Livent—When Maria, When? – Lack of Moral Courage

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Livent, once the world's premier live entertainment companies, was sold in 1998 to buyers who soon found that the value they had paid for was an illusion. Livent had thrilled audiences with performances of *Phantom of the Opera*, *Ragtime*, *Kiss of the Spider Woman*, *Sunset Boulevard*, *Showboat*, *Joseph and the Amazing Technicolor Dreamcoat*, *Fosse*, *Candide*, and *Barrymore*. Needless to say, Garth Drabinsky and Myron Gottlieb, the creators of Livent, were suspected of fraud, but justice was slow in coming in Canada.

Whereas the U.S. Securities and Exchange Commission pursued fraud charges in 1999,[1] it was not until May 2008, over ten years after their alleged manipulation of earnings, that Drabinsky and Gottlieb finally went on trial in Toronto for two counts of fraud and one of forgery. The manipulations occurred from 1993 to 1998 and were reported to be significant. For example, according to the testimony of Gordon Eckstein, Livent's senior vice president of finance, an internal document showed a loss of $41 million for the third quarter of 1997 that was reported publicly as a $13.4 million profit after adjustments were made by accounting staff.[2] Eckstein also reported, "Just before Livent was sold, its managers wrote down the value of its assets to 'clean up the books' and declared a loss of $44 million for 1997."[3]

Maria Messina, Livent's CFO, had joined Livent in May 1996 after having been a partner at Deloitte & Touche, Livent's auditors. Messina had worked on the audit but testified that she did not become aware of the manipulation until July 1997, "when she saw a set of internal statements showing a loss of about $20 million for the first six months of 1997, then later saw a subsequent set showing an $8 million profit."[4] Interestingly, she never revealed the fraud to her former colleagues at Deloitte. In fact, she did not disclose Drabinsky's manipulative influence to any outsider until July 1998, when she met the new owner's CFO, Roy Furman. She then revealed the fraudulent behavior on August 6, 1998, when she met with Robert Webster, the new executive vice president, who had asked for a report on construction costs, the area affected by many of the manipulations.

Why did Maria delay so long? At first, she was shocked and numbed. She questioned her manager, Gordon Eckstein, who replied, "it's just income smoothing. Everybody does it."[5] She

[1] Release 99-3 SEC Sues Livent and Nine Former Livent Officials for Extensive Accounting Fraud; U.S. Attorney Files Criminal Charges Washington, https://www.sec.gov/news/press/pressarchive/1999/99-3.txt.
[2] Peter Small, "Livent Hid Large Losses, Court Told," *Toronto Star*, May 21, 2008, A7.
[3] Ibid.
[4] Janet McFarland, "Former Livent CFO 'Numb' over Extent of Fraud," *The Globe and Mail*, June 10, 2008, B3.
[5] Ibid.

was so shocked that she panicked and was “completely immobilized by fear . . . didn’t know how to get out of the situation and didn’t have the courage to expose the fraud and ‘take on’ Mr. Drabinsky and Mr. Gottlieb.”[6] Drabinsky, in particular, was somewhat famous and had a reputation for being frighteningly intimidating. “Instead she settled on a campaign of ‘baby steps,’ and tried to persuade M r. Eckstein to stop the fraud.”[7] During this period, she did work on manipulated financial statements. Eckstein’s proposal was presented at an executive meeting in February 1998, but it was not accepted. In April 1998, she wrote a memo to Drabinsky and Gottlieb, indicating that proposed adjustments were not in accord with GAAP and that she would not support them. This worked: the manipulations were abandoned, and some of the accumulated fraud was written down.[8] However, on June 30, when she met with Drabinsky to show him an estimate of second-quarter earnings indicating a loss of $13 million, he said, “these numbers are all f—— up. You don’t know what the f—— you are doing. You can’t show these to anyone.” Drabinsky then demanded that second-quarter earnings be boosted from a loss of $13 million to just $200,000.[9] This was the situation that she disclosed to Roy Furman, but she did not tell him about the earlier fraud. When asked why not, she replied, “How do you tell somebody that, when you are a chartered accountant? I was also obviously going to be destroying my own life. It just took me several weeks to find the courage to do it.”[10] She paid a high price. On January 7, 1999, she pleaded guilty to a federal felony charge and as a “36-year-old single mother of a 10-year-old girl faced up to five years in jail and fines as high as $250,000.”[11] In addition, she lost her chartered accountant designation.

Questions

1. What prevented Maria from disclosing Livent’s fraudulent profit and asset misrepresentations earlier?
2. Why didn’t Myron Gottlieb or Gordon Eckstein oppose Garth Drabinsky’s directions to manipulate profits or report it to the auditors?
3. What is the lesson to be learned from the Livent Case by investors, auditors, investigators, and other employed professional accountants who are expected to demonstrate professional skepticism?

Additional questions are available in the source publication: *Business & Professional Ethics for Directors, Executives & Accountants*, 9e, Leonard J. Brooks & Paul Dunn, published by Cengage Learning, Inc., ©2021, ISBN: 978-0-357-44188-6.

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[6] Ibid.
[7] Ibid.
[8] Janet McFarland, “Ex-Livent Executive Says She Blew the Whistle,” *The Globe and Mail*, June 11, B3.
[9] Ibid.
[10] Ibid.
[11] “Is Fraud the Thing?,” *BusinessWeek*, February 15, 1999, 104.

Source: Professional Skepticism Case Collection for Professional Accountants, University of Toronto Professional Accounting Centre, 2023, PAC website https://www.utm.utoronto.ca/pac/case-collections/enhancing-professional-skepticism-case-collection.