NORTHERN ILLINOIS UNIVERSITY

The Effects of Enron

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Honors Thesis Abstract

The purpose of this study is to examine the effects of Enron’s collapse and the long-term implications of its failure. The areas affected by the company’s demise are: society’s perception of business, energy industry, large corporations, and regulation.

One way the energy company was made apparently profitable was through a constant push for deregulation of the energy market. In 2000 Enron reported revenue of $100.8 billion, making them number seven on the Fortune 500 list of the largest companies in the country. It is know realized that Enron’s accomplishments were due mostly to their misrepresentation of financial documents. This misrepresentation eventually caught up with them – Enron ended up filing the largest bankruptcy in history.

Enron’s fall has severely hurt investors’ view of business. In large measure, Enron’s collapse accelerated the public’s lack of confidence in regulators and the stock market. In addition to this, the Enron disaster has left large companies with problems such as maintaining their 401(k) pension plans. Furthermore, the energy industry is now being more tightly regulated and found it especially difficult to obtain credit to fund expansion and new projects. In order to combat the effects of Enron, changes have been made to regulation. The most significant addition of law has been the Sarbanes-Oxley Act, which sets more restrictions for executives.
Attacks on September 11, 2001 left the nation with a vulnerable feeling during an already slumping economy. A few months later, Enron's collapse added to America's feeling of vulnerability in this poor economy. Once considered an exemplary case of innovation and growth, Enron Corp. has come to be perceived as the definition of corruption in recent years as it filed the largest bankruptcy in history. Even in this time of economic trouble, the collapse of Enron was difficult to foresee. After tremendous growth it was realized that the energy company was built on a foundation of deceit. Its bankruptcy hurt Enron employees, investors, and the rest of the economy – while leaving CEOs of Enron with millions of dollars.

The purpose of this study is to examine the effects of Enron and the long-term implications of its failure. The areas affected by the company's demise are: society's perception of business, energy industry, large corporations, and regulation. Although Enron has negatively affected all of these aspects, its unveiling of corruption will lead to positive affects in the long run.

Enron's fall has severely hurt investors' view of business. In large measure, Enron's collapse accelerated the public's lack of confidence in regulators and the stock market. In particular, Enron hurt portfolio managers who had a great deal invested in Enron stock. Also, mutual funds were forced to keep Enron stock as it plummeted since it was not immediately removed from the S&P 500. Even companies with good revenues and accurate financial statements suffer from poor stock performance due to the increased skepticism about large corporations.

In addition to this, the Enron disaster has left large companies with problems such as maintaining their 401(k) pension plans. After witnessing the neglect of 401(k)
pension plans at Enron, thousands of employees began taking legal action against their own companies with worries of mismanagement of their 401(k). It has also become more difficult obtaining insurance coverage. Insurers are much more skeptical with applications and charge more for things such as a lack of auditor independence.

Furthermore, the energy industry is now being more tightly regulated and found it especially difficult to obtain credit to fund expansion and new projects. Credit rating agencies have been quick to downgrade companies, making it difficult to obtain loans.

In order to combat the effects of Enron, changes have been made to regulation. The most significant addition of law has been the Sarbanes-Oxley Act. The Sarbanes-Oxley Act has set more restrictions for CEOs and CFOs and for the independence of auditors.

But while the collapse of Enron has hurt investor confidence and caused problems across most industries, changes in regulation will lead to positive outcomes.

**What Happened**

Enron was formed in 1985 when Kenneth Lay, then CEO of Houston Natural Gas (HNG), organized a merger between his company and InterNorth, which was a natural-gas pipeline firm. The deal was first proposed by InterNorth, which owned one of the best pipeline systems in America. It had a system connecting Texas and Oklahoma with cities in the Midwest and up into Canada. InterNorth was also much larger than HNG. It was three times as large, with 10,000 employees and assets of great value. They purchased HNG for $2.4 billion. This was considered by experts to be a great deal for HNG. Although Lay sold his company, he still managed to remain in charge through the
deal that was made. Lay was named chairman and CEO of Enron in 1986. Also, most executives of Enron were brought over by Lay from HNG. In addition, Lay negotiated the location he wanted: Enron was based in Houston.

