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CORPORATE SCAM- ENRON (US) 2001

INTRODUCTION

Enron's bankruptcy filing in November 2001 marked the beginning of an unheard sign of corporate scandals. officials at global Com, AOL Time Warner, ImClone, Tyco, Adelphia, Global Crossing, Quest and charter Communications joined Enron executives as targets of congressional hearings, stockholder proceedings, SEC seeks and criminal indictments. Enron's problem, which has been center level, become quickly pushed to the history by using subsequent revelations of company wrongdoing. Enron failed in massive elements because of the unethical practices of its senior officials inspecting the moral shortcomings of Enron's executives as well as the elements that contributed to their misbehaviors can offer critical detection the way to deal with the subject of ethics inside the management and more current instances of corporate corruption need to not diminish the significance of Enron as a case examines in ethical failure.

HISTORY

Enron scandal, collection of events that resulted inside the financial ruin of the U.S. power, commodities, and offerings organization Enron organization and the dissolution of Arthur Andersen LLP, which had been one of the biggest auditing and accounting agencies within the global. The fall apart of Enron, which held greater than $60 billion in assets, concerned one among the largest bankruptcy filings within the records of America, and it generated a whole lot debate as well as rules designed to improve accounting requirements and practices, with long-lasting repercussions in the monetary international.

Enron changed into based in 1985 by way of Kenneth Lay within the merger of herbal-gas-transmission groups, Houston natural fuel agency, and InterNorth, Inc.; the merged agency, HNG InterNorth, became renamed Enron in 1986. After the U.S. Congress adopted a series of legal guidelines to deregulate the sale of herbal gas inside the early Nineteen Nineties, the employer misplaced its extraordinary proper to function its pipelines. With the help of Jeffrey Skilling, who changed into first of all a representative and later became the employer's leader working officer, Enron converted itself into a trader of energy by-product contracts, acting as an intermediary among natural-gasoline manufacturers and their clients. The trades allowed the producers to mitigate the danger of electricity-charge fluctuations by way of solving the selling fee in their merchandise through a contract negotiated with the aid of Enron for a fee. Underneath Skilling's management, Enron soon ruled the market for herbal-gas contracts, and the business enterprise started to generate big earnings on its trades.

Skilling also gradually changed the subculture of the organization to emphasize competitive buying and selling. He hired top applicants from MBA packages around the USA and created intensely competitive surroundings in the corporation, wherein the point of interest turned into more and more on ultimate as many cash-generating trades as viable inside the shortest amount of time. One of his brightest recruits became Andrew Fastow, who fast rose via the ranks to come to be Enron's leader economic officer. Fastow oversaw the financing of the agency through investments in more and more complex devices, at the same time as Skilling oversaw the building of its large buying and selling operation.

The bull marketplace of the Nineties helped to gas Enron's ambitions and contributed to its fast growth. There have been deals to be made anywhere, and the company was geared up to create a marketplace for something that every person became willing to exchange. It for that reason traded by-product contracts for a huge kind of commodities—which includes strength, coal, paper, and steel—or even for the weather. An internet trading division, Enron on line, become launched at some point in the dot-com boom, and the corporation invested in constructing a broadband telecommunications network to facilitate excessive-velocity buying and selling. Enron confronted improved competition in the energy-trading business, the business enterprise's earnings shrank swiftly. under strain from shareholders, corporation executives started out to depend upon doubtful accounting practices, which includes a method referred to as "mark-to-market accounting," to hide the troubles. Mark-to-marketplace accounting allowed the enterprise to put in writing unrealized future profits from a few buying and selling contracts into current income statements, hence giving the illusion of higher modern-day profits. Furthermore, the afflicted operations of the enterprise have been transferred to so-referred to as special motive entities (SPEs), which might be essentially restricted partnerships created with out of doors events. Even though many corporations disbursed assets to SPEs, Enron abused the practice by using SPEs as dump sites for its stricken assets. Transferring those belongings to SPEs intended that they were saved off Enron's books, making its losses look much less severe than they certainly were. Sarcastically, several the ones SPEs were run via Fastow himself. All through those years, Arthur Andersen served now not best as Enron's auditor however also as a consultant for the company.

