

Accounting Fraud: Case Study of PICNIC Pcl*

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Abstract

The PICNIC case discussed the accounting frauds committed at a fast-growing company in the Stock Exchange of Thailand, PICNIC Pcl. during 2004. It provides an insight into the ways by which the financial statements were manipulated at PICNIC. The PICNIC fraud was the result of a failure of corporate control and governance. PICNIC did make numerous transactions with its closely related parties to inflate its earnings and hence share prices. Some transactions seemed to point out that they were made to siphon cash from the company. The dysfunction, conflicts of interest, and break down of governance standards and management practices had damaged investor confidence and weaken the credibility of Thai capital market.

Keywords: Accounting Fraud, Corporate Governance, Conflicts of Interest, Investor Confidence

* This case study was compiled from published sources, and is intended to be used as a basis for class discussion and not as a primary information source.

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กรณีศึกษาการตกแต่งงบการเงิน: บริษัทปิกนิกจำกัด (มหาชน)*

อังครัตน์ เปรียบจริยวัฒน์**

บทคัดย่อ

กรณีศึกษาปิกนิกนำเสนอการทุจริตทางการเงินบัญชีของบริษัท ปิกนิก จำกัด (มหาชน) ซึ่งมีการเจริญเติบโตอย่างรวดเร็วในตลาดหลักทรัพย์ในระหว่างปี 2004 โดยแสดงให้เห็นถึงวิธีการที่บริษัทใช้ในการตกแต่งงบการเงิน การทุจริตของปิกนิกเป็นผลมาจากความล้มเหลวของการควบคุมและการกำกับดูแลกิจการ ปิกนิกได้เข้าทำรายการธุรกิจจำนวนมากกับบุคคลและกิจการที่เกี่ยวข้องกันเพื่อให้กำไรและราคาหุ้นของบริษัทสูงขึ้น นอกจากนี้ บางรายการธุรกิจที่เกิดขึ้นดูเหมือนจะแสดงให้เห็นว่ามีการโอนเงินจากบริษัทอีกด้วย การไม่ปฏิบัติตามมาตรฐานการกำกับดูแลกิจการและความขัดแย้งทางผลประโยชน์ของผู้บริหารบริษัทได้ทำลายความเชื่อมั่นของนักลงทุนที่มีต่อบริษัทและลดความน่าเชื่อถือของตลาดหุ้นไทย

คำสำคัญ: การทุจริตทางการเงินบัญชี การกำกับดูแลกิจการ ความขัดแย้งของผลประโยชน์ ความเชื่อมั่นของนักลงทุน

* กรณีศึกษานี้รวบรวมจากข้อมูลที่มีการเผยแพร่ต่อสาธารณะ โดยมีวัตถุประสงค์เพื่อใช้ในการอภิปรายในห้องเรียน และไม่ควรใช้เป็นแหล่งข้อมูลเพื่อการอ้างอิงใด ๆ

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Background

In October 2001, Union Gas and Chemical Co. Ltd. (UGC) acquired a financially troubled company, BeGrimm Engineering System Pcl. Ltd. (BGES) which originally operated the business of engineering construction contracts such as air conditioning, electrical and fire protection systems and renamed it to Picnic Gas and Chemical Pcl. Ltd. (PGC). Early 2003, PGC purchased its parent company (UGC) assets including trademark “PICNIC Gas” and entered into the LPG trading business. The company changed its name, PGC, to Picnic Gas and Engineering Pcl. and later, in 2004, to Picnic Pcl. (PICNIC) in response to the broader business covering more than LPG and engineering. PICNIC two main businesses in 2004 were:

1. Liquid gas business under the trademark “Picnic Gas” which distributes to the wholesale customers which could be divided into the following areas:

- 1.1 Gas Storage facility: filling LPG in gas tanks and distribute to gas shops and eventually sold to household uses. These gas tanks are retailed under the “Picnic Gas” trademark, which is owned by the company.
- 1.2 Gas Stations: selling gas to automobile that use gas as fuel.
- 1.3 Industrial Factories that use gas as fuel.