Enron faced controversy for the first time in 1987 when it reported a loss of $85 million. The true loss for the company was $142 million to $190 million. Two top executives pled guilty to conspiracy to defraud and to filing false tax returns. In 1996 Lay named Jeffrey Skilling as president and chief operating officer. By 2000 Enron grew from a large natural-gas pipeline company to an energy-trading company that bought and sold gas and electricity. So much of their business came from trading energy that Enron became somewhat of an “energy bank.” Another way the company was made apparently profitable was through a constant push for deregulation of the energy market.

The most prominent example of this push for deregulation, in California, led to much criticism. Eliminating regulation of energy allowed Enron to take advantage of California’s severe power shortage by inflating prices. Enron was viewed by critics as an opportunistic energy company benefiting from the state’s crisis.

When California passed deregulation laws in 1996, it was intended to lower the price of power. There were aspects in the agreement to deregulation that were viewed as beneficial to both sides:

- Utility firms had to sell power-generating assets; however, they received opportunities for new business and better profits.
- Prices for consumers were held constant until assets were sold and things settled down. When competition in the industry began, consumers enjoyed lower prices.
Instead of the industry being regulated and government driven, the market was free and determined by supply and demand.

(Cruver 106-107)

Although this scheme worked at first, it was only because California had an excess amount of power when the deregulation was agreed upon. The electricity demand grew due to the state’s economic growth. In addition, California experienced unusually warm weather in 2000, but did not have enough power plants. This caused alerts of severe shortages of power reserves. In June of that year prices dramatically increased and continued to do so for the rest of the year. In raising the price of power for Californians during their crisis, Enron became a political target. The debate over deregulation would be renewed after Enron’s collapse. Other than the California crisis, Enron’s business was viewed as phenomenal.

Fortune named Enron “The Most Innovative Company in America” in 2000 for the fifth year in a row. In the same year Enron reported revenue of $100.8 billion, making them number seven on the Fortune 500 list of the largest companies in the country. This seemed even more impressive since just a year before their revenues totaled $40.1 billion. These factors helped Enron’s stock hit an all time high of $90 per share in August 2000.

In her book, Enron: The Rise and Fall, Loren Fox explains one way Enron grew so quickly. She points out that Enron made some misleading but legal accounting moves. For instance, they recorded the full value of each trade as revenue instead of the actual profit of each transaction. A simple example was given by Fox: If Enron bought $100,000 worth of natural gas, then immediately sold it for $101,000 they recorded $101,000 as their revenue instead of the actual $1,000. In addition to this, Enron hid
losses of more than $1.1 billion. By using special purpose entities (SPEs) Enron was able to have many undisclosed and risky trading operations in a way that did not accurately reflect their debt on financial reports. An SPE is usually a subsidiary company with a structure that keeps it secure even if the parent company goes bankrupt. A corporation can use these entities to fund projects without putting the entire firm at risk. Ordinarily, SPEs are perfectly legitimate, unlike in Enron’s case. The Generally Accepted Accounting Principles (GAAP) requires that a company account for SPEs in its financial statements unless two conditions are met: the SPE has to have an independent investor with at least three percent equity capital at risk throughout the existence of the SPE, and the independent owner has to be active in his or her control of the SPE (Sridharan, Dickes, and Caines 12-14). Many Enron SPEs, hiding significant losses, did not meet these requirements.

While senior executives used questionable accounting practices to hide the company’s financial troubles, Arthur Andersen, Enron’s accounting firm, colluded. Andersen was indicted and accused of obstructing justice when shredding documents. According to most news reports, the destruction was done at such a frantic pace that employees worked overtime and shredding machines could not keep up.

Jeffery Skilling and Kenneth Lay claimed that they relied on Enron’s accountants to advise them when it came to disclosing financial evidence. It is understandable for Lay and Skilling not to have been expert accountants; however, CEO’s of a Fortune 500 company not knowing the fundamentals of the transactions responsible for the majority of the company’s profits is not believable.
Their perceived success and complicated accounting activities made it very difficult for financial analysts to detect Enron's problems or even to understand what they were doing. An article in *Newsweek* quoted one company executive as saying that it is "impossible to understand what the company actually did." It was in 2001 that Enron's financial misrepresentations caught up with them.

