Enron Lays Bush:
Contradictions Or Conflicts Of Interest?

Stream 7: Critical Accounting

Tony Tinker

Leicester University

Nihel Chabrak

CEREG – Université Paris

Chris Carter

St. Andrews University, Scotland

Leicester Management Centre, Leicester University
Baruch College at the City University of New York
School of Accounting and Information Systems at the University of South Australia

CEREG – Université Paris IX DAUPHINE
and
Institute for National Telecommunications
France

Enron Lays Bush: Contradictions or Conflicts of Interest?

Abstract

The audit failures in which World capital markets are currently mired, have dealt a serious blow to the liberal reformist policies. Liberal vocabulary is inadequate for apprehending the rolling crises that now besiege virtually all realms of modern capitalism. This moment in history provides an unprecedented opportunity for a new kind alliance between accounting and other fields of endeavour. While conventional accounting might be adequately provisioned to address the technical complexities of financial failures (off-balance sheet financing, special purpose entities, hedge contracts and derivatives, etc), its traditional theoretical basis is a poor equipped to grasp of the social, historical, and economic foundations of the current crisis. Critical accounting and labor process theory are, in contrast, better versed in the social and historical antecedents to today's challenges.

Enron Lays Bush: Contradictions or Conflicts of Interest?

1. Introduction

It isn't just that Kenneth Lay ('Kenny-Boy' as he was affectionately known to President George Bush) was cosy with the Bush Administration, and that the whole affair reduces to a singular, Welinsky-type indiscretion. Enron is both prototype and a bellwether of of things to come from modern capitalism and its institutional corporate expressions. It represents an unprecedented degree of corporate penetration of the Commonweal/ Civil Society. Specifically: the scope and depth to which different spheres of everyday life are being articulated and subordinated to commodity production. Not only the political sphere (in the U.S. and beyond), but also banking and finance, auditing, consulting, state regulatory authority, journalism and the media, and – of course – university education and research.

Yet notwithstanding the urgency of the times, there exists an interregum between, on one hand, the financial crises that besets contemporary capitalism and, on the other, its long-time-coming theoretical appropriation. Such is the unprecedented opportunity confronting progressive scholars. The reasons for the long-fuse theorization lie, in large measure because its epi-phenomenal form. Enron, Wordcom and Vivendi Universal do not appear in neatly labelled packages – addressed to 'sociology', 'finance', or 'economics'. Rather, they are phenomenological misfits, requiring a radical conceptual reconfiguration in order that they can be adequately appropriated.

Two disciplines most germane to the analysis are critical accounting, and (what we might loosely describe as) labor process research. The former brings to the table the technical tools for describing the complexity of the phenomena (leverage ratios, bond covenants, EPS etc); the latter offers a capability for putting accounting observations in a social and historical context and for devising the political means for engaging commodification.

We begin with a socio-historical setting for the Enron-like problematic, and proceed to a micro-level analysis of the Enron-accounting indices of the crisis. This is followed by a review of the extent to which accounting (auditing) education and research has been complicit in preparing the ground for Enron-like fiascos, and an examination of some liberal and progressive strategies for resisting the degradation of education and research.

2. Contradictions or conflicts of interest?

Liberal and other conventional analysts typically locate Enron-like problems as acts of individual greed and corruption. Hence, George W. Bush's first major policy statement on a pending market-meltdown announced a doubling of sentences for those found guilty of document shredding and related crimes. Similarly, Abraham Briloff call for audit reform made the 'return to a priesthood' as the centrepiece of his plan (Briloff, 2002).[1] Even

---

[1] These atomistic renditions hide as much as they reveal and, more important, they impair effective political action. Their failure to delineate the structural conditions of possibility (market based processes of competition and capital accumulated) ensures

institutional reforms, such as the divestment of consulting by audit firms, are premised on a notion of conflicts of interest that only dimly perceives the scale and depth of contradictions that are intrinsic to capitalism.[2]

While the agency of individuals is always important in 'making structures real', this does not diminish the significance of apprehending the market context in which individual conflicts of interest are constituted. We can begin to examine this context, and its irreducible contradictions, in the transition from a social order devoted primarily to self-consumption (that exchanges any occasional surpluses) to what eventually evolves under capitalism: production for surplus value (Figure 1).