2. Engineering Businesses which operated to support the LPG business and also undertaking construction contractor for both the government and private sectors which could be divided into two main areas:

- 2.1 Contracts for building installation covering air conditioning & ventilation systems, water sanitary & fire extinguishing systems and electrical & telecommunication System
- 2.2 Construction of Electricity Substations for the Provincial

Under the control of Larpwisuthisin family, owners of UGC, PICNIC grew rapidly through acquisitions. In the first quarter of 2004, the company acquired S.S.C. Petro Development Company Ltd., which wholly owns SCT Vietnam Gas Company Limited (the LPG distributor in Vietnam) for a price of Baht 447 million. During the fourth quarter of 2004, PICNIC again acquired World Gas (Thailand) Company Ltd., which operates an LPG trading business, for Baht 1,011 million. Total goodwill paid for both acquisitions was Baht 1,049 million, about 72% of the total price. Starting in October 2003, to support its plan for growth, PICNIC

increased its capital from Baht 400 million to Baht 750 million. In September 2004, PICNIC increased its registered capital to Baht 1,500 million (par value at Baht 1) and the total paid up capital at the end of 2004 was Baht 1,296 million. The total contributed capital at the same date comprised of paid up capital, share premium and share subscription received stood at Baht 3,162 million.

During 2004, the Company also established 3 subsidiary companies:

- Picnic Marine Company Ltd., to operate LPG distribution services with a capital of Baht 500 million.
- Picnic Corporation (Singapore) Pte. Ltd., to operate an LPG trading business in Singapore with a registered capital of the SGD 0.1 million.
- Picnic Ethanol Company Ltd., to operate an energy business established with a capital of Baht 1 million.

PICNIC's 2004 consolidated financial statements showed revenues from core business in 2004 at Baht 7,023 million, increasing nearly 3 times compared with Baht 2,363 million in 2003. The main increase in revenues came from domestic LPG business (Baht 4,350 million in 2004 as compared to Baht 2,094 million in 2003) and installation and services business (Baht 1,465 million as compared to Baht 269 million in 2003). Net profit for year 2004 was Baht 735 million, increasing more than Baht 470 million or 177 percent from Baht 265 million in 2003. Total assets at the end of year 2004 stood at Baht 12,808 million almost 3 times of Baht 4,492 million at 2003.

The financial information by industry segment of the consolidated earnings statements for year ended 31 December 2004 and 2003 is as follows: -

(Unit : Thousand Baht)

For the Year ended 31 December 2004 and 2003									
	LPG Business			Petroleum Oil Business		Installation and Services Business		Total	
	2004	2003	2004	2003	2004	2003	2004	2003	
	Domestic	Overseas	Domestic						
Revenues	4,350,011	810,392	2,094,540	397,331	-	1,465,529	269,197	7,023,263	2,363,737
Cost	(3,864,597)	(728,575)	(1,856,576)	(382,521)	-	(1,107,002)	(207,982)	(6,082,695)	(2,064,558)
Gross Profit	485,414	81,817	237,964	14,810	-	358,527	61,215	940,568	299,179
Central Expenses								(248,958)	(85,980)
Other Income and Expenses								327,257	85,893
Earnings before Interest Expenses and Corporate Income Taxes								1,018,867	299,092
Interest Expenses								(143,613)	(33,706)
Income Tax								(139,876)	-
Net Earnings for the Years								735,378	265,386

The financial information by industry segment of the consolidated balance sheets as at 31 December 2004 and 2003 is as follows :-

(Unit : Thousand Baht)

	LPG Business			Petroleum Oil Business		Installation and Services Business		Total	
	2004	2003	2004	2003	2004	2003	2004	2003	
	Domestic	Overseas	Domestic						
Trade Accounts and Notes	966,662	73,811	703,604	128,239	-	1,207,642	311,065	2,376,354	1,014,669
Receivables – Net									
Property, Plant and Equipment Net	4,414,371	293,023	1,331,794	161	-	30,414	2,672	4,737,969	1,334,466
Other Assets								5,694,146	2,143,791
Total Assets								12,808,469	4,492,926

Meanwhile PICNIC share price opened the first day of trading on February 4, 2003 at the maximum of Baht 29.50 compared to Baht 1.30 (par value at Baht 10) of the BGEC last trade before PICNIC acquired it. During 2003 PICNIC's share price went up to a maximum of Baht 94.50 (par value at Baht 5 after stock split) on December 23, 2003 and the price continued to Baht 100 on January 13, 2004. On January 27, 2004, the stock was split again to the par value of Baht 1. At the beginning of 2005, PICNIC share was traded around Baht 14.60.