One of the first steps to exposing Enron happened on August 15, 2001 when Sherron Watkins, an accountant at Enron, sent an anonymous memorandum to Ken Lay. She warned him of potential accounting scandals at Enron. Two months later the Securities and Exchange Commission (SEC), which has a responsibility to protect the investing public, began an investigation of Enron. On October 17, Enron changed its 401(k) pension plan so that employees could not sell the stock for the following month; this same rule did not apply to executives. This would prove to be disastrous to the employees as the stock began falling dramatically. As the SEC intensified its investigation Enron’s stock fell to $11 per share. Anticipating its own collapse, Enron attempted to make a deal to merge with Dynegy, its largest competitor. However, as Enron’s troubles mounted Dynegy rejected the merger. By November 2001, Enron Stock was trading at less than $1 per share.

On December 2 Enron filed for Chapter 11 bankruptcy protection. In filing Chapter 11, Enron was given a period of time to reorganize and recover from bankruptcy. During this time they laid off 4,000 employees. Enron employees greatly suffered financially since their 401 (k) retirement investments were in the valueless Enron stock. Andersen also collapsed after laying off 7,000 employees and losing major clients.
Perception of Business

In a speech last year, President Bush addressed the subject of misconduct at companies such as Enron: "Corporate misdeeds will be found and will be punished." A recent survey indicates that more than 7 out of 10 Americans don't trust CEOs of large companies. Almost 8 out of 10 say they believe that top executives will take inappropriate actions to benefit themselves at the expense of their organizations (Wright 150). One of the most significant reasons causing America's lack of trust is the way Enron executives showed no concern for their employees. Table 1 shows the shares sold by Enron's top managers, while their employees lost their retirement funds.

Table 1  Activities Before Enron's Collapse

<table>
<thead>
<tr>
<th>Name</th>
<th>Position at Enron</th>
<th>Shares sold</th>
<th>Proceeds from shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lou Pai</td>
<td>CEO</td>
<td>3,912,205</td>
<td>$270,276,065</td>
</tr>
<tr>
<td>Ken Lay</td>
<td>Chairmen</td>
<td>4,002,259</td>
<td>$184,494,426</td>
</tr>
<tr>
<td>Robert Belfer</td>
<td>Board of Directors</td>
<td>2,065,137</td>
<td>$111,941,200</td>
</tr>
<tr>
<td>Rebecca Mark</td>
<td>CEO</td>
<td>1,895,631</td>
<td>$82,536,737</td>
</tr>
<tr>
<td>Ken Rice</td>
<td>CEO</td>
<td>1,234,009</td>
<td>$76,825,145</td>
</tr>
<tr>
<td>Ken Harrison</td>
<td>Board of Directors</td>
<td>1,011,436</td>
<td>$75,416,636</td>
</tr>
<tr>
<td>Jeffrey Skilling</td>
<td>CEO</td>
<td>1,307,678</td>
<td>$70,687,199</td>
</tr>
</tbody>
</table>
The loss suffered by Enron employees was not the only effect of the company's decline in stock value. The reliable performance of mutual and index funds attracted the investment of many Americans' retirement's funds. More than twenty-five mutual funds listed in the S&P 500 Index were forced to include Enron stock in their investment portfolios since it was part of the S&P 500. Even worse, Enron was not dropped until late November 2001. This meant that the value of the stock went down over 99% before being removed from investors' portfolios.

Surprisingly, there were some portfolio managers who invested even more as Enron's stock fell, in hopes that it was going to recover. The asset firm with most invested in Enron was Alliance Capital Management, the investment manager for the Florida Retirement System (FRS). They bought 4.9 million shares of Enron between August and November 2001. Alliance sold 7.5 million shares two days before Enron filed for Chapter 11. It is estimated that FRS lost $281 million to $321 million. As a result, Alliance was fired. The American Federation of State, County and Municipal Employees, one of the largest employee unions in the nation, is investigating why the Florida State board allowed Alliance to continue purchasing Enron stock even as the SEC investigation was pending (Sridharan, Dickes, and Caines14-16).

