



The Midnight Journal Entry Case Study

Business, Government and Society

MBA 605

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Introduction

The Midnight Journal Entry tells the story of Richard Okumoto, CFO of Electro Scientific Industries. Okumoto became suspicious of the company's accounting when he found several entries made just after midnight when the quarter closed. He found himself faced with a moral dilemma to find the truth and do the right thing. After investigating, Okumoto found the accounting entries to be deliberately manipulated. However, the accounting manipulation of ESI not only effects the business, it can have negative impacts on government and society.

Summary

Richard Okumoto began to work for the company on February 17, 2003. At the time, the company was experiencing significant hardships. In the fiscal year 2002, ESI weathered the worst downturn in the electronics industry in over 30 years (Lawrence, 2012). In order to generate greater profits and shareholder return, the company was reevaluating its market and product strategies. The company was also exploring an “informal merger” with another firm in southern California.

However, shortly after joining the company, Okumoto had major concerns. On February 24, Okumoto received an email from John Isselman Jr. advising him to forward a set of revised work rules, which terminated retirement benefits for Japanese, Korean and Taiwanese employees. Prior to the email, Okumoto assumed that the employees had already been notified of the cancellation of their retirement benefits and agreed to the changes (Lawrence, 2012). But that was not the case.

While closing the company's books for the third quarter of fiscal year 2003, Okumoto noticed a “sharp dip in accrued liabilities” and that several accounting entries had been made

around midnight on September 12, 2002. ESI had wiped out an accrued liability of \$977,000 associated with the anticipated cost of retirement and severance benefits to company employees (Lawrence, 2012). As a result, the company was permitted to report earnings instead of a loss.

On several occasions, Richard Okumoto spoke with members of management and the accounting team about his findings. For example, on March 4, he spoke with CEO James Dooley about his concerns that the reversal of benefits for Japanese, Korean and Taiwanese employees might expose ESI to litigation (Lawrence, 2012). On March 13 he attended a meeting of the board of directors' audit committee. At the meeting, he recommended that the company's financial statements for the previous two quarters be restated, and that it hire an independent accounting firm to conduct an audit of the Asian benefits issue (Lawrence, 2012). Each time Okumoto brought his issues forward, he was told to let it go.



Government Perspective

The government plays a key role in business markets. For example, in 1934 Congress created the U.S. Securities and Exchange Commission. Its purpose was to promote full public disclosure, protects investors against fraudulent and manipulative practices in the market, and monitors corporate takeover actions in the United States (Chen, 2019). One way that the SEC carries out its mission is with Generally Accepted Auditing Standards. GAAP is a term that refers to a set of rules, standards and practices used throughout the accounting industry to prepare and standardize financial statements that are issued outside the company (Arline, 2015). These standards help investors and creditors better compare companies. The SEC requires public companies to follow GAAP accounting to ensure transparency and protect investors.


ESI went public in 1983 and is therefore required follow GAAP accounting. When the company erased its retirement liability, they violated the rules set forth by the SEC and GAAP.

The company had manipulated its earnings in order to merge with another company. It was clear among management that this was fraud. Morrison Foerster, an outside law firm on retainer to ESI, had advised that it was illegal to cancel the retirement benefits without employee consent (Lawrence, 2012). The memo that advised of illegal activity was shared with members of management.

Business Perspective

Manipulation and fraud is bad for business. When manipulating earnings, companies appear better off than they actually are. Therefore, they may not have the means to pay investors which can lead to debt and bankruptcy. Businesses found guilty of fraud face severe consequences. For example, as Bankrate's successor in interest  Baton Holdings has agreed to pay \$28 million to settle the accounting fraud charges against Bankrate. According to the U.S. Justice Department, Baton admitted that former Bankrate executives inflated earnings, which led to at least \$25 million in losses for shareholders (Guerin, 2019). In addition, once revealed that a company cannot pay its investors, stock prices decrease and can lead  to a market crash.

Society Perspective

When accounting is manipulated, society can feel its effects. It has the power to put employees out of work once the fraud is exposed or collapses (Coenen, 2016). The public may even distrust our financial markets. The accounting fraud of ESI, may have caused its employee to lose their retirement benefits without their consent. Although private employers in Japan are not obligated to pay retirement benefits, doing so was considered a good industry practice, and since 1981 ESI had offered such a benefit to its employees there (Lawr , 2016). Not only would their actions violate law, it would also violate society's morals.

Correlation and Conclusion

Case Review of The Midnight Journal Entry

Business, government and society are interrelated and this is true with Electro Scientific Industries. The government sets laws and regulations in order to protect businesses and society. Such regulations include the formation of the SEC and GAAP. In spite of these regulations, ESI purposefully manipulated its liabilities to appear more profitable for a merger. The company retracted its retirement benefits for their Asian employees and erased the liability from its financial statements. Fraud can result in debt, fines, bankruptcy and much more for businesses. These actions are harmful to the society because employees may not only lose their retirement benefits but also their jobs. Because of these questionable ethics, society can lose faith in corporations and markets.

References

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Comment Summary

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Page 2

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