Enron: Wall Street's Titanic

An Analysis of Enron's Management Flaws

Research Paper by:

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INTRODUCTION

July 1985

Houston Natural Gas merges with InterNorth, a natural gas company based in Omaha, Nebraska, to form the modern-day Enron, an interstate and intrastate natural gas pipeline company with 37,500 miles of pipe. It formed an American energy, commodities, and services company based in Houston, Texas.

April, 1987

Two years after its founding, the company becomes embroiled in scandal after two traders begin betting on the oil markets, resulting in suspiciously consistent profits. One of the traders, Louis Borget, is also discovered to be diverting company money to personal and offshore accounts. Lay learns that Louis Borget and Tom Mastroeni, the men in charge of the Valhalla operation, were gambling beyond their limits, destroying trading reports, keeping two sets of books and manipulating accounting in order to give the appearance that Valhalla was earning steady profits. The board does not fire the Valhalla executives because Lay makes it clear that they are making too much money to let them go. Lay increases the trading limits of the Valhalla traders. After auditors uncover their schemes, Lay encourages them to "keep making us millions".

October, 1987

However, the traders are fired after it is revealed that they gambled away Enron's reserves; the company is narrowly saved from bankruptcy by the timely intervention of executive Mike Muckleroy, who managed to bluff the market long enough to recover Borget's trading losses from one billion dollars to 140 million dollars, thus saving the company and prevent a margin call.

June, 1990

Lay hires Jeffrey Skilling, a consultant for McKinsey & Co. and a visionary who joins Enron on the condition that they use mark-to-market accounting, allowing the company to record potential profits on certain projects immediately after contracts were signed, regardless of the actual profits that the deal would generate. This gives Enron the ability to subjectively give the appearance of being a profitable company even if it wasn't.

June 11, 1991

Enron asks the Security Exchange Commission (SEC) to approve mark-to-market accounting.

January 30, 1992

SEC approves mark-to-market accounting for Enron.

1993

Enron and the government of the state of Maharashtra, India sign a formal agreement to build a massive power plant leading to the formation of the Dabhol Power Company, a joint venture of Enron, General Electric and Bechtel. The cost for construction will soar to 2.8 billion dollars.

May, 1999

Tim Belden, head of Enron's West Coast Trading Desk in Portland Oregon, conducts his first experiment to exploit the new rules of California's deregulated energy market. Known as the Silverpeak Incident, Belden creates congestion on power lines which causes electricity prices to rise and at a cost to California of $7 million. This will be the first of many "games" that Belden and his operation play to exploit "opportunities" in the California market. This marks the beginning of the California Energy Crisis.

August, 2000

With its success in the bull market brought on by the dot-com bubble, Enron seeks to beguile stock market analysts by meeting their projections. Executives push up their stock prices and then cash in their multimillion-dollar options, a process known as "pump and dump". Enron also mounts a PR campaign to portray itself a profitable, prosperous and innovative company, even though its worldwide operations are performing poorly. Elsewhere, Enron begins ambitious initiatives such as attempts to use broadband technology to deliver movies on demand, and "trade weather" like a commodity; both initiatives fail. However, using mark-to-market accounting, Enron records non-existent profits for these ventures. CFO Andrew Fastow creates a network of shell companies designed solely to do business with Enron, for the ostensible dual purposes of sending Enron money and hiding its increasing debt. Fastow also takes advantage of the greed of Wall Street investment banks, pressuring them into investing in these shell entities.

Enron's successes continue as it became one of the few Internet-related companies to survive the burst of the dot-com bubble in 2000 relatively unscathed, and is named as the "most admired" corporation by *Fortune* magazine for the sixth year running. However, Jim Chanos, an Enron investor, and Bethany McLean, a *Fortune* reporter, question irregularities about the company's financial statements and stock value.

Stock hits all-time high of 90 dollars. Market valuation of 70 billion dollars. FERC (the Federal Energy Regulatory Commission) orders an investigation into strategies designed to drive electricity prices up in California. Soon after, FERC (Federal Energy Regulatory Commission) investigation exonerates Enron from any wrongdoing in California.

May, 2000

CA ISO (Independent System Operator), the organization in charge of California’s electricity supply and demand, declares a Stage One Emergency, warning of low power reserves. The events that began unfolding in May 1999 led to this infamous California Energy Crisis.

