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Adverse Media Monitoring Report

2024-06-11

Entity information

Entity ID	Type	Name	Date of birth	Citizenship	Resi
—	**Company**	**Enron Corporation**	—	**United States**	—, l

Needs Investigation

Reviewer Comment

No comment provided.

Batch ID	Transaction ID	Media Provider
f5df95c8-d2f5-4f8e-946e-96daba6caaaa	**73f17271-f9b2-4911-8626-8a64ff8268fd**	**Google**

Overview of search results - 10

What Was Enron? What Happened and Who Was Responsible

Google · Needs Investigation (Score 0.90) investopedia.com

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What Was Enron? What Happened and Who Was Responsible

... Jeff Skilling was convicted on 19 of the 28 counts of securities fraud he was charged with, in addition to other charges of insider trading. He was sentenced to 24 y though the U.S. Department of Justice reached a deal with Skilling in 2013 ...

... Andy Fastow and his wife, Lea, pleaded guilty to charges against them, including money laundering, insider trading, fraud, and conspiracy. Fastow was sentenced testify against other Enron executives. Fastow has since been released from prison ...

Top Accounting Scandals

Google · Needs Investigation (Score 0.84) corporatefinanceinstitute.com

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Top Accounting Scandals

... Enron Corporation was a US energy, commodities, and services company based out of Houston, Texas. In one of the most controversial accounting scandals in th in 2001 that the company had been using accounting loopholes to hide billions of dollars of bad debt resulted in shareholders losing over $74 billion as Enron's share inflating the company's earnings ...

... The two were convicted, largely based on the testimony of former Enron employee, Sherron Watkins. However, Lay died before serving time in prison. Jeff Skilling prison ...

Enron Scandal and Accounting Fraud: What Happened?

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Reviewed by Auto on June 11, 2024

Enron Scandal and Accounting Fraud: What Happened?

... Kenneth Lay, Enron's founder, and former CEO was convicted on six counts of fraud and conspiracy and four counts of bank fraud. Before sentencing, he died of a
... Former CEO Jeffrey Skilling received the harshest sentence. He was convicted of conspiracy, fraud, and insider trading in 2006. Skilling received a 17½-year sente
years in 2013 ...

[Numbers manipulator describes Enron's descent]

Google · Needs Investigation (Score 0.74) fraud-magazine.com

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Reviewed by Auto on June 11, 2024

Numbers manipulator describes Enron's descent

... As the former CFO of Enron Corporation, Fastow's role in this toxic corporate culture has forever cemented the fate of the multibillion-dollar American energy, comı
Enron's bankruptcy in 2001 wiped out $40 billion in stock market value and led to the collapse of its well-known accounting firm, Arthur Andersen ...
... Many key players were indicted and sentenced to prison. Fastow pleaded guilty to two counts of wire and securities fraud and was sentenced to six years in prison

[Enron Corporation - Financial Scandals, Scoundrels & Crises]

December 7, 2016 · Google · Needs Investigation (Score 0.66) econcrises.org

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Reviewed by Auto on June 11, 2024

Enron Corporation - Financial Scandals, Scoundrels & Crises

... On 16 October 2001, Enron Corporation reported a $638 million loss for Q3 and declared a $1.01 billion charge to equity due to write-offs of failed water trading, br
unwinding of the Raptor SPE's run by CFO Andrew Fastow ...
... Days earlier, Arthur Andersen determined that Swap Sub failed to qualify for non-consolidation. Consequently, Enron was forced to consolidate Swap Sub and hen
announcement. Little more than 3 weeks after announcing the major charge to earnings and write-down of equity on 16 October, Enron disclosed that Swap Sub was
November, 2001 ...

[United States v. Kevin Howard]

June 9, 2015 · Google · Needs Investigation (Score 0.66) justice.gov

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article content, or both.

Reviewed by Auto on June 11, 2024

United States v. Kevin Howard

... Kevin Howard, former chief financial officer and vice president of finance for Enron Broadband Services (EBS), Enron Corporation's failed telecommunications divis
and records, in on November 2, 2009 to one year of probation of which nine months are home confinement and ordered to pay a $25,000 fine. Howard pleaded guilty
Vanessa D ...
... According to the superseding indictment and the plea agreement, Howard knowingly and willfully caused Enron's Form 10K for the year-ending 2000 to be falsified
Enron's newest "core" business group and announced that EBS would report a loss of $60 million for the year 2000. According to court documents, by the fourth quar
generate any significant revenue ...

[How the Enron Scandal Changed American Business Forever]

December 2, 2021 · Google · Needs Investigation (Score 0.56) time.com

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article content, or both.

Reviewed by Auto on June 11, 2024

How the Enron Scandal Changed American Business Forever

... In early December 2001, innovative energy company Enron Corporation, a darling of Wall Street investors with $63.4 billion in assets, went bust. It was the largest of the corporation's executives, including the CEO and chief financial officer, went to prison for fraud and other offenses ...
... In many ways, the legislation wasn't needed because the Justice Department and the Securities Exchange Commission already had the powers to prosecute exec books or at a minimum were less than transparent with the truth, Hanke says ...

[FBI Houston Marks 10-Year Anniversary of Enron Case — FBI]

Google · Needs Investigation fbi.gov

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FBI Houston Marks 10-Year Anniversary of Enron Case — FBI

May 25, 2016 ... Today, May 25, 2016 marks 10 years since the convictions of Enron Corporations Kenneth Lay and Jeffrey Skilling. Lay was chairman and chief exe

[Ten-Year Anniversary of the Convictions of Chief Executives in FBIs ...]

Google · Needs Investigation fbi.gov

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Ten-Year Anniversary of the Convictions of Chief Executives in FBIs ...

May 25, 2016 ... ... Crime Investigation. HOUSTON, TX—Today, May 25, 2016 marks ten years since the convictions of Enron Corporations Kenneth Lay and Jeffrey

[Phillips Petroleum Company and Enron Corporation, In the Matter of]

September 29, 2014 · Google · False Positive (Score 0.34) ftc.gov

False positive. Non-adverse media.

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Phillips Petroleum Company and Enron Corporation, In the Matter of

... **The .gov means it's official.** Federal government websites often end in .gov or .mil. Before sharing sensitive information, make sure you're on a federal governme
... **The site is secure.** The **https://** ensures that you are connecting to the official website and that any information you provide is encrypted and transmitted securely

Article details

What Was Enron? What Happened and Who Was Responsible

Google · Needs Investigation (Score 0.90) investopedia.com

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bankruptcy | debt | concerns | fraudulent | collapse | lost | convicted | died | insider trading | protection | sentence | se
conviction | defendants | emergence | emerging | extremely | illegal | money laundering | official | officially | securities fraud
settlements | violations

What Was Enron? What Happened and Who Was Responsible

Enron was an energy-trading and utility company based in Houston, Texas, that perpetrated one of the biggest accounting frauds in history. Enron's executives emplo falsely inflated the company's revenues and, for a time, made it the seventh-largest corporation in the United States. Once the fraud came to light, the company quick bankruptcy in December 2001.

Enron was an energy company that began to trade extensively in energy derivatives markets.

The company hid massive trading losses, ultimately leading to one of the largest accounting scandals and bankruptcy in recent history.

Enron executives used fraudulent accounting practices to inflate the company's revenues and hide debt in its subsidiaries.

The SEC, credit rating agencies, and investment banks were also accused of negligence—and, in some cases, outright deception—that enabled the fraud.

As a result of Enron, Congress passed the Sarbanes-Oxley Act to hold corporate executives more accountable for their company's financial statements.

Enron was an energy company formed in 1986 following a merger between Houston Natural Gas Company and Omaha-based InterNorth Incorporated. After the merg
the chief executive officer (CEO) of Houston Natural Gas, became Enron's CEO and chair.
Lay quickly rebranded Enron into an energy trader and supplier. Deregulation of the energy markets allowed companies to place bets on future prices. In 1990, Lay c
Corporation and appointed Jeffrey Skilling, whose work as a McKinsey & Company consultant had impressed Lay, to head the new corporation. Skilling was then one
McKinsey.
Enron provided a variety of energy and utility services around the world. Its company divided operations in several major departments, including:

Enron Online : In late 1999, Enron built its web-based system to enhance customer functionality and market reach.

Wholesale Services : Enron offered various energy delivery solutions, with its most robust industry being natural gas. In North America, Enron claimed to deliver alm
electricity compared to its second tier of competition.

Energy Services : Enron's retail unit provided energy around the world, including in Europe, where it expanded retail operations in 2001.

Broadband Services : Enron provided logistical service solutions between content providers and last-mile energy distributors.

Transportation Services : Enron developed an innovative, efficient pipeline operation to network capabilities and operate pooling points to connect to third parties.

However, by leveraging special purpose vehicles, special purpose entities, mark-to-market accounting, and financial reporting loopholes, Enron became one of the m
world. Upon discovery of the fraud, the company subsequently collapsed. Enron shares traded as high as $90.75 before the fraud was discovered but plummeted to a
was revealed.
The former Wall Street darling quickly became a symbol of modern corporate crime. Enron was one of the first big-name accounting scandals, but uncovered frauds a
WorldCom and Tyco International soon followed.
Before coming to light, Enron was internally fabricating financial records and falsifying the success of its company. Though the entity did achieve operational success
misdeeds were finally exposed in 2001.
Leading up to the turn of the millennium, Enron's business appeared to be thriving. The company became the largest natural gas provider in North America in 1992, a
EnronOnline, its trading website allowing for better contract management just months before 2000. The company also rapidly expanded into international markets, lec
Water.
Enron's stock price mostly followed the S&P 500 for most of the 1990's. However, expectations for the company began to soar. In 1999, the company's stock increase
additional 87%. Both returns widely beat broad market returns, and the company soon traded at a 70x price-earnings ratio.
In February 2001, Kenneth Lay stepped down as Chief Executive Officer and was replaced by Jeffrey Skilling. A little more than six months later, Skilling stepped dow
Lay taking over the role again.
Around this time, Enron Broadband reported massive losses. Lay revealed in the company's Q2 2001 earnings report that "...in contrast to our extremely strong energ
quarter in our broadband businesses." In this quarter, the Broadband Services department reported a financial loss of $102 million.
Also, around this time, Lay sold 93,000 shares of Enron stock for roughly $2 million while telling employees via e-mail to continue buying the stock and predicting sign
total, Lay was eventually found to have sold over 350,000 Enron shares for total proceeds greater than $20 million.
During this time, Sherron Watkins had expressed concerns regarding Enron's accounting practices. A Vice President for Enron, she wrote an anonymous letter to Lay
and Lay eventually met to discuss the matters, in which Watkins delivered a six-page report detailing her concerns. The concerns were presented to an outside law fi
accounting firm; both agreed there were no issues to be found.
By October 2001, Enron had reported a third quarter loss of $618 million. Enron announced it would need to restate its financial statements from 1997 to 2000 to corr
Enron's $63.4 billion bankruptcy was the biggest on record at the time.
On Nov. 28, 2001, credit rating agencies reduced Enron's credit rating to junk status, effectively solidifying the company's path to bankruptcy. On the same day, Dyne
Enron was attempting to merge with, decided to nix all future conversations and opted against any merger agreement. By the end of the day, Enron's stock price had
Enron Europe was the first domino, filing for bankruptcy after close of business on Nov. 30. The rest of Enron followed suit on Dec. 2. Early the following year, Enron
auditor , citing that the auditor had yielded advice to shred evidence and destroy documents.
In 2006, the company sold its last business, Prisma Energy. The next year, the company changed its name to Enron Creditors Recovery Corporation with the intentio
creditors and open liabilities as part of the bankruptcy process.
After emerging from bankruptcy in 2004, the new board of directors sued 11 financial institutions involved in helping conceal the fraudulent business practices of Enro
nearly $7.2 billion from these financial institutions as part of legal settlements. The banks included the Royal Bank of Scotland, Deutsche Bank, and Citigroup.

