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Business Ethics Utilitarianism Perspective on Financial Engineering and The Impact to The Company

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ABSTRACT:- The purpose of this study is to analyze the review of business ethics in the perspective of ethical utilitarianism in the financial engineering process of financial statements conducted by Enron Corporation. This study uses a qualitative approach that only focuses on one phenomenon and is understood in depth and ignores other phenomena, in this case the authors explore the process of financial engineering of financial statements conducted by Enron Corporation. The data analysis technique used in this study is in the form of data presentation that is a collection of data and information compiled so as to provide the possibility of drawing conclusions in the form of qualitative presentations in the form of narrative texts. In providing conclusions on the case the author uses literary literature sourced from scientific journals as well as books that discuss the Enron Corporation case. The results showed a company could collapse if it was not ethical according to the ethical perspective of utilitarianism in conducting financial engineering financial statement activities.

Key words:- Enron, ethics, utilitarianism.

I. INTRODUCTION

As fierce business competition develops, the company continues to develop its business in becoming a choice for the community, but companies that are managed in intense competition do not always produce the expected performance and need more funds for investors (Santoso & Surenggono, 2018).

In developing its business, companies need to maintain ethics in doing business, where business ethics is an important aspect in building a company. Ethical actions that are not well done by the company can cause retaliation from consumers and the public and reduce sales and corporate value (Budiyanti, 2015).

One of the ways to demonstrate good business ethics for public companies is to publish financial statements in accordance with generally accepted standards (International Financial Reporting Standards or IFRS) and is also a way to convince investors to invest funds in the company. Publication of the company's annual financial statements causes trading volume and stock profit levels higher after the company publishes financial statements. (Jatmiko, 2003)

In preparing the company's financial statements, the company's top management needs to follow accounting standards in conducting financial engineering of the company's financial statements, but this is sometimes not followed by good business ethics. It was shown in 2019, Indonesia was shocked by the events that occurred at the Business Entity State-owned namely PT Garuda Indonesia where there was a rejection of the 2018 financial statements by 2 (two) Commissioners and in 2019 the Ministry of Finance of the Republic of Indonesia in its decision found violations and imposed sanctions on all members of the Board of Directors, the board of commissioners who approved the financial statements and auditors who carried out the audit of PT Garuda Indonesia Tbk financial statements.

A similar case had occurred in 2000, where financial engineering was carried out by Enron Corporation which was the most innovative company in corporate America for 6 (six) years from 1995 to 2000 according to Fortune business magazine.

Related to the phenomenon that occurs, the authors are interested in doing a deeper analysis of financial engineering on financial statements from the perspective of business ethics through the perspective of utilitarianism, where the perspective of utilitarianism is a perspective that is not often realized often used in life or in public decision making. The case study taken by the author is financial engineering financial statements conducted by Enron Corporation which is the number 7 (seven) largest company in the United States based on income and the impact of the financial engineering to the company.

II. LITERATURE & METHODOLOGY REVIEW

2.1 Financial engineering

Accounting is an information provider tool in decision making that is influenced by a changing business environment and the increasingly complex and sophisticated development of financial markets, economics requires new collaboration with several other disciplines. A planning, development and innovation of financial instruments by management in forming a financial formulation that is able to create innovation, added value and better performance in solving financial problems known as financial engineering. (Finerty, 1988)

The purpose of financial engineering is to control the risk of companies caused by several factors such as price changes, foreign exchange rate measurements and interest rates caused by the realization of price movements, exchange rates and interest rates that will have an impact on cash flow, balance sheets, and income statement that will affect the company's accounting performance (White et al., 1997).

2.2 Business Ethics

Etymologically the word ethics comes from the Greek ethos which means attitude, moral character or customs and ways of thinking and used in the assessment of the system of values that exist in certain groups of people. In general ethics can be interpreted and understood as a reflection of good / bad, right / wrong that must be done or how to do good or right. (Dwiyanto, 2014: 15)

In the business world, ethics is very necessary to run company business activities that cover all aspects of business related to companies, individuals and society. Business ethics can be interpreted to emphasize the majority opinion about something that is ethical according to company leaders and thus business ethics is more than just virtue, integrity, or character. This involves understanding someone about something that is morally right and honest when there is an ethical dilemma and places rules, codes of ethics and principles in regulating behavior. (Lewis, 1985)

By understanding and learning business ethics for company leaders, it aims to advance the competencies of company leaders in order to achieve the business objectives of the company being led. Business ethics can be learned using methods such as role playing, strategy simulation, project simulation will effectively help understand conflicts and how solutions to conflicts can be designed and implemented in a structured manner. (Pies, Beckmann & Hielscher, 2009)

