



Rush to judgment: the lynching of Arthur Andersen & Co.

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Received 21 November 2002; received in revised form 4 April 2003 and
3 November 2003; accepted 1 January 2004

Abstract

Since the bankruptcy of Enron, many concluded—before sufficient facts were available to form a reasoned judgment—that Andersen was responsible for the debacle. As the facts have been uncovered, it is clear that the destruction of Andersen, the censure of the public accounting profession and the host of new regulations regarding CPAs are all based on a theory unsupported by facts.

This study explores the publicly available evidence regarding Enron and Andersen, as well as the actions of politicians and financial institutions. The facts show that Enron officers committed fraud within off-balance sheet partnerships (SPEs) with the willing assistance of various prominent financial institutions. Neither the SPEs nor the financial institutions were audit clients of Andersen. Further, the SEC granted Enron a special exemption to investor protection laws, thus allowing Enron to set up the SPEs and setting the stage for the fraud.

The Department of Justice rushed to indict Andersen for obstruction of justice. The evidence shows that Andersen personnel destroyed duplicate copies of old memos, old magazines and requests for charitable contributions and these were destroyed before the SEC had issued any subpoena to Andersen or even discussed the possibility of such a subpoena with Andersen. In contrast, the Department of Justice gave misleading testimony, engaged in leaks, allegedly threatened witnesses and admitted in Court that it had failed to review the most crucial evidence, Andersen's audit workpapers.

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Keywords: Enron; Andersen; Audit; Corporate collapse; Special purpose entities; Corporate governance; Financial statement fraud; Auditor independence

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1. Introduction

The floundering economy of the past 24 months has uncovered an appalling amount of corporate fraud, wreaking untold damage on shareholders and employees and causing a loss of confidence in our market system. The series of frauds and the government's response to those frauds have serious and wide-ranging consequences to the stability of our financial system.

The collapse of Enron followed the restatement of Enron's financial statements to reflect the consolidation of the off-balance sheet partnership (SPE), Chewco, which had been accounted for incorrectly because of fraudulent representations to Enron's auditor, Andersen. The disqualification of Chewco as a non-consolidated SPE in turn disqualified JEDI, in which Chewco was a limited partner, from non-consolidation.

- It is important to note Andersen's actions immediately upon discovery of the fraud. Andersen (1) notified the SEC and the Justice Department, (2) withdrew its audit opinion and (3) required Enron to issue corrected financial statements.

Auditors do not test every transaction because to do so would be prohibitively expensive, thereby eliminating corporate profits. Auditors analyze a client's system of internal controls designed to prevent error and fraud and then test transactions to determine if the system of internal control is being followed. Auditing is thus a statistical sampling process depending on a high degree of judgment. If the scope of the testing of internal controls is reasonable and if that testing shows minimal or no exceptions to the internal control system and if the balances being tested are corroborated by what are considered reliable third parties, a CPA signs off that the client's financial statements "fairly present" the client's financial condition. However, statistical sampling clearly cannot provide pinpoint accuracy. Further, the fraudulent collusion of employees, particularly if aided by supposedly reliable outside third parties such as banks, brokerages and law firms, cannot be detected in any audit.

When the Chewco fraud became apparent, Andersen intensified its review of other transactions. That review indicated that Swap Sub, the subsidiary of another SPE, LJM1, should have been consolidated with LJM1 because Swap Sub did not meet the 3% residual equity required for non-consolidation. In evaluating the residual equity level, there were some "complex issues concerning the valuations of various assets and liabilities" (Berardino, 2001). Andersen promptly notified Enron and properly took responsibility for the error. This error accounts for US\$ 100 million or 20% of the restatement.

Shareholders' equity was incorrectly presented on Enron's balance sheet for 2000 and in two unaudited quarters in 2001. In 2000, Enron recorded US\$ 172 million as an asset rather than its correct presentation as a reduction in shareholders' equity. The US\$ 172 million misstatement was "less than one-third of 1% of Enron's total assets and approximately 1.5% of shareholders' equity of US\$ 11.5 billion and had no impact on earnings or cash flow and therefore fell below the scope of the audit" (Berardino, 2001). In the first quarter of 2001, Enron accounted for several similar transactions in the same way, increasing the misstatement of shareholders' equity by about US\$ 828 million (Berardino, 2001). Since audited quarterly financial statements are not required, these errors were not detected until Enron closed out the transactions during the third quarter. Andersen had previously discussed with Enron accounting staff the proper accounting treatment for such transactions

and had set the audit scope accordingly (Berardino, 2001). In light of the pattern of fraud that subsequently unfolded at Enron, one has to wonder whether Enron's misstated shareholders' equity was accidental or deliberate.

As a result of the restatement to consolidate the SPEs, Enron was required to address proposed adjustments that were not made during the periods subject to restatement. Auditors typically propose adjustments at the conclusion of the audit work—usually 1 or 2 months after year-end. Like many companies, Enron books adjustments after year-end when the amounts are deemed immaterial.² This represents a timing difference. Therefore, if the US\$ 51 million of 1997 adjustments booked in 1998 are re-booked to 1997, they should properly be reduced by the 1996 adjustments booked in 1997.

Adding fuel to the fire of the accounting revelations were charges of insider trading. Amalgamated Bank, a pension fund manager, filed suit in U.S. District Court asserting that insiders gained about US\$ 1.1 billion from the sale of more than 17.3 million shares of Enron over the prior 3 years (Reuters, 2001). According to the lawsuit, Lou Pai, Chairman and CEO of Enron unit, Enron Accelerator, allegedly gained the most from insider trading of Enron shares, reaping US\$ 353.7 million (Reuters, 2001). Ken Lay posted a gain of US\$ 101.3 million, the second highest (Reuters, 2001). Enron's market value—peaking at almost US\$ 80 billion in August, 2000—had plunged to less than US\$ 1 billion by December 2001 (Reuters, 2001).³

In contrast, Enron's 20,000 employees and retirees were temporarily blocked at a critical time from selling stock held within their 401(k) accounts because Enron had hired a new plan administrator. A temporary lockdown in order to transfer data to a new administrator is routine. However, from October 26, 2001—the last trading day before the lockdown—until November 12, 2001 when the lockdown ended, the stock dropped from US\$ 15.40 to 9.24 (Ivanovich, 2001a). The stock had approached US\$ 90 twelve months earlier (Ivanovich, 2001a). Although the 401(k) plan offered a selection of mutual funds in addition to Enron stock, participants had chosen to invest about 63% of the plan's assets in Enron stock (Ivanovich, 2002a). The failure to diversify their investments had disastrous consequences for many individuals. Enron's defined benefit retirement plan had assets of about US\$ 270 million, none of it invested in Enron shares (Ivanovich, 2002a).

The fact that the executives were selling stock that they owned outside their 401(k) accounts while the employees' and retirees' stock was held inside temporarily frozen 401(k) accounts created a "rags versus riches" scenario. It also created hysteria.

Enron experienced both a cash and credit crunch. Enron's debt was downgraded to junk status (Davis, 2001). Enron Online, which handled about 60% of Enron's trading business (Davis, 2001) or about US\$ 2.8 billion a day in trading (Davis, 2001), halted trading. Enron's subsequent bankruptcy on December 2, 2001 was at that time the largest bankruptcy in history.

² In accounting terms, an item is material if it is of such significance that it will affect the decision of whether or not to hold a stock. For example, while US\$ 10 million would certainly be material in assessing the financial condition of most individuals, in the context of a multi-billion corporation such as Enron, a US\$ 10 million timing difference would be immaterial.

³ As of November 11, 2003, there was nothing in the public record that Mr. Pai or Mr. Lay either did or did not have knowledge of the fraud.

The combination of politicians trying to distance themselves from political favors given to Enron (a major donor to both political parties) and the feeding frenzy of a media for whom a big story translates into profits created a mob mentality. Rather than uphold the rule of law, the cornerstone of which is the presumption of innocence, the government and media crucified Andersen by smear while Andersen was silenced by a Justice Department gag order. The final execution was the Justice Department's indictment of Andersen on the charge of obstruction of justice.

