

Corporate fraud



Enron Corporation was the largest American company dealing on energy and Service Company before its bankruptcy in December of 2001. According to Michael (2011), it was one the biggest providers of gas and electricity, employing up to 21000 people by the mid 2001. It was the only company supplying natural gas to consumers. During this time, there was doubt regarding the future of gas industry causing prices to change drastically. Many producers and companies were unwilling to venture into the risky business. However, the company collapsed due to mismanagement and misappropriation of funds. This paper considers the nature of fraud by the corporation and its participants. In addition, the paper explores the role of the auditor in the fraud and why the external auditors failed to discover the fraud. Finally, the paper discusses the effect of fraud, as well as whether the stakeholders were charged and prosecuted or, otherwise, punished for their involvement in the fraud.

The management of Enron Corporation ensured that they had established limited liabilities so that they did not appear in their books of accounts and thus reporting a growing stock price. Additionally, many of the recorded assets and profits of the company were inflated or were non-existent in order to keep increasing investment and confidence. A deliberate fraud created the feeling of actual money, but actual lack of them implied a company financial sham. This organizational fraud affected all of the shareholders.

The management applied for government deregulation and granted meaning that the government could not regulate and authorize commercial activity of the corporation. The chief Executive Officer of the company was able to maintain agency in the earning reports released to the public and other

financial information users. This gave a leeway for the company to twist the earning reports, and remove any loss in order to attract investment into the corporation. Gary & Jean (2006) stipulates that the misrepresentation of profit without following the generally Accepted Accounting Principles ensured that the firm enjoyed profit. The executives of the company misused funds transmitted from investments privy to the true financial information. They continued reporting false information, and thus flourishing of earnings from the current shareholders. This had attracted new investors who desired to enjoy to the apparent financial gains.

Enron's stock price was so important because of its dealing with other firms in partnership. This allowed the company to get millions of investments which wrote off the firm's losses and affected Enron stocks. They established an extravagant process to conceal losses and the company's debts, so that it would seem to be profitable. The investment banks guiding Enron did this for them thereby profiting themselves. The purpose was to hide losses and debts and illustrate a profit, while at the same time borrowing cash. They could receive no money from investors thier they were aware about the true state of affairs. From their remarks, it appears that both Enron and the banks believed that their transactions were lawful and acceptable. Both internal and external auditors of Enron were from Arthur Andersen. This is a violation of regulations (Structured Finance). Enron's former Chief Executive Officers, Kenneth Lay and Jeffry Skilling allegedly played major roles in the bankruptcy, but did not directly affect the financial reporting and auditing issues.

Andrew Fastow former Chief Financial officer created a special purpose entity that permitted accounting deceptions reputed as a money wizard. It created the compound financial tool that propelled Enron's expansion. David Delainey was the Chief Executive Officer of the retail and wholesale energy divisions. He did the insider trading by participating in manipulating reported financial performance. Ben Gilson, a former treasurer and Fastow's assistant Michael Kopper, as well as Enron's Chief Accountant Richard Causey handled the conspiracy related to financial reporting deceptions. Enron's Auditor was Andersen's Partner David Duncan. He headed the Enron audit and allegedly orchestrated a document shredding campaign. Joseph Bernardino, supervising partner and CEO of Andersen, tried to protect its audit of Enron rather than admitting failures and accept the result (Gary & Jean, 2006).

The fraud involves fraudulent financial reporting and misappropriation of assets too. Enron misled outsiders and misrepresented its financial situation. Enron and their auditor Arthur Andersen were found guilty for committing one crime, obstruction of honesty, for having destroyed potential evidence by shredding documents, knowing that those documents could be used in an inquiry by the SEC. Enron and Andersen both acted with a recognizable disregard of any notion of ethical conduct. Ethically, Enron breached banking, legal and financial analysis profession, which were apparent in their presentation. Enron violated Generally Accepted Accounting Principles (GAAP) when recording books of their accounts. Firstly, there was a wrong accounting for SPEs including failure to consolidate and selective use of the equity method of accounting. This gave a leeway for the company twist of

the earning reports to remove any loss in order to attract investment into the corporation.

