The unethical impact of creative accounting on the financial performance of companies OLYMPUS SCANDAL

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Abstract: The motivation behind this examination is about the risks of utilizing what is known as inventive bookkeeping as a result of its effect on decorating fiscal reports and indicating them in an unreasonable manner, which was the reason for the worldwide monetary emergency that hit the economies of the creating and created world the same. The utilization of innovative bookkeeping with its perceived techniques prompts an absence of unwavering quality in the budget summaries, which significantly affects the assessment and choice of the inner and outer client of the organizations and associations put resources into, and therefore the effect on the monetary situation of the organization in the currency market and its deficiency of intensity in the realm of business.
Keywords: Creative Accounting, Competitiveness, Financial Statements, Scandal, Accounting Fraud..

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1. Introduction

Olympus Corporation (オリンパス株式会社 Orinpasu Kabushiki-gaisha?) is a Japanese manufacturer of optics and reprography products. Olympus was established on 12 October 1919, initially specializing in microscope and thermometer businesses. Olympus enjoys a majority share of the world market in gastro-intestinal endoscopes. It has a roughly 70% share of the global market whose estimated value is US$2.5 billion. Its global headquarters are in Shinjuku, Tokyo, Japan.

In 2011, the company gained coverage in global media when it fired its newly appointed British chief executive (CEO) Michael Woodford. Woodford, a 30-year Olympus veteran and Olympus' president and chief operating officer (COO) since April that year, had sought to probe financial irregularities and unexplained payments of hundreds of millions of dollars following his appointment as CEO. Although the board initially dismissed Woodford's concerns via mass media as being "disruptive" actions and Woodford as failing to grasp local culture, the matter quickly snowballed into a corporate corruption scandal over concealment (called Tobashi) of more than 117.7 billion Yen ($1.5 billion) of investment losses and other dubious fees and other payments dating back to the late 1980s and suspicion of covert payments to criminal organizations. By 2012, the scandal had developed into one of the biggest and longest-lived loss-concealing financial scandals in the history of corporate Japan; it had wiped 75–80% off the company's stock market valuation, led to the resignation of much of the board, investigations across Japan, the UK, and US, the arrest of 11 past or present Japanese directors, senior managers, auditors and bankers of Olympus for alleged criminal activities or cover-up and raised considerable turmoil and concern over Japan's prevailing corporate governance and transparency and the Japanese financial markets. Woodford himself, who stated he had received death threats over his exposing of the cover-up, received a reported £10 million ($16 m) in damages from Olympus for defamation and wrongful dismissal in 2012; around the same time, Olympus also announced it would shed 2,700 jobs (7% of its workforce)] and around 40 percent of its 30 manufacturing plants by 2015 to reduce its cost base. The company is owned 17% by two large camera makers, Sony and Mitsubishi (makers of Nikon).

Facts and timeline of the olympus scandal

In 1980, Toshiro Shimoyama was the president and CEO of Olympus Corporation. Olympus' operating income fell significantly because of the sharp appreciation of the yen. The CEO decided to develop an aggressive financial assets management unit within the Accounting Department headed by Hideo Yamada. This unit was to make speculative investments known as zaiteku. From these aggressive asset management activities, handsome profits were produced.

In 1987, with Yamada in charge of the speculative investments deal, a man named Hisashi Mori became his subordinate in the investment dealings. In time, Yamada and Mori's dealings propelled them into upper management. Mori became an executive vice president and board director while Yamada became a standing corporate auditor. Ten years passed before the speculative investment activities resulted in substantial losses.

Yamada and Mori's investment group doubled and tripled down by investing in high-risk, high-return products, and risky financial products that offered interest advancement as well as the riskier, complex structured bonds.(McKenna, 2012)

By the late 1990s, investment losses at Olympus had reached nearly $100B yen. Yet Yamada and Mori continued to bet money in risky investments in a desperate bid to recover losses. These losses were masked through a Japanese accounting standard that allowed financial assets to be accounted for at historical cost basis versus writing them down to a lower market value. In 1997, the accounting laws were modified which forced Japan to adopt the fair value accounting system, or "market-to-market accounting," as part of its implementation of International Financial Reporting Standards. (Mintz, 2012) As accountants, Yamada and Mori knew they would soon be forced to reveal the fair value of the impaired assets they were holding.

In 1998, with President Shimoyama's knowledge and approval, Yamada and Mori came up with a "loss separation scheme" to work their way around the new market-to-market accounting laws. It would transfer the nearly worthless financial assets Olympus had acquired to entities whose accounts would not be consolidated back into Olympus' financial statements. These entities are referred to as "shell companies," which are off balance sheet companies. This scheme involved selling the assets to parties that would accept them at book value. It would be necessary to create dummy entities that Yamada and Mori could influence in order to continue to hide the losses. Olympus asked the President of Axes Japan Securities and the President of Axes America to set up these dummy entities. The president of Axes Japan Securities and President of Axes America were asked by Olympus to set up these dummy entities. In 1998, the first "receiver fund," or dummy entity, called Central Forest and registered in the Cayman Islands, was set up to hide the losses. Yamada and Mori obtained financing from a bank in Liechtenstein. As collateral to obtain a loan to finance this dummy entity, Yamada and Mori deposited Olympus-owned Japanese government bonds valued at about 21 billion yen with the bank in return for 30 billion yen from them. Olympus' Asset Management also invested 35 billion yen in a class fund managed by this bank, which found its way into this dummy entity as well. Aside from borrowing from the bank in Liechtenstein, Yamada and Mori used a bank in Singapore to get another 45 billion yen into the dummy entity. After Central Forest was set up, Yamada and Mori began setting up the second dummy entity called Easterside Investments. Yamada and Mori invested another 60 billion yen into a different fund whose bond portfolio was lent to this dummy entity. (Bacani, 2011)

Up until 1998, Yamada and Mori succeeded in hiding these assets with a combined book value of 64 billion yen in Central Forest. Adding one last dummy entity, Yamada and Mori set up Quick Progress, having a book value of 32 billion yen. Yamada and Mori knew they needed to find a way to make the losses disappear, so they began to set up a loss disposition scheme. This involved the purchase of start-ups and entrepreneurial ventures at vastly inflated prices and payment of huge advisory fees for merger and acquisitions (M&A) deals.

They used part of the money that flowed out of Olympus for these inflated purchases to retire the loan from the banks. Those banks financed the dummy enterprises and other obligations, and then would bring back the money that went into the investment funds.

The high purchase prices of companies were accounted for as goodwill on Olympus' balance sheet. Yamada and Mori believed they were golden because the goodwill would be amortized over time down to zero. Then the money that Yamada and Mori lost on bad assets was transferred to the receiver funds, which could be properly accounted for without anyone's knowledge. (McKenna, 2012)

Years later, Olympus' external auditor, KPMG, did not agree with the vastly overvalued goodwill ascribed to the purchases. Olympus was forced to take an impairment charge of 55.7 billion yen in March of 2009 and another 1.3 billion yen in March of 2010.

The company took a financial hit, but from Yamada and Mori's point of view, the impairment still allowed them to finally dispose of part of the investment losses they had hidden away in the receiver funds.

Yamada and Mori then embarked on a scheme to acquire a company named Gyrus. The purpose of this transaction was to make another attempt to disguise the 62 billion yen represented by the money invested in the fund lent to Easterside as goodwill.

The purpose of this transaction was to make another attempt to disguise 62 billion yen represented by the money invested in the fund lent to Easterside as goodwill. With this transaction, Yamada and Mori believed they would finally be able to retire the last of their investment losses. Yamada and Mori had to somehow inflate the purchase price, to account for the purchase of Gyrus; so, the two men overpriced the advisory fees for this purchase.

Acting as M&A advisors, the presidents of Axes America and Japan negotiated a cash payment of US $12 million of the grant of Gyrus warrants and preference shares that Olympus later bought back for US $670 million. Most of this money freed up the lent-out bond holdings of Easterside fund, thus allowing Yamada and Mori to redeem 3.2 billion yen.

This represented the last of the investment losses they had hidden away. The final step was to book goodwill from the Gyrus deal and to amortize that goodwill over ten to twenty years. Again, KPMG questioned the excessive M&A advisory fees paid out. (Bacani, 2011) Yamada and Mori waited until KPMG was replaced in 2009 by Ernst & Young before buying back the preference shares. Ernst & Young, in turn, allowed US $177 million to be booked as goodwill on the Gyrus acquisition.

In 2007, Olympus appointed British CEO, Michael C. Woodford. He immediately began questioning these transactions – specifically, the exorbitant M&A advisory fees. Woodford was fired by Olympus two weeks later after talking to management in an attempt to rectify the discrepancies with the books. Woodford then went forward to British authorities as a whistleblower.

In 2011, after years of investigation, Olympus was forced to create an independent committee; whose findings were made public on December 6, 2011. A six-man committee, headed by a former Supreme Court judge, was appointed to investigate the Olympus scandal. Olympus survived the prospect of being delisted from the Tokyo Stock Exchange (TSE). The TSE removed the company from its watch list for automatic ejection from the world's second-largest bourse. It filed five years' worth of corrected statements, plus overdue first-half results, just hours before a deadline set by the TSE(Japan Times, 2012).

Shuichi Takayama assumed office as President and CEO of Olympus after Shimoyama stepped down in November of 2011. In total, Takayama created three committees to look into the panel’s findings: a management reform committee, a committee formed of attorneys that would investigate the liability of the board directors, and

another committee made up of external lawyers that would study the liability of the non-directors and the corporate auditors.

Olympus set January 8, 2012 as the due date for filing lawsuits against directors, and January 17, 2012 for other persons, including audit firms.

As of 2012, Olympus is suing its current president and 18 other past and present company officials over the scandal, seeking up to 3.6 billion yen in compensation for the accounting scam. Olympus said that all board members subject to the lawsuit would quit at an emergency shareholder’s meeting to be held in March/April of 2012. On January 20, 2012, the Tokyo Stock Exchange decided to let Olympus stay listed after paying a small fine of 10 million yen or US $130,000(Japan Times, 2012).

In February 2012, Japanese prosecutors arrested and formally charged Olympus’ former chairman,TsuyoshiKikukawa, two other former executives, Hisashi Mori and Hideo Yamada, and three men from consulting companies who allegedly collaborated in the scandal, with criminal charges. Prosecutors started a fresh investigation over alleged falsification from 2008 to 2010. These six men faced up to 10 years jail time or US $125,000 fine. The Nikkei Newspaper also reported that Olympus was fined $1.2 million for false accounting (Gallagher, 2012).

Japanese, U.S. and British officials are still investigating the case. The stock price fell from a high of 2,769 yen on July 22, 2011 to a low of 460 yen by November 11, 2011. As of July 6, 2011, Olympus shares traded at 1,291 yen. (Tokyo Stock Exchange, 2012) As of this writing March 3, 2014, the stock had recovered to 3,425 yen..

The ethics they broken

They broke the recognizing the elements in the balance sheet because the company was using the GAAP principle and the used the fare value and it was not allow to them :-

(A historical cost is a measure of value used in accounting in which the price of an asset on the balance sheet is based on its nominal or original cost when acquired by the company. The historical-cost method is used for assets in the United States under generally accepted accounting principles (GAAP).

For example, say the main headquarters of a company, which includes the land and building, was bought for $100,000 in 1925, and its expected market value today is $20 million. The asset is still recorded on the balance sheet at $100,000.).

They used the off balance sheet :-

(Off balance sheet (OBS) items refer to assets or liabilities that do not appear on a company's balance sheet but that are nonetheless effectively assets or liabilities of the company. Assets or liabilities designated off balance sheet are typically ones that a company is not the recognized legal owner of, or in the case of a liability, does not have direct legal responsibility for. As an example, although loans issued by a bank are ordinarily kept on the bank's balance sheet, when some loans are securitized and sold off as investments, that securitized debt will be kept off the bank's books, and an operating lease is one of the most common off-balance items).

They recorded an real expense for the Acquisitions.

Were recognized expenses in the income statement when there is a shortage arises in the future economic benefits due to the lack of an asset or an increase in the commitment and measurable degree of confidence. This actually means that the recognition of expenses conducted concurrently with the recognition of an increase in liabilities or decrease in assets (for example, prove the benefits of employees or the depreciation of equipment).

Conclusion

This case study is suited to financial accounting classes as an ethics exercise.

First, top management was able to hide $1.7 billion in investment losses for nearly 20 years while external auditors lacked due diligence and failed to uncover all the falsified business transactions. Olympus' top management continued to pursue failed investments that resulted in major losses. The company was initially able to hide these losses by booking the assets at historical cost versus fair market value. When accounting regulations changed, it forced them to book their assets at fair market value. As a result, Olympus created off-balance sheet entities to hide these losses. In a final attempt to complete this scheme, Olympus purchased Gyrus and booked the investment losses as goodwill.

Second, the whistle blower was Olympus' own President and CEO, Michael C. Woodford. He was from Great Britain, and had been employed by the company for more than a decade in Olympus' Europe division. He was an outsider that began to question the large, questionable M&A fees. He was fired two weeks after attempting to address this issue.

Third, Woodford's charges gained credibility and the truth began to surface. Five months after the scandal broke in July 2011, Olympus stock was trading at a mere 16% of its former high. The company faced a potential delisting of shares from the Tokyo Exchange.

The firm was not delisted but paid a small fine of US $130,000. Olympus sued the President and 18 other officials. The Board resigned in April 2012. Japan prosecuted the Olympus Chairman Kikukawa, Mori, and Yamada as well as three consultants. Perhaps the Economist summed this up best with the comment:

This is not an accounting misdeed-it is a mindset. Olympus, and the response of Japanese officialdom, is less about a single, sad incident as it is a view about the malleability of rules, and the subjectivity of their enforcement. Until Japan's institutions of governance-those internal to the corporations, as well as external regulators and prosecutors change, Japan cannot change

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