

Nature of scandals perpetrators and their roles accounting essay

[Business](#), [Accounting](#)



A figure of accounting dirt has occurred within the past old ages, the consequence of which will go on to be remembered by the general populace. These dirt was blamed on series of factors, ranging from hapless corporate administration to the compensation-plan of top direction. Two of the most dramatic and popular dirt were Polly Peck in the UK in 1990 and Enron in the US in 2001. These two dirt were different in their own ways, but their end-results were similar - distraught stockholders lost their full life nest eggs, employees lost their occupations, creditors did not acquire paid back, and tons more.

NATURE OF SCANDALS, PERPETRATORS AND THEIR ROLES

In 1980, a company known as Restro Investment which was controlled by Asil Nadir bought 58 % of the portions of Polly Peck, a little company in the fabric industry for ? 270, 000. With this, he had control over the company and within 10 old ages of purchase, Polly Peck grew into a large company (Wearing, 2005) . Within the old ages 1982 - 1989, turnover, pre-tax net income, and net assets rose from ? 21 million to ? 1. 16 billion, ? 9 million to ? 161 million, and ? 12 million to ? 845 million severally (Jones, 2011) . However, despite its first-class consequences, Polly Peck was unable to pay its creditors. What was surprising was that although Nadir had merely 25 % of the portions as at 1989, he still controlled and dominated the board and the company as a whole. Nadir extracted hard currency from Polly Peck and transferred it into its subordinate companies like Uni-Pac before he finally transferred it out for his personal usage. These backdowns would look in Polly Peck 's histories as sum owed by subordinates and would later be

cancelled out as inter-company balance (Jones, 2011) . An probe by the Serious Fraud Office (SFO) besides revealed that Polly Peck cooked up its assets in some of its subordinates so as to call off out the sum owed by these subordinates to Polly Peck. What besides made the dirt worse were the accounting policies adopted by Polly Peck which were in conformity to the demand of accounting criterions at that clip. In 1983, Polly Peck adopted the SSAP 20 (Foreign Currency Translation) and take to utilize the mean rate to interpret its profitless points. Therefore, when it restated its 1982 fiscal statement in line with SSAP, there was an addition of ? 2. 7 million in turnover and ? 1. 5 million in net assets for that twelvemonth merely. Hence, Polly Peck continued with its mean method in interpreting net income and loss points, and from 1983-1989, Polly Peck made a net income before involvement and revenue enhancement of ? 599 million and within the same period, debited ? 415 million to the net income and loss history due to the motions on exchange. Of this ? 415 million, ? 56 million was as a consequence of the usage of the mean method in change overing its net income and loss points, while the balance was due to the interlingual rendition of its opening net investings. Hence, Polly Peck continued to turn each twelvemonth, as motion on the exchange was inauspicious.

Andrew Fastow, the CFO at Enron, was behind the creative activity of Particular Purpose Entities (entities set up to transport out certain activities) into which Enron could dump debts and generate income, thereby lead oning investors on the existent nature of their capital construction. With this, he was able to conceal debt worth over \$ 1 billion in the SPEs. Besides, due to

the fact that the US GAAP stipulated that such SPEs need not be consolidated if at least 3 % of its entire funding came from independent equity holders, Enron had the perfect alibi not to consolidate their statements with those of their SPEs. However, it was subsequently discovered that the equity was not really owned by independent 3rd party, but by Enron itself. Therefore, Enron should have consolidated the SPEs in the first case. Besides, Enron's CEO, Jeffrey Skilling pleaded with regulators to enable the company utilize the mark-to-market accounting method, thereby enabling him to set down \$ 65 million of net income for his section. This was entirely done to enable him run into analysts' outlook and besides obtain the promised compensation of 3 % of the value of his section's concern.