Since mutual funds only release a list of their holdings twice a year, it is difficult to say for sure how many held Enron stock. Below is a table of institutions known to have invested in Enron as of September 30, 2001.
Table 2  
Investments in Enron

<table>
<thead>
<tr>
<th>Institutions</th>
<th>Number of shares held (million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alliance Capital</td>
<td>42.94</td>
</tr>
<tr>
<td>Janus Capital</td>
<td>41.4</td>
</tr>
<tr>
<td>Putnam</td>
<td>23.1</td>
</tr>
<tr>
<td>Barclays Global</td>
<td>23.1</td>
</tr>
<tr>
<td>Fidelity</td>
<td>20.8</td>
</tr>
<tr>
<td>Smith Barney</td>
<td>19.4</td>
</tr>
<tr>
<td>State Street</td>
<td>16.1</td>
</tr>
<tr>
<td>Aim</td>
<td>14.0</td>
</tr>
<tr>
<td>Vanguard</td>
<td>11.4</td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>10.1</td>
</tr>
</tbody>
</table>

*(Sridharan, Dickes, and Caines12-15)*

Since Enron has shown the vulnerability of capital markets, investor confidence has greatly decreased. There is less confidence in especially large businesses, objective auditors, financial analysts, and the SEC. This lack of confidence has also had a negative affect on our economy and stock market. Even organizations that perform well and have transparent financial statements do not have a stock that performs equally as well. One example is Fannie Mae. Although their revenue increased 21% in the first half of 2002
(compared to -2% for the S&P 500) its stock fell 17%. Even well established blue chip companies could not withstand the negative affects of Enron.

Companies such as General Electric, which is greatly admired and has not been accused of anything illegal, seems to have lost trust, and its stock has struggled. In a speech given by Bob Wright, Vice President and Executive Officer of GE, he blames the corruption of leading executives in America for their poorly performing stock. Despite performing well in the third quarter of last year, earning $4.1 billion, GE stock continued to fall. Moody’s Investors Service, whose analyses have a huge influence on investors, requested additional information from about 4,000 companies whose accounting methods are thought by Moody’s to make it harder to judge creditworthiness. To investors this is not a positive indicator. Furthermore, some companies are acting before they receive any criticism. Bank of America published a report extensively explaining a $418 million gain in the fourth quarter of last year. The gain in revenue was from a subsidiary established in 2000 to deal with problem loans. After bad loans were shifted to the subsidiary, they received a tax break, which resulted in the gain. By explaining this to analysts and investors, Bank of America’s stock went up 4% in the following week.

The ultimate challenge to businesses has been to restore the confidence of investors. Without the investment of citizens, many corporations would not be able to survive.
Affects on the Energy Industry

The collapse of Enron has especially affected the energy industry because it is being more tightly regulated. A congressional committee investigating Enron’s collapse, however, claimed that gross negligence on the part of the Federal Energy Regulatory Commission (FERC), the industry’s foremost regulator, was to blame. It is partly because of this that FERC will come down harder on energy firms. They have recently created the Office of Market Oversight and Investigations (OMOI), and doubled the number of employees overseeing the industry. In intensifying their investigation FERC has uncovered other misconduct.

The regulatory commission has also accused energy companies Williams Cos. Inc. and AES of driving up prices during the California power crisis in 2000. Furthermore, California legislators were told companies that publish energy prices, such as Dow Jones, were given false numbers by energy companies. Activities such as these have made it more difficult to receive financing, and have increased the demands for collateral (Economist 365.8300).