Two questions need to be addressed:

- (1) Did Andersen participate in the Enron fraud?
- (2) Did Andersen obstruct justice?

To find the answers, we must examine facts which even today have been overlooked or perhaps deliberately hidden.

I. Andersen was not the auditor of the partnerships—Chewco, LJM1 and LJM2—where the frauds were committed.

Instead, the LJM1 and LJM2 partnerships were audited by accounting rival, KPMG. Chewco was apparently not audited. Does that mean that KPMG was party to the frauds? No, it does not. One would have to review the audit workpapers to determine KPMG's responsibility, if any.

Andersen was also not hired to audit the SPEs that were eventually folded into Chewco, LJM1 and LJM2. For example, Andersen was not the auditor of RADR, Southampton, Raptors I, II, III or IV, Delta, Mahonia, Braveheart, Slapshot, Fishtail, Nighthawk, Roosevelt or Bacchus, to name just a few.

Andersen also did not prepare Enron's tax return, which was prepared in-house by Enron employees. Andersen has been criticized for assisting Enron on two tax transactions—Tanya and Valor—that saved Enron US\$ 148 million in taxes. The two transactions were, in substance, identical and resulted in deducting the same expenses twice. What was not mentioned by politicians or the media were the facts that (1) the deals were legal and the Internal Revenue Service approved the transactions ([Joint Committee on Taxation, 2003, p. 123](#)), and (2) it required a change in the tax law to eliminate this technique ([Joint Committee on Taxation, 2003, p. 131](#)).⁴

In an audit, auditors ask detailed questions about major transactions and request all documentation regarding those transactions. Further, they ask that the parties assert in representation letters that all information and documentation relating to the transaction have been given to the auditors.

However, the fact that Andersen was not the auditor of Chewco or LJM1 and LJM2 (hereinafter referred to as LJM) means that Andersen did not have access to any documents *within* these entities, including the partnership agreements identifying the partners. Thus, Andersen was forced to rely on assertions, letters of representation and confirmation of loan balances from individuals within Enron, the Chewco and LJM partnerships and the banks and brokerages with which the partnerships did business.

⁴ Also see I.R.C. Section 358(h)(1).

If Andersen had been the auditor of Chewco and LJM, individuals in these entities might still have successfully colluded to defraud both Andersen and the Enron shareholders. However, Andersen would have at least been in a position to correctly identify the Chewco and LJM partners who were Enron personnel. It was this hidden ownership by Enron employees in Chewco and LJM that caused the SPEs to be related parties to Enron.

(1) Did the government know that Andersen was not the auditor of Chewco and LJM when Andersen was summarily executed? Should they have known?

- On October 31, 2001, Enron announced that the SEC inquiry had been upgraded into a formal investigation focusing on off-balance sheet partnerships (hereinafter referred to as SPEs) (Fowler, 2001a), namely Chewco and LJM. On December 11, 2001, it was announced that an investigation by the Justice Department was under way (Flood, 2001). Surely one of the first orders of business would be to determine the correct identity of the auditor of the partnerships under examination.
- On January 17, 2002, Andersen made a statement regarding the Client Retention Memo of February 6, 2001 that was being widely quoted out of context in the media.⁵ Listed in the section of the memo labeled “Take away To Do’s” is the statement regarding LJM that has been strangely ignored. To quote,

Why did Andy (Fastow) not select AA [Andersen] as auditors, including when PwC [PricewaterhouseCoopers] was replaced by KPMG. Discussions concluded that we would likely not want to be LJM’s financial advisors given potential conflicts of interest with Enron. (Jones, 2001)

- By January 20, 2002, at least nine congressional investigations were focused on Enron (Hedges, 2002).
- On February 7, 2002, Thomas Bauer, Andersen partner, testified before the House Committee on Energy and Commerce. His testimony described how the fraud within Chewco was committed by means of a hidden side agreement that reversed the appropriate accounting for the transaction. Had the side agreement not been hidden, Chewco would have been properly consolidated with Enron. Further, Bauer’s testimony indicates that Andersen was not Chewco’s auditor. To quote,

I also requested that I be provided documents relating to Chewco’s formation and structure. Mr. Glisan told me that Enron did not have these documents and could not obtain them because Chewco was a third party with its own legal counsel and ownership independent of Enron. (Bauer, 2002)

⁵ Memorandum written by Michael D. Jones addressed to David B. Duncan and Thomas Bauer, all of Arthur Andersen, February 6, 2001. The mention of potential fees was in the context of a concern about independence. To quote,

We discussed whether there would be a perceived independence issue solely considering our level of fees. We discussed that the concerns should not be on the magnitude of the fees but on the nature of fees. We *arbitrarily* (emphasis added) discussed that it would not be unforeseeable that fees could reach a US\$ 100 million per year amount considering the multi-disciplinary services being provided. Such amount did not trouble the participants [of the Andersen conference call] as long as the nature of services was not an issue.

If Andersen were the auditor of Chewco, Bauer would not be asking Enron employee, Ben Glisan, for Chewco documents. Instead, Bauer would have been requesting access to Chewco documents from Chewco personnel.

- On February 15, 2002, *Business Week* published an article which included the paragraph,

Some documents associated with LJM2 identified PricewaterhouseCoopers as the partnership's auditor. A December, 1999 memo prepared by Merrill Lynch to help sell a US\$ 200 million private placement of LJM2 partnership interests listed the firm (PwC) as LJM2's auditor. In fact, KPMG was the auditor. The PwC spokesman says his firm didn't even bid for the audit contract. (McNamee and Timmons, 2002)

In summary, the SEC, the Department of Justice and numerous congressional committees all had full access to the Andersen audit workpapers of Enron. Is it possible that not one individual in all those government investigations bothered to inquire as to the identity of the auditors of the SPEs? Failure to correctly identify the auditors constitutes gross negligence. The only other plausible explanation is that all these investigators knew full well that Andersen was not the auditor of the fraudulent SPEs but hid the truth so that Andersen would be wrongly blamed.

Long before the indictment, the media also had the facts to conclude that Andersen was not the auditor of either Chewco or LJM. Yet the February 15, 2002 *Business Week* article is apparently the only media reference to date that sought to identify the correct auditor of any of the SPEs.

Amazingly, neither the Powers Report (Powers, 2002), the government reports on *The Report on the Role of the Board of Directors in Enron's Collapse* (Governmental Affairs, 2002a), *The Role of Financial Institutions in Enron's Collapse* (Governmental Affairs, 2002b), *Financial Oversight of Enron: The SEC and Private-Sector Watchdogs* (Governmental Affairs, 2002c), the Report of the Enron Directors' Response (Eggleston and Nionakis, 2002) nor the first three interim reports of the Bankruptcy Examiner (Batson, 2002; Batson, 2003a,b) mention the correct identity of the auditor of the fraudulent SPEs. How can one account for the oversight of such a basic yet crucial fact?

(2) It is unclear whether the Enron Board of Directors was aware that Andersen was not the auditor of either Chewco or LJM.

The outside Enron Directors, who along with Andersen were repeatedly lied to by Enron management, stated they believed Andersen would review the SPE transactions to provide a safeguard (Powers, 2002, p. 153). Andrew Fastow presented the ideas for the Chewco transaction in an Executive Committee meeting by conference call (Powers, 2002, p. 149) and for the LJM2 transaction in a Finance Committee meeting also not attended by Andersen (Powers, 2002, p. 153). Fastow's presentation included assurances that Andersen would be overseeing the transactions. Andersen was not present to caution the Directors on the severe constraints on anybody other than the auditors of the SPEs to examine specific SPE transactions concerning banks, brokerages and other third parties. Apparently, the Directors relied on Fastow for their understanding of Andersen's responsibilities and never raised the issue with Andersen.

Andersen advised Enron on the proper criteria for determining whether an SPE should be consolidated. However, determining the criteria for the proper accounting treatment should not be confused with the responsibility for auditing the specific transactions of an audit client.

