



Module 3

The Language and Tools of Financial Analysis

Accounting Scandals 1: The Fall- out from Enron (What to look out for...)

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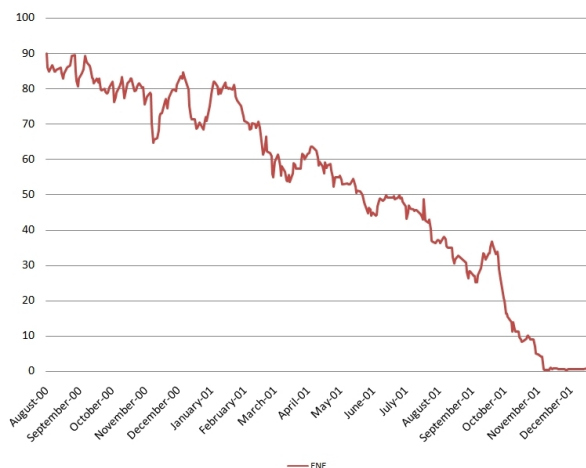
THE UNIVERSITY OF
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BNY MELLON

The Corporate Deceased

Enron Stock Price from August 23, 2000 to January 11, 2002



United States Senate
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
Committee on Homeland Security and Governmental Affairs
Carl Levin, Chairman
Tom Coburn, Ranking Minority Member

WALL STREET AND THE FINANCIAL CRISIS: Anatomy of a Financial Collapse

MAJORITY AND MINORITY
STAFF REPORT

PERMANENT SUBCOMMITTEE
ON INVESTIGATIONS
UNITED STATES SENATE



April 13, 2011



What happened?

The Enron case is the prime example of investor deception by numbers

Originally a natural gas transmission and distribution business, Enron transformed into an energy, commodities and services giant in the 1990s.

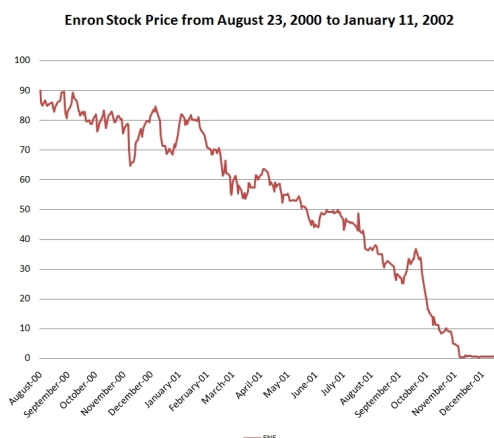
In mid 90s, financial analysts criticized Enron on its debt level. Enron management pursued the critics aggressively, as they did with accountants, lawyers, and the financial media.

What happened?

Enron's growth sparked its sharemarket success – analysts were recommending “buy” (only turning to “neutral” in 2001)

But... assets and profits were inflated or non-existent – selling assets at inflated prices with a buy-back promise at even higher prices, only recording the revenue

Meanwhile debts and losses were parked in offshore entities (that did not appear in the financial statements)





How Accounting was involved?

How did the auditors miss it?

- Bullying by Enron's executives
- Accounting loopholes
- Sophisticated fraud (from the top down)
- Conspiracy by executive management team
- Irrational exuberance?

The external auditor also provided Enron's internal auditing services

Was the independent audit compromised?

How Accounting was involved?

Big 5 accounting firm and Enron auditor, Arthur Andersen's performance was scrutinized by the media, regulators and government

- Despite being cleared, impact of the scandal ultimately destroyed the firm
- Agreed to surrender its CPA licenses and its right to practice in 2002
- Spotlight on its audits of other notable problem companies (Sunbeam, WorldCom)



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Slide 2:

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