Because of this, banks have reevaluated the way they lend money to US power and natural gas industries, which has made credit hard to come by. During Enron’s success, there was a more open money market that permitted power plant projects to be easily financed. In contrast, currently one of the only ways to fund a project is with a long-term supply contract that guarantees consistent revenue. This is even more critical since a dramatic increase in demand for natural gas is predicted for the next decade. Energy companies have reacted to these problems with a sense of urgency.
Stock values of energy traders such as Mirant and Dynegy, which were once viewed as safe investments, have plummeted. Therefore, energy companies have been forced to work together to survive. A committee of chief risk officers from 31 firms met in November 2002 and set best-practice standards in corporate government, credit and risk management, and financial disclosure. Many firms are also considering mergers, although they fear that this could lead to downgrades in their credit ratings. Credit agencies like Standard & Poor's believe that many of the recently discovered problems at energy companies began with mergers and acquisitions. It is thought that extensive buying of utilities by companies, as Enron did in the early 1990's, is what led to the current debt in the energy industries (O'leary 12). This is another reason that many companies are not merging. For example, Cinergy Corp., an energy company in good financial condition, stated to investors that although the industry would benefit from consolidation, it is not planning any large deals. This is because of their concerns about being downgraded if they consolidate with another company. Also, the firms themselves are more concerned when merging, especially in a weaker company. This is because companies are more cautious of unknown hidden trading losses or irregular balance sheets, such as Enron's. Although companies cannot make the mergers and acquisitions they would like, many have been trying to improve their current situation.

In this attempt to recover, energy companies have started cleaning up their balance sheets. There have been billions of dollars worth of moves by leading energy companies to prove this:
• Dynergy issued shares to net $750 million and reduced spending by $500 million. It has also rolled over assets, raising several hundred dollars more. Dynergy has also bought Enron's Northern Natural Gas Pipeline for $950 million.

• The energy company El Paso sold $750 million of common stock, reduced capex, increased equity, renegotiated some of its debt and has sold about $2 million in assets.

• Williams sold 30 and 10-year notes to raise $1.5 billion. It has been able to reduce capex by $1.2 billion after selling their Kern River Gas Transmission Co.

(Haines 7).

Affects on Large Corporations

It was because Enron was such a big company that they were able to hide financial losses. Consequently, large companies have greatly suffered from Enron’s aftermath. Also, employees of large companies are less trusting of their companies.

A class action suit is being filed on behalf of the employees of Enron that lost their retirement funds. The Department of Labor has supported the class action with a 61-page legal brief clarifying existing law. The complaint details how Andersen provided false information that implied Enron was following the provisions of GAAP. This has sparked lawsuits across all industries and companies that offer their own stock in 401(k) plans are most susceptible.

Due to the concern of potential Enron situations, more employees are suing their companies, officers, directors, and accountants under the Employee Retirement Income Security Act (ERISA). As of November 2002, 115 suits have been filed against 35
companies claiming employees' 401(k) plans were not managed appropriately. Also, 22 other cases are in the process against companies like AOL Time Warner, Qwest, and Procter & Gamble (Nelson 60).

By the end of 2000, 19% of 401(k) assets were in company stock. Corporate lawyers are worried that their companies will get sued for unjust reasons, such as simply having a bad quarter. Forbes cites a few hypothetical scenarios given by Mark Ugoretz, president of the ERISA Industry Committee: A company offers a 401(k) that does not perform well and the employees sue the company for failing to maintain it. Another potential situation is if two companies merge and stop offering the less beneficial 401(k) plan. The negative affect of Enron even stretches to smaller non-profit organizations.

Many groups depended on Enron's donations for years. Therefore, there bankruptcy also had a negative impact on disease research programs, universities, and hospitals. One example is the cancer prevention clinic, which Enron created at the M.D. Andersen Cancer Center.

Insurance providers are also more concerned about their investment with companies since Enron collapsed. Premiums for liability insurance increased from 15% to 50% in 2001 (Semple 85). Applications for new and renewal insurance coverage have to be filled out in much more detail. The relationship between company and accounting firm has also become a large concern. Firms will have to address potential conflicts of conducting auditing and consulting for the same company. If a company does auditing and consulting, they will have a harder time obtaining affordable coverage.

Large companies are also finding that their creditworthiness is in question. In addition to requiring more information from companies, Moody's downgraded the credit
of 54 companies while only upgrading 12 the July following Enron's collapse. Those who were downgraded have found it harder to acquire capital in commercial paper. Companies that don’t have great credit, such as Tyco, a Bermuda-based conglomerate, have had to use their backup lines of bank credit, which is more costly. Partly due to its higher borrowing cost, Tyco issued a profit warning. This happened less than two months after Enron filed for Chapter 11. Furthermore, according to Economy.com, soon after Enron's problems were revealed, 27 cents out of every dollar of corporate cash flow was going towards interest payments. In contrast, during 1996 only 19.9 cents of every dollar were being used to pay for interest rates.

