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Corporate Financial Frauds-A Case Study on First Leasing Company of India Ltd

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Abstract: *White collar crimes are committed by various individuals in greed of self enrichment. When such crimes are committed collectively in association of various individuals in a business becomes a corporate fraud. Corporate frauds are committed more sophisticatedly by the corporate executives, Directors, Promoters etc. The impact of such frauds is very adverse to commerce and economy. It leads to loss of trust by investors and vested parties. The purpose of this paper is to study on reported corporate fraud committed by The First Leasing Company of India Ltd.*
Key words**:** *Corporate Frauds, White Collar Crime*

I. Introduction

According to the dictionary meaning of fraud, it is a deliberate act in concealment of facts with an intension to deceive the other party. Corporate frauds are committed with involvement of higher hierarchy very professionally. It encompasses various criminal and civil violations. Fraud is committed by taking the shelter of the grey areas of law. Frauds are committed because of greed, unethical professionalism, towards the grabbing of wealth. Such frauds are commonly found in small business entities when it grows into a big company. This can be checked when the company has an in-built technique of internal check and control.

II. Literature Review

Nandini Rajagopalan and Yan Zhang (Feb 2008): In their research article stated about corporate governance which was hindered by privatization and globalization. They studied about the obstacles of implementation of corporate governance in four dimensions namely, lack of incentives, power of dominant shareholder, underdeveloped external monitoring system and lack of qualified independent directors.

K. Sowmya (July 2009-Jan 2010): This study explains about the various types of frauds committed by the corporate. This study has also listed out the various causes of corporate frauds. It also suggested various voluntary measures to control and curb such frauds like whistle blowing mechanism, Helpline services, collective actions etc.

Varsha Ragoria SSRN (Jan 2010): This study elaborated about the motives of such corporate frauds committed individually, or collectively. This paper also explained about the appointment of various commissions by the Government for prevention of corruption such as Vivian Bose Commission of inquiry of Dalmia-Jain group companies for tampering the records for personal gain and tax evasion purposes.

Paulina Kurant (August 2014): Studied on various aspects of frauds committed by companies. It has been studied that the reported fraudulent company faces the threat of challenges and risks on cost of capital. This paper also examined and found that there is an increase in total risk and residual risk and decrease in systematic risk was observed in detection of fraud.

Dr. Ponduri S.B, Ms. V. Sailaja, and Ms. Syeda Amina Begum ISSN (Feb 2014): Explained in their paper the major areas of frauds. They also explained various fraud preventive mechanisms to detect and control frauds. They suggested the development of fraud protection policy mechanism and make it knowledgeable to their employees, customers, depositors and stake holders. They highlighted the ethical code of conduct o the Auditors and Accountants in their discharge of duties.

P.K. Gupta & Sanjeev Gupta(2015): Stated that the regulatory system to be very weak, and there is a dire need of redefining the role of auditors. They also highlighted that the reporting of fraud and publication of fraud prevention policy are absolutely not found in the regulatory. It also emphasized that the frauds can be prevented if the individuals in corporate act with due diligence and responsibility. This paper has also investigated about the fraud perpetrators, quantum of fraud, and how it has been committed.

Hari Ram Anthala (2014): The author studied upon the various modus operandi committed by the Banker by injuring the customer as well as the image of the banks. This concept has been studied by the author with three different case studies involving the bank and the customer with legal proceedings. It has been analyzed very clearly by the author about the legal proceedings and the justice pronounced on such corruption cases. It has been strongly suggested by the author that the persons resorting to such frauds need to be punished severely by punishing them with life time imprisonment.

III. Methodology

Rationale of Study: Corporate frauds decrease the confidence of the investors, shareholders, banks, financial institutions etc. This will have an adverse effect not only on that particular business and industry but also on the whole economy. Despite various legislations, regulatory authorities exist; such frauds are persistently happening and shaking the global business environment. Therefore a need was felt on study of corporate frauds.

Objective of the study:
1. To understand the concept of corporate fraud.
2. To understand how the fraud is committed.
3. To understand what happens to a company when such fraud is detected.

