THE ROLE OF ETHICS IN RECENT CORPORATE SCANDALS

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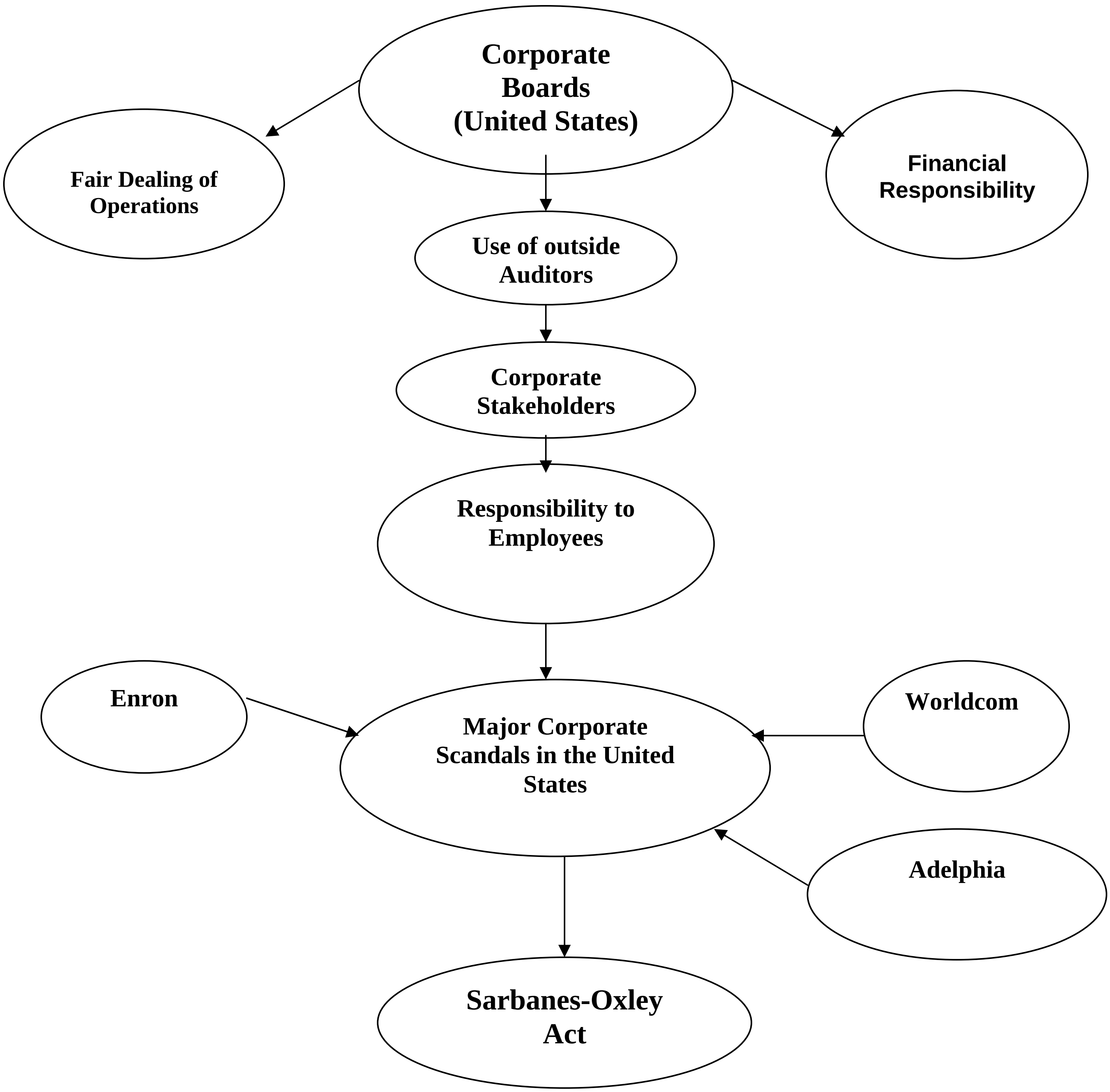
Abstract

Assessment of the impact of corporate Board ethical responsibility regarding corporate image, reputation and financial performance are considered. Many stakeholders of corporations including management, employees, vendors and customers, have suffered significant losses from corporate scandals in the United States, which in some cases they were unable to re-emerge from. Consequently, the Board of Directors of corporations in the United States has been under increased scrutiny to maintain a balance within their organizations financially and ethically to enforce a system of fairness for all stakeholders of the corporation. Essentially, Boards and management must be very prudent about their decisions and actions in the best interests of the corporation or face criminal and/or civil action for failing to do so.