December 13, 2000

Enron announces that President and COO Jeffrey Skilling will take over as chief executive in February. Kenneth Lay will remain as chairman.

Enron uses “aggressive” accounting to declare 53 million dollars in earnings for broadband on a collapsing deal that hadn’t earned a penny in profit.

February, 2001

However, public perception of Enron is changed dramatically due to its role in the California energy crisis: Enron traders exploited the shaky foundation of the state's newly deregulated energy market by shutting down power plants and exporting power out of the state to create artificial shortages that would drive up the cost of electricity to Enron's benefit; Enron would make $2 billion off of the crisis.

The strong political connections Ken Lay and Enron had, particularly to the administrations of 41st President George H. W. Bush and his son, Texas governor and later 43rd President George W. Bush, and suggests that Enron's actions during the California energy crisis could have been intended as a means of sabotaging California governor Gray Davis, who was being speculated as a strong potential challenger to Bush in the 2004 Presidential election.

Senior partners from Arthur Anderson, Enron’s accounting firm, meet to discuss whether to retain Enron as a client. They call use of mark-to-market accounting “intelligent gambling.”

August, 2001

Meanwhile, throughout 2001 much more scrutiny is brought upon Enron's balance sheet and this agitates CEO Skilling, who was on the verge of a nervous breakdown as the company and its fraud start to unravel. He engages in odd and irrational behaviour - such as verbally abusing an investor during a conference call when asked why Enron isn't as transparent about its finances as its competitors. The public reacts negatively to his behaviour and Skilling is hit in face with blueberry tofu cream pie by a protester while speaking at the Commonwealth Club in San Francisco. This then culminates in his abrupt resignation as CEO in August 2001 in which Ken Lay retakes the position.

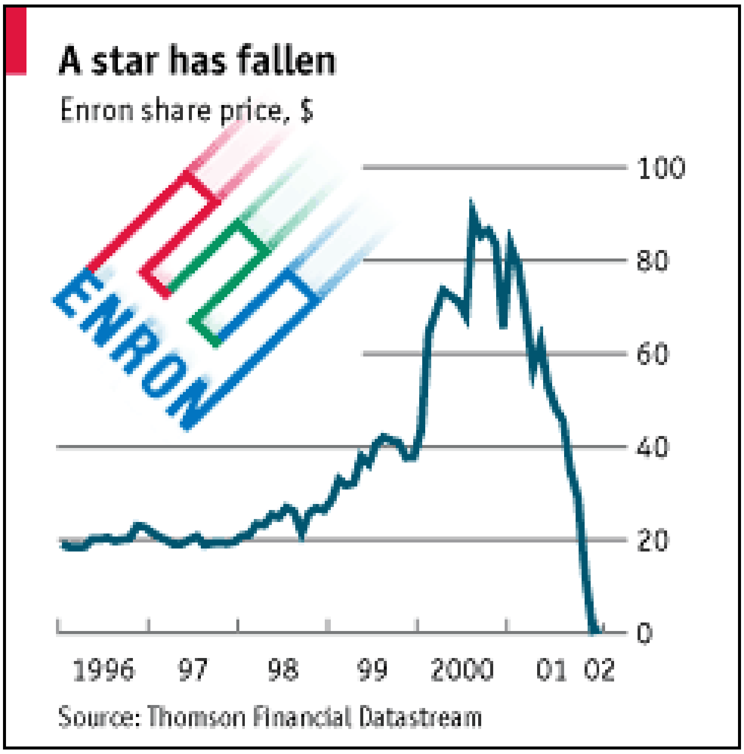
Skilling's odd behaviour serves as a red flag to investors who begin to question how financially healthy the company really is and start selling their shares; Enron's stock price begins to rapidly decline. Immediately after Skilling's departure, whistle-blower Sherron Watkins, who had just recently discovered the fraud in Enron's books, alerts Lay and tells him that the company is headed to certain collapse unless he acts immediately. Like in 1987, Lay largely ignores Watkins' warnings and assures employees and the public that Skilling left for personal reasons and that the company was financially solid.