The data are collected from secondary sources from company web sites, magazines, financial reports, newspapers etc. The study is conducted on First Leasing Company of India Ltd., a Chennai based company offering financial services. The study is for the period 2002 to 2013 the year in which the fraud is reported. This sample is selected because it is a low profile company and it is committing frauds for quite a few years and many banks like IDBI, SBI were affected.
The scope of the study is focused on the fraud committed by the First Leasing Company of India Ltd and the action taken on that company. Since it is a low profile company the data available in public domain is limited.

IV. Profile Of The First Leasing Company Limited

First Leasing Company of India Limited (FLCL) was the first Indian leasing company incorporated in September 1973 and commenced its operations in India from November 1973 in Madras. It came out with its first public issue in 1983 under the promoter ship of A C Muthiah and Farouk Irani. The former was the Chairman and the latter was its Managing Director. Since the company was a Non Banking Financial Institution (NBFC), it had a great market demand for leasing and hire-purchase transactions.

Due to growing need on industry expansion, these financial services bridged up the gap between the requirements of capital goods for the capital goods industries. In January 1992, FLCL expanded it business activity by issuing Rights Issue of Rs.3.5 lakhs, with 17% partially convertible debentures of Rs.200, aggregating to Rs. 7 crores. The Commonwealth Development Corporation (CDC), a British Government Department with 10% stake invested in FLCL Rs. 11.50 Crores. The Indian Railway Finance Corporation entered with an agreement with FLCL for Rs. 75 crores, which was unprecedented in the leasing finance in the history of India. The company was performing very healthily by paying back its shareholders good dividends. It was one of the premier companies of such business.

V. Analysis And Interpretations

Farouk Irani, the Managing Director of the First Leasing Company Limited admitted the fraud in 2013 which it led for several years along with the Industrialist AC Muthiah, have declared that the balance sheets are manipulated to the extent of Rs. 1000 crores.

There was a falsification of balance sheet, by overstating the accounts payables, etc. on the liability side with creation of some non-existence asset on the asset side of the balance sheet. The Managing director of the Company started diverting the company’s assets in the name of his relatives, close associates and himself. When the bankers had asked the company to pay its loan it said it does have enough funds to re-pay, rather it declared that its assets are insufficient to re-pay its liabilities.

The blame-game started. The statutory auditors of the company started blaming the internal auditors and internal auditors the reverse. Both the statutory Mr. Sarathy & Balu and internal auditors MK Dandeker & Co blamed the Reserve Bank of India for its eye wash inspection conducted by it. Later the Reserve Bank of India took to its pride that it has found this fraud only during its inspection. By the time the financial crime has become irreparable. More surprisingly, the CARE the credit rating agency who was also a share holder in the company was continuously grading the company with AA for the investor’s magnetizing investment.

The company has been asked by its bankers to immediately open an escrow account with SBI and, collect and submit post dated cheques given to customers to SBI for credit, besides furnishing a list of receivables and assets.

When a team of bankers led by a senior official of State Bank of India asked Irani where the remaining funds were deployed, he could not give any satisfactory reply. Stunned bankers told the company to close accounts with all banks outside the consortium. The meeting with bankers took place a few days after the Reserve Bank of India barred the company from doing any business until further orders. In reply to pointed queries from the media, Mr. Irani simply said, "We confirm an RBI audit is under way of our accounts and until the audit is complete we cannot presuppose what the numbers are," When told that there are suspicions that funds have been diverted by the company's management to unrelated activities, Irani said, "There has been no diversion of funds. Once the RBI audit is over it will reconfirm money was not diverted for any improper purpose. Further, he added that "Funds have only been committed for the benefit of the company's stakeholders who would include payment of interest to the banks, the income tax, sales tax, salaries to the staff etc."

According to banking circles, the company's troubles started during the 1980s when Mercantile Credit Corporation, a group company of MAC, founded by Muthiah's father late MA Chidambaram, ran into trouble. (Muthiah is the chairman emeritus of Southern Petrochemical Industries, SPIC also.)