Figure 1


Corporate Boards (United States)
Fair Dealing of Operations
Financial Responsibility
Use of outside Auditors
Corporate Stakeholders
Responsibility to Employees
Enron
Worldcom
Major Corporate Scandals in the United States
Adelphia
Sarbanes-Oxley Act

THE CORPORATE BOARD IN THE UNITED STATES:

In today's business world, characterized as the information age, where media has extended its boundaries to reach even the smallest of populations across the globe, the Board of Directors of all corporations must go to extreme measures to maintain due diligence in every aspect of their duties in managing corporations. Any corporate transgressions can be immediately disclosed to the world through television, radio and most recently the Internet. These perceptions of misconduct, whether true or false, can greatly affect the corporations' position in the marketplace. Because of the critical affect that inappropriate conduct on the part of Directors and corporate management has on the future of the corporation in addition to the adverse affects on all of its stakeholders, the United States government passes the Sarbanes-Oxley Act of 2002. This act was initiated in order to create a specific framework for auditing all functions of Board members to circumvent corruption as well as to encourage improvements in the stock market. Improving the confidence of stockholders in the United States was also a major consideration in the implementation of this legislation (Thompson, 2005).

Prior to the passing of the Sarbanes-Oxley Act, several infamous cases of corporate misconduct surrounding major corporations in the United States caused serious repercussions and devastation to shareholders, employees and other stakeholders that were in most cases irreversible. This paper will review the following corporations and the roles that their corporate Boards played in the corporate unethical activities that lead to major scandals in the United States: Enron, Worldcom and Adelphia.

ENRON CORPORATION:

Undoubtedly the most notorious example of corporate misconduct, in recent times, is the case of the collapse of the Enron Corporation after serious criminal investigation for improper accounting practices. Enron came into existence in 1985 through the acquisition of InterNorth and Houston Natural Gas companies, which made Enron the leading natural gas pipeline system in the United States (Enron, 2006). Enron acquired Portland General Electric (PGE) in 1997 and subsequently the corporation became a major force in the power market in the United States as well as Australia, Argentina and the United Kingdom. Kenneth Lay, a former executive, was appointed the CEO of Enron in 1984 and although Mr. Lay resigned as CEO in 2001 and was replaced by COO Jeffrey Skilling, Lay returned as CEO during that same year after Jeffrey Skilling's resignation (Enron, 2006).

The Securities Exchange Commission (SEC) became suspicious of Enron's accounting practices as well as valuation of corporate assets in 2001. Enron's CFO, Andrew Fastow was center-stage of what appeared to be improper "off balance sheet transactions" (Thallner, 2002, p. 3). The CEO of Enron received information from a whistleblower regarding improper accounting procedures. Arthur Anderson LLP, which had previously done significant business with Enron, was hired to audit the allegations of improper accounting. In fact, Arthur Anderson was Enron's regular auditor. Arthur Anderson LLP determined that the accounting practices of Enron were "aggressive" and “creative” however were appropriate under SEC guidelines and that there was no need for further investigation (Thallner, 2002, p. 3). In 2002, The United States Department of Justice initiated criminal investigation into Enron after the corporation filed for Chapter 11 bankruptcy protection. Furthermore, investigation into exposed that auditors from Arthur Andersen LLP had disposed of Enron documents.

The devastating results of Enron improprieties affected employees’ jobs, retirement funds as well as complete destruction of share values. Subsequently, the former Treasurer, Ben Glisan, pled guilty to criminal conspiracy and for which he received a prison sentence (Enron, 2006). Mr. Fastow, CFO, also pled guild to “fraud, money-laundering and conspiracy” for which he received a 10 year prison sentence and was forced to pay $24 million. Roughly twenty other Enron executives have been charged with felonies including Kenneth Lay, former CEO. Table 1 shows the devastating effects that corporate ethical scandals can have on the revenue and, in this case, dissolving of a large corporation.

Corporate Boards are required to use due diligence in the selection and utilization of outside auditors and other experts. In the case of Enron, the question has been whether the Board received the reports and recommendations of their outside auditing firm and accepted them as fact because it benefited the Board to do so or whether Board members were negligent due to lack of diligence. Regardless, the massive devastation to Enron, Arthur Andersen LLP, employees’ positions and pensions of both companies as well as stockholders’ portfolios and negative impact to other stakeholders of Enron makes it quite clear that Board members do have a responsibility for overall financial performance and fair dealings as well as duty of care in the supervision of their organizations (Cooley, et al, 2003).

