Toshiba Scandal

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**Introduction**

Toshiba is an old company which started operations in 1873 when a person was hired to develop telegraphic equipment. The company eventually developed into a part of present company named Toshiba. The second part of company was developed by a student who made the first arc lamp for the country and country had to import all its lamps before that. During the World War II, company filled in huge orders for the state in terms of radios, vacuum tubes and other military equipment. The company saw a very lucrative time from the mid 1950 to the first oil crisis of 1973. Toshiba invested heavily in the research and development after 1973.

The major problems in this case are the individual stance taken by Toshiba and the weakness of Japanese system of governance. In May, 2015, Toshiba had a decrease in its share price right after it had announced problems in its accounting records. The Japanese stock exchange rose by 7.6 % whereas the company stock fell by 17% in value. There were many executives of company who had resigned due to accounting reporting issues. Before the announcement of these issues, Toshiba was considered as most important part of Japanese economy and it was recognized all over the world. The company works within many segments across many industries which makes its business complex. The company intended to compete in the global business environment by reinforcing earnings base. The accounting scandal of Toshiba took place because company had to face global competition from around the world and executives attempted to show that company is successful (Hass, Burnaby, & Nakashima, 2018).

The major ethical issue in this case is that the company had communicated wrong results to the stakeholders and more specifically the shareholders and investors. Operating results were altered by company by more than $ 1.2 billion from the time of financial crisis 2008. The problem was that the company set the operational goals which were impossible to achieve. There were no written documents which could show the approach of management in terms of setting impossible targets and many leaders in company did not even know about existence of any problem. The profits were deliberately overstated by the company over a period of many years because there was no internal control practiced by the company. There were many fake transactions that took place just before the completion of some accounting period. It was the duty of auditors to find out this practice and put a check over it but they failed to do so. The management had a perception that set targets will be achieved by their employees. Another ethical issue is that the person who raised his voice over any issue was frowned upon by all other members. The organization valued teamwork for the achievement of the goals set by top management. The legal issues associated with this practice were improper implementation of the accounting principles and in some instances, ignoring the application of these principles. The industry played some part in forcing this practice because the corporate governance system in the country to look after such activities. This weakness of system allowed company executives to manipulate the figures to show wrong results and even the auditors did not catch any fraud in the financial statements.

**Major Issues and Actual Happening**

The issue started in 2008 when the chief executive Asutoshi Nishida stated that a loss of 18.4 billion Yens should not be announced because it was too embarrassing. The employees in company started to change the figures to convert this huge loss to a profit of 500 million yens. There were no written proofs of such manipulations found during the external investigation of the matter. The problem with such manipulation is that the company has to continue changing the figures in financial statements until these frauds are exposed and reported. The employees achieved the untrue goals set by the top management and they set even tougher goals for the next accounting period. All divisions were involved in the misrepresentation of accounting results. The continuous achievement of goals meant that there was a continuous increase in profitability of the company. It was suggested by the investigative authority that a huge penalty may be placed over the company for misstatement of financial results. They also analysed the financial statements prepared by Toshiba and there were four main characteristics of fraudulent activities. In the first instance, company understated the total amount of a contract by using percentage of completion accounting whereas the work in process aspect of the project was understated which resulted in an increase of sales and decrease in expenses. If any contract is noticed to be losing money, its total cost was underestimated at the end of accounting period which meant that losses from provision of contract were understated for the accounting period (Hock & Chung, 2008). There were manipulations of numbers in terms of part transactions and operating expenses in the visual products business of company. One of the accountants did notice some problems in financial representation of electronic goods segment of company but did not blow the whistle and did not share the information with any of his team member. One reason may be that whistle blowers were not seen as a positive character in the Japanese business world.

There was a carryover process used by company so that profits can be overstated by adjusting profits and losses. If the sales initiatives were not able to cover any gap, these carry overs were used to adjust them. The company used an accounting process that was based on used cash instead accrual system of accounting, overstated values in consolidated statements of accounting and an early record of reduction costs. The last aspect of fraud related to false representation of inventory of semi-conductor inventory by manipulating buying and selling transactions. The total restatement of income from continuing operations was 224 billion yen.

The Securities and Exchange Surveillance Commission started investigating the issues at Toshiba and presumed that legal charges will be put on the three men in power at the company. The public prosecutor had the opinion that criminal charges could not be placed on these people. The manipulation of earnings from buy-sell transactions was not regarded as illegal.

The Japanese culture comprises of obedience and deference which makes it easier for businesses to hide their wrong doings. There have been many stories of Japanese companies hit by various forms of scandals. In order to stop these frauds, the Japanese firms should forego the obedience factor to hierarchy. There were much developments in the US corporate governance after some major scandals in the USA and authorities have come up with the Sarbanes-Oxley act in 2002 and other related reforms to make a stronger system of corporate governance. The law requires that there should be more directors on the board who are unrelated to the core business of company so that there is a separation of interest between the business and directors. Their major goal was that the directors should represent external stakeholders and shareholders rather than working to benefit the internal stakeholders. The Japanese system of corporate governance is not very strong as compared to the US system. Japan was ranked very low in terms of corporate governance by a survey in 2010. Current government thinks that economy is improved by a stronger system of governance will improve the economy and bring in more investment from outside (Bremaer, Akio, Kotaro, & Kazunori, 2017). In 2003, the main idea in country was a company with committee which meant that all companies will have a committee to oversee the corporate governance issues. This was further changed to a company with nominating committee in 2015. Toshiba Company had more members on its board of directors and a small percentage of these directors were from outside of company. In other firms, there was a smaller number of members on board and they had a larger percentage of members from outside of the company. There is a whistle blower protection act of 2006 which was enacted in April 2006 and the fraud at Toshiba was reported by such a whistle blower in 2014.

