

Can Satyam Like Fraud Happen in Pakistan

M. Farid Alam, FCA



Keeping in view the events that took place across the border with reference to the accounting and auditing flaws at Satyam Computer Services, it is pertinent to understand the related role of shareholder activism. In this article we will discuss the role of 'shareholder activism' in Pakistan, with specific reference to the Satyam case. Furthermore, we will also discuss how shareholder activism was not able to protect investors' interest in Satyam, and if the same situation were to arise in Pakistan would shareholder activism be able to protect investors' interest?

Shareholder activism has not yet taken off in Pakistan. The reason for this does not lie in absence of cases like Satyam (although the amount involved and global investor base was enormous) but rather in the lack of interest taken by large corporate investors/mutual funds representatives on the boards of companies in preventing and detecting and reporting shabby or foul play practices.

The Case of Satyam

On 7 January, 2009 the Chairman of Satyam, Mr. Ramalinga Raju made some extraordinary revelations. He stated that accounts of Satyam were overstated to the tune of INR 50.4 billion (~US\$1billion) related to cash and bank balances. The startling revelation has led analysts in India to dub the Satyam scandal as India's own Enron. The revelations were taken very seriously not only because of the large amount involved but also because of the fact that Satyam in Hindi means truth and there was nothing but truth in its financial statements presented to all the stakeholders year after year.

Regarding the Satyam scandal, the seed of mistrust between the Chairman and the shareholders was sown a few weeks prior to these stark revelations. Satyam had made its intentions of purchasing two companies from the then Chairman's son for well over US\$1 billion. The two firms to be purchased were Maytas Properties and Maytas Infra.

The decision to purchase these companies was overturned due to shareholder pressure. This was the first instance of 'shareholder activism' playing some part in Satyam's recent history and forcing Mr. Raju to make the revelations of the accounts overstatement, since he had exhausted all available options to sweep the fraudulent activities under the carpet. Had the Satyam-Maytas deal gone through, Mr. Raju would have conveniently incorporated the purchased assets on the books of Satyam and to a substantial degree would have balanced the books. The shareholders of Satyam saw possible foul play and made those feelings clear, leading to the abandonment of the Satyam-Maytas deal.

Shareholder Activism- Satyam

The revelations made by the Chairman suggested that cash was overstated by INR5,040 crores, debtors were overstated by an amount of INR4,900 crores and that liabilities were understated by INR1,230 crores. These misstatements pertained to failure on the part of the auditors to pinpoint discrepancies, particularly those related to cash balances. In this regard, the local affiliate of the international firm charged with auditing Satyam's accounts has stated that its reliance on management information may have rendered its audit unreliable. In this case, shareholder activism does not seem to have had a great role to play since catching these discrepancies falls within the auditor's ambit, with ordinary shareholders having to trust audited accounts.

Hence shareholder activism was not completely missing. Shareholders did raise their voice against the proposed deal to purchase two companies from the ex-Chairman's

For leading organizations decision based information is based around daily / weekly information on progress within the organization's critical success factors (CSFs). In one company the senior management team have a 9 o'clock news report every morning followed by further weekly information. At the monthly management meeting to discuss results even the HR manager is able to take a shot at guessing the month end result.

family - which eventually led to the revelations about accounting misstatement. Indeed, Mr. Raju has admitted that the proposed Satyam-Maytas deal was the final attempt to plug the hole in the balance sheet.

Nevertheless, it appears that this act of shareholder activism came too late, and was only triggered by a questionable deal concerning a related party. During the time Satyam was reporting excellent profits; shareholders were content to reap the benefits and only raised their voices when it was already too late. An analysis of the Satyam case suggests that shareholders only became active after seeing signs of mismanagement and remained inactive during periods of high profitability and Satyam had a remarkable history of declaring higher profitability year after year.

Shareholder Activism- Global Perspective

'Shareholder Activism', as understood globally, is considered a tool of corporate transparency at the behest of the shareholders of a corporate entity. The roots of shareholder activism can be traced to the United States, where it is believed that the infamous stock market crash of the late 1920s was caused in significant part by companies' lack of transparency. Post the market crash, the Securities

and Exchange Commission (SEC) was formed through The Securities Act of 1933 and 1934. The purpose was to create public disclosure and enforcement mechanisms to guard shareholders and encourage the dissemination of reliable corporate information.

