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Accounting and Control

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Case Study 1: Toshiba Accounting Fraud

1. How can the fraud triangle be applied to explain Toshiba's fraud and reveal the motives behind it

Toshiba's accounting seemed to have poor control during the time of fraud. This is the result of a few factors which include management-only decision making and responsibility attribution organizational culture, lack of internal accounting controls and no external controls. These factors created opportunity for the executives to manipulate the accounting data. Knowing that the company's structure discourages challenging upper-level decisions, led executives to feel confident they could ask for fraudulent actions without it being reported or being called out. The overstating of profits or understating of costs becomes a usual practice that the employees do not question.

In Toshiba's case there wasn't a person or team dedicated to the evaluation and validation of the contract costs (As it's mentioned an internal group was form until the investigations started), the numbers were not checked for discrepancies or valuated against background sources of the contracts and neither did they go into the detail of the reported profits. Furthermore, it seems there wasn't anyone from outside monitoring the accounting operations or actively monitoring the cash movements.

The fraudulent acts started in 2008, during the financial crisis in which Toshiba was suffering negative results on profitability, an inconvenient for whoever is in charge at the moment because he or she must face the board and investors. In order for the executives to make Toshiba look more profitable and increase the stock price of the company, so they can be praised as efficient managers and gain monetary, career or personal bonuses, they started inflating the profit digits. This is the financial pressure faced by those in charge.

This situation, combined with the high expectations and goals stated by the company, creates the rationalization in their thoughts to push for more attractive financial statements. An additional factor that allows for this to happen is the fact that Toshiba had a high rotation rate on high/level positions and so they would commit the fraud knowing that in the medium to long run, someone else would face the consequences.

2. What are the issues at Toshiba from the point of view of its stakeholders (especially the investors)

Investors, naturally, look for a return on the money investments. This return on investment comes mainly from dividends, paid from the net profits of the company, and the rise in the price of stocks which can later be sold for a profit over the price they bought it at. The concerns therefore arise when something can affect these profit streams, as mentioned in the case “The company’s stock prices had declined by 38 per cent since it announced the accounting probe, and the company had withdrawn the dividend that had been declared earlier”. Investors don’t want the company to be related to scandals in fraud because it’ll plummet the stock prices rendering their gain over stock sales non profitable, it causes the company to gain a negative reputation that will limit their future performance, decreasing the profits and then the dividends.

Other stakeholders, such as providers, rely on the success of their clients. They will want to stop making deals with them to avoid being related to the bad reputation, this also reduces their own profits when Toshiba starts selling less and requiring less supplies. Customers also tend to not pay for services or products from companies that take actions they do not agree with or are considered unethical. They do not wish to support them.

The governments are also concerned with the issue. Japan's government pursues international investment in local companies, it is beneficial to the country's economy. When a scandal like this happens, global investors stop considering putting their money in operations based in Japan. Other countries where Toshiba's operations take place might also have laws that are broken with the frauds, such as the United States.

3. What are the ethical issues in this case? What would you do if you were in the same situation as the Toshiba employees?

To start with, the stakeholders have been deceived, led to believe that Toshiba was actually succeeding in its operations and bringing in bigger profits. They were lied to. In the long run it caused investors to lose money when the fraud was exposed, they were directly affected by the malpractices.

If I was to enter Toshiba and realize that there are fraudulent actions being done, I would report it to the board, and also tip the authorities about what is happening. I wouldn't wish to work at such company and/or be associated with it.

4. What options are available for the company moving forward? How can it prevent such fraud in the future?

Toshiba should develop their accounting controls. When the Securities and Exchange Surveillance Commission started investigating them, a committee was formed, the committee being integrated by people independent from the company allows for an audit where the members' interests are not aligned with fraud. And so external audits are a good measure against fraud. The internal anti/fraud controls are also really important. Toshiba should require document validations with quotes on contract costs to minimize the understating in the books. They should have a system of accounting which includes the control of numbers by different sides, not allowing only one team to register and monitor. Do active revisions on the books to see if they match the sales from each department.

Organizational Culture and structure should be redefined as to give employees related to accounting more power, not having the executives asking them or encouraging them to go forward with fraudulent statements. Human resources should have active campaigns related to topics surrounding bad accounting practices. The human factor also has great significance. Background checking is to be conducted on everyone, including CEOs or board members, to ensure there is some control on who is entering the company.