The scandal happened because the firm followed individualism as the major theory. This theory implies that the only obligation of the business is towards stockholders whose wealth has to be maximized within the law. The company however changed the figures of financial statements to provide benefits to stockholders especially the revenue section was manipulated so that stock holders were benefitted in short-run. In the long run, company had to report their losses and hit the stockholders with decline in prices. A completely opposite theory is the utilitarianism that forces businesses to take all the stakeholders into consideration while making any decision. There is a sense of unhappiness in the stakeholders of Toshiba because there were 7000 employees who lost their jobs because of the scandal. Customers were unhappy because they will not be able to buy Toshiba products in future (Markelevich & Rosner, 2013). The stockholders lost a huge amount of money as the stocks fell by 40% as a result of scandal being reported. The only happy stakeholder as a result of this scandal is the securities and exchange surveillance commission because it identified and rectified the accounting errors in company records.

The government authorities made sure that there are more effective audits performed by auditors after the happening at Toshiba. There has been more detail pursued by the auditors while conducting audits at firms. More time is also spent on an average audit by the concerned persons. The companies put the majority of blame for Toshiba scandal on a weak corporate culture regarding governance in the country. More and more companies are increasing steps to comply with the rules and regulations already laid down. The companies also mentioned that they will shuffle employees in and out of accounting and finance departments so that they do not get too much used to the practices of company and cannot conduct any fraudulent activity (Wilson, 2016).

**Various effects**

There will be many implications of steps taken by authorities after Toshiba scandal. The steps taken are relevant in a way that they will not allow the same scenario to take place again. A stricter system of governance will also compensate the obedience-based system of Japanese firms because employees will follow the orders of their seniors but if there is something wrong, governance authorities will take care of that. Another relevance of these steps is that the accounting personnel will not be allowed to stay at the same position for a longer period of time so they cannot team up to undertake any fraudulent activity. This was a major reason for the Toshiba scandal to occur. In order for these solutions to be sustainable, the authorities have to take all stakeholders into confidence. All stakeholders should believe that the application of such actions will benefit them in the long run. Stakeholders such that shareholders will definitely benefit from these steps so they will consider these measures as sustainable over a longer period of time. From the perspectives of enforcing authorities, these steps will take a considerable time before they can be considered truly sustainable over a longer period of time. These steps will have much more value in terms of social impact because they will rebuild the confidence of society in the accounting records presented by firms. The auditors will be more respected in the society as well as their work will become more difficult as compared to the past. The financial aspects of these resolutions will be that companies will have to spend more money in hiring and keeping their auditors because their work will be more complex and important. One most important impact of this happening is an increase in auditor’s liability (Rahman & Bremaer, 2017). For the particular auditor, there were no serious implications of the event. There are three major authorities for announcing and implementing any punishment for auditors in case of any such occurrence. The SESC recommends any action against auditors to the financial services authority. There have been two actins imposed on Ernst and Young ShinNihon for wrong audit of Toshiba. The firm cannot take up any new audit case for three months starting from January 2016 and implementing a fine of an amount which is equal to two-year audit fee from Toshiba. There were seven accountants who were accused of being negligent in their duties. The firm laid off the CEO and imposed a significant pay cut on all the employees who were involved in practice. The stance of SESC was that Toshiba should be fined to an amount of 7.37 billion Yen but this fine was not imposed actually. The association of public accountants in Japan suspended the membership of Ernst and Young for three months from July to September. Toshiba itself cancelled the contract with the firm and made a new contract with PWC. The company has also announced that it will share information with audit committee more frequently.

**Conclusion**

The case of Toshiba in Japan has many implications for the current and future scenarios. On the organizational level, it has triggered a change of audit firm and application of better governance principles. On the industry level, it can force other firms to have more detailed audit reports and assess the role of personnel from accounting and finance department so that they can be held responsible for any wrong doing. The future for organizations will be tough in Japan particularly and all over the world generally (Peursem, 2005). In Japan, the business ethics culture will improve as other organizations will learn from the experience of Toshiba. On an international level, ethics culture will go from the individual approach to the stakeholder approach which will mean that there will be more importance given to concerns of all stakeholders of business. Auditors will also have to be more careful in selecting the clients because cases like these will affect their reputation. Both the companies and auditors have to work very hard to improve their reputation while working with financial and accounting data. There should be appropriate use of technology by both firms and organizations which will allow them to know any relevant trends in performance of a particular sector or organization. In order to curb such practices in the future, strong ethical practices have to be shown by businesses so that employees are ethically trained and raise their voice if they see some wrong doing.

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