Fraud and Deception: An Enron Case Study

Course Description

The purpose of this course is to review the factors that led to the demise of Enron. This course also looks at the aftermath of Enron including changes that have been made to accounting, auditing and SEC rules as a direct result of those issues identified as existing in Enron. This course reviews the GAAP rules in effect at the time of the Enron abuses, at the Enron case with particular emphasis on the four special purpose entities that led to Enron’s restatement of its financial statements and its ultimate bankruptcy filing. It also looks at the aftermath of Enron including the Sarbanes Oxley Act of 2002 and its rules affecting auditors and accountants, and the new consolidation rules related to variable interest entities (VIEs) which require that certain off-balance sheet entities be consolidated.

Completion Deadline & Exam: This course, including the examination, must be completed within one year of the date of purchase. In addition, unless otherwise indicated, no correct or incorrect feedback for any exam question will be provided.

Course Level: Overview. This program is appropriate for professionals at all organizational levels.

CPE Credits: 10 (CPA) (Accounting- 5 hours, Auditing 5 hours)

Category: Accounting

Prerequisite: None.

Advanced Preparation: None

Course Learning Objectives

Section 1:

1. Outline the GAAP rules that existed at the time of Enron, as they relate to investments, special purpose entities (SPEs) and consolidations;
2. Compare and contrast the three tiers of ownership of outstanding voting stock and their accounting treatment;
3. Categorize the three types of securities and the accounting treatment within the categories under FASB No. 115;
4. Identify when the equity method should be used;
5. Name the general rule for consolidation under ARB 51;
6. Explain the SEC’s position on consolidation;
7. List the factors that the registrant should consider in determining the most meaningful presentation in deciding upon consolidation policy;
8. Provide examples of when to use combined financial statements;
9. Delineate the basic rules that must be followed when presenting combined financial statements;
10. Name the exceptions to the more than 50% ownership test of ARB No. 51;
11. Define the term “special purpose entity”;
12. Trace the steps that were usually taken by an SPE;
13. Name the advantages of using SPEs under the previous rules in effect during Enron;
14. Describe the three general criteria for non-consolidation;
15. Summarize the special rules for SPEs involved in leasing transactions;
16. Explain the rules for SPEs when there was a transfer of financial assets and liabilities;
17. Identify the rule for balance sheet classification of notes receivable in connection with the issuance of equity and paid-in capital; and
18. Name the rule regarding companies recording income and gains on their own stock.

Section 2:

1. Trace the development of Enron’s mishandling of SPEs;
2. Explain the various way that Enron violated the three non-consolidation criteria for SPEs;
3. Draw and outline the basic structures of Enron’s SPEs;
4. Delineate the events of each phase of the first Enron SPE, JEDI and Chewco Investments L.P.;
5. Name the GAAP violations that occurred during each phase of JEDI-Chewco;
6. Explain the outcomes of JEDI-Chewco and its GAAP violations;
7. Recognize the other GAAP issues related to Chewco and JEDI;
8. List the events of each phase of the LJM1 partnership;
9. Recognize the GAAP violations that occurred during each phase of LJM1 and Swap Sub;
10. Name the events of each phase of LJM2 and the Raptors;
11. Identify the GAAP violations that occurred during each phase of LJM2 and the Raptors;
12. Explain how the LJM partnerships mishandled other transactions;
13. Delineate how several employees were personally enriched at the expense of Enron;
14. Identify the restatements that Enron made in November 2001;
15. Trace the demise of Enron following the announcement of the restatements;
16. Illustrate Enron’s disclosure deficiencies;
17. Describe the existing GAAP requirements for related party transactions;
   a. Delineate the general rules for disclosing related party transactions;
   b. Name the SEC rules for related party transactions; and
18. Discern whether or not Enron satisfied the GAAP and SEC disclosure requirements;

Section 3:

1. Summarize the background for boards of directors and audit committees;
   a. State some obvious symptoms that existed in companies that committed fraud;
   b. Describe the SEC’s rules related to audit committees provided in Audit Committee Disclosure;
   c. Identify the changes that were made to Audit Committee Disclosure;
2. Determine whether Enron’s board of directors was independent of management;
3. Explain the breakdown in internal control;
4. Identify the specific roles of Enron’s board of directors;
5. Delineate the specific roles of Enron’s audit and compliance committee;
6. List the specific roles of members of Enron’s senior management; and
7. Explain the specific roles of Arthur Anderson.