Were the Directors aware that Andersen as the auditor of Enron could only audit the transactions from the perspective of Enron? The frauds took place within Chewco and LJM with the assistance of numerous financial institutions. Neither Chewco, LJM nor any of the other parties to the fraud were Andersen clients. Thus Andersen had no access to the SPEs' accounting records or documentation. Andersen was forced to rely on confirmations and oral and written representations (all of which were inaccurate) from the SPEs and third parties.

One can hardly blame either Andersen or the Enron Directors for failing to foresee that so many supposedly reputable financial institutions (and possibly lawyers) would assist Enron management in "cooking the books." While the structure of these SPEs were far from optimal, they were structured according to both SEC and Financial Accounting Standards Board (FASB) dictates which left auditors dependent on the truthfulness of third party representations. Until the Enron debacle auditors generally regarded representations from financial institutions as reliable. Obviously that assumption was tragically incorrect.

Perhaps the Directors assumed that they had engaged Andersen to audit both Chewco and LJM. In a discussion of internal controls, the Powers Report cited the Andersen engagement letter for the year 2000 (Powers, 2002, p. 154). An engagement letter is written by a CPA firm to detail its understanding of its contractual responsibilities. Thus the Andersen engagement letter would have listed by name the entities that Andersen was being hired to audit. If Andersen had listed Chewco and LJM as their auditing responsibility, Mr. Powers would most certainly have mentioned it. However, he did not.

The Powers Report states that "although Andersen reviewed the [Chewco] transaction at the time it occurred, we do not know what information the firm (Andersen) received or what advice it provided" (Powers, 2002, p. 53). The only relevant facts regarding the quality of an audit are (1) the information sought by the auditor, and (2) the information received in response. By his own admission, Dean Powers did not have the relevant facts necessary to reach a valid conclusion because those facts can only be determined by a knowledgeable and comprehensive examination of the audit workpapers.

Nevertheless, the Powers Report concludes that since Andersen charged fees for reviewing the transaction, Andersen must be at fault. This leap in logic ignores the fact that an auditor must examine a client's books without recourse to subpoena or other means of legal enforcement. If employees of a client withhold vital information AND supposedly reputable and independent third parties assist by also hiding information, then no auditor can uncover the fraud until it collapses of its own weight.

The Board of Directors and the Powers Report blame Andersen for not uncovering the fraud in the SPEs. However, one can only conclude that the Board either mistakenly thought they had hired Andersen to audit the SPEs or they knew that they had not hired Andersen and sought to blame Andersen anyway. In either case, the Board and the Powers Report lack credibility in their condemnation of Andersen.

Further, the conclusions of the Powers Report regarding Andersen have no foundation because the most crucial facts regarding the audit—the information given Andersen which

is carefully detailed in the audit workpapers—are not examined. To reach any conclusion regarding the quality of an audit without this vital information is irresponsible.

In summary, the Powers Report has two fatal flaws: (1) it omits the material fact that Andersen was never hired to audit any of the SPEs, and (2) its conclusions regarding Andersen's audit are without foundation since none of the relevant facts were examined.

II. The frauds were committed *within* the Chewco and LJM partnerships and could only have succeeded with the help of supposedly reputable financial institutions. How did they do it?

(1) Chewco

Chewco was a partnership formed to acquire the 50% interest in the JEDI partnership owned by the California Public Employees Retirement System. In order for Chewco to qualify as an SPE subject to non-consolidation, at least 3% of its capital had to be at-risk and attributable to entities independent of Enron. In addition, neither Enron nor a related party of Enron, such as an employee, could control Chewco.

Enron personnel provided Andersen a copy of a loan agreement between Chewco and JEDI that both in its verbiage and its provisions regarding both capital and control required Chewco's non-consolidation with Enron. Yet on the very same day, the very same people signed a side agreement that reversed the provisions of the original agreement, requiring the partnership to be consolidated (Bauer, 2002). Because Andersen was not the auditor for Chewco, Andersen did not have direct access to the agreements and therefore had to rely on the integrity of Enron personnel.

Andersen requested all documents and reviewed Board minutes pertaining to the transaction. Andersen also requested and was given representation letters from both Enron and JEDI, stating that all related party transactions had been disclosed and that all financial records and related data had been made available to Andersen (Bauer, 2002). Nevertheless, the side agreement was hidden from Andersen until November 2, 2001 (Bauer, 2002). One might conclude that the lawyers who drew up the side agreement and the individuals who signed it are guilty of fraud.

(2) LJM

The many frauds perpetrated in the LJM partnerships used a different technique. Time after time, the personnel in the LJM partnerships were able to convince supposedly reputable financial institutions to “provide funds and supporting paperwork, set up sham offshore trading partners” (Roach, 2002) and resort to *oral* side agreements (Governmental Affairs, 2002d) in phony “prepay” transactions so that Enron could characterize the funds as cash flow from operations or equity transfusions rather than loans (Roach, 2002).

This is amazing. First, by not demanding a written loan agreement, the financial institutions jeopardized their ability to collect from Enron, thus breaching their fiduciary responsibility to their own shareholders. Second, as the financial institutions well knew, oral agreements leave no audit trail and thus cannot be audited. Why would financial institutions be willing to resort to oral loan agreements, thus endangering their ability to collect from Enron? Was it to help Enron to defraud Andersen? Query: has anyone ever known a bank or brokerage to lend even US\$ 10 without a signed document? Yet Enron was able

to borrow billions without signing any loan agreement. If there is an innocent explanation, what is it?

Several of the banks in question have asserted that they were told that Andersen had blessed the transactions (Batson, 2003b, Appendix D, p. 143).⁶ Do the banks have written opinion letters from Andersen stating that it is proper to enter oral side agreements that change the nature of a transaction from a sale or an equity investment to a loan? Or did the banks rely on an Enron officer's assertion that Andersen blessed the transactions? Whatever Enron officers may or may not have told the banks has no bearing on Andersen's responsibility. Andersen is responsible only for what Andersen people told the banks, if anything.

Andersen documented its criteria for the proper accounting for prepays in a memo dated June 1999 (Turner, 2002). According to the testimony of Mr. Lynn Turner, former Chief Accountant for the SEC, Andersen's criteria were correct (Turner, 2002). Andersen criteria for valid prepays focused on the necessity of the transactions being between independent entities with economic substance entering into substantive business contracts (Turner, 2002). Andersen criteria for valid prepays do not endorse the use of oral side agreements to hide loans from shareholders and creditors.

Prior to the transactions, Andersen also discussed the "sale of assets by Enron through several steps to an SPE that was not consolidated on Enron's financial statements" with the SEC. The SEC confirmed that "non-consolidation of SPEs and sale treatment are consistent with GAAP (generally accepted accounting principles)" (Batson, 2003a, p. 39).

Evidence shows that Andersen questioned the independence of the trading partners and requested letters from them representing that they were independent operational businesses apart from both the banks and Enron. Andersen was provided those letters despite the fact that the trading partners were not independent from the banks (Roach, 2002). Dishonest representation letters defrauded both Andersen and the Enron shareholders.

- JP Morgan Chase (Chase) and LJM engaged in at least 12 sham "prepay" transactions, with a combined value of more than US\$ 3.7 billion (Roach, 2002).
- Citigroup and LJM engaged in at least 14 sham "prepay" transactions, with a combined value of at least US\$ 4.8 billion (Roach, 2002).
- Evidence shows that not only did Chase and Citigroup structure these phony deals with LJM but the banks started selling Enron-style "prepays" to other companies. Chase informed the Governmental Affairs Permanent Subcommittee on Investigations that Chase had entered into Enron-style "prepays" with seven companies apart from Enron (Roach, 2002). Citigroup admitted that it sold the idea to at least three companies in addition to Enron (Roach, 2002).