October, 2001

The board fires CFO Fastow after discovering that he had embezzled more than $30 million from the company through his shell companies. With Fastow gone, Enron's accountants issue a series of restatements that erase a majority of the company's profits from 1997 through 2000, report a $638 million third-quarter loss, adds nearly $1.01 billion of debt to the company's balance sheet, and removes over $1.2 billion of shareholder equity as a means of writing down the losses from Fastow's shell companies. Despite Lay's continued assurances that Enron is in good shape and will pull through, the company's stock price tanks as its investors and customers lose all confidence.

Soon, in a massive shredding operation, Arthur Andersen destroys one ton of Enron documents.

On November 28, 2001, Enron shares drop below one dollar.



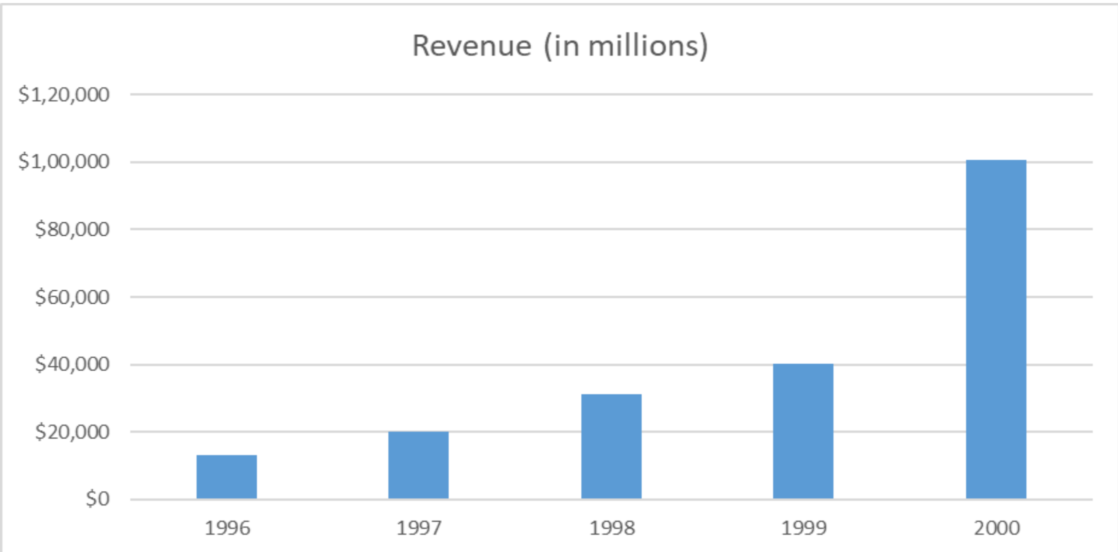
December, 2001

Enron is forced to file for Chapter 11 bankruptcy protection on December 2, 2001. As a result of Enron's bankruptcy, many of its employees lose their pensions and life savings, while investors lose over $11 billion in shareholder value. Congressional hearings are held into the scandal, where Ken Lay and Andrew Fastow plead the fifth. Fastow eventually pleads guilty in a deal that he will testify against his former co-workers in exchange for a reduced sentence, while Lay and Skilling plead innocent and spend tens of millions of dollars on defence attorneys.

> "I think the Enron story's so fascinating because people perceive it as a story that's about numbers. That it's somehow about all these complicated transactions. But in reality, it's a story about people and it's really a human tragedy."
>
> *-Enron: The Smartest Guys in The Room*

Enron's $63.4 billion in assets made it the largest corporate bankruptcy in U.S. history until WorldCom's bankruptcy the next year.

Enron's Revenue was one of the fastest growing ones, or at least they showed it to be:



Above: Enron's Revenue over the years

THE ICEBERGS: REASONS FOR THE FALL OF ENRON

Enron's complex financial statements were confusing to shareholders and analysts. In addition, its complex business model and unethical practices required that the company use accounting limitations to misrepresent earnings and modify the balance sheet to indicate favourable performance.

The combination of these issues later resulted in the bankruptcy of the company, and the majority of them were perpetuated by the indirect knowledge or direct actions of Kenneth Lay, Jeffrey Skilling and Andrew Fastow. 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, advocated the use of mark-to-market accounting (accounting based on market value, which was then inflated) 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 could understand them.

