

ACCOUNTING & CORPORATE SCANDALS: ENRON AND BEYOND

By Lawrence Kalbers, Ph.D., CPA

In 2001, the Enron debacle became the news of the day. Enron's financial statements were restated, its stock plummeted, documents were shredded, resignations and firings took place, Enron declared bankruptcy, and numerous investigations were under way. Unfortunately, it was only the beginning. In the months to come, many more examples of corporate misconduct and accounting irregularities would be alleged.

Contributing Factors

In October of 2001, Enron, long a darling of Wall Street, disclosed restatements of prior years' income in excess of \$600 million and additional debt of \$1.2 billion. Enron's stock began to tumble, ultimately losing nearly \$80 billion of market value from its market high. The Enron story involves a confluence of factors. Enron had expanded its operations to include a wide range of energy products, including derivatives for natural gas, electricity, weather, and broadband services. Enron's business practices and financial reporting became more aggressive over time. For example, Enron set up numerous subsidiaries and "special purpose entities" to hide its massive debt and to shift income to off-shore "tax havens." Conflicts of interest surrounded every aspect of Enron. Many of the newly formed entities were owned or managed by officers of the corporation and other related parties. There were business and personal ties between management and outside directors on its board. Arthur Andersen, the outside auditors, earned \$27 million in consulting fees in addition to its \$25 million in audit fees for the previous year. Enron's outside attorneys, Vinson & Elkins, were selected to review internal allegations of wrong doing, despite their substantial billings and close relationship. Analysts at major Wall Street firms continued to recommend Enron's stock well after problems emerged and the stock had already taken a significant fall. Many of these firms also provided investment banking services to Enron. Governmental agencies

and politicians made decisions that benefited Enron. The financial press was favorable even after a Fortune article questioned Enron's profits.



Numerous Companies

Problems with corporate governance, financial reporting, and the financial markets have now touched many lives. Substantial restatements of earnings, bankruptcies, questionable transactions, and management greed have plagued numerous companies. A July 2002 study by Weiss Ratings, Inc., identified 33 companies with "allegations or news of accounting irregularities." The list includes Adelphia Communications, Computer Associates, Enron, Global Crossing, Halliburton, Quest Communications, Tyco International, WorldCom, and Xerox. The total market values for the stock in these 33 companies declined \$1.276 trillion from the peak in their market value. In addition to the bankruptcies of publicly held companies, Arthur Andersen, one of the Big 5 accounting firms, has essentially ceased operations and virtually all of its employees in the U.S. left the firm or were released after Anderson was found guilty of obstruction of justice in the Enron case.

Reforms

Various reforms must now be put in place to ensure investor confidence in financial reports and the financial markets. This past summer, President Bush signed into law the Sarbanes-Oxley Act. This Act provides for various controls over financial reporting, management, and auditors for publicly held compa-

nies. Many other actions are being taken to prosecute or initiate new controls over individuals and firms involved in the financial markets. For links to more information about Enron, other companies, and the Sarbanes-Oxley Act, please go to: <http://phoenix.liu.edu/~lkalbers/enron>.

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RECENT CBR PROJECTS

From a Human Resources Executive:

Our Long Island-based electronics company is expanding and will be recruiting to fill several top management positions. We want to be competitive in our salary offers, but also need to keep our bottom line in mind. Can you provide salary information for executives at the vice-presidential level in finance, engineering, operations, and production in our region?

The CBR found a number of government, research, consulting, and news organization reports that provided data on top compensation in manufacturing and finance positions. Regional and national data was provided for the desired positions, as well as general salary surveys and CPI Trends.

Cost of this project: \$400.00

From a Management Consulting Firm:

Can you help us to identify trends in the U.S. over the last five years in kitchen remodeling and small appliances for food storage, handling, preparation, cooking, and waste management. Could you also provide us with information on trends in home environments related to air quality, air filtration, heaters, and humidifiers?

Using online resources, the CBR reviewed the trade literature for the past five years and found approximately fifty relevant articles that satisfied the clients request.

Cost of this project: \$955.00

WWW SOURCES FOR COMPANY INFORMATION



The Securities and Exchange Commission (SEC) requires all public companies to file registration statements, periodic reports (such as the 10-K), and other forms electronically through the *Electronic Data Gathering, Analysis, and Retrieval* (EDGAR) system. These electronic reports are accessible to the public at: <http://www.sec.gov/edgar.shtml>.

Annual reports are often available through Investor Relations links on individual company homepages. The *Investor Relations Information Network* (IRIN) provides a single point of reference for accessing current electronic annual reports for over 3,000 companies at <http://www.irin.com>. If you are also interested in obtaining a hard copy of an annual report, IRIN will forward your request to the appropriate company.

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