⁶ According to Appendix D to Examiner's Report (Role of Citigroup and its Affiliates) (In Re: Enron Corp.) July 28, 2003, p. 143, "Current and former Citigroup employees testified that Enron told them that Andersen had approved a particular transaction or aspect thereof, but none of these individuals had any recollection of having talked directly with Andersen in its capacity as Enron's auditor and they consistently testified that to do so would have been highly unusual for Citigroup." Appendix I to Examiner's Report (Role of Merrill Lynch and its Affiliates) (In Re: Enron Corp.) July 28, 2003, p. 40 states that Merrill Lynch employees "asked to speak directly to Andersen regarding the accounting issues [re: 1999 electrical trades]. Causey [Enron's Chief Accounting Officer] opposed this request. The [Merrill Lynch committee] then requested, as a condition for approval of the transactions, that Causey provide a letter to Merrill Lynch warranting that Andersen had approved the transactions . . . Causey did so and the deal was closed."

- Enron SPEs also engaged in sham “prepays” with other banks over the last 10 years, including Barclays, CreditSuisse First Boston, FleetBoston, Royal Bank of Canada, Royal Bank of Scotland and Toronto Dominion, with an estimated combined value in excess of US\$ 1 billion (Roach, 2002).
- Merrill Lynch also participated in sham transactions where the documentation supported what appeared to be sales by LJM but were in reality loans (Roach, 2002).
- Merrill Lynch was private placement agent for LJM2, helping raise over US\$ 390 million from outside investors (Ivanovich and Fowler, 2002a). Schuyler Tilney, Managing Director of Merrill Lynch’s Global Energy and Power Group, had key role in Merrill Lynch’s decision to invest in a SPE to operate power generators off Nigerian coast (Ebage) (Ivanovich and Fowler, 2002a). Tilney’s wife, Beth, is former Enron executive (Ivanovich and Fowler, 2002a). Nearly 100 Merrill Lynch executives invested in LJM2 (Ivanovich and Fowler, 2002a).

In summary, selected personnel at Chase, Citigroup and Merrill Lynch were all willing to assist Enron personnel within LJM in order to enable Enron to misstate its financial condition. In order to do so, they intentionally failed to document key elements of transactions that would have totally reversed the accounting of those transactions. The financial institutions’ decisions to rely on oral agreements also impaired their ability to collect on their disguised loans and thus were a breach of fiduciary responsibility to their own shareholders.

Neither JP Morgan Chase, Citigroup nor Merrill Lynch were audit clients of Andersen.

In contrast, according to the testimony of Mr. Lynn Turner, former Chief Accountant of the SEC, Andersen criteria for accounting for prepays were correct. Had Enron followed those criteria, there would have been no fraud. However, if individuals at major banks and brokerages are willing to enter into oral side agreements and then lie on representation letters to auditors, an auditor has no hope of discovering the fraud in time to prevent shareholder losses.

III. Instead of participating in a fraud, Andersen was itself defrauded. Yet Andersen was executed by the government on charges of obstruction of justice predicated on the theory that Andersen was party to the Enron fraud. The questions are: (1) What did the government know? And (2) When did they know it?

(1) As we have seen, the government should have known the correct identity of the auditor of the SPEs by December, 2001.

Further, Thomas Bauer gave detailed testimony regarding the Chewco fraud on February 7, 2002, elaborating on public remarks of Joseph Berardino on December 12, 2001 regarding the fraud. A rational individual with a rudimentary knowledge of accounting and auditing who read the comments by Bauer and Berardino would understand that Andersen had been defrauded just as surely as the Enron shareholders. Further, upon discovering the fraud, Andersen promptly notified the SEC and the Justice Department and required Enron to restate their financial statements.

Andersen also promptly acknowledged its own responsibility for an error regarding LJM1 and LJM1’s subsidiary, Swap Sub, both of which should have been consolidated in 1999 (Berardino, 2001). As soon as the US\$ 100 million error was discovered in October, 2001, Andersen required that Enron restate its financial statements. This error accounts for 20% of Enron’s total restatement (Berardino, 2001).

(2) Instead of withholding judgment until further facts were known, the government initiated a well-coordinated campaign of smear and innuendo against Andersen. Why?

- The Enron restatements required by Andersen reduced income and increased debt. As Enron's bad investments became more apparent its credit rating slipped, rumors swirled, cash dried up and traders took their business elsewhere. Enron filed for bankruptcy on December 2, 2001.
- Several factors combined to fuel a firestorm:
 - Part of the meltdown of Enron stock occurred during a pre-arranged 1-month period when Enron employees' 401(k) accounts were frozen while Enron switched administrators for the Enron Savings Plan. During that period, employees were precluded from the possibility of selling their Enron stock and transferring the cash to any of the 18 mutual funds in the Enron Savings Plan (Buggs, 2002). Some of the employees had chosen to invest nearly all of their retirement funds in Enron stock. Their lack of diversification brought disastrous results.
 - Lawsuits were filed accusing Enron executives and Board members of insider trading because they earned nearly US\$ 600 million over the 4 years preceding the bankruptcy (Antosh and Fowler, 2001). Because this stock was not held within the 401(k) accounts of the Enron Savings plans, some of these sales took place while employees' 401(k) accounts were frozen.
 - Days before bankruptcy, Enron paid US\$ 55.7 million in bonuses to approximately 500 employees (Fowler, 2001b).
- Enron and its Chairman, Kenneth Lay, had powerful political connections because of generous campaign contributions to both Democrats and Republicans. The Center for Responsive Politics reports that Enron had given campaign contributions to 71 sitting Senators and 43% of House members. Enron spent US\$ 2.1 million lobbying politicians in 2000 and US\$ 1.9 million in 1999 (Houston Chronicle website).
- In 1999, Ken Lay offered a seat on Enron's board to Robert Rubin (Associated Press, 2002a), who was then Treasury Secretary under President Clinton. Lay lobbied Rubin and his successor on issues affecting Enron (Associated Press, 2002a). Rubin is Chairman of the Executive Committee of Citigroup (Associated Press, 2002a).
- On November 26, 2001, 6 days before it declared bankruptcy, Enron contributed US\$ 100,000 to the Democratic Senatorial Campaign Committee (Ivanovich, 2001b).

However, Enron and Kenneth Lay were more closely associated with Republicans, especially President Bush. Ken Lay was the President's friend and Enron was the President's largest donor (Associated Press, 2002b). Enron and employees gave President Bush over US\$ 500,000 in 2001 alone (Fournier, 2002). Meanwhile, Andersen gave President Bush US\$ 146,000 from 1999 to 2001 (Fournier, 2002).

Lay had also assisted Vice President Cheney in formulating national oil policy. The newly elected Republican National Committee Chair, Marc Racicot, was a former Enron lobbyist. Secretary of the Army Thomas White was a former Vice Chairman of Enron Energy Services (which engineered the infamous California energy swaps). One of Enron's "favorite electricity regulators," Texas' Pat Woods III, was the new head of the Federal

Energy Regulatory Commission (Ivanovich, 2001c). Karl Rove, Chief of Staff for President Bush, had helped former Christian Coalition Director Ralph Reed secure a consulting job with Enron (Ratcliffe, 2003). White House economic advisor Larry Lindsey served on an Enron board and received US\$ 50,000 in 2000 (Associated Press, 2002c).

