# Arthur andersen: questionable accounting practices

Business, Accounting

Arthur Andersen: Questionable Accounting Practices Name Instructor Course Date Arthur Andersen: Questionable Accounting Practices 1. Review the mandated requirements for legal compliance (from Chapter 4) and determine which requirements apply to the Arthur Andersen case. Explain your rationale. The Arthur Andersen case was marred by lack of legal and ethical compliance. Andersen had a conflict of interest because it undertook both auditing and consulting services for clients.

This contributes to accounting improprieties. A conflict of interest occurs when an organization or individual must make a choice to advance individual interest or those of another organization or group (Ferrell, Fraedrich & Ferrell, 2011). Andersen's provision of consultancy services made independent auditing difficult. The firm had an interest to protect within the organizations it audited. Independence encourages the auditor to undertake an objective approach. However, Arthur Andersen undertook a subjective approach that was driven by their business interest in the organization. Integrity is important to ensure auditor independence.

However, the audits lacked accountability and integrity. In order for companies such as Enron to increase the investor base, it was important for the financial statements to record positively. However, Andersen did not disclose the poor financial status among clients such as Enron, the Baptist Foundation of Arizona (BFA) and Waste Management. Investors and partners therefore operated on falsified financial statements.

Approval of false and misleading financial statements results in fraud. The firm approved reports such as inaccurate net income, expenses, inflated

earnings and reports for sales in the future during the present quarter. Obstruction of justice was also undertaken when Andersen shredded incriminating documents. This led to the destruction of meaningful evidence. These illegal activities involved legal matters pertaining to business. 2. Discuss how the issues with the Arthur Anderson case may have played out differently if the Sarbanes-Oxley Act had been enacted in 1999. The Sarbanes-Oxley Act of 2002 instituted new regulations that would be essential towards ensuring accounting and corporate responsibility.

Conflict of interest by the Andersen firm would have been limited by the act. The act has restricted accounting firms from providing a combination of audit and other services for similar clients (Halbert & Ingulli, 2012). This is stated under Section 201 of Services outside the scope of auditors; Prohibited activities.

Decisions and activities undertaken by the audit firm would therefore be independent of the interest of other services provided. This would have helped in ensuring that the audits were independent therefore preventing false financial information. Periodic reviews of audit firms would also have revealed the unethical conduct at Arthur Andersen that allowed release of false financial statements. Accounting misconduct would also have been prevented as the act discourages publishing of misleading and false statements by firms. Andersen allowed the release of quarterly statements that projected future sales and concealed crucial financial information.

Firms such as Enron and Waste Management would not have had the opportunity to mislead investors and partners through their financial

statements. In addition, auditors are expected to give reports to the committees that work for the board and not the company. Consequently, boards have the power to rectify and investigate audit reports.

Investigation of the Arthur Andersen reports would have revealed financial inconsistencies before the information was revealed to investors and partners. This would have been instrumental towards reducing the lawsuits against companies and organizations such as Sunbeam and the Baptist Foundation of Arizona. 3. Determine and discuss which elements of the framework for ethical decision making in business (from Chapter 5) played the biggest role in the Anderson case. Explain your reasoning.

Organizational factors played the largest role for ethical decision making at Andersen. Organizational factors include corporate culture and obedience to authority. Ethical culture is bred from corporate culture (Shaw, 2011). Andersen was primarily focused on increasing revenue. Employees who continually increased the revenue base through audits and accounts enjoyed high-level promotions. Quantity was emphasized over quality.

This compromised work quality. This organizational culture was not keen on other ethical aspects that shape the policy and guidelines of the organization. In addition, the company had untrained and inexperienced consultants and auditors. This would compromise integrity as they were frequently sent to client sites. Consequently, they were ignorant of company policies among clients.

Integrity was also compromised as Andersen lacked a system of checks and balances to review audit teams. They would therefore enjoy a level of discretion with respect to issuance of financials and restatements. A system of checks and balances enables an organization to identify misconduct among employees.

Checks and balances also instill a sense of accountability among employees. However, the employees were solely accountable for the level of revenue they brought into the company. Organizational culture therefore determined the services that were offered to clients. These services were therefore of poor quality and encouraged fraud. This perpetuated a cycle of financial impropriety in companies such as Enron, Waste Management, Sunbeam and the Baptist Foundation of Arizona. The organizational culture therefore lacked a suitable system to ensure compliance to ethical conduct. 4. Discuss how the situations at Arthur Anderson may have played out differently if their senior management had displayed the habits of strong ethical leaders.

Provide specific examples to support your response. Strong ethical leadership provides direction towards the establishment of an ethical culture in an organization. Specific individuals particularly leaders in an organization are linked to the operations of an organization. Ethical leadership manifests itself through personal character and integrity. If the management exercised honesty, the organization would have helped to provide partners and investors with the essential financial information.

Management that exhibits and encourages honesty reduces chances of fraud in an organization. Honesty would have prevented the release of falsified

financial statements that misled investors and partners. In addition, employees of Arthur Andersen engaged in fraudulent activities would have been eliminated. This would in turn prevent lawsuits from partners of their client companies.

Ethical leadership also constrains employees from activities that would lead to conflict of interest. The provision of both audit and consultancy services by Arthur Andersen presented a conflict of interest. Conflict of interest limits proper judgment and decision making within an organization. Andersen management should have instituted a system that prevented conflict of interest. This would have led to the decision to provide one service per client. Focus on quality instead of revenue growth would also have established an organization that provides quality services to clients. Therefore, misconduct and lack of compliance among employees would be limited.

An integrated system in which management is involved in the formulation of a system of checks and balances encourages accountability among employees. Transparency within the organization is ensured and ethics promoted. Therefore, ethical standards are transferred from the highest to the lowest level in the organization. References Ferrell, O.

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