Business ethics – the enron scandal

Sociology, Ethics

The Enron ScandalEnron was an energy and commodities company based in America which went bankrupt out of fraud perpetrated by the employees which was favored by professionals acting for the company. The scandal developed over time and it came to the public knowledge in October 2001 when the company was restating its financial statements to correct accounting errors. The adjustments resulted in restatement of net income by $500 million for that period and reduction of shareholders equity by $1. 5 billion and increased debt to $2. 5 billion. At the wake of these restatement revelations of false financial statement the market lost its $68 billion market value leading to collapse and eventual bankruptcy in December 2001 (Milhaupt & Pistor, 2008). The specific issue arose from a chain of failures which developed over time rather than a single breakdown. The Enron engaged in accounting fraud. There was use of unlawful accounting procedures so as to present its statements as though they were in sound position. They misused the generally accepted accounting principles (GAAP) where it allows securities to be revalued at market value for their benefit. They established the market price by selling part of its securities to third parties affiliated to Enron thus setting inflated price which they used to revalue assets in its balance sheet. It also engaged in sham hedging with related parties under its control which was designed to conceal losses it sustained by making it appear as if the amount was owed by a creditworthy third party. However, the capital of the counterparty was actually contributed by Enron which meant it was actually hedging against itself (Milhaupt & Pistor, 2008). According to Milhaupt & Pistor (2008), the company then abused the special purpose entities (SPEs). This is an act of transferring risk to an independent entity which is legitimate. However, they cheated on the 3% rule that is required so as not to consolidate the statements because the business was actually affiliated to Enron officers and not a third party. They then made several transactions especially debts off balance sheet with the aim of achieving favorable financial statements. In addition, they offered great incentives to executives who were engaged in the misconduct. The board failed in its oversight role due to its conflict of interests (Bauer, 2009). Moreover, the professionals who included the company lawyers and auditors acquiesced in the accounting fraud for failing to disclose what they knew about the company dealings. Finally, when all these information came to be discovered, it led to the bankruptcy (Milhaupt & Pistor, 2008). The business environment that allowed the systematic failures was that of compromise in Enron officers. The Enron corporate counterparts were being compensated and they also compensated their staff heavily at the expense of the company performance. The environment was that of failed board to carry out its oversight board as well as auditors who had conflict of interest in the company. The auditor, Arthur Andersen, was earning more consultancy fees than auditing fees creating a conflict of interest. Thus the entire circumstances, gave the opportunity for the systematic unethical practices which led to the ultimate failure (Milhaupt & Pistor, 2008). The danger signs were noticed by the auditor but failed to raise the issue. The other sign came out of its stock performance which was being manipulated. The stocks were too good to be true (Milhaupt & Pistor, 2008). There was a memo written by Sherron Watkins, former employee of Anderson raising the concerns of the treatment of various transactions.

However, the company retained its law firm to carry out the investigations and since it was its regular counsel it concluded that there was no cause of alarm and that all was ok in the Enron company. The situation was resolved by filing in bankruptcy by the company and its ultimate failure. There were investigations which led to the judging of several company officers including the auditor Anderson who were found guilty (Milhaupt & Pistor, 2008). The root cause of this failure is the fact that every person who participated did so in their own personal interest. The Enron officers manipulated the financial statements so as to benefit from their high compensation packages in pretence of best performance. The auditors and the lawyers were interested in their fees rather than giving out the true position of the company. This failure occurrence was driven by ethical egoism where the only interest was to promote is self-interest. This ethical failure does not contradict the principle ethical egoism because company officers, auditors and lawyers acted purely in their self-interests in Enron case. The consequence of this ethical failure is that it eventually led to the collapse of one of the largest companies in America which had a negative impact on the business community. It led to lack of trust in the professional bodies by several businesses. I believe that what should have been done was for the employees and professional firms to act in the best interest of the company by disclosing all the matters and not engage in unethical behavior to conceal the truth from the public. The Enron case tarnished the image of accounting profession and it should be repaired by focusing on the core value of integrity in the practice. There should be explanations to the public that it was one case and that tough measures have been put in place to cub errand auditors who are being held liable for their own information. The controls needed are those of independence of the auditors and board so as to lift the conflict of interest. There is no need for a firm to offer both consultancies as well as audit services as in the case of Enron auditors. Thus the issue of conflict of interest in all matters of company management beginning from officers, board and professional firms should be eliminated to allow independent judgments. Personally, I have learned of the ethical failure in business and how it can bring down an entire business empire and ultimately leading to prosecutions. Out of this knowledge, it has caused me to be more cautious in dealing with any sensitive information and always strive to offer an ethical solution while disclosing all information.