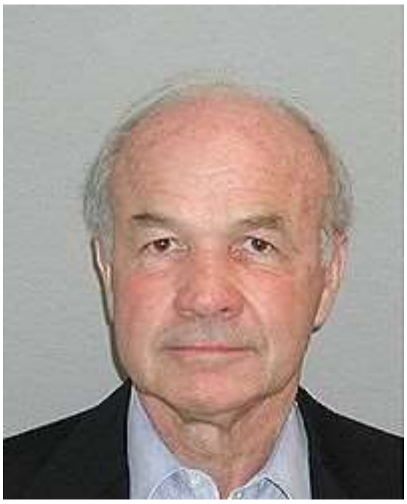
The severity of the situation started out to end up apparent in mid-2001 as some of the analysts started out to dig into the details of Enron's publicly released financial statements. Internal research changed into initiated following a memorandum from an employer vice-chairman, and soon the Securities and exchange fee (SEC) changed into investigating the transactions among Enron and Fastow's SPEs.

On December 2, 2001, Enron filed for bankruptcy eleven bankruptcy protection. Many Enron executives were indicted on a selection of charges and have been later sentenced to prison. Arthur Andersen came under severe scrutiny and ultimately misplaced a majority of its clients. The harm to its recognition became so extreme that it turned into pressured to dissolve itself. In addition to federal proceedings, masses of civil fits were filed with the aid of shareholders towards both Enron and Andersen. The scandal led to a wave of latest rules and regulations designed to increase the accuracy of financial reporting for publicly traded organizations. The most crucial of those measures, the Sarbanes-Oxley Act (2002), imposed harsh consequences for destroying, changing, or fabricating monetary statistics. The act additionally prohibited auditing firms from doing any concurrent consulting commercial enterprise for identical customers.

Review of Enron's Rise and Fall

Throughout the late 1990s, Enron was almost universally considered one of the country's most innovative companies -- a new-economy maverick that forsook musty, old industries with their cumbersome hard assets in favor of the freewheeling world of e-commerce. The company continued to build power plants and operate gas lines, but it became better known for its unique trading businesses. Besides buying and selling gas and electricity futures, it created whole new markets for such oddball "commodities" as a broadcast time for advertisers, weather futures, and Internet bandwidth. Enron was founded in 1985, and as one of the world's leading electricity, natural gas, communications, and pulp and paper companies before it bankrupted in late 2001, its annual revenues rose from about $9 billion in 1995 to over $100 billion in 2000. At the end of 2001, it was revealed that its reported financial condition was sustained substantially by institutionalized, systematic, and creatively planned accounting fraud. The drop in Enron's stock price from $90 per share in mid-2000 to less than $1 per share at the end of 2001, caused shareholders to lose nearly $11 billion. And Enron revised its financial statement for the previous five years and found that there was $586million in losses. Enron fall to bankruptcy on December 2, 2001. One of the lessons of the Internet boom is that it's often difficult for analysts to understand and evaluate new kinds of businesses. And executives like Mr. Skilling, who once swore at an analyst during a conference call for asking a pointed question about Enron's balance sheet, don't do much to foster the kind of open inquiry that could lead to better information. But the Enron debacle is also emblematic of another problem that has become all too evident in the last few years: Wall Street's loss of objectivity. Investment banks make far more money from underwriting or merger deals than they do from broker fees. Analysts at these firms often face conflicting loyalties. They can be put in the position of having to worry as much about whether a chief executive might find a report offensive as whether an investor might find it helpful.

Rise of Enron



In 1985, Kenneth Lay merged the natural gas pipeline companies of Houston Natural Gas and InterNorth to form Enron. In the early 1990s, he helped to initiate the selling of electricity at market prices, and soon after, Congress approved legislation deregulating the sale of natural gas. The resulting markets made it possible for traders such as Enron to sell energy at higher prices, thereby significantly increasing its revenue. After producers and local governments decried the resultant price volatility and asked for increased regulation, strong lobbying on the part of Enron and others prevented such regulation.