Kenneth Lay pleaded not guilty to eleven criminal charges. He was convicted of six counts of securities and wire fraud and was subject to a maximum of 45 years in p
5, 2006, before sentencing was to occur.

Jeff Skilling was convicted on 19 of the 28 counts of securities fraud he was charged with, in addition to other charges of insider trading. He was sentenced to 24 year
though the U.S. Department of Justice reached a deal with Skilling in 2013. The deal resulted in 10 years being cut off of his sentence.

Andy Fastow and his wife, Lea, pleaded guilty to charges against them, including money laundering, insider trading, fraud, and conspiracy. Fastow was sentenced to
against other Enron executives. Fastow has since been released from prison.

Select Events, Enron Corp

.

1990	**Jeffrey Skilling (COO at the time) hires Andrew Fastow as CFO.**
1993	**Enron begins to use special-purpose entities and special purpose vehicles.**
1994	**Congress began allowing states to deregulate their electricity utilities.**
1998	**Enron merged with Wessex Water, a core asset of the new company by giving Enron greater international presence.**
January 2000	**Enron opens trading their own high-speed fiber-optic networks via Enron Broadband.**
Aug. 23, 2000	**Enron stock reaches an all-time high. Intra-day trading reaches $90.75, closing at $90.00 per share.**
Jan. 23, 2002	**Kenneth Lay resigns as CEO; Jeffrey Skilling takes his place.**
April 17, 2001	**Enron reports a Q1 2001 profit of $536 million.**
Aug. 14, 2001	**Jeffrey Skilling resigns as CEO; Kenneth Lay takes his place back.**
Aug. 15, 2001	**Sherron Watkins sends an anonymous letter to Lay expressing concerns about internal accounting fraud. Enron's stock $42.**
Aug. 20, 2001	**Kenneth Lay sells 93,000 shares of Enron stock for roughly $2 million**
Oct. 15, 2001	**Vinson & Elkins, an independent law firm, concludes their review of Enron's accounting practices. They found no wrong**
Oct. 16, 2001	**Enron reports a Q3 2001 loss of $618 million.**
Oct. 22, 2001	**The Securities and Exchange Commission opens a formal inquirity into the financial accounting processes of Enron.**
Dec. 2, 2001	**Enron files for bankruptcy protection.**
2006	**Enron's last business, Prisma Energy, is sold.**
2007	**Enron changes its name to Enron Creditors Recovery Corporation.**
2008	**Enron settles with financial institutions involved in the scandal, receiving settlement money to be distributed to creditors**

Enron went to great lengths to enhance its financial statements, hide its fraudulent activity, and report complex organizational structures to both confuse investors and
Enron scandal include but are not limited to the factors below.

Enron devised a complex organizational structure leveraging special purpose vehicles (or special purpose entities). These entities would "transact" with Enron, allowin
disclosing the funds as debt on their balance sheet.

SPVs provide a legitimate strategy that allows companies to temporarily shield a primary company by having a sponsoring company possess assets. Then, the spons
secure cheaper debt than the primary company (assuming the primary company may have credit issues). There are also legal protection and taxation benefits to this

The primary issue with Enron was the lack of transparency surrounding the use of SPVs. The company would transfer its own stock to the SPV in exchange for cash o
would then use the stock to hedge an asset against Enron's balance sheet. Once the company's stock started losing its value, it no longer provided sufficient collatera
carried by an SPV.

Enron inaccurately depicted many contracts or relationships with customers. By collaborating with external parties such as its auditing firm, it was able to record trans
accordance with GAAP but also not in accord with agreed-upon contracts.

For example, Enron recorded one-time sales as recurring revenue. In addition, the company would intentionally maintain an expired deal or contract through a specific
off during a given period.

Many of Enron's financial incentive agreements with employees were driven by short-term sales and quantities of deals closed (without consideration for the long-term
many incentives did not factor in the actual cash flow from the sale. Employees also received compensation tied to the success of the company's stock price, while up
large bonuses tied to success in financial markets.

Part of this issue was the rapid rise of Enron's equity success. On Dec. 31, 1999, the stock closed at $44.38. Just three months later, it closed on March 31, 2000 at $
by the end of 2000, the massive profits some employees received only fueled further interest in obtaining equity positions in the company.

Many external parties learned about Enron's fraudulent practices, but their financial involvement with the company likely caused them not to intervene. Enron's accou
received many jobs and financial compensation in return for their services.

Investment bankers collected fees from Enron's financial deals. Buy-side analysts were often compensated to promote specific ratings in exchange for stronger relatio
institutions.

Both Enron Energy Services and Enron Broadband were poised to be successful due to the emergence of the internet and heightened retail demand. However, Enron
company over-promising online services and timelines that were simply unrealistic.

The ultimate downfall of Enron was the result of overall poor corporate leadership and corporate governance . Former Vice President of Corporate Development Sher
out about various financial treatments as they were occurring. However, top management and executives intentionally disregarded and ignored concerns. This tone fr
across accounting, finance, sales, and operations.

In the early 1990s, Enron was the largest seller of natural gas in North America. Ten years later, the company no longer existed due to its accounting scandal.

One additional cause of the Enron collapse was mark-to-market accounting. Mark-to-market accounting is a method of evaluating a long-term contract using fair mark
term contract or asset could fluctuate in value; in this case, the reporting company would simply "mark" its financial records up or down to reflect the prevailing market

There are two conceptual issues with mark-to-market accounting, both of which Enron took advantage of. First, mark-to-market accounting relies very heavily on man
long-term, complex contracts requiring the international distribution of several forms of energy. Because these contracts were not standardized, it was easy for Enron
contract because it was difficult to determine the market value appropriately.

Second, mark-to-market accounting requires companies to periodically evaluate the value and likelihood that revenue will be collected. Should companies fail to contin
contract, it may easily overstate the expected revenue to be collected.

For Enron, mark-to-market accounting allowed the firm to recognize its multi-year contracts upfront and report 100% of income in the year the agreement was signed,
provided or cash collected. This form of accounting allowed Enron to report unrealized gains that inflated its income statement, allowing the company to appear much

The Enron bankruptcy, at $63.4 billion in assets, was the largest on record at the time. The company's collapse shook the financial markets and nearly crippled the en
executives at the company concocted the fraudulent accounting schemes, financial and legal experts maintained that they would never have gotten away with it witho
Securities and Exchange Commission (SEC), credit rating agencies, and investment banks were all accused of having a role in enabling Enron's fraud.

Initially, much of the finger-pointing was directed at the SEC, which the U.S. Senate found complicit for its systemic and catastrophic failure of oversight. The Senate's
the SEC reviewed any of Enron's post-1997 annual reports, it would have seen the red flags and possibly prevented the enormous losses suffered by employees and

The credit rating agencies were found to be equally complicit in their failure to conduct proper due diligence before issuing an investment-grade rating on Enron's bon
Meanwhile, the investment banks—through manipulation or outright deception—had helped Enron receive positive reports from stock analysts, which promoted its sh
of investment into the company. It was a quid pro quo in which Enron paid the investment banks millions of dollars for their services in return for their backing.
Enron reported total company revenue of:

$13.2 billion in 1996

$20.3 billion in 1997

$31.2 billion in 1998

$40.1 billion in 1999

$100.8 billion in 2000

By the time Enron started to collapse, Jeffrey Skilling was the firm's CEO. One of Skilling's key contributions to the scandal was to transition Enron's accounting from a
accounting method to mark-to-market accounting, for which the company received official SEC approval in 1992.
Skilling advised the firm's accountants to transfer debt off Enron's balance sheet to create an artificial distance between the debt and the company that incurred it. En
accounting tricks to keep its debt hidden by transferring it to its subsidiaries on paper. Despite this, the company continued to recognize revenue earned by these s
public and, most importantly, shareholders were led to believe that Enron was doing better than it actually was despite the severe violation of GAAP rules.
Skilling abruptly quit in August 2001 after less than a year as chief executive—four months before the Enron scandal unraveled. According to reports, his resignation s
raised suspicions despite his assurances that his departure had "nothing to do with Enron."
Skilling and Kenneth Lay were tried and found guilty of fraud and conspiracy in 2006. Other executives plead guilty. Lay died shortly after his conviction, and Skilling s
longest sentence of any of the Enron defendants.
In the wake of the Enron scandal, the term " Enronomics " came to describe creative and often fraudulent accounting techniques that involve a parent company makir
with its subsidiaries to hide losses the parent company has suffered through other business activities.
Parent company Enron had hidden its debt by transferring it (on paper) to wholly-owned subsidiaries —many of which were named after Star Wars characters—but it
subsidiaries, giving the impression that Enron was performing much better than it was.
Another term inspired by Enron's demise was "Enroned," slang for having been negatively affected by senior management's inappropriate actions or decisions. Being
stakeholder, such as employees, shareholders, or suppliers. For example, if someone lost their job because their employer was shut down due to illegal activities they
been "Enroned."
As a result of Enron, lawmakers put several new protective measures in place. One was the Sarbanes-Oxley Act of 2002, which enhances corporate transparency an
manipulation. The Financial Accounting Standards Board (FASB) rules were also strengthened to curtail the use of questionable accounting practices, and corporate b
more responsibility as management watchdogs.
Enron used special purpose entities to hide debt and mark-to-market accounting to overstate revenue. In addition, it ignored internal advisement against these practic
disclosed financial position was incorrect.
With shares trading for around $90/each, Enron was once worth about $70 billion. Leading up to its bankruptcy, the company employed over 20,000 employees. The
billion of company-wide net revenue (though this figure has since been determined to be incorrect).
Several key executive team members are often noted as being responsible for the fall of Enron. The executives include Kenneth Lay (founder and former Chief Execu
(former Chief Executive officer replacing Lay), and Andrew Fastow (former Chief Financial Officer).
As a result of its financial scandal, Enron ended its bankruptcy in 2004. The name of the entity officially changed to Enron Creditors Recovery Corp., and the company
reorganized as part of the bankruptcy plan. Its last business, Prisma Energy, was sold in 2006.
At the time, Enron's collapse was the biggest corporate bankruptcy ever to hit the financial world (since then, the failures of WorldCom, Lehman Brothers, and Wash
The Enron scandal drew attention to accounting and corporate fraud. Its shareholders lost tens of billions of dollars in the years leading up to its bankruptcy, and its e
pension benefits. Increased regulation and oversight have been enacted to help prevent corporate scandals of Enron's magnitude.

Top Accounting Scandals

Google · Needs Investigation (Score 0.84) corporatefinanceinstitute.com

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scandal · scandals · sentenced · conspiracy · convicted · crisis · debt · fined · lost · toxic · bankruptcy · breach · c
collapsed · conviction · convictions · died · fake · fine · fraudulent · indicted · investigating · investigations · manipulation
settled · stolen

Top Accounting Scandals

A recap of the top scandals in the past

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cheat sheets. Start Free

The last two decades saw some of the worst accounting scandals in history. Billions of dollars were lost as a result of the said financial disasters, which destroyed cor
Many of these accounting scandals were a result of the excessive greed of a few individuals whose actions led to disastrous consequences which brought down whol
of people. In this article, we look at the 10 biggest accounting scandals in recent times.

Top 10 Accounting Scandals in the Past Decades

Waste Management Scandal (1998)

Waste Management Inc. is a publicly-traded US waste management company. In 1998, the company's new CEO, A Maurice Meyers, and his management team disc
reported over $1.7 billion in fake earnings.

The Securities and Exchange Commission (SEC) found the company's owner and former CEO, Dean L Buntrock, guilty, along with several other top executives. In ac
Management's auditors, Arthur Andersen, over $7 million. Waste Management eventually settled a shareholder class-action suit for $457 million.

