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RESEARCH ARTICLE

THE LESSON FROM ENRON CASE - MORAL AND MANAGERIAL RESPONSIBILITIES

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ABSTRACT

The Enron scandal, give out in October 2001, Enron Top officials abused their privileges and power, manipulated information put their own interests above those of their employees and the public and failed to exercise proper oversight or shoulder responsibility for ethical failings which eventually led to the bankruptcy of an American energy company based in Houston, Texas, and the dissolution of Arthur Andersen, which was one of the five largest audit and accountancy partnerships in the world. In addition to being the largest bankruptcy reorganization in American history at that time, Enron undoubtedly is the biggest audit failure. It is one of companies which fell down too fast. This paper will analyze the reason for this event in detail including the management, conflict of interest and accounting fraud. Meanwhile, it will make analysis the moral responsibility From Individuals' Angle and Corporation's Angle. Therefore, this paper will prove that the bankruptcy of the Enron was because of managerial scandal for the self benefit than shareholder's benefit of this company.

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INTRODUCTION

Enron's bankruptcy filing in November 2001 marked the beginning of an unheard signal of corporate scandals. Officials at World Com, AOL Time Warner, ImClone, Tyco, Adelphia, Global Crossing, Quest and Charter Communications joined Enron executives as targets of congressional hearings, stockholder lawsuits, SEC search and criminal indictments. Enron's problem, which had been center stage, was soon pushed to the background by subsequent revelations of corporate wrongdoing. Enron failed in large part because of the unethical practices of its senior officials. Examining the ethical shortcomings of Enron's executives as well as the factors that contributed to their misbehaviors can provide important detection how to address the topic of ethics in the leadership and more recent instances of corporate corruption should not diminish the importance of Enron as a case study in moral failure.

Enron Corporation Historical back ground

Enron Corporation can call as one of the largest fraud scandals in the world history.

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As a result of the fraud investigations, the company in December 2001 was forced to file for bankruptcy. Enron was "a provider of products and services in natural gas, electricity and communications to wholesale and retail costumers".[1] Enron Corporation has its roots in Omaha, Nebraska. In 1985, Houston Natural Gas merged with Inter North to form an energy company based in Huston, Texas. The company created the first nationwide natural gas pipeline system by integrated several pipeline systems. In 1986 Ken Lay, former chief executive officer of Houston Natural Gas, was named chief executive officer and chairman at the fresh energy company, after discovering the oil traders in New York have overextended the company's accounts by almost one billion dollar, the company works its loss down to 142 million dollar in 1987. The loss immediately leads Enron to reduce the risk of price swings by developing different services. After one year, Enron Corporation in England opened its first overseas office; the company's pursue unregulated markets by regulated pipeline business as new strategy which revealed to the senior officials. Jeffrey Skilling joined Enron Corporation in 1989 and launch Gas Bank, a program under which at fixed prices

[1] Chary, VRK, "Ethics in Accounting. Global Cases and Experiences", 2004, Punjagutta, The ICFAI University Press, India.

buyers of natural gas could lock in long-term supplies and corporation at the same time for oil and gas producers started to offer financing. Enron Corporation by acquiring Transport adora de Gas del Sur expended to South America and started to push to extend on the continent in 1992. In England after one year Enron's Teesside power plant began operations as the first successes for Enron's international strategy. The corporation made its first electricity trade in 1994 and in the next years it turns into one of biggest profit centers for Enron. In London by establishment of a trading center, Enron in 1995 entered the European wholesalers market as part of Enron Europe. In 1996, Dabhol power plant construction started in India. However, the project would be plagued by political problems and eventually Enron put the project up for sale in 2001. After one year, Enron bought Portland General Electric Corporation, the utility serving the Portland, Oregon (USA), which would be sold for about 1.9 billion Dollars in 2001 to Northwest Natural Gas Co, in the same year, Enron Energy Services was formed to provide energy management services to commercial and industrial customers. Enron continued its policy of acquiring companies and in 1998 acquired Wessex Water in the United Kingdom which formed the basis for its water subsidiary Azurix. But in 1999, when in an action one-third of Azurix sold to the public, the company's problems become apparent as the shares fell sharply after an early rise. The same year, Enron Online, the company's commodity trading Internet site, started to operate. Enron Energy Services turned its first profit in the last quarter of the year.

Enron's annual revenues reached one hundred billion Dollars in 2000, which was reflecting the growing importance of trading. However, the problems with Azurix continued and Rebecca Mark resigned from her position of chairwoman while Enron announced the intention to take the subsidiary private. The same year, The Energy Financial Group ranked Enron the sixth-largest energy company in the world, based on market capitalization.[2] In April 2001 Enron disclosed it had owned 570 million Dollar by bankrupt California utility Pacific Gas & Electric Co. While the top executives were likely aware of the debt and the illegal practices, the fraud was not revealed to the public until October 2001 when Enron announced that the company was actually worth 1.2 billion Dollar less than previously reported. This problem prompted an investigation by the Securities and Exchange Commission[3] , which has revealed many levels of deception and illegal practices committed by high-ranking Enron executives, investment banking partners, and the company's accounting firm, Arthur Anderson. At the end of the year Enron's shares closed at 8.63 Dollar per share, an 89 percent drop since the beginning of the year. The critical dates in the scandal are October 16, 2001 and November 8, 2001. On October 16, Enron announced that it had made a loss of 618 million Dollar in 3 months, while on the second date it announced that it had exaggerated its revenue since 1997 by 586 million Dollars. In Fact, accounts of Enron had not shown the true state of its huge indebtedness on that time.