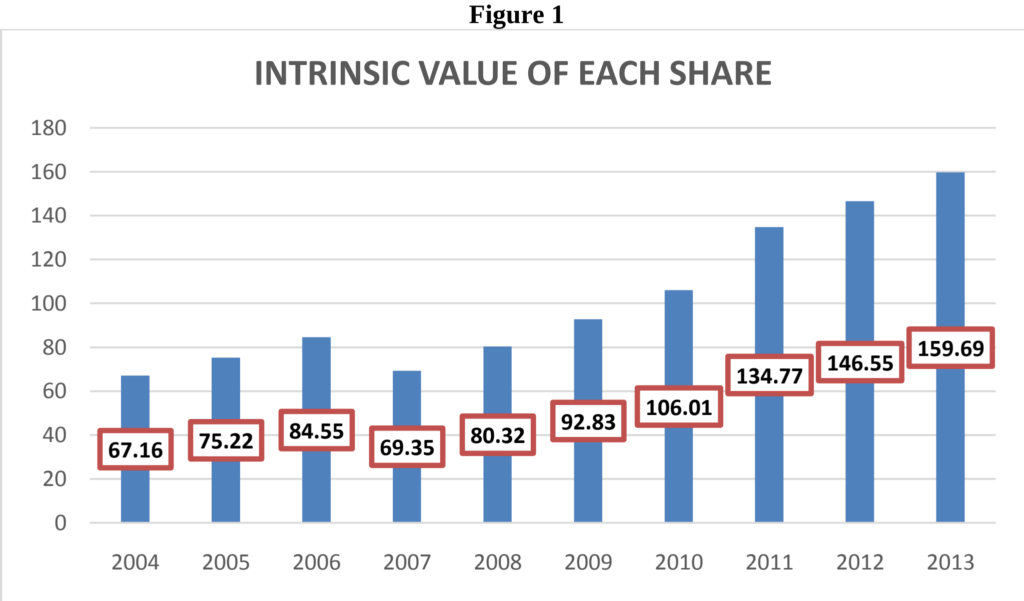
In 1988, First Leasing had to pay out Rs 170 cr to depositors, borrowing money at a higher rate, when MAC faced financial difficulties. The tight money condition of the 1990s worsened things and later Rs 65 crore was lost in "misguided transactions" (but this amount was recovered after a period of time). The payment of Rs 170 crore, however, was never reported to banks.

The CEO of another south-based financial services group told ET that First Leasing also lost out as it failed to change with time and bring in new financial investors like private equity houses. More recently, it has been borrowing from banks to repay dues. The members of banking consortium include SBI, IDBI, UCO, State Bank of Travancore, Syndicate, Vijaya, State bank of Patiala, ICICI, IndusInd, Axis, Bank of Maharashtra, State Bank of Mysore, HDFC, and Catholic Syrian. The combined credit limit extended by them is. 1,322 crore and the present standing is Rs 1,211 crores. Currently, all the subsidiaries of SBI is consolidated and merged in to State Bank of India.

Due to the acknowledgement of a fraud, there were question marks on the audited financials of First Leasing.

The following graphs depict the manipulated financial position of First Leasing Company.

Figure 1



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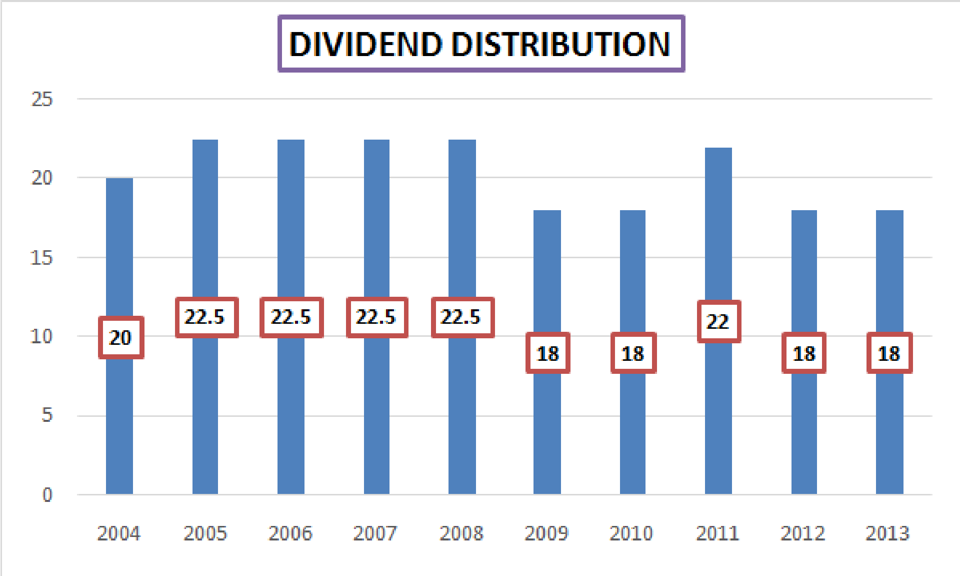
Moneycontrol.com