❖ MARK-TO-MARKET ACCOUNTING

Enron incorporated "mark-to-market accounting" for the energy trading business in the mid-1990s and used it on an unprecedented scale for its trading transactions. Under mark-to-market rules, whenever companies have outstanding energy-related or other derivative contracts (either assets or liabilities) on their balance sheets at the end of a particular quarter, they must adjust them to fair market value, booking unrealized gains or losses to the income statement of the period. A difficulty with application of these rules in accounting for long-term futures contracts in commodities such as gas is that there are often no quoted prices upon which to base valuations. Companies having these types of derivative instruments are free to develop and use discretionary valuation models based on their own assumptions and methods. Even though Enron extensively relied on derivatives for its business, the company's Finance Committee and board did not have enough experience with derivatives to understand what they were being told. The Senate subcommittee argued that had there been a detailed understanding of how the derivatives were organized, the board would have prevented their use.

For a company such as Enron, under continuous pressure to beat earnings estimates, it is possible that valuation estimates might have considerably overstated earnings. Furthermore, unrealized trading gains accounted for slightly more than half of the company's $1.41 billion reported pre-tax profit for 2000 and about one-third of its reported pre-tax profit for 1999.

❖ REVENUE RECOGNITION

Enron and other energy suppliers earned profits by providing services such as wholesale trading and risk management in addition to building and maintaining electric power plants, natural gas pipelines, storage, and processing facilities. When accepting the risk of buying and selling products, merchants are allowed to report the selling price as revenues and the products' costs as cost of goods sold. In contrast, an "agent" provides a service to the customer, but does not take the same risks as merchants for buying and selling. Service providers, when classified as agents, are able to report trading and brokerage fees as revenue, although not for the full value of the transaction.

Enron selected to report the entire value of each of its trades as revenue. This "merchant model" was considered much more aggressive in the accounting interpretation than the agent model. Enron's method of reporting inflated trading revenue was later adopted by other companies in the energy trading industry in an attempt to stay competitive with the company's large increase in revenue. Other energy companies such as Duke Energy, Reliant Energy, and Dynegy joined Enron in the wealthiest 50 of the Fortune 500 mainly due to their adoption of the same trading revenue accounting as Enron.

Between 1996 and 2000, Enron's revenues increased by more than 750%, rising from $13.3 billion in 1996 to $100.8 billion in 2000. This extensive expansion of 65% per year was unprecedented in any industry, including the energy industry which typically considered growth of 2–3% per year to be respectable. For just the first nine months of 2001, Enron reported $138.7 billion in revenues, which placed the company at the sixth position on the Fortune Global 500.

❖ Abuse And Overuse Of Special Purpose Entities

Enron, like many other companies, used “special purpose entities” (SPEs) to access capital or hedge risk.

Under Fastow’s leadership, Enron took the use of SPEs to new heights of complexity and sophistication, capitalizing them with not only a variety of hard assets and liabilities, but also extremely complex derivative financial instruments, its own restricted stock, rights to acquire its stock and related liabilities. As its financial dealings became more complicated, the company apparently also used SPEs to “park” troubled assets that were falling in value, such as certain overseas energy facilities, the broadband operation or stock in companies that had been spun off to the public. Transferring these assets to SPEs meant their losses would be kept off Enron’s books. To compensate partnership investors for downside risk, Enron promised issuance of additional shares of its stock. As the value of the assets in these partnerships fell, Enron began to incur larger and larger obligations to issue its own stock later down the road. Compounding the problem toward the end was the precipitous fall in the value of Enron stock. Enron conducted business through thousands of SPEs.

The special purpose entities were used for more than just circumventing accounting conventions. As a result of one violation, Enron's balance sheet understated its liabilities and overstated its equity, and its earnings were overstated. Enron disclosed to its shareholders that it had hedged downside risk in its own illiquid investments using special purpose entities. However, investors were oblivious to the fact that the special purpose entities were actually using the company's own stock and financial guarantees to finance these hedges. This prevented Enron from being protected from the downside risk. Notable examples of special purpose entities that Enron employed were JEDI, Whitewing, and LJM.

❖ Unethical Corporate Governance

Corporate governance is the mechanisms, processes and relations by which corporations are controlled and directed. Governance structures and principles identify the distribution of rights and responsibilities among different participants in the corporation (such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders) and includes the rules and procedures for making decisions in corporate affairs.