- Democrats called for subpoenas of the White House contacts with Enron. Democratic lawmakers and environmental groups intensified their demands for the records of Vice President Cheney’s oil policy meetings (Reinert and Masterson, 2002).
- The General Accounting Office prepared to file suit, requesting information on participants, dates, locations and costs of the Energy Task Force gatherings (Reinert and Masterson, 2002).
- “Enron contributions revive effort to restrict soft money. Trying to get around Republican leaders who are blocking the [Campaign Finance Reform] bill, supporters have been circulating a discharge petition to bring bill to floor for debate.” (Khanna, 2002)
- J. Clifford Baxter, former Vice Chairman of Enron who resigned in May, 2001, committed suicide (Houston Chronicle Staff, 2002).
- CBS-New York Times poll: 67% say Bush is either hiding something or lying about Enron, up from 53% the week before (Associated Press, 2002d).
- “The White House, resisting congressional efforts to learn which business executives met with President Bush about energy policy, accused investigators of overstepping their legal authority.” (Associated Press, 2002e)
- “Enron’s collapse haunts World Economic Forum. Ken Lay had been scheduled to participate but he was uninvited.” (Powell, 2002)
- “Employees who have worked hard all their lives should not have to risk losing everything if their company fails.”—President Bush in a speech suggesting proposed changes to 401(k) accounts (Knutson, 2002).
- “Bush shuns call by Democrats for Special Counsel. Senate Commerce Committee Chairman Ernest Hollings, D-SC, said the Justice Department can’t be objective because too many Bush administration officials have ties to Enron.” (Riechmann, 2002)
- “If a special counsel is needed to replace the Justice Department, then a ‘special Congress’ is needed to handle investigations on Capitol Hill by lawmakers who have received contributions from Enron.”—Joseph DiGenova, a former independent counsel (Riechmann, 2002).
- “Enron investigation more compelling than Winter Olympics. According to Pew Research Center for the People and the Press, 70% polled said the worst thing to come out of the Enron collapse was that employees lost their retirement money. Majorities in the poll found that both parties were tarnished by Enron. Overall 68% say Enron exerted influence over Republican leaders; 58% said the same about the Democrats.” (Mason, 2002a)
- Stephen Hess, expert on politics at the Brookings Institution, stated “The political press corps . . . are really hot for this one [the Enron story] because they have been kept out of things all fall [due to September 11 tragedy].” (Mason, 2002a)
- “Nine out of fourteen members of a state legislative committee investigating Florida’s pension fund losses in Enron scandal have received campaign contributions from Enron or one of its subsidiaries.” (Associated Press, 2002f)

- General Accounting Office sues White House for records on Energy Task Force meetings (Reinert, 2002).
- “Democrats cite Enron mess to argue against privatizing Social Security.” (Mason, 2002b)
- “Democrats scrutinizing Bush’s business record at Harken Energy Company.” (Associated Press, 2002b)

While the White House tried to publicly distance itself from the political turmoil, later reports indicate “officials launched a feverish series of previously undisclosed e-mail and conference call consultations, including the Council of Economic Advisors, Federal Energy Regulatory Commission and the Commodity Futures Commission. The White House Report suggests that Bush officials then became deeply concerned about political and financial fallout of the Enron debacle” (Allen and Morgan, 2002). Pundits began calling Enron “Bush’s Whitewater” (Ivanovich, 2002b).

- On January 10, 2002, Andersen announced that in the months before the SEC issued its subpoena of Andersen papers, “a significant but undetermined number” of electronic and paper documents had been destroyed (Goldberg, 2002).

The objective of an audit is to produce files that meticulously document all conclusions reached (including those superseded by subsequent events or analyses), each signed and dated to carefully delineate responsibility. Removing papers from the permanent audit file would be sacrilege.

On the other hand, to build such a file requires a mountain of To Do lists and review points that become scrap paper after all relevant information has been documented in the files. In addition, the logistics of managing a large audit require numerous staff scheduling memos and e-mails asking clients to pull documentation of the transactions to be tested, the results of which are shown in the audit workpapers. Finally, memos discussing the proper accounting for an unusual transaction will frequently be widely distributed for staff training purposes. According to Andersen documentation policy then in effect, these duplicate copies and extraneous papers were to be destroyed no later than the end of an audit (Andersen Practice Administration, 2000, Section 3.5.3). Thus, according to Andersen policy, this type of trash was supposed to have been destroyed by February, 2001.

Storage of workpapers must be both accessible and secure and is therefore extremely expensive. Like most people, public accounting firms are not eager to pay high fees to store trash. In an era plagued with identity theft, public accounting firms routinely shred scrap paper to protect confidential information such as clients’ taxpayer identification and bank account numbers.

The central question is: Were the destroyed papers the usual trash or were they taken from the audit workpapers?

Logic tells us that if there were anything incriminating, it never would have been put in the audit workpapers to begin with. Further, if an auditor were so foolish as to commit fraud in an atmosphere where literally hundreds of people can and do review his work at any time and he left something incriminating in the audit workpapers, the incriminating item would not be on a significant number of documents. Finally, the fact that documents were destroyed openly in broad daylight indicates there was no criminal intent.

However, America abandoned all logic. A scapegoat was needed and Andersen was chosen.

Andersen immediately hired law firms to investigate, prohibited destruction of any type of e-mail or paper and was able to recover a large percentage of the scrap paper. David Duncan, Andersen lead partner on the Enron engagement was fired and others were placed on administrative leave. Yet anti-business hysteria fueled by politicians eager to distance themselves from the fact that they routinely exchange favors for campaign contributions created an unprecedented campaign of smear and innuendo against Andersen. Politicians scrambling to gain political advantage and a media giving a tabloid portrayal of a story involving complex accounting issues served to further destabilize the market.

By January 20, 2002, in addition to the investigations launched by the SEC and the Justice Department into both Enron and Andersen, there were at least nine congressional investigations into Enron (Hedges, 2002). Enron's Board of Directors was also investigating the events under the leadership of William Powers, Jr., Dean of the University of Texas Law School, who had been appointed to the Board for the project.

Logic and reason were drowned out by turmoil and finger-pointing. Financial statements are historical documents reflecting the results of business decisions. Financial statements don't cause bankruptcies; poor business decisions cause bankruptcies. Ken Lay of Enron stated,

In hindsight, we made some bad investments in non-core businesses. The negative impact of these investments was exacerbated through the extensive use of debt capital both on and off the balance sheet. (Fowler, 2001c)

While accuracy is essential in financial statements and fraud is reprehensible, it makes as much sense to blame an auditor for a bankruptcy as it does to blame a historian who writes about a war whose outcome we dislike. It is important for a historian to be factually correct but the historian did not make the decisions that lost the war.

Enron made poor investments using borrowed money, the classic formula for bankruptcy. Further, Enron and colluding financial institutions hid debt in a massive fraud, thereby delaying the timely reporting of the inevitable bankruptcy. Andersen auditors failed to uncover the fraud in a stunning audit failure.

However, an audit failure can occur despite a "good" audit where all reasonable tests are performed in accordance with generally accepted auditing standards and every lead is pursued. This appears to be the case with the Enron audit. For example, when the Raptor SPEs (not Andersen clients) were set up, Andersen required Enron to obtain an independent opinion regarding the transaction. PricewaterhouseCoopers provided that opinion. Further, Andersen's John Stewart testified that in numerous cases, Andersen cleared prospective transactions with the SEC and in many cases, the SEC agreed with Enron's more aggressive positions rather than Andersen's more strict ones (Stewart, 2002). Both of these examples indicate a careful audit by Andersen.

Another widespread misconception is that if Andersen had uncovered the fraud earlier, the shareholders and employees would not have incurred losses. If the fraud had been uncovered earlier, the stock price might not have been so over-hyped (by the same banks that, according to the Enron Bankruptcy Examiner, "aided and abetted" Enron's fraud) (Batson, 2003b, pp. 38–39). However, shareholders are destined to be harmed in a bankruptcy even if there

is no fraud. Shareholders could not demand a refund of their investment from Enron. Their only recourse was to sell their stock to an unsuspecting buyer who would then suffer the loss. Thus, the question is not whether shareholders are going to be harmed in a bankruptcy or fraud. The only question is the identity of the shareholders left holding the worthless investment.

Three events signaled the beginning of the end for Andersen.

- On January 24, 2002, in the televised hearings of the Subcommittee on Oversight and Investigations for the House Energy and Commerce Committee, Chairman Jim Greenwood (R-PA) addressed opening comments to David Duncan, Andersen partner on the Enron engagement. Before hearing any testimony and before a single fact was determined, Chairman Greenwood announced,

Enron robbed the bank, Arthur Andersen provided the getaway car and they say you were at the wheel (Mason, 2002c).

So much for “fact finding” and the presumption of innocence.

- On January 25, 2002, Budget Director Mitch Daniels of the Office of Management and Budget directed the General Services Administration to review Federal contracts with Enron and Arthur Andersen to determine whether they are “worthy of government business” (Fournier, 2002).
- Former SEC Chairman Arthur Levitt appeared on television and stated that Andersen lacked independence because of performing “consulting work” in addition to the audit. The clear implication was that Andersen had purposely overlooked the fraud.