The above graph (Figure 1) depicts the intrinsic value of share for 10 years starting from 2004 to 2013 which was showing an increasing trend till 2013 when the fraud was reported.

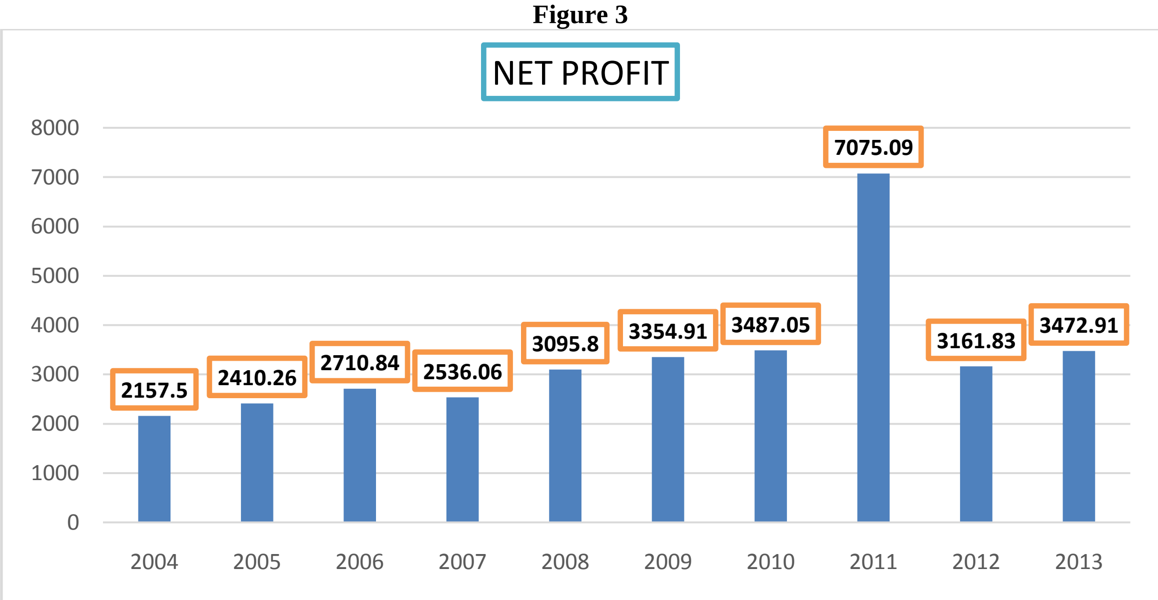
Figure 2



Source: Moneycontrol.com

The above graph (Figure 2) shows the dividends declared by the company since 2004 till 2013. It is noted that the company has declared a minimum dividend of 18% and the maximum of 22.5% during this 10 years period of the study.