Enron Scandal (2001)

Enron Corporation was a US energy, commodities, and services company based out of Houston, Texas. In one of the most controversial accounting scandals in the p
2001 that the company had been using accounting loopholes to hide billions of dollars of bad debt resulted in shareholders losing over $74 billion as Enron's share pr
the company's earnings . The scandalcollapsed from around $90 to under $1 within a year.

An SEC investigation revealed that the company's CEO, Jeff Skillings, and former CEO, Ken Lay, had kept billions of dollars of debt off the company's balance sheet.
the company's auditing firm, Arthur Andersen, to ignore the issue.

The two were convicted, largely based on the testimony of former Enron employee, Sherron Watkins. However, Lay died before serving time in prison. Jeff Skillings w
prison. The scandal of Enron and dissolution of Arthur Andersen. led to the bankruptcy

After the fact, the convictions were as controversial as the company's collapse had been shocking, as prosecutor Andrew Weissman indicted not just individuals, but t
Andersen, effectively putting the company out of business. It was little consolation to the 20,000 employees who had lost their jobs when the conviction was later over

WorldCom Scandal (2002)

WorldCom was an American telecommunications company based out of Ashburn, Virginia. In 2002, just a year after the Enron scandal, it was discovered that WorldC
almost $11 billion, making it by far one of the largest accounting scandals ever.

The company had underreported line costs by capitalizing instead of expensing them and had inflated its revenues by making false entries. The scandal first came to
audit department found almost $3.8 billion in fraudulent accounts. The company's CEO, Bernie Ebbers, was sentenced to 25 years in prison for fraud, conspiracy, and
scandal resulted in over 30,000 job losses and over $180 billion in losses by investors.

Tyco Scandal (2002)

Tyco International was an American blue-chip security systems company based out of Princeton, New Jersey. In 2002, it was discovered that CEO, Dennis Kozlowski
stolen over $150 million from the company and had inflated the company's earnings by over $500 million in their reports. Kozlowski and Swartz had siphoned off mon
stock sales.

The scandal was discovered when the SEC and the office of the District Attorney of Manhattan carried out investigations related to certain questionable accounting pr
Kozlowski and Swartz were both sentenced to 8 to 25 years in prison. A class-action suit forced them to pay $2.92 billion to investors.

HealthSouth Scandal (2003)

HealthSouth Corporation is a top US publicly traded healthcare company based out of Birmingham, Alabama. In 2003, it was discovered that the company had inflate
The SEC had previously been investigating HealthSouth's CEO, Richard Scrushy, after he sold $75 million in stock a day before the company posted a huge loss. Alt
acquitted of all 36 counts of accounting fraud. However, he was found guilty of bribing then Alabama Governor, Don Siegelman, and was sentenced to seven years ir

Freddie Mac Scandal (2003)

The Federal Home Loan Mortgage Corporation, also known as Freddie Mac, is a US federally-backed mortgage financing giant based out of Fairfax County, Virginia.
Freddie Mac had misstated over $5 billion in earnings. COO David Glenn, CEO Leland Brendsel, former CFO Vaughn Clarke, and former Senior Vice Presidents Rob
intentionally overstated earnings in the company's books. The scandal came to light due to an SEC investigation into Freddie Mac's accounting practices. Glenn, Clar
and the company was fined $125 million.

American International Group (AIG) Scandal (2005)

American International Group (AIG) is a US multinational insurance firm with over 88 million customers across 130 countries. In 2005, CEO Hank Greenberg was four
. The SEC's investigation into Greenberg revealed a massive accounting fraud of almost $4 billion.

It was found that the company had booked loans as revenue in its books and forced clients to use insurers with whom the company had pre-existing payoff agreemen
stock traders to inflate the company's share price. AIG was forced to pay a $1.64 billion fine to the SEC. The company also paid $115 million to a pension fund in Lou
pension funds in Ohio.

Lehman Brothers Scandal (2008)

Lehman Brothers was a global financial services firm based out of New York City, New York. It was one of the largest investment banks in the United States. During th
discovered that the company had hidden over $50 billion in loans. These loans had been disguised as sales using accounting loopholes.

According to an SEC investigation, the company had sold toxic assets to banks in the Cayman Islands on a short-term basis. It was understood that Lehman Brothers
This gave the impression that the company had $50 billion more in cash and $50 billion less in toxic assets. In the aftermath of the scandal, Lehman Brothers went ba

Bernie Madoff Scandal (2008)

Bernie Madoff is a former American stockbroker who orchestrated the **biggest Ponzi scheme in history** , and also one of the largest accounting scandals. Madoff ra
Securities LLC. After the 2008 financial crisis, it was discovered that Madoff had tricked investors out of over $64.8 billion.

Madoff, his accountant, David Friehling, and second in command, Frank DiPascalli, were all convicted of the charges filed against them. The former stockbroker recei
years and was also ordered to pay $170 billion in restitution.

Satyam Scandal (2009)

Satyam Computer Services was an Indian IT services and back-office accounting firm based out of Hyderabad, India. In 2009, it was discovered that the company ha
marking one of the largest accounting scandals.

An investigation by India's Central Bureau of Investigation revealed that Founder and Chairman, Ramalinga Raju, had falsified revenues, margins, and cash balances
admitted to the fraud in a letter to the company's board of directors. Although Raju and his brother were charged with breach of trust, conspiracy, fraud, and falsificatio
when the Central Bureau of Investigation failed to file charges on time.

Additional Resources

This has been CFI's guide to the Top 10 Accounting Scandals. To continue learning and advancing your career, these additional CFI resources will be helpful:

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bankruptcy scandal debt collapse lost bubble conspiracy convicted conviction sentence toxic attack

conflicts corrupt defraud died illegal insider trading investigating logging misconduct official resigned se

victims wire fraud

Enron Scandal and Accounting Fraud: What Happened?

Before its demise, Enron was a large energy, commodities, and services company based in Houston, Texas. Its collapse affected over 20,000 employees and shook shares were worth $90.75. When it declared bankruptcy on Dec. 2, 2001, shares traded at $0.26.

Enron's accounting method was revised from a traditional historical cost accounting method to a mark-to-market (MTM) accounting method in 1992.

Enron used special-purpose vehicles to hide its debt and toxic assets from investors and creditors.

The price of Enron's shares went from $90.75 at its peak to $0.26 at bankruptcy.

The company paid its creditors over $21.8 billion from 2004 to 2012.

Gregory Smith / Contributor / Getty Images

Enron was formed in 1985 following a merger between Houston Natural Gas and Omaha, Neb.-based InterNorth. Houston Natural Gas' chief executive officer (CEO) CEO and chair. Deregulation of the energy markets allowed companies to place bets on future prices, and Enron was poised to take advantage. In 1990, Lay created appointed Jeffrey Skilling, to head the new corporation.

Skilling transitioned Enron's accounting from a traditional historical cost accounting method to a mark-to-market (MTM) accounting method, for which the company rec Exchange Commission (SEC) approval in 1992.

MTM measures the fair value of accounts that can change over time, such as assets and liabilities. MTM aims to provide a realistic appraisal of an institution's or com and it is a legitimate and widely used practice. However, in some cases, the method can be manipulated, since MTM is not based on actual cost but on fair value , wh

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During the 1990s, the dotcom bubble was in full swing, and the Nasdaq hit 5,000. Most investors and regulators accepted spiking share prices as the new normal. En October 1999. It was an electronic trading website that focused on commodities. Enron was the counterparty to every transaction on EOL; it was either the buyer or th reputation, credit, and expertise in the energy sector to entice trading partners.

In July 2000, Enron Broadband Services and Blockbuster partnered to enter the burgeoning video-on-demand market. The VOD market was a sensible pick, but Enro earnings based on the estimated growth of the VOD market, which vastly inflated the numbers.

By mid-2000, EOL was executing nearly $350 billion in trades. When the dot-com bubble began to burst, Enron decided to build high-speed broadband telecom netwo 2000, Enron had significant exposure to the most volatile parts of the market. As a result, many trusting investors and creditors found themselves on the losing end of Skilling hid the financial losses of the trading business and other operations using MTM accounting. This technique measures the value of a security based on its curr book value.

The company would build an asset, such as a power plant, and immediately claim the projected profit on its books, even though it didn't reap positive returns. If the re proved less than the projected amount, the company would transfer the asset to an off-the-books corporation instead of taking the loss. The loss would go unreported Enron to write off unprofitable activities without hurting its bottom line .

The MTM practice led to schemes designed to hide the losses and make the company appear profitable. To cope with the mounting liabilities, Andrew Fastow, chief fi developed a deliberate plan to show that the company was in sound financial shape even though many of its subsidiaries were losing money.

Enron orchestrated a scheme to use off-balance-sheet special purpose vehicles (SPVs), also known as special purpose entities (SPEs), to hide Enron's debt and toxi creditors.

Enron would transfer some of its rapidly rising stock to the SPV in exchange for cash or a note. The SPV would subsequently use the stock to hedge an asset listed o would guarantee the SPV's value to reduce apparent counterparty risk.

The SPVs were not illegal but differed from standard debt securitization in several significant—and potentially disastrous—ways. SPVs were capitalized entirely with E compromised the ability of the SPVs to hedge if Enron's share prices fell. Enron also failed to reveal conflicts of interest. While Enron disclosed the SPVs' existence to adequately disclose the non-arm's-length deals between the company and the SPVs.

In addition to CFO Andrew Fastow, a major player in the Enron scandal was Enron's accounting firm, Arthur Andersen LLP, and partner David B. Duncan. As one of t the United States at the time, Andersen had a reputation for high standards and quality risk management. Despite Enron's poor accounting practices, Arthur Andersen reports. By April 2001, many analysts questioned Enron's earnings and transparency .

In 2001, Lay retired in February, turning over the CEO position to Skilling. In August 2001, Skilling resigned as CEO, citing personal reasons. Around the same time, a rating for Enron's stock, and the stock descended to a 52-week low of $39.95. By October 16, the company reported its first quarterly loss and closed its Raptor I SPV of the SEC.

A few days later, Enron changed pension plan administrators, essentially forbidding employees from selling their shares for at least 30 days. Shortly after, the SEC an
Enron and the SPVs created by Fastow. Fastow was fired from the company that day. The company also restated earnings back to 1997. Enron had losses of $591 m
the end of 2000. Dynegy, a company that previously announced it would merge with Enron, backed out of the deal on November 28. By Dec. 2, 2001, Enron filed for
The amount that shareholders lost in the four years leading up to Enron's bankruptcy.
Enron's Plan of Reorganization was approved by the U.S. Bankruptcy Court, and the new board of directors changed Enron's name to Enron Creditors Recovery. The
"to reorganize and liquidate certain of the operations and assets of the pre-bankruptcy Enron for the benefit of creditors." The company paid its creditors over $21.8 bi
payout was in May 2011.

In June 2002, Arthur Andersen LLP was found guilty of obstructing justice for shredding Enron's financial documents. The conviction was overturned later on appeal b
by the scandal and dwindled into a holding company .

Kenneth Lay, Enron's founder, and former CEO was convicted on six counts of fraud and conspiracy and four counts of bank fraud. Before sentencing, he died of a h

Enron's former CFO, Andrew Fastow, pleaded guilty to two counts of wire fraud and securities fraud for facilitating Enron's corrupt business practices. He ultimately
federal authorities, served more than five years in prison, and was released in 2011.

Former CEO Jeffrey Skilling received the harshest sentence. He was convicted of conspiracy, fraud, and insider trading in 2006. Skilling received a 17½-year sentenc
in 2013. Skilling was required to give $42 million to the fraud victims to cease challenging his conviction. Skilling was released on Feb. 22, 2019.

