

AFTERMATH OF ACCOUNTING SCANDALS IN COMPANIES

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ABSTRACT:

Titled, “Aftermath of accounting scandals, this study aims to showcase the impact frauds and scandals has on the financial performance of a company. The paper critically and empirically focuses on the aftermaths of an accounting scandal, being the specification for the study model. For the purpose of investigation, five companies which were immersed in frauds and scandals during the years 2000-2015 were considered. The analysis was done using four variables, being sales/revenue, ratios, profits and Earnings per share. The trends in these were observed for the years before and after, the fraud years, for understanding the changes occurred in the financial performance of the company. The study brings immediate focus of attention to the fact that frauds knocks down the company’s performance or even heads it towards bankruptcy. The scrutiny conducted shows that such affair pessimistically impacts all the related parties. Hence, this study enrolls to show that companies must stand on ethical values, to avoid drastic aftermaths of accounting scandals.

Keywords: *Accounting scandals, Frauds, Performance, bankruptcy, Ethical Values*

I. INTRODUCTION:

In today’s scenario most of the big companies fail due to urge of getting a better financial position in market against its competitors using illegal means. These are usually termed as scandals or frauds. Accounting fraud is nothing but an intentional depiction in the financial statements made by the top level management or any other people playing an important role such as those charged with governance, etc of the company to attract more and more investors. Usually companies achieve this by way of showing higher figures in their financial statements like hiking their sales or profits or over stating their assets or under stating their liabilities, etc. Every year the world economy encounters number of financial losses of different kind. These losses not only effect country as a whole, but also impact every individual who are directly or indirectly related to happening of such events. The financial drop in the graph of the companies might be due to various reasons; one such can be named as frauds or scandals. Sometimes such financial drop maybe acknowledged early whereas some at an irrecoverable stage. The more the economy of a country is

progressing the more such frauds and scandals are being recorded and noted. These frauds are done because of copious intensions whereas varied motivations stand as a reason for the same. Since forever the companies have been facing frauds and scandals which are causing huge losses of money over the years. Fraud and damages don't occur in a vacuum; numbers of different people are involved in such accounting scandal. Such people include managers investment analysts, auditor, etc. happening of the same will also bring legal authorities into the frame.

The most important aftermath of frauds is the long term consequences and losses. The noticed consequences are that either the settled empire of a company sees downfall and collapses, or it is taken over by the other side of coin the share prices fall and the investor faces losses. The guilty are punished and the parties who suffered losses are financially compensated. However the impact of fraud is sever and nothing at more can handle the dip.

II. REVIEW OF LITERATURE:

Title: The Satyam Computer services Ltd Scandal : The author examines the famous Satyam Scandal. He mentions various facts and processes to give the detailing about the scandal. The company admitted a fraud of Rs.78000 million. The management goes on to mention that they have been indulged in creative accounting of these books, since 2001 to inflate profits and the cash flow of the company. The next step of company was to acquire Maytas firm to fill the gap of fictitious assets with the real one, however it didn't work. The author refers on the basis of his understanding that the fraud was a result of creative accounting, insider trading and misgovernance of corporate. The creative accounting that lead to the fraud caused damage to various aspects like, the promoter's holding went down from 25.6% to 3.6%, share prices fell by 77.6% causing loss of money to shareholders all over the world. (jones, 2011)

Title: The effects of financial fraud and liquidity on financial performance of commercial banks in Kenya(2010) : In this paper Fredrick odhiambo olongo shows the study conducted on the banks fraud in Kenya, there is an increasing number of frauds observed over the years. The author performs the analysis to show the effects of financial fraud have on the financial performance various tools are used to show different quantitative analysis and impact of the fraud. The conclusion by the author specifies that the banks in Kenya should come up with different mechanism for detection of frauds. (olongo, 2010)

Title: cooperate governance consequence of accounting scandals (2016) : Anup Agrawal and Tommy Cooper in their paper examines the outcome of accounting scandals on the management of the company, the auditors and officers. The author also focuses on the Enron and WorldCom accounts being misstated and aftermath resulting in bankruptcy. The management comes to danger calling for replacement, if their worth

leads to more of costs and less benefits. Various other factors are brought to analysis and study for understanding the consequences of accounting scandals.(agrawal & cooper, 2016)

Title: A review of financial accounting fraud detection based on data mining techniques(2012) : Anuj Sharma and Prabin Kumar mention that the increased number of the financial accounting has led to draw attention and focus towards financial losses. The authors in the paper use data mining technique to detect frauds, they also bring internal auditing system into picture. The increasing frauds over the years, like the ones observed in Satyam, WorldCom, Enron, etc. makes it important to use fraud detection, as frauds go on cause huge financial losses.(sharma & panigrahi, 2012)

