



SAAC NEWSLETTER

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THE BREAKDOWN OF SAHARA SCAM



INTRODUCTION

~by Vaibhav Verma

A corporate scam where SEBI's powers were tested in corporate fundraising by financial institutions such as SAHARA corporations. This ₹25000 crore fiasco was caused by two subsidiaries **SIRECL** and **SHICL**.

Sahara Parivar was founded by **Subrata Roy** in Lucknow, Uttar Pradesh, 1979. Its business activities include financial services, insurance, real estate, manufacturing, media and entertainment, health care, educational institutes both offline and online, artificial intelligence, hospitality and co-operative society. Beside this, Sahara Parivar also owned their own airlines which was sold to Jet Airways in 2007.

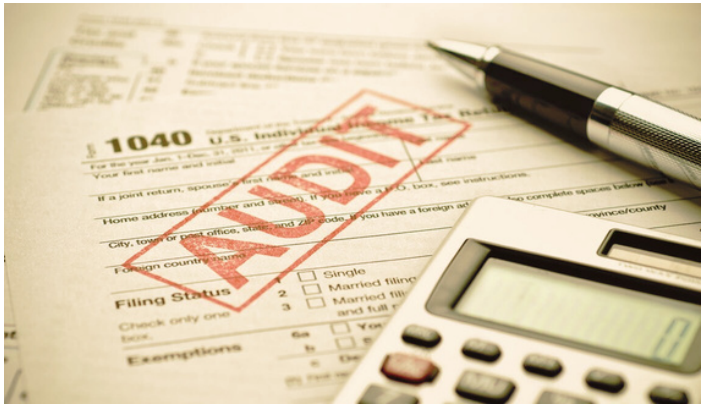
It also marked its ownership in the sports industry by acquiring the Awadhe Warriors of Lucknow, an Indian top 8 badminton team. It also formerly owned Pune Warriors India: a franchise cricket team that played in Indian Premier League (IPL).



Sahara's growth was unstoppable in the early 2000's and it was one of the very few Residuary Non-Banking Companies to raise thousands of crores and gain millions of investors' faith in their operations.

While going public with its another subsidiary Sahara Prime City Limited, they had filed a RHP with the stock exchange, it was during this time when SEBI discovered that it cannot trace back Rs 25000 cr which other two companies of Sahara group had raised through issue of **optionally fully convertible debentures**.

The case between SEBI VS SAHARA went on for over 3 years. Sahara group had sold the OFCD to more than 30 million investors. Mind due the **area targeted by Sahara was the lower and middle class layman** because they were unaware of the stock market technicalities and were only interested in earning high returns with minimum capital investment which Sahara gladly promised them. An issue this big of a size is supposed to be closed within *six weeks* but Sahara kept it open for almost *10 years* and the amount of this issue was around ₹17,250 crores excluding interest. Although it was not publicly called a scam as such, it was an extremely complex legal issue with various perspectives.



This edition of SAAC's newsletter is going to give our readers an insight on how an audit was and could have been involved in a complex legal case as Sahara.

Sahara's Timeline

~by Jaspinder Kour

- 1978** Roy started a para-banking venture under the name of Sahara, where it accepted deposits as small as Rs1 per day from investors.
- 2008** It became India's largest Non-Banking or *Residuary Non-Banking company*. Year of 2008 was a highlighting period or could also be named as the beginning of the first chapter which Sahara was planning to write in the Indian Financial history of scams. *RBI sanctioned Sahara to collect deposits from the public maturing in 3 years until June 2011. As part of this scheme, Sahara issued their unaudited financial statements to their investors for the first time.*
- JUNE 2008** Banking regulatory body complained to RBI that Sahara was not complying with their rules and regulations regarding payment of required interest payments, Know Your Manager documents and notification of repayment on maturity of the deposits.
- JULY 2008** With the money collected by investors, Sahara invested around Rs 17584 crores in diverse portfolios mainly consisting Government Bonds and other securities.