As Enron became the largest seller of natural gas in North America by 1992, it's trading of gas contracts earned $122 million (before interest and taxes), the second-largest contributor to the company's net income. The November 1999 creation of the EnronOnline trading website allowed the company to better manage its contracts trading business. To achieve further growth, Enron pursued a diversification strategy. The company-owned and operated a variety of assets including gas pipelines, electricity plants, pulp and paper plants, water plants, and broadband services across the globe. The corporation also gained additional revenue by trading contracts for the same array of products and services with which it was involved. Enron's stock increased from the start of the 1990s until year-end 1998 by 311%, only modestly higher than the average rate of growth in the Standard & Poor 500 index. However, the stock increased by 56% in 1999 and a further 87% in 2000, compared to a 20% increase and a 10% decrease for the index during the same years. By December 31, 2000, Enron's stock was priced at $83.13 and its market capitalization exceeded $60 billion, 70 times earnings and six times book value, an indication of the stock market's high expectations about its prospects.

THE CAUSES OF ENRON'S BANKRUPTCY

- **Accounting Problems**

The conventional wisdom is that it was "innovative" accounting practices and their consequences that started the tide of losses that brought the energy giant down. Enron collapsed not so much because it had gotten too big, but because it was perceived to be much bigger than it really was in the first place. By decentralizing its operations into numerous subsidiaries and shell corporations, Enron was able to hide huge derivative losses that would have halted its growth much sooner if widely understood. Publicly traded corporations are required to make their financial statements public, but Enron's finances were an impenetrable maze of carefully crafted imaginary transactions between itself and its subsidiaries that masked its true financial state. In other words, losses were held off the book by subsidiary companies, while assets were stated.

- **Fallout from Fraud**

Taken at its word, this rosy scenario made the company the darling of Wall Street, and it was able to borrow almost endlessly and expand into e-commerce and other questionable ventures. Its stock literally soared, which made employee compensation and pensions in the form of stock options seem very attractive. But what were already considered accounting practices on the edge of acceptable standards were eventually revealed to be outright fraudulent. The disgrace drove so much business away from and created such liability for accounting firm Arthur Anderson that it was itself forced out of business. By this time, though, the true value of the company had been revealed and the stock price collapsed, leaving employees with worthless options and pension packages. Of course, executives that understood the real picture sold their shares in advance of the collapsed and waltzed away with billions.

- **Management Culture**

Of course, the Enron fiasco did not happen by accident. It was facilitated by a corporate culture that encouraged greed and fraud, as exemplified by the energy traders who extorted California energy consumers. Rather than focus on creating real value, management's only goal was in maintaining the appearance of value, and therefore a rising stock price. This was exacerbated by a fiercely competitive corporate culture that rewarded results at any cost. Some divisions of Enron replaced as much as 15 percent of its workforce annually, leaving employees to scramble for any advantage they could find to justify their continued employment.

- **Preferential Treatment**

While the internal integrity of the company remained thusly challenged, the facade was the exact opposite. The company leveraged political connections in both the Clinton and Bush administrations, as well as on Wall Street, for preferential treatment and the air of legitimacy that allowed it to perpetuate its frauds. In this context, the accounting practices widely considered the cause of the Enron collapse is just a symptom of a larger management culture that exemplified the dark side of American capitalism.

- **Interest**

It has been suggested that a lack of independent oversight of managing 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. The energy trading arm has been tied up in a complex deal with UBS Warburg as Enron's core business. The bank has shared some of the profits with Enron but has not paid for the trading unit.

THE WARNING OF ENRON'S SCANDAL

(1) There should be a healthy corporate culture in a company. In Enron's case, its corporate culture played an important role in 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 losses in order to protect their reputations instead of trying to do something to make it correct. The "to-good-to-be-true" should be paid more attention by directors of the board in a company.

(2) 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 to the behavior of management and the way of making money. In addition, Enron's fall also had a strikingly bad influence on the whole U.S. economy. Maybe the government also should make better regulations or rules in the economy.

(3) "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 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 the "mark to market" accounting method. The ignorance of the drawbacks of this accounting method by SEC also caused the final scandal. Thus, an accounting system that can disclose more financial information should be created as soon as possible.

(4) 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.