Analyzing the Fraud: Timeline and Financial Highlights

Enron Corporation until December 2001 appeared very strong, voluntary made the decision to restate its financial statements. This proved to be mortal. While the bankruptcy of a small company is taken as a routine, the corporation had to go for a bankruptcy. During the 1990s, Enron expended into several areas quickly such as developing a pipeline and a power plant, however, this expansion required long gestation period and large initial capital investments. Enron raised a lot of debt funds from the market hence any other attempt to raise funds would affect Enron's credit rating. Enron had to maintain the credit ranking at investment rate in order to continue business but Enron was not making enough profits. Hence, Enron began making partnerships and other special "arrangements" like SPE or Special Purpose Entity. These companies were used to keep Enron's debts and losses away from its balance sheets, therefore allowing it to have a good credit rating and showing good look in front of the investors. Enron goal was to overcome the rules of consolidation and, in the same time increase credibility. If a parent company (in this case Enron) financed less than 97 percent of an initial investment in a SPE, it didn't have to consolidate in into its own accounts[4]. In order to achieve non-consolidation, according to GAAP,[5] two conditions must be met first the assets must be legally isolated from the transferor and second an independent third party owner has to make a substantive capital investment which should amount to at least 3 percent of the SPE's total capitalization. The independent third party owner must exercise control over the SPE in order to avoid consolidation. The third party control and the legal isolation over the SPE, reduce the risk of the credit. Therefore, off-balance sheet treatment of such a SPE involves enough third party equity which must be "at risk", otherwise the transferor would be required to consolidate the SPE into its own financial statements. Therefore, thoughts solution of Enron was to find outside investors willing to enter into financial arrangements with them and started several structured entities in the name of SPEs. To allow the SPE to borrow from the market, in many cases Enron provided credit support such as guaranty. Enron's off-balance sheet treatment was subject to achieved of all its SPEs, without test of accounting to determine to know whether the SPE should be consolidated or not. The Enron followed this policy in financing which ultimately would enable it to be valued more attractively by rating agencies and Wall Street analysts. after word the huge debt took place into the subsidiaries and many obligations flew from US companies into Enron's SPEs, while the contracts likely to end up in loses were mentioned unclearly in the footnotes of company accounts. Enron used several dependent sectors in rising of

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[2]The Collapse of Enron Corporation, (23, March 2015), Retrieved from: https://www.ukessays.com/essays/accounting/the-collapse-of-enron-corporation-accounting-, accessed on: 05May2016.

[3] "The United States Securities and Exchange Commission (commonly known as the SEC) is a United States government agency having primary responsibility for enforcing the federal securities laws and regulating the securities industry, stock market", Retrieved from: https://en.wikipedia.org/wiki/U.S._Securities_and_Exchange_Commission, accesses on: 8 May 2016.

[4] EITF (Emerging Issues Task Force) is "an organization formed in 1984 by the Financial Accounting Standards Board (FASB) to provide assistance with timely financial reporting" Retrieved from: http://www.investopedia.com/terms/e/eitf.asp, accessed on: 05May2016.

[5] These rules and standards are mandated for the creation of uniform financial reports by publicly traded companies. "It includes the standards, conventions, and rules accountants follow in recording and summarizing transactions, and in the preparation of financial statements", Retrieved from: http://www.accounting.com/resources/gaap/, accessed on: 05May2016.

equity and structured its financial arrangements by using existed weakness of laws and trying to not consolidate into its accounts by intentionally not fulfilling certain conditions.

Key Management at Enron

Kenneth Lay (Former Enron Chief Executive, Chairman and Board Member)[6]

Lay took up the reins at Enron in 1986 after it was formed from the merger of two pipeline firms in Texas and Nebraska. Prior to Enron's collapse, he was credited with building Enron's success. Lay resigned as CEO in December 2000, and was replaced by Jeffrey Skilling. In August 2001, he resumed leadership after Skilling resigned. Lay resigned again in January 2002 after becoming the focus of the anger of employees, stockholders and pension fund holders who lost billions of dollars in this disaster.

Jeffrey Skilling (Former Chief Executive, President and Chief Operating Officer)[7]

Skilling joined Enron in 1990 from the consultancy firm McKinsey, where he had developed financial instruments to trade gas contracts. Prior to becoming Chief Executive in February 2001, Skilling was President and Chief Operating Officer of the firm. Skilling was also seen as a key architect of the company's gas-trading strategy. Skilling resigned his post as Enron's chief executive in August 2001 without a pay-off.