Section 4:

1. Differentiate between the authority provided for fraud and illegal acts;
2. Explain how Enron’s audits identified some signs of fraud;
3. Name the problems that were associated with independence and conflicts of interest between Anderson, Enron and the Big Five;
4. Recognize what portion of the Big Five’s revenue was derived from non-audit services;
5. Discern whether there is any correlation between the receipt of large consulting fees and the quality of the audit;
6. Trace the SEC’s attempt to change the independence rules;
7. Provide examples of the problems with conflicts of interest among the financial analysts community; and
8. Outline the new rules that the Sarbanes-Oxley Act requires of analysts and investment bankers.

Section 5:

1. Categorize the major changes that have been made and will be made as a direct result of Enron;
2. Outline the changes that Harvey Pitt made to Congress;
3. Explain the general changes that the Sarbanes-Oxley Act of 2002 made;
4. Provide details about the makeup of the Public Company Accounting Oversight Board (PCAOB);
5. Identify how the Sarbanes-Oxley Act affects SEC auditors;
6. Recognize how the Sarbanes-Oxley Act changes the conflicts of interest and auditor independence rules;
7. Describe how the Sarbanes-Oxley Act affects boards of directors and audit committees;
8. Illustrate how the Sarbanes-Oxley Act affects corporate officers;
9. List the new corporate disclosures required by the Sarbanes-Oxley Act;
10. Determine the punishments for various violations;
11. Explain the revised rules for investment bankers and analysts;
12. Recognize other provisions of the Sarbanes-Oxley Act;
13. Illustrate the trickle down effect of the Sarbanes-Oxley Act;
14. Identify results of the GAO’s Mandated Study on Consolidation and Competition in the Accounting Profession;
15. List the recommended changes for FASB;
16. Explicate Enron’s impact on a principles-based accounting system;
17. Compare a rules-based system of accounting to a principles-based accounting system;
18. List advantages and disadvantages of both a rules-based system and a principles-based system;
19. Explain Enron’s impact on the change in the SPE rules (i.e., FASB Interpretation No. 46R);
20. Define a “variable interest entity”;
21. Categorize and describe off-balance sheet entities;
22. Apply and explain the rules of FASB Interpretation No. 46R;
23. Name the three basic rules for consolidation;
   a. Determine whether there is a variable interest entity;
   b. Establish whether an entity or individual has variable interests in the VIE;
   c. Resolve the issue of the primary beneficiary;
24. Define the term “variable interest”;
25. Provide examples of variable interests;
26. Define the term “primary beneficiary”;
27. Follow the rules to determine who the primary beneficiary of the VIE is;
28. Outline the related-party rules for primary beneficiaries;
29. Explain the operating lease issue;
30. Follow the rules for initial testing and measuring of the VIE by the primary beneficiary;
31. Recognize the effective date and transition requirements of Interpretation No. 46R for public entities and non-public entities;
32. Describe the ongoing changes being made in Congress to pensions and 401(k) plans;
33. List reasons why individuals would choose to not serve as a board member or on a company’s audit committee;
34. Illustrate the new post-Sarbanes environment for directors;
35. Provide examples of possible claims against directors and officers;
36. Explain the issue of D&O insurance;
37. List the three areas of D&O insurance coverage;
38. Recognize the effect of higher malpractice insurance rates and higher audit fees;
39. Identify how the cost of section 404 of Sarbanes-Oxley compliance is exceeding estimates;
40. Outline reasons why European companies are delisting from the U.S. exchanges and why smaller companies are going private; and
41. Explain the effect that the Enron scandal has had on the accounting profession.