➢ **Executive Compensation: The Rich Get Richer**

Although Enron's compensation and performance management system was designed to retain and reward its most valuable employees, the system contributed to a dysfunctional corporate culture that became obsessed with short-term earnings to maximize bonuses. Employees constantly tried to start deals, often disregarding the quality of cash flow or profits, in order to get a better rating for their performance review. Additionally, accounting results were recorded as soon as possible to keep up with the company's stock price. This practice helped ensure deal-makers and executives received large cash bonuses and stock options.

The company was constantly emphasizing its stock price. Management was compensated extensively using stock options, similar to other U.S. companies.

Employees had large expense accounts and many executives were paid sometimes twice as much as competitors. In 1998, the top 200 highest-paid employees received $193 million from salaries, bonuses, and stock. Two years later, the figure jumped to $1.4 billion.

➢ **Risk Management: Trying to Save A Sunken Ship**

Before its scandal, Enron was lauded for its sophisticated financial risk management tools. Risk management was crucial to Enron not only because of its regulatory environment, but also because of its business plan. Enron established long-term fixed commitments which needed to be hedged to prepare for the invariable fluctuation of future energy prices. Enron's bankruptcy downfall was attributed to its reckless use of derivatives and special purpose entities. By hedging its risks with special purpose entities which it owned, Enron retained the risks associated with the transactions. This arrangement had Enron implementing hedges with itself.

Enron's aggressive accounting practices were not hidden from the board of directors, as later learned by a Senate subcommittee. The board was informed of the rationale for using the Whitewing, LJM, and Raptor transactions, and after approving them, received status updates on the entities' operations. Although not all of Enron's widespread improper accounting practices were revealed to the board, the practices were dependent on-board decisions. Even though Enron extensively relied on derivatives for its business, the company's Finance Committee and board did not have enough experience with derivatives to understand what they were being told. The Senate subcommittee argued that had there been a detailed understanding of how the derivatives were organized, the board would have prevented their use.

- **Financial Audit: Hiding in The Shadows**

Enron's auditor firm, Arthur Andersen, was accused of applying reckless standards in its audits because of a conflict of interest over the significant consulting fees generated by Enron. During 2000, Arthur Andersen earned $25 million in audit fees and $27 million in consulting fees (this amount accounted for roughly 27% of the audit fees of public clients for Arthur Andersen's Houston office). The auditor's methods were questioned as either being completed solely to receive its annual fees or for its lack of expertise in properly reviewing Enron's revenue recognition, special entities, derivatives, and other accounting practices.

Andersen's auditors were pressured by Enron's management to defer recognizing the charges from the special purpose entities as its credit risks became known. Since the entities would never return a profit, accounting guidelines required that Enron should take a write-off, where the value of the entity was removed from the balance sheet at a loss. To pressure Andersen into meeting Enron's earnings expectations, Enron would occasionally allow accounting companies Ernst & Young or PricewaterhouseCoopers to complete accounting tasks to create the illusion of hiring a new company to replace Andersen. Although Andersen was equipped with internal controls to protect against conflicted incentives of local partners, it failed to prevent conflict of interest. In one case, Andersen's Houston office, which performed the Enron audit, was able to overrule any critical reviews of Enron's accounting decisions by Andersen's Chicago partner. In addition, after news of U.S. Securities and Exchange Commission (SEC) investigations of Enron were made public, Andersen would later shred several tons of relevant documents and delete nearly 30,000 e-mails and computer files, causing accusations of a cover-up.

FAILED CAPTAINS: THE EXECUTIVES' MANAGERIAL FAULTS

❖ INTERPERSONAL ROLES

These roles involve the behaviours associated with human interaction. In other words, interpersonal roles are those roles that allow a manager to interact with his or her employees for the purpose of achieving organizational goals. There are three roles listed under interpersonal roles, which include figurehead, leader and liaison.

➢ Figurehead

As a figurehead, Kenneth Lay has certain social, ceremonial and legal responsibilities that his employees expect him to fulfil. He is seen as a source of inspiration and authority to his employees.

Lay was driven by short term profits, and often ignored the long-term benefits of his company. An example of him overlooking his legal commitments was when he cancelled his scheduled appearance before a Senate committee during his trial.

