Moha Computer Services Limited: A Fraud Case

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Three Directors of Moha Computers Arrested screamed the headlines of Deccan Chronicles, the premier English language daily in Hyderabad. Mr. Boju, the CEO and his brother, both founders and directors of the company, and Mr. Mani, the CFO, were arrested in January 2009 following the revelation of massive fraud at Moha Computers. Boju was one of India's most honored entrepreneurs and had an excellent reputation in the public arena. He was the recipient of numerous international business awards and ran a well-funded charity in Hyderabad. "It was like riding a tiger, not knowing when to get off without being eaten," Boju said in a letter to the board of directors. Boju claimed that a scheme developed to fix a minor accounting indiscretion had "attained unmanageable proportions". He added in that letter: "I am now prepared to subject myself to the laws of the land and face consequences thereof." In February 2009, the entire board of Moha Computers was dismissed and a new management took over the reins of the company. The new company is now called "Indra Moha Computers Limited" and trades on the Bombay Stock Exchange.

News media was comparing the Moha fraud to the Enron fraud. The $2.4 billion fraud was the largest corporate fraud in India. It was ironic that a software giant should get embroiled in a scandal while trying to amass wealth through land acquisitions and get caught in the real estate bubble! After the demise of global financial giant Lehman Brothers in 2008, the Bernie Madoff Ponzi scheme, and the massive federal bailout of other prominent companies in the U.S., similar trouble in India and other parts of the world appeared inevitable.

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A scion of an illustrious family, Mr. Boju, set up Moha Computers in his parents' garage in 1984 in Hyderabad, India. Boju's younger brother, Banju, was an electrical engineer. Banju quit his job at a multinational firm in Bombay to join his brother in the new startup company. Hyderabad is a sprawling metropolis in the state of Andhra Pradesh in Southern India. During the dot com boom in the 1990s, Moha Computers grew rapidly to become a giant IT/software consulting company in India. Moha Computers aggressively courted brand name companies in the US and Europe. Moha appeared to emphasize reaching a deal with global companies rather than taking a serious look at profitability in these consulting contracts. While competitors such as Infosys and Tata Consulting were clear-eyed and took on mostly profitable projects, Moha appeared interested in scoring big headlines in the business press by announcing impressive deals with global brands.

Moha's client list included a third of Fortune 500 companies and several stalwarts such as General Electric, Cisco Systems, Ford Motor, Nestle, Sony, Caterpillar, and others. Moha Computers is a public company trading at the Bombay Stock Exchange and has 400,000 shareholders. Its auditor was the Indian associate of one of the Big 4 accounting firms. Moha's ADR is traded in the New York Stock Exchange. An ADR (American depositary receipt) is a stock that is traded in the United States but it represents a certain number of shares in a foreign company.

As the company grew, internal controls did not keep pace with that growth. The CFO had half a dozen of his classmates holding important positions in the accounting department. Sanju, another brother of the CEO, was the chief operating officer. The well respected software major, Moha Computers, got involved in acquisitions of real estate and construction companies since 2001. Two sons of Boju ran the real estate operations, and the family owned 40 percent equity in these real estate subsidiaries. Mr. Boju came from a famous family, had charisma, and was charming in many ways. He was also ruthless in business dealings and had an autocratic management style. People inside Moha Computers were afraid to challenge him. Moha management (including the CEO and CFO) was also aggressive in promoting the company with the business press and was perennially optimistic in making earnings forecasts.

Shenanigans

The Boju family had invested in land for decades, but their holdings have increased dramatically in the past ten years. AHOM Properties, a subsidiary of Moha Computers, purchased vast tracts of prime land in Hyderabad and other Andhra cities. These were purchased at low prices. A newspaper report stated that the Boju family controls over 100 companies. Each of these companies holds up to 49 acres of land to circumvent the 50-acre cap limit. AHOM took huge loans to purchase much of the land. Mr. Boju secretly pledged Moha's receivables to raise $245 million for land acquisition. Some of Moha's cash also was diverted to buy these real estate assets – land and construction companies. This land was virtually given away by the Andhra Pradesh government. Bribes, kickbacks, illegal gratuities, etc. are rampant in India at the bureaucratic and political levels.

Moha Computers inflated bank balances to the extent of $1 billion. Cash was overstated by over a billion dollars in their 2007 balance sheet. Moha management forged bank documents. Fake deposit slips and bank statements were manufactured to fool the auditors. Auditors also accepted photocopies of bank confirmations from prestigious global banks operating in India. Moha reportedly paid ghost employees, some 13,000 of them! Salaries paid to fictitious workers amounted to $8 million per month and this practice continued for several years. Moha employed

40,000 software professionals and not 53,000 as it claimed in the accounting records. There were material misstatements in the financial results reported by Moha for 2007. Revenues were overstated by 46 percent and profits by 60 percent. Boju used his shares to secure massive loans. Nine Moha executives reaped nearly $6 million in profits from the sale of their shares in the company in nine months before the scandal emerged. The Registrar of Companies in India (akin to SEC), which is one of several agencies investigating the Moha fraud, says everything about Moha's finances (from books of accounts to bank statements) may have been falsified. The new management team at Moha restated, at the behest of KPMG and Deloitte, its financial results for the period 2002 to 2008 in September 2009.