C > C'
C >M > C'
M > C > M'
M > C > ..P.. C' > M'

Figure l: Contradictions in the development of Commodity Relations & Capital Accumulation

C > C represents a social economy that is mainly devoted fulfilling basic needs, andwhere exchange occurs only infrequently, involving occasional surplus. In the second and third (mercantilist) case, a universal equivalent (e.g, money) facilitates specialization, and thus increases the production of the 'necessities of life'. At the same time, it increases production for exchange that, in turn, invokes a growing disciplinary effect of market competition. At the limit, it radically reconstructs life and work, as exhibited in the last (mature) case of capital accumulation. Here, labor itself is bought with M as a wage-commodity (with other wage-labor produced commodities C), used in a production process, P, to generate commodity products, C', that are exchanged for money capital M' (Marx, 1977, pp. 188-240).

What is distinct about each phase of the above formulation is that it is a process that is a 'unity-in-difference' or an 'interpenetration-of-opposites'. Equilibrium analysis in neoclassical economics does admit the possibility for unstable equilibria, but this only partially describes what is intended here. Each phase (say, for example, that of mercantilism: M > C > M') accomplishes a stability as it approaches maturity as a mode of production, yet it is unstable insofar as it embodies the seeds of its own self-transformation (as, for instance, as merchants were forced, by competition, to begin to increasingly intervene in reorganizing labor processes to reduce costs (Allen, 1975; Baritz, 1960; Braverman, 1988; Pollard,1965; Zerzan and Zerzan, 1980).

The contradictions typifying the (capitalist) world of Enron are specific to the state of contemporary American capitalism.

---

that political remedies never addresses the factors that underpin acts of individual greed.

[2] This assertion will be examined carefully in subsequent passages.

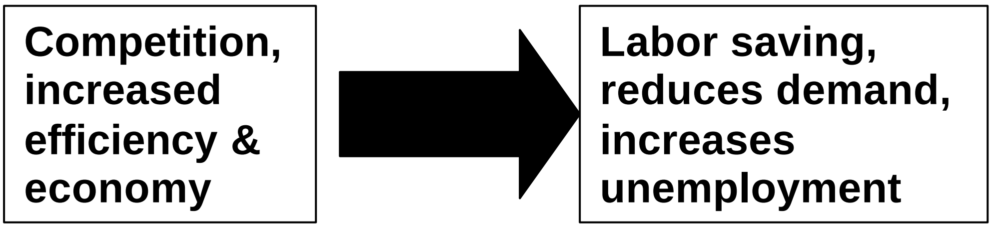


Figure ll: Commodity form Contradictions

The historical specificity of Figure ll, was vividly evidenced in the 1990's by the impact of information technology. Following Braverman's prescient remarks some 25 years earlier, management set about 'severing their own limbs' in the U.S. throughout the 1990's (Braverman, 1988). While disputes remain as to the exact magnitude of the productivity savings that actually accrued from information and communication technology, these challenges – while often well-intentioned in their scepticism as to the fruits of capitalism – often miss the point. Market competition induces economizing and greater efficiency that makes recession, slumps, layoff, and 'delayering' that poses an ever-present threat to social stability.

Recessionary tendencies in the U.S, have been postponed by a variety of techniques, including Keynesian Deficit spending (especially heavy military expenditures (Mandel, 1975); overseas capital account borrowing (notably massive investments by Japanese pension funds throughout the 1990's), and finally, private trading and bank credit expansion, of which Enron, Global Crossings, Worldcom, and Vivendi International were the institutional forms, and the dot.com bubble that – as George Soros has wryly noted – involved a capital writedown of over 40 Enrons.

Enron and Worldcom were major players in this spectacle. Enron, for instance, was a heavy investor in speculative dot.com stocks (Rhythm Investments for instance, see below). Emblematic of the whole fiasco was Enron's infamous $500,000 fake trading room in energy futures and broadband contracts. In a manner reminiscent of Barry Minkow's ZZZ Best fraud some 20 years earlier (where, to sidetrack curious investors and stock market analysts, Minkow devised a phoney, to-scale, building restoration site) so Enron invented a trading-room-for-the-day, to fool a gullible audience of stock market analysts and press commentators (Burkeman,2002).

