

In Focus: The Enron Scandal

This corporation was identified by Fortune as America's Most Innovative Company 1996 to 2001 (Lindstrom par. 1). It was garnered as the 7th largest company on the Fortune 500 list in the US in 2000 and it placed sixth in the largest energy company in the world in 2000 ("Enron Corporation" par. 6). Who does not know the Enron Corporation, a giant in the commerce of energy? But among all these prestigious titles, there is another that the Enron Corporation is famous for, the Enron Scandal.

Enron is a result of a merger between two gas pipe line companies in 1985 – one based in Texas, the Houston Natural Gas and another was from Omaha and Nebraska, the InterNorth. The fusion became the Enron Corporation in 1986 ("Enron Corporation" par. 2). The firm experienced a rapid growth as it shifted from being a gas pipeline company into a "global energy trader ("Enron Corporation" par. 6)." Enron enjoyed profuse economic benefits, with revenues amounting up to 100 billion dollars by 2000 ("Enron Corporation" par. 6). The firm ventured to other facilities like Internet broadband called Enron Online (Lindstrom par. 9). Reported to be harvesting so much profit and having so many investments would boggle your mind on why Enron still broke down. Where did Enron go wrong? What brought this billion dollar business down into bankruptcy?

It was in the year 2001 that the company's stability was put into question. Enron entered into an agreement to run movies on the World Wide Web with Blockbuster Inc., "a motion-picture video rental company". However in March, this deal was cancelled and in April, Enron admitted that insolvent Californian energy firms are indebted with the company for more than \$500 million dollars. The resignation of its chief executive officer (CEO), Jeffrey Skilling in August strengthens the validity of the shocking disclosure. By October 16, the company declared a \$618 million loss for its third-quarter and the following day and the following day Enron stated the most scandalous truth, that is, the company's net worth is

overstated by more than \$1 billion. It is because of these two shocking revelations that Enron's stock price dropped (Lindstrom par. 11). It turns out that the company is suffering huge losses beforehand, but the company managed to manipulate its accounting data to allegedly cover up the undesirable information regarding its finances. The fraudulent acts were thought of very well as the company was able to deceive even the most keen debt and capital investors, which include the pension funds holders and investment banks (Lindstrom par. 16). How did Enron do it? – Through “creative accounting (Lindstrom par. 16)”. In order to escape reporting its enormous losses and to make it look like the company is still profiting, the company used creative accounting. For example, Enron appraised values of its assets, just like the deepwater drilling operations wherein the worth of the mineral deposits is recorded higher than their actual value or they declare higher values for future contracts. But, the most notorious tactic was Enron camouflaged the deficits through partnerships or legally termed as “special purpose entities” (SPEs) (Lindstrom par. 16).

SPE's are used by firms to help minimize risk by transferring assets under distinct partnerships that can be bought by external investors. What Enron did is it sold its assets that are not earning anymore to partnerships and the company recorded the proceeds as income. Accounting principles only accept this kind of set-up when SPE's are legally separated from the company that made it, however Enron did opposite. The SPEs were dependent on Enron's leadership and skill capacity and capital stock. You would ask how did Enron got away with it since there would come a time when the financial reports of the company would be audited. Well, the auditing committee of the company has little information handed to them to work with. This was very irresponsible on their part. Also, the management gives them sufficient benefits so they are not really encouraged to ask the management controversial questions (Lindstrom par. 17). The external auditor, Arthur Andersen LLP, on the other hand served more as a consulting rather than an auditing firm for Enron. Anderson

also defended that it is only able to audit the figures made available to him by Enron. However it was proven that Andersen destroyed documents in anticipation of SEC investigation and therefore was sentenced guilty for obstruction of justice in 2002. With this verdict comes fall of the Anderson auditing firm's credibility (Lindstrom par. 18).

Enron gave \$680 million to its 140 managers, Lay and Skilling received \$67 and \$42 million respectively a year before the declaration of insolvency. Some of this earnings are from the sale of stock before Enron plummeted, which observers say is a wrong move since these "executives caused the company's failure and then cashed out early when the company's stock was still high (Lindstrom par. 19)."

The shortfall of Enron caused suffering to individuals and businesses as well. The employees who invested in the company lost a lot of their pensions. The deceptions of the company caused fear in the business world as well. The credibility of businesses' financial reports is put into question. Even the reputations of the stock analysts of Wall Street were doubted. The flow of stock selling was disrupted as stock prices plummeted. Although the Enron scandal caused losses to many, the bright side on this mayhem is that it instigated reform in the business sector in terms of compliance with accounting standards. It helped form a more strict auditing practice. Congress also passed laws that will benefit and will help protect the investors (Lindstrom par. 24).

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