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Enron's collapse and the financial havoc it wreaked on its shareholders and employees led to new regulations and legislation to promote the accuracy of financial rep
In July 2002, then-President George W. Bush signed the Sarbanes–Oxley Act into law. The act heightened the consequences for destroying, altering, or fabricating fi
defraud shareholders.
The Enron scandal resulted in other new compliance measures. Additionally, the Financial Accounting Standards Board (FASB) substantially raised its levels of ethic
boards of directors became more independent, monitoring the audit companies and quickly replacing poor managers. These new measures are important mechanism
companies have used to avoid accountability.
Jim Chanos of Kynikos Associates is a known short-seller . Chanos said his interest in Enron and other energy trading companies was "piqued" in October 2000 after
pointed out that many of these firms employed the "gain-on-sale" accounting method for their long-term energy trades. His experience with companies using this acco
"earnings" were created out of thin air if management used highly favorable assumptions. Chanos said that this mismatch between Enron's cost of capital and its retu
the cornerstone of his bearish view of Enron. His firm shorted Enron's common stock in November 2000 and netted Chanos and his Kynikos firm hundreds of millions
Sherron Watkins, a vice president at Enron, wrote a letter to Lay in August 2001 warning that the company could implode in a wave of accounting scandals; a few mo
Watkins' role as a whistleblower in exposing Enron's corporate misconduct led to her being recognized as one of three *Time* "Persons of the Year" in 2002.
Enron no longer exists. It sold its last business, Prisma Energy, in 2006.
Enron's collapse was the biggest corporate bankruptcy in the financial world at the time. It has since been surpassed by the bankruptcies of Lehman Brothers, Washi
General Motors. The Enron scandal drew attention to accounting and corporate fraud, as shareholders lost $74 billion in the four years leading up to its bankruptcy, a
pension benefits.

Numbers manipulator describes Enron's descent

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misleading attorneys bankruptcy debts illegal sentenced toxic fraudulent aggressive collapse conspiracy
died human indicted inmates insider trading lost manipulate manipulating penalty problem securities fraud

Numbers manipulator describes Enron's descent

Nearly 15 years ago the actions of Enron's C-suite executives led to the company's demise. In this interview with Andrew Fastow, former Enron CFO, read how the to
rationalizations behind "finding the loopholes" led to one of the largest and most well-known cases of corporate fraud and corruption.
"The inmates in prison camp were easier to get along with than Enron executives," says Andrew Fastow during a sit-down interview with *Fraud Magazine* in Singapor
"People [at Enron] were incentivized to do the wrong thing and senior management set very bad examples by the decisions they were making. … We had senior exec
were doing deals that sent a bad ethical message." at the 2015 *ACFE Asia-Pacific Fraud Conference*
As the former CFO of Enron Corporation, Fastow's role in this toxic corporate culture has forever cemented the fate of the multibillion-dollar American energy, commo
Enron's bankruptcy in 2001 wiped out $40 billion in stock market value and led to the collapse of its well-known accounting firm, Arthur Andersen. Fastow admits that
implications of his unethical business dealings that led to the company's demise. "I was the gatekeeper," continues Fastow. "I should have been making the tough cal
Instead of making those tough calls, Fastow helped set up a system of structured financing that gave Enron greater access to capital and made financing less expens
into transactions that didn't have economic substance. These transactions kept debts off the balance sheets and made the company appear healthier than it actually v
income — its equity value was a couple of billion dollars less than its balance sheet stated. Using "partnership" companies the company had created, Enron masked h
its trading businesses.

Fastow maintains they intended to follow accounting rules and the company's accountants and attorneys technically approved the deals; nonetheless they were misle
machinations fraud. "I always tried to technically follow the rules, but I also undermined the principle of the rule by finding the loophole," he says. "I think we were all o
deal structure where the accountant said, 'The accounting doesn't work,' then we wouldn't do those deals. We simply kept changing the structure until we came up wi
within the rules."

The beginning of the end

Pressure from within the C-suite eventually reached a boiling point. "We only made our numbers many quarters because of the finance group, and there was a lot of p
Fastow says. "There was pressure that other people put on me as well as me putting it on myself. I wanted to do these deals, I wanted to be the hero. That was also r
of control."

In the third quarter of 2001, when it became apparent that Enron would finally have to recognize the losses, Kenneth Lay, Enron's chairman and CEO, refused to issu
downgraded to junk status, which triggered the company's bankruptcy. Eventually, thousands of employees lost their jobs and saw their pension funds obliterated bec
some unethical decisions.

Many key players were indicted and sentenced to prison. Fastow pleaded guilty to two counts of wire and securities fraud and was sentenced to six years in prison. L
conspiracy, fraud and insider trading. Lay died before his sentencing, and Skilling received 24 years and four months, which was later reduced, and a $45 million pen
2019.

"What I did was wrong and it was illegal, and for that I'm very sorry, very remorseful," says Fastow. "I wish I could undo it."

After serving 4½ years of his sentence, Fastow is slowly easing himself back into the public eye as he tells his story before audiences of college students, business pe
also speaking more to the media as he did to *Fraud Magazine* .

FM: Tell me about your first job out of college. **AF:** My first job out of college was at The Original Pancake House for six weeks before I was supposed to start
Chicago. When my wife-to-be and I arrived in Chicago, the first thing we did was unpack our TV so we had something to listen to, and there was a newsflash that Cor
and started walking down the street until I found a job with The Original Pancake House.

Six weeks later I was able to start at Continental, which was operating during its reorganization. They had … a 2½-year training program where you work in different a
banks operate. They teach you credit and you get your MBA at night, so I worked and got mine at Northwestern.

FM: How did you come to work for Enron? **AF:** Long story short — I received a call from a headhunter who'd learned what I was doing at Continental. I was w
financing and there were very few people in the country doing it at that point in time. He'd learned that I had a connection to Houston, so he put it all together, and tha
for at that time.

FM: Did you start in the lower echelons of Enron or did they bring you in in a high position? **AF:** No, no, I wasn't brought in at a high level. At Enron each
pipeline company, oil and gas company, international development company) had their own businesses and a finance person, and the job of that finance person was
Enron had just set up a trading and finance company, which was headed by Jeff Skilling, and they needed a person to do off-balance sheet financing. And the specific
financing they wanted to do was very analogous to what I was doing at Continental Bank — that's why they hired me. But I came in at a relatively low level. It was an
corporate level, and I was just a finance guy. About seven years later I became CFO of Enron.

FM: What do you think made you stand out to the executives during those seven years? **AF:** I think my ability to do structured financing, to finance things o
to manipulate financial statements — there's no nice way to say it. Like I said at the conference, I was good at finding loopholes; that's a nicer way of saying manipula
being misleading, and I was good at it. I'm not proud of it now, but I was very proud of it at that time.

**FM: When you went to work for Enron — and let's focus on when you were in those first positions — what were your first impressions? What did you thinl
company?** **AF:** I thought Enron did kind of questionable accounting. I was hired in November of 1990 and I said to the guys, to Jeff Skilling, that I would like to sta
month off, spend it with my family — we had a vacation planned. And he said, "No, no, I need you down here immediately; you have to get something off our balance
less than 30 days to do a financing transaction. I've never been at the company before, and I hadn't done this particular type of financing.

So, we worked very hard to get the deal done, and on about December 30 we signed all the documents, and the accountants and attorneys approved it, and we were
think I could get it done, but we got it done.

On January 2, I'm walking down the hall at Enron, and I bump into the head of accounting for this operating company and I made some innocuous comment like, "It su
done," and he said, "We didn't really get it done." And I said, "What are you talking about? We signed the documents, I was there." He replied, "Yeah, but the account
to throw that into the materiality basket." That meant that we were just going to ignore it.

FM: What did materiality mean in this instance? **AF:** So, basically it's the accountant saying that even if we don't think it's quite correct, it's small enough that w
worrying about that. And I went back to my office, and I was stunned because they told me it worked, and now I'm learning it didn't really work, and I remember thinkir
that? How could they just ignore it?" At that point I should have just gotten up and walked out and gone back to Chicago or somewhere else. But I didn't, and that was
no one else's. Instead I embraced it, and I figured that I'd find ways to be good at it.

**FM: Interesting. So those were your impressions, but I'm also curious to know what you think they thought of you when you first came to the company, m
first deals.** **AF:** I can't tell you what was in their heads, but they kept giving me promotions and raises and bonuses.
I was the gatekeeper. I should have been making the tough calls and I didn't. I just abdicated. "

**FM: So, then what led to the beginnings — the beginning of the end, I guess you could say? What led to the beginning of the structured financing that you
What led to the beginning of, I guess, the fraud itself?** **AF:** It's a little difficult to say when the fraud started because it's better described as the aggregation of
each maybe technically correct but also misleading. We created something that was monstrously misleading, but any one of those deals alone wasn't necessarily con
aggregation of the impact of the deals, however, *was* fraudulent, so I'm not sure at which point we crossed the line, where it became too big and too misleading. It's a
this, and maybe this helps answer the question: When I first started doing these structured financing deals, there was clear economic benefit in doing the deals for the
addition to the economic benefit, there were financial reporting advantages to doing it. So, the accounting made the company look better, but the underlying transactio
made our financing less expensive. It gave us greater access to capital — something like that.

Eventually the deals morphed into transactions that didn't necessarily have economic substance, and that were being done just to be misleading. So, we devolved int
the whole purpose of doing the deals — was to be misleading. Again, the deal technically may have been correct, but it really wasn't because the intent was wrong. A
when we crossed the threshold, but there are some deals that stand out as being worse than others in that regard.

Now, all of the deals were technically approved by our attorneys and accountants, so if that's your definition of fraud then there was no fraud. I will say to you that I be
oversimplifying, but if a fraud examiner is typically looking for compliance with the rules, the problem in Enron's case is that you had compliance with the rules yet you
thing that happened is even though the deals were technically approved — because the attorneys and accountants said we were following the rules — they were non

FM: What was the aggregate impact? You say you could look at each individual deal and not see it, but on a bigger scale what was that? **AF:** A simple v
given an investment grade by credit rating agencies, but in my opinion it wasn't close to investment grade. It was a junk credit. So, the aggregate impact of the compli
misleading. The second issue is that we did these deals because there were economic reasons to do the deals: there was a lower cost of financing, or there were oth
credit or transferring risk … there was some good reason. Eventually we were doing transactions just because they altered the financial reporting. So, while the deal r
the intent was not correct at all — that's fraud.

