Enron case study assignment

ASSIGN
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Executive Summary: As per requested this group assignment prepared from Group 2 (NASA) contributed by Norazman Saharum , Shaufi Akil , Abd Manaf Jalil and Zubir Zainal Abidin . This group assignment part of final course entitle for 25 marks . This assignment to fulfill our MSU MBA Syllabus for subject Accounting For Corporate and Evaluation (DAC 5013) instructed by Dr Mazlinah Mat Zain . Our group have chosen The Arthur Andersen Troubles. The most famous scandal case Arthur Anderson scandal was involved in was the fraudulent auditing of Enron.

In this case Arthur Anderson shredded vital documents sourcing the audit of Enron which occurred in the year 2002. Enron has clearly done some damage to the U. S. economy, but it will not hold up recovery from the current recession. The fundamental health of the U. S. economy is strong and now getting stronger. Some individual new economy companies will have depressed stock prices for some time, but they, too, will recover as they demonstrate that they are prepared to prevent Enron-like behaviour. We do believe Enron will be the morality play of the new economy.

It will teach executives and the American public the most important ethics lessons of this decade. We will discuss more information on this issues based on the question given on Arthur Andersen and among them are the conflict of interest between the two roles played by Arthur Andersen, as auditor but also as consultant to Enron; the lack of attention shown by members of the Enron board of directors to the off-books financial entities with which Enron did business; and the lack of truthfulness by management about the health of the company and its business operations.

Lastly, we would like to thanks to Dr Mazlinah on her dedicated and helpful to achieve our mission and mission to be a successful entrepreneur for the future. Arthur Andersen case study reminds us the most important ethics lessons of this decade. AMIN. Introduction; Arthur Andersen LLP, based in Chicago, was once one the “ Big Five” accounting firms among Price Water House Coopers, Deloitte Touche Tohmatsu, Ernst & Young and KPMG , providing auditing, tax, and consulting services to large corporations.

In 2002, the firm voluntarily surrendered its licenses to practice as Certified Public Accounting in the United States after being found guilty of criminal charges relating to the firm’s handling of the auditing of Enron, the energy corporation, resulting in the loss of 85, 000 jobs. In this case Arthur Andersen shredded the vital documents sourcing the audit of Enron which occurred in the year 2002 . Although the verdict was subsequently overturned by the Supreme Court of the United States, it has not returned as a viable business.

However, how did this company get the reputation that it has while following such a moral slogan? As the clients demanded for more profit margins , Arthur Andersen scandal had to compromise his morality leading to the allegation that he had fraudulently altered the statement of such companies and corporation for example Sunbeam Products, Waste Management Inc. , Asia Pulp and Paper, The Baptist Foundation of Arizona , and WorldCom . Due to the downfall of Arthur Andersen, it lost nearly all of its business and clients.

It lost not millions but billions of dollars due to this intense investigation. Although it is still in business and operating under Omega Management and

has not as of yet declared bankruptcy, the firm will never reach its past legacy. Arthur Anderson's motto of " Think straight, talk straight" has forever been tainted in the eyes of Americans corporations. This devastation of fraudulent activity has forever left a deep and painful scar on America's businesses. . The Arthur Andersen's Troubles: Question 1: What did Arthur Andersen (AA) contribute to the Enron disaster?

The most famous scandal case Arthur Andersen was involved in was the fraudulent auditing of Enron. In this case Arthur Andersen shredded vital documents sourcing the audit of Enron which occurred in the year 2002. According to Watkin, a financial executive who worked with Andrew Fastow told Enron CEO Kenneth Lay she feared that Enron would " implode in a wave of accounting audit scandal " (1: USA Today, Wed, Jan 16, 2002) AA apparent mistakes may have been made for several reasons to the Enron disaster including: • Incompetence , as displayed and admitted in the rhythms case . Judgement errors; . as to the significants of each of the audit findings, or of the aggregate impact in any fiscal year. • Lack of information caused by Enron staff not providing critical information, or failure on the part of AA personal to search it out . • Time pressures : related to revenue generations and budget pressures that prevented adequate audit work and the full considerations of complex SPE and prepay financial arrangements . • Desire not to confront Enron management or advise the Enron board in order not to upset management, and particularly fastow, Skilling and Lay Lack of Independence. The Board of Directors failed to ensure the independence of the company auditor , allowing AA to provide internal audit and consulting services while serving the Enron outside auditors . • A failure of AA's internal

policies whereby the concerns of a quality control or practice standards partner can and was overruled by the audit partner in charge of the Enron account. AA was the only one of the Big 5 accounting forms to have this flaw and it left the entire firm vulnerable to the decisions of the person with the most to lose by saying no to a client. A misunderstanding of the fiduciary role required by auditors . for example AA allowing Enron to engage in high risk accounting , inappropriate conflict of interest transactions, extensive undisclosed off-the-books activities and excessive executive compensation . Given this " tone at the top'. It is reasonable to assume that AA partners were going to be motivated by revenue generations. But if too many risks are taken in the pursuit of revenue the probability of a series of audit problems leading to increasingly unfavorable consequences becomes greater .