WORLDCOM:

In 1983, Bill Fields and his friend Bernie Ebbers built Worldcom in Hattiesburg, Mississippi upon Long Distance Discount Services (LDDS). Bernie Ebbers became CEO of the company and the company went public in 1989 at which time there was a merger between LDDS and another long distance company. In 1995, Worldcom was born in pursuit of attracting global business (Hoovers, 2005, p. 1). The trouble for Worldcom when it’s CEO, Bernie Ebbers, was forced to sell off shares of Worldcom stock. The Board of Directors of Worldcom became derelict of their duties when they authorized $366.5 million in loans to Bernie Ebbers to prevent him from having to sell off additional shares of Worldcom (Worldcom, 2006). Table 2 exemplifies the negative impact that corporate ethical scandals have on dividends paid and decreased profits .

Bernie Ebbers resigned from his position as CEO of Worldcom in April of 2002 under scrutiny of improper accounting practices and the appropriateness of the loans made to him by the Board of Directors. Furthermore, Ebbers was found guilty of securities fraud, conspiracy and seven counts of “filing false statements with the SEC” (Worldcom, 2006). Worldcom’s CFO, Scott Sullivan, was subsequently fired as a result of these issues. An interesting sidebar is that Worldcom had utilized Arthur Andersen as their auditing firm prior to this misconduct. In 2002, Michael Capellas was given the position of CEO and Chairman of Worldcom replacing Ebbers and Bert Roberts, previous Chairman of Worldcom. Worldcom has since been successful in reducing its corporate debt from $41 billion to $5 billion and has paid off SEC fines of $750 million for improper accounting procedures (Worldcom, 2006). In addition, Worldcom changed its name to MCI and in 2004 prepared to be bought out by Verizon Communications (Worldcom, 2006).

ADELPHIA:

Another major recent corporate scandal that gained much notoriety is the case of Adelphia Communications Corporation. John and his brother Gus Rigas incorporated Adelphia in 1972 as a cable company in Coudersport, Pennsylvania in 1972. Gus Rigas sold his portion of his business to John in 1983 after which the company reincorporated into a holding company consisting of five cable television companies. In 1998 Adelphia went public and increased its subscriber ship two-fold by expanding nationally. In the year 2001, Adelphia suffered from the declining economy in the United States and subsequently was forced to eliminate its workforce by 8%. Adelphia ventured into the telecommunications business in 2002 in hopes of reviving their declining cable business and decided to sell off part of their cable subsidiaries in order to raise funds (Adelphia, 2006).

During the process of this change, Adelphia's accounting practices fell under inquiry for potential fraud on the part of the Rigas family. John Rigas, founder and CEO of Adelphia, as well as his son Timothy were indicted and later convicted of the following serious charges: conspiracy and bank and securities fraud and they were forced to pay the corporation some of what was taken from the company (Adelphia, 2006). Adelphia's board was replaced with a special committee of independent directors who were left with the responsibility of returning the corporation to a profitable as well as ethically run corporation. The father and son team were caught for concealing $2 billion in Adelphia debt as well as stealing from the corporation. The assistant Treasurer, Michael Mulcahey, of Adelphia was charged as well however he was acquitted of all charges (Neumeister, 2005, p. E1). If the Board of Directors had taken its responsibility seriously and performed proper financial supervision of the company's assets, there would likely have been no need for a new special committee to be appointed to attempt to bring Adelphia out of this devastating situation.

CONCLUSION:

The passage of the Sarbanes Oxley Act of 2002 has developed a specific set of auditing tools and guidelines for directors. Directors now have a legal responsibility to follow these guidelines and their corporate bylaws or, as evidenced by the aforementioned scandals, face public scrutiny as well as criminal and civil action. According to John Nash, president of the National Association of Corporate Directors, directors are now being mandated to "be more accountable, to hold executives more accountable" to align themselves with the shareholders who actually employ them (Potts and Swoboda, 1992, p. 6). Boards of Directors must utilize the following resource committees to help to keep a balance of organization within a corporation: Committee of outside directors, Executive committee, Compensation committee, Audit committee, Nominating and Governance committee (Cooley, et al, 2003).

When utilized to their full potential and properly assigned tasks are given to the various board members, these committees are essential to the current operations and successful future of the corporation. Determining managerial compensation, maintaining a smaller set of board members who are available to meet almost immediately, auditing the corporate activities as required by the Securities and Exchange Commission (SEC) and recruitment of new board members are all crucial aspects of these standing committees (Cooley, et al, 2003). It is clear that the Boards and management of Enron, Worldcom and Adelphia corporations did not follow the basic principles that are required to successfully run major corporations. Although thousands of shareholders, employees and other stakeholders were severely adversely affected by the actions of the directors of these corporations, the ensuing legislation and scrutiny of current Boards is expected to help to substantially decrease corruption in the governance of corporations in the United States in the future.

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