Title: the Parmalat case : The author examines the case of the Parmalat, the accounting fraud in Italy. The CFO admits to have made personal gains from the fraud, whereas the other players made percentage of money from the same. The fraud was unveiled at the end of 2003, when the company defaulted on a euro150 million bond. As per the details given by the author, the fraud happened because of deliberate misstatement of information in the financial statement. The company overstated its earning and underreported its debts. The author mentions that a clear creative accounting was done with reference to preference shareholders and gives a detailed explanation as an example of same. As a matter of conclusion and on the basis of quantitative information, the study shows various damages encountered by the business and shareholders. (jones, 2011)

III. RESEARCH DESIGN:

The Study conducted shows the impact of accounting scandals on the financial performance of the company. Various factors like revenue/sales, share prices, liquidity ratio, profits were taken to understand the trends using graphs for each variable. These factors were used to interpret the results and the aftermath of Accounting Scandals.

POPULATION:

For the purpose of study our population has been publically listed companies and we have considered five companies as our target population.

SAMPLE SIZE:

The sample being a small group selected from population, our companies were selected on basis of following characteristic in common-

- The company selected is a public company

- The company have engaged in scandals
- Such scandals are faced by the company from the year 2000 till 2015.

SOURCE OF DATA:

For the purpose of research, objectives of study and the problems to be answered, secondary data has been used as source of collection. The data have been taken from financials statement and the annual report of the companies which encountered frauds. The data collected is for a period of 5 to 7 years for each company. The data was collected from the company's website, money control.com, economic times.com, etc.

Revenue/sales, earnings per share (EPS), share price, ratio were the factors used for interpreting the aftermath of accounting scandals. These variables were selected as they get most affected due to the performance of the company. The analysis of the data was done using an excel sheet. Various graphs were drawn up to analyse the collected data. The graphs were drawn up for each variable to show the impact of the accounting scandal on a company's health. The trends in the graphs was used to interpret the figures. For each company, the data was analysed and aftermath of accounting scandal as investigated.

STATEMENT OF PROBLEM:

Accounting scandals and frauds over the years has become topic of global concern that makes frauds and scandals as immediate focus of attention.

- Accounting scandals puts shareholders money in danger.
- Accounting scandals have put an question to company's survival
- The confidence of investors is oscillated due to the frauds done by the company.
- The drastic impact of accounting scandals and frauds leads to the collapse of the well-established empire of the company.
- It also becomes a reason for major amendment in laws making it difficult for small companies or start-ups to survive.

OBJECTIVE:

- To determine the impact of accounting scandals and fraud on the financial performance of the companies.
- To study the effect accounting scandals and fraud on shareholders' investments.

LIMITATIONS:

- Difficulties in getting data for the year of fraud as the financial statements were restated by the company.
- Many companies yet adhere to proper ethics however could not condense to comparisons
- Could not draw focus towards the changes in accounting policies due to such frauds.
- The study was narrowed only to five companies involved in frauds.

IV. DATA ANALYSIS AND INTERPRETATIONS:

The information for purpose of study was share price, net profits, ratios and revenue/sales of five listed companies.

SATYAM:

Satyam fraud was recorded in the year 2009. The trends in the graph showed various interpretations, company recorded share price of Rs 470.35 and Rs396.35, sales of Rs6228.47(cr) and 8137.20(cr), profits of Rs1423.23(cr) and Rs1738.18(cr) for the years 2007 and 2008 respectively. However in the year of fraud share price fell to Rs38.45, sales recorded Rs8406.2(cr) and profits of Rs-641(cr) was recorded. This decreasing trend in variables shows financial loss suffered due to the fraud. The following years 2010, 2011, 2012, 2013 had decreasing trend in the growth of the variables.

The fraud caused huge financial loss that can be interpreted from the fall in share price showing direct impact on stakeholders. The company not only suffered financial crises but goodwill of the company was also affected.

TESCO:

Tesco's fraud was recorded in the year 2014. The trends in the graph showed various interpretations, company recorded share price of £ 343.45 and £ 377.30, sales of £71,402 and £72,363 profits of £3,164 and £1,386 for the years 2007 and 2008 respectively. However the year of fraud share price fell to £229.60, sales recorded £70,894 and profits of £1,912 was recorded. This decreasing trend in variables shows financial loss suffered due to the fraud. The following years 2015, 2016, 2017, 2018 had decreasing trend in the growth of the variables.

Though we see a slight increase in profits in year of fraud the immediate next year that is 2015 the scale of profits goes to huge negative figures and the immediate impact of fraud on financial statements can be observed with a downfall in sales and share price of the company. And till the year 2018 company has not

yet reached the stage which it was before the fraud. This shows kind of impact that a fraud can cause to the goodwill of the company.