Andrew Fastow (Former Chief Financial Officer)[8]

Fastow was fired in October 2001, when Enron made losses amounting to $ 600 million. Fastow was allegedly responsible for engineering the off-balance sheet partnerships that allowed Enron to cover its losses. Fastow was also found by an internal Enron investigation to have secretly made $30 million from managing one of these partnerships.

Clifford Baxter (Former Chief Strategy Officer and Vice Chairman)[9]

Baxter was known to have been one of the Enron executives, who had opposed its creative accounting practices. Baxter retired from Enron in May 2001. Baxter committed suicide in January 2002.

Enron's Auditor (Arthur Andersen)[10]

Arthur Andersen, one of the world's five leading accounting firms, was Enron's auditing firm. This means that Andersen's job was to check that the company's accounts were a fair reflection of what was really going on. As such, Andersen should have been the first line of defense in the case of deception or any fraud. Arguments about conflict of interest had been thrown at Andersen since they acted as both consultants and auditors to Enron. Andersen earned too much fees of audit and consultants work from Enron Company. Scandal broke; the US government began to investigate the company's affairs, Andersen's Chief Auditor for Enron, David Duncan, ordered the thousands of documents that might prove compromising. That was after the Securities and Exchange Commission had ordered an investigation into agents Enron. Duncan said he was acting on an e-mail from a lawyer at Andersen his name was Nancy Temple, but Temple denied giving such advice. While Andersen fired Duncan, its Chief Executive Officer, Joseph Berardino, insisted that the firm did not act improperly and could not have detected the fraud. Berardino conceded that an error of judgment was made in shredding documents, but he still protested Andersen's innocence.[11]

Enron Trials

Fastow and Lea (his wife), both pleaded guilty to charges against them. Fastow was initially charged with 98 counts of fraud, money laundering, insider trading and conspiracy among other crimes.[12] Fastow pleaded guilty to two charges of conspiracy and was sentenced to ten years with no parole in a plea bargain to testify against Lay, Skilling, and Causey.[13] Lea was indicted on six felony counts, but prosecutors later dismissed them in favor of a single misdemeanor tax charge. Lea was sentenced to one year for helping her husband hide income from the government.[14] Lay and Skilling went on trial for their part in the Enron scandal in January 2006. The 53 count, 65-page indictment covers a broad range of financial crimes, including bank fraud, making false statements to banks and auditors, securities fraud, wire fraud, money laundering, conspiracy, and insider trading. United States District Judge Sim Lake had previously denied motions by the defendants to have separate trials and to relocate the case out of Houston, where the defendants argued the negative publicity concerning Enron's demise would make it impossible to get a fair trial. On May 25, 2006, the jury in the Lay and Skilling trial returned its verdicts. Skilling was convicted of 19 of 28 counts of securities fraud and wire fraud and acquitted on the remaining nine, including charges of insider trading. He was sentenced to 24 years and 4 months in prison.[15] The United States Department of Justice in 2013 reached a deal with Skilling, which resulted in ten years being cut from his sentence.[16] Lay

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[6]Kenneth Lay, Retrieved from: https://en.wikipedia.org/wiki/Kenneth_Lay, accessed on; 10 June 2016

[7] Jeffrey Skilling, Retrieved from: https://en.wikipedia.org/wiki/ Jeffrey_Skilling, accessed on; 10 June 2016

[8] Andrew Fastow, Retrieved from: https://en.wikipedia.org/wiki/Andrew_ Fastow, accessed on; 10 June 2016

[9] J. Clifford Baxter, retrieved from: https://en.wikipedia.org/wiki J._Clifford_Baxter, accessed on : 8 June 2016

[10]Some of the biggest accounting scandals, *The author is an FCA, ACS, AICWA, LL.B. M.B.A. Dip IFRS (UK), Dip LL&LW, Retrieved from:*http://flame.org.in/KnowledgeCenter/Someofthebiggestaccountingscandals.aspx, *accessed on: 5 may 2016.*

[11]The collapse at Enron, Retrieved from: *Essay UK* - http://www.essay.uk.com/essays/finance/the-collapse-at-enron/, *accessed on: 10 June 2016.*

[12]DeVogue, Ariane; Peter Dizikes; Linda Douglass (18 February 2002)."Enron Fires Arthur Andersen", ABC News. Archived fromthe original, accessed on 5 May 2016

[13]Said, Carolyn (9 July 2004)."Ex-Enron chief Ken Lay Enters Not Guilty Plea".San Francisco Chronicle. Archived fromthe original,accessed on: 5 May 2016.

[14]Hays, Kristen (5 May 2016)."Fastow's Wife Pleads Guilty in Enron Case". USA Today. Archived fromthe originalon; 2010-10-17. accessed on: 5 May 2016.

[15]Johnson, Carrie (2006-10-24)."Skilling Gets 24 Years for Fraud at Enron ".Washington Post. Archived fromthe originalaccessed on: 5 May 2016.