**FM: So, for a layperson like myself, or some of our fraud examiners who aren't accountants or auditors, can you explain a little bit of the machinations of s
to-market accounting?** **AF:** Well, it's going to be impossible to capture that in an article. This is what I would say. I wouldn't expect the typical fraud examiner to I

accounting background to be making determinations whether the accounting is correct. And, in fact, you might conclude the accounting's correct and then where are y
was. So, it should be other questions that they are thinking about. Like what is the intent of this transaction? Is the intent to be misleading? Or is there some true ecor
this transaction?
**FM: Establishing a firm tone at the top is an important practice we teach at the ACFE. What was the tone at the top like at Enron? The media painted execu
hungry, but what was your impression of the corporate culture when you started at Enron or as you worked your way up?** **AF:** I think it was a bad corpor
incentivized to do the wrong things, and senior management, including myself, set very bad examples by the decisions we were making. At Enron, we had the best m
conduct and all those things that look great. We had a great human resourcing department that churned this stuff out, but we had an incentive system that incentivize
were good for financial reporting purposes but bad for the long-term value of the company. And we had senior executives, like myself, who were doing deals that sent
So, you could tell people to be ethical, have beautifully written statements about company values and all that, but you have a CFO who does a deal that's intentionally
You have to remember we hired the brightest, most ambitious young people, and they were smart enough to figure out what the CFO just did. And so, despite your cc
code of ethics, those people saw that this guy became CFO, and he is incredibly misleading. So they decide, "I'm going to be misleading. I will be misleading to the pe
customers."
So, what the top does is very important, and they should assume that the people who work for them are smarter than they really believe. It's like every generation doe
smarter than they are, and can outsmart them whenever they want, and top management should understand that their employees see right through them.
FM: Did you have doubts along the way? Were there times when you got a bit nervous? **AF:** No, it never dawned on me that what I was doing was illegal. I
what I was supposed to be doing. I was excited and enthusiastic about these deals. We had parties when we closed deals, and we felt like rock stars. For a bunch of t
that's as close to rock stardom as you get, so it wasn't like we were hiding in a dark room. We were giving interviews about the deals, having closing parties. We were
also knew it was intentionally misleading, like a weird dichotomy. I rationalized it by saying, "This is how the game is played," but it was really just a lack of character c
FM: You speak at universities like Tufts, Harvard and Dartmouth. What is the most important thing you tell the students? **AF:** To develop a few questions
from time to time — not knowing what their different circumstances will be in the future — that will help keep them within these reasonable boundaries. I'm not sure wh
might be different for different people, but they should think of generic questions like, "If I own this company and I were leaving it to my grandchildren would I make thi
that would have caught 99 percent of the fraud that went on at Enron, because the answer would have been "No." This forces you to go through the thought process c
What I hope they take away is that at some point they need to pause and think about their actions. I don't try to give them the answer — I am the least qualified perso
thinking about it, that's a step forward.
***Emily Primeaux** is the assistant editor of* Fraud Magazine *. Her email address is: eprimeaux@ACFE.com .*

Enron Corporation - Financial Scandals, Scoundrels & Crises

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debt collapse disclosure aggressive charge conflict crisis problem violated bankruptcy laws liquidity abuse bonds concern concerned disclosures fine human investigations kicked lost officially regulatory emerging investigator

Enron Corporation - Financial Scandals, Scoundrels & Crises

The Enron story is a living manifestation of the flight of Icarus from Greek mythology. According to legend, Icarus and his father Daedalus were imprisoned in the laby
was an elaborate maze with very high walls. As Daedalus was an inventor, he created a set of wings so they both could escape. Because the labyrinth was too compl
high to scale and the land was well guarded, the wings would let them fly over the walls and away over the sea. But the wings were made of wax and feathers. So, Da
too high in the air would place him too close to the sun, where the heat would melt the wax. Similarly, flying too low would place him too close to the water, where the
to fall out. Icarus could not resist the temptation and flew all over the sky, high by the sun and low by the sea. His father tried in vain to get Icarus to stop but to no ava
behavior was dangerous, Icarus did it anyway. Sure enough, just as his father had warned, as Icarus flew by the sun, the wax melted and his wings came apart. Icaru
could not resist the temptation, even knowing that the very thing he was tempted to do would kill him.
Like Icarus, Enron embarked on a precarious path. For a time, it flew high by the sun. The company grew revenues from $10 billion to $100 billion in 10 years. It was a
executives became fabulously rich and were widely admired in their industry, the media, and the public eye. But Enron was destined to fail.
Before examining the Enron crisis the company experienced in 1987. [1] On 23 January 1987, Enron managers learned that Louis Borget and Tom Mastroeni, two tra
Valhalla, New York, were engaged in unethical activity. Enron discovered that the two had opened a business bank account at Eastern Savings Bank and failed to no
Houston. Moreover, the pair had transferred $2 million from the business account to a personal account in Mastroeni's name at the same bank (Eastern Savings Bank
issue, Borget and Mastroeni told Enron CEO Kenneth Lay that they used the accounts to hide two derivatives transactions that would shift profits earned in one quarte
not want to draw undue attention to the company. In examining the issue further, Lay discovered that the two had doctored the bank statements when presenting their
trading unit had posted profits of $10 million in 1985 and $28 million in 1986. of 2001, it may be instructive to consider an underreported crisis
In contrast to the trading unit, the parent company had been struggling financially. Enron had reported a $79 million *loss* in 1985, and although it reported $556 million
that money came from recoveries of past income taxes. EBIT in 1986 was only $230 million. The profits reported by the oil trading unit were thus the lone bright spot i
learning of their serious transgressions, Lay kept Borget and Mastroeni in place.
Later in 1987, Borget and Mastroeni were again under scrutiny. This time, Enron was staring at a potential trading loss from Borget of $1 billion, which would force the
executive Mike Muckleroy stepped in, however, to finesse the trades and ultimately worked the losses down from $1 billion to $140 million. According to later testimor
protested the trading practices going on in the Oil Trading Unit — even to the point of getting kicked out of his office, Kenneth Lay played the 'I didn't know anything a
broke" (Moore 2005). Lay, despite knowing intimate details of what had been going on, professed shock at the scandal and fired Borget and Mastroeni.
Despite the problems, Lay remained attracted to the trading business. It was was lucrative and had much lower capital requirements than the energy production and p
struggled with the capital intensity and low returns of its traditional business, Lay remained focused on building Enron's trading capabilities. It was just a matter of gett
Enter Jeffrey Skilling. In 1990, Lay hired Skilling to lead the company's commodities trading unit. Later that year, Lay hired Andrew Fastow, who ultimately became ch
consultant at McKinsey, Skilling devised an "asset-lite" strategy to selling natural gas, whereby the company would promise delivery of the commodity but not necessa
would use their skills to bring natural gas to market from multiple suppliers at the best price (for Enron). Lay first brought Skilling in as a consultant and then brought h

approach at Enron. Over the next decade, Enron, leaving behind its old roots, fully embraced the energy-trading business. Lay and Skilling devised a plan to aggressi Fastow was to figure out how to finance it.

Not only was the market swept up in Enron-mania, but sell-side analysts and financial media were as well.

During the run-up to the technology bubble in the late 1990s, Enron rode the wave and promised to transform the energy business, and even the internet, with bandw Enron as a transformative leader. At its peak in 2001, Enron's stock price reached more than $90 per share, and its market capitalization topped $66 billion (Tran, 200 at March 2001 (McLean, 2001). The company was part of the so-called New Economy, which was light on assets and fast moving. And Enron fulfilled this perception Enron lost its reputation in a wave of scandals, culminating in the company's spectacular collapse. Seldom in corporate history has a company gone from dominant c in such a short time.

What Went Wrong?

Enron was deceitful in four main areas. First, Enron managers manipulated the intent and purpose of using Special Purpose Entities (SPE's) by using them as vehicle parent company's reported revenues and earnings. Second, they used "mark-to-model" accounting which essentially let the company estimate – and book – large pro regardless of how the contracts performed over time. Third, senior Enron executives, such as CFO Andy Fastow, were principals in many of the SPE's, not only prese but also enriched themselves in the process. Fourth, Enron posted large amounts of its stock as collateral to back the financing of many of the SPE's making the entir vulnerable to a material decline in Enron's stock price (for any reason).

Enron's Special Purpose Entities: JEDI and CHEWCO

In the first area of deceit, Enron used and misused off-balance-sheet financing vehicles known as special-purpose entities (SPEs). SPE's were used in many aspects early 1990's until its demise in 2001. By the time Enron collapsed, it had created as many as 3,000 SPE's. According to a piece in the New Yorker, the paperwork for pages each (Gladwell, 2007). To understand all of Enron's SPE's would require analysis on 3,000,000 sheets of dense legal disclosure. Consequently, there was no exhaustive review of each and every deal as it would be far too unwieldy. Consequently, the analysis presented below details the inner workings of two different SPE' understanding the nature of Enron's scheme.

The accounting rules regarding SPEs (SFAS 125, SFAS 140, and EITF 84-30, 90-15, and 96-21) were designed for companies engaged in the sale and lease back o for Enron to avoid consolidating the financials of these SPEs, each SPE had to meet three criteria. First, outside investors have to have at least 3% ownership. Secon has to have control of the SPE in such a way that it does not act on behalf of the sponsor (e.g., Enron). Lastly, the SPE must possess the lion's share of the risks and these criteria were met, Enron did not have to consolidate an SPE on its financial statements. Enron typically used the Equity Method of accounting for SPE's meanin proportional share in the earnings of each SPE in a single line item on its income statement without disclosing corresponding balance sheet, cash flow and other cons failed on all three criteria.

On 16 October 2001, Enron Corporation reported a $638 million loss for Q3 and declared a $1.01 billion charge to equity due to write-offs of failed water tra and the unwinding of the Raptor SPE's run by CFO Andrew Fastow.

Off-balance-sheet financing techniques are, in fact, common in the energy business (and others) and can certainly be used in ethical ways. However, as is clear with and misuse of SPE's over time, they became increasingly bold in circumventing ethical practices. In 1993, Enron created an off-balance SPE named the Joint Energy or "JEDI" for short. This was a joint venture with CalPERS where CalPERS invested $250 million in cash and Enron invested $250 million in stock. At the time the first s stock was trading at roughly $16 (split adjusted), while at the time of the disposition of CalPERS stake in 1998, Enron's stock was trading at about $30. In other wor Enron stock in JEDI1 in 1993 was worth about $460 million by 1998. Which brings us to an important point: just because a risky action worked out well once (or for a mean it *always* works out well. In other words, had Enron stock fallen to $8 instead of rising to $30 during this time period, the SPE, and perhaps even Enron, might h Moreover, volatility of individual securities is a given in finance. In fact, the only rational expectation is that a given stock will inevitably experience meaningful bouts of successful the enterprise. That said, the JEDI 1 deal was not necessarily unethical, though it may not have been entirely prudent as discussed below.

When Enron wanted to engage in a second JEDI deal (JEDI2) with CalPERS in 1998, they discovered that CalPERS wanted out of the first JEDI deal before they wou $250 million stake in JEDI 1 was then valued at $383 million. So, Enron had to come up with $383 million to buy them out. Enter Chewco. It is best to think of the Che transactions, one for temporary financing of the purchase of CalPERS' stake (which we will review first) and the other permanent financing (to replace the temporary f second).

The Chewco deal was a landmark for Enron. In fact, it served as a model for a number of subsequent deals whereby Enron skirted disclosure and accounti

In the temporary financing deal, Enron created an SPE called Chewco through which Enron would buyout CalPERS' stake. Chewco borrowed $383 million from two b interest in Jedi for $383 million, closing out CalPERS' stake in JEDI 1. So far, so good. However, in order for these two banks to underwrite the loans to Chewco, they the loans, which Enron did. (The Powers Report also intimates that Enron was required to keep half the loan proceeds on deposit at the lending banks as collateral, b essence, Enron bore all the risk of these loans while Chewco got the rewards (i.e., the financing). Because Chewco gained approval from Enron's auditors, the debt v as an SPE. For Enron, the debt was merely a guarantee. The temporary financing deal to buyout CalPERS share of Jedi is illustrated below:

With respect to the permanent financing of the CalPERS buyout deal, this is where you have to pay attention closely. Fastow engaged in an elaborate scheme to kee on Enron's consolidated financial statements, partly by creating a daisy chain of SPE's that could potentially comply with accounting criteria governing non-consolidati Since leaving prison in 2011, Fastow has been fairly open about his motives while CFO of Enron. In a Fortune article dated July 2013, Fastow states:

" *Accounting rules and regulations and securities laws and regulation are vague. They're complex … What I did at Enron and what we tended to do as a company [wa vagueness … not as a problem, but as an opportunity. The only question was 'do the rules allow it — or do the rules allow an interpretation that will allow it?"*

As each SPE was required to have a general and limited partner, Fastow simply created another layer of SPE's to act as the general and limited partners. Rather tha Fastow was solving a disclosure "problem." The General Partner and Limited Partner in Chewco were SPE's also created by Enron called Big River and Little River, r Little River each borrowed $11.5 million from Barclays (for a combined $23 million). The documents governing these loans to Big River and Little River closely resem agreements. Nevertheless, they were labeled "certificates" and "funding agreements" rather than simply being called "loans." In fact, instead of requiring Big River an Barclays, the Big River and Little River SPE's were required to pay "yield" at a specified percentage rate (Powers Report, 2002). If you think that sounds an awful lot l for all intents and purposes, it was. In other words, the money capitalizing the general and limited partners of Chewco only met the 3% requirement for equity contribu regarding the debt. The documentation was intentionally ambiguous allowing Barclays to characterize the transactions as loans (for its business and regulatory reaso Chewco to simultaneously characterize them as equity contributions. Of course, a single capital transaction cannot be debt for one party and simultaneously be equit it was labeled, in effect it was debt for Chewco and should have moved the entire transaction onto Enron's balance sheet. In essence, the Chewco deal was kind of li mortgage to buy a house and fails to tell the bank that the downpayment was also borrowed (from someone else). Enron borrowed money to put down equity on thes through deceitful accounting. (According to the Powers Report, this was not an unusual practice, though the practice is certainly unethical.)

