



Enron Corporation

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The Enron scandal, revealed in October 2001, eventually led to the bankruptcy of the Enron Corporation, an American energy company based in Houston, Texas, and the dissolution of Arthur Andersen, which was one of the five largest audit and accountancy partnerships in the world. In addition to being the largest bankruptcy reorganization in American history at that time, Enron undoubtedly is the biggest audit failure.

Enron was formed in 1985 by Kenneth Lay after merging Houston Natural Gas and InterNorth. Several years later, when Jeffrey Skilling was hired, he developed a staff of executives that, through the use of accounting loopholes, special purpose entities, and poor financial reporting, were able to hide billions in debt from failed deals and projects. Chief Financial Officer Andrew Fastow and other executives were able to mislead Enron's board of directors and audit committee of high-risk accounting issues as well as pressure Andersen to ignore the issues.

Enron's stock price, which hit a high of US\$90 per share in mid-2000, caused shareholders to lose nearly \$11 billion when it plummeted to less than \$1 by the end of November 2001. The U.S. Securities and Exchange Commission (SEC) began an investigation, and Dynegy offered to purchase the company at a fire sale price. When the deal fell through, Enron filed for bankruptcy on December 2, 2001 under Chapter 11 of the United States Bankruptcy Code, and with assets of \$63.4 billion, it was the largest corporate bankruptcy in U.S. history until WorldCom's 2002 bankruptcy.

Many executives at Enron were indicted for a variety of charges and were later sentenced to prison. Enron's auditor, Arthur Andersen, was found guilty in a United States District Court, but by the time the ruling was overturned at the U.S. Supreme Court, the firm had lost the majority of its customers and had shut down (see Arthur Andersen LLP v. United States). Employees and shareholders received limited returns in lawsuits, despite losing billions in pensions and stock prices. As a consequence of the scandal, new regulations and legislation were enacted to expand the reliability of financial reporting for public companies. One piece of legislation, the Sarbanes-Oxley Act, expanded repercussions for destroying,

altering, or fabricating records in federal investigations or for attempting to defraud shareholders. The act also increased the accountability of auditing firms to remain objective and independent of their clients.

The rise of Enron

Kenneth Lay founded Enron in 1985 through the merger of Houston Natural Gas and InterNorth, two natural gas pipeline companies. In the early 1990s, he helped to initiate the selling of electricity at market prices and, soon after, the United States Congress passed legislation deregulating the sale of natural gas. The resulting markets made it possible for traders such as Enron to sell energy at higher prices, allowing them to thrive. After producers and local governments decried the resultant price volatility and pushed for increased regulation, strong lobbying on the part of Enron and others, was able to keep the free market system in place.

By 1992, Enron was the largest merchant of natural gas in North America, and the gas trading business became the second largest contributor to Enron's net income, with earnings before interest and taxes of \$122 million. The creation of the online trading model, EnronOnline, in November 1999 enabled the company to further develop and extend its abilities to negotiate and manage its trading business.

In an attempt to achieve further growth, Enron pursued a diversification strategy. By 2001, Enron had become a conglomerate that both owned and operated gas pipelines, pulp and paper plants, broadband assets, electricity plants, and water plants internationally. The corporation also traded in financial markets for the same types of products and services.

As a result, Enron's stock rose from the start of the 1990s until year-end 1998 by 311% percent, a significant increase over the rate of growth in the Standard & Poor 500 index. The stock increased by 56% in 1999 and a further 87% in 2000, compared to a 20% increase and a 10% decline for the index during the same years. By December 31, 2000, Enron's stock was priced at \$83.13 and its market capitalization exceeded \$60 billion, 70 times earnings and six times book value, an indication of the stock market's high expectations about its future prospects. In addition, Enron was rated the most innovative large company in America in Fortune's Most Admired Companies survey.

Causes of downfall

Enron's nontransparent financial statements did not clearly detail its operations and finances with shareholders and analysts.^{[11][12]} In addition, its complex business model stretched the limits of accounting, requiring that the company use accounting limitations to manage earnings and modify the balance sheet to portray a favorable depiction of its performance. According to McLean and Elkid in their book *The Smartest Guys in the Room*, "The Enron scandal grew out of a steady accumulation of habits and values and actions that began years before and finally spiraled out of control."^[14] From late 1997 until its collapse, the primary motivations for Enron's accounting and financial transactions seem to have been to keep reported income and reported cash flow up, asset values inflated, and liabilities off the books.