Governance Issues

The business press in India is blaming the corporate board of Moha for not exercising its oversight responsibility. Moha fraud was undetected by external auditors for more than seven years. A la Bernie Madoff, Boju confessed to the board and only then did the fraud come to light. The board of directors at Moha included several Indian-origin professionals of international reputation. One was the inventor of the Pentium chip at Intel and another one was an advisor to the Kennedy School of Government as Harvard and a third one was a senior associate dean at the Harvard School of Business. Another was the Dean of Indian Business School in Hyderabad. There were no financial experts serving on the Audit Committee of Moha Computers and still Moha's American Depository Receipt (ADR) was trading at the NYSE. ADRs are securities of non-U.S. companies that trade on US stock exchanges and they pay dividends in US dollars.

During times of rapid growth and economic boom, effective governance lagged behind at many companies in India. Everyone was making money and no one was exercising professional skepticism and asking the difficult questions. Investors, auditors and regulators were all believers! In addition, Indian corporations are still operating under past regulatory systems that have not caught up with times. Regulations in India were often more politically motivated than legally based.

Indian corporations have a largely well-deserved notoriety for nepotism. They also conduct many deals in secrecy and lack transparency. For example, Moha Computers, like many other Indian companies had three family members of Boju on its board of directors. Family businesses in India dominate the corporate scene. Eighty seven percent of outstanding shares in Indian companies are held by insiders and their families, and a paltry 13 percent of all of the country's listed shares are held by outside investors. BwT, Moha's auditor for the past seven years, has announced that it will be conducting an internal review. BwT auditors in India also will be examined by the Institute of Chartered Accountants of India (ICAI) for their role in the audit of Moha Computers. The ICAI also has issued a new auditing standard requiring <u>direct</u> confirmation of bank balances. Photocopies of confirmation are now insufficient audit evidence.

Collateral Damages

To address the cash flow problems, the new board is asking its global customers to pay outstanding balances. These payments will augment the operating funds. Moha customers/clients may be in trouble. Many customers have a desire to cut ties with Moha, but without a necessary clause in their contract they may not be able to. If a customer has no contingency plan, it may suffer. Moha clients who are among the world's largest companies must make careful review and tough decisions. Some of Moha's customers may have difficulty finding new consulting firms to perform their work at comparable prices. The Securities and

Exchange Board of India (SEBI) is investigating the fraud at Moha Computers. Moha is also being examined by India's Serious Fraud Investigation Office.

The Aftermath

The Moha fraud has put brakes on its future growth. For example, Moha Computers and the Australian government were planning on working together to build a software laboratory that was projected to create 2,000 jobs in Sydney and produce annual revenues of $175 million. This project is on hold for now. India's financial regulators are slowly moving to tighten the corporate governance practices of publicly traded firms managed by their founders or owners. The Securities and Exchange Board of India is pushing for increased disclosures. Additional regulations will require founders or major shareholders to disclose the number of shares they have used as collateral. The Ministry of Finance will now require that at least 25 percent of a company's outstanding shares should be held by the outside (public) stockholders. Shareholders blocked Moha's $1.6 billion takeover of two other real estate companies promoted by Boju's sons. This defiant act was due to what appeared to be inflated prices. Boju admitted that the proposed merger was a final attempt to fill Moha's fictitious assets with real ones!

News Flash: After 33 months in jail, Mr. Boju was finally released on bail in November 2011. The criminal investigation and trial are continuing. If and when criminal charges against him are proved, Boju is looking at a very long prison time!

Required:

1) Apply SAS 99 (AU-C 240) and identify red flags (fraud risk factors) that are present in the Moha case. Red flags should be grouped under three categories: pressures/incentives, opportunities, and (ethical) attitudes/ rationalizations.

2) Describe “utilitarian ethics.” Who are all (individuals and groups) affected by the massive fraud at Moha Computer Services Limited and how are they affected?

3) What were the weaknesses in the “control environment” of Moha Computer Services Limited? Enumerate them in detail.

4) Investors, the auditor, audit committee, SEBI (regulators), and others - all should have exhibited professional skepticism. What do you understand by the phrase “professional skepticism?” Describe it in detail.

5) What organizational controls including internal controls [read AS 5 from the PCAOB thoroughly before answering this] should be put in place to prevent another Satyam fraud from occurring again?

6) How did the audit firm (PricewaterhouseCoopers in India) miss the fraud? What were the weaknesses in the Indian auditing standards?

If you would like the Teaching Notes to this case, please contact either of the authors.

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