On May 11, 2005, the SEC ordered PICNIC to amend its 2004 financial statements. On May 16, the first business day after May 11, the Stock Exchange of Thailand suspended PICNIC stock trading and the shares were closed at Baht 11. On June 30, 2005 the SEC accused PICNIC's Managing Director and his sister, a director and deputy Managing Director¹, of submitting false statements, fraudulent accounts and violating their fiduciary duties resulting in profits overstated by Baht 178.4 million. On July 1, one day after the accusation, investors sold off PICNIC shares heavily after the SET allowed trading to resume for the first time since May 16, when the shares had closed at 11 baht. The stock ended the day at 4.90 baht, down 6.1 baht or 55%, in trade worth 2.49 billion.²

After restating its 2004 financial statements as ordered by SEC, PTCNI reported as at the end of 2004, current liabilities of Baht 6,456 million and current assets of Baht 4,623 million. As at 31 December 2005 PICNIC and its subsidiaries had outstanding loans from financial institutions totaling Baht 5,053 million, of which Baht 3,374 million became due during the year 2005 but had not been paid by PICNIC. As at the end of 2006, PICNIC reported default loans of Baht 1,479 million and some loans were under prosecution. On January 14, 2008, the Company filed petition for rehabilitation to the Central Bankruptcy Court.

Accounting Fraud³

In the Report to the Shareholders and Board of Directors of PICNIC for 2004 financial statements, the independent auditor drew an attention that PICNIC's majority earnings for the year ended 31 December 2004 came from transactions with a particular group of gas fillers and distributors on its gas sales and rental of gas cylinders. Followed up with the auditor's observation, SEC had conducted an in-depth investigation,

including, tracing the trail of funds among those related parties and found that PICNIC had close relationships with those gas fillers and distributors and also found that one management executive of PICNIC had made substantial payments into the accounts of those distributors during the year 2004. Some transactions appeared to be payments made to the gas distributors for subsequent payments back to PICNIC in settlement for the rental charges of gas cylinders.⁴

On May 11, 2005 the SEC ordered PICNIC to

- (1) arrange to have an auditor to perform a special audit on all transactions between PICNIC and the gas fillers and distributors in which it has close relationships or to which it has sold gas at high prices;
- (2) amend its 2004 financial statements to record the gas cylinder rental transactions as deposits;
- (3) consider disclosing the business transactions with these gas fillers and distributors in accordance with the accounting standard concerning related party disclosure; and
- (4) arrange for a new financial advisor to prepare a new appraisal value report of the two additional subsidiaries acquired by PICNIC in 2004, in order to determine impairment on the value of goodwill (if any) in the first quarter financial statements in 2005.

Irregular Transactions with 18 Gas Fillers and Distributors

The evidence obtained by SEC's in-depth investigation showed that PICNIC had close relationships with a particular group of gas fillers and distributors on its gas sales and rental of gas cylinders. SEC also found that substantial funds were received by the distributors from one management member of PICNIC. The amounts were regarded as self-dealing and should therefore not be recorded as income. The later special audit reported there were a total of 18 such companies instead of 10 as found by SEC. Most of the Company's revenue in 2004 was generated from gas sales and cylinder rental to this group of customers.

Gas Cylinder Rental Income and Gas Sales

1. During 2004, PICNIC entered into 3-year cylinder rental agreements with total contract values of Baht 900 million with this group of gas filling

and distributing customers. The Company recorded rental income from these customers at Baht 180 million in 2004. The rental agreements stipulate that these customers are to purchase gas only from the Company. The industry as well as PICNIC practices with other gas filling customers were to treat fund received for use of gas cylinder as a deposit since companies must return the fund when customers return cylinders. The auditor reported that SEC found one management executive of PICNIC had made substantial payments into the accounts of those distributors during the year 2004 and that some transactions appeared to be payments made to the gas distributors for subsequent payments back to PICNIC in settlement for the rental charges of gas cylinders.