3. Contradictions, Credit, and Enron

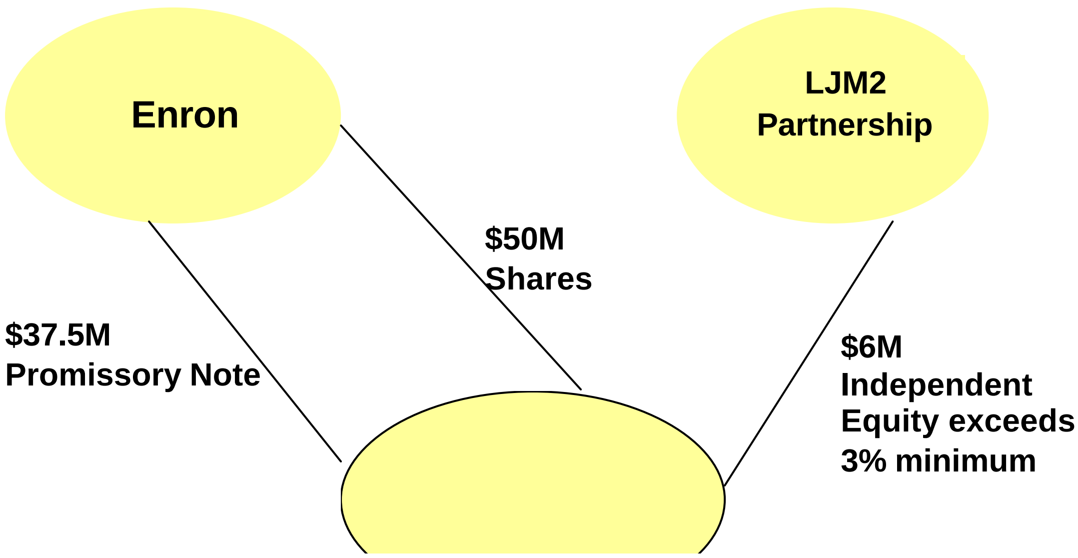
Inflated stock prices, fuelled by exaggerated audited earnings, was a key factor in both the Worldcom and Enron frauds. The former used a bloated stock price to acquire the 'real' assets of some 70 businesses in a 4 year takeover campaign. Knowing their stock price was bloated, Enron management insiders – and their broker confidants – peddled the stock to outsiders, stuffed it into employee pension funds (while liquidating their own holdings). The pivotal role of accounting numbers is explored in Table l.

Enron Corporation and Subsidiaries Consolidated Balance Sheet Information		
	Stock Price $	**Earnings $M**
1966	44	584
2000	84	979

Table I: Enron's Earnings Highlights as at Dec. 31, 2000 (1999)

The near-doubling of Enron's stock price between 1996 and 2000, provided a lucrative source for executive compensation in salary bonuses and stock options, loan security for banks, pension fund compensation for employees, and a war-chest for acquisitions and takeovers. As late as mid 2001, Enron's chief financial officer was bragging that a stock price of $125 was within reach (Burkeman, 2002). By 2001, the share price had fallen to 57c.

Table I also delineates the accounting 'drivers' of the stock price inflation: the near doubling of accounting earning or profits. However, for Enron to sustain its accounting fiction, it first needed to create a number of legal entities that were legally separate from Enron. Figure III provides one such illustration from the Enron affair, involving a limited partnership (LJM2) and a Special Purpose Entity or SPE (called Raptor).