Both Big River and Little River each invested the $11.5 million into Chewco. Then Barclays, the same bank that lent $23 million to Big River and Little River, also lent a deal total of $263 million from Barclays). As if that weren't enough, JEDI – the very same entity that just received financing from Chewco at the temporary stage – t $132 million in the permanent stage (presumably by selling some Enron stock that was now valued at about $460 million). Lastly, Michael Kopper (an accountant wor $125 thousand as a personal investor in the deal. So, for a total money raised of $395 million, the only real equity in this deal (Kopper's) amounted to a mere 0.03% o equal to a leverage ratio for Chewco of 3,161x. From the perspective of the accounting, the capital Chewco received from JEDI was considered equity in Chewco, no

entity A to finance entity B so that entity B can finance entity A. It should be noted that such financing was ONLY possible because Enron stock price appreciated mat
sure if JEDI received additional third party financing during this period, such large financing would only have been possible in one of three ways: a) by using the Enror
some; b) using the Enron stock that JEDI owned as collateral on third party loans; or c) by having Enron guarantee this third party financing. Whatever the case, Enro
The astute observer may suggest that individual SPE's don't need to have the same safety and soundness that the overall parent company does, particularly if there i
the leverage does illustrate quite clearly that any declines in asset values will push the SPE's financial needs back onto the parent. The Chewco "Permanent" Financir
In the Chewco transaction, it is not entirely clear what the participating banks knew about Enron at the time. Presuming that they were not directly colluding with Enror
from a micro-macro bias (i.e., missing the forest for the trees). By looking at the limited scope of an individual transaction, it's conceivable that they may have neglecte
desirability as a trading partner, ethics and financial health. In fact, if they had just achieved an understanding of the entirety of the very deal in which they were instru
then both ethics and prudence would demand refraining from doing business with Enron. Alternatively, these banks may well have been aiding and abetting Enron, bu
scope of this investigation. Whatever the case, the Chewco deal, and others like it, enabled Enron to hide debt.

One of the ways they used SPE's was to purchase assets from the parent company. By investing in projects first with the corporate balance sheet and then selling the
Corporation could book a gain on sale almost regardless of how the underlying assets performed. This process created the illusion of ongoing earnings from these ga
on the parent company's financial statements. The SPEs then carried the debt used to finance the deal, which would remain off balance sheet and undisclosed to Enr
scheme, the aggressive accounting techniques combined with aggressive growth to maintain the illusion of success. In 2001, Enron reported a total debt of $10.2 billi
revealed that Enron owed a total of $22.1 billion (more than 2x the reported amount) (Fisher, 2006).

The Chewco deal was a landmark for Enron. In fact, it served as a model for a number of subsequent deals whereby Enron skirted disclosure and accounting conven
convoluted Chewco deal, Enron was clearly using off-balance sheet vehicles with the explicit intent of hiding assets and debt and thereby creating a picture of a comp
better than it actually was.

Enron's Special Purpose Entities: LJM1

Another reason Enron engaged in SPE's was for so-called "hedging" transactions. In essence, this is how Enron manufactured gains and hid losses. In March of 1998
Internet Service Provider named Rhythms Net Connections. A little over a year later, in April 1999, the Rhythms stock went public in an IPO. The stock immediately s
bubble) and by May of 1999, Enron's stake was valued at $300 million. However, due to a lock-up provision, Enron was prohibited from selling its shares until Deceml
investment was part of Enron's merchant portfolio, its gains and losses would flow through to Enron's income statement. Given the windfall gain, Enron wanted to hec
because Rhythms stock was illiquid, there were no over-the-counter options with which they could hedge the position.

So, in June of 1999, Enron created the LJM1 special purpose entity (SPE). As it happened, Enron was also obligated to fulfill a number of forward contracts on Enron
an unrelated transaction. However, the appreciation of Enron stock during this period beyond the fixed fulfillment price of the forward contracts encouraged Enron to e
GAAP accounting does not allow a company to recognize gains or income from changes in the value of its own stock, Enron sought to take advantage of any increase
this "hidden value." Yet again, Enron management chose a path that was technically legal, but clearly unethical.

Forbes magazine had ranked Enron as the most innovative company in the United States for six years running as of 2001.

Enter LJM1. In essence, Enron created this vehicle to hedge their position in Rhythms stock with Enron stock. As you will see, there is no economic basis for believing
all. Upon creating the LJM1 SPE on 30 June 1999, Enron also created the Swap Sub SPE. Furthermore, both LJM1 and Swap Sub had their own general and limited
layers of affiliated companies (Enron, the SPE's and their GP's/LP's). The LJM1 transaction is illustrated below:

Enron transferred 3.4 million shares of Enron stock (valued at $168 million) to LJM1. Based on Enron's closing stock price on 30 June, the value of these shares was
However, because there were restrictions in place that precluded their sale or transfer for four years, Enron discounted the value of the stock by 39% when recording
discounted value of $168 million. In exchange, Enron received a note (i.e., a promise) from LJM1 for $64 million (due 31 March 2000) and a put from the SwapSub SF
$108 million, for a combined total increase in assets of $168 million. As you can see, Enron recorded $168 million going out and $168 million coming in. So the transa
balance sheet assets at the initiation of the hedge…from an accounting standpoint.

Next, LJM1 capitalized Swap Sub by "investing" $3.75 million in cash and 1.6 million of the Enron shares (recorded at $80mm) into the Swap Sub SPE, for a combine
exchange, Enron received a put option on 5.4 million shares of Rhythms stock from Swap Sub. Note that Swap Sub – Enron's hedging partner – records a net equity
right, its liabilities exceeded its assets, so it was negative.

In order for a transaction to truly act as a hedge, it must be entered into with an independent third party who has both the ability and willingness to assume the costs a
so many things wrong with this set up its hard to know where to start. Swap Sub was far from independent having Fastow and other Enron employees involved in the
limited partners. With Swap Sub showing negative equity, they were far from having the financial wherewithal to take on a large single security hedge. Moreover, usin
stock has no economic basis. If Enron's stock had appreciated, then Swap Sub, and in turn LJM1, would have been capable of fulfilling their obligations under the swa
would have been due to sheer luck. There was absolutely no basis to believe Enron stock might appreciate if and when Rhythms stock declined. So, there was no eco
structure did assume economic risk which would be born when ENE stock price fell.

In the days after the LJM1 transaction closed, Enron accountants determined that the hedge was not working effectively – creating volatile income on Enron's income
this unwanted volatility from the hedge, Enron entered into four additional derivative transactions on 13 July 1999 on Rhythms stock with Swap Sub at no cost to eithe
how these additional derivatives were structured. On 17 December 1999, LJM1 paid Enron the $64 million note plus accrued interest. As LJM1 was capitalized with or
where they came up with the proceeds to pay off the note. Because the Enron shares held by LJM1 were restricted (due to their role in the futures contract with an inv
LJM1 borrowed much of the money to pay off the note by using the Enron stock as collateral.

The Unwind of LJM1

In early 2000, Enron decided to close out the hedge on Rhythms. Just like the creation of Chewco had a temporary and a permanent phase, so did the unwind of LJM
the hedge transaction, Fastow and a number of his Enron colleagues created an SPE named Southampton, LP which bought out LJM1's interest in Swap Sub as the
unwind phase, the principal investors in Southampton were meaningful beneficiaries of the unwinding of the LJM1 deal (more about Southampton in the Behavioral ar
The temporary phase of the unwind began on 8 March 2000. At this time, Enron gave Swap Sub a put on 3.1 million shares of Enron stock priced at $71.31 per share
million. That same day, Enron stock closed at $67.19 (lower than the strike price on the put) meaning that the put Swap Sub received was "in the money" by $12.8 mil
Officer Richard Causey testified to the Powers Committee that the put was given to Swap Sub to freeze the economics while the negotiating of the unwind could be fir
On 22 March 2000, Enron and Swap Sub entered into an agreement to unwind the hedge. The terms were as follows:

The options on Rhythms was terminated.

Swap Sub returned 3.1 million shares (post split) of Enron stock having an unrestricted market value of $234 million.

Swab Sub would keep $3.75 million received at the initiation of the hedge agreement.

Enron paid $16.7 million to Swap Sub.

The impact of the hedge was as follows:

The value to Enron from the puts on Rhythms amounted to $207 million.

The Economics of the LJM1 Transaction

As illustrated in the below table, the three primary entities involved in the LJM1 hedging transaction were Enron(ENE) as the sponsor, LJM1 as the senior SPE and S
Because not all of the former employees cooperated with investigations subsequently, not all of the documentation of Enron's off balance sheet entities were recovere
knowledge. Of course, each SPE had its own general and limited partners, but data on those was even harder to come by. Nevertheless, a fairly clear picture of what
indeed emerge. As illustrated by note 1 in the graphic below, the Rhythms hedge had no impact on Enron's reported assets when it was entered into on 30 June 199
reported a gain of $319 million from the transaction at the date of unwind on 28 April 2000, just shy of 10 months later, but the net change in cash to Enron was only f
note from LJM1.

As far as LJM1 is concerned, it received 3.4mm shares (pre-split) of ENE stock at initiation valued at $168mm (including the 39% discount), but forwarded only 1.6mm
subordinate SPE). LJM1 simply kept 53% of the ENE shares they received as a windfall gain worth an estimated $89mm at initiation. Moreover, upon the unwind of th
also wrote-up the ENE stock to effectively remove the 39% discount (that had been debited against the shares at the initiation of the hedge) as illustrated in note 3. L
Fastow. So, in essence, Enron legally bilked 3.6mm Enron shares (post-split) from investors so that various employees of Enron might personally benefit. Take a brea
used ENE stock as collateral in these deals so that they might personally enrich themselves in violation of accounting rules, but this very strategy of using ENE stock i
collapse when the price of ENE stock fell.

Lastly, as illustrated in note 4, SWAP SUB was more or less a pass through entity. It received 1.6mm shares (or 3.2 mm shares post-split) of ENE stock at initiation a
split) of ENE stock at unwind. (It appears that SWAP SUB retained 100k shares for itself at the unwind – meaning we don't know where those shares went, but they li
the sole purpose of SWAP SUB's existence was to help LJM1 achieve non-consolidation of its financials. The net effect of this "hedge" from Enron's point of view was
posting ENE stock as collateral during a period when Enron's stock price was down roughly 15%.

In turning to the ethics of these transactions, several Enron employees were secretly offered financial interests in LJM1 by Fastow through Southampton SPE. These
opportunity in clear violation of the company's Code of Conduct policy. Why do employees do such a thing? It's not quite clear, but participation in these SPE's sugge
processes at work. First, it suggests a Milgram bias where employees may participate in an unethical activity by assigning blame to the senior executive(s) sponsorin
incentive-caused bias as these employees might have been reluctant to disappoint a senior executive at the firm to maintain job security. It also shows greed, that the
the obvious conflict of interest. And it shows micro-macro bias insofar as these employees failed to understand the totality of what their involvement meant in what the
truth, employee participation in the Enron SPE's is probably due to the intersection of all these human foibles.