[16]Ex-Enron Chief's Sentence is Cut by 10 Years to 14". 'The New York

pleaded not guilty to the eleven criminal charges, and claimed that he was misled by those around him. He attributed the main cause for the company's demise to Fastow.[17] Lay was convicted of all six counts of securities and wire fraud for which he had been tried, and he was subject to a maximum total sentence of 45 years in prison.[18] However, before sentencing was scheduled, Lay died on July 5, 2006. At the time of his death, the SEC had been seeking more than 90 million Dollar from Lay in addition to civil fines. The case of Lay's wife, Linda, is a difficult one. She sold roughly 500,000 shares of Enron ten minutes to thirty minutes before the information that Enron was collapsing went public on November 28, 2001.[19] Linda was never charged with any of the events related to Enron.[20] Although Michael Kopper worked at Enron for more than seven years, Lay did not know of Kopper even after the company's bankruptcy. Kopper was able to keep his name anonymous in the entire affair.[21] Kopper was the first Enron executive to plead guilty. Chief Accounting Officer Rick Causey was indicted with six felony charges for disguising Enron's financial condition during his tenure.

After pleading not guilty, he later switched to guilty and was sentenced to seven years in prison.[22] All told, sixteen people pleaded guilty for crimes committed at the company, and five others, including four former Merrill Lynch employees, were found guilty. Eight former Enron executives testified the main witness being Fastow against Lay and Skilling, his former bosses.[23] Another was Kenneth Rice, the former chief of Enron Corp.'s high-speed Internet unit, who cooperated and whose testimony helped convict Skilling and Lay. In June 2007, he received a 27-month sentence.[24] Michael W. Krautz, a former Enron accountant, was among the accused who was acquitted of charges related to the scandal. Represented by Barry Pollack, Krautz was acquitted of federal criminal fraud charges after a month-long jury trial.[25] Arthur Andersen was charged with and found guilty of obstruction of justice for shredding the thousands of documents and deleting e-mails and company files that tied the firm to its audit of Enron.[26] Although only a small number of Arthur Andersen's employees were involved with the scandal, the firm was effectively put out of business; the Securities And Exchange Commission is not allowed to accept audits from convicted felons. The company surrendered its Certified Public Accountant license on August 31, 2002, and 85,000 employees lost their jobs.[27][28]The conviction was later overturned by the U.S. Supreme Court due to the jury not being properly instructed on the charge against Andersen.[29] The Supreme Court theoretically left Andersen free to resume operations. However, the damage to the Andersen name has been so great that it has not returned as a viable business even on a limited scale. Gary Mulgrew, David Bermingham, and Giles Darby worked for Greenwich NatWest. The three British men had worked on a special purpose entity called Swap Sub. When Fastow was being investigated by the Securities and Exchange Commission, in November 2001 the three men met with the British Financial Services Authority to discuss their interactions with Fastow.[30]

In June 2002, the U.S. issued warrants for their arrest on seven counts of wire fraud, and they were then extradited. On July 12, a potential Enron witness scheduled to be extradited to the U.S., Neil Coulbeck, was found dead in a park in north-east London.[31] Coulbeck's death was eventually ruled to have been a suicide. The U.S. case alleged that Coulbeck and others conspired with Fastow. In a plea bargain in November 2007, the trio pleads guilty to one count of wire fraud while the other six counts were dismissed. Darby, Bermingham, and Mulgrew were each sentenced to 37 months in prison.[32] In August 2010, Bermingham and Mulgrew retracted their confessions.

Employees and Pension Fund Holders as a Victim

Collapse of Enron has left thousands of people out of work. Thousands of people lost their personal investments and pensions and it has left many employees out of their work such as money employees had personal pension funds made up of Enron shares, a common situation in America, where occupational schemes based on final salary payments are increasingly rare and money purchase schemes, known as 401K plans, are the norm. Employees at Enron were encouraged to do so by the company, which also forbade them from selling their stocks, when the company share price came down. In contrast, many Enron executives were able to cash in their share options when the company's fate became clear.[33]

Times', accessed on 5 May 2016.

[17]Leung, Rebecca (2005-03-14). "Enron's Ken Lay: I Was Fooled". 60 Minutes (CBS News). Archived fromthe originalon 2010-10-17. Accessed on : 5 May 2016.

[18]Hays, Kristen (2006-05-26)."Lay, Skilling Convicted in Enron Collapse".The Washington Post. Archived fromthe original on 2010-10-17, accessed on: 5 May 2016.

[19]Eichenwald, Kurt (2004-11-17)."Enron Inquiry Turns to Sales By Lay's Wife".The New York Times. Archived from the original, accessed on: 5 May 2016

[20]Johnson, Carrie (2006-06-10)."A Woman Of Conviction".The Washington Post. Archived fromthe originalon 05/05/2016, accessed on: 5 May 2016

[21]McLean, Bethany; Peter Elkind.The Smartest Guys in the Room. p.153.ISBN1-59184-008-2

[22]McCoy, Kevin (2005-12-28)."Former Enron executive pleads guilty".USA Today. Archived fromthe original, accessed on: 5 May 2016.

