

# The most significant implications of the enron collapse essay sample



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## Introduction

Enron, the seventh top company in the United States until 2001, it collapsed because its' executive officers: the chief executive officer, the chief operation officer and the chief finance officer used the tool: the accounting standard of " market to market" to accommodate the financial phenomena. " Market to market" is an accounting principle that the focus of its' financial value is the present market price; however, the Enron's independent directors independent directors did not audit the problem of the financial situation. " Sarbanes-Oxley legislation" highlights the responsibility of business directors to supervise accounting affairs; similarly, Smith, the Management Consultant from the U. S. A (2007) emphasized that to conform the financial phenomena is not for legal way. Sarbanes- Oxley legislation is a regulation for corporate governance. In Order to fill the gap between directors and accountants, independent directors have to work in audit committee, likewise, executive officers could not change the accounting standard to cover up the financial problems. Therefore, the responsibilities of independent directors and choosing the disclosure and transparent accounting standard are important elements to manage a company.

## The responsibilities of independent directors

Wallison, the codirector of American Enterprise institute's program on financial markets deregulation (2006) believed that independent directors is an important part of corporate governance . He stated that independent directors and the contortion of financial status are problems in some companies. Cornfrod, the Bard college professor (2004, p. 7) argued that

independent directors failed to avoid the collapse of company at sometimes. These independent directors neglected in their management job. Eichenwald, the New York Times journalist (2003), cited in Hamon that independent directors intended to do insider trading and fraudulent behavior. Independent directors, lacked of the knowledge of company, supposed to be governing and their limited encouragement to know more risks management. As a result, Wallison implied that poor independent directors are the cause of the company collapse.

In Wallison ' s view, one of the implications is that the system of independent directors is a controversial issue. Independent directors or business representatives can get the implication through the independent directors' features: effects, role and number. Wallison insisted that the independent director is a controversial issue. His explication is that the experience of corporate scandals proves that independent directors are not effective in financial fraud. Although little cases support independent directors contribute to better company governance, there are only a few people try careful to be excellent outside directors.

Wallison insisted the connection between independent directors and corporate governance. If independent directors make negligence or mistakes, executive managers will easily practice fraud in the company, such as " preventing scandal", " financial manipulations", and " improving transparent corporate reporting". He insisted that the legislation's major features are telling independent directors should do their job to an " audit committee. " Moreover, to improve " corporate reporting " by internal control is their duty. Furthermore, a great independent director should know <https://assignbuster.com/the-most-significant-implications-of-the-enron-collapse-essay-sample/>

the importance to establish a “ separate quasi-government body”. In short, their best, the companies would have better governance.

Wallison also warned that no study supports the suitable number of directors in the committee. Sarbane-Oxley legislation was ambiguous in the number of directors of the committee. Independent directors can get regulation from Sarbanes- Oxley legislation. Because company had over half of the employees who are independent directors, the company still collapsed. So, the evidence shows that if independent directors want to avoid the tragedy, they need to keep their careful minds.

Changing accounting standard at current time

Changing accounting standard at current time is another important element of corporate governance . The issue is that administrators who do the confusion of financial status. Cunningham and Harris, the professor and his student (2006, p. 4), stated that Enron and Anderson did not emphasize on showing the truth financial report. Wallison insisted that the chief finance officer were violating the “ Generally Accepted Accounting Principles” for special purpose entity. Enron’s Chief Executive Officer failed to combine, selective use of the equality. Furthermore, Enron’s Chief Executive Officer failed to disclose full financial reports. While Enron members provided unfair financial reports, Enron and Anderson, the audit company, used the illegal way to manipulate the rule. Stakeholders can get implications through the Enron cases. As a consequence, Cunningham and Harris implied that the gap between accounting standard and the financial status cause of the Enron collapse.

Since the companies without stock business could not use the accounting standard of “ market to market” to accommodate the financial report, Smith, the Management Consultant from the U. S. A (2007) was found the other implication from the “ market to market”. US Securities and Exchange Commission agreed that the Enron Company to use the accounting standard “ market to market” to audit the financial report. Business representatives can get the implication of the market to market through the features: the value of each day and the inflection of current security price

In Smith’s view, current security price and corporative governance make connection between benefit and professional diagnosis. Accounting standard could improve disclosure and transparency because the accounting standard will impact the stock price. If executive officers are used “ accounting legerdemain” to cheat investors, nobody would find the truth immediately; likewise, if the managers can use “ market to market” to make the high stock price, nobody knows that the truly liabilities would exist in Special purpose entities. Despite the financial phenomenon happened, Managers have to face it. Clearly, if managers choose the right accounting standard in financial report at the beginning, it might not happen.

Business representatives were noticed that if people settle accounts with “ market to market” standard, assets would lose its value when the present value had been discounted (Smith, 2007). It is very dangerous if they cannot get income at future, this accounting standard will become the “ last straw”, and it is clear that if people want to avoid this situation. In brief, Fuller suggested executive officers choose “ balanced scorecard.” to choose an accounting standard. Consequently, it is clear that Sarbanes-Oxley <https://assignbuster.com/the-most-significant-implications-of-the-enron-collapse-essay-sample/>

legislation and balanced scorecard is suitable to solve the problem of the poor independent directors and the disclosure

### Future Development

If business representatives intended to become good independent directors, they should read Sarbanes-Oxley legislation in depth. Similarly, if people are intended to get a suitable accounting standard, they would choose balanced scorecard. Sarbanes-Oxley legislation and balanced scorecard are important elements to do better corporate governance. Therefore, to develop Sarbanes-Oxley legislation and balanced scorecard are very important for corporate governance..

Greenspan, the famous economist from the U. S. A, warned that the members of committee from outsiders is important (2007, p. 226). If people are to avoid Enron scandal, they should improve the internal auditors; nevertheless, if the company spends too much money on audit standard or auditor members, the budget would not enough to support it; in the same manner, if the company auditors to look for business adventure, the company would fall too. He was given an example to people: if an elephant is going to the other place, and people just use a rope to colligate it, the tragedy will happen. In fact, despite people are asking him the solution, he always argues later from that moment. In the mean time, Greenspan gave people an answer with no answer. Although other people mislead his meaning, he agreed that people should consider then to do their choose. Consequently, one argument is that the governance made “ Sarbanes-Oxley

legislation.” In the meanwhile, Smith shown that the other argument is balanced scorecard.

Another way to improve corporate governance is the balanced scorecard. Fuller, the editor of Long-Range-planning cited in maltz, aaron and rilly (2003) that business representatives use the balanced scorecard as a supervision institution and a fair way to corporate governance. Such Sarbanes- Oxley legislation as response, the balanced scorecard is a tool for governance. It consists of financial perspective, customer perspective, internal perspective and learning and growth perspective. People can get the answer that is suitable for the accounting standard. In Fuller’s view, the balanced scorecard helps people find the best balance between balanced and score. Fuller stated that if the governance had been better, Enron would keep growing up. Enron’s strategy is very successful to develop the marketing; nevertheless, the members of Enron did not use the balanced scorecard to do risk management and the best accounting standard for legal way. The balanced scorecard can help people to study, and then choose the best way to go. Accordingly, it is clear that if people use the suitable way, it would provide safety.