

Volume 2: Financial Failures & Scandals: From Enron to Carillion
By Krish Bhaskar and John Flower
Online companions volume
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Wirecard Breaking news November 2019

FT continues its story on Wirecard (the German payments company)

This story originated in the FT so it is not surprising that the FT wants to reinforce the authenticity of the story despite repeated claims by the German management of ‘nothing to see’. The claim is that Wirecard faced calls from analysts to provide detailed information on its accounting after the German fintech group sought to dismiss the FT’s claims of suspect book-keeping. Let’s recap¹:

The FT has published internal financial reports that appear to show that Wirecard routed billions of euros in payments for 34 clients through a Dubai partner company called Al Alam Solutions in 2016 and 2017.

The documents indicate that a quarter of the German group’s sales in 2016 were attributed to the arrangement, yet out of 34 client names listed in the documents, eight had ceased trading at the time business was attributed to them. A further 15 told the FT they had never heard of Al Alam, of which only four said they were clients of Wirecard in the period concerned. Six of the 34 named entities declined to comment and five could not be traced.

Wirecard’s statement said Al Alam was an independent partner, its service providers were often active in the background and that “the 34 company names mentioned by the Financial Times refer to labels of customer clusters created for reporting and reconciliation purposes, each containing hundreds of individual genuine merchants”.

In a note to clients, Deutsche Bank analyst Nooshin Nejati said “it is not clear why the company would use such a clustering for its reporting” and called for the involvement of Wirecard’s auditor. “The company needs to ask EY for an official view on these allegations that it should publish separately” Ms Nejati said.

The Wirecard statement is not sufficient to allay investor scepticism around Wirecard’s accounting practices and controversies. Meanwhile Wirecard faces a continuing investigation by the Singaporean authorities into alleged fraudulent accounting at a number of subsidiaries in Asia. Wirecard has said there was no material impact on its group accounts from the Singapore investigation, but that some employees in the city state may face criminal liability.

¹ McCrum, D., and Storbeck, O., Wirecard faces calls from analysts for information on its accounting, *Financial Times*, 16 October 2019.

Available at:

<https://www.ft.com/content/04706e68-f029-11e9-ad1e-4367d8281195>

Accessed October 2019.

Breaking news November 2019/Continued

KPMG independent review of accounting at Wirecard

Finally the FT obtained some movement. Wirecard has appointed KPMG to review questions over its accounting practices that were raised by whistleblowers and reported by the FT²:

The FT last week published documents that appeared to indicate a concerted effort to fraudulently inflate sales and profits at the Dax 30 company, leading to calls for an external assessment of work that was done by its auditor EY, and criticism of management's response.

The company has categorically denied impropriety and said the conclusions drawn by the FT about the files were incorrect. In a statement to the German stock exchange on Monday, Wirecard said its management and supervisory boards had decided to conduct "an additional independent audit to clarify fully and independently all accusations raised".

Then the FT also announced that KPMG had widened its investigation into some types of transactions which it is claimed cannot possibly have occurred as described by Wirecard³:

...the company said KPMG would also look at accusations made by short-sellers about a type of lending known as "Merchant Cash Advance". Wirecard said last year it had put €400m into making short-term loans to its customers, with many of them being located in Turkey and Brazil.

Merchants using Wirecard to process credit card payments can wait a month to receive the money, so the product is designed to bridge that gap. However, an anonymous group of short-sellers that calls itself MCA Mathematik has raised doubts about whether the activity is taking place as Wirecard has described.

In a letter to Wirecard's supervisory board, MCA Mathematik said "the two countries in which management has claimed MCA lending is most significant — Brazil and Turkey — cannot possibly be offering any meaningful programme of this type".

Filings made by Wirecard's Brazil subsidiary at the country's central bank do not describe significant MCA lending, according to MCA Mathematik. In Turkey, such advance cash loans to merchants were not legal, the short-sellers alleged, asking where money for the loans had gone.

² Storbeck, O and McCrum, D., Wirecard appoints KPMG for independent review of accounting, *Financial Times*, 21 October 2019.

Available at:

<https://www.ft.com/content/eeb18c70-f3ce-11e9-a79c-bc9acae3b654>

Accessed October 2019.