Enron's board of managers fell abruptly of their duties by putting aside the codification of morals and letting illegal partnership to take topographic point. Besides, the board did not follow through the probe carried out by the finance section since the compensation of Fastow. Although the board argued that they had no cognition about what was traveling on, the Powers Report stated that the board had failed in its oversight responsibilities (Gown & A ; Abelson, 2002) .

The audit commission at Enron had every right to look into the traffics that Enron was traveling into in order to halt it from the oncoming. However, they did not inquire any inquiries nor did they size up the boards (Peel & A ; Hill, 2002) .

Analysts on the other hand compounded the fraud by endorsing Enron and promoting people to purchase their portions even when the stock monetary value was falling. Whenever analysts opted to state otherwise, they would run into jobs with their employers. This was the instance of Chung Wu who was sacked by his director Price Webber because Chung sent an electronic mail to Enron 's investors stating them to `` take some money off the tabular array " as the fiscal state of affairs at Enron was non looking good.

Detriments TO STAKEHOLDERS OF THE ENTITIES

One of the negative effects of accounting frauds is the disadvantage it normally has on stakeholders like creditors, employees, stockholders, and any other individual or group of people who have a good involvement in the house. As respects Polly Peck, it was revealed that they owed over 1.3 billion to creditors. And to do affairs worse, these creditors merely received 4 pence for every lb they were owed. Besides, most stockholders every bit good as 1000 s of pensionaries lost all of their investing. Ten 1000s of employees besides lost their occupations.

As with employees at Enron, they were deceived into believing that the company was still making good and were farther prevented from selling their stock or diversifying their portfolio even while the top executives were selling theirs. They watched haplessly as their life nest eggs vanished from their eyes. As a consequence of the dirt, the reputations of top direction was destroyed and it led to some of them like Jeffery Skilling, Andrew Fastow, and Kenneth Ley being persecuted and later imprisoned. Since the investors at Enron, both institutional and single investors lost an immense sum of their investing

because they were deceived into believing that the house was still executing well. Regarding executives and senior direction, unethical patterns were paramount in Enron whereby those who played along were showered in compensations and wages, while those who challenged the traffics were persecuted.

GOVERNANCE ROLES THE BOARDS HAVE OVER THE ENTITIES

The board of managers are those who are responsible for guaranting that the company is being managed by the directors in the involvement of the stockholders, and they are responsible for keeping the ethical codification of the organisation. Board of managers are besides meant to supervise accounting patterns in order to guarantee conformity with accounting criterions, reappraisal wage strategies of top executives in order to forestall struggle of involvement arising, and guarantee independency of company 's hearers by revolving the audit house after every few old ages and forestalling the audit house from supplying both internal and external audit services. This was non the instance at Enron as the improper administration of its board of managers was one of the major jobs which led to its autumn.

It can besides be said that there was weak administration at Polly Peck as Nadir was able to travel big amounts of money without any employees or managers oppugning him. This was likely due to the fact that Nadir was moving as both president and CEO, thereby giving him absolute power and control and besides due to the deficiency of effectual control system within Polly Peck 's caput office in London. The control systems were so weak to the

extent that even the demand for double signatures on bank backdrops was absent.

ROLE OF EXTERNAL AUDITORS AND AN ASSESSMENT AS TO WHETHER THEIR AUDIT DUTIES WERE FULFILLED

The hearers of Polly Peck were Erdal & A ; co. (Turkish subordinates hearers) and Stoy Hayward (UK- based group hearers) . Erdal & A ; co. collaborated with Polly Peck in the uses of their histories and this led to the exclusion of Erdal spouses from the Institute of Chartered Accountants of England and Wales, while Stoy Hayward was criticized on the footing of inefficiency in the appraisal of Erdal in transporting out the audit of the Turkish subordinates of Polly Peck ; inefficiency in reexamining Erdal 's working documents ; and failure to look into the causes of the unnatural growing in its subordinates.