Clearly, Fastow and other senior executives' ownership in these SPEs shows something much different. These executives were in full purview of the nature and scop
plausible to accept the notion that they believed that Enron stock would never go down materially. This is a question of basic finance. All the principals involved here,
to Kenneth Lay were far too sophisticated and experienced in finance to gloss over such a basic concept of risk. Using Enron stock to back these financing deals sug
almost unparalleled. It suggests that they thought they could scam investors and grow the company without ever having a consequence. It suggests that their financi
with their corporate strategy. On some level, they had to know that it could not continue.

> No matter how distorted a company's accounting is, eventually, accounting and economics converge.

Whatever the case, they discovered that using SPE's in this way could shift mark-to-market losses on specific investments from Enron to the SPE (or a group of SPE'
heads-I-win, tails-you-lose situation, in reality these tactics were merely delaying the economic consequences of their investments and enabling them to build up to u
because the hedge "worked" for Rhythms, it led Enron to believe they could amplify these efforts with SPE's called Raptors. The Raptor SPE's by and large mirrored
The Raptors 1 transaction transferred Enron stock to Raptor I (Talon LLC) to hedge a host of merchant investments, such as Avici Systems. The Raptor II transaction
Raptor 1 had exhausted its credit capacity with the combined declines in both Enron's merchant investments as well as Enron stock. Raptor III was identical to the oth
to hedge the value of stock warrants in a company called New Power Holdings with stock warrants in a company called New Power Holdings. That's not a mis-print. T
Raptor IV was created to provide financial support to the other three Raptors. But the tech stock bubble collapse throughout 2001, reduced the value of securities an
portfolio, and created a recession in the US economy. This combination meant that Enron's stock went down (not up) as the value of these other assets went down. V
2001 simply fulfilled what a sensible observer could have expected all along.

By the third quarter of 2001, the Raptors had a combined deficiency of over $500 million. Enron was no longer able to keep the Raptors off the parent company's boo
Raptors from Fastow's LJM2 partnership for $35 million. On 16 October 2001, Enron Corporation reported a $638 million loss for Q3 and declared a $1.01 billion cha
failed water trading, broadband trading and the unwinding of the Raptor SPE's run by CFO Andrew Fastow. The write-offs required historical charges as well. 1997 ea
1998 earnings declined by $133 million; 1999 earnings declined by $248 million; and 2000 earnings by $99 million. The bulk of this write-off represented the consolida
this announcement surprise the market, but it immediately began to destroy trust the market had placed in the firm.

The announcement caused not only the financial markets to reconsider their relationship with Enron, but also Enron's auditors. Arthur Andersen, Enron's chief audito
blessing to many of these deals, suddenly reversed course. As stated in the subsequent Congressional testimony dated 12 December, 2001 Andersen CEO Joe Bera

"When we reviewed this [LJM1/Swap Sub] transaction again in October 2001, we determined that our team's initial judgment that the 3 percent test was met was in e
correct it."

Days earlier, Arthur Andersen determined that Swap Sub failed to qualify for non-consolidation. Consequently, Enron was forced to consolidate Swap Sub and hence
announcement. Little more than 3 weeks after announcing the major charge to earnings and write-down of equity on 16 October, Enron disclosed that Swap Sub was
November, 2001. Enron Corporation then fell into a fatal tailspin and officially declared bankruptcy on 2 December 2001. Inevitability had met reality. In the span of ju
that Enron engaged in had come undone.

The LJM1 transactions reveal a lot about the mindset of Enron management. Using Enron's stock as collateral made Enron's ability to keep these deals off their book
Enron's stock. Using the [off-the-books] SPE's to enrich themselves made this disclosure imminent if and when the SPE's were consolidated. Using the SPE's to take
that the company was not only taking on large amounts of risk, they were also ensuring that the large amounts of risk would be dealt with harshly if and when the ma
this hidden debt was not just financial. The favorable ratings of Enron's public bonds by the ratings agencies (e.g., S&P) were critical to their ongoing ability to finance
of foolish tactics sealed Enron's fate. The Enron approach was not just a different way of doing business, it was, in fact, a way of going out of business, albeit slowly.
company's accounting is, eventually, accounting and economics converge.

Enron's executives violated the condition that the SPE was not supposed to act on behalf of the sponsor (i.e., Enron) because of the obvious conflict of interest. More
alone to bear the success or failure of their investments. In fact, Enron's finance team made numerous amendments to many of the agreements with their SPEs over
Corporation from losses accrued. Enron executives also violated the third criterion for non-consolidation regarding the risks and rewards of ownership. Clearly, the ris

not fully transferred to these SPE's. Perhaps this is where Enron's executives got tripped up – thinking they could keep changing the rules of the game and extend it i the margin paled in comparison to the central thrust of their approach – wagering that Enron stock would continue going up indefinitely.

Mark-to-Market & Mark-to-Model

Turning now to Enron's accounting methods, Enron used mark-to- *model* (not just mark-to- *market*) in accounting for a wide range of commodity and derivatives cont readily available market price, Mark-to-market accounting allowed the company to estimate the present value of each contract by projecting both future costs and ben uncertain at the time the contract is entered. In essence, Enron booked profits at the date the contract began, regardless of how these contracts ultimately performed legal way to inflate earnings. Of course, for illiquid assets, marking to model is necessary, but in such cases, there needs to be an aggressive discount for the uncerta costs will be realized over the life of the contract, not to mention the constraints from poor liquidity.

> Mark-to-model accounting allows management to book essentially any amount of profit it wants today.

Perhaps the most aggressive usage of mark-to-market accounting was included in accounts Enron called "price risk management assets" (or PRMA's). This was the t *estimated* fair value of various trading and derivative contracts. Of course, where there were liquid markets, Enron was supposed to record a value consistent with qu many contracts, Enron was a holder of unique and/or illiquid contracts where it had to create models to estimate the "fair value." In 1999, Enron's PRMA's were value 2000, Enron's PRMA's were valued at $21 billion. Without being able to analyze each individual contract and the assumptions made, it is not possible to render a prof an area that gives management wide latitude to distort the economic value of contracts.

Mark-to-market accounting [on liquid marketable securities] presents enough difficulty grappling with the expected prices, costs, and hence estimated profits that mus contract is entered. Mark-to-model accounting is even more tenuous. Rather than live with the subsequent gains and losses of a typical mark-to-market contract, this underlying economic reality of the business; the contract owner can simply make up a number and not be confronted with a different reality until the contract expires. I position, one can make a case for such accounting treatment, particularly where liquidity can be a concern. For illiquid assets, such hedges have material basis risk. A got to cherry-pick which assets for which they wanted to "hedge" and consequently manufacture gains.

In an interview with short-seller Jim Chanos, he stated that he first gained interest in Enron after learning that energy merchant banks had successfully lobbied the US mark-to-market accounting for certain derivatives contracts, and Enron chose this accounting method. In Chanos's words, "Any time you have a company that can fro the company of corporate abuse" (Chanos 2010). Moreover, the off-balance-sheet techniques it used also enabled Enron to sell underperforming assets to book gain company could pick the assets that performed well to keep on the balance sheet, divest those that were underperforming, and book a gain.

Gross Self-Dealing

Third, senior Enron executives, including CFO Fastow, were part owners in some of these SPEs. Not only was their personal ownership inadequately disclosed, but th to enrich the executives at the expense of shareholders. During his tenure at Enron, Fastow "earned" $37 million just from these off-balance-sheet financing deals, se compensation as CFO. Because these transactions were not arm's length, such self-dealing was clearly unethical and also violated securities laws and numerous reg fiscal year 2000 financial statements, one note refers to a related-party transaction with a senior executive, although the note does not cite Fastow by name. It sugges that the terms of the transactions with the Related Party were reasonable compared to those which could have been negotiated with unrelated third parties." Yet, the t the sale for $41 million of put options by Enron, where the put was almost certainly never going to be in the money, to one of its SPE subsidiaries controlled by Fastov

Posting Stock as Collateral

Finally, Enron aggressively financed its SPEs by posting large amounts of Enron's stock as collateral, which also remained undisclosed. Of course, stock prices of eve hard for both good reasons and bad. In fact, any rational person with even limited experience in the markets would know that stock prices fluctuate— materially. If Enr materially — whether from an occasional misstep, a bear market, or even on the back of a rumor — the unwinding of the entire financial structure of the firm would be avoid volatility in its stock price forever. Therefore, Enron's demise was inevitable.

In August 2001, Enron accountant Sherron Watkins warned CEO Kenneth Lay in a now-famous email about accounting irregularities discovered at the company (Wat raised issues about two off-balance-sheet structures, Raptor and Condor, and described the intricacies of how Enron pledged stock to support these vehicles. Enron v meltdown was inevitable.

Many Wall Street firms provided both strategic and financial advice to Enron during the lead-up to Enron's demise. Merrill Lynch, JP Morgan, Credit Suisse First Bostc intimately involved in the financing of Enron's SPEs. Unlike Daedalus, these firms were all too happy to encourage Enron to fly near the sun. Analysts now believe tha banks engineered for Enron moved about $11.9 billion off of Enron's reported debt levels in 2000. The fees from the banks' engagements were, of course, very lucrat Congressional Investigator Robert Roach, both JP Morgan and Citigroup then proposed the Enron scheme to other companies to help them hide debt. And Citigroup 2002).

All of this analysis is of course possible in hindsight. But it also begs the questions "What was knowable and when?" How could an astute investor have identified som fundamental perspective, the company was reporting exceptionally high growth while also reporting very low returns on invested capital. While there is nothing inhere of itself, it does suggest a couple points worthy of investigation. First, perhaps the low returns are temporary. As the company establishes a foothold in its markets, pe soon begin to offset large capital outlays. In the case of Enron, they had begun investing in the trading business in the early 1990's. By 2001, they should have been v Established trading operations, such as the major investment banks (Goldman Sachs, Morgan Stanley, JP Morgan, etc.) didn't endure years and years of investment investment banks suffer limited harvests during the period that Enron had. Nor did that make sense given the nature of Enron's trading operations.

The combination of low returns and high growth likely induce a reliance on capital markets, which on the margin creates more risk to future cash flows. Enron of cours capital markets. Perhaps the low returns demonstrated a company that is aggressively pushing growth at the expense of prudence. In the case of Enron, they were co return energy businesses with high return trading businesses. Consequently, the combined business should have demonstrated high incremental returns. It didn't. Thi observable from public information over the 5 years preceding its collapse.

In terms of history, the Cendant fraud began to unravel in 1998. There are some similarities between the two cases insofar as management in both situations used tra results and disguise self-dealing. In the case of Enron, they used off balance sheet vehicles. In the case of Cendant, they used M&A. In both cases, they engaged in g of employees to facilitate the fraud. A High volume of legal transactions creates opportunities for management to revalue assets and liabilities for their own personal b common in cases of fraud and should be considered, not necessarily a red flag, but a cause for further investigation.

Agency & Behavioral Dimensions

In terms of agency costs, the magnitude of agency problems with Enron is truly staggering. Obviously, management was not acting in shareholder interests. However were in on the ruse. Enron's auditors provided their blessing on deals that were clearly designed for Enron's accounting benefits, not for their economic benefits. In sc fairness opinions on specific transactions from supposedly independent third parties, like PWC. Lastly, investment bankers were intimately involved in many of these c concept around to other companies to help them manufacture earnings. Enron even tried to "capture" Wall Street analysts. A number of sources suggest that Enron e competing investment banks if the banks did not fire analysts who took a negative view of the company. While analyst retribution is common in finance, its familiarity c problematic. Such capture is an example of one of many agency costs faced when investing.