Raptor (SPE)

Figure lll: Enron and Partners

The Raptor SPE in Figure lll provided hedging 'insurance' to Enron for any losses the latter might suffer from its volatile investments. To serve this purpose however the Raptor needed to be a legal entity that was independent and separate from Enron (otherwise, accounting rules would require that the Raptor was 'really Enron', and would have to be consolidated into Enron's accounts – insurance losses and all. Hence, in the illustatration, Enron is shown to have has a $12.5M stake in the Raptor, after depositing $50M in stock in the latter, and receiving a promissory note of $37.5M in return. The limited partnership LJM2 is shown to contribute $6M, which is more than sufficient to meet the 3% outside interest minimum requirement to make Raptor independent of Enron.[3] The balance sheet in Table II shows that the Raptor is in compliance with the minimum 'outside' capital requirements.[4] In addition, further liquidity of $40M liquidity is supplied by banks.[5]

Raptor Inc (SPE)					
Balance Sheet as at XXXXX					
Assets ($000s)			**Equity and Liabilities ($000s)**		
	$			**$**	**%**
			Lynch-Morgan Chase-Citibank Inc	**40,000**	
			Promissory Note	**37,500**	
Cash	**46,000**				
Enron Stock	**50,000**		**Enron**	**12,500**	**94.5**
			LIM2	**6,000**	**6.5**
Total:	**96,000**		**Total**	**96,000**	**100**

[3] This illustration uses a 3% of total assets rule. There has been some confusion in the accounting literature as to whether the 3% rule applies to 3% of total assets, or 3% of total equity. This example passes both tests, and relieves Enron from any obligation to consolidate the SPE's losses into its own accounts.

[4] That Enron executives formed the partners of LJM2 is not considered to compromise the SPE independence according to U.S. Generally Accepted Accounting Principles.

[5] The additional $40 million, provided by banks (who typically collected their fees – up-front) provided the liquid assets that allowed the Raptor to compensate the partners of LJM2 for their services in arranging the hedge. In the LJM2 case, over $30 million is was paid to partners who were, in effect, executives of Enron.

Table ll: Raptor's compliance with the Independent Entity Requirement

The Raptor in the illustration is in full compliance with GAAP

Enron Inc.					
Balances Sheet as at Dec. 31, 2000 (1999)					
Assets			Equity and Liabilities		
	1999	**2000**		**1999**	**2000**
	$Bill.	**$Bill.**		**$Bill.**	**$Bill.**
Current Assets	7	30	Current Liabilities	7	29
Investments	15	23	Long Term Debt	14	23
Fixed Assets	10	12	Owners Equity	11	15
TOTAL:	32	65	**TOTAL:**	32	65

requirements as to its independence from Enron. It is now in a position to offer Enron a hedge contract on any of the latter's investments, whereby the Raptor guarantees Enron that it will absorb any loss in value should the value of Enron's asset portfolio decline. No consideration for the hedge was needed from Enron by the Raptor, as the Raptor would be allowed to reap any profits (in the unlikely event that) the investment appreciated in value.

The positive impact of the Raptor's services to Enron is evident from Enron's balance sheet.

Table lll: Enron's Balance Sheets for 1999 and 2000

The owner's equity, shown at $15 billion at December 31, 2000, is a rough accounting proxy for the firm's stock price. It was supported by a $23 billion investment on the asset side of Enron''s balance sheet that included highly volatile dot.com stocks. Should the market value of these fall, then absent the hedging insurance, the losses would diminish the owners equity. For instance, Enron purchased an investment in Rhythm Inc for $10 million that rose to $500 million. The full $500 is included in the $23 billion on

Enron's balance sheet ($490 million was taken as profit and thereby increased owners equity by the same amount). If the value of the investment in Rhythm had subsequently declined, Enron would be required to write-off the loss, reducing the value of its investment and the value of the owners equity. The hedging insurance provided by the Raptor was intended to insulate Enron against any such eventuality.

The scheme unravelled when Enron's own stock declined in value amidst rumours about the firm's economic viability. The first impact was on the Raptor's balance sheet (Table ll) where – after the heavy payout of 'consulting fees' to the partners – the Raptor no longer met the 3% independence test. In consequence, this Raptor (and several other SPE's) were consolidated into Enron's accounts, registering an immediate loss of over $500 million.