That is exactly what happened to Enron disaster. Unfortunately, the leaders of AA failed to recognize the cumulative degree to which the public, the politicians, and the SEC (The Securities and Exchange Commission) were angered by the progression of AA audit failures . Question 2: What Arthur Andersen (AA) decision were faulty? Arthur Andersen (AA) decision were faulty . This is the ' Enron Debacle" section presented previously covers in detail many of the questionable accounting transactions, legal structures, and related disclosures that AA reviewed as auditors of and consultants to Enron.

AA faulty may have been made for several reason , including: • AA apparently approved as auditors and consultants (and collected fees for the consulting advice) the structure of many special purpose entities (SPEs) that

were used to generate false profits, hide losses, and keep financing off Enron's consolidated financial statements , failed to meet the required outsiders 3 percent equity at risk, and decision control criteria for non consolidation . AA failed to recognize the generally accepted accounting principle (GAAP) that prohibits the recording of shares issued as an increase in shareholders' equity unless they are issued for cash . • AA did not advise Enron's audit committee that Andrew Fastow, Enron's CFO and his helpers were involved in significant conflict of interest situations without adequate alternative means of managing these conflicts. • AA did not advise the Enron audit committee that Enron's policies and internal control were not adequate to protect the shareholders' interests even though AA had assumed Enron's internal audit functions . Many transactions between Enron and the SPEs were not in the interest of Enron shareholders since: a) Enron profits and cash flow were manipulated and grossly inflated, misleading investors and falsely boosting management bonus arrangements. b) Extraordinarily overgenerous deals, fees, and liquidation arrangements were made by Fastow, or under his influence, with SPEs owned to Fastow , his family, and Kopper, who was also as employee of Enron . AA aparently did not adequately consider, the advice of its quality control partner, Carl Bass. He asked AA for an accounting change that would have resulted in a $30 – $50 million charge to Enron's earnings. • AA apparently did not find significant audit evidence, or did not act upon evidence found, related to the: 1)Mistaken valuation of shares or share rights transferred to SPEs 2)Side deals between Enron and banks removing the bank's risk from transactions such as the : a) Chewco SPE Rhythms hedge.) Numerous prepay deals for energy futures, even though AA made a presentations to Enron on the GAAP

and AA requirements that preclude such arrangements. Questions 3: What was the prime motivation behind the decision of Arthur Andersen's audit partners on the Enron, WorldCom, Waste Management the public interest or…? Cite examples that reveal this motivation . The AA was motivated by greed instead of serving the public interest. The amount of money they got from the consulting fee has compromised their auditing works.

In 1997, client Waste Management Inc. had the largest earnings restatement to date, wiping out $1. 7 billion in profits that it pulled in through the 1990s. The lead auditor on Waste Management was Robert Allgyer, who was known inside the firm as " the Rainmaker" for his success in cross-selling extra services to auditing clients. He was clearly successful at selling to Waste Management, which paid $17. 8 million in fees unrelated to the audit between 1991 and 1997, against audit fees of $7. 5 million.

But he was also signing off on drastically inaccurate books. Among other things, the fast-growing trash hauler wasn't properly writing off the value of assets such as garbage trucks as they aged, a ruse that pumped up reported profits. The SEC's acting commissioner, Laura Unger, concluded that the agency had the " smoking gun" it was looking for to prove that the lure of consulting fees compromised auditor independence. The SEC filed suit in March 2002, accusing six former Waste Management executives of fraud. It alleges that Mr.

Allgyer's judgment was skewed by consulting fees, in particular a $3. 7 million " strategic overview" of Waste Management operations. The project lasted for 11 months, but the client didn't adopt the recommendations.