The combination of these issues later led to the bankruptcy of the company, and the majority of them were perpetuated by the indirect knowledge or direct actions of Lay, Jeffrey Skilling, Andrew Fastow, and other executives. Lay served as the chairman of the company in its last few years, and approved of the actions of Skilling and Fastow although he did not always inquire about the details. Skilling, constantly

focused on meeting Wall Street expectations, pushed for the use of mark-to-market accounting and pressured Enron executives to find new ways to hide its debt. Fastow and other executives, "...created off-balance-sheet vehicles, complex financing structures, and deals so bewildering that few people can understand them even now."


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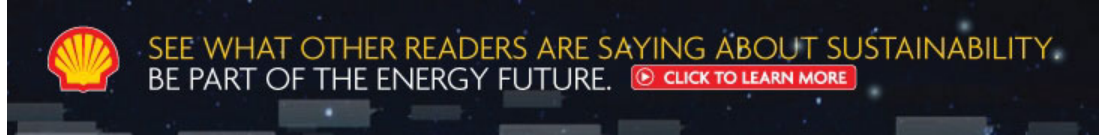
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Enron Scorecard

Since the collapse of Enron, many executives who worked for the company or had business dealings with it have been swept up in the investigations and prosecutions of wrongdoing at the former energy giant. Here is the status of those executives.

Name / Title	Pleaded Guilty	Convicted	Acquitted	Convicted, but overturned	Sentence	Status	Charges
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TOP EXECUTIVES

 Kenneth L. Lay Chairman and chief executive		Yes, but vacated after he died				Deceased	Conspiracy, Securities fraud, Wire fraud, Bank fraud
 Jeffrey K. Skilling Chief executive		Yes			24.3 years	In prison	Conspiracy, Securities fraud, Insider trading, Perjury/lying to investigators/ auditors
 David W. Delainey Chief executive, energy divisions	Yes				2.5 years	Released	Insider trading
 Andrew S. Fastow Chief financial officer	Yes				6 years	In prison	Conspiracy
 Ben F. Glisan Jr. Treasurer	Yes				5 years	Released	Conspiracy
 Richard A. Causey Chief accounting officer	Yes				5.5 years	In prison	Securities fraud
 Mark E. Koenig Director of investor relations	Yes				1.5 years	In prison	Aiding and abetting securities fraud
 Paula H. Rieker Board secretary, manager of investor relations	Yes				2 years probation	On probation	Insider trading

Name / Title	Pleaded Guilty	Convicted	Acquitted	Convicted, but overturned	Sentence	Status	Charges
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MID-LEVEL EXECUTIVES



	Michael J. Kopper Vice president	Yes			3 years 1 month	In prison	Conspiracy, Money laundering
	Timothy Despain Assistant treasurer	Yes			4 years probation	On probation	Conspiracy
	Lawrence M. Lawyer Finance executive	Yes			2 years probation	On probation	Filing false tax returns
	Christopher F. Calger Vice president, energy trading division of Enron North America	Yes, but trying to withdraw it				Charges dismissed	Conspiracy

Name / Title	Pleaded Guilty	Convicted	Acquitted	Convicted, but overturned	Sentence	Status	Charges
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BROADBAND

	Kenneth D. Rice Chief executive, broadband	Yes			2 years 3 months	In prison	Securities fraud
	Joseph M. Hirko Chief executive, broadband			Acquitted of some charges		Awaiting retrial	Conspiracy, Securities fraud, Wire fraud, Insider trading, Money laundering
	Kevin A. Howard Chief financial officer, broadband			Yes			Conspiracy, Wire fraud, perjury/lying to investigators/auditors
	Kevin P. Hannon Chief operating officer, broadband	Yes			2 years	In prison	Conspiracy
	Rex T. Shelby Senior vice president, broadband			Acquitted of some charges		Awaiting retrial	Conspiracy, Insider trading
	F. Scott Yeager Senior vice president, broadband			Acquitted of some charges		Awaiting retrial	Conspiracy, Securities fraud, Wire fraud, Insider trading, Money laundering
	Michael W. Krautz Accounting officer, broadband			Yes (in second trial)		Free and clear	Conspiracy, Wire fraud, perjury/lying to investigators/auditors

Name / Title	Pleaded Guilty	Convicted	Acquitted	Convicted, but overturned	Sentence	Status	Charges
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ENERGY TRADING

	Timothy N. Belden Managing director	Yes			2 years probation	On probation	Conspiracy
	Jeffrey S. Richter Senior trader	Yes			2 years probation	On probation	Conspiracy
	John M. Forney Senior trader	Yes			2 years probation	On probation	Conspiracy

Name / Title	Pleaded Guilty	Convicted	Acquitted	Convicted, but overturned	Sentence	Status	Charges
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NIGERIAN BARGE DEAL

Daniel O. Boyle		Yes			3 years,	In prison	Conspiracy, Wire fraud, perjury/lying to investigators/
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