[23]Pasha, Shaheen; Jessica Seid (2006-05-25). "Lay and Skilling's Day of Reckoning".CNNMoney.com. Archived fromthe original, accessed on: 5 May 2016.

[24]Porretto, John (2007-06-18)."Ex-Enron broadband head sentenced". USA Today. Archived from the original, accessed on: 5 May 2016

[25]Murphy, Kate. "One Guilty and One Acquitted in Enron Broadband Trial". The New York Times.

[26]Thomas, Cathy Booth (2002-06-18)."Called to Account".Time. Archived fromthe original, accessed on: 5 May 2016.

[27]Rosenwald, Michael S. (2007-11-10)."Extreme (Executive) Makeover".The Washington Post. Archived fromthe original, accessed on: 5 May 2016

[28]Alexander, Delroy; Greg Burns; Robert Manor; Flynn McRoberts; and E.A. Torriero (2002-11-01)."The Fall of Andersen".Hartford Courant. Archived fromthe original, accessed on: 5 May 2016

[29]"Supreme Court Overturns Arthur Andersen Conviction". Fox News.Associated Press. 2005-05-31. Archived fromthe original, accessed on: 5 May 2016.

[30]Hays, Kristen (2007-11-27)."Source: British bankers to plead guilty in Enron case ".Houston Chronicle. Archived fromthe original, accessed on: 5 May 2016.

[31]"Enron Witness Found Dead in Park". BBC News. 2006-07-12. Archived from the original, accessed on: 5 May 2016.

[32]Murphy, Kate (2008-02-22)."'NatWest 3' sentenced to 37 months each".The New York Times. Archived fromthe original, accessed on: 5 May 2016.

[33]B.B.C News, Enron: who's who, employee and pension holders, retrieved from: http://news.bbc.co.uk/hi/english/static/in_depth/business/2002/enron/9.stm, accessed on:13 June2016

The Causes of Enron's bankruptcy

Truthfulness

The truthfulness was missed by management of Enron about the health of the company, according to Kirk Hanson, the executive director of the Markkula Center for Applied Ethics. He believed Enron had to be the best at everything it did and that they had to protect their reputations and their compensation as the most successful executives in the U.S.A. There is no evidence that when Enron's CEO told the employees that the stock would probably rise and he was selling stock. Moreover, the employees would not have learned of the stock sale within days or weeks, as is ordinarily the case. Only the investigation surrounding Enron's bankruptcy enabled shareholders to learn of the CEO stock sell-off before 14 February 2002 which is when the sell-off would otherwise have been disclosed. The stock was sold to the company to repay that the CEO's owed money and the sale of company stock qualifies as an exception under the ordinary director and officer disclosure requirement. It does not have to be reported until 45 days after the end of the company's fiscal year.[34]

Interest

It has been suggested that a lack of independent oversight of management conflicts and interest by Enron's board contributed to the firm's collapse. In addition some have suggested that Enron's compensation policies engendered a myopic focus on earnings growth and stock price. Moreover, recent regulatory changes have focused on enhancing the accounting for SPEs and strengthening internal accounting and control systems. We review these issues, beginning with Enron's board.[35] The conflict of interest between the two roles played by Arthur Andersen While investigations continue, Enron has sought to salvage its business by spinning off various assets. It has filed for bankruptcy under Chapter 11, allowing it to reorganize while protected from creditors. Former chief executive and Chairman Kenneth Lay have resigned, and restructuring expert Stephen Cooper has been brought in as interim chief executive. The energy trading arm has been tied up in a complex deal with UBS Warburg as Enron's core business. The bank has share some of the profits with Enron buthas not paid for the trading unit.

Enron and the reputation of Arthur Andersen

In the third quarter of 2001 the revelation of accounting irregularities at Enron caused regulators and the media to focus extensive attention on Andersen. The magnitude of the alleged accounting errors, combined with Andersen's role as the widespread media attention and Enron's auditor provide a seemingly powerful setting to explore the impact of auditor reputation on client market prices around an audit failure. CP investigates the share price reaction of Andersen's clients to various information events that could lead investors to revise their beliefs regarding Andersen's reputation.[36] Most damaging to Andersen's reputation Perhaps was their admission on 10 January 2002 that employees of the firm had destroyed documents and correspondence related to the Enron engagement. Office clients of Andersen's Houston, where Enron was headquartered, experienced a negative market reaction than Andersen's non-Houston clients.[37] Overall, CP concludes the shredding announcement had a significant impact on the perceived quality of Andersen's audits, and that the resulting loss of reputation had a negative effect on the market values of the firm's other clients.