2.3 Utilitarianism Ethical Theory

Utilitarianism is an ethical theory which states that an appropriate action is one that maximizes happiness and reduces suffering. In 1859-1865 Jeremy Bentham and J.S. Mill developed a theory of utilitarianism. Bentham's philosophy is based on psychological hedonism, human happiness needs to be endeavored and believes that humans in accordance with their nature try to pursue pleasure and avoid pain.
However, according to Mill, happiness itself has quality so that the benchmark of a choice is not only quantitative but also qualitative and results in a theory where something is right and must produce quality happiness to many people. (Heydt, 2016)

The strengths of the theory of utilitarianism, according to J.S.Mill, are to use clear and rational principles and have elements that are in accordance with human morality as social creatures and the behavior affects the interests and happiness of many people and does not even cause pain or suffering. But there is also a drawback that the happiness described still emphasizes subjectivism, where the views on the useful and beneficial of each person differ which can lead to acts in the name of happiness for many people calmly violating human rights as an example of property rights. (Mangunhardjana, 1997)

In other words, the theory of utilitarianism is a consequential ethical theory that makes us think about the greatest good for the highest number and the smallest bad for the small amount. The interests of the largest number are more important than the smallest number, this is considered in accordance with democracy in determining public policy. Unwittingly this theory is a theory that is often used in life but it cannot be denied that it will be difficult to give good and bad values to different people. (Ni'am, 2008)

2.4 Methodology

The author uses a qualitative approach in which the qualitative approach contains the belief that social reality is a social construction and results in a holistic and contextual and situational understanding based on an investigation in a scientific setting (Wahyuni et al., 2016)
The qualitative approach here uses a case study design and can be translated this research only focuses on one phenomenon that is chosen and understood in depth by ignoring other phenomena and events, in this case the financial engineering of Enron Corporation's financial statements viewed from the ethical perspective of utilitarianism.
Data collection was carried out in this study using literature study data collection techniques, meaning that the research was carried out by tracing documents that the authors considered related to the research focus

Meanwhile there are three qualitative data analysis techniques, namely data reduction, data presentation and conclusion drawing (Miles and Huberman, 1984). This research using data analysis techniques in the form of data presentation techniques, i.e. when a set of information and activities are compiled that allows drawing conclusions in the form of qualitative data presentation in the form of narrative texts. To answer the formulation of the problem, namely regarding Financial engineering of financial statements in the perspective of utilitarianism ethical theory.

Researchers use several kinds of literature that comes from various sources relating to the problems that want to be examined in this study such as books and scientific journals.

III. DISCUSSION & RESULT

3.1 Beginning of the Case

Enron Corporation was formed by Kenneth Lay in 1985 located in Houston, USA and is the result of a merger between Houston Natural Gas and InterNorth. Enron Corporation has electricity, natural gas, pulp, paper, communications, future transactions, non-energy commodity trading and financial business activities. Enron managed to grow into the largest trading company on the North American continent in 1992, thanks to its lobbying skills and the use of US government regulations for natural gas sales. (Lukman, 2013)

Enron also conducts business transformation from which only conventional natural gas suppliers become intermediaries between natural gas and electricity producers to end users. Pipeline management and in 1999 introduced an internet-based trading platform for metal, energy and wood products. And in 2000 Enron Corporation was ranked 7 (seven) largest companies in the USA in terms of revenue growth in the gas and utilities sector and posted revenues of $ 100 billion. At first Enron had an image of excellent corporate citizen with all corporate social responsibility (CSR) as well as business ethics guidelines (Sims &Brinkmann, 2003).

The fall of Enron began with reports made by three subcommittees led by William Power to investigate several re-statements of capital positions related to investments from 1977 to 2000 and resulted in the cause of the restatement of financial statements stemming from human error. The report is known as a power report (Lukman, 2013).

A few moments later, top Management sold shares in 2001 before Enron's share price fell, around 29 Enron executives had sold their shares with a value of more than $ 1 billion (Madura, 2007).

In October 2001 the Securities and Exchange Commission questioned the conflict of interest between Enron, the Board of Directors and partnerships in particular Special Purpose Entities (Paul and Krishna, 2003). The various cheats committed by Enron are as follows

1) Misused accounting treatment for Enron's subsidiary, Mariner Energy, which created a fictitious income of $ 181 Million by inflating the value of Mariner Energy from $ 185 million to $ 366 million.
2) Enron sells future cash flows or future income streams at present value in generating a number of fictitious income, but it is Enron that guarantees future income and creates accounting sales without real profits or profits.
3) Enron borrowed large amounts of operational funds and $ 8 billion was deliberately classified as futures energy trading.
4) Enron Corporation also hides losses and debt under the off-balance sheet method used in preparing financial statements.
5) Another controversy is to appoint people from public accountants Arthur Andersen as Director of Finance, Head of Internal Audit and most accounting staff.