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 bankruptcy. During the 1990s, Enron expanded into several areas quickly such as developing a pipeline and a power plant, however, this expansion required a 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 the investment rate in order to continue the 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 a good look in front of the investors. Enron's goal was to overcome the rules of consolidation and, at the same time increase credibility. If a parent company (in this case Enron) financed less than 97 percent of an initial investment in an SPE, it didn't have to consolidate it into its own accounts4. 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 an 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, the solution to the thoughts 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 achieve of all its SPEs, without the test of accounting to determine to know whether the SPE should be consolidated or not. Enron followed this policy in financing which ultimately would enable it to be valued more attractively by rating agencies and Wall Street analysts. afterword 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.

Bankruptcy

Enron's stock price from August 23, 2000 ($90) to January 11, 2002 ($0.12). As a result of the decrease in the stock price, shareholders lost nearly $11 billion. On November 28, 2001, Enron's two worst-possible outcomes came true. First, Dynegy's board unanimously accepted Watson's recommendation to tear up the merger agreement. Next, Enron's credit rating was reduced to junk status. Watson later said, "In the end, you couldn't give it [Enron] to me." Although they had seemingly ironed out the issues at a meeting in New York over the previous weekend, ultimately Dynegy's concerns about Enron's liquidity and dwindling business proved insurmountable. The company had very little cash with which to operate, let alone satisfy enormous debts. Its stock price fell to $0.61 at the end of the day's trading. One editorial observer wrote that "Enron is now shorthand for the perfect financial storm."

Systemic consequences were felt, as Enron's creditors and other energy trading companies suffered the loss of several percentage points. Some analysts felt Enron's failure indicated the risks of the post-September 11 economies, and encouraged traders to lock in profits where they could. The question now became how to determine the total exposure of the markets and other traders to Enron's failure. Early calculations estimated $18.7 billion. One adviser stated, "We don't really know who is out there exposed to Enron's credit. I'm telling my clients to prepare for the worst." Within 24 hours, speculation abounded that Enron would have no choice but to file for bankruptcy. Enron was estimated to have about $23 billion in liabilities from both debt outstanding and guaranteed loans. Citigroup and JP Morgan Chase, in particular, appeared to have significant amounts to lose with Enron's bankruptcy. Additionally, many of Enron's major assets were pledged to lenders in order to secure loans, causing doubt about what, if anything, unsecured creditors and eventually stockholders might receive in bankruptcy proceedings.

By the close of business on November 30, 2001, it was obvious Enron was at the end of its tether. That day, Enron Europe, the holding company for Enron's operations in continental Europe, filed for bankruptcy. It became the largest bankruptcy in U.S. history, surpassing the 1970 bankruptcy of the Penn Central (WorldCom's bankruptcy the next year surpassed Enron's bankruptcy so the title was short held), and resulted in 4,000 lost jobs. The day that Enron filed for bankruptcy, thousands of employees were told to pack their belongings and given 30 minutes to vacate the building. Nearly 62% of 15,000 employees' savings plans relied on Enron stock that was purchased at $83 in early 2001 and was now practically worthless. In its accounting work for Enron, Andersen had been sloppy and weak. But that's how Enron had always wanted it. In truth, even as they angrily pointed fingers, the two deserved each other. On January 17, 2002, Enron dismissed Arthur Andersen as its auditor, citing its accounting advice and the destruction of documents. Andersen countered that it had already ended its relationship with the company when Enron became bankrupt

Aftermath

Enron's shareholders lost $74 billion in the four years before the company's bankruptcy ($40 to $45 billion was attributed to fraud). As Enron had nearly $67 billion that it owed creditors, employees and shareholders received limited, if any, assistance aside from severance from Enron. To pay its creditors, Enron held auctions to sell assets including art, photographs, logo signs, and its pipelines. In May 2004, more than 20,000 of Enron's former employees won a suit of $85 million for compensation of $2 billion that was lost from their pensions. From the settlement, the employees each received about $3,100. The next year, investors received another settlement from several banks of $4.2 billion. In September 2008, a $7.2-billion settlement from a $40-billion lawsuit was reached on behalf of the shareholders. The settlement was distributed among the main plaintiff, University of California (UC), and 1.5 million individuals and groups. UC's law firm Coughlin Stoia Geller Rudman and Robbins received $688 million in fees, the highest in a U.S. securities fraud case. At the distribution, UC announced in a press release "We are extremely pleased to be returning these funds to the members of the class. Getting here has required a long, challenging effort, but the results for Enron investors are unprecedented.

