPs(Depository Participants) not following strict norms for opening the accounts of the investors, which leads to major scam, like IPO's scam.
4. Inadequate implementation of the disclosure norms.
5. Turning a blind eye by the regulatory authorities towards the bullish market.
6. Failure of the money Laundering Act

If these short coming are avoided with the help of centralized regulatory authority, vigilant check by the stock exchanges at the time of abnormal rise in prices, strict actions with heavy penalties, fixing the responsibilities of chartered account as well as auditors to furnish true and fair position of the company to investors, strictly ban on the insider trading etc. only then the stork market can respect the sentiments of innocent investors which in turn helpful in enhancing the confidence among the investors not only in India but all over the world towards the Indian stock market.



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