Michael (2011) stipulate that the misrepresentation of profit without following the generally Accepted Accounting Principles ensured that the firm enjoyed profit. The executives of the company embezzled funds channeled from investments privy to the true financial information. They continued reporting false information and thus flourishing of earnings from the current shareholders and attracted new investors who desired to enjoy the apparent financial gains. The accountants failed to deliver complete disclosure, interpreted by the GAAP in an aggressive manner and failed considering fairness in reporting financial information. Additionally, they ignored the legal standards that emphasize justice over detailed rules, as well as the accounting theory that emphasizes economic matter over lawful form (Michael, 2011).

Enron's auditor Arthur Andersen acted as both internal and external auditors. The Enron's auditors ignored accounting methods approved by the Professional Standard Group. Andersen auditors had informed the corporation that they would use the special purpose entity method in accounting. This was in opposition to the view of many experts, as well as the generally accepted accounting procedures. Later, Enron hinted to the Andersen audit team that the SEC had commenced an investigation concerning the Enron " special purpose entities" and the connection of Enron's Chief Financial Officer. Therefore, after an emergency conference meeting among top Andersen board addressed the SEC inquiry, and it

decided that Andersen auditors' documented the report to assist in counter to the SEC.

Therefore, Andersen partners gave the order to Enron's team who was engaged in this audit to search for all the audit and non-audit papers in connection to demolish. This demolition of papers, files, e-mails and computer related files took place at both Enron's and Andersen's offices. They held special meetings with Andersen personnel and instructed them to destroy which are relative to the SEC to be charge Enron. The internal auditors also participated in this document shredding. Then they commenced to tear up physical documents and erase computer records. Tons of papers linking the Enron inventory frayed as part of the arranged document were shredded. A methodical work commenced and carried out to erase the computer hard-drives and all E-mail system of Enron-related files. Therefore, Andersen as an internal and external auditor knew what was going on at Enron and discovered what had happened. However, to overcome the scandal they tried their best to protect Enron doing wrongful activities (Michael, 2011).

The stakeholders of a firm include individuals, groups, or other organizations affected by the decisions made by the firm. Variably, stakeholders may include governmental agencies, for example, the Securities and Exchange Commission, employees, social activist groups, self-regulatory organizations, suppliers, distributors, shareholders, the media and even the community in which the firm is located among many others. In Enron's case, some of the stakeholders also participated in the role of committing fraud such as accountants, bankers, etc. Therefore, such stakeholders were punished for <https://assignbuster.com/corporate-fraud/>

their involvement in the fraud done at Enron. David Duncan is a partner in the Houston office of Andersen, who headed the Enron audit and allegedly arranged the document destroying campaign. Joseph Bernardino, managing partner and CEO of Andersen, was also involved in the fraud and given imprisonment.

Carl Bass is the head of the Professional Standards Group at Andersen's Houston office had mislead the auditors accounting methods of Enron was also punished by the law (Gary & Jean, 2006). Therefore, Andersen became one of the participants of fraudulent activities with Enron. As a result, stakeholders such as Andersen's and Enron's employees, shareholders, bankers, suppliers, distributors and others who were involved in business activities with these companies also due to this fraud were affected and had to suffer. Employees of Enron and Andersen lost their employments and some were guilty and sentenced with imprisonments with regarding this. Their family's children faced hardships. Other companies were not willing to give them employment under them because they assumes the same kind of thing may happen to their companies if they hire them or their shareholders and their stakeholder will create problems if they employ these Enron and Andersen's employees.

Finally, we can say that most affected parties due to Enron scandal are the innocent employees, innocent partners, their families, and company's suppliers, distributors and bankers. The banks also did many billions of dollars business for Enron and organized many loans to keep Enron steady. They have given much advice to the company on its businesses dealings. When Enron needed to increase its income or to remove their losses from

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the balance sheet and the accounting books, these banks advised and assisted them in doing it. Citigroup and J. P. Morgan Chase were the main banks who got involved. Merrill Lynch & Co was also involved, but there were many more involved as stakeholders. Enron told the investors many lies and their bankers helped them to show it as the truth. Therefore, the investors affected and suffered due to this Enron Fraud (Structured Finance). We can say that Enron had played with the lives of their employees, investors, shareholders as well as many more people who were involved in their business.