

# Lessons from the recent Toshiba problem

By

Ramki

22 Jul 15

## The extent of the scam

- Expected hit estimated at \$1.2B to \$1.6B
- Some reports suggest it could be as high as \$3.2 B

# Was a star in Corporate governance!

- 140 years old Company
- Very reputed
- Shares in every pension fund of Japan
- In varied businesses like Nuclear power, Laptops/PC, Infrastructure, Chip making , Televisions etc
- **Met or surpassed new set of Corporate Governance guidelines brought in last year by Japanese Govt.**
- 4 outside directors (quarter of total no.) –twice the norm!
- One of the earliest to admit outside directors in Board
- One independent director was a Morgan Stanley banker and another University professor of repute
  - Satyam also had a great Board and stars in it!

# How it surfaced?

- Whistle blowing
- SESC (Securities exchange surveillance committee) launched investigation
- By an external panel of lawyers and accountants
- Result- 82 page summary of findings

# The scam –details

- Accounting gimmicks and short cuts in all divisions of the company
- Intentional inflation of profits
- ‘Institutional accounting malpractices’
- Over 6 years!
- Initial estimates were around 50B yen and now over 170B yen (Profit for last year 51B yen)
- Biggest scam in Japan after Olympus (in 2011 spread over 13 years)
  - Read [Lessons from recent Olympus problem](#) 29.11.11

# Areas of accounting problems

- Percentage of completion estimates wrong/inflated in infrastructure projects
- Despite rise in material costs and loss due to exchange rate fluctuation, adequate reserves not created
- Losses in construction contracts not recorded in timely manner
- Under-stating /deferring reporting of costs
- Failing to book appraisal/valuation losses
- Less loan loss allowances
- Deferred tax assets overstated
- Medical subsidiary Toshiba medical info. Systems also overstated results for many years

# Reason

- Due to recession and Fukushima disaster, sales and profits were under huge pressure
- As demand fell for products, pressure built up to show better sales and profits, from bosses
- **Corporate culture where it was impossible to go against the wishes of the bosses.**
- Pressure also from clients who were Government linked projects

# What went wrong?

- Two out of four independent directors diplomats with no commercial experience
- Past CEO/CFO's had a huge say in Company
  - **“Biggest cause that ruins Japanese companies is Governance led by former executives”**
- Past CFO's were audit committee chairman
- Rivalry between key top management people leading to employees falling into 2 factions that blamed each other



# Was top management involved?

- Suspected systematic involvement by top management
- Top management pressurized executives to meet increasingly difficult profit goals
- Instead of telling executives to cook the books they told under performing divisions such as TV, that they may withdraw from the business if targets were not met.

# Auditors

- Ernst & Young Shin Nihan, Japan
- Insufficient explanations were provided to auditors
- Japanese Institute of CPA's reviewing files and interviewing auditors
  - They can
    - admonish, suspend or expel auditors and
    - Impose penalties

# The impact

- Share value has come down by 25% since Apr 15
- Hisao Tanaka –CEO resigned along with 7 other officials
- Half of the board removed
- Mar 15 accounts not yet finalized (may take upto Aug end)
- Dividend suspended
- Cost to insure debt has jumped by 62 basis points
- Company bonds downgraded to lowest investment grade
  - Big blow to PM Shinzo Abe who is campaigning for Corporate Governance reform

# Lessons

- Corporate governance can not ever be legislated
- Corporate governance rules, Jsox etc. can be easily followed or even surpassed without any visible results
- Governance led by former executives is a joke
- Quality and not quantity of directors counts
- Corporate culture should allow employees to show dissent to bosses
- Scams do not happen overnight
  - But once you ‘mount the tiger’ there is no looking back!
- Auditors need to show much more skepticism?
- Whistle blowing works! (Thank God something works!)

# Sources

- Scandal Upends Toshiba's Lauded Reputation - The New York Times
- Toshiba's accounting firm Ernst & Young- Asian extractor
- Regulators to seek penalty on Toshiba for false accounting ( Japan Today\_ Japan News and Discussion)
- Toshiba accounting scandal snowballs to 24 cases, ¥54.8 billion \_ The Japan Times
- Toshiba cancels dividend, pulls outlook in accounting scandal \_ Reuters.html

# Sources contd.

- Toshiba CEO Resigns After Accounting Scandal – WSJ
- Scathing report says Toshiba CEOs had role in accounting scandal - FT.com
- The 7 Biggest Corporate Scandals in Japan - Bloomberg Business
- Toshiba boss quits over £780m accounting scandal \_ World news \_ The Guardian
- Toshiba CEO quits over accounting scandal \_ Reuters
- Toshiba Executives Resign Over \$1.2 Billion Accounting Scandal - Bloomberg Business
- Toshiba CEO quits in \$1.2 billion accounting scandal \_ The Verge