³ Storbeck, O and McCrum, D., KPMG widens review of Wirecard accounting, *Financial Times*, 6 November 2019.

Available at:

<https://www.ft.com/content/e132cb98-0073-11ea-b7bc-f3fa4e77dd47>

Accessed November 2019.

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Breaking news November 2019/Continued
KPMG independent review of accounting at Wirecard/Continued

A Wirecard spokeswoman said that MCA Mathematik's allegations were "based on wrong assumptions which lead to wrong conclusions".

So we will have to wait for the conclusions on this ongoing saga. That said, we believe that the FT has found something that is not normal and will probably render the accounts less than accurate. Whether this is significant or material remains to be seen.

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The Wirecard Case – update September 2019

These are the latest financial press comments (FT):

An internal Wirecard spreadsheet shows that three partner companies contributed half the sales and more than 90 per cent of the profits to the scandal-hit German payments group in 2016 and early 2017.

The file, an excerpt of which was published today by the Financial Times, informed an FT article last month that raised new questions about the accounting at a company that is regarded by many as Europe's next tech champion⁴.

Though there were some reports of problems⁵:

...digital bank Revolut blamed Wirecard for a problem that caused some customers to be charged twice for transactions.

Evidence that the markets are taking this company backed by Deutsch Bank seriously include⁶:

JPMorgan Cazenove started coverage of Wirecard, the German payments processing company, with a “neutral” rating and €165-a-share price target. Wirecard is substantially cheaper than peers after accounting for predicted growth, which is “a function of accounting-related controversies”, JPMorgan told clients.

/Continued

⁴ McCrum, D., Wirecard document points to reliance on 3 partners, *Financial Times*, 20 May 2019.

Available at:

<https://www.ft.com/content/7d394c4e-77c4-11e9-be7d-6d846537acab>

Accessed September 2019

⁵ Megaw, N., IT outage leaves UK bank customers unable to pay bills, *Financial Times*, 20 August 2019.

Available at:

<https://www.ft.com/content/7d394c4e-77c4-11e9-be7d-6d846537acab>

Accessed September 2019

⁶ Elder, B., Stocks to watch: Rentokil, Purplebricks, Just Eat, Wirecard, Campari, *Financial Times*, 10 September 2019.

Available at:

<https://www.ft.com/content/58daf112-d3aa-11e9-a0bd-ab8ec6435630>

Accessed September 2019

The Wirecard Case – update September 2019/Continued

Although the company seems to have recovered from its accounting problems the markets value is low (compared to its peer groups) and there is some positive analysis:⁷

German financial technology group Wirecard has been rated just above junk status by rating agency

Moody's as it looks to issue a €500m bond. Moody's assigned a Baa3 rating — the lowest investment grade classification — to both Wirecard generally and the planned unsecured notes specifically, citing constraints including the payment company's size relative to US rivals and the “constant threat” of competition from new market entrants and technologies.

But the rating agency also cited positives including Wirecard's strong market position in Asia and Europe, its diversity, scalability and “sound financial profile”.

“Wirecard's Baa3 issuer rating reflects its leading position in the payment processing market, especially in Europe and in the strongly growing Asian markets and its comprehensive product portfolio in the highly competitive industry,” said Dirk Goedde, Moody's lead analyst for Wirecard.

Based out of Aschheim, Germany, Wirecard has grown rapidly in recent years, selling technology and knowhow used by businesses to take payments from customers. Its share price has been under pressure since late last year when it became embroiled in an accounting scandal.

Moody's gave the group a stable outlook and said it expects it to generate growth in adjusted earnings before interest tax depreciation and amortisation in the “high-teens to mid-twenties” over the next 12-18 months.

It added that it does not expect Wirecard to exceed an adjusted debt to ebitda ratio of three times, including the new €500m bond and an “envisaged” €900m investment by Japan's SoftBank via a convertible bond that was announced earlier this year.

Wirecard plans to begin a roadshow for the new five-year bond on September 2 to meet with fixed income investors. Crédit Agricole, Deutsche Bank and ING will act as global coordinators, while Citi and Credit Suisse will be active bookrunners.