In recent times 'shareholder activism' has largely been linked to two particular traits, namely; *Socially-Oriented shareholder activism* and *Corporate Governance activism*. Socially-orientated activism generally deals with shareholders' concerns about social responsibility issues. These issues are wide ranging and stem from religious/political beliefs of the shareholder community. The notion of ethics and integrity being maintained in all corporate activity at the demand of the shareholders is integral to the idea of socially-responsible shareholder activism.

Corporate Governance activism is the trait most likely missing in the Satyam case as well as other high profile accounting cases like Enron. Even in the context of discussing shareholder activism in Pakistan, it is the Corporate Governance side of shareholder activism which should be considered for discussion.

Shareholder activism- Pakistan Perspective

Keeping in mind the Satyam case, key questions warranting an answer from stakeholders are:

- ❑ Whether a case like Satyam could happen in Pakistan and if the answer is in affirmative,
- ❑ Can shareholder activism prevent or detect it from happening in a timely manner?

With respect to shareholder activism, the following need to be examined before these questions can be answered.

Free Float

The free float of the listed shares remains low as sponsors keep their shareholdings well above the simple majority. The free float of the market is around 20%. In this backdrop the minority shareholders do not get any representation on the board. Even if one or two seats do come their way their power to participate/prevail upon in the policy discussion remains weak, thus limiting their powers to have any significant bearing in the context of preventing or detecting any foul play.

On the flip side this practice and psyche of sponsors of keeping higher shareholding of listed companies within the group acts as a measure of risk sharing. However, in the

case of Satyam it may be noted that the sponsors were not holding sizeable shareholding in the company.

Individual Shareholder

There is also a tendency among Pakistani investors to keep a short term view of the market. Generally, 'small investors' do not keep a long-term and dividend orientated view of their equity investments. With quick gains desired, their focus is least likely on the company itself, as a result of which minimal shareholder activity is seen in Pakistan. The psyche of the individual shareholder is not to hold any particular scrip for an extended period, rather they prefer switching from one scrip to another on the premise that active trading will earn them larger capital gains. In this regard, small shareholders in Pakistan do not really see themselves as part owners of the company whose share they hold.

Institutional Shareholder

It is disheartening to note that nominee directors of corporate and mutual fund industry have not taken over the role of whistleblower on detecting any foul play. Their presence on the board is mainly ceremonious and restricted to attending board meetings and at the most protecting their company's interest in achieving a block deal with the sponsors at a price which has historically been way above the market price for the particular stock because of low float in the scrip.

In my view their inactivity and disinterest causes more harm than good since their presence (on the boards of prestigious organizations they represent) lends credence to the misdeeds of the sponsors.

Minority Shareholder Legislation

In Pakistan there exists a minimum limit for seeking solution from court against cases of mismanagement under the Companies Ordinance, 1984. For that to happen at least twenty percent of the shareholders will have to take the initiative. Luckily, however, there is really no restriction to refer a case to the regulator and that too in a most cost efficient manner.

The investment horizon for minority shareholders is usually less than one year as they prefer churning their portfolios for earning better returns. So, holding minority shareholders responsible for detecting fraud may be asking too much from them even if they suspect unfair and malafide practices in their investee company.

These are the main reasons why shareholders don't really care when the going is good.

Would shareholder activism actually unearth and bring the fraudulent activities to limelight? It appears that shareholder activism does not seem to work when the going is good and only becomes active when something is blatantly wrong. That said, it appears that enforcement division of SECP and the auditing discipline are the only vehicles capable of arresting fraudulent activity in Pakistan's context since shareholder activism is generally subdued and confined to

AGMs only where response is pretty lukewarm.

In Pakistan, many fraudulent acts have been unearthed by whistleblowers, bringing the story to limelight and appropriate actions have been taken by the regulators. Some pertinent cases making news, where management was involved in deceiving shareholders through various manipulative ways, are cited below.

