

Study Case 1: Toshiba Accounting Fraud

With a history of more than 140 years, Toshiba Corporation is a multi-industry Japanese company, whose products are in the houses of billions of people all over the world.

In 2015, an accounting fraud estimated at \$1.2 billion within the entire Toshiba conglomerate led to a public scandal and an overall questioning of what had been going on with the company.

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

The fraud triangle is a theoretical concept used to help one understand why one person would commit fraud and it comprises three elements: rationalization, incentive and opportunity¹. In the Toshiba case, it seems that all of these aspects can be easily integrated into a conceptual framework.

Opportunity refers to the motives that could have helped the Toshiba employees to intentionally manipulate the books. Such motives could be:

- the fact that the internal controls² did not work at both the company, even if they were in place, they existed by name only;
- top management would only care about meeting the profit targets, and not care about how they would actually be met, meaning there was little regard for the accounting practices as long as they were showing profits (not losses);
- the cash-based method was used instead of the accrual method, which also created room for maneuvering, meaning that those responsible choose not to record certain operating expenses³.

Rationalization means the logical reasons that the Toshiba employees would appeal to in order to justify his or her actions. Some of those could be:

1. "Even if I disagree with my superior, I must obey him, since he is my superior".

¹ <https://www.agacgfm.org/Intergov/Fraud-Prevention/Fraud-Awareness-Mitigation/Fraud-Triangle.aspx>

² https://www.toshiba.co.jp/about/ir/en/news/20151208_2.pdf, p. 312

³ https://www.toshiba.co.jp/about/ir/en/news/20151208_2.pdf, p. 201

It seems the corporate culture within Toshiba was such that no superior would be challenged when issuing an order.

2. The fact that Toshiba is a Japanese company and it is a matter of pride to show profitability.
3. “I don’t want to disappoint our stakeholders, by not showing them economic growth”.

Between 2009-2013, the company recorded decreasing sales by 11%, compared to the period of the years before 2008, when the sales had reached overall sales growth.

Some of the **incentives the Toshiba employees** would use are:

- **Financial** - the company uses a performance evaluation system based on financial metrics⁴. Thus, it is in the employee's best interest to achieve or even overpass the estimated profits.
- There was also **internal pressure** to perform, as failure would not be accepted⁵.
- Sometimes, the business unit presidents would receive the request to improve the profit/less forecast just three days before the deadline⁶. It is understandable this could not have happened using normal operational methods, but using accounting records.

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

When one makes the decision to invest in a company, it is done mainly because there are elements within it that suggest trust. Toshiba, with a history of 140 years, was very well reputed and trusted, up until 2015. That is when the investors and stakeholders were extremely disappointed as a result of the uncovering of the large accounting scandal. The credibility of the company and its reputation were damaged, which led to a drop of stock prices by 38%, which in turn affected their financial outcomes. The investors were not treated fairly: their expectations are to be treated with respect and with truth, so that they in return are able to analyze and make the right decisions for the company in the long-term. They were lied to and have every right to demand their rights in a court of justice.

⁴ https://www.toshiba.co.jp/about/ir/en/news/20151208_2.pdf, p. 319

⁵ <https://www.investopedia.com/articles/investing/081315/toshibas-accounting-scandal-how-it-happened.asp>

⁶ <https://www.japantimes.co.jp/news/2015/09/18/business/corporate-business/pressure-to-show-a-profit-led-to-toshibas-accounting-scandal/>

Another issue for Toshiba's stakeholders is the corporate culture that allowed for something of these dimensions to take place. Obeying the superiors without questioning them reveals a culture frozen in time, when such things were acceptable. However, most people who chose to commit those frauds were considered to be honest, trustworthy and knowledgeable. They did leave aside their own morals and principles when they cheated their stakeholders.

The dimension of the scandal allows for the blame to be put on not on a single person, but on a higher number of people: from top managers to smaller executives. It certainly reveals a pattern of conduct not compatible with values that had long been included in the definition of the Japanese giant.

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

The main ethical issues in this case relate to the culture of the company, in general.

First of all, the main issue is, in my opinion, the professional ethics. One plays a very specific role in a company, it has very precise responsibilities: the persons in charge of accounting should have done their job, should have behaved in a professional manner, following their own professional requirements. Their duty is to always act in the interest of the company and to provide the investors financial reports that reflect reality as it is, not a cosmetization of it.

Second of all, it seems that the culture within the company would not allow superiors to be contradicted by a colleague of an inferior role. This is a clear sign of a company whose health can be easily destroyed if the leadership is corrupt. And instead of having the right incentives to ensure the proper conduct, one has to focus on finding the right people. But people are no angels. In any organization, the focus has to be on the framework, on the organizational mechanisms, elements that encourage transparency and dialogue, criticism and openness.

As far as I am concerned, in such a situation, in which the culture does not encourage people to do their jobs, I would have spoken to my superiors. And if that would not have led to any results, I would

probably go forward and become the whistleblower. Such practices are corrupt and they damage the company. If one cannot stop it from within, then one must appeal to exterior factors.

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

As the company moves forward, certain mechanisms can be explored and put to trial. Some of them would be:

1. Hold training all over the company on business ethics and compliance.
2. Elaborate budget constraints and milestones correlated with the company's real ability and capacity.
3. Implement a functional whistleblowing system within the company, with rewards for allegations that turn out to be real.
4. Insert clauses in the employment contracts that state that if one employee is found to have deceived/lied/cheated the investors, then it has to pay a certain amount of money. The amount should be high enough to prevent the employee from doing that. It would apply to all contracts, from top management to smallest executive.
5. Encourage a culture that fosters dialogue and criticism.
6. Implement the highest accounting standards.
7. The external auditor should also have a clause in the contract that underlines their obligation to notice and report any misappropriate accounting or management behaviour.
8. Establish functional internal audit and control.
9. Introduce methods of testing the employees' honesty using "mystery shopping" methods⁷.
10. Hire foreign experts (non-Japanese) to improve the diversity of the company.

⁷ <https://www.anchin.com/news/anchin-in-the-news-understand-the-fraud-triangle-to-help-combat-occupational-fraud>