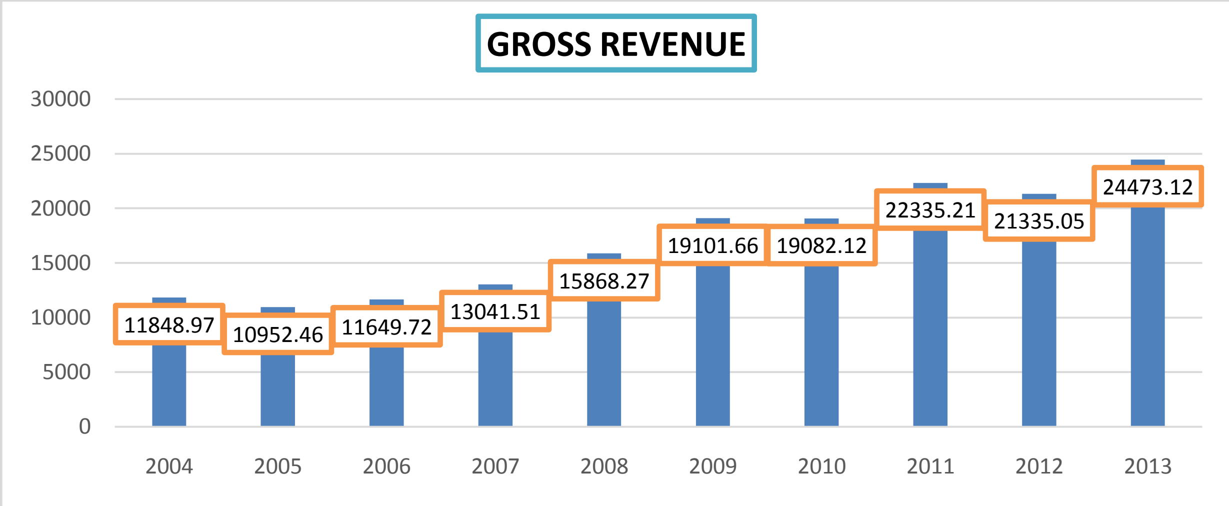
Figure 3



Source: Moneycontrol.com

The above Figure 3 states net profit of the company which was maintained by the company very fictitiously for the past 10 years in order to state the financial position to be healthy.

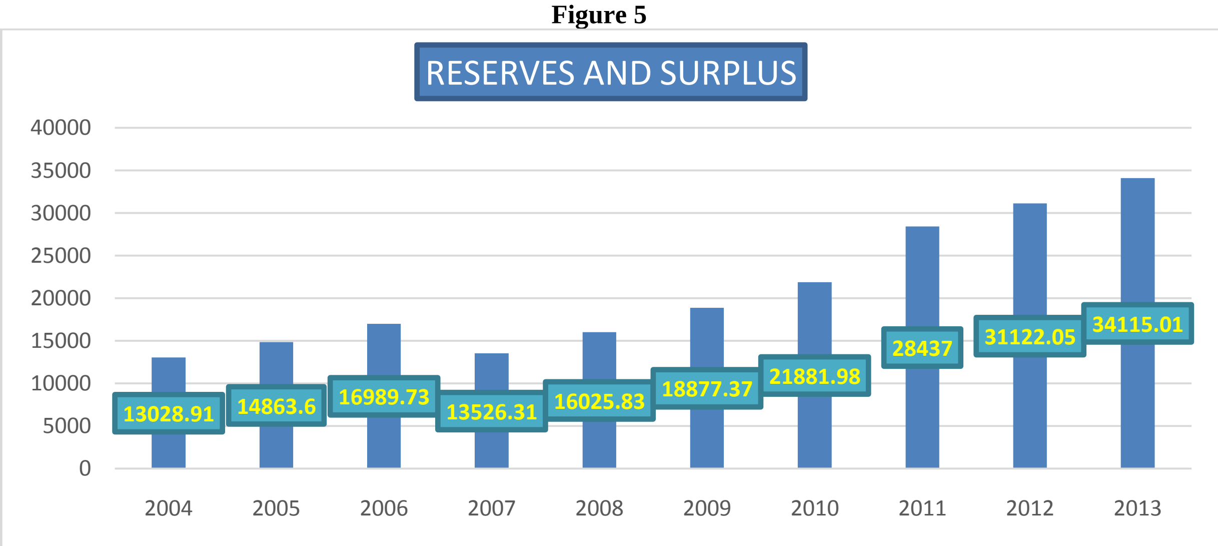
Figure 4



Source: Moneycontrol.com

The above graph (Figure 4) states the gross revenue, which was manipulated for the period 2004 to 2013, the year in which the fraud was reported.

