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Business, Company

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Analysis of the Collapse of Enron

Introduction

Every business venture can be characterized by a series of ups and downs. A startup business, for example, may initially face a lot of problems, big problems at that, perhaps to make both ends meet. After the initial stages, the business may enter a period of stability. And that is where the cycle of ups and downs often begins. Enron, a business that started in the 1980s as a securer of oil and natural gas pipelines in the United States, is not an exemption. Its business life cycle may well be characterized by a series of ups and downs too. Enron’s earliest story started in 1932, during which its name was Northern Natural Gas Company headquartered in Omaha, Nebraska. Back then, the company was engaged with small scale energy dealings only.

The company entered a period of reorganization and reconstruction in 1979 during which the name was changed to Inter North. Having been involved in a series of mergers since its inception in 1932, Enron’s client base grew. Its operations and dealings also expanded. By then, the company was already doing major business operations in the natural gas production, marketing, transmission, and was also continuing to grow in the oil and plastic industry. Enron’s almost unstoppable streak of ups did not stop there.

The result was a rapid company downsizing which later on led to the company’s filing of Chapter 11 Bankruptcy after botched attempts to convince Dynegy, a relatively smaller player in the energy industry compared to Enron, not to walk out from the deal of buying Enron . As soon as reports about the company’s fraudulent corporate and accounting activities got confirmed and became proclaimed truths, the issue suggesting that the company was submerged in debts, huge debts, turned into truth. The objective of this paper is to analyze Enron’s collapse, focusing on the causes of its collapse, and the government and the economy’s response after it, specifically, the Sarbanes Oxley Act of 2002.

Many investors, economists, and market analysts were left bewildered and confused about what happened to Enron. The most common question back then probably was “ How could one of the United States’ largest blue chip corporations—something so big and so powerful, and also one of Wall Street’s key players disappear almost overnight?” Enron’s collapse was not just caused by the scandal but rather a combination of economic and intra-organizational factors.

Accounting Problems and Loopholes and Greedy and Dirty Management Culture

The Enron’s management team’s modus operandi went like this. Firstly, Enron would build an asset such as a network of natural gas pipeline, a power plant, or a new subsidiary (in some cases, the company acquires assets instead of building a new one). During the first few phases of the company’s fraudulent scheme, the source of funding for the asset acquisition or construction either came from profits or from funds from investors. As the company’s managers realized that they could easily get away with their hideous activities, they thought that if they could borrow money through bonds and loans to build more assets, they can make the company grow bigger. Eventually, this decision worked against them. After building or acquiring assets, the company will input immediate claims about those assets’ projected profits in its books despite the fact that the company was not able to get even a cent from it.

In the event that the acquired or constructed asset’s revenue was less than the projected and declared amount—the amount which was reflected in the company’s books, Enron would transfer those losses to an off-the-books subsidiary or corporation, making the loss practically invisible. According to reports, Enron established a couple of off-the-books subsidiaries for the very purpose of hiding their losses.

These were the two parts of the cycle that led to the company’s eventual downfall. The company kept on doing these two things. As a result, they were able to fool the investors, the credit rating agencies, and even the banks. The company’s stock price experienced sharp gains over the period that they were doing this fraudulent activity. This type of accounting practice led to the creation of the mindset that the company did not need profits to survive and expand; that Enron could easily write off and disregard losses and still interpret them as profits .

Conspiracy with Accounting Firms and Top Wall Street Firms

Normally, analysts, auditors through business auditing firms operating in Wall Street and in other places, would eventually be able to find out about the shady activity that Enron was engaged in for years. The reason why the company was able to pull off its fraudulent business for so long a time was the fact that the company’s CEO, Skilling, conspired with Auditing firms and many top Wall Street firms just so no one from the higher governing bodies would discover Enron’s secret recipe to success. Enron’s CEO showered its co-conspirers with lots of corporate benefits and luxuries. Eventually, despite the company's effort to conceal its dirty little secret, rumors about its fraudulent business scheme spread, prompting the United States Security and Exchange Commission (SEC) to conduct a thorough investigation. As expected, the investigation led to the uncovering of the truth which is what led to the scandal that caused the spiraling down of events for Enron, leading to its collapse .

The Purpose of the Sarbanes Oxley Act of 2002 when it was signed by President George W. Bush

Enron's collapse was partly due to the industry-wide auditing problems and loopholes. If Enron was able to fool the entire industry about its real business standing for so long a time, what assurance does the investors and other industry stakeholders have that all other existing and operating companies aside from Enron are not committing such fraudulent acts. This dilemma is the practical reason why the Enron scandal prompted the creation of reforms in auditing businesses to ensure accuracy, transparency, and to make sure that the things that led to Enron's collapse would not happen again in the future. Part of the market and the government's response to the events that happened in the Enron scandal was the ratification of the Sarbanes Oxley Act of 2002 (SOX), which is also known as the Public Accounting Reform and Investor Protection Act (Senate), or the Corporate and Auditing Accountability and Responsibility Act (Congress), under the George W. Bush administration.

The Sarbanes Oxley Act of 2002 is a U. S. federal law that enhances the then current legislations and standards for all public company boards and executives, and public accounting firms in the United States, following the events that happened in the Enron scandal. Under the said act, top management or board members and executives of public firms in the U. S. will be required to individually certify the accuracy and reliability of the financial information they will display on their public financial statements; penalties for inaccuracies, especially for intended ones, and other fraudulent activities and entries will also be more punitive and severe. The Act’s long title actually explains what it is all about, what its purpose is, and its intended benefactors. The long title of the SOX 2002 is “ An Act to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes” .

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