An important factor: accounting fraud (using "mark to market" and SPE as tools)

In addition there are new findings that shed light on an auditor reputation effect which is important to auditors and their clients. In this regard, there is an important factor namely "accounting fraud" which using "marks to market" and SPE as tools which will be discussed below;

Mark to Market

As a public company, Enron was subject to external sources of governance including market pressures, oversight by government regulators, and oversight by private entities including auditors, equity analysts, and credit rating agencies. In this section we recap the key external governance mechanisms, with emphasis on the role of external auditors. This method requires that once a long-term contract was signed, the amount of which the asset theoretically will sell on the future market is reported on the current financial statement. In order to keep appeasing the investors to create a consistent profiting situation in the company, Enron traders were pressured to forecast high future cash flows and low discount rate on the long-term contract with Enron. The difference between the calculated net present value and the originally paid value was regarded as the profit of Enron. In fact, the net present value reported by Enron might not happen during the future years of the long-term contract. There is no doubt that the projection of the long-term income is overly optimistic and inflated.

SPE (Special Purpose Entity)

Accounting rule allow a company to exclude a SPE from its own financial statements if an independent party has control of the SPE, and if this independent party owns at least 3 percent of the SPE. Enron need to find a way to hide the debt since high debt levels would lower the investment grade and trigger banks to recall money. Using the Enron's stock as collateral, the SPE, which was headed by the CFO, Fastow, borrowed large sums of money. And this money was used to balance Enron's overvalued contracts. Thus, the SPE enable the Enron to convert loans and assets burdened with debt obligations into income. In addition, the taking over by the SPE made Enron

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[34] The Conference Board, Inc., 845 Third Avenue, New York, NY 10022-6679. Retrieved from: www.conference-board.org., accessed on : 5May 2016

[35] Gillan SL, Martin JD, (2007), corporate governance post-Enron: effective reforms, or closing the stable door?, journal of corporate finance.

[36] Nelson KK, Price RA, & Rountree BR. (2008). "The market reaction to Arthur Andersen's role in the Enron scandal: Loss of reputation or confounding effects?". (Journal of Accounting & Economics, 46(2): 279-293- December 2008)

[37] Barreveld, D. J, "The Enron collapse: Creative accounting, wrong economics or criminal acts?",(San Jose, CA: Writers Club Press- 2002).

transferred more stock to SPE. However, the debt and assets purchased by the SPE, which was actually burdened with large amount of debts, were not reported on Enron's financial report. The shareholders were then misled that debt was not increasing and the revenue was even increasing.

Abuse of Power

Both Lay and Skilling could wield power ruthlessly. The position of vice-chair was known as the "ejector seat" because so many occupants were removed from the position when they took issue with Lay or appeared to be a threat to his power. Skilling, for his part, eliminated corporate rivals and intimidated subordinates. Abdication of power was also a problem at Enron. At times, managers did not appear to understand what employees were doing or how the business which was literally creating new markets operated. Board members also failed to exercise proper oversight and rarely challenged management decisions. Many were selected by CEO Kenneth Lay and did business with the firm or represented non-profits that received large contributions from Enron.[38]

Excess Privilege

Excess typified top management at Enron. Lay, who began life modestly as the son of a Baptist preacher turned chicken salesman, once told a friend, "I don't want to be rich, I want to be world-class rich".[39] At another point he joked that he had given wife Linda a $2 million decorating budget for a new home in Houston which she promptly exceeded[40]. The couple borrowed $75 million from the firm that they repaid in stock. Linda Lay fanned the flames of resentment among employees when she broke into tears on the Today Show to claim that the family was broke. This was despite the fact that the Lays owned over 20 properties worth over $30 million.[41] During Enron's heyday, some of the perks filtered down to followers as well. Workers enjoyed such benefits as lavish Christmas parties, aerobic classes, free taxi rides, refreshments, and the services of a concierge.

Deceit

Enron officials manipulated information to protect their interests and to deceive the public, although the extent of their deception is still to be determined. Both executives and board members claim that they were unaware of the extent of the company's off-the-books partnerships created and operated by Fastow and Kopper. However, both Skilling and Lay were warned that the company's accounting tactics were suspect.[42] The Senate Permanent Subcommittee on Investigations, which investigated the company's downfall, concluded, "Much that was wrong with Enron was known to the board"[43] Board members specifically waived the conflict of interest clause in the company's code of ethics that would have prevented the formation of the most troublesome special partnerships Employees were quick to follow the lead of top company officials. They hid expenses, claimed nonexistent profits, and deceived energy regulators and so on.