ENRON:

Fraud by Enron came to public's eye in the year 2001. And in the year of fraud itself the company become bankrupt. In the year 1996 it had recorded a share price of \$42.63, revenue \$13,289, and net income of \$584 and these variables kept increasing showing a positive growth of the company till the year 2000. The share price, revenue and net income of the company was \$83.13, \$100,789, \$979 respectively. This can be interpreted as a reason of fraud by the company from past few years. But as soon as the fraud was known publicly the company had to shut down its operations causing a lot of loss not only to shareholders but also government, employees, public at large and others involved in the company.

FREDDIE MAC:

Freddie mac's fraud was recorded in the year 2003. As per the years observed by us we see can increase in the company's share price from the 2002 to 2006 reason being the investors point of view about the company that it would do better in the coming future hence fetching them more returns. But when it comes to observing other factors of our study like net income, EPS and average asset ratio we can see that the company has not moved as per the expectations of the investors causing them more losses. In the year 2002 we can see it showed a net income of \$ 10,090, EPS of \$ 14.22 and average asset ratio of \$1.40, and in the year of fraud that is 2003 sales reduced by \$ 5274, EPS by \$ 7.53 and average asset ratio by \$ 0.8. In year 2005 net income, EPS and average asset ratio further reduced to \$2,937, \$3.96, \$0.40 respectively. But in the same year we can see increase in share price reason being the same of investors. And in 2006 we see a tremendous reduction even in the share prices of the company and negative growth in net income, EPS and average asset ratio of the company marking a downfall of the company in all aspects.

XEROX:

Year 2000 marked as a downfall of a well-established company since the year 1960. In the year 2000 the company Xerox had publicly known for the fraud it had done in its books of accounts to make their financials look even better to the investors. It marked a decrease in its EPS which had fallen to \$ (0.48) in year 2000 from \$ 1.20 in the year 1999. Not only EPS but also share price, current ratio and sales showed a negative growth within the company.

From the analysis of these companies done by us based on their financial statements before, after and during the fraud we conclude that intentionally misrepresentations done by the company in their statements leads to a downfall it may not be immediate but definitely. The company may gain its advantages until it

doesn't come to the eye of the public but once known it marks huge losses which may not be recoverable. The company would take immensely lot of time to get back to a stable stage and over the years it would have lost huge amount of profits other than the loss already suffered due to fraud. On happening of such events the company will be forced to drag its attention towards matters which would not contribute to anything. The company not only faces financial losses but also loses the faith of investors, opportunity for growth, years of working. The functioning of the company after the fraud is slowed down as they face difficulties from every area of internal and external working. It remains answerable to different groups and at the same time needs to get management to proper functioning. Over the years such frauds show a complete disaster faced by the companies, many studies prove the loss of the fraud years have immense negative impact to the extent that some companies may come to a point of shutdown or bankruptcy like Enron had faced one.

V. FINDINGS AND SUGGESTIONS:

FINDINGS:

The study carried in the paper investigates into the matter of financial crisis suffered due to accounting scandals. The paper clearly shows that the company and related parties underwent a downfall. The data's collected and the trend analysed showed the aftermath of such financial drop suffered. The companies which were effectively doing well had to face such outcome which brought the companies to an irrecoverable stage. Due to the various reasons studied in the cases it can be analysed that these scandals were recorded at different stages of the company's financial performance standards. However the aftermath showed a decreasing trend in the financial performance standards. It can also be noted that companies taken for the purpose of study to an extent contributed towards the country's economy and such event not only affected the life of the companies but also impacted the economy at varied percentage. On basis of study made on the fraud cases of the companies it can be considered that the management must take a stronger stand on ethical values and ensure such ethics are followed at every stage of its functioning.

SUGGESTIONS:

- A more detailed analysis can be done by taking into count more number of years of data.
- Other aspects of balance sheet and income statement can be analysed.
- The focus of study with respect to population can be expanded to various other sectors.
- Creative accounting one of the aspects of fraud can be touched upon

VI. CONCLUSION:

The study conducted in the paper gives a complete aftermath outlook on how the company's financial statements get effected due to fraud. Where Satyam was having huge profits due to fraud it not only faced financial loss but lost its goodwill as well, Tesco recorded a complete drop in its financial statements, Enron faced bankruptcy, Xerox Company found things difficult with management, finance and shareholders investments, and Freddie Mac faces financial crises. These companies analysis gives a direct interpretation that fraud leads to the downfall of companies, effecting shareholder's investments, company's goodwill, profits and financial performance. The study concludes that the fraud negatively influences the share prices, profits, revenue/sales, and ratios. It can also be noted that an early or late detection of fraud would not play any role if the company's intension remains unethical and fraudulent. It can also suggested on the bases of study that the companies should have strict code of conduct to ensure such fraudulent events can be avoided and company's performance and goodwill is not at stake. Companies also share a competitive base in the market with the other companies and such events goes on to affect the market trends at varied percentage. An overall conclusion can be drawn that frauds and scandals leaves the company at a stage where the performance is affected and in some cases it's irrecoverable.

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