In November 2001 the Securities and Exchange Commission ordered Enron to restate financial statements for the past 5 years to incorporate SPE into the company's finances. The restatement of the financial statements increased Enron's debt report by $ 690 million which will mature in 2001. In a relatively short period of time, Enron's share price, which was originally estimated at $ 90 per share to under $ 1 per share, and Enron filed a bankrupt statement and removed from the New York Stock Exchange List. (Rampersad, 2006)

3.2 Involvement of Arthur Andersen Public Accountant

Arthur Andersen Public Accountant office began in 1913 under the name Anderse Delany & Co. and changed its name to Arthur Andersen in 1918. Arthur Andersen's Public Accountant is an accounting services company based in Chicago, Illinois, United States which includes "The Big Five "And became Enron's external auditor and management consultant with an audit fee of $ 25 million for audit fees and $ 27 million for consulting fees but Arthur Andersen was inadequate in evaluating sound business assessments in Enron Corporation's financial statements. (Paul and Krishna, 2003)

In March 2002 Arthur Andersen as a whole as a public accounting firm was found guilty by the Justice Department for being indicated to obstruct the investigation by destroying audit-related documents on Enron. (Sridharan, Dickes and Royce, 2002)

And in the end, Arthur Andersen firm had to submit his practice license because Arthur Andersen's public accounting firm was accused of having applied loose standards in auditing financial statements due to conflicts of interest over large fees for services. (Paul and Krishna, 2003)

3.3 Impact of Financial Engineering To The Enron Corporation

The unfolding of the actions taken by Enron's top management is to conduct financial engineering of the company's financial statements, resulting in a number of impacts on many parties that have a significant impact both on the company itself, employees, investors, public accounting firms, financial institutions, and the United States more broadly.

The impact of the financial engineering of financial statements conducted by Enron has a direct impact on companies where public trust in company transparency and an impact on negative market sentiment to Enron causes a dramatic drop in Enron's share prices starting from the beginning of the first quarter of 2001 until the company filed a bankrupt statement in December 2001

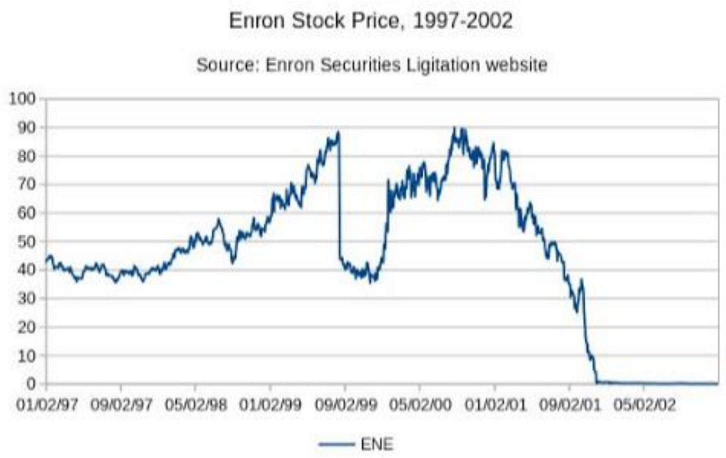

Figure 1: Enron Stock Price

With the bankruptcy experienced by Enron also creating thousands of unemployed, the loss of 70 to 90 percent of pension funds and employee savings invested in company shares (Hearing, 2001) and harming financial companies by leaving debts of approximately $ 23 billion to companies financial companies such as Merril Lynch ($ 80 million), JP Morgan ($ 2.2 billion), Citigroup ($ 2 billion), Canadian Imperial Bank ($ 2.8 billion), Toronto Dominian Bank ($ 130 million), Royal Bank of Canada ($ 25 million), and Royal Bank of Scotland ($ 42 million) and caused several Bank executives to be found guilty of finding fraud or collusion. (Brook, 2007: 77)

IV. CONCLUSIONS

In the utilitarianism ethics theory it is stated that this theory emphasizes the happiness of many people and avoids illness, from the fact that the authors meet it can be concluded that the practice of financial engineering of Enron Corporation's financial statements does not seem to be ethical when viewed from ethical utilitarianism which is reinforced by 5 (five) big factors which is caused as follows

1. The fall in Enron's share price.
2. Resulting in a lot of lost investor funds.
3. Financial institutions suffered losses and several senior financial institutions were affected by legal cases.
4. Thousands or even tens of thousands of employees lost their jobs and also lost pension funds and savings.
5. And also the closing of the public accounting firm Arthur Andersen as an Auditor who audits Enron's financial statements.

In this research, it can also be concluded that a company can collapse if it is not ethical in the ethical perspective of utilitarianism in conducting financial engineering financial statement activities.

The author realizes that there are limitations to this paper. This paper does not look at other factors both internal and external factors outside of research that have accelerated the collapse of the Enron Company.

It is expected that in the future there will be research that shows both internal and external factors that cause fall of Enron Corporation with viewpoint of other ethical theories.

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