Inconsistent Treatment of Internal and External Constituencies

Enron's relationships with both employees and outsiders were marked by gross inconsistencies. Average workers were forced to vest their retirement plans in Enron stock and then, during the crucial period when the stock was in free fall, were blocked from selling their shares. Top executives, on the other hand, were able to unload their shares as they wished. Five-hundred officials received "retention bonuses" totaling $55 million at the same time laid off workers received only a fraction of the severance pay they had been promised. Enron treated its friends royally. In particular, the company used political donations to gain preferential treatment from government agencies. Kenneth Lay was the top contributor to the Bush campaign and officials made significant donations to both Democratic and Republican members of the House and Senate. In return, the company was able to nominate friendly candidates for the Security Exchange Commission (SEC) and the Federal Energy Regulatory Commission (FERC). Federal officials intervened with foreign governments to promote Enron projects, and company representatives played a major role in setting federal energy policy that favored deregulation of additional energy markets. Anyone perceived as unfriendly to Enron's interests could expect retribution, however. In one instance, Lay withdrew an underwriting deal to pressure Merrill Lynch into firing an analyst who had downgraded Enron stock. Skilling called one analyst an "asshole" when he questioned the company's performance during a conference call.

Misplaced and Broken Loyalties

Enron officials put their loyalty to themselves above those of everyone else with a stake in the company's fate stock holders, business partners, rate payers, local communities, foreign governments, and so on. They also betrayed the trust of those who worked for them. Employees apparently believed in the company and in Lay's optimistic pronouncements. In August 2001, for example, he declared "I have never felt better about the prospects for the company"[44]. In late September, just weeks before the company collapsed, he encouraged employees to "talk up the stock" because "the company is fundamentally sound"[45]. These exhortations came even as he was unloading his own shares. The sense of betrayal experienced by Enron employees only added to the pain of losing their jobs and retirement savings.

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Irresponsible Behaviour

Enron officials acted irresponsibly by failing to take needed action, failing to exercise proper oversight, and failing to shoulder responsibility for the ethical miscues of their organization. CEO Lay down played warnings of financial improprieties and some board members did not understand the numbers or the company's operations. Too often company managers left employees to their own devices, encouraging them to make their numbers by any means possible. After the collapse, no one stepped forward to accept blame for what happened.

Lay and Fastow claimed Fifth Amendment privileges against self-incrimination when called before congressional committees; Skilling testified but claimed he had no knowledge of illegal activity. The unethical behavior of Enron's leaders appears to be the product of both individual and situational factors. Greed was the primary motivator of both managers and their subordinates at Enron. Optimistic earnings reports, hidden losses and other tactics were all designed to keep the stock price artificially high. Lofty stock values justified generous salaries and perks, deflected unwanted scrutiny, and allowed insiders to profit from their stock options. Greed was not limited to top Enron executives, however. Meeting earnings targets triggered large bonuses for managers throughout the firm, bonuses that were sometimes larger than employees' salaries. Rising stock prices and extravagant rewards made it easier for followers as well as leaders to overlook shortcomings in the company's ethics and business model.

Hubris was also a major character flaw at the Crooked E, a fact reflected in the company banner that declared: FROM THE WORLD'S LEADING ENERGY COMPANY: TO THE WORLD'S LEADING COMPANY.[46]Skilling, who lacked the social and communication skills of Ken Lay, best exemplifies the haughty spirit of many Enron officials. At the height of the California energy crisis he joked that the only difference between the Titanic and the state of California was that "when the Titanic went down, the lights were on".[47] Even the so-called "heroes" of the Enron debacle failed to demonstrate enough virtue to delay or to prevent the company's collapse. Former company treasurer Clifford Baxter complained about Fastow's financial wheeling and dealing, but then retired without going public with his complaints. Vice-president of corporate development Sherry Watkins outlined her concerns about the firm's questionable financial practices in a letter and in a meeting with Lay. Later she discussed the same issues with an audit partner at Anderson. While these are commendable acts, in her letter she recommended quiet clean up of the problems rather than public disclosure. She stopped short of talking to the press, the SECURITIES AND EXCHANGE COMMISSION and other outside agencies when her attempts at internal reform failed.[48] The destructive power of individual greed and pride was magnified by Enron's corporate culture that encouraged creativity and risk taking. Employees invented a host of new commodity products which earned Enron top ranking six straight years on Fortune magazine's list of most innovative companies[49].

Ken Lay was fond of telling the story of how Enron employees in London started its on-line trading business which later carried a quarter of the world's energy trades, without the blessing or knowledge of corporate headquarters in Houston.[50] The cost of freedom, however, was pressure to produce that created a climate of fear. Enron's atmosphere was similar to that of an elite law firm where talented young associates scramble to make partner.[51] Adding to the stress was the organization's "rank and yank" evaluation system. Every six months 15 percent of all employees were ranked in the lowest category and then had a few weeks to find another position in the company or be let go.[52] Workers in the next two higher categories were put on notice that they were in danger of falling into the lowest quadrant during the subsequent review. This system encouraged cutthroat competition and silenced dissent. Followers were afraid to question unethical and or illegal practices for fear of losing their jobs. Instead, they were rewarded for their unthinking loyalty to their managers who ranked their performance and the company as a whole. Lack of controls, combined with an intense, competitive, results-driven culture made it easier to ignore the company's code of ethics which specifically prohibited conflicts of interest like those found in the SPEs and to seek results at any cost.[53] Anderson auditors signed off on its questionable financial transactions for fear of losing lucrative auditing and consulting contracts with Enron.