Shareholder Activism - Some Corporate Fraud Cases in Pakistan

Year	Name of Company	Fraudulent activities	Whistleblower
2006	Ahmed Spinning Mills Ltd.	Sale of shares of United Sugar Mills Limited	SECP
2008	Norrie Textile Mills Ltd.	Huge difference in eligible securities in CDC and paid-up capital	CDC
2005	Islamic Investment Bank Ltd.	Misappropriation of bank guarantee	Client/SECP
2008	Haseeb Waqas Sugar Mills Ltd.	Related party transactions	Auditors
2007	CallMate Telips	Inaccurate revenue recognition policy	Auditors
2008	Bank of Punjab (BOP)	Non compliance in lending	Internal auditors

Case I: Ahmed Spinning Mills Limited in the case of sale of shares of United Sugar Mills Limited

The case was brought to light by the SECP itself. Ahmed Spinning Mills Limited sold shares of United Sugar Mills Limited to Clearshore Limited, a UK based company, at PKR16 per share. The shares were then sold to JDW Sugar Mills Limited at PKR333.33 per share. Clearshore was able to make PKR213 million from the said transaction in a short span of one year. This irregular transaction was detected by the officers of the Commission. Later, it was revealed that the management of Ahmed Spinning owned Clearshore. The Commission directed JDW to deposit the amount to the Commission as it belonged to shareholders of Ahmed Spinning, which was upheld by the Honorable Court.

Case II: Norrie Textile Mills Limited

On intimation by the Central Depository Company (CDC), the SECP noted the existence of share fraud in the accounts of M/s Norrie Textile Mills. The eligible securities in Central Depository System (CDS) and paid-up capital report stated in accounts disclosed huge differences; Paid-up capital of PKR48.6 million was reported in the quarterly accounts for the period ended March 31, 2008, while eligible securities of PKR598.6 million were registered in CDS. These differences coupled with unusual trading pattern transpired that counterfeit shares of the company were in circulation in the market. The decision by the regulator of this case is still pending.

Case III: Islamic Investment Bank Ltd. (IIBL)

A financial scam of PKR634.4 million, moved forward by the Client/SECP, was unearthed implicating 20 high-profile executives including the president and directors of Islamic Investment Bank Ltd (IIBL) and a former registrar of the Supreme Court. The 22 high-profile figures were found involved in embezzling a bank guarantee of PKR634,393,898 given by Fecto Belarus Tractors to the Supreme Court. Former registrar of the Supreme Court was accused to have misappropriated the money in connivance with the president and directors of the Islamic Investment Bank Ltd.

Case IV: Haseeb Waqas Sugar Mills Limited

The auditors brought to the notice of the SECP that the directors were in breach of Section 208 of the Ordinance and ongoing default from 2004 to 2007 in respect of the investments made in the associated concerns. After going through the facts, the Commission established that the directors had contravened the provisions of Section 208 and had invested funds without prior authorization of the shareholders, for which one of the directors was fined and other directors were instructed to remain vigilant in the future. The Commission also directed to bring the extracts of all transactions with associated undertakings to the notice of the shareholders.

Case V: CallMate Telips

Rifts surfaced between CallMate and its auditor regarding CallMate's revenue recognition policy. The auditor declined to book the revenues on the basis of sale of cards (a practice which was being followed for the last four years) without having to wait for usage of these cards. The auditor noted that it is a common practice worldwide and in Pakistan that the revenues are booked on the basis of sale of prepaid cards and not on their usage, as according to a survey 25% of the prepaid cards are never used.

Case VI: Bank of Punjab (BOP)

Within the financial sector, the scandal at Bank of Punjab is relatively recent. Despite internal auditors' warnings that some loans exceeded limits and the borrower did not satisfy all requirements, bank management failed to take action. As a result, BOP's CY07 accounts carried an auditor's qualification which subsequently led to a change in bank's management. The particular loan in question is still outstanding, and has been restructured. Shareholder activism has been largely silent on this issue despite BOP share price collapsing from more than PKR100/share to just above PKR10/share.

Conclusion

Hence, it may be argued that Satyam like cases can and will continue to happen around the globe, and in Pakistan, unless proactive role is played by all stakeholders including shareholders and regulators.