Ethics and law in business and society flashcard

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I started to think about what type of a Law or a bill I would do for my policy paper, and it dawned on me after a week of thought and brainstorming that my uncle who was a Software Engineer at Enron had gotten laid off. He never likes to talk about it, but knowing that he had lost half of what he had earned in his entire life, was gone in an instant, motivated me to choose Sarbanes Oxley Act as my policy paper.

I was unable to speak to my uncle about his previous job at Enron, but keeping in mind how he has become successful again in his life motivated even more. Dr. Jasso had mentioned Sarbanes Oxley Act in class quite a few times, and used it as a key example for his lecture also. I knew the surface of what Enron had done, but did not know a lot about how Sarbanes Oxley Act was related to it. I will start off with a prologue of what the Sarbanes Oxley Act is, and later going in detail about the Act.

Prologue The corporate scandals in the year 2001 of Enron and WorldCom, where Enron was able to produce fake reports of high profits with false accounting methods and WorldCom, who artificially reduced their expenses to falsely increase in the appearance of their revenues, created a market failure. Major stakeholders such as investors, government, regulatory authorities, stock exchanges, citizens and board members just to name a few, were negatively impacted by these fraudulent events.

Many investors were becoming fearful and were losing confidence in businesses. Due to this market failure known as the “ Meltdown of 2001”, the government had to step in by putting new reforms into place for future avoidances of such major frauds. One of the reforms that were passed by

Congress was the Sarbanes Oxley Act. “ It is to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes. (First line in Sarbanes-Oxley Act)

The Sarbanes Oxley Act intended to bring back protection to investors through a series of laws in order to restore their confidence in the U. S. market in a time where the market was in a desperate need for help. I strongly believe that the implementation of Sarbanes Oxley Act has worked to recapture the confidence of investors and most importantly has brought awareness to the significance of why we need Corporate Social Responsibility for the long-term sustainability of a company.

The main objective Professor Jasso wants us to understand is “ the Sarbanes-Oxley Act as a public policy in response to market failure – that is when the market stops providing efficient and ethical solutions to society” (Jasso, 2009, p. 1). This means that he wants us to learn how unethical behavior can cause market failure and how through government regulation a public policy can be created to fix the market; the purpose of this paper is to look more into depth of the actions that led to the creation of the Sarbanes Oxley Act.

We will look at why the government had to step into the market and why the Meltdown of 2001 was clear as a market failure. We will also trace the Implementation of the Act by looking at two particular codes and to what agencies it pertains and also how it was passed in congress. Later on my policy paper, will describe the major impacts of Sarbanes Oxley Act had on businesses and society, till the present time. Lastly we will analyze whether

the act has been effective and efficient or not and whether investors have gained more confidence in the U. S. market and if businesses have been following the rules of being more accurate and reliable to corporate disclosures. The Past of Sarbanes Oxley Act In the article Sarbanes Oxley – Context & Theory, Professor Jasso describes the 1990's and the beginning of the millennium as the boom era, a time of much " technological innovation, exceptional economic growth, as well as a turnover in American political leadership" meaning the U. S. market was growing day to day and investors were comfortably investing their money in the successful market.

However, it was also simultaneously a time of when many well-known corporations were acting for their own personal benefit with morally wrong behavior. These morally wrong behaviors were experienced with Enron and WorldCom, the corporations who were part of the so called " Meltdown of 2001" – the year of corporate scandals (De Kluyver, 2009, p. 22). Enron acted as a disreputable company by not following the general accounting method procedures, which by falsely overstating their revenue, when however their real revenue was diminishing.

Thinking that they could easily modify their balance sheets with fraudulent information of revenue with the simple change of a number on a spreadsheet, Enron executives were ignorant and careless, taking home millions of dollars for their own personal gains and disregarding their stakeholders. Not thinking about how it would impact them and their future. They successfully hid their fraudulent activities for five years, until they were finally caught in the year 2001.