➢ Leader

Lay's role as a leader requires him to direct and manage the performance of his employees. He will spend time communicating performance goals, training and mentoring employees, supporting employee efforts, supplying resources, evaluating employee performance and motivating employees toward a higher level of productivity.

Although Enron's compensation and performance management system was designed to retain and reward its most valuable employees, the system contributed to a dysfunctional corporate culture that became obsessed with short-term earnings to maximize bonuses. With the vision of transforming Enron from an energy supplier to an energy trader, Skilling imposes his interpretation of Darwinian worldview on Enron by establishing a review committee that grades employees and annually fires the bottom fifteen percent, a process nicknamed within the company as "rank and yank". Employees constantly tried to start deals, often disregarding the quality of cash flow or profits, in order to get a better rating for their performance review. This was due to Enron's "Survival of the Fittest" environment. It taught employees to step on other people's throats if it will help them advance their career.

Employees were rewarded in stock options more than cash bonuses. The company was constantly emphasizing its stock price. After the fall of Enron, many have seen their pension plans wiped out because they were full of Enron shares.

> "In the Titanic, the captain went down with the ship. And Enron looks to me like the captain first gave himself and his friends a bonus, then lowered himself and the top folks down the lifeboat and then hollered up and said, 'By the way, everything is going to be just fine.'"
>
> *-U.S. Senator Byron Dorgan*

- **Liaison**

As a liaison, Lay communicates with internal and external members of the organization. This networking activity is a critical step in reaching organizational goals, especially those concerned with customers. The top managers at Enron abused their role as a liaison. While they formed external links to encourage their own malpractices, Enron leadership valued creative, visionary thinkers and entrepreneurial individuals, and the leadership welcomed good ideas and acted on them. They maintained a good communication web internally, but what went on externally was an entirely different story.

Chief Financial Officer Andrew Fastow and other executives not only misled Enron's board of directors and audit committee on high-risk accounting practices, but also pressured Arthur Andersen, Enron's auditing firm, to ignore the issues. Arthur Anderson was encouraged to hide their mountains of debt and losses from the customers and government officials.

To ease the government scrutiny on his company, Kenneth Lay, contributed more than $290,000 to George Bush's election campaign, gaining his confidence and aid in return.

Jeffrey Skilling resigns abruptly, just months before Enron would file for bankruptcy, citing personal reasons and Lay returns to his position of CEO and says there are "no issues" behind the resignation.

❖ **INFORMATIONAL**

The informational roles include those roles in which a manager must generate and share knowledge to successfully achieve organizational goals. There are three roles listed under informational roles, which include monitor, disseminator and spokesperson.

➢ **Monitor**

The monitor role that Kenneth Lay must fill involves the task of researching, locating and choosing useful information. As a monitor, he has to stay abreast to current industry standards and changes occurring in both the internal and external business environments. This also includes monitoring the performance of employees and their level of productivity.

Enron monitored their employees by "expecting them to perform to a standard that was continually being raised" and "the only thing that mattered was adding value."

Enron perceived and marketed itself as an "innovative organization." They took very dominant and aggressive perspective approaches to the marketplace. With respect to their external environment, the managers at Enron were excellent at gauging the market and keeping up to its standards.

Even though Enron extensively relied on derivatives for its business, the company's Finance Committee and board did not have enough experience with derivatives to understand what they were being told. The Senate subcommittee argued that had there been a detailed understanding of how the derivatives were organized, the board would have prevented their use. This is where Lay and his fellow managers failed as monitors. They failed to oversee and correct these flaws of their organisation.

- **<u>Disseminator</u>**

As a disseminator, Lay must take the information he gathered as a monitor and forward it on to the appropriate individuals. He must keep his employees and other stakeholders well informed about what is happening in the business and what is going to affect them.

When Jeffrey Skilling was hired, he developed a staff of executives that – by the use of accounting loopholes, special purpose entities, and poor financial reporting – were able to hide billions of dollars in debt from failed deals and projects.

Later, Enron disclosed to its shareholders that it had hedged downside risk in its own illiquid investments using special purpose entities. However, investors were oblivious to the fact that the special purpose entities were actually using the company's own stock and financial guarantees to finance these hedges, which was in fact very harmful to the company.

