

The effects of enron crisis on audit firms research paper examples

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The Enron Crisis revealed in October 2001 is one of the greatest auditing scandals in the history of the United States of America (USA). It involved Enron Corporation which traces its history to 1985 when it was born from the Houston Natural Gas InterNorth (Fusaro and Ross, 2001). This followed the decision of Kenneth Lay to amalgamate the two firms to form one big corporation which has a dominant control over the energy market in Texas. Despite its enormous growth, Enron's troubles began after hiring Jeffrey Skilling as one of its topmost officers who were at the helm of the organization's management.

The Enron Crisis is a scandal which was caused by Jeffrey in collaboration with Andrew Fastow amongst other officers in this company. As the Chief Financial Officer, Andrew used his position to collude with other managers to defraud the Board of Directors and the company's audit committee. As a result of their actions, Enron Corporation published wrong financial statements to appease the shareholders. However, as it would later be discovered, this was a deliberate conspiracy aimed at laundering funds and defrauding the shareholders (Salter, 2008).

Surely, the occurrence of this crisis greatly impacted on auditing firms. Before its occurrence, there were laxities in auditing because of limited regulations. The auditing firms were strictly monitored hence creating room for them to participate in unethical practices such as biasness and recklessness. This was particularly observed at the then prestigious Arthur Andersen Auditors which deliberately chose to violate the regulations of the Financial Accounting Standards Board (FASB) which had been put in place to check on the actions of auditing firms. At the same time, the auditing

firms were not free to transact their activities autonomously. Just like Arthur Anderson, many auditing firms were manipulated by big companies which were dictating the mode of their services.

The other important feature about auditing firms before this crisis is that they were not accountable in their services. Most of them were not keen of discharging their operations as they ought to. Meaning, they were reckless and often generated inaccurate reports. This is what Arthur and Anderson did when it had been contracted to audit the accounts of Enron Corporations. In fact, it went ahead to engage in unethical practices when it opted to adopt merchant model instead of the more simpler and practical agent model which was popular amongst the auditing firms at the time. Because of this approach, it never yielded any fruit rather than complicating the simple figures and eventually confusing the unsuspecting shareholders. This is a clear indication of how the auditing firms were subject to manipulations by their contractors through whom they advanced the practice of conspiracy, money laundering and fraud.

However, these practices did not last because they were affected by the occurrence of the Enron Crisis. As already highlighted, the magnitude of scandals involved in this crisis compelled the government to take appropriate actions against the perpetrators. In other words, the break up of this incidence introduced several changes in the auditing industry. First, Arthur and Anderson Auditors which had been convicted of several counts of fraud, was forced to go out of business. Hence, on 31/12/2001, it surrendered its CPA license before being saved by the court of law which overturned the earlier decision (Eichenwald, 2007). However, even if it

managed to return to business, it lost its glory and has been dwindling up to now. This was a good lesson to the auditing firms which had been taking advantage of their skills to defraud investors.

Besides, this crisis led to the introduction of new auditing regulations to monitor the operations of auditing firms. One such law was the Sarbanes-Oxley Act which was enacted by the Congress in 2002 to provide a framework for checking the activities of the auditing firms in the country. As a new legislation, Sarbanes-Oxley Act was authorized to punish any audit firm which was convicted of violating the new auditing policies (Cruver, 2003). Since it had put the interests of the investors at heart, it helped in preventing the notorious auditing firms from defrauding them as they used to do before.

As a result of the introduction of these regulations, there was a big transformation in the auditing industry in the country. They became accountable, unbiased and accurate. They would no longer be susceptible to manipulation by the corporations which were engaging them in defrauding the shareholders of their investments in these companies. Moreover, they were to be transparent in their activities and were expected to reveal all the necessary information to the Federal Bureau of Investigations in case of any investigations. As a result of this, they became autonomous and accountable for their decisions (Collins, 2000).

In conclusion, Enron Crisis greatly impacted on the auditing firms in USA. The collapse of Arthur and Anderson which was one of the leading auditing firms in the country paved way for the reformation of the auditing sector. The

government became keen on this industry and enacted stringent legislations such as Sarbanes-Oxley Act to protect investors.

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