Continued

⁷ McCormick, M., Wirecard rated just above junk by Moody's as it launches €500m bond, *Financial Times*, 29 August 2019.

Available at:

<https://www.ft.com/content/2daa1610-ca4c-11e9-af46-b09e8bfe60c0>

Accessed September 2019

The Wirecard Case

First a bit of background before the possibly fraudulent issues is outlined (denied by management). According to Wikipedia⁸, Wirecard (AG) is a global internet technology and financial services provider which is listed on the German stock exchange and is headquartered in Aschheim, Munich. The company offers its customers electronic payment transaction solutions, as well as the issuing and processing of physical and virtual cards.

Wirecard shares dropped sharply (in total by more than a third and wiping \$9 billion of the market capitalisation [\$14 billion]) after a report that a senior executive at the payments company was suspected of using forged contracts and suspicious transactions.

An internal presentation last year described potentially fraudulent flows of money at the company, the FT⁹, citing a copy of the document. The transactions were allegedly ordered by an executive who oversees Wirecard's accounting in the Asia-Pacific region, according to the FT. The FT went on to publish more details of the report claiming that An external law firm commissioned by Wirecard to investigate the payment company's Singapore office found evidence indicating "serious offences of forgery and/or of falsification of accounts"¹⁰. The report was based on an internal presentation to Wirecard's most senior management in May 2018. The German company has said that "no material compliance findings" have resulted from its internal and external audits.

If true and confirmed, this would imply serious offences of forgery and falsification of accounts. As the FT said:

As these acts were intentional, there are reasons to suspect that they may have been carried out to conceal other misdeeds, such as cheating, criminal breach of trust, corruption and/or money laundering."¹¹

Continued

⁸ <https://en.wikipedia.org/wiki/Wirecard>

⁹ McCrum, D., 2019, Executive at Wirecard suspected of using forged contracts: Internal presentation pointed to possible 'falsification of accounts', *Financial Times*, 30 January 2019.

Available at:

<https://www.ft.com/content/03a5e318-2479-11e9-8ce6-5db4543da632>

Accessed February 2019

<https://www.ft.com/content/03a5e318-2479-11e9-8ce6-5db4543da632> <https://www.ft.com/content/03a5e318-2479-11e9-8ce6-5db4543da632>

¹⁰ McCrum, D., and Palma, S., 2019, Wirecard's law firm found evidence of forgery and false accounts: German payments company provides no comment on internal investigation, *Financial Times*,

Available at:

<https://www.ft.com/content/79f23db0-260d-11e9-8ce6-5db4543da632>

Accessed February 2019

¹¹ Ibid

The next phase

The FT comments¹²:

The new revelation raises further serious questions about one of the world's most successful financial technology companies, fuelling pressure on Wirecard to explain to investors and regulators what allayed the suspicions of its lawyers at Rajah & Tann — a top-notch law firm in the region — who had found sufficient evidence to warrant an investigation dubbed “Project Tiger”.

Putting this in context, Bloomberg commented¹³:

It's not the first time Wirecard has had to defend its reputation. The shares plunged after past claims were published about accounting irregularities in 2008 and fraud allegations in 2016. But analysts have stayed true to the company, with 79 percent recommending investors buy the stock, according to data compiled by Bloomberg.

Finally the reports¹⁴ do go with some admittance of a serious financial problem. Wirecard told investors on 4 February 2019 that an external law firm has been investigating alleged accounting manipulations by a member of Wirecard's finance team in its Singapore operations since May 2018. That said:

In a call with analysts, Wirecard chief executive Markus Braun called the matter a “non-event”. He stressed that while the external investigation by Rajah & Tann was not officially concluded, “we consider the whole issue as resolved” and he expected it to end soon. He stressed that the company does not “expect any material findings here”. Wirecard had previously called the FT reports “inaccurate, misleading and defamatory”.

Singapore police said on Monday that they were looking into “the matter”. Munich prosecutors told the FT on Monday that they did not see a reason to start a criminal investigation into Wirecard as the potential misconduct did not happen inside Germany's jurisdiction.

“With regard to the potential criminal behaviour at question, German prosecutors can only become active if it was conducted domestically or by German nationals,” a spokesperson said, adding that neither seemed to be case.