The executives at Enron should have been faithful and honest about the company's status, while working on improving it, rather than hiding it. Since what they were doing provided them with short term profits, they were not hesitant in using immoral and unethical means of business.

- **<u>Spokesperson</u>**

Acting as a spokesperson on behalf of the organization is Lay's final informational role. As a spokesperson, he is expected to communicate information about the organization to outside parties.

Enron was a highly secretive company. Not only did they hide vital information from their shareholders and investors, but also the general public. Enron's collapse and the financial havoc it wreaked on its shareholders, its employees, the public and the Wall Street led to new regulations and legislation to promote the accuracy of financial reporting for publicly-held companies. This gave birth to the Sarbanes-Oxley Act.

❖ DECISIONAL ROLES

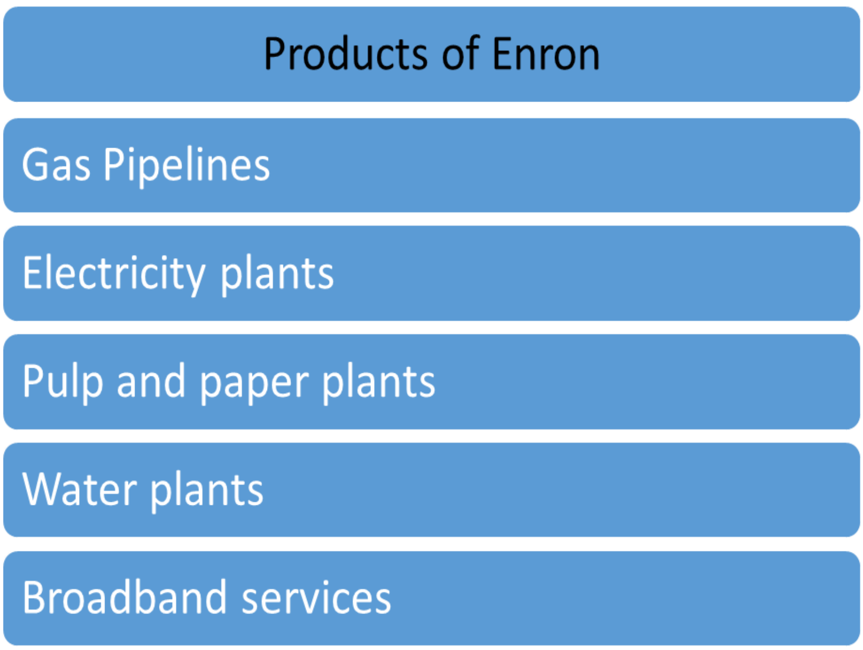
The decisional roles of a manager require them to plan strategy and utilisation of resources for achievement of organisational goals in an efficient and effective manner. An individual cannot be expected to perform the role of a manager without being competent to make decisions.

➢ Entrepreneur

Managers create and control change within the organization. This means solving problems, generating new ideas, and implementing them. Lay was an admirable entrepreneur. He was a visionary which led to Enron being named America’s Most Innovative Company in under 10 years of its establishment.

As Enron became the largest seller of natural gas in North America by 1992, its trading of gas contracts earned $122 million, the second largest contributor to the company's net income. The November 1999 creation of the EnronOnline trading website allowed the company to better manage its contracts trading business in an era where online trading had just begun flourishing.

In an attempt to achieve further growth, Enron pursued a diversification strategy. The company owned and operated a variety of assets including gas pipelines, electricity plants, pulp and paper plants, water plants, and broadband services across the globe. This included setting up power generation plants in developing countries and emerging market including The Philippines, Indonesia and India.



➢ **Disturbance Handler**

When an organization or team hits an unexpected roadblock, it's the manager who must take charge. He also needs to help mediate disputes within it.

Before its scandal, Enron was lauded for its sophisticated financial risk management tools. Enron established long-term fixed commitments which needed to be hedged to prepare for the invariable fluctuation of future energy prices. Enron's bankruptcy downfall was attributed to its reckless use of derivatives and special purpose entities. By hedging its risks with special purpose entities which it owned, Enron retained the risks associated with the transactions. This arrangement had Enron implementing hedges with itself.