2. During 2004, sales of gas by PICNIC to 10 gas filling companies in this group (total 18 companies) amounted to Baht 2,400 million. The unit prices charged by PICNIC to these companies were 16-19 percent higher than the prices charged to normal customers. The management of PICNIC reasoned for the high prices that it gave generous credit term to those companies (the companies were granted a credit term of 90 days instead of the 10 day credit term granted to normal buyers) and the gas cylinders as delivered to these gas distributors were new. However, according to the documents received by the auditor, the sales of gas were made at abnormally high prices, since the distributing companies' sale to retail outlets were made at prices lower than those at which they had paid to PICNIC. In addition, some gas fillers were able to purchase the same type of gas from other suppliers at much lower prices than that purchased from PICNIC. If PICNIC had sold the gas to these gas fillers and distributors at the same price as sold to normal customers, its revenues for the year 2004 could have been reduced by approximately Baht 372 million.

The auditor was unable to confirm with certainty the financial accounts of those distributing companies because the state of their internal controls and accounting systems did not facilitate such an examination. The auditor also found that a large number of accounting documents were abnormal and she was not permitted to confirm with customers of the gas distributors the value of those customers' purchase transactions and the rental of gas cylinder from the gas fillers. She concluded that she was unable to clearly identify whether the gas fillers were made to perform transactions to generate earnings for PICNIC.

At the end of 2005, the 18 gas filling companies stopped their operations, the outstanding balances of accounts receivable of PICNIC comprised the amount of Baht 719 million of outstanding trade receivables. PICNIC had therefore set up provision for doubtful accounts amounting to Baht 719 million.

Other Irregular Transactions

Purchases of Small Gas Cylinders

During 2004 PICNIC purchased small gas cylinders, for delivery to the gas fillers who fill gas for sale to retailers, for Baht 1,321 million from a cylinder manufacturer. These purchases were recorded as fixed assets in the balance sheets of PICNIC but all cylinders were directly delivered to the gas fillers, without passing through PICNIC, and the gas filling companies would acknowledge receipts of the cylinders on behalf of PICNIC. The auditor found that (1) the cylinder manufacturer has a close relationship with some of the 18 gas filling companies, since they have common major shareholders and/or management; (2) there was no evidence of the supporting documentation and control registers for the quantities of cylinders delivered to the retailers. Due to weaknesses in control of the gas cylinders, the whereabouts of their cylinders may not all be accountable. The additional facts revealed gave rise to doubt as to the quantities of the cylinders in the custody of the gas fillers. In 2005 PICNIC set up a provision for the loss from small gas cylinder at Baht 1,000 million and additional Baht 228 million in 2007, as estimated by an independent appraiser after performing a physical count, random check of physical condition and appraisal of value of such cylinder asset.

Purchases of Large Gas Cylinders (Gas Storage Tanks)

In 2004 PICNIC entered into an agreement to purchase Baht 852 million of large gas cylinders (for use as gas storage tanks) with a limited partnership which is a major trading partner. PICNIC advanced the total purchase price of Baht 852 million which was recorded as assets in PICNIC's balance sheets. However, the auditor reported that (1) this trading partner is an entity which has a close relationship with one of the 18 gas filling companies; and (2) the counterparty has delivered tanks with a total value of only Baht 160 million to PICNIC and the remaining Baht 692 million is still being treated as deposits since PICNIC has not yet

received the tanks. The auditor found that PICNIC has no preventive measure in the event that the counterparty is unable to fulfill the contract. There is a chance that PICNIC could suffer losses on this agreement.

PICNIC cancelled the agreement and called back the deposit as the trading party could not deliver gas tanks as agreed. At the end of 2006, PICNIC set a provision for bad debt of Baht 453 million, the deposit amount that the partnership still owed to PICNIC.

Payment of deposit for land purchase

In 2004 PICNIC agreed with two companies to purchase lands with the structures thereon (consisting of an oil storage facility, a pier, and a permit from the Harbour Department) at the price Baht 980 million. PICNIC paid a deposit of Baht 565 million to both companies.

In her special audit, the auditor found that there has been no report on the progress of the pier project, the application for the permit to construct a gas tank, and that the ownership of the lands had not yet been transferred to PICNIC. At the end of Quarter 1, 2005, PICNIC cancelled both contracts and called back deposits which it received the amount of Baht 530 million, by the end of 2005.