Continued

¹² Ibid

¹³ Nicola, S., 2019, Wirecard Loses \$8.3 Billion in Three Days on Fraud Allegations, Bloomberg, 1 February 2019. Available at:

<https://www.bloomberg.com/news/articles/2019-02-01/wirecard-shares-drop-after-new-report-on-law-firm-s-findings>

Accessed February 2019

¹⁴ Storbeck, O., and Palma, S., 2019, Wirecard discloses investigation into accounting allegations: Singapore police are looking into matter but shares gain on group's reassurances, Financial Times, 4 February 2019. Available at:

<https://www.ft.com/content/79bd8da2-2830-11e9-a5ab-ff8ef2b976c7>

Accessed February 2019

The question

The next question concerns Wirecard's possibly stretched valuation even after its rebuttals of allegations of dodgy accounting. Bloomberg has been sceptical¹⁵:

Wirecard AG has strongly denied fraud allegations reported by the Financial Times last week. But that hasn't stopped about 5 billion euros (\$5.7 billion) being wiped from the German fintech darling's market value in a matter of days. Even if the allegations are as unfounded as the company says, there are valid questions about whether the payments processing specialist justifies its generous valuation (it was worth more than Deutsche Bank AG at the start of last week). Hedge fund manager Crispin Odey, for one, made a large bet against the firm.

The FT's reporting alleges that suspicious transactions in the millions of euros were flagged internally at Wirecard – which processed some 90 billion euros of payment volumes in the first nine months of 2018 – but with seemingly no resulting compliance action. It also alleges that a law firm hired by the company to investigate its Singapore office found evidence suggesting “serious offences” such as forgery or faked accounts. Wirecard has denied the reports, saying that a member of its team had flagged potential compliance breaches for the 2015-2018 period but that it deemed them to be “unfounded.” It said neither the company nor its external law firm had made any “conclusive findings” of misconduct

Continued

¹⁵ Laurent, L., Wirecard Has a \$17.5 Billion Question To Answer: The German fintech darling's stretched valuation is in the spotlight, even after its rebuttals of allegations of dodgy accounting, *Bloomberg*, 4 February 2019.

Available at:

<https://www.bloomberg.com/opinion/articles/2019-02-04/wirecard-has-a-17-5-billion-valuation-question-to-answer>

Accessed February 2019

The accounting scandal now explained

In another FT article¹⁶, the detailed personnel and accounting transactions were explained:

One year ago, Edo Kurniawan, a jovial 33-year-old Indonesian who runs the Asia-Pacific accounting and finance operations for global payments group Wirecard AG, called half a dozen colleagues into a Singapore meeting room. He picked up a whiteboard pen and began to teach them how to cook the books.

His company would soon become one of Germany's most valuable financial institutions, but as Mr Kurniawan spoke, the task at hand was to create figures that would convince regulators at the Hong Kong Monetary Authority to issue a licence so Wirecard could dole out prepaid bank cards in the Chinese territory.

The FT article goes on to detail the round-tripping transactions:

His company would soon become one of Germany's most valuable financial institutions, but as Mr Kurniawan spoke, the task at hand was to create figures that would convince regulators at the Hong Kong Monetary Authority to issue a licence so Wirecard could dole out prepaid bank cards in the Chinese territory.

Mr Kurniawan then sketched out a practice known as "round tripping": a lump of money would leave the bank Wirecard owns in Germany, show its face on the balance sheet of a dormant subsidiary in Hong Kong, depart to sit momentarily in the books of an external "customer", then travel back to Wirecard in India, where it would look to local auditors like legitimate business revenue.

The FT article goes on to say that this was not the result of a rogue employee, but it was part of a pattern of book-padding across Wirecard's Asian operations over several years. The FT also claims that they have seen documents which show that two senior executives in the Munich head office 'had at least some awareness of the round-tripping scheme: Thorsten Holten and Stephan von Erffa, respectively the company's head of treasury and head of accounting'.

Continued

¹⁶ McCrum, D., and Palma, S., 2019b, Wirecard: inside an accounting scandal: A preliminary report by a top law firm has unveiled a pattern of suspected book-padding across the group's Asian operations, *Financial Times*, 7 February 2019.

