quest. He predicts that Alison will begin seeing

CASE 2. *Accounting for Enron*

Enron Corporation has come to symbolize the worst of recent corporate corruption scandals. Billions of dollars were lost by investors, and thousands of people lost their jobs and their retirement savings when the one-time seventh-largest United States corporation went bankrupt, the largest bankruptcy in history at the time, as a result of the fraud

From Joseph R. DesJardins and John J. McCall, *Contemporary Issues in Business Ethics*, 5th ed. (Belmont, CA: Thompson Wadsworth, 2005).

created by its highest-ranking executives. But the story of Enron is also the story of a failed watchdog system designed to prevent such fraud. Auditors, attorneys, and government officials who had responsibilities to protect investors and ensure the integrity of financial markets systematically failed to live up to their responsibilities.

Enron's collapse began in 2001 when some independent stock analysts and journalists publicly raised questions about the value of Enron's stock. At that time, Enron's stock was trading at more than $80 a share, and Enron's CEO Jeffrey Skilling was publicly claiming that it ought to be valued at well over $100 a share. During the summer of 2001, several Enron insiders, including Vice Chair Clifford Baxter, Treasurer Jeff McMahon, and Vice President Sherron Watkins, all expressed doubts internally about Enron's financial practices. During this same period, other Enron insiders, including CEO Skilling and Board Chair and former CEO Kenneth Lay, Enron's corporate counsel, and several board members were selling millions of shares of Enron stock.

In October 2001 when Arthur Andersen auditors finally reversed their previous decisions and restated Enron's financial situations, the collapse of Enron began in earnest. By December, when its stock was worth just pennies a share, Enron declared bankruptcy and dismissed over 4,000 employees.

Enron's collapse was mirrored by the collapse of its auditing firm, Arthur Andersen. Once one of the "Big Five" accounting firms, Arthur Andersen was driven out of business by its role in the Enron scandal. On January 9, 2002, the United States Justice Department announced that it had begun a criminal investigation into Arthur Andersen's activities related to Enron. At the time, Arthur Andersen was already on probation by the SEC for its questionable accounting practices in previous scandals at Sunbeam Corporation and Waste Management. The next day, Andersen admitted that it had shredded thousands of documents related to its Enron audits. Five days later, Andersen fired David Duncan, an Andersen partner and head auditor for Enron. Soon after, the Justice Department indicted Arthur Andersen on charges of obstruction of justice. Finally, on June 15, 2002, Arthur Andersen was found guilty in a criminal trial of obstructing justice by shredding evidence relating to the Enron scandal and, as a result, the firm agreed to cease auditing public companies by August 31.

Records show that as early as May 1998, Andersen's auditors were expressing grave concerns about Enron's financial practices. On that date, in an e-mail to David Duncan, Benjamin Neuhausen, a member of Andersen's Professional Standards Group, expressed his thoughts on the Special Purpose Entities (SPEs) that were at the heart of the Enron scandal. "Setting aside the accounting, [sic] idea of a venture entity managed by CFO is terrible from a business point of view. Conflicts of interest galore. Why would any director in his or her right mind ever approve such a scheme?" Neuhausen then went on to highlight the many accounting problems with the SPEs being managed by Enron CFO Andrew Fastow. Duncan replied, "But first, on your point 1 (i.e. the whole thing is a bad idea), I really couldn't agree more." Nevertheless, the Andersen auditors continued to cooperate with Enron by attesting to the soundness of Enron's financial statements.

In February 2001, more than a dozen Andersen auditors once again met to discuss the financial status of Enron's SPEs. Evidence shows that Andersen's auditors had serious concerns about the validity of Enron's financial self-portrait. In light of these concerns, they considered dropping Enron as an audit client. Michael Jones, one of Andersen's Houston employees, summarized the meeting in an e-mail to David Duncan, who also participated. Jones' notes reveal "significant discussion