**Regulation**

The Mid-American Journal of Business stated that “the ‘asset-light’ strategy, the SPEs, and the off-balance-sheet financing . . . appear to be the root cause of Enron’s eventual failure.” Before this, most of the business world was in favor of deregulation. However, the failure of the current system of regulators to detect this has renewed the debate over deregulation and caused significant changes.

A few years after the stock market crash of 1929, the SEC was created. Before this there was very little support for government regulation of the stock market. However, investors lost confidence after the stock market crash. To help restore confidence, Congress passed the Securities Act of 1933 and Securities Exchange Act of 1934 (Sridharan, Dickes, and Caines12-15). The Securities Exchange Act of 1934 created the SEC. As was mentioned earlier, the SEC’s task is to protect investors and make sure that stocks, bonds, and other securities are ethically maintained. In doing this,
the SEC oversees corporate disclosure of information to the investing public. U.S. public firms with more than $10 million in assets and whose securities are held by more than 500 owners are required to file annual and quarterly reports with the SEC. The importance of these reports is to ensure the full and fair disclosure of financial information and the way business is conducted. Not only is the SEC responsible for making these reports available, but also for making them more understandable to investors. In their failure to detect Enron's collapse, the SEC has had to intensify regulation.

More specifically, credit-rating agencies have had to deal with increased scrutiny from regulators. The SEC held two public hearings in Washington to discuss the three largest agencies: Standard & Poor's (S&P), Moody's Investors Service, and Fitch Ratings. These hearings concentrated on the fact that agencies are being stretched too thin. Credit-agencies have been dealing in what the SEC feels are areas which they are not qualified to handle. Agencies' duty of rating debt securities has grown to responsibilities in which they are not knowledgeable enough to add enough value. Also, agencies are overcompensating for their oversight by acting too quickly in downgrading company's ratings to prevent more accusations. Last November several prominent French firms complained that rating agencies unfairly downgraded them, causing several debt crises.

The SEC itself is also being criticized for not preventing the Enron disaster. Harvey Pitt, the SEC's chairman during the Enron disaster, resigned in 2002. Although Pitt was believed to be very qualified, he lost the confidence of the SEC staff and the financial markets. A large reason for this is related to the failure of Enron. Pitt fought
against most congressional plans to increase audit regulation. It is because of this that the SEC did not have a large role in bargaining over the Sarbanes-Oxley act (SOA).

The Sarbanes-Oxley Act of 2002 was passed by Congress and signed into law by President Bush in late July 2002. The act is to promote the regulation of corporate America and accounting practices. SOA is intended to reassure investors that corruption of the capital market system in America will stop. It also raises the ethical and fiduciary standards for corporate executives and establishes a new regulatory system for the audit profession. One of the biggest changes made by the SOA is that CFO’s and CEO’s have to certify corporate financial reports. It also requires auditor independence. The act ensures this by not allowing auditors to do any non-auditing services such as bookkeeping, financial information systems design and implementation, appraisal or valuation services, actuarial services, and investment advisor or investment banking services. The act states that the SEC will thoroughly investigate the role of agencies to raise standards of corporate practice (Economist 365.8297).

Under SOA, the SEC now requires companies to explain off-the-books transactions that might have a significant affect on their financial position. This is a direct effect of Enron shifting their liabilities to off balance sheet “special purpose vehicles” whose existence was not disclosed to investors. In relation to this, the Financial Accounting Standards Board, which sets American accounting rules, has approved new rules requiring companies to combine things not in their accounts in a broader range of circumstances. Also, the SOA forbids auditors to conduct any non-audit services such as internal auditing or actuarial services. The only exception would be if it were sensible to conclude that the firm will not review the results of such work when auditing the client’s
financial statements. Another recent rule states that accounting firms must keep
documentation of audits for seven years. Also, the act prohibits companies from hiring
anyone who has worked as an auditor during the one-year period preceding an audit.
This significantly affects important positions such as the CEO, CFO, and controller.

