

# Fall of enron



Q1- Who were the key stakeholders involved in, or affected by the collapse of Enron? How and to what degree were they hurt or helped by the actions of Enron management? Ans- The key stakeholders affected by the collapse of Enron were its employees and retirees. Stakeholders and mutual funds investors lost \$ 70 billion market value. Banks were also affected by the meltdown of the company. They included big banks like J P Morgan Chase and Citigroup. Not only the stakeholder and bondholder lose out, the confidence in the company also fell. This was the major setback for the company.

The actions of Enron management left a deep scare for its 4000 employees which lost out their jobs and also impacted others around them. Some blamed Arthur Andersen; Enron's accounting firm and some blame the board of directors for insufficient oversights. The damage was so big that it was likely to take years for the court to sort the wreckage. The company did not think of its future and took many bad steps just to earn money. The CEO should have looked into the company matters long time ago and took action so that hundreds of jobs could have been saved. The companies who were associated with the big firm were affected on a very large scale. This was the biggest bankruptcy of a firm with \$63.4 billion in assets.

Q2- Considering all aspects of the case, what factor or factors do you believe most contributed to the collapse of Enron? In your answer, please consider both external and internal factors. Ans -Enron's non transparent financial statements did not clearly depict its operations and finances with shareholders and analysts. The company started manipulating the revenue

figures. Enron used many methods to make the companies condition look better by starting different accounting practices.

They also broke the legal and ethical integrity of the company by overseeing the company's financial reports. Even supporting the political parties didn't help them. They had a complex business model and they misrepresented their financial status to the public so that they can have a better position in the eyes of the public and earn money on basis of that. All the above issues that led to the bankruptcy of the company were perpetuated by the actions of Lay, Skilling, Fastow and other executives.

They all led to the collapse of the company. Lay did not enquire about the decisions that Skilling and Fastow were taking. He just approved to everything that they kept in front of him. Skilling always wanted to keep up to the Wall Street expectations and for this he gave pressure on his executives to find new ways to hide the debt. This was the major setback for the company as they didn't know that in future everything was going to come out and it would have led to bad consequences. Lay did not enquire about all this and approved of all the work Skilling was doing.

Q3- What steps should be taken now by corporate managers, stakeholders, and policy makers to prevent a similar event from occurring in the future?

Ans- People should not lie about the company's financial status just to bring it up in the market. Eventually the truth is going to come out one day or the other. Auditors should properly keep track of the finances. Managers, stakeholders and directors should be aware of everything that is happening in the company. Policy makers should think about what steps they are taking

and how it will affect other people's lives. They should not make policies for the benefits of the big companies who give them finances for their political endeavours.

Updated case:

Many executives at Enron were indicted of a variety of charges and then sentenced to prison. Enron's auditors, Arthur Andersen, was found guilty in a United States district court, but by the time the ruling was overturned at the US Supreme Court, the firm has lost most of its customers and had to shut down. Employees and shareholders received limited returns in the lawsuits they filed. As a consequence of the scandal, new regulations and legislation were enacted to expand the accuracy of financial reporting for public companies.

Special purpose entities Enron used special purpose entities—limited partnerships or companies created to fulfil a temporary or specific purpose—to fund or manage risks associated with specific assets. The company elected to disclose minimal details on its use of special purpose entities. These shell firms were created by a sponsor, but funded by independent equity investors and debt financing. For financial reporting purposes, a series of rules dictates whether a special purpose entity is a separate entity from the sponsor.

In total, by 2001, Enron had used hundreds of special purpose entities to hide its debt. 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

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earnings were overstated. Enron disclosed to its shareholders that it had hedged downside risk in its own illiquid investments using special purpose entities. However, the 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 setup prevented Enron from being protected from the downside risk. Notable examples of special purpose entities that Enron employed were JEDI and Chewco, Whitewing, and LJM. The justices agreed to look at two issues in the appeal of Mr. Skilling's 2006 conviction that could have broader repercussions, say legal observers. One deals with the government's contention that Mr. Skilling violated his legal obligation to provide "honest services" to Enron shareholders because he lied about the energy-trading company's financial condition before it collapsed into bankruptcy in December 2001. Mr. Skilling's attorneys maintained that prosecutors misapplied the honest-services statute, arguing their client hadn't lied and didn't cheat Enron or its shareholders.

The second issue involves Mr. Skilling's claim that he wasn't able to get a fair trial in Houston, site of Enron's headquarters, because of anger in the community over the company's collapse. Daniel Petrocelli, Mr. Skilling's lead attorney, said the Supreme Court's decision means the defense "will finally get an opportunity for a full, frank and fair hearing" of issues that led to "Jeff's wrongful conviction." The Justice Department declined to comment. The Supreme Court earlier accepted for review another appeal related to corporate honest-services fraud. That case involves the conviction of former Hollinger International Inc. Chairman Conrad Black.

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Oral arguments in Mr. Black's Supreme Court case are scheduled for December. No date has been set for oral arguments in the case of Mr. Skilling, who is in federal prison in Colorado. The question of what constitutes honest-services fraud is under debate. "The lack of clear guidance" on the statute "has been a problem in this area of criminal law for years," said Mark Biros, a former federal prosecutor and now a partner in the Washington office of Proskauer Rose LLP. "It would be helpful to everyone if the Supreme Court steps in." Mr. Biros said the court might be considering treating the Skilling and Black appeals as companion cases.

The justices could use the two cases to provide a broader interpretation of the honest-services issue, he said. The court's agreement to hear Mr. Skilling's arguments on the location of his trial surprised Columbia Law School professor John Coffee. "The area of venue is something the Supreme Court hasn't touched for a long, long time," Mr. Coffee said. If the court agrees with Mr. Skilling, whose attorneys argued for a venue change before the trial, it could have a wide impact. In the 2006 trial, Mr. Skilling and former Enron Chairman Kenneth Lay were convicted of fraud and conspiracy. Mr. Skilling was also convicted of insider trading.

Shortly after the trial, Mr. Lay died of heart-related problems and his conviction was vacated. Former Enron chief financial officer Andrew Fastow, 44, was sentenced to six years in prison Tuesday, more than two years after he pleaded guilty to two counts of conspiracy for his involvement in the energy company's 2001 collapse. Jurors in the Houston trial of Enron founder Kenneth Lay and former CEO Jeffrey Skilling reached a verdict Thursday, the

sixth day of deliberations, finding both defendants guilty of most conspiracy and fraud charges.