

# Due July 24: Delivery of Case Study 1

## Assignment Questions

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

Answer: Given that there are 3 factors that contribute to fraudulent acts (the right opportunity, any type of financial pressure that can push a person to make unethical actions and the rationalization process, where the person's mind tend to make comparisons and assumptions which makes him/her feel unsatisfied with his/her work conditions).

I believe that in this case, the strongest fraud triangle's motivation was the **"financial pressure"**, as this discovered fraud scandal started in 2008, when the worldwide financial crisis was hitting its peak. It is stated that by that year, due to the crisis, Toshiba's has had a huge reduction of their profits, which was for sure the main reason that triggered these fraudulent acts.

Also, I've researched that Toshiba suffered a big pressure also after the disaster of Fukushima in 2011, which shook up the nuclear unit of Toshiba, as well as the computer's segment increasing competition's force.

It is also clear that the **"Opportunity"** factor was also there, as he corporation had a policy of personnel rotation, meaning that when the financial statements recorded losses, the responsible persons were not part of the team anymore and couldn't answer for it. It helped for sure, that for such a long period, profits were overstated

and certain costs were hidden from the balance sheet, and so many other false data were entered into the company's financial documents, without being disclosed.

Also, related to this motivation, was the facts that Toshiba's management decisions could not be challenged as defined by their corporate culture, and also by the fact that they used a cash-based method to create their income statements, as opposed to the accrual one – so, a lot of bad practices which give space to fraudulent acts to happen when the triangle is complete.

As for the “**rationalization**” motivation, we have no proofs that tell us that tell us that the board members who were behind these fraud scheme had rationalized and in what way, but we for sure know that, to occur such an accounting fraud, these 3 factors have to present. I would say that the board members who have conducted these misleading practices were consumed by the need to continue their previous comfortable life and though it was somehow, their right to get more earnings that they were supposed to have in those crisis years. This was clearly a motivation focused on greed and unethical ambitions.

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

Answer: The biggest issue for the stakeholders after such a fraud case, is to recover the trust in the company's governance.

And of course, what really interests investors is their earnings, and with this case, after these 8 years fraudulent scheme happening, Toshiba's shares had a substantial decrease from the peak stock price. So, I'm sure investors, which worry about the companies' cash generating power perspective, were very worried and rethinking

whether they should keep investing on this corporation or not, as to recover from all its losses, a lot of assets would have to be sold and the decrease on the stakeholder's shares was guaranteed, as the financial statements show – if we look at the statement of cash flows for instance, we can find a substantial reduction of the cash and cash equivalents in the end of the year, as 6 years' time, it has decreased to 50%.

Then, penalties were requested to be paid due to the offensive and misleading acts made over the years, and it was also very likely that Toshiba would start having issues with the financial institutions and that could bring real problems to the company's investors.

The other strong issue Toshiba had for their stakeholders is the lack of transparency of their financial decisions and results.

It was also clear that investor were really confused, questioning the reason's why such a scandal occurred in such a stable and reliable company as Toshiba.

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

Answer: If I was a Toshiba's employee I would be really upset and would try to create a committee with all the other employees, pressuring the management to change their practices, as it is not only the reputation of such a mature, experienced and reliable company's name that was in risk, but also the sustainability of my job and my career.

The main ethical issues involved in this case the lack of trust provided by the board members, and the serious failure in the transparency of financial statements and

management methods. And in my opinion, Toshiba showed lack of ethics to the entire community (stakeholders, consumer and to the government as well)

One of the things that impressed me the most in this case, in terms of unethical behavior, is the fact that management decisions are not questionable and there's a permanent rotation of personnel. Those, of course, are the first steps to create a management structures that do what they wants, and that can hide fraudulent acts without being discovered easily.

I believe that was also very unethical the way Toshiba's managers have set some unattainable objectives for the context the world was living, and that made all the employees work a lot for something almost impossible to achieve, and in the end they came up with really bad results, and it was not the employee's fault at all.

Above all, it is very unethical to hide financial information of a company, mainly such a complex and big one, like Toahiba, and to manipulate information, such as debts and credits, that were declared in accounting periods that were not real, as a way to manipulate the results of the period accounting. These are very serious practices that undermine the credibility of a company.

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

Answer: In order to compensate the loss and regain the trust of the society in general, I believe the first action should be to restructure all the management team, and starting to be more demanding with the profile needed, and with the requirements for each job position and exploring better the background of each person chosen for important roles in the company's administration.

There is also the need to change a lot the practices of Toshiba in terms of transparency on the results they disclose, opening up the financial reviews and giving more explanations on the company's financial movements, mainly to the shareholders, (as this case clearly states that there was a lack of communication between the management of the company and its shareholders). The company could also try to involve more other employees on decision and analysis processes and it will be very important that they start (if they haven't done yet), involving external consultants to supervise the work of the internal auditors and if possible, to change the external company every few years, to make sure that even those auditors are not corrupted and involved in possible future fraud schemes.,

Another action to move forward could be to brainstorm a way to pay in the shortest time the long-term debts, which have increased a lot in these years where fraud activity was taking place.

I agree with one of the actions stated in this article, that says that "Toshiba will scrap its monthly president's meetings", and move the company into a very different focus, creating realistic and attainable objectives that will not be only defined by the TOP management, but should be created by each teams.

So, in general it looks to me that Toshiba will need to "organize the house" in terms of management, as its disorganization was one of the factors which allowed all this scandal to occur in first place.

Strengthening and improving the internal audit work would also be essential, putting into practice new methods of internal control and stricter rules, in order to improve the company's management structure and avoid such situations in the future. The company should also ensure that all accounting information is communicated to the responsible authorities in each country in which the company operates, who must carry out the necessary audits.

To avoid similar situations in the future, I would also improve the following company's financial practices:

- Better control of all the activities and stronger risk assessment
- Improve the communication processes
- Guarantee more segregation of duties (making sure there is an independent internal verification to assess the monthly results, and whose work should be confirmed by an external analyst as suggested above)
- Better human resources control, maybe trying the tactics of rotating employee's duties once in a while, to avoid a "vicious circle on accountability".

Patrícia Mesquita

23/07/2021