To a CPA, this accusation is no less serious than to assert, before there is even an autopsy, that a doctor whose patient died during surgery is guilty of murder. Just as there are many possible reasons for the death of a patient, there are many possible reasons why a fraud can be successfully hidden from auditors.

What was this “consulting” work that was considered so damning? The year 2000 Enron financials list the US\$ 27 million “consulting” fees paid. They include:

- i US\$ 0 for financial information systems design and implementation fees;
- ii US\$ 4 million paid to Accenture (formerly Andersen Consulting) which was totally independent from Andersen during 2000; and
- iii US\$ 23 million fees primarily related to business process and risk management, tax consulting, due diligence related to acquisitions and other activities, work performed in connection with registration statements and various statutory and other audits (Enron 10-K, 2000).

In short, the “consulting” was all audit or tax related. Under SEC regulations, many services that can only be provided by auditors must be disclosed as “consulting” fees. It is ironic that the SEC definition of “consulting” is itself inherently misleading.

Even if Andersen had performed any consulting as it is generally defined (i.e. systems design and implementation as opposed to audit and tax-related services), Andersen’s independence (or lack thereof) was not the problem. The collusion to defraud committed by the Enron SPEs, assisted by banks, brokers and other outside parties, none of whom were Andersen clients, could not have been uncovered by any audit technique now in existence.

An audit is based on the presumption that banks and other outside parties are honest and credible. In this case, nobody was. Yet this fact continues to be ignored.

The statements by Congressman Jim Greenwood and former SEC Chairman Arthur Levitt are staggering. One would think that responsible government officials would seek to diffuse hysteria rather than inflame it. What was their motivation?

- It was under the chairmanship of Arthur Levitt that in 1997 the SEC caved in to political pressure and exempted Enron from the provisions of the Investment Act of 1940 (Labaton, 2002). If not for that exemption, Enron would have been prohibited from setting up the SPEs—Chewco and LJM—where the frauds took place. Thus, the frauds would have been prevented.

Who applied that political pressure?

- The House Committee on Energy and Commerce under the leadership of Representative Billy Tauzin and Representative Jim Greenwood urged the SEC to grant the exemption to Enron.

The Investment Company Act of 1940 governs companies that engage primarily in investing, reinvesting and trading in securities. The Act imposes on these companies certain disclosure requirements, places limits on the companies' investment activities and affiliate transactions and provides for a particular corporate structure. The Investment Company Act applies to a company that owns investment securities having a value exceeding 40% of the company's total assets (Governmental Affairs, 2002c, p. 57). Securities of a subsidiary that is majority owned by the company are excluded from the definition of "investment securities" and do not count toward the 40% limit (Governmental Affairs, 2002c, p. 57). Because SPEs had a residual equity limit of 3%, they would be considered "investment securities" and consequently Enron and/or its affiliates, as their use of SPEs expanded, would potentially be considered investment companies subject to the Act.

Enron initially sought a broad statutory exemption from the provisions of Investment Company Act of 1940 as part of what became the National Securities Markets Improvement Act of 1996 on the grounds that that Enron's investment in foreign infrastructure projects required the use of SPEs for legitimate tax, liability and governance reasons (Governmental Affairs, 2002c, p. 57). Enron's efforts were unsuccessful (Governmental Affairs, 2002c, p. 58).

However, in its report on the bill, the House Committee on Energy and Commerce stated,

"The Committee supports appropriate administrative action by the [SEC] to prevent the Investment Company Act from having unintended and adverse consequences to U.S. companies in the business of developing or acquiring and operating foreign infrastructure projects," that "the activities of U.S. companies involved in foreign infrastructure projects are not the sort of activities the Investment Company Act was designed to regulate" and that when exemptive relief was a requirement for investments in these projects, "the Committee expects the [SEC] to take administrative action expeditiously." (H.R. Rep. No. 104-622 at 19 June 17, 1996 as quoted in Governmental Affairs, 2002c, p. 58)

Is this proof that former SEC Chairman Arthur Levitt, Congressman Billy Tauzin, Chairman of the House Committee on Energy and Commerce, and Congressman Jim Greenwood,

Chairman of the Subcommittee on Oversight and Investigations for the House Energy and Commerce Committee, were party to the frauds? Certainly not. Such an assertion without proof would be extremely irresponsible, on a par with the assertions without proof made against Andersen. However, the actions of Congressmen Tauzin and Greenwood and former SEC Chairman Levitt did allow Enron to set up SPEs that set the stage for the fraud.

Was the exemption for Enron inappropriate? Experts have disagreed on the question (*Governmental Affairs, 2002c*, p. 59). Even if the exemption is deemed appropriate, one can safely conclude that Mr. Levitt and Representatives Tauzin and Greenwood were not eager to have the public equate Enron's lavish campaign contributions with their support for Enron's exemption from a vital investor protection law.

It would be useful to determine if Mr. Levitt, Representative Billy Tauzin and Representative Jim Greenwood knew that Andersen was not the auditor of the entities where the fraud took place when they made their statements. Surely the Congressmen should have known because their Committee had been investigating Enron for a month.

If these gentlemen did not know any facts, why would they make such inflammatory statements? They would certainly have known (or should have known) that an accusation of fraud against a major accounting firm would inevitably destabilize the markets, thereby jeopardizing everybody's economic wellbeing. To make such a charge without knowledge of the facts is breathtakingly reckless, on a par with shouting "Fire!" in a crowded room.

If these gentlemen *did* know that Andersen was not the auditor of the entities where the fraud took place, they were deliberately accusing innocent people in order to distract attention from their own culpability.

It is ironic that since 1988 Andersen has repeatedly urged the SEC and the FASB to require consolidation of off-balance sheet partnerships in order to prevent earnings manipulations.⁷ What if politicians had not bent the rules for Enron? What if the SEC and the FASB had supported Andersen's recommendation of mandatory consolidation? What if Andersen had been able to detect the fraud? In all these cases, Enron would still be bankrupt because of Enron's poor business decisions and both shareholders and creditors would have lost money.

Corporations other than Enron also received special exemptions allowing them to set up SPEs. It would be useful to determine who these corporations were, how much and to whom they may have paid political contributions and whether they used their SPEs to commit fraud. It would also be instructive to determine the amounts and payees of any political contributions made by the various parties involved with Enron's duplicity.

⁷ In a Letter to the Editor of the *Wall Street Journal*, May 3, 2002, Patrick Dorton, spokesman for Arthur Andersen, states that Andersen "has advocated a greater focus on a risk and reward standard that would lead to more consolidation, more on-balance-sheet treatment of securitizations and thus more transparent disclosure of various types of special purpose entities. [Thus Andersen] proposed a model for consolidation of [SPEs]. We began discussing our concerns about the accounting model for SPEs with the SEC staff in 1988 and wrote letters to the FASB . . . on consolidation . . . in 1992, repeating our views in 1994, 1996 and 1999. In our December 29, 1994 letter we stated, 'The real issue here is whether the SPE has sufficient substance to allow the sponsor not to consolidate the SPE. If the SPE lacks substance, its creation should not cause the accounting to be different than if the SPE did not exist.' In our January 16, 1996 letter, we told the FASB, 'We are also concerned that the change the Board proposes will create significant new opportunities for 'financial statement engineering' and accounting results that are contrary to the economics.'"

One giant step in cleaning up political fraud would be to hold everyone equal under the law, instead of granting exemptions to the politically favored few. If our laws are inadequate in certain circumstances, debate them openly and change them as necessary. It must be noted that from a politician's point of view, this is an unattractive prospect because politicians would lose leverage for collecting campaign contributions.