Kenneth Lay was an intelligent man but his flaws lied in his decisive weakness. He was bad at dealing with problems facing the organisation. Although he had good interpersonal skills, especially in soothing conflicts, he avoided tough decisions that would directly affect his organisation. Instead of drawing clear boundaries, Lay created complex arrangements that confused people.

> "Things that have happened with Enron and companies like that, where they've squandered their employees' pension funds, I think it has brought a new level of anxiety. People don't feel like they can trust their employer."
>
> *-Mike Huckabee*

➢ **Resource Allocator**

A manager is also required to determine where the limited organizational resources are best applied. This involves allocating funding, as well as assigning staff and other organizational resources.

Kenneth Lay was a visionary, he seized the opportunity of founding Enron around the time of deregulation of oil prices in America and became the ambassador-at-large of deregulation.

Skilling believed that if employees were constantly worried about cost, it would hinder original thinking. As a result, extravagant spending was rampant throughout the company, especially among the executives. Employees had large expense accounts and many executives were paid sometimes twice as much as competitors.

- **<u>Negotiator</u>**

In an organization, a manager may be needed to take part in, and direct, important negotiations within your team, department, or organization. He must negotiate with outside parties as well as within the organization.

Enron's auditor firm, Arthur Andersen, was accused of applying reckless standards in its audits because of a conflict of interest over the significant consulting fees generated by Enron. During 2000, Arthur Andersen earned $25 million in audit fees and $27 million in consulting fees (this amount accounted for roughly 27% of the audit fees of public clients for Arthur Andersen's Houston office). The auditor's methods were questioned as either being completed solely to receive its annual fees or for its lack of expertise in properly reviewing Enron's revenue recognition, special entities, derivatives, and other accounting practices.

Enron hired numerous Certified Public Accountants (CPAs) as well as accountants who had worked on developing accounting rules with the Financial Accounting Standards Board (FASB). The accountants searched for new ways to save the company money, including capitalizing on loopholes found in Generally Accepted Accounting Principles (GAAP), the accounting industry's standards. One Enron accountant revealed "We tried to aggressively use the literature [GAAP] to our advantage. All the rules create all these opportunities. We got to where we did because we exploited that weakness."

To ease the government scrutiny on his company, Kenneth Lay, contributed more than $290,000 to George Bush's election campaign, gaining his confidence and aid in return.

AFTERMATH

Enron's shareholders lost $74 billion in the four years before the company's bankruptcy ($40 to $45 billion was attributed to fraud). As Enron had nearly $67 billion that it owed creditors, employees and shareholders received limited, if any, assistance aside from severance from Enron. To pay its creditors, Enron held auctions to sell assets including art, photographs, logo signs, and its pipelines.

In May 2004, more than 20,000 of Enron's former employees won a suit of $85 million for compensation of $2 billion that was lost from their pensions. From the settlement, the employees each received about $3,100. The next year, investors received another settlement from several banks of $4.2 billion. In September 2008, a $7.2-billion settlement from a $40-billion lawsuit, was reached on behalf of the shareholders.

- **The Sarbanes-Oxley Act**

Between December 2001 and April 2002, the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services held multiple hearings about the Enron scandal and related accounting and investor protection issues. These hearings and the corporate scandals that followed Enron led to the passage of the Sarbanes-Oxley Act on July 30, 2002

The Sarbanes-Oxley Act of 2002 is a United States federal law that set new or expanded requirements for all U.S. public company boards, management and public accounting firms. There are also a number of provisions of the Act that also apply to privately held companies, for example the wilful destruction of evidence to impede a Federal investigation

CONCLUSION

The Enron story has produced many victims, the most tragic of which is a former vice-chairman of the company who committed suicide, apparently in connection with his role in the scandal. Another 4,500 individuals have seen their careers ended abruptly by the reckless acts of a few. Enron's core values of respect, integrity, communication and excellence stand in satirical contrast to allegations now being made public.

The old saying goes, "Lessons learned hard are learned best." Some former Enron employees are embittered by the way they have been treated by the company that was once "the best in the business." Others disagree. In the words of one of Enron's former employees: "Just for the record, my time and experience at Enron have been nothing short of fantastic. I could not have asked for a better place to be or better people to work with. Please, though, remember this: Never take customer and employee confidence for granted. That confidence is easy to lose and tough—impossible—to regain."

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