We can see that this fraud was made possible due to the lack of regulation of government that made “ Enron’s rise as a $100 billion company possible” (De Kluyver, 2009, p. 3); so even though they claimed to be making billions of dollars they were actually not and the executives involved in the fraudulent activities were taking home billions of dollars. Another fraudulent company that triggered the Meltdown of 2001 was WorldCom; they reported $3. 5 billion in expenses when in reality they had actually lost a staggering $1. 2 billion. WorldCom Company begins in 1983 as Long Distance Discount Services and in 1989 through a merger with Advantage Companies Inc. , it went public. The name in 1995 was LDDS WorldCom, and later changed to WorldCom.

On November 4, 1997, WorldCom and MCI Communications announced their $37 billion dollar merger to form MCI WorldCom Company, making it the biggest merger in US history at the time. CEO Bernard Ebbers became very wealthy from the rising price of the common stock in WorldCom. But, in 2000, the telecommunication industry went into a downturn from the abandonment of merger between WorldCom and Sprint due to US Justice Department in fear of creating a monopoly. In 2002, WorldCom declared bankruptcy, and paid a $2. 25 billion dollars in fines. The story did not end here.

Enron, which ended up in Bankruptcy, left 20, 000 of its employees jobless and without retirement funds. WorldCom had to let go of 17, 000 of its employees. Looking at all the occurrences of corporation fraudulent activities in the year of the Meltdown, investors started to gain fear and loose confidence in businesses and started to question what their real intentions

were. These scandals had a major negative impact on “ the welfare of the U. S. economy, the government, regulatory authorities, stock exchanges, investors and ordinary citizens” (De Kluyver, 2009, p. 4).

The fraud that was for the benefit of not more than ten individuals ended up affecting thousands of individuals and its stakeholders. Here we can see a clear case of a market failure, as described by Weimer and Vining; “ It is a circumstance in which the pursuit of private interest does not lead to an efficient use of society’s goods”, at Enron and WorldCom, executives were solely acting for their own private interest, enriching themselves with money in a corruptly manner, and as a result not being efficient to the company as a whole.

Enron ended up in bankruptcy and WorldCom had to let thousands of employees go. Had there been guideline of the government, these scandals could have been avoided and thousands of employees, who were just doing their job didn’t have to be affected in such a negative way; for this reason the government decided they had to step in to fix this market failure that these corporate scandals had created.

The government decided to make a series of reforms for the betterment of the regulation of the board, “ by making boards more responsive, more proactive, and more accountable” which means to have better communication within the firm and outside of the firm, for the key purpose of trying to regain the confidence of the business investors and all the other major stakeholders that were impacted by the meltdown (De Kluyver, 2009, p. 25).

One of the reforms that were passed by Congress was ‘ The Sarbanes-Oxley Act,’ which was implemented due to a market failure, since according to the economic theory, the market failed to produce solutions for the society, which was the case of this meltdown in 2001. The market did not just stop being competent, but it also worsened the situation by acting in the complete opposite way, but by being disreputable and impacting the society in a negative way. Tracing Implementation of the Bill The House passed Representative Oxley’s bill (H.

R. 3763) on April 24, 2002, by a vote of 334 to 90. The House then referred the “ Corporate and Auditing Accountability, Responsibility, and Transparency Act” to the Senate Banking Committee with the support of President George W. Bush and the Security Exchange Committee. Senator Paul Sarbanes (D-MD) was preparing his own proposal, Senate Bill 2673. Senator Sarbanes bill passed the Senate Banking Committee on June 18, 2002, by a vote of 17 to 4. On June 25, 2002, WorldCom exposed that it had overstated its earnings by more than $3. billion during the past five quarters, mainly by improper accounting for its operating costs. Senator Sarbane introduced Senate Bill 2673 to the full Senate that same day, and it passed 97–0 less than three weeks later on July 15, 2002.