Available at:

<https://www.ft.com/content/d51a012e-1d6f-11e9-b126-46fc3ad87c65>

Accessed February 2019

Wirecard affair shows up German tendency to close ranks

This is the title from a FT report¹⁷:

It is not often that investment banks rescind their own published analyst reports. But in late January Commerzbank did just that. The report in question — entitled “More fake news” — attacked an investigative journalist at the Financial Times over his revelations about German payments technology group Wirecard.

and

In response to the FT’s reporting, Singapore’s public prosecutor launched an investigation and last week it emerged entities in Indonesia, Malaysia, India, the Philippines and Hong Kong were also being probed. Singapore’s police have carried out at least three searches and seized 229 boxes of documents. Prosecutors say six Wirecard employees are suspected of “arrestable offences”. Court submissions issued by the attorney-general’s office stated that the police were investigating forgeries, falsified documents, money laundering and round-tripping of funds believed to have taken place between 2014 and 2018.

and

Commerzbank’s analyst note not only branded the FT’s reporting “fake news” with no apparent attempt to check the reported details. It went further, attacking the journalist who broke the story, alleging market manipulation with the “active participation of the FT”. The bank swiftly retracted its ill-judged research note when challenged.

The FT¹⁸ also made a more general point (after the Singapore authorities became involved):

The allegations highlight a broader point about fintechs and young companies more generally: immature, fast-growing start-ups require robust oversight of their global operations. Anyone who latched on to fintechs as the squeaky-clean antidote to big banks and their abuses always risked being disappointed.

Continued

¹⁷ Jenkins, P., 2019, Wirecard affair shows up German tendency to close ranks, *Financial Times*, 18 March 2019.

Available at:

<https://www.ft.com/content/de7a9810-4753-11e9-b168-96a37d002cd3>

Accessed March 2019

¹⁸ Ibid.

Wirecard admits some Singapore employees may face criminal liability

So the wheel turns again and come round again. Wirecard's protestations of everything is in compliance has at last been rescinded – at least partially. The FT, despite being heavily criticized by the German banking community, has actually shown that its reports were correct and not 'fake news'¹⁹. Wirecard is still trying to limit the damage by claiming "no material impact" and just a local low level Singaporean affair. Without further evidence it is impossible to say. However, we take the point that fast growing fintechs (like Metro Bank) are sometime weaker on compliance and governance. Therefore, just on gut feel, perhaps the issue is slightly more important than Wirecard is currently admitting. Wirecard has also put back its date for publication of its annual report.

There is still some criticism over the operations of the Wirecard group²⁰. There are two main areas:

- a) Wirecard relied on three opaque but close partners for almost all its profits.
- b) Whistleblowers claim that a unit of Wirecard payments group was not audited.

This FT article reported²¹:

Half of the worldwide revenue and almost all of the reported profits of Wirecard, the German payments group that is battling an accounting scandal, have come from only three opaque partner companies in recent years, according to documents seen by the Financial Times.

Much of these profits from the three partners were booked through Wirecard's largest business, CardSystems Middle East, in Dubai in 2016 and 2017, according to whistleblowers who said accounts for the unit were not audited in those years.

Investors, regulators and business partners rely on disclosures of material facts about how and where a company operates when making decisions with significant financial consequences. But the importance of CardSystems and the three partners to Wirecard's financial ecosystem has never been flagged to shareholders in one of Europe's highest-flying financial technology groups, which on Wednesday announced a €900m convertible bond investment from SoftBank.

So we shall see what happens in the next few months. .

¹⁹ McCrum, D., 2019, Wirecard says some Singapore employees may face criminal liability, Financial Times, 26 March 2019.

Available at:

<https://www.ft.com/content/2d8baf22-4fd1-11e9-b401-8d9ef1626294>

Accessed March 2019

²⁰ McCrum, D., 2019, Wirecard relied on three opaque partners for almost all its profit, Financial Times, 24 April 2019

Available at:

<https://www.ft.com/content/a7b43142-6675-11e9-9adc-98bf1d35a056>

Accessed April 2019

²¹ Ibid