4. Analysis and Implications

Academic commentories are frequently guilty of political voluntarism, or its sleeping partner, logocentricism, where it is assumed that 'rational' academic analysis, once voiced through publications and pronouncements, will be unproblematically transformed into political action (Ryan, 1982; Tinker et. al, 1991). This is a kind of intellectual vanity that fails to undertake the hard theoretical and experiential task of uncovering the political mechanisms by which 'thought' is transformed into action. Thus, while this paper assesses the efficacy of recent policy intentions, aimed at salvaging market stability and confidence in the aftermath of Global Crossings, Enron, Worldcom, Vivendi, et. al, this is not offered as yet another perpetuation of the conceit of voluntarism. Rather; it contends that a blend of social and accounting analysis is a necessary (but not sufficient) step towards a politically progressive displacement of the present crises of capitalism.

The analysis developed previously identifies two deficiencies with the remedies with the contemporary liberal reforms. The first concerns the individualist reconstruction of events; the second involves the silence (repression) as to the broader crisis of overproduction the besets global capitalism. Both oversights stem from the failure to appreciate the pervasive nature of capitalism's current crisis and contradictions.

a. Atomistic Analysis

First, "The" Enron problem is conceived primarily in terms of individual misconduct and, less frequently, institutional conflicts of interest created by the co-existence of consulting and auditing. Abe Briloff, for instance, calls for the profession to become a 'priesthood'.[6] In the same vein, the centerpiece of Bush and Blair-like reforms is a call for greater personal and professional integrity, and a doubling of prison sentences for those found guilty.

Individuals are bearers of (market) structural conditions; an atomistic analysis fails to articulate the common forces that propel individual and collective misconduct. In recent years, the market imperative has reconstituted the subjectivity and circumstance of managers, auditors, politicians, stock traders, educators, bankers, newspaper correspondents, etc. In academia for example, colleges, research, and professorial chairs are now heaviliy dependent on corporate funding. The bombastic oratory of Enron's financial executives – that the unfettered maximization-of-

[6] This analysis makes no assumptions about actor rationality or intentionality. It may well be that politicians 'understand' that, in order to preserve the status quo, their interventions must limited to a cosmetic treatment of symptoms. It is also possible that others appreciate that such political window-dressing can, at best, displace, not correct, the problem.

earnings per share was not only good for the firm, but good for America – is a rhetoric that is inculcated through virtually every MBA program in the U.S. Couple this with the recent fad in many accounting-accredited colleges an universities, of 'value-added auditing' (a euphormism for subordinating the audit quality to the client's profitability requirements) and we have a potent mixture for subverting current reforms.

Yet, even on their own terms, the current reforms are a tepid response to the problem. The separation of management advisory services from auditing has a checkered history. A few years ago, Arthur Andersen spun-off its consulting unit into Accentura (sp?) in a hightly publicized and acrimonous settlement with its consulting executives. Resentments continued to fester at Andersen (Auditing) who – like the mythical Hydra -- soon (re)launched a new consulting unit that, within a very short period, was larger than Accentura. It was that new consulting outlet that figured so prominently in the Enron debacle. As both the Bush and the Blair administrations have resisted legislative proposals for divorcing the joint provision audit and consulting services, there is nothing prohibiting the Big 4 from reversing their recent voluntary divestitures of consulting services, when commercial necessity dictates, and the political wariness tires.

Accounting firms are market entities; their competive market survival and expansion cannot be contained by invocations for individual restrain. Evidence from the hightly 'incentivized' climate of Andersen shows that partners who failed to secure a sufficient rate of growth of new (and contented) audit and consulting clients were eased out. The auditing branches of the Big 5 firms grew typically from 20 – 40% per annual during the bull market. Auditing, in contrast, delivered typically around 5%.

Even though, in the current recession, consulting is in the dulldrums, and auditing has regained some of its lustre, this does not detract from the main thesis: that capitalism pospones and displaces its own contraditions by an ever-expanding subordination of the subjective and objective realms of existence through commodification. The tenacity and persistence of these forces is evident from the historical reversals: the privatization of what was once nationalized; the shredding of what was once regarded as secure safety nets for the sick, poor, and infirm; the unrelenting foreign policy hostility towards all countries that refused to open their markets to international capital (Cuba being the most notable and long-standing example) and – closer to home – the compromising of an audit function that was established in the 1933-4 Securities Acts, to restore trust, integrity and confidence to capital markets.