The SEC has also changed rules about executive pay. The loopholes Enron used
that allowed upper-level managers time to report share sales if they were to repay a loan
to the company no longer exist. Also, executives can no longer sell shares while
employees are not given the same opportunity which was also taken advantage of by
Enron before there stock price fell. In addition to rule changes, groups of regulators have
been created and eliminated since Enron’s collapse (Reeves 31).

The most significant example of this was when the Public Oversight Board voted
to “terminate its [own] existence.” Established in 1977, the POB had the duty of
overseeing the accounting profession and assure investors and the rest of the public that
company’s financial statements were accurate. The POB made this decision after, then
SEC Chairmen, Harvey Pitt suggested that a new body be created. In a letter to Pitt the
POB stated “the proposals for changing the system of self-regulation of the accounting
profession do not include a place for the POB” (Williams 19).

Under the Sarbanes-Oxley Act, the Public Company Accounting Oversight Board
(PCAOB) was created, in place of the POB. The PCAOB is a five member group and is
under the supervision of the SEC. To add diversity to the group, only two of the five
members can be CPAs, even though some believe this takes away from the accounting
and auditing expertise of the PCAOB. Board members are required to be fulltime
employees of the PCAOB and are forbidden from receiving payments from public
accounting firms. The board is independent from the accounting industry and supervises the audit of public companies that were subject to securities laws and established and imposed auditing standards. While having the responsibility for oversight, the SEC also has the authority to appoint board members, review board actions, and modify the new boards authority. The oversight board is currently without a leader. It was proposed that a former judge William Webster be appointed chairman, but he had been involved in companies that had problems with the SEC. Another problem is that members of Congress are complaining that five board members will be earning over $400,000/each. Supporters of the high pay feel that it is necessary to attract the best employees (Global Agenda 1).

**Positive Affects**

The role of CEOs and CFOs are under a higher level of scrutiny and are forced to guarantee the honesty and ethical behavior of their companies. Due to the collapse of Enron, it is more difficult for companies to make unethical deals to influence the stock market. Basic and solid accounting principles are expected to return to the CFOs office and they will have to deal with increased scrutiny.

The CFO's duties as strategist, capital manager, and ambassador to investors are now even more important to the well being of the company. In addition, they will be involved in every aspect of the company: treasury and risk management; pensions and benefits; investor and public relations; information technology; operations; and human resources (Reeves 31). Previous to this CFO's had very little or no hand in these aspects.
These new requirements demanded of CEO's and CFO's comes from the Starbanes-Oxley Act. The most significant factor of the act is that these chief officers have to now sign off on financial statements and take criminal responsibility for failure to reveal certain information, whereas before they were not as liable. CEO's and CFO's must certify that:

• They have reviewed the report
• The report contains no false statements, does not leave out relevant information, and is not misleading
• Financial data within the report is accurately represented as of the date and for the period of the report
• Any flaws in the design or operation of internal controls have been revealed to the auditor and audit committee of the board of directors
• Internal controls are being maintained in an effective way

(Semple 97)

In requiring this, CEOs and CFOs have to be aware of the process used in coming up with numbers and make sure the procedures are working. Since this requires that management get information, evaluate it and confirm that it abides by SEC regulations they will have had to become involved in more aspects of business. The Sarbanes-Oxley Act also forbids companies from punishing whistle-blowers.

After Sherron Watkins expressed her concern to Kenneth Lay about Enron’s financial misdeeds, Lay contacted external lawyers to see if she could be fired. He was then informed that Texas did not protect whistle-blowers from termination. Although Watkins was not fired after warning Lay, she was punished. The hard drive of her
computer was confiscated and she was demoted from her executive suite to a “rickety metal desk and a pile of make-work projects” (Morse, Bower 53). Since Watkins has spoken out there have been changes in laws regarding whistle blowers.

At the urging of the SOA, Congress and state legislators have passed laws that offer protection for whistle-blowers from the retaliation of their employer. Not only does the Sarbanes-Oxley Act offer protection to employees of publicly traded companies who report misconducts, the Ohio State Revised Code is one that also protects against employer retaliation. There are also statutes, known as Qui Tam laws, which allow people to take legal action against companies that are deceiving the public treasury. A successful Qui Tam plaintiff is entitled to a large share of the recovery against the defendant.