THE COLLAPSE OF ENRON AND MORAL RESPONSIBILITY (FROM INDIVIDUALS' ANGLE)

As corporate acts originate in the choices and actions of human individuals, these individuals must be the primary bearers of moral duties and moral responsibility. The then chairman of the board, Kenneth Lay, and CEO, Jeffrey Skilling, to allow the then CFO, Andrew Fastow, to build a 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 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 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. If the board and other shareholders paid more attention to those decisions made by the chief, CEO, CFO, and those relevant staff, ENRON can avoid this result.

CONCLUSION

The remarkable financial event of the Enron employer proven that principal corporate businesses in the gasoline and software enterprise had been manipulating the organization's economic statements. Further, the implementation of the Sarbanes-Oxley Act of 2002 helped align and reshape publicly-traded company's monetary reporting structures. Furthermore, the U.S. Securities and trade fee (SEC) required publicly traded agencies with a glide capital of $75 million to conform to the Sarbanes-Oxley Act of 2002. Furthermore, the SOX fee of compliance internal manipulates the system is $3.5 million. Consequently, because of the adoption of the Sarbanes-Oxley Act of 2002, auditors and publicly traded corporations have experienced a high fee of compliance in the monetary marketplace amongst economies of scale. In summary, pinnacle officers at Enron abused their strength and privileges. They manipulated records while engaging in the inconsistent remedy of internal and outside constituencies. Those leaders placed their very own interests above the ones of their personnel and the general public and did not work out proper oversight or shoulder obligation for ethical failings. Therefore, there is want the directors to follow precise examples in the following subjects:

First, there ought to be a healthful corporate way of life in an organization. In Enron's case, its corporate culture performed a vital role in its crumble. The senior executives believed Enron needed to be excellent at everything it did and the shareholders of the board, who were no longer worried about this scandal, had been over-optimistic approximately Enron's running situations. When there existed failures and losses of their agency performance, what they did change into overlaying up their losses which will guard their reputations in preference to seeking to do something to make it accurate. Consequently, the "to-right-to-be-true" should be paid extra interest through administrators of the board in an enterprise.

Secondly, a greater entire machine is wanted for owners of a business enterprise to oversee the executives and operators and then get the concept of the corporation's operating. There may be no question that extra governance from the board can also keep Enron from falling to financial disaster. The forums of directors ought to pay nearer attention to the conduct of management and the way of making money. In addition, Enron's fall also had strikingly terrible have an impact on the complete U.S. economy. Maybe the government also should make better policies or guidelines inside the economic system.

Thirdly, "Mark to market" is a plan that Jeffrey Skilling and Andrew Fastow proposed to pump the stock price, cover the loss and attract extra funding. However, it's miles not possible to gain in an extended-term operation in this manner, and so it's miles truly immoral and unlawful. But it changed into reported that the then US security and alternate fee allowed them to apply the "mark to marketplace" accounting method. The lack of knowledge of the drawbacks of this accounting technique with the aid of Securities and change commission also prompted the very last scandal. For this reason, an accounting device that could expose more financial information should be created as quickly as viable. And fourthly, maybe commercial enterprise ethics is the maximum thesis factor people doing enterprise must cognizance on. As a faithful agent of the company, the supervisor has a duty to serve the enterprise in anything approaches will enhance the enterprise's self-hobby. In this case, they violated the precept to be unswerving to the employer in their Enron. in particular for accountants, keeping a monetary statement disclosed with genuine profits and losses data is the fundamental responsibility that they should comply with its miles really worth citing that the Enron Corp case become the largest in a series of scandals that broken the reputations of agencies as a direct result, the Congress surpassed a law, known as the Sarbanes auditors and made corporate executives criminally answerable for mendacity approximately their debts. The Enron scandal moved the balance of electricity away from the corporation forums closer to the investors. After the scandal, there is extra caution among company executives about spinning off accounts that is probably faulty, as now they face crook liability. But, the temptation to enhance stock expenses has of booming markets overall when the rewards for executives are excessive. In the end, it may be proved that the bankruptcy of the Enron become because of managerial scandal for the self-benefit than shareholder's gain of this organization. Therefore, through regulation that has passed by Congress after this situation, the rights of investors and employees might be guaranteed greater.

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