SAS 82 requires external hearers to look for fiscal and non-financial inducements as indexes of fraud while transporting out their audit responsibilities. Harmonizing to Apostolo et Al (2001) , there were two of these non-financial inducements present at Enron which were ignored by Andersen. They were: compensation being linked to aggressive accounting patterns, and direction 's casual attitude over the internal controls. Besides, Andersen did non describe the revenue enhancement turning away strategy used by Enron. From another point of position, the drastic alterations in the fiscal statements of Enron were supposed to hold made the external hearers leery. Such as:

Why the operating income, Earnings per portion (EPS) , and gross borders fluctuated greatly between the old ages 1997- 2000

Why the stock monetary value increased enormously in 2000, when the EPS merely increased by a small per centum, and in fact gross border per centum dropped from 13. 3 % to 6 % .

With all this, it can be said that both Stoy Hayward and Andersen did non take a close expression at the ruddy flags which suggested that there could be fraud at Polly Peck and Enron severally.

AUDITORS CONFLICT OF INTERESTS

Hearers ' struggle of involvement refers to a state of affairs whereby the personal involvement of hearers struggles with their fiducial responsibilities, therefore holding undue influence on their duties and forestalling them from moving in the best involvement of stockholders. This struggle of involvement can be existent or perceived. Arthur Andersen was Enron 's external hearer, supplying it with external audit services, internal audit services and consultancy services. Coupled with the fact that a big sum of the house 's fee was from its non-audit work instead than its audit work, it can be stipulated that there was a menace to the independency of Arthur Andersen, thereby taking to a struggle of involvement. In add-on, the relationship between Enron and Andersen 's employees was so close that at Enron 's office in Houston, it was hard to distinguish Enron 's employees from Andersen 's. To decline the state of affairs, Enron 's internal audit staff became Andersen 's staff when Enron 's internal audit division was taken

over by Andersen. This depicts a true scenario of struggle of involvement as the independency place of the hearers has been compromised. Though Andersen argued that this relationship did not in any manner affect their independency place, it still was against the AICPA's (American Institute of Certified Public Accountants) codification of professional behavior demand that external hearers should at all times give the " visual aspect of independency " in order to give credibleness to their work.

In the instance of Polly Peck, the struggle of involvement that arose was on the portion of Coopers & A ; Lybrand, who were responsible for the disposal and receivership of Polly Peck. There was a struggle of involvement as they had portions in Polly Peck, audited its subordinates, served as advisers to the managers and reported on the company's prospectus (Sikka, 2004) . Besides as Polly Peck was one of Stoy Hayward's most established clients, there was the possibility of struggle of involvement as Stoy Hayward would not desire to lose a major beginning of their income.

LESSONS LEARNT FROM THE SCANDALS

Before the prostration of Polly Peck, stakeholders and the general populace found it difficult to understand how the company was doing its money even though it had no hard currency, but no 1 was making or stating anything about it, and there were no inquiries asked. Therefore, an of import lesson learnt is that inquiries should be raised and probes should be carried out when there is uncertainty, in order to place the possibility of a fraud before it's excessively late. Besides, Asil Nadir was moving as both the president and CEO of Polly Peck, thereby holding so much authorization and power which

means there was barely any segregation of responsibilities, doing it hard to acknowledge the fraud from the beginning. Hence, another lesson learnt is to hold two different persons moving as CEO and president, as stated in the Cadbury study.

One of the lessons learnt from the Enron dirt is that hearers should be rotated after a certain figure of old ages so as to keep their independency. In the instance of Enron, Andersen was its hearer since its origin in 1983, hence, the stopping point relationship between Andersen and Enron. This likely led to Andersen overlooking the abnormalities of Enron.

Besides, it was learnt that there should be a cheque on bonus-based compensation for employees, as this could hold made them beg any agencies to accomplish the declared fillip, even though it could be to the hurt of the company in the long tally.

