ENRON – THE COMPANY

- 1985 Houston Natural Gas merges with InterNorth.
- During the 1990s, ENRON went from a gas-pipeline company to the biggest energy trader in the US.
- It move away from owning “hard” assets.
- Traded energy, broadband, and all sorts of financial products.
- At one point ENRON had a market value of $77 billion and reported $101 billion of revenue in 2001.
ENRON – THE ACCOUNTING

- ENRON is not the only company with accounting issues:
  - Revenue recognition issues: Telecom companies, Xerox, EMC, Computer Associates, and many high tech companies.
  - Off-balance sheet financing: PNC Financial Services, Sunrise Assisted Living, Elan, and others.

ENRON - WHAT WENT WRONG?

- Bad investments in “new economy” ventures.
- Off-balance-sheet entities (SPEs) created to eliminate losses and remove liabilities from books.
- Many off-balance-sheet loans collateralized by Enron stock.
- Opaque reporting encouraged short sellers.
- Form over substance in reporting.
APPARENT FAILURES – 20/20 HINDSIGHT

- Arrogant corporate culture.
- Opaque reporting posture with investors.
- Finance and accounting staff largely recruited from Andersen. Independence compromised?
- Special investigation by main legal counsel – not independent counsel.
- Andersen apparently consciously decided not to resign in 2000 in spite of “red flags” and fraud signal from it decision aid.
ENRON - LOTS OF QUESTIONS

- Opaque disclosure / “bad” accounting?
- How could the CFO be at the center of conflict of interest concerns?
- Was management conduct unethical?
- Whose watching the company? Where were the…
  - Board of directors / Audit committee?
  - Attorneys (in-house and external)?
  - Auditors?

AUDIT COMMITTEES

- Strengthening the requirements for financial experts on audit committees.
- Need financial expertise to understand increasingly complex issues.
- Need to be proactive and engaged.
- Need to challenge management and the auditors.
REVISED ACCOUNTING

- FASB Reform
- Need for new Standards:
  - Consolidation of Special Purpose Entities
    - “control” - based standard regarding SPE’s
  - Determining fair value of forward contracts
    - Rules for determining value where contracts are not traded or thinly traded.

POSSIBLE EFFECTS ON AUDITING PROFESSION

- New body as industry regulator
- Eliminating the ability of the auditors to do nonaudit services for their clients.
- Prohibit revolving door for audit partners – not employable w/ clients.
- Mandatory rotation of audit firms.
- Major increase in the level of audit firm peer review work.
THE AFTERMATH

- What will become of Enron and Andersen?