In a similar vein, the objective of financial reporting is to provide investors with a means of comparing one investment with another. The rules are not optional because without rules, there would be no comparability. The 3% residual equity threshold is pathetically inadequate. It doesn't begin to pass the "sniff" test to qualify as an unrelated entity. Yet until the SEC and the FASB mandate reform, CPAs are obligated to follow the rule. The fact that politically connected companies can be granted exemptions from investor protection laws so that they only have to meet the 3% threshold undercuts comparability and cries out for reform.⁸

- Jackie Spinner of the *Washington Post* reports that in February, 2002 Congressman Billy Tauzin (R-LA), Chairman of the House Committee on Energy and Commerce, met with representatives of the Final Four accounting firms (Deloitte & Touche, KPMG, PricewaterhouseCoopers and Ernst & Young). Over a lunch of crabcakes in a crowded restaurant overlooking what is known as the "Suicide Bridge," they agreed to "push Andersen off the bridge" (Spinner, 2002).
- According to Spinner, the representatives of the Final Four "portrayed Andersen as an outsider, a renegade company with poor internal controls for catching bad auditors and bad audits" (Spinner, 2002). "I didn't know that," replied Tauzin. "Make sure that the rest of America knows that" (Spinner, 2002).
- According to others at the meeting, the Final Four representatives (one of whom was KPMG—the auditor of the SPEs where the Enron frauds were committed), did not mention "that Andersen was also trying to save itself by urging broad reforms on the accounting profession, such as a requirement that audit firms spin off lucrative consulting practices. Some of the Final Four were adamantly opposed to such steps" (Spinner, 2002).
- One wonders if the representatives at the "Suicide Bridge" meeting also discussed how they would divide the spoils of Andersen's most valuable assets—its people and its clients.
- A government official conspiring with businesses to destroy a competitor could be considered racketeering subject to the RICO statutes. At the very least, such Mafia tactics are prohibited by the ethics requirements of state CPA regulators and professional associations. The American Institute of Certified Public Accountants (AICPA) Code of Conduct states that "a member shall not commit an act discreditable to the profession" (AICPA Code of Conduct, ET Section 501). Further, "a member in public practice shall not seek to obtain clients by advertising or other forms of solicitation in a manner that is false, misleading or deceptive. Solicitation by coercion, over-reaching or harassing conduct is prohibited" (AICPA Code of Conduct, ET Section 502). State laws regarding the conduct of CPAs and CPA firms have similar prohibitions regarding conduct.

⁸ The FASB has recently proposed changing the residual equity standard from 3 to 10%; a marginal improvement at best.

In summary, many had something to gain from Andersen's demise—those trying to distance themselves from their political ties and favors to Enron, CPA competitors seeking to gain Andersen's clients and superbly trained people, the auditors of the banks assisting Enron in their fraud and specifically KPMG who was perhaps also hoping to hide the fact that it was KPMG, not Andersen, that audited LJM where most of the fraud was committed.

Meanwhile Andersen was silenced by Justice Department gag order. In the crisis, Andersen leadership appeared weak but probably even the strongest leaders could not have saved a firm in such circumstances. Andersen people wrote letters and contacted politicians but many politicians were too scared to talk to an Andersen person.⁹ Few papers were willing to publish a letter cautioning that it was important to consider facts before rushing to judgment and that nothing is known until the audit workpapers have been carefully analyzed to determine precisely what facts and documents were given to the auditors. Perhaps the media considered such technical details boring compared to wild speculation and gossip.

Most of America stood silent while the lives and livelihoods of 85,000 employees and over 5000 retirees and their families were irreparably damaged. Many Americans laughed. Others cheered.

On February 5, Andersen Managing Partner and CEO Joe Berardino announced that former U.S. Federal Reserve Chairman Paul A. Volcker would chair a new Independent Public Oversight Board with authority to mandate changes in Andersen's auditing processes. Berardino also reiterated the need for replacing the current audit report for one that:

- grades the quality of a company's accounting and risks;
- helps investors understand areas of imprecision and the effects of unusual transactions (and focus attention on key performance indicators beyond earnings per share); and
- is written in plain English (Berardino, 2002).

Any one of these common sense suggestions would greatly improve financial reporting.

Berardino also urged that the law be changed to make it a felony to lie, mislead or withhold information from an auditor (Berardino, 2002). It is beyond comprehension that the damage done by the defrauding of Andersen does not rise to the level of a felony.

Government hearings and meetings with the SEC and Justice Department dragged on. All reports indicated that what was destroyed was the sort of normal scrap paper that was supposed to have been destroyed by the end of an audit. Clearly, the failure to do so was poor job management and a breach of Andersen document policy. Andersen document policy further states that "in the event Andersen is advised of litigation or subpoenas regarding a particular engagement, the related information should not be destroyed" (Andersen Practice Administration, 2000, Section 4.5.4). Unfortunately the policy failed to address the situation where a client is under investigation but the SEC had neither subpoenaed Andersen nor even discussed the possibility with Andersen, which were the facts in the Enron case.

The destruction of audit workpapers would be disastrous at any time, not just after a subpoena. On the other hand, the destruction of trash should be allowed before a subpoena. Otherwise, what is the purpose of a subpoena if not as a cut-off point?

⁹ Interestingly, the few written responses that Andersen people received from politicians were strikingly similar. Whether the politician was a senator or congressman, Republican or Democrat or from Washington or Texas, their form letters were virtually identical.

The Justice Department wanted Andersen to admit criminal wrongdoing. There was no question that paper was destroyed but it was done openly in broad daylight and it was Andersen who reported the possibility of wrongdoing to the SEC and Justice Department. Thus it was clear that there was no criminal intent. A guilty plea would bar Andersen from SEC audits unless the SEC granted a waiver.

The SEC was purported to want Andersen to survive as a viable concern and as a leader in reform with the ability to pay damages to investors (*Associated Press, 2002g*). In prior years, the government has been against consolidation among the large firms because of antitrust concerns. Chairman Paul Volcker of Andersen's Oversight Board insisted that the only viable option was a package agreement that settled with the Justice Department, the SEC and the plaintiffs. However, some of the banks that were claiming damages were the same banks that had assisted the fraudulent SPEs in their duplicity.¹⁰ Thus the plaintiffs were unable to agree among themselves. Finally, Andersen partners walked away from Volcker's vision of an all-audit firm. Again, the definition of "consulting" was the rub.

It is one thing to decide not to perform appraisal services for an SEC audit client. But those who think that audit firms should not perform tax work for a client are clearly not CPAs. An important part of the audit is the analysis of the current and deferred tax provision. CPAs who have large clients are specialized. Just as an obstetrician would never perform brain surgery, an audit partner would never sign off on the tax provision of a large and complex client. A tax CPA qualified to sign off on the tax provision of a complex company only becomes partner after years of tax research or "consulting." Therefore an accounting firm that limited itself to performing audits would never develop personnel with the expertise to sign off on the tax provision.

So whatever deal that may have been possible fell apart. SEC Chairman Harvey Pitt was one of the rare government officials knowledgeable about public accounting. However, his past contacts with Andersen meant that he had to step aside. Just as in the public debate, those who actually knew something about public accounting were drowned out by those who had a strong opinion but little or no knowledge.

- According to "legal sources," the SEC took a time out while the Justice Department proceeded with the criminal case (*Associated Press, 2002g*).

Andersen people, active and retired, believe that the position of the Justice Department is both legally wrong and immoral.

- To be guilty of a criminal offence, a person must have criminal intent. Only a person can form criminal intent. A partnership is no more than a legal agreement on a piece of paper; it can no more form criminal intent than can a table or a chair.
- It is unethical to plead guilty to something you did not do in order to get a reduced sentence. It is dishonest. Further, it leaves the real perpetrators free to commit more crimes.

¹⁰ Regarding Citigroup, JP Morgan Chase, Barclays Bank, BT/Deutsche, Canadian Imperial Bank of Commerce (CIBC) and Merrill Lynch, the Enron Bankruptcy Examiner concludes that

these Financial Institutions aided and abetted [Enron] officers in breaching fiduciary duties. There is sufficient evidence of inequitable conduct by [these] Financial Institutions in connection with the SPE transactions for a court to determine that the claims of such Financial Institutions, totaling in excess of US\$ 5 billion, may be equitably subordinated to the claims of other creditors. (*Batson, 2003b, pp. 4–5*)

- The Andersen tradition is that if there is a mistake, the person or persons responsible stand up and take responsibility. A guilty plea by Andersen would stain the reputations of every active and retired partner, in addition to every employee and retired employee. It is unethical to smear people who never so much as touched an Enron paper.