How were these lessons incorporated into subsequent codifications on corporate administration? Explain what these codifications aimed to accomplish

As a disincentive for the dirt in Enron happening in future, the Sarbanes Oxley act 2002 (SOX) was introduced. This SOX does non undertake the issue of corporate administration by implementing codification of best pattern or rule, but by puting more duties on managers and senior direction. For illustration, the CEO and CFO must attest that to the best of their cognition that the one-year study and quarterly studies do non incorporate an untrue statement or skip of immaterial fact and that the fiscal statements and fiscal information reasonably represent, in all stuff facets, the true fiscal

status and consequences of operations of the company. Therefore, one of the purposes of the SOX is to do the CEO and CFO guarantee that fraud does not happen, otherwise they will be held responsible and penalized. The act requires all listed companies to hold audit commissions which will be responsible for finding their audit fees and naming hearers, thereby guaranteeing they carry out their work decently. These audit commissions must dwell of independent managers who must not, in whatsoever circumstance, obtain confer withing and non-board fees from the company, thereby beef uping their independency from the company. Audited account houses are prohibited from functioning as hearers of a peculiar house for a twelvemonth, if it so occurred that the CEO, CFO, or main accounting officer of the audited house has in any manner participated in the company 's audit while employed by the audit house, thereby avoiding any struggle of involvement on the portion of hearers.

Another measure taken was the constitution of PCAOB (Public Company Accounting Oversight Board) for the debut of stiff processs that will safeguard the hearers ' independency from direction and the ordinance of the profession. Besides, the PCAOB was put to supervise the audit of public companies in order to protect the involvement of investors.

The Cadbury study was published in 1992 after the prostration of some outstanding UK companies, including Polly Peck. The prostration was chiefly as a consequence of board inadvertence and weak administration systems. The Cadbury study is a study of a commission chaired by Adrian Cadbury which focuses on the agreement of company boards and accounting systems

to cut down corporate administration hazards and failures. It recommends the constitution of a non-statutory codification of best practice and administration issues in listed companies. This was known as the combined codification which was to go the anchor of corporate administration. The codification recommends that board of UK corporations or publically traded companies should include at least three outside non-executive managers effectual internal control systems should be put in topographic point, there should be transparency in its fiscal coverage, and that places of Chairman of the Board (COB) and Chief Executive Officer (CEO) be held by two different persons.

PRINCIPLE BASED CODES VERSUS RULES BASED CODES

It can be said that the codifications under the US Code of Corporate Governance (for illustration, Sarbanes Oxley Act) are regulations based while those under the UK Code of Corporate Governance (for illustration, Cadbury study) are principle based. The US Code of Corporate Governance focuses on quantitative steps such as audit commission and outside managers while the UK Code of Corporate Governance focuses on qualitative steps such as transparency and due diligence. This can be seen in the instance of Enron - although it met the quantitative steps of corporate administration, it failed to run into the qualitative steps. The regulations based codifications can be said to be regulator-led as the SEC are apt for implementing, implementing and supervising codifications of corporate administration, hence, have a one-size-fits all attack and gives small or no room for creativeness, while the rule based codifications on the other manus

can be said to be shareholders-led as the stockholders have the right to make up one's mind on what codifications are indispensable and suited to guard their involvement.

Harmonizing to Rezaee (2008) , the rules based attack is seen to be more effectual than the regulations based attack due to the fact that it is more flexible and enables the participants of corporate administration, for illustration hearers, audit commission and managers exercise their professional opinion, thereby, keeping the dependability and quality of the corporate administration system.

Your positions as to whether the corporate administration codifications have addressed all the issues raised or whether other countries need to be addressed either through codifications or through companies ain corporate administration processs

It can be concluded that though most of the issues sing the Polly Peck and Enron dirt have been addressed in the codifications of corporate administration, the issue of the audit commission has non been to the full addressed. Although the SEC requires listed companies to hold audit commissions, we believe they should be held more responsible and penalized if there is a corporate administration failure in the company which they are supervising.