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Ethical Implications of Full Disclosure Principle on the fall of Enron Corporation

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Abstract

For companies to remain competitive and in business, they ensure that stakeholders' interests are pursued and protected. Among such interests is increase in profits, market share and rise in share price. It is believed that companies that adequately provide information related to stakeholder-interest build their trust and are perceived to be ethical which leads to high performance. Hence, this study sought to theoretically assess the ethical implications of Enron's failure to comply with the Full Disclosure Principle in the Accounting Profession. Different ethical theories were employed to analyze the actions of the executives of Enron Corporation. It was discovered that teleological ethics, situationism, and conflicting absolutism supported the actions of these executives while deontological ethics, generalism, unqualified absolutism and graded absolutism found the actions of the executives as having no ethical justification. Nonetheless, antinomianism was indifferent in describing the actions as ethical or not. The study concludes that these managers were acting based on their own interests rather than their duties to employees and other stakeholders which led to the pursuit of huge compensation and other benefits. Companies should create a business environment that up holds transparent and full disclosure to enjoy all its associated benefits in both short and long term to ensure firms' continuous survival as it was the cause of Enron Corporation's fall.

Keywords: Full disclosure, teleological ethics, deontological ethics, antinomianism

1. Introduction

1.1. Introduce the Problem

Due to constantly changing competitive environments, business organizations find new methods to meet competition other than the traditional ways of better products (most consumers believe that competitive products are fairly equal in terms of quality), more services associated with a sell (more companies are finding that providing more and more services negatively affect profitability), or lower prices (competing on price results in erratic market share and unstable profits). Business organizations are responding to these challenges today by establishing partnerships and more collaborative relationships with their stakeholders (Dertouzos, Lester & Solow, 1989).

Relative to these relationships there has been much discussion in the last several years regarding ethical practices by business organizations. For the most part, it has been assumed that organizations would do what was right for both their customers and their employees in the interest of long-term positive relationships. Unfortunately, we have learned the difficult lesson that such behavior is not always the norm. Unethical and illegal activities by such companies as Enron, WorldCom and Adelphi have shaken the foundation of trust that has formed the basis of marketplace relationships between companies and stakeholders. While there has been a greater focus on business ethics as a result of these companies' activities, questions are still asked regarding the financial return related to developing processes that insure absolute adherence to high ethical standards in organizations (McMurrian & Matulich, 2006).

Ethics could be seen as a constraint on profitability. This view indicates that ethics and profit are inversely related (Bowie, 2000). There are probably times when doing the right thing reduces profits. A more positive view, however, is that high standards of organizational ethics can contribute to profitability by reducing the cost of business transactions, building a foundation of trust with stakeholders, contributing to an internal environment of successful teamwork, and maintaining social capital that is part of an organization's market-place image (McMurrian & Matulich, 2006).

Ethics and the importance of ethical decision making have taken on increasing significance because of the pressures placed on business managers by shareholders, creditors, and other parties affected by financial performance. It is not surprising therefore that a recent survey of investment management firms revealed that nearly three-quarters of the respondents felt that unethical behavior, such as personal trading, insider trading, and fraudulent financial reporting are areas of high concern. Another survey indicated that nearly half of over 700 human resource professionals said they feel pressurized to compromise their organizations' standards of ethical business conduct.

Every organization is supposed to present to their stakeholders financial and operational information at the end of the entity's reporting date as per IAS 1 (Presentation of Financial Statements). This includes but not limited to annual

reports which comprise Income Statement, Statement of Financial Position, Statement of changes in Equity, Cash Flow Statement, Accounting Policies and Notes, Director's Report and Auditor's Report. In recent times, it is realized that the information will be communicated alright but as to whether they have met the full disclosure principle is another thing. Thus, the full disclosure principle means communicating all business transactions that can influence the decision of the stakeholders to them (Horngren & Harrison, 2008). For instance, if the accountant is asked to hide a business transaction which has occurred in the current year just to declare profit to its users raises ethical issues which need to be discussed.

1.2. Brief Description of Enron Corporation's Case

In the film 'Enron: The Smartest Guys in The Room,' analyst Jim Chanos asks why, the 7th largest company in the world at the time, could not supply investors with basic financial statements. These statements as we learn in accounting are the fundamental tools through which we communicate a corporation's financial position. So why was it that a corporation valued as much as \$70 Billion at one time would have ever achieved such success without performing basic accounting functions? The CEO, Jeff Skilling's caustic reply to the question foreshadowed the collapse of a company that had been built on lies and deceit. While the Enron scandal is one of the best known in the history of international business, the reasons for the collapse were built into the company from its very roots. The aforementioned film, Enron: The Smartest Guys in The Room was an excellent resource as it was primarily historical footage and first-hand accounts from individuals involved with the scandal.

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 broadcast time for advertisers, weather futures, and Internet bandwidth (Li, 2010).