Andersen refused to knuckle under, knowing that a criminal indictment would be the death knell of the firm and would result in the loss of jobs, capital, health care coverage and retirement benefits. To their eternal credit no Andersen person, to my knowledge, has questioned the need to truthfully answer the trumped-up charges of the Justice Department.

IV. Andersen was indicted and executed on March 14, 2002.

Deputy Attorney General Larry Thompson “hinted that the indictment may be used to force a defiant Andersen to accept a plea agreement” (Hedges and Ivanovich, 2002). If the Justice Department thought Andersen people would lose their nerve, they were mistaken. On the other hand, there was certainly no need to pressure Andersen for assistance in determining who committed the fraud. Andersen people were even more furious about the fraud than Enron employees and shareholders. After all, Andersen people had first been defrauded and then blamed for the fraud.

- The Justice Department rushed to indict Andersen in the height of proxy season, apparently so shareholders would pressure clients to drop Andersen.
- The next day, Andersen was banned from all new government contracts for the duration of the indictment. This not only denied Andersen the opportunity to bid for government contracts but it meant that clients with government contracts would feel threatened if they retained Andersen.
- Clients reported to Andersen that they were actively threatened by government regulatory agencies. For example, hospitals audited by Andersen were told that they would lose Medicare funding unless they changed auditors.
- Some clients had left in the early stages of the hysteria. However, at the time of the indictment Andersen still retained 98% of its clients (Bartley, 2002). They stayed with Andersen because they respected Andersen people and their work. Clients called and e-mailed support but rarely spoke out on advice of their lawyers for fear of retaliation from the Justice Department. Some clients did speak out and stayed with Andersen until there was no office to serve them, waiting to find out where Andersen people would land so that they could follow them.
- Hemorrhaging cash¹¹ and clients, Andersen sought the speediest possible trial, which under Federal law guaranteed a trial within 70 days (Fowler, 2002a).
- After refusing to allow Andersen to present evidence to the grand jury before indictment, the Justice Department called witnesses to the grand jury for questioning afterwards. Andersen attorney Rusty Hardin appealed to Judge Melinda Harmon, arguing that the

¹¹ CPAs are precluded by professional rules from practicing under a corporate form of organization. Therefore public accounting firms have no outside investors and are capitalized by printers' contributions and earnings retained by the current and retired partners plus debt. According to a source within Andersen, Citigroup provided financing to Andersen partners which presumably could have been called at any time. Thus Citigroup crippled Andersen by participating in oral side agreements with Enron SPEs while at the same time Citigroup was in a position to bankrupt Andersen partners and potentially Andersen.

government was improperly using the grand jury to try to build its case. Courts have banned such use. Motion denied (Ivanovich and Fowler, 2002b).

- Andersen Managing Partner and CEO Joe Berardino resigned under pressure from the partners (Carpenter, 2002).
- After being silenced by Justice Department gag order and refused the opportunity to present witnesses before the grand jury before the indictment, Andersen people took to the street to show the heart and faces of people being so viciously scapegoated. They flooded the phone and fax lines of the White House and the Justice Department. Michael Chertoff, Chief of the Criminal Division of the Justice Department, was said to be furious.¹²
- Justice Department lawyers appealed to Judge Harmon, complaining that material posted on Andersen's website was "witness coaching." The offending words were:

There is no doubt that some Andersen personnel in Houston exercised extremely poor judgment in encouraging or permitting the expedited destruction of documents during a sensitive period for Enron. But those personnel may well have acted not to frustrate any SEC inquiry but to comply with Andersen document policy at a time when their work was coming under scrutiny by senior accountants within the firm. (Ivanovich and Fowler, 2002b)

- Justice Department lawyers also blasted a two-page ad in the *Wall Street Journal* that read:

Injustice for All. One indictment. 28,000 Andersen U.S. men and women. 5,200 retirees. 85,000 family members. All put at risk. It's simply unjust. (Ivanovich and Fowler, 2002b)

¹² One of the hundreds of thousands of letters from Andersen people addresses the topic of Mr. Chertoff's ire: "Dear Mr. Chertoff:

I was puzzled by a comment I in read yesterday's *Los Angeles Times* and I was hoping you might clarify it for me. The quote was as follows—" . . . Justice Department officials confirmed Tuesday that Andersen employees and supporters had besieged the department with calls and emails over the last two days." "It's a nuisance," said one Justice Department official. "But we're not swayed by phone calls. We're swayed by facts."

First of all, let me apologize for the insensitivity of all my fellow employees and supporters. It must be quite bothersome, having to deal with all these pesky innocent people. My heart bleeds for you. But I am confused that you are "swayed by facts." Just which facts are those, Mr. Chertoff?

Are you swayed by the fact that tens of thousands of people you indicted had absolutely no involvement in anything to do with Enron? Are you swayed by the fact that capital markets will be thrown into disarray as companies scramble to sign up new auditors? Are you swayed by the fact that while Enron executives took the Fifth and ran for the exit, we self-reported the shredding issue and cooperated fully in your investigation? Are you swayed by the fact that overall audit quality will suffer as understaffed, overworked and inexperienced audit teams from other firms rush through the audit process? Are you swayed by the fact that innocent people all over the world are watching their retirement, health insurance, homes and careers slipping away?

Mr. Chertoff, this indictment is an outrage and it cannot stand. I suspect that the reason you indicted the entire firm is because you couldn't pull a case together and you hoped a blanket indictment would quickly kill off the Firm without you having to expose your pair-of-deuces hand. Bad news, sir—we're calling your bluff. We will not go quietly into that good night. If you have names, name them. If you have a case against individuals who you believe committed crimes, indict them. In the meantime, withdraw this shameful and unprecedented indictment and admit your mistakes. When we screwed up, we were honest enough to admit it, stop it and fix it. Are you man enough to do the same?—R.G., Dallas.

- Enron shareholders' lawyer expands lawsuits to include law firms Vinson & Elkins and Kirkland & Ellis and financial firms JP Morgan Chase, Citigroup, Creditsuisse First Boston, Canadian Imperial Bank of Commerce (CIBC), Merrill Lynch, Bank of America, Barclays, Deutsche Bank and Lehman Brothers. The lawsuit accused the financial institutions of hiding billions of dollars of loans while making deals for themselves. According to the suit, banks underwrote Enron SPEs, invested in the SPEs and then touted the stock to investors (Flood, 2002a). Ten of the 15 major stock analysts who followed Enron rated the company as a "buy" or "strong buy" as late as November 8, 2001, even after word the SEC was investigating Enron (Fowler, 2002b).
- On April 9, 2002 David Duncan, Andersen lead partner on the Enron engagement, pleaded guilty to obstruction of justice, saying that he ordered employees to comply with a policy to retain certain documents and destroy others 2 days after he learned the SEC was investigating Enron (Fowler, 2002c).
- According to the Philadelphia Inquirer on April 13, 2002,

"Andersen shredding overstated by the DOJ. [Before the grand jury] prosecutors painted a portrait of a firm run amok. 'Andersen employees, including senior officials, destroyed hundreds of thousands of documents and e-mail messages in offices around the country and as far as London,' they said. But according to several accounts, document destruction [was] limited to a relative handful of partners and staff in Houston office and other Andersen employees involved in Enron audits" (Mondics, 2002).

 - i Congressional investigators support findings of Andersen. Found no involvement by any senior management (Mondics, 2002). It was not reported when congressional investigators reached this conclusion—before or after Duncan was persuaded to plead guilty.
 - ii Justice Department had declined repeated requests that it focus on individuals involved, not the entire firm (Mondics, 2002).
- Sealed document (to which Andersen had been denied access) regarding grand jury deliberations leaked to the *Wall Street Journal*. Andersen attorney Rusty Hardin protested to the Judge that the steady stream of leaks beginning in early March about the prosecution's case and pending indictment are an effort to pressure Andersen (Fowler, 2002d). Per Former SEC investigator and Assistant U.S. Attorney now in private practice, the leaks violate codes of conduct