



Lessons from Reebok/ Adidas India scam

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How it all began?

- Adidas of Germany took over Reebok an US brand
- Reebok India under Shubinder Singh was very aggressive and pioneered 'guaranteed dealer margins' to push sales
- This practice was not favored by Adidas in view of its German conservative roots
- There was a stand off between new management and Shubinder right from the beginning
- This led to an all out war

What happened?

- Director Shubinder Singh Prem and COO Vishnu Bhagat of Reebok India, booked for a scam on May 21, 12 after Internal investigations by Company's director finance Shahin Padath.
- March 25, 2012 Shubhinder Singh Prem dismissed as Reebok India's MD.
- FIR filed in Guragaon Police station
- Shubhinder Singh files a defamation case against the company claiming Rs 15 cr as damages
- Charges by Adidas:
 - Fudging company a/cs
 - Operating secret warehouses
 - causing loss to the extent of Rs 870cr

The first investigation

- Adidas commissioned KPMG's forensic arm in India to do a study in 2010 itself
- KPMG probe (secret code :Project Diamond) known only to few people in Adidas, over many months, scanned 50,000 emails exchanged since 1992.
- However this did not lead to any finding of wrong doing by the key executives

The KPMG probe details

- EMI of Prem Rs 10.79 Lakhs more than his monthly take home pay of Rs 9.15 lakhs
 - He said he had nine real estate properties in Delhi/NCR
 - KPMG found 3 more properties in his name which he claimed were jointly owned with family
- COO Vishnu Bhagat had alleged links with franchisees.
- KPMG probed links of Bhagat with Neeraj Viash a franchisee and HG retail a leading Reebok retailer
- KPMG had meetings with both executives
- At the end KPMG seems to have stated there was no evidence "to prove allegations of possible fraudulent behavior" in Jun 2011
- After KPMG's clean chit another company Control risks P Ltd was hired to conduct a fresh probe and the key executives fired.
 - What went wrong?

FIR filed in Gurgaon Police station

- Irregularities include
- over-invoicing to the tune of Rs 147 crore
- Running a false franchisee referral programme, receipts from which were about Rs 114 crore
- Maintaining four secret warehouses where company goods were diverted, all of which have been sealed and goods confiscated
- Raising fake invoices of about Rs 98 crore to show higher sales and claim promotions, bonus and incentives
- And collusion with some customers to aid the two officers in the scam

The write off by Adidas Germany

- Adidas, German parent of Reebok, showed in its filings a near 200-million Euros write off for India operations due to alleged commercial irregularities.
- Email of Adidas to HT says:
 - “Unfortunately, we discovered commercial irregularities at our Reebok business in India, which will likely affect the prior-year consolidated financial statements of the Adidas Group. In total, we are talking about a negative impact of up to a pre-tax amount of €125 million,”
- This should be the Rs 850 crore scam being talked of
- Is there a disconnect between the FIR and the scam amount mentioned by Adidas?
- May be not –as they may be referring to the Goodwill or other impairment charge they took in their books for the Indian arm. After all *that is their* loss.

The auditor

- KPMG were not the auditors in India
- Local audit firm N.Narasimhan & co is the auditor
- Surprising as normally all the MNC cos require their auditors (normally Big 4) to be auditors locally also

SFIO probe

- SFIO took over case from Ministry of company affairs
- Investigation covers books of a/cs since 2003
- SFIO will be studying the BS and financials of major footwear and apparel companies to study the industry standards
- The 'padding up' of Dec sales has not been taken that seriously by SFIO
- "What we will have to concentrate on is whether the numbers shown in December were delivered successfully in a reasonable time frame; to define a 'reasonable time frame', we would need to compare details of other major footwear brands."

SFIO probe contd.

Initial findings:

1. Amount of scam appeared to be 'exaggerated'
2. Annual sales has not exceeded Rs 500cr over the years; so scam amount seems inflated

SFIO has stated they will call upon local auditors and employees to record their statements

Other developments

- Other agencies probing the scam:
 - IT department
 - ROC under S 234 of companies act
 - Enforcement directorate may also look into the money laundering aspects if any
 - ICAI
- ADIDAS has filed a defamation suit against its former MD for his remarks against Adidas
- IT department has asked Adidas the parent company for some details regarding its Indian activities
- City police raided the secret godowns (two in Vasant Vihar and one each in Bijwasan and Palam Vihar) run by the former executives, as also their residences. They seized computers and hired CA's to study the BS.

Lessons for auditors

- Cut off is a very important audit check. Especially in sales, as sales can be inflated to achieve targets and bonuses based on targets
- Cross check information on warehouses and what is stored in them
- If company adopts 'aggressive' practices in booking in sales, we need to certainly comment on that in our ML;
- What is acceptable to one country's management may not be acceptable to management of another country
- When company is audited by not-so-famous auditor one needs to be all the more careful- Bernard Madoff had small time audit firm
- Look at how the employees live- if they live beyond their means –it should raise a suspicion.
- Ensure the approvals from global HQ are in place for all key things in MNC's and the Boss in non MNC Indian companies!

Sources

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