With respect to the behavioral dimensions of the Enron scandal, there are many factors at work. Because there was a kernel of truth to Enron's financial innovation — financial profile of Enron was disguised from the public — the market became swept up in Enron euphoria. Enron was considered a so called "New Economy" compar proof were powerful allies in carrying Enron to stratospheric heights. In early 2001, ENE had reached a peak multiple of 63x earnings. And of course, this was based c In fact, Enron would have collapsed much sooner had its stock price collapsed sooner. Not only was the market swept up in Enron-mania, but sell-side analysts and fi Consider the following quotes published just months before Enron's demise:

"For Enron to say we can do bandwidth trading is like Babe Ruth saying I can hit that pitcher. You tell him to get up there and take 3 swings. The risk is staggeringly l high." – Steven Parla, Energy Analyst at CSFB, *Fortune,* 24 January 2000).
"What's new is that Enron is trying to make bandwidth a commodity. Absolutely, it will succeed. I think everyone wins." Brownlee Thomas, senior telecom industry ana *Fortune, 24 January 2000).*
"Enron has built unique and, in our view, extraordinary franchises in several business units in very large markets." – Goldman Sachs analyst David Fleischer. *(Fortu*
Of course, such lavish praise means absolutely nothing when it comes to due diligence. But it is just as clear that many market participants are fooled by such memes
The financial media similarly promoted the innovation meme. *Forbes* magazine had ranked Enron as the most innovative company in the United States for six years r extolling the virtues of Enron were rife on Wall Street and Main Street alike creating belief by repetition. This strange combination of events enabled Enron to fool mar the company with higher and higher stock valuations. It all worked just fine — until it didn't. And its collapse was all so predictable — had details of its financing struct
The stock price history of Enron is noted in the graph below:
Many presume that large public companies have enough interested parties to prevent gross self-dealing like this. Alas, Enron stands as a testament to the limits of ou disclosures). But it also requires a bit of suspended disbelief to come to accept that a large, "successful" company with well-credentialed management and a wide ran something so utterly foolish. In the final analysis, executives at Enron were simply too tempted by the rewards and prestige of running a large successful company wit consideration for all the other interested stakeholders. They were willing to do just about anything to fly by the sun, but they were, quite simply, destined to fail.
[1] The source for this paragraph is Arbogast (2008).
[2] SFAS is statement of financial accounting standards; EITF is the Emerging Issues Task Force of the Financial Accounting Standards Board.
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falsified falsifying fine indictment officially sentenced violation trial

United States v. Kevin Howard

United States v. Kevin Howard Court Docket Number: 3093-1 (Appeal-5th Cir, 07-20212)
Kevin Howard, former chief financial officer and vice president of finance for Enron Broadband Services (EBS), Enron Corporation's failed telecommunications divisio and records, in on November 2, 2009 to one year of probation of which nine months are home confinement and ordered to pay a $25,000 fine. Howard pleaded guilty Vanessa D. Gilmore to one count of falsifyingviolation of Title 15, United States Code, Sections 78m(b)(2)(A), 78m(b)(5) and 78ff).
According to the superseding indictment and the plea agreement, Howard knowingly and willfully caused Enron's Form 10K for the year-ending 2000 to be falsified ur s newest "core" business group and announced that EBS would report a loss of $60 million for the year 2000. According to court documents, by the fourth quarter of 2 any significant revenue. Howard admitted that he and others at EBS and Enron knew that absent a large revenue-generating transaction, EBS would miss the annour According to court documents, while EBS had little revenue, it had entered into an agreement with Blockbuster to provide video on demand (VOD) services. This agre revenue in the hundreds of millions of dollars. Howard admitted that, in an attempt to generate earnings sufficient to meet the earnings target, he and others at EBS s "Project Braveheart" designed to "monetize" or book a portion of the anticipated hundreds of millions of dollars of future earnings from EBS's agreement with Blockbus because it did not accurately and fairly reflect, in reasonable detail, the transactions and dispositions of Enron's assets. In January 2000, Enron officially
Howard admitted that, in November 2000, he and others at EBS approached a small VOD technology company and asked if the company would be willing to be EBS' could meet its earnings target for the year 2000. According to the plea agreement, through discussions with Howard and others at EBS, the VOD technology company suffer financially in any way from participating in Project Braveheart and that EBS was going to arrange for the company to be bought out of the joint venture by a third admitted he explained to the company that its participation in the joint venture was simply a "bridge mechanism" to get EBS into the next quarter. Based on these con be the joint venture partner. Howard admitted that, prior to the close of Project Braveheart, he learned that Enron's auditors, Arthur Andersen, would probably not hav earnings from Project Braveheart if it had known that the VOD technology company intended to exit the joint venture in the first quarter of 2001. Howard admitted that inform Andersen or cause Andersen to be informed of the VOD technology company's intentions. Similarly, Howard admitted that he knowingly and willfully failed to ir company prior to the close of the transaction that he had learned that the company could not be bought out in the first quarter as originally discussed.
According to the plea agreement, Project Braveheart closed on December 22, 2000, and EBS subsequently sold a portion of its interest in the joint venture and booke transaction in the fourth quarter of 2000. Project Braveheart enabled EBS to falsely record these earnings as revenue in order to meet the $60 million loss goal and th in Enron's 10K for the year 2000.

Plea Agreement - June 1, 2009

Order Granting Howard Trial Continuance - April 20, 2009

Amended Scheduling Order - August 7, 2008

Minute Entry - June 30, 2008

Fifth Circuit Decision - February 12, 2008

How the Enron Scandal Changed American Business Forever

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How the Enron Scandal Changed American Business Forever

It's the kind of historic anniversary few people really want to remember.

In early December 2001, innovative energy company Enron Corporation, a darling of Wall Street investors with $63.4 billion in assets, went bust. It was the largest ba
the corporation's executives, including the CEO and chief financial officer, went to prison for fraud and other offenses. Shareholders hit the company with a $40 billion
auditor, Arthur Andersen, ceased doing business after losing many of its clients.

It was also a black mark on the U.S. stock market. At the time, most investors didn't see the prospect of massive financial fraud as a real risk when buying U.S.-listed
been the gold standard in transparency and compliance," says Jack Ablin, founding partner at Cresset Capital and a veteran of financial markets. "That was a real one
was a watershed for the U.S. public."

The company's collapse sent ripples through the financial system, with the government introducing a set of stringent regulations for auditors, accountants and senior e
record keeping, and criminal penalties for securities laws violations. In turn, that has led in part to less choice for U.S. stock investors, and lower participation in stock
In other words, it was the little guy who suffered over the last two decades.

Americans lost trust in the stock market

The collapse of Enron gave many average Americans pause about investing. After all, if a giant like Enron could collapse, what investments could they trust? A signifi
foregone participating in the tremendous stock market gains seen over the last two decades. In 2020, a little more than half of the population (55%) owned stocks dire
such as 401Ks and IRAs. That's down from 60% in the year 2000, according to the Survey of Consumer Finances from the U.S. Federal Reserve.

That could have had a large financial impact on some folks. For instance, an investment of $1,000 in the S&P 500 at the beginning of 2000 would recently have been
dividends. Wealthier people, who often employ professionals to handle their investments, were more likely to stick with their stocks, while middle class and poorer peo
doubt this drop in stock market participation has contributed to the growing levels of wealth inequality across the U.S.

It became harder for companies to IPO

While lack of trust in the market is a direct consequence of Enron's mega fraud, the indirect consequences of government actions also seem to have hurt Main Street
Immediately following the bankruptcy, Congress worked on the Sarbanes-Oxley legislation, which was meant to hold senior executives responsible for listed company
CFOs are now held personally accountable for the truth of what goes on the income statement and balance sheet. The bill passed in 2002 and has been with us since
criticisms.

"The most important political response was Sarbanes-Oxley," says Steve Hanke, professor of applied economics at Johns Hopkins University. "It was unnecessary, a
In many ways, the legislation wasn't needed because the Justice Department and the Securities Exchange Commission already had the powers to prosecute executiv
books or at a minimum were less than transparent with the truth, Hanke says.

The direct result of the legislation was that public companies got dumped with a load of bureaucratic form-filling, and executives would be less likely to take on entrepr
is also much ambiguity in the law about what is or what isn't allowed and what are the ultimate consequences of non-compliance. "You don't know what you are facing
back off of everything risky," he says.

Quickly, that meant the stock market underwent two significant changes. First, fewer companies are listed now than since the 1970s. In 1996, during the dot-com bub
listed on stock exchanges in the U.S., according to data from the World Bank. That figure had fallen to 4,266 by 2019.

That drop was partially a reflection of the regulatory burden of companies wishing to go public, experts say. "It costs a lot of money to employ the securities attorneys
Robert Wright, a senior fellow at the American Institute of Economic Research and an economic historian. "Clearly, fewer companies can afford to meet all these requ
Companies now wait under they are far larger before going public than they did before the Sarbanes-Oxley rules were introduced. Yahoo! went public with a market c
1996, and in 1995 Netscape got a valuation of $2.9 billion. Compare that to the $82 billion IPO valuation for ride share company Uber in 2019, or Facebook $104 billio
Now, companies grow through investments that don't require a public market listing and that don't involve heavy bureaucratic costs. Instead, startups go to venture ca
recent rise in the use of Special Acquisition Corporations (SPACs) is seen by some as a relatively easy way to skirt some of the burdensome regulations of listing stoc
to reduce ongoing costs or burden of complying with the Sarbanes-Oxley rules.

But when companies stay private longer, they spend more time without the public accountability required of listed companies. Former blood testing company Therano
move some theorized was to avoid publicizing internal data. Because of the high barriers Sarbanes-Oxley placed on going public, the business world is now littered w
don't have to reveal their inner workings.

Delaying going public also affects Main Street because most individual investors cannot buy shares in companies that aren't public. They haven't been able to share i
stage corporate growth that is typically seen in companies like Facebook and Uber.

Put simply, the Sarbanes-Oxley regulations have chased away some investing opportunities from the public market to the private ones. And in doing so have exclude
participating—and gaining.

"Now smaller investors are shut out and all the big economic profits go to venture capitalists and the like," Wright says. That, in many ways, is the legacy of Enron.

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The .gov means it's official. Federal government websites often end in .gov or .mil. Before sharing sensitive information, make sure you're on a federal government
The site is secure. The **https://** ensures that you are connecting to the official website and that any information you provide is encrypted and transmitted securely.
FTC Matter/File Number
Enforcement Type

Appendix - search request details

Google API

Entity ID	Type	Name	Date of birth	Citizenship	Resi
—	Company	Enron Corporation	—	United States	—, I

High-risk countries

Russian Federation NK

Keywords

ACCUSE ARREST BRIBE CONVICT CORRUPT COUNTERFEIT CRIME EMBEZZLEMENT FRAUD GUILT INVESTIGATION KICKBACK MONEY LAUNDERING NARCOTIC PENALTY SANCTION SENTENCED EVASION TE TRAFFICKING VIOLATION

Article Language(s)
Any

Search time period
10 Years

Report Explanation

Case Status: the recommendation based on the analyst''s findings. Possible values are Further investigation needed, True positive or False Positive. Th
name.

High-Risk Countries: shows flagged countries which were found within the article(s). Note that additional countries that were not found within the article
screening.

Keywords: shows keywords found within the article(s) that are commonly associated with a True Positive alert. Note that additional keywords that were n
may have been used in the screening.

Article Title: the name of the article returned by the search parameters. Clicking the name of the article title in the Summary section will navigate you to t
article details section.

Article Status: a risk-based category assigned to an article. Possible values are “Needs Investigation”, “False Positive”, "True Positive". Articles that wer
Positive" by the model are automatically assigned "Needs Investigation" unless a human team member changes the status during the review process.

Score: a model-based assessment that determines the relevance of the entity and a risky activity and/or crime. It is given on a 0.00 to 1.00 scale, with 1.

Reviewer: the name and ID of the final analyst who reviewed the article and updated its status and/or comment. Possible values are the name and ID of
or "Auto" if it was processed automatically by the digital worker Evelyn. It is possible for different articles to be reviewed by different analysts within the sa

Comment: articles are first analyzed by the machine learning model. If the model dispositioned the article as False Positive, you''ll see the reasoning liste
comments made by analysts during their manual review in this section.