Bellow table shown example AA's involvements in the major financial scandals as the audit firm that failed to discover their mistakes that reveal this motivation: | CLIENT | PROBLEM MISSED, DATE | LOSSES TO SHAREHOLDERS | JOB LOSSES | AA FINE | | WorldCom |$4. billion overstatement of | 4179. 3 Million | 17, 000 | N. A | | | earnings announced on June 25,| | | | | | 2002 | | | | | | | | | | | | Inflation of ncome, asset, | | | | | | etc bankrupt Dec 2, 2001 | | | | | Enron | |$66. 4 Billion | 6, 100 |$. 5 Million | | | Overstatement of income by | | |(for shredding) | | |$1. billion, 1992-1996 | | | | | | | | |$7 Million | | | | | | | | Waste Management | | 420. 5 Billion | 11, 000 | | Question 7: Under what circumstances should audit firm shred or destroy working paper ?

According to section 802 of the Sarbanes-Oxley Act of 2002, accountants who audit or review an issuer's financial statements are required to retain certain records relevant to that audit or review. These records include workpapers and other documents that form the basis of the audit or review, and memoranda, correspondence, communications, other documents, and records (including electronic records), which are created, sent or received in connection with the audit or review, and contain conclusions, opinions, analyses, or financial data related to the audit or review.

To coordinate with forthcoming auditing standards concerning the retention of audit documentation, the rule requires that these records be retained for seven years after the auditor concludes the audit or review of the financial statements. Refer to the above question, for example if we as a professional audit firm can't simply shred or destroy working paper. How long to keep a document, when and how to store the document, and how to dispose of the

document, will depend on the type of document . As any internal auditor knows, there are numerous types of documents that may be accumulated as part f an audit or review. The final rule here requires the retention of all records relevant to the audit, including working papers and other documents that form the basis of the audited financial statements, as well as certain supporting documents. The guideline for document retention is that they must meet two criteria: (1) Documents are created, sent, or received in connection with the audit or review, (2) the documents contain conclusions, opinions, analyses, or financial data related to the audit or review.

Both Enron and Arthur Andersen are now gone, but this audit work-paper clean-up exercise, no doubt, was a major motivating factor for the Sarbanes-Oxley Act , Section 802 rules outlining penalties for the destruction of documents. The rules require external auditors who audit or review an enterprise's financial statements to retain certain records relevant to that work, including work papers and other documents that form the basis of the audit or review.

These retention requirements include memoranda, correspondence, communications, other documents, and records, as well as related electronic records that are created, sent, or received in connection with the audit work and contain conclusions, opinions, analyses, or financial data related to the work. These records are to be retained for seven years after the auditor concludes the financial statements review. This rule was nothing new for many internal auditors as many audit functions have followed similar document retention rules based on U.

S. tax document retention guidelines. The rules also states that if you know your company is under investigation, or even suspect that it might be, all document destruction and alteration must stop immediately. And, you must create a company records showing that you’ve ordered a halt to all automatic e-data destruction practices. Question 8: Answer the “ Lingering Question” on page 94 . Enron has clearly done some damage to the U. S. economy, but it will not hold up recovery from the current recession.

The fundamental health of the U. S. economy is strong and now getting stronger. I do believe Enron will be the morality play of the new economy. It will teach executives and the American public the most important ethics lessons of this decade. Among these lessons are: 1. You make money in the new economy in the same ways you make money in the old economy – by providing goods or services that have real value. 2. Financial cleverness is no substitute for a good corporate strategy. . The arrogance of corporate executives who claim they are the best and the brightest, “ the most innovative,” and who present themselves as superstars should be a “ red flag” for investors, directors and the public. 4. Executives who are paid too much can think they are above the rules and can be tempted to cut ethical corners to retain their wealth and perquisites. 5. Government regulations and rules need to be updated for the new economy, not relaxed and eliminated.

Due to the downfall of Arthur Anderson, it lost nearly all of its business , employees, and clients. It lost not millions but billions of dollars due to this intense investigation. Although it is still in business and operating under Omega Management and has not as of yet declared bankruptcy, the firm will

never reach its past legacy. We believe accounting regulations should be altered to prohibit ownership of both auditing and consulting services by the same accounting firm.

Accounting firms are already moving to sever their consulting businesses. The SEC should probably adopt additional disclosure requirements. Various regulators should tighten requirements for directors to be alert and provide protections for whistleblowers who bring improper behaviour to public attention. But, in the final analysis, the solution to an Enron-type scandal lies in the attentiveness of directors and in the truthfulness and integrity of executives. Clever individuals will always find ways to conceal information or to engage in fraud.