Revenues from systems installations/business

In 2004 PICNIC earned income from two companies for installation contract, which had been recognized based on the percentage of completion. One company is related and another has a close relationship with the 18 gas filling and distributing companies. The amounts involved were Baht 580 billion and Baht 266 million respectively. Revenues from these two companies were about 58 percent of the total Baht 1,465 million revenues from systems installation and services business. During 2005, PICNIC agreed with some trade receivables in debt restructuring by reducing the overdue debt to Baht 254 million and in the first quarter of 2006 set up the full provision for bad debt.

Goodwill

In 2004, PICNIC acquired S.S.C. Petro Development Company Ltd. for Baht 447million, and World Gas (Thailand) Company Ltd., which operates an LPG trading business, for Baht 1,011 million. Total goodwill

paid for both acquisitions was Baht 1,049 million or 72 percent of the purchase price. The SEC, in May 2005, ordered PICNIC to assess whether there was any impairment of goodwill. At the end of 2005, World Gas reported loss but PICNIC and its financial advisor confirmed that there was no impairment loss for goodwill. However, in 2006 both S.S.C. and World Gas still reported loss and PICNIC wrote off goodwill as it was impaired Baht 337 million.

Going Concern

PICNIC, in its restated 2004 financial statements, reported as at the end of 2004, current liabilities of Baht 6,456 million and current assets of Baht 4,623 million. As at 31 December 2005 PICNIC had outstanding loans from financial institutions totaling Baht 5,053 million, of which Baht 3,374 million became due during the year 2005 but had not been paid. As at the end of 2006, PICNIC reported default loans of Baht 1,479 million and some loans were under prosecution. Auditors, therefore, raised doubt of PICNIC's ability to continue its operation. On January 14, 2008, the Company filed petition for rehabilitation to the Central Bankruptcy Court. The Court approved the petition and the rehabilitation plan in December 2009 and May 2011 respectively.

Lawsuit Brought by Office of Chief Public Prosecutor

On 25 October 2005 an official of the Office of Special Prosecutions, Special Cases Division 1, of the Office of the Chief Public Prosecutor charged the executives of PICNIC⁵, together with the Company itself, with violations of the Securities and Exchange Act B.E. 2535 and the criminal code, in relation to the accounting fraud for recording of revenues from gas cylinder rental and the granting of loans to two companies. In December 2006, Bangkok South Criminal Court decided to dismiss the accounting-fraud case against PICNIC and its former executives on grounds of insufficient evidence. The SEC appealed. Later, in February 2012 the Appeal Court handed down 12-year jail sentenced to two former executives⁶ of PICNIC for accounting fraud and securities violations. The Appeal Court also found other defendants guilty and gave them each a five-year prison term. The 10 gas-bottling companies were fined 600,000 baht each while PICNIC was fined 100,000 baht.

Closing Section

The PICNIC fraud was the result of a failure of corporate control and governance. PICNIC did make numerous transactions with its closely related parties to inflate its earnings and hence share prices. Some transactions seemed to point out that they were made to siphon cash from the company. The dysfunction, conflicts of interest, and break down of governance standards and management practices had damaged investor confidence and weakened the credibility of Thai capital market. The company's board and management had failed at the most basic aspect of corporate governance and control. PICNIC case should be a catalyst for stimulating regulators, investors, and market intermediaries in accounting, financial consulting, banking and investment advisory, etc. to address this business challenge.

Issues for class discussion:

- Accounting fraud
 - Identify the methods employed by companies to manipulate their financial statements to their advantage.
 - How did PICNIC manipulate its financial statements?
 - Can accounting fraud be prevented?
- Corporate governance
 - What are benefits and costs of companies and capital market in promoting good corporate governance?
 - Who should be responsible for corporate governance and how?
 - What are warning signals that a company may not observe the best practice in corporate governance?
 - Did PICNIC follow good corporate governance?
 - Discuss roles of SEC and Court in PICNIC case.

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Endnotes

- ¹ Both are members of Larpwisuthisin family.
- ² Normal trading limits of 30 percent were raised to 100 percent as the stock suspension lasted more than 15 consecutive business days.
- ³ The information in this part was mainly drawn from PICNI's auditor reports and financial statements 2004-2007.
- ⁴ Auditor's Report to the Shareholders and Board of Directors for the restated 2004 financial statements.
- ⁵ Executives at the time the fraud was committed.
- ⁶ Former Managing Director and Deputy Managing Director.