Figure 5



Source: Moneycontrol.com

The reserves and surplus (Figure 5) for the year 2004 to 2006 was showing an increase, with a fall in 2007 and again started increasing gradually till 2013. The accounts were suitably cooked up in the favor of the organization.

VI. After Fraud Action

Criminal Cases

Several criminal cases had been filed against Mr. Farouk Irani for cheating, falsification of records, frauds, breach of contract and defrauding banks of public money.

The cases have been registered at several police stations and the Central Bureau of Investigations (CBI) took over the case and investigating the use of funds illegally.

Finding a suitable buyer

First Leasing Company had informed to the government in March 2014 that it is scouting for a suitable buyer to take over and revive the company even as it is awaiting forensic audit report to initiate actions against the persons who were alleged to have been involved in falsification of company's accounts.

The company, on Tuesday, informed the stock exchanges that it had replied to Reserve Bank of India (RBI) stating that it was looking for a suitable entrepreneur, who would be willing to step in at this juncture and take over the management of FLCI for revival of the company.

``In view of the large gap in the assets and liabilities of the company and serious violations of statues committed by the erstwhile Managing Director, the company finds it extremely difficult to identify such entrepreneur. However, efforts are continuing,'' it said

Forensic Audit

First Leasing Company also said the forensic audit by R.K. Raghavan, former director of CBI, was in progress. Once the report was received, the company proposed to initiate both criminal and civil action against the persons identified by the audit, it added.

The reply to RBI comes after the regulator issued a show-cause notice dated February 18, 2014, for cancellation of registration after a RBI-appointed auditor found falsification of company accounts when Farouk Irani was the Managing Director.

Changes in Management

The company's board, which met on March 5, 2014, had decided to convene the 38th annual general meeting of the company on April 4, 2012.

Mr. I V Manivannan had been appointed as additional director in the place of Justice S Mohan. V Selvaraj has been elected as the chairman of the company's board.

Liquidation

In spite of vigorous efforts, First Leasing could not find a suitable buyer owing to the huge liability and very less assets.

A petition was filed in the Madras High Court by ICICI Bank for liquidation of the company. First Leasing owed Rs.50 crores to ICICI Bank. According to ICICI Bank, First Leasing owed a consortium of banks nearly Rs 1,200 crore and that the company had no assets enough to meet the liabilities.

ICICI bank further informed the court that a special audit undertaken by a consortium banks revealed that money lent by the banks had been siphoned off by the promoters, directors, employees, relatives of the directors and entities controlled by the directors and their relatives. "Financials have been cooked up by the company to avail itself of greater credit limits from the banks, including ICICI. Only if the provisional liquidator takes charge, can the court have jurisdiction to surcharge all those persons, employees, and directors for recovering money belonging to the company and fraudulently secreted by them to the detriment of the creditors of the company, which are banks,"

Based on the petition of ICICI Bank, Justice M Duraiswamyof the Madras High court passed the interim orders for winding up. The Madras High Court passed orders for appointments of an official liquidator and directed him to take charge of the assets of the company. The ex-directors of the company are to file their statements of affairs before the official liquidator within 21 days.

VII. Findings

It is evident from the above analysis that to conceive an idea of business and implementing it, is as difficult as to run it successfully. The promoters and founder member of First Leasing Company of India Ltd, has taken a lead with a new concept of financial leasing business in India. They are successful for quite a period of almost four decades. On seeing the welfare functioning of the company, the Directors and all the founder members could not resist themselves in personal encashment of the benefits derived by the business. This intension has led them to falsify their accounting records and corrupt their business environment.

VIII. Suggestions

As observed from the above study, the business entity should follow anti-fraud check which will check the functioning of the organization at various levels with regular intervals. There should be an in-built internal check system in the organization. Every employee and business men should be educated on ethical values and the same should be practiced. The regulatory should impose severe punishment for business entity for committing such frauds and that should create a fear of punishment in the minds of fraudsters.

IX. Conclusion

In order to have a safe business place, each one involved in the course of business should be honest enough to function. Unless the Auditors are vested with the authority and responsibility, such frauds cannot be ruled out. The Multi-regulatory system is creating a stage for blame game. A single regulatory with a proper device of control would be solicited.

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