Under Qui Tam, it is required that each public company in the U.S. has a board of directors to supervise management. It is the responsibility of each director to act in the best interests of the company. If a member of the board of directors is aware of unethical practice at the company they can also be held liable. Each board of directors has an audit committee. Usually an audit committee will select the company’s external auditors and recommend their salaries. The audit committee is also expected to review the external auditor. This includes reviewing annual statements and ensuring that reports abide by GAAP. Now, because of the Sarbanes-Oxley Act, the board of directors’ audit committee has more work to do. SEC requires audit committees to review and talk about the audited financial reports with the companies management and independent external auditors, previously this was not as required. One member of the group now has to have an auditing background. They must use their auditing skills to question every transaction.
Companies are allowed to hire an independent team to advice them and to thoroughly question the committee.

Steve Shapiro, a senior vice president at Burlington Resources, claims that many changes have taken place at his company. The number of people that now have to sign off on financial statements is 20 and they have composed a disclosure committee to make sure investors have the information necessary. In addition, a governing committee makes sure of the capability of the members and creates committee assignments. The company has also created a communications system with more meetings to ensure the correctness of reports and to provide tangible proof that they have met legal requirements of the act.

The field of records and information management (RIM) has also changed as a result of the corruption at Enron. The jobs within this profession are relied on to provide things such as strategic information and global knowledge. Companies are no longer able to retain, share, and store information in traditional ways; they must, like most other aspects of business, be updated and intensified. RIM professionals are under more scrutiny from senior management. The managers know need to know everything that's being done, who is doing it, and how well they are doing it. Because of this, RIM managers are forced to work with people at a higher level in the organization. Also, instead of dealing with the tactical and operational aspects of information they know they have to think more strategically. The collapse of Enron has proved that information managers have to be knowledgeable about things outside of their own organization, which is why they must work from a more global perspective. Another added responsibility is that information managers must be prepared to be disaster recovery managers in addition to their regular work (Ayres 36-40). Furthermore, one of the most
significant positive changes is Title VIII of the SOA, the Corporate Fraud Accountability Act (CCFA).

The CCFA establishes penalties for illegal shredding and altering of documents, added protection for whistle-blowers, demand that auditing records be kept for five years, and prevents violators of securities laws from using bankruptcy to avoid liability. Before this the law against destruction of financial evidence was not very clear and contained many loopholes. For instance, it was a crime for someone to persuade another to destroy documents; however it was not illegal if that person destroys the same evidence.

The CCFA is intended to close loopholes revealed by Enron and Arthur Andersen. No official charge of tampering existed in order to charge Arthur Andersen. Instead they are being accused of witness tampering. In addition, these new rules are not limited to registered public accounting firms, publicly traded companies, or investment banking firms; they apply to every individual and organizations that retain records. A provision added to the code imposes a fine and/or imprisonment of up to 20 years for “whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence an investigation or proceeding by a federal department or agency or any case filed in bankruptcy (Tillman 12-15).”

In addition, the act is intended to prevent corporate fraud, protect people from fraud, and hold people responsible for corporate fraud. CCFA also forbids debt due to violation of securities fraud laws from being disregarded in bankruptcy.

Another positive is that investors are forcing not just the energy industry, but also other large companies, to clean up the way they do business. These changes have been
made in making financial statements more transparent since investors are steering clear of companies that have faulty or confusing financial statements. Companies are now quickly restating their balance sheets and making them more understandable and visible to investors.

As a result of the eye-opening collapse of Enron, many necessary changes have been made in the business world. America will look back on the difficulties resulting in the energy company’s downfall as a necessary step in making these changes. The severity of Enron’s collapse has forced us to reexamine the way business is conducted. Most importantly, the Sarbanes-Oxley Act, has made upper level management more accountable for their actions. When the top level of an organization sets ethical performance standards high, it trickles down to the rest of the company.

Also, many companies have gone to great lengths to clean up their financial statements. In the long run this will improve company performance. Eventually, a higher quality of performance will lead to better competition.
Works Cited