Enron was also a victim of larger social and cultural factors. Publicly traded firms in the United States are judged by their quarterly earnings reports. Obsession with short-term results encourages executives to do whatever they can to meet these expectations. Enron's explosive growth took place during the economic boom of the 90s. All the major stock indices soared and billions were wasted on Internet start-ups that never had a realistic chance to make a profit. During this period the Cult of the CEO emerged. Business leaders achieved rock star status, gracing the covers of national magazines and best selling biographies.[54] In this heady climate, government regulators and investors felt little need to study the operations or finances of apparently successful companies led by business superstars. The recent spate of corporate scandals and the accompanying market crash may be the penalty that society must pay for the excesses and inattention of the last decade.

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The collapse of ENRON and Moral Responsibility

From Individuals' Angle

As corporate acts originate in the choices and actions of human individuals, these individuals who must be seen as the primary bearers of moral duties and moral responsibility. The then chairman of the board, Kenneth Lay, and CEO, Jeffrey Skilling, to allowed the then CFO, Andrew Fastow, to build private cooperate institution secretly and then transferred the property illegally. The CFO, Andrew Fastow, violated his professional ethics and took the crime of malfeasance. When the superior, the chairman of the board of Kenneth Lay and CEO Jeffrey Skilling, ordered conspiratorial employees to carry out an act that both of them knowing is wrong, these employees are also morally responsible for the act. The courts will determine the facts but regardless of the legal outcome, Enron senior management gets a failing grade on truth and disclosure. The purpose of ethics is to enable recognition of how a particular situation will be perceived. At a certain level, it hardly matters what the courts decide. Enron is bankrupt which is what happened to the company and its officers before a single day in court. But no company engaging in similar practices can derive encouragement for any suits that might be terminated in Enron's favor. The damage to company reputation through a negative perception of corporate ethics has already been done. Arthur Andersen violated its industry specifications as a famous certified public accountant.

From Corporation's Angle

The acts of a corporation's managers are attributed to the corporation so long as the managers act within their authority. However, the shareholders of Enron didn't know and realize this matter from the superficial high stock price. Therefore, the whole corporation was not of responsibility for this scandal. Actually, if the board and other shareholders paid more attention to those decisions made by the chief, CEO, CFO and those relevant staffs, ENRON can avoid this result.

Conclusion

In summary, top officials at Enron abused their power and privileges. They manipulated information while engaging in inconsistent treatment of internal and external constituencies. These leaders put their own interests above those of their employees and the public, and failed to exercise proper oversight or shoulder responsibility for ethical failings. Therefore, there is need the directors to follow particular examples in following matters:

First, there should be a healthy corporate culture in a company. In Enron's case, its corporate culture played an important role of its collapse. The senior executives believed Enron had to be the best at everything it did and the shareholders of the board, who were not involved in this scandal, were over optimistic about Enron's operating conditions. When there existed failures and losses in their company performance, what they did was covering up their losses in order to protect their reputations instead of trying to do something to make it correct. Therefore, the "to-good-to-be-true" should be paid more attention by directors of board in a company.

Secondly, a more complete system is needed for owners of a company to supervise the executives and operators and then get the idea of the company's operating situation. There is no doubt that more governance from the board may keep Enron from falling to bankruptcy. The boards of directors should pay closer attention on the behavior of management and the way of making money. In addition, Enron's fall also had strikingly bad influence on the whole U.S. economy. Maybe the government also should make better regulations or rules in the economy.

Thirdly, "Mark to market" is a plan that Jeffrey Skilling and Andrew Fastow proposed to pump the stock price, cover the loss and attract more investment. But it is impossible to gain in a long-term operation in this way, and so it is clearly immoral and illegal. However, it was reported that the then US Security and Exchange Commission allowed them to use "mark to market" accounting method. The ignorance of the drawbacks of this accounting method by Securities and Exchange Commission also caused the final scandal. Thus, an accounting system which can disclose more financial information should be created as soon as possible. And fourthly, maybe business ethics is the most thesis point people doing business should focus on. As a loyal agent of the employer, the manager has a duty to serve the employer in whatever ways will advance the employer's self-interest. In this case, they violated the principle to be loyal to the agency of their Enron. Especially for accountants, keeping a financial statement disclosed with true profits and losses information is the basic responsibility that they should follow

It is worth mentioning that the Enron Corp case was the biggest in a series of scandals that damaged the reputations of corporations as a direct result, the Congress passed a law, called the Sarbanes auditors and made corporate executives criminally liable for lying about their accounts. The Enron scandal moved the balance of power away from the company boards towards the investors. After the scandal there is more caution among corporate executives about spinning off accounts that might be inaccurate, as now they face criminal liability. However, the temptation to boost stock prices has of booming markets mostly when the rewards for executives are high. Finally it can be proved that the bankruptcy of the Enron was because of managerial scandal for the self benefit than shareholder's benefit of this company. Therefore through law which has passed by Congress after this case, the rights of investors and employees will be guaranteed more.

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