Enron college essay

ASSIGN BUSTER

Enron entered the year 2001 as the seventh largest public company in the U. S, only to exit the year as the largest company to ever declare bankruptcy in U. S history. a) What were the business risks Enron faced and how did those risks increase the likelihood of material misstatements in the Enron's financial statements? Enron faces most of the risk ordinarily faced by any energy company, including price instability and foreign currency risks. Enron operated in many different areas of the world with different regulatory and political risks. The speculative nature of Enron exposed the company to much additional risk, which created pressure to adopt aggressive financial reporting practice.

Enron acted as a broker of speculative energy futures, offered financial hedges. Further many of Enron's deals (including the SPEs) depended heavily on a high and raising stock price. The company had guaranteed its obligations with stock and had contractually agreed that those obligations would become immediately due and payable if the stock price fell below certain levels. If the company were to report poor or deteriorating results its partners might begin to question the company's ability to meet its obligations and consequently refuse to do business with the company. b) Discuss the responsibility of i) the board of directors and ii) the audit firm, for the fall of Enron. The boards of directors are responsible for ensuring that firms management is acting in the best interest of the owners.

The board could have taken several steps to improve corporate governance. In the reports following the fall of Enron the committees placed a good deal of blame on the board of directors and the audit committee. They could for example have • Prohibited accounting practices and transactions that put

the company at high risk • Prohibited conflict of interest arrangements that allow company transactions with a business owned or operated by senior company personnel • Prohibited off-the-books activity• Preventing stock based compensation plans that encourage use of improper accounting • Increased independency – requiring a majority of outside directors to be free of material financial ties to the company • Strengthen external auditors independence – prohibiting Andersen from providing internal auditingWe should though be aware of the fact that the board only meet periodically and to not have an investigative arm and do not monitor the companies on a full-time basis. The audit firm is of course responsible for their own work. The audit report did not include the modifications that should have been there. In order to fulfill their task and provide high quality audit they should have prevented the aggressive (and fraudulent) accounting produced by Enron.

What were the business risks Enron faced, and how did those risks increase the likelihood of material misstatement in Enron's financial statements? Enron's business risks involved risks such as fraud; however, their ultimate failure was when they entered into aggressive transactions involving special purpose entities (SPE's). The problem was that the accounting practices were questionable when they treated loans to look like revenue and did not record them as liabilities, such as notes payable. This risk is that they did not show the liabilities on the financial statements and misled creditors, investors, and customers into believing that they were making more money then they actually were. Another business risk Enron faced was losing all their investors as they continued to cash in their shares of Enron stock. In the same year, the CEO at the time Jeffrey Skilling resigned from his short career

at Enron. The company lost a great amount of their reputation and public trust due to all the bad publicity they received in the media, all of this created a weak future as they encountered a liquidity crisis later in 2001.

Other business risks involved bad management decisions and practices.