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. According to Thomas (2002), the drop of 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's compensation plan seemed oriented toward enriching executives rather than generating profits for shareholders, and encouraged people to break rules and inflate the value of contracts even though no actual cash was generated. Enron's bonus program encouraged the use of non-standard accounting practices and the inflated valuation of deals on the company's books. Indeed, deal inflation became widespread within the company as partnerships were created solely to hide losses and avoid the consequences of owning up to problems (Mehta, 2003). Enron fall to bankruptcy on December 2, 2001 (Partington, 2011).

1.3. Ethical Issue

The rise and fall of Enron Corporation raises a lot of ethical issues which include greed, stealing, deceit, among others. However, as far as this paper is concerned the ethical issue to be considered from Enron's fall is the inadequate disclosure of or failure to disclose relevant financial information to stakeholders to permit informed judgments and decisions to have prevented the fall in the last month of 2001 which amount to deceit.

2. Discussion

The executives at Enron Corporation did not break any specific laws by encouraging employees to buy more shares of stock even when they believed the company was in financial trouble and the price of the shares was likely to decline. However, this behavior was a clear violation of the executives' ethical responsibilities to employees (Geisler, 2010). These managers were acting based on their own interests rather than their duties to employees and other stakeholders which led to the pursuit of huge compensation and other benefits.

The Psalmist says in Psalm 50:10 that 'For every beast of the forest is Mine, the cattle on a thousand hills.' This means that all money, all wealth, all things, and all resources belong to God. He is the owner because He is the Creator. We must never confuse earthly ownership with who is ultimately on the throne of all. Thus, amassed for them in vain. Again, Proverbs 13:11 says, 'Wealth obtained by fraud dwindles, but the one who gathers by labor increases it.' Some people are more concerned about their own present well-being such that they are willing to steal from others, even from future generations. Fraud dishonors God, but faithful and honest labor is a good thing.

The teleological ethics (utilitarianism) posits that it is the results that determine the rule. Thus, the executives of Enron pursued the utilitarian view by looking at the compensation and the benefits they were enjoying as the end product of their unethical behavior of deceit or inadequate disclosure of financial information to the users (Fung, 2014). However, the deontological ethics states that the rules determine the results which goes contrary to the actions of the executives. This suggests that the executives should have been transparent in their dealings with the stakeholders since transparency in financial reporting as stated by Fung (2014) enables investors, creditors, and market participants to evaluate the financial condition of an entity. In addition to helping investors make better decisions, transparency increases confidence in the fairness of the markets.

Antinomianism claims that inadequate disclosure of financial and operational information to earn profit or increase market share is neither right nor wrong. It insists that there are no objective moral principles by which the issue can be judged right or wrong. The issue must be decided on subjective, personal, or pragmatic grounds, but not on any objective moral grounds. Generalism claims that inadequate disclosure is generally wrong. In specific cases, however, this general rule can be broken. Since there are no universal moral laws, whether a given inadequate disclosure is right will depend on the results. If the results are good, then the inadequate disclosure is right. Most generalists believe that inadequate disclosure to earn profit or increase market share is right because in this case the end justifies the means. But Enron executives' failure to disclose financial information was for their personal gains not the gains of the company. In this context, their action is unsupported by this theory.

Situationism, such as that held by Joseph Fletcher, claims there is only one absolute moral law, and it is not truth-telling. Love is the only absolute, and inadequate disclosure may be the loving thing to do. In fact, inadequate disclosure to earn profit and increase market share of shareholders is the loving thing to do. Hence, inadequate disclosure is sometimes right. Any moral rule except love can and at times should be broken for love's sake. Everything else is relative. This might also be the position of the executives since they found delight in glorifying some few people in the company.

Unqualified absolutism, such as was taught by St. Augustine, claims there are many absolute moral laws, and none of them should ever be broken. Truth is such a law. Therefore, one must always tell the truth, even if the company will go bankrupt or fold up as a result of it. Truth is absolute, and absolutes cannot be broken. Therefore, there are no exceptions to telling the truth. Results are never used to break rules, even if the results are very desirable.

Conflicting absolutism recognizes that we live in an evil world where absolute moral laws sometimes run into inevitable conflict. The German theologian Helmut Thielicke espoused this view. The conflicting absolutist insists that in unavoidable conflicts it is our moral duty to do the lesser evil. That is, we must break the lesser law and plead mercy. For instance, we should break the full disclosure principle to prevent bankruptcy and then ask for forgiveness for breaking God's absolute moral law and in this case, Enron's failure to tell the true state of the company through its financials. Our moral dilemmas are sometimes unavoidable, but we are culpable anyway. God cannot change His absolute moral prescriptions because of our moral predicaments.

Graded absolutism, such as Geisler holds, insists there are many moral absolutes and they sometimes conflict. However, some laws are higher than others, so when there is an unavoidable conflict it is our duty to follow the higher moral law. God does not blame us for what we could not avoid. Thus He exempts us from responsibility to follow the lower law in view of the overriding obligation to obey the higher law (Geisler, 2010).

The lack of truthfulness by management about the health of the company, according to Kirk Hanson, the executive director of the Markkula Center for Applied Ethics. The senior executives 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. The duty that is owed is one of good faith and full disclosure. There is no evidence that when Enron's CEO told the employees that the stock would probably rise that he also disclosed that 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 February 14, 2002 which is when the sell-off would otherwise have been disclosed. Why the delay? The stock was sold to the company to repay money that the CEO owed Enron (Li, 2010).

Increasing transparency provides benefits to the firm, but entails costs as well. Better transparency improves the board's monitoring of the CEO by providing it with an improved signal about his quality. But better transparency is not free: The better able the market is to learn about the CEO's ability, the greater the risk to which the CEO is exposed. In our setting, the profit-maximizing level of transparency requires balancing these two factors (Weisbach & Hermalin, 2007). The quality of financial disclosure can impact firms' cash flows directly, in addition to influencing the cost of capital at which the cash flows are discounted. We posit financial accounting information of firms and their competitors aid managers and investors in identifying and evaluating investment opportunities. An absence of reliable and accessible information, as in the case of Enron Corporation, in an economy impedes the flow of human and financial capital toward sectors that are expected to have high returns and away from sectors with poor prospects. Even without agency conflicts between managers and investors, quality financial accounting data enhances efficiency by enabling managers and investors to identify value creation opportunities with less error. This leads directly to more accurate allocation of capital to highest valued uses (Bushman & Smith, 2003).

3. Biblical Perspective

The Christian view of right and wrong is neither arbitrary nor groundless. It is not arbitrary because what God wills is in accord with His nature as absolute good. It is not groundless because it is rooted in what never changes, namely, God's immutable essence: 'I the Lord change not' (Mal. 3:6); 'There is no shadow of change' with God (James 1:17).

Even though the universe will change, 'You [God] are the same,' declared the psalmist (Ps. 102:27). Although God is free to act according to the dictates of His own essential goodness, He is not 'free' to act contrary to it. Likewise, His commands will always be rooted in His immutable nature as the ultimate Good. Hence, what is right cannot be justified by the results. So whether Enron Executives had good intentions of maximizing shareholders wealth and increasing profit (which was not even the case) or not, does not make violating basic accounting principle, full disclosure, a right thing to do. In other words, whether the executives were pro generalists or situationists did not justify their inability to disclose

relevant information to stakeholders to permit informed decision since truth is one and absolute as God our remodel and savior is.

Again, 'It is impossible for God to lie' (Heb. 6:18), so we should not lie either (Col. 3:9). 'God is love' (1 John 4:16), and so Jesus said, 'Love your neighbor as yourself' (Matt. 22:39). In brief, Christian ethics is rooted in God's immutable nature, but it is expressed by God's will.

Paradoxically, people seeking redemption by partially admitting their big lies feel guilty because they do not take complete responsibility for their bad behaviors. True guilt relief requires people to fully come clean (Shalvi, 2014). So, the executives attempt to falsely increase the price and pretend as if the company was doing excellently was a lie, and did not show that love God expects to permeate among His creatures

4. Conclusion

Expectations of high standards of ethical corporate behavior are rising, as companies face legal and economic penalties for pursuing unethical and illegal activities. Indeed, some companies have made ethical leadership in the market a central part of their corporate strategy. They believe that ethical behavior is not just the right thing to do, it is also good business.

In Christian ethics these results are all calculated within rules or norms. That is, no anticipated result as such can be used as a justification for breaking any God-given moral law.

Certainly, there are companies that still believe that unethical business practices will not be discovered and there will be no negative business implications. In fact, we will most likely see more ethical lapses among business organizations in the future (McMurrian & Matulich, 2006). While disclosure has manifest pitfalls, according to Loewenstein, Cain, and Sah (2011) there are also enormous opportunities for designing policies that will enhance its benefits. Care must be taken, however, to ensure that disclosure does not replace more effective measures, such as working harder to eliminate conflicts of interest in the first place.

There are still two good reasons that business organizations should be concerned about their ethical reputations (Richardson, 2003). First, unethical business practices, once they have become public, can lead to government intervention and regulations that are more problematic to businesses than self-policing in the first place. Such regulations can prove to be not only limiting in terms of what a business can and cannot do (both externally in the market and internally related to labor and accounting practices), but also financially costly for companies to adhere to. Second, and even more important than governmental intervention, is trust. Companies lacking trust by employees, business partners, and customers will suffer financially in the long-term. Trust, based on ethical reputations, may become even more important in the future.

We live in an ever increasing e-commerce world where business organizations are becoming geographically far-removed from their customers. In such an environment, customer trust based on reputations grounded in the process quality component of customer value is even more important to the long-term growth and profitability of companies.

The broader scope of Biblical teaching provides us with an alternate vision, calling us to live in alignment with the mission of God. Thus, our work should partner with God's transformative mission of human flourishing. Business, then, is better seen as a calling to serve God and our neighbors, seeking the 'common good.' Although much more needs to be done, business already participates in kingdom work by creating goods and services that enhance people's lives, providing meaningful work, and helping investors save for goals such as college and retirement. Thus, companies should create a business environment that up holds transparent and full disclosure to enjoy all its associated benefits in both short and long term to ensure firms' continuous survival as it was the cause of Enron Corporation's fall.

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