b. The broader economic crisis

The personification of problems serves a second ideological role: to divert attention away from an even greater insoluable problem: the current recession. Just as, in the 1929-34 era, the stock market crash, and the accounting palliatives aimed at restoring investor confidence, were merely the supporting cast relative to the broader economic malaise, so the Enron troupadors are mere bit-players in a much larger circus (Galbraith,1980; Merino and Neimark, 1982). In language that are reminicient of the eminent economist Fisher's becalming remarks in the 1930's, so the Bush Adminstration's refrain -- that 'the basic economy is essentiall sound', rings hollow. The much touted productive potential of the U.S. economy "is" the problem! Demand, in the form of the credit-saturated consumer (who constitutes 80% of U.S. gross domestic product) exceeds supply. Alan Greenspan, chair of the U.S. Federal Reserve (who sat smugly through both the gluttonous bubble and its eventual bust) has commissioned an 800 study of the Japanese economy, to see what lessons migh be gleaned from the 10 year recession of the World's second largest economy.

While there are marked differences between U.S. and Japanese experiences: there are also disquieting parrallels. Japan was also boasted to be an powerhouse of economic efficiency; serving as a Mecca for many pilgrims of Western management thought (Ouchi and Johnson, 1978). The parlous state of Japan's banking system and its 'bought' political system are often cited as important differences by Western observers, however both differences reflect a rather self-serving and U.S. centric analysis. The U.S. political regime is also 'bought'; what critics of the Japanes economy are seeking is a diminution of indigenous Japanese institutions and constituencies, and an elevation of interests more favourable to international market (American) capital. A similar argument – of commercial expediency -- applies to Western calls for reform the undoubtedly corrupt Japanese banking system. In neither case is there a clear connection between the putatively reforms, and crisis of overproduction that afflicts the Japanese economy.

References

Allen, V., Social Analysis: A Marxist Critique and Alternative, (Harlow: Longmans, 1975).

Baritz, Loren, THE SERVANTS OF POWER: A HISTORY OF THE USE OF SOCIAL SCIENCE IN AMERICAN INDUSTRY, (New York: John Wiley & Sons, 1960).

Braverman, H., LABOR AND MONOPOLY CAPITAL: 25th Year Anniversary Edition (New York: Monthly Review Press, 1998).

Briloff, A, "Tony Tinker's Beyond the Brilovian Critique: A Brilovian Rejoinder", Accounting in the Public Interest Journal, American Accounting Association: 2002.

Burkeman, O., "I was a Teenage Fraudster", The Guardian, Thursday, July 11, 2002.

Galbraith, John Kenneth, THE GREAT CRASH 1929, (New York: avon Discuss Books), 1980.

Mandel, E. (l975) "Late Capitalism•, London, New Left Books.

Marx, Karl, CAPITAL: A CRITIQUE OF POLITICAL ECONOMY, Volume One (New York: Vintage Books, 1977.)

Merino, B., and Neimark, M.(1982) "Disclosure Regulation and Public Policy: A Sociohistorical Reappraisal", "Journal of Accounting and Public Policy•, Vol. 1, No.1: 33-57.

Ouchi, W(r) and Johnson, J.B., Types of Organizational Control and their relationship to empotional well-being, Administrative Science Quarterly, (1978(c) Vol(r) 23, pp(r) 293-317.

Pollard, S., THE GENESIS OF MODERN MANAGEMENT: A STUDY OF THE INDUSTIRAL REVOLUTION IN GREAT BRITAIN (London: Edward Arnold, 1965).

Ryan, M., MARXISM AND DECONSTRUCTION: A CRITICAL ARTICULATION (Baltimore: John Hopkins University Press, 1982).

Tinker, T., C. Lehman and M. Neimark; "Falling Down the Hole in the Middle-of-the-Road Theorizing: Political Quietism in Corporate Social Reporting," Accounting, Auditing and Accountability Journal, Vol. 4, No. 2, 1991, pp. 28-53.

Zerzan, J., and P. Zerzan, INDUSTRIALIZATION AND DOMESTICATION (Seattle, WA: The Black Eye Press, 1980).