The House and the Senate formed a Conference Committee to reconcile the differences between Senator Sarbanes bill (S. 2673) and Representative Oxley’s bill (H. R. 3763). The conference committee relied greatly on S. 2673 and “ most changes made by the conference committee strengthened the prescriptions of S. 673 or added new prescriptions. ” (John T. Bostelman, The Sarbanes–Oxley Deskbook § 2–31.) The Committee approved the final

conference bill on July 24, 2002, and gave it the name “ the Sarbanes–Oxley Act of 2002. ” The next day, both houses of Congress voted on it without modifications, producing an overpowering margin of victory: 423 to 3 in the House and 99 to 0 in the Senate.

On July 30, 2002, President George W. Bush signed it into law, stating it included “ the most far-reaching reforms of American business practices since the time of Franklin D. Roosevelt. The implementation of the new law was to steer clear of accounting frauds and bad corporate behavior from reoccurring by protecting investors and regaining their confidence in the U. S. market with new regulations and corporate governance requirements for public companies. The law was there to provide them with accurate and honest audit reports by having the Public Company Accounting Oversight Board established to oversee the audit of companies.

With the Sarbanes Oxley being established, the government’s goal was to fully protect investors, and more importantly regain their confidence and to try to create a place as Dr. Jasso describes “ for positive self-interest where buyers and sellers would grow capital, wealth, and the future” (Jasso, 2009, p. 5). This means that the U. S. market should be a safe atmosphere for individuals to invest their money and not have to feel the worry of any fraudulent activities from reoccurring that may eventually affect their future. Tracing the Act’s Implementation As stated previously, had there been government guidelines, scandals such as Enron and WorldCom could have been prevented. Since Corporate Social

Responsibility was lacking, there was no clear communication among the workers and executives. So with no communication, how would a worker at Enron really know if an executive was acting with integrity or not? However, another argument to support my view on the importance of Corporate Social Responsibilities is that maybe a co-worker at Enron actually did know that some executives were acting immorally by wrongly reporting profits on the accounting sheets for their own private interest, and disregarding the crucial effect it would have on the rest of the employees and stakeholders.

However that particular co-worker may have failed to speak out the truth in order to stop this fraudulent activity from worsening because he might have been afraid for his own self-interest. The executives might have found out that he was the one that found out about their fraudulent activities, or maybe the executives threatened that particular person’s life or the danger of his family, if he were to spill out the confidentiality to the public. Therefore, the individual chose to remain silent. This example could have likely occurred.

This case shows us the big fear many employees may have with the matter of whistle blowing. Because employees fail to be whistle blowers, out of fear, scandals such as those like of Enron have an even greater risk of occurring. For that, we thank Sarbanes Oxley Act; employees no longer have to deal with the fear of whistle blowing. Taking a closer look at one of the implementations of the Sarbanes Oxley Act in section 1107, code 18 U. S. C. § 1513(e), Retaliation against informant, states that “ Whoever knowingly, with the intent to retaliate, takes any action harmful to any person”…. Shall be fined under this title or imprisoned not more than 10 years, or both. ” This

statement strictly explains that if an employee ever wants to get back at someone by threatening their life or family for example by spilling out the truth about fraudulent activities, they will seriously be fined and/or imprisoned for their false actions. Further more, if any person goes against Sarbanes Oxley Act, it is also going against the Securities and Exchange Commission.

Therefore this shows how the Security Exchange Commission is associated with the Sarbanes Oxley Act and how the code grants authority to the Security Exchange Commission to implement the Sarbanes Oxley Act. Since the key person that had falsified profits in the case of the Enron scandal, was an accountant, it is probable that executives threatened the accountant's job, family, life or had even manipulated the accountant with a promise of paying him an immense amount of earnings for the practice of fraudulent activity he or she would get involved with.

We must understand that in the position of the accountant, he or she may have no way out, from this deal. Even if the accountant refuses to get paid for the fraudulent activities he/she is committing, it may go against his moral beliefs, which he/she can still be pressured to do it, due to job, life or family at stake.