

The Unethical Behaviour of Lehman Brothers

Ethical standards in a business are a necessity, as they provide structure in the workplace and allow for business objectives to be met. The unethical activities undertaken by the global financial services firm, Lehman Brothers Holdings Inc., drew worldwide attention from media generating numerous accounts and a 2,200-page examiner's report on the case. The firm's failure to account for their finances honestly and transparently ultimately led to its downfall, as on 15 September 2008 Lehman filed a Chapter 11 bankruptcy petition as the largest bankruptcy in history with \$639 billion assets sold to other firms and \$619 billion of debt (Investopedia, 2017). Its collapse is believed to have prompted bailouts of several financial institutions and the subsequent unfolding of the Global Financial Crisis.

Throughout its life, Lehman Brothers served the financial needs of governments and municipalities, corporations, clients, and wealthy individuals. Despite being headquartered in New York, Tokyo and, London, Lehman Brothers was rooted in Montgomery, Alabama where Henry Lehman founded a small shop in 1844, selling dry goods, groceries and utensils to cotton farmers. By 1850 he joined his two brothers to form Lehman Brothers. During the next 158 years, the business transferred its operations to New York where they reformed themselves and created numerous partnerships (Investopedia, 2017). By 2008, it was the fourth-largest investment bank in the USA, offering investment banking, investment management, trading, private banking, private equity, research and brokerage among other services all of which were formerly reinforced by strong ethics.

The company collapsed to its unethical activities including illiquid mortgage holdings and elements of corporate malfeasance. Examiner Anton R. Valukas considered the "materially misleading" accounting ploy "Repo 105" concealing Lehman's true financial situation as they participated in "actionable balance sheet manipulation" and "nonculpable errors of business judgement" (Merced & Sorkin, 2010). Repo 105 is a short-term repurchase agreement in which a loan is logged as a sale and the cash acquired from this supposed sale is expended to

pay off debt to lower the liability on the company's balance sheet (Nasdaq, n.d). Loopholes in financial accounting standards enabled Lehman to arrange transactions in which they sold toxic assets at the end of each quarter with the understanding that they would be repurchased days later (Whalen, n.d.). Following this technique, Lehman discarded \$38.6 billion from its balance sheet in the fourth quarter of 2007, \$49.1 billion in the first quarter of 2008 and \$50.4 billion in its second quarter (Lenzner, 2010). A 2010 *New York Times* article uncovered Lehman's 'gatekeeper' Hudson Castle, a small company used by Lehman to shift these toxic assets off its balance sheet. It revealed that Lehman owned 25% of the company with its board controlled by Lehman and its employees mostly being former employees of Lehman (Story & Dash, 2010). Lehman's auditors oversaw the unethical activities and failed to reveal the business' undertakings in temporarily lowering the company's debt to meet specific objectives and make the firm appear financially stronger to stakeholders.

Ethical standards are incredibly crucial within a business, not only providing a moral framework for the company to follow but also guaranteeing the protection of the stakeholders' interests. A stakeholder is an individual, group, organisation or society at large that has an interest or concern in the business such as ownership and property interests, legal interests and responsibilities, and rights (Grimsley, n.d.). The primary stakeholders of Lehman included shareholders, consumers and employees as well as its creditors, regulators and rating agencies. The firm's shareholders and consumers were most impacted by its unethical behaviour. The employment of Repo 105 by Lehman led their shareholders and clients to believe that the company was financially fruitful while it had been struggling with debt. If revealed, Lehman's stock price would likely have been affected. Consequentially, countless of Lehman's shareholders lost a considerable amount of money with Lehman reporting \$26.3 billion of total shareholders' equity preceding its bankruptcy filing. Its employees were also greatly affected by the unethical behaviour of Lehman, being naïve and unsuspecting of the occurrences of manipulation and concealment within the company. By the time of Lehman's bankruptcy filing, over 25,000 employees were left confounded and jobless. The notion of a stakeholder automatically heightened the ethical

implications Lehman's dealings and actions, as all of them were in some way negatively impacted by the incident.

The highly scrutinised downfall of Lehman can be attributed to the company's grossly unethical behaviour. Primarily, the endorsement by CFO Erin Callan and senior executive members of falsifying Lehman's true financial health was done with the aim of preserving its appearance and manipulating its stakeholders. Secondly the gross negligence by the company's auditors Ernst & Young reinstates the unprofessionalism of its workers, as they deceived the general public particularly, the involved stakeholders. Charles Perkins, a spokesperson for Ernst & Young, stated "Our last audit of the company was for the fiscal year of Nov. 30, 2007...Lehman's financial statement for that year was fairly presented in accordance with Generally Accepted Accounting Principles (GAAP)..." (Merced & Sorkin, 2010). Well aware of the unethical actions of Lehman its auditors failed to follow the fundamental principles of the *APES 110 Code of Ethics for Professional Accountants* such as integrity and professional behaviour. They were unsuccessful in disclosing to a regulatory body the cumulative conducts of forgery as well as the extreme measures taken by the company to conceal its finances. Hence, the unethical decisions made by the parties involved were unjust and dishonest.

Through this course and the research undertaken on Lehman Brothers, I have gained insight into the true meaning of business ethics. Throughout my study of ACCG100, I learned that business ethics consists of a vastly grey-scale of decisions as opposed to the black and white view I had of business ethics prior to this study. This assignment has most of all, allowed me to gain a comprehensive understanding of the way stakeholders are affected. I learned how companies make business decisions on a daily basis that deeply impact the lives of many and that these decisions need to be reinforced by ethical principles in order for its outcomes to be positive. Ethical standards are imperative in a business as they provide a sense of organisation, defend the interests of its stakeholders and allow for their goals to be met. The dramatic collapse of Lehman Brothers and the trail of destruction and suffering it left behind reinforces the negative

outcome that can result from a poor, unethical decision and its effect on numerous amounts of people, organisations and societies. Hence, it is a necessity in the business world as every business decision that is made imposes an implication on the lives of others.

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