- RBI appointed 3 *independent directors* in Sahara's board, H.N Sinor(former ICICI managing director), T.N Manoharan(Chartered Accountant and founding partner of Manohar Chowdhary and Co) and Arvind K D Jadhav(former mining secretary and chairman of Maharashtra Water Resources Regulatory Authority)
- RBI obligated Sahara to maintain independence in the board and as a result Roy's relatives resigned from the board. They also had to *change their auditors from D.S Shukla and Co and Chaturvedi and Co to GP Apte and Kalyaniwalla and Mistry, both Pune based firms.*
- Being restricted from accepting deposits, two subsidiaries of Sahara namely *Sahara India Real Estate Incorporation Ltd* and *Sahara Housing Investment Corporation Ltd* issued *Optionally Fully Convertible Debentures* to 30 million investors for an amount of Rs 19000 excluding interest.
- To raise more finance Sahara Prime City Ltd decided to get listed and issued a *Red Herring Prospectus* with SEBI where officer K M Abraham spotted the whopping Rs 19000 investment raised by the two subsidiaries without approval of SEBI.
- SEBI asked Sahara to repay the entire investment and Sahara argued that this issue by their subsidiaries was beyond SEBI's jurisdiction as it was a *Private Placement*.

- **2010** Sahara went to Securities Appellate Tribunal (SAT) but their argument was denied here as well as SAT declared their judgement that any issue made to investors over the size of 23 million falls under SEBI's jurisdiction and every regulation applicable to such issue. February 2011 - Delhi High Court temporarily stopped proceedings against Roy and others.
- **MAY 2011** Supreme Court asks SIREC to provide OFCD application format and list of agents.
- **JUNE 2011** SEBI orders Sahara firms to refund money from OFCD sales.
- **OCT-OBER 2011** SAT ordered Sahara to refund Rs. 17,656.53 crore plus interest.

- **AUGUST 2012** Supreme Court directed Sahara to refund over Rs. 24,400 crore.
- **FEBRUARY 2014** Roy was arrested by UP police for not appearing in the Supreme Court.
- **MARCH 2014** Roy and the directors were sent to Tihar jail.
- **MARCH 2015** Total dues from Sahara increased to Rs. 40,000 crore.
- **JULY 2015** SEBI cancelled Sahara's mutual fund licence.
- **JANUARY 2021** Delhi High Court allows Sahara Credit Co-Operative Society and Saharayn Universal Multipurpose Society to continue operations, noting payment of Rs. 17,487.82 crore.



Details of Audit performed over the years

~by Shruti Gupta

ICAI, India's apex audit body, however didn't allow RBI to use the forensic report as it had been conducted by a multinational not affiliated to it. RBI then had to conduct its own inspection and validate the KPMG finding.

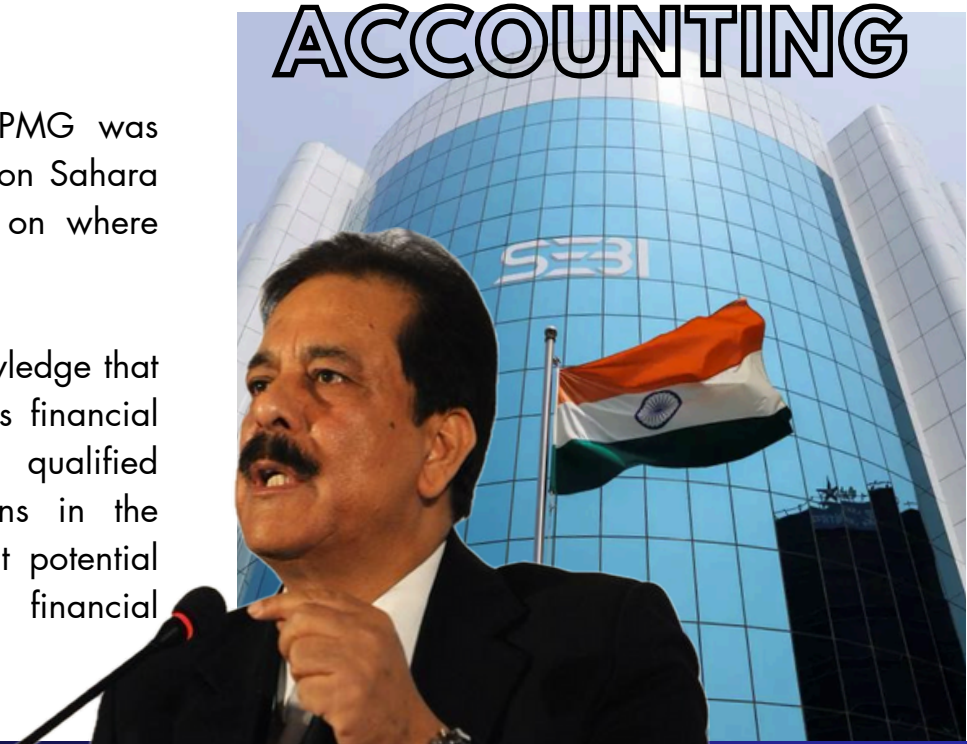
If we talk about the details of the audit of Sahara India, here are some conclusions drawn from the trend of their auditor's report year after year. With help of a high profile panel, RBI performed a discreet audit of Sahara para-banking services the report of which was never made public.

