



**ANDERSEN**

Business Ethics and Corporate governance  
The Andersen vs. Enron Scandal

Assignment 3

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## **Introduction**

Arthur Andersen was a son of a Norwegian immigrant. After attending evening school and working as a mail boy during the day, Arthur was hired as an assistant controller of Allis- Chalmers in Chicago. This is where his interest for public accounting was founded. He continued his studies of accounting at the University of Illinois and Northwestern University. At the age of 28 Andersen and DeLany founded Andersen, DeLany & Co; later in 1918 to become Arthur Andersen & Co. Andersen continued his devotion to the firm until his death in 1947.

Arthur Andersen was a great believer of the need of high standards in the accounting industry. He argued that the accountants' responsibility should lie not with the clients but the investors. The companies' motto remained 'Think straight, act straight' for many years to come. However, in 2001 the auditing and consulting firm got a tough blow, which it didn't survive. Something Arthur Andersen himself probably would have never imagined to happen.

## **Andersen's severe punishment**

The Enron auditing scandal marked the end for the once so prestigious auditing firm, Arthur Andersen. Around 85.000 employees worldwide had to loose their job. Partners lost their investments. Was the destruction of Andersen the right decision? *Is it justified to blame the whole worldwide company network for what happened at Enron?* For this, we would have to go deeper into the case and look from an ethical perspective upon what happened.

## **How Andersen's loose internal controls created the potential for ethical failure**

Arthur Andersen consisted of an accounting and consulting wing. Employees were expected to show a maximum of dedication. Team building, extensive training and morale raising exercises were an important part of the company culture tools. All this was founded strongly on the "one-firm philosophy" of Arthur Andersen himself. This implied widespread integration of departments amongst each other. **How, with this seemingly healthy company culture, could it have turned in such a disaster?** Taking a look at the company history, the Enron lawsuit appears not to be the only case of fraudulent auditing. Until today, there are around a 100 civil lawsuits still pending.

*“Every action implies ethical judgment, it can become habitual and unconscious but once we reflect on why we do things, we invoke ethical principles.” (John Hooker, May 2005, Carnegie Mellon University)*

The Andersen problem was the fact that the HQ seemingly had lost control over the rest of the company network. There was no higher level commitment to the ethical issues. This meant that some employees could act out of misplaced self-interest (Act-Egoism) or think they were acting for the **company’s good (Act-Utilitarianism), whereas they were not**. Neither the company CEO (Joseph Berardino) nor the CFO did have the insight into the amount of damage that was already done, by some employees. Citing an extract from a BBC News article concerning Mr. Duncan, the former head of the Enron account:

*“He only realized that he had broken the law after poring over legal textbooks, and admitted to his family in March that he thought he had committed a crime. Mr. Duncan, who had in January questioning claimed innocence, said his decision to admit guilt followed "a lot of soul searching about my intent and what was in my head at the time". From; Enron auditor feared Lawsuit, May 15 2002, BBC News*

The lack of control meant the regional partners could keep close relationships with companies such as Enron, from which it profited, *for the time being*. The positive attitude towards these practices did not restrain itself to one office; it became a global network issue. **But at the time, there was nobody to see the fatal signs and prevent further escalation.**

### **Why arm’s length relationships are crucial for ethical integrity in auditing**

Every country has its **General Accepted Accounting Principles**, they may differ per country to some extent, but the main point is globally accepted: An auditor must be objective and free from bias at all times. He/She also has to practice conservatism. This must be rooted deeply into the company practices. Under Act-Utilitarianism, means to reach a goal can get distorted. The main goal for Andersen became to have the best reputation and more clients, and as a result, bring in more money. This is not wrong de facto, but siding with clients and accepting their malicious accounting system, no matter how big they are, results in absence of objectiveness and brings conservatism in danger.

Besides that, certain social policies and generally accepted ethical rules are ignored. Though this may have seemingly profitable results in the short run, it destroyed the long nourished company reputation which made Andersen so big in the first place.

### **The logic of indicting the entire company for ethical failures**

Human nature, being a social person, demands people to relate to others. In the Andersen case, seeing some executives having huge success with their, alas, risky ethical approach, made the other employees to practice a Relativism way of decision making. This implied that employees began to involve in the same practices and didn't see the actual danger of it. Why indict the whole company? The fact that the company participated in these malicious practices, not only at the Houston office, completely destroys the credibility of the firm. Andersen violated many GAAP principles and other social laws, despite that after the Waste Management case the firm agreed to the SEC consent decree. **This may be ethically justified in the employees' point of view, but it makes them free-riders in the eyes of society.** There are certain rules in society, a way to maintain justice, which a company has to consider, no matter what the main ethical base may be. If those rules are violated, the firm might want to do business; but nobody would want to tarnish their own credibility by doing business with the firm. The attitude towards Andersen could be well described by the victims of the Baptist Foundation of Arizona case, which also filed bankruptcy after fraudulent accounting practices. Citing an article from Salon.com dealing with the Andersen issue:

*"...some BFA victims have braved the hot sun from time to time to picket Andersen's elegant headquarters in Phoenix. They've even thought up a song, which not only dates them, but also expresses their bitter sentiments. To the tune of "Where Have All the Flowers Gone," the BFA victims like to sing: "Where has all the money gone? Just Ask Arthur Andersen ..."From; Arthur Andersen and the Baptists; Feb.7 2002; Salon.com*

### **How could Andersen have been able to avoid this disaster?**

It may seem surprising, but in the early 1980's, almost no company took the initiative to set up its own **Corporate Ethics Programme**. A company, especially a financial one, and suffer greatly from distorted ethics. Apart from the fines and court judgments a company can loose billions and even cease to exist at all. Seeing the amount of damage that can result from ethical misbehavior, such a

programme is crucial for a company, especially one of scale. **With the increased focus by the media on corporate conduct, government pressure and growing maturity of business institutions, a company cannot do without.** Besides a standard Corporate Policies Scheme a company can do the following:

- Set up a Code and Compliance programme: regulate behavior of employees; deal with conflicts of interest, bribing, anti competitive behavior etc.
- Set up an Identity and Values programme: deals with what the corporation stands for; integrity, respect for others, service to stakeholders etc.
- Give regular Corporate Ethics trainings
- Assign one contact person at every office to deal with ethical issues
- Become member of Ethics Officers Association for more support

If Andersen would have integrated more conscious moral behavior in its company culture, much damage could have been avoided. For example the confusion about what is ethically acceptable and what isn't in the company. After all, for an auditing firm, especially today, this is one of the things that make a rich ground to cultivate success.

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