The key findings of this audit report:

- **Source of revenue:** RBFC earned revenue majorly through their liabilities, yes you heard it right! They make money through forfeiture of deposits since interest is not to be paid on those thereafter.
- **Cash collections:** by Sahara were outsourced to a partnership firm under Sahara groups name but being another entity RBI had no jurisdiction to review their financial statements and other relevant documents.
- **Forensic Audit:** Post this audit KPMG was asked to perform a forensic audit on Sahara Financial Services to dig deeper on where this money was circulating.
- **Qualified Opinions:** It's public knowledge that auditors' reports on Sahara India's financial statements have often contained qualified opinions. This indicates limitations in the auditor's scope or concerns about potential material misstatements in the financial statements.

- **Regulatory Scrutiny:** SEBI, the Indian market regulator, has at times been critical of the audit processes used for Sahara India. This suggests that SEBI may have had additional insights into the audit approach.
- Although Sahara was an unlisted conglomerate they were acting in public interest by issuing Optionally Fully Convertible Debentures to the general public of over 30 million. This forces them to audit their financial statements to allow their investors to stay updated with the company's performance.

FRAUD AUDITING & FORENSIC ACCOUNTING



Audit Report



REPORT

Impact on audit of financial statement

~by Mahi Rana

- Where was 95% of the amount refunded to? There is a clear absence of evidence to evaluate whether this refund was genuine or not.
- In order to base an opinion whether the financial statements are fairly presented, the auditors require *sufficient evidence* to scrutinise whereas Sahara had none. Many of the investors couldn't be traced back due to lack of KYC details and thus there were no traces of where the bank transfer was made.
- The most reliable source of evidence in this case would be requesting a management representation that the board was aware of this issue and they take full responsibility of it but in the case of Sahara the board in itself was to blame behind orchestrating the mismanagement of funds.

The audit procedures that should have been performed in order to obtain evidence regarding the OFCD issued and other relevant securities:

- **Analytical procedures:** to understand the trend of data in their financial statements and identify if there is any significant change from past to current. In Sahara's case the analytical procedures would have highlighted the continuous injections of an aggregate Rs. 19000 crores.
- **Inspection of documents:** SEBI was unable to call all the investors to refund their money back due to lack of KYC but in presence of an auditor, they would have performed inspection of the electronic records and obtained confirmation letters from the depository where the securities are held.
- **Internal Audit:** Not a mandatory practice but when an organisation is dealing with such volume of investors it becomes a requirement to act in their best interest. Presence of an Audit committee and regular internal audit procedures would have helped to identify that KYC of investors was missing and thus relevant action should have been taken immediately. *External auditors have the option to rely on internal auditors' reports after validating it with their evaluation.*
- **Substantive audit procedures:** recalculating a sample of the investment securities offered could help to agree the mathematical accuracy of the amounts input in financial statements and other corroborating evidence provided by Sahara.
- **Correspondence with previous outgoing auditor:** Being newly appointed, the current auditor could have contacted the previous outgoing auditor for 25 years and with client's permission requested their audit documentations and audit report to evaluate any similarities and discrepancies in current year's financial statements.
- **Fundamental principles:** Auditors should not be threatened by intimidation from the board of the company and maintain professional scepticism and be independent at all times. External auditors are appointed to assist the shareholders in providing them an assurance of whether the company's financial statements are fairly presented or buried with material misstatements, thus it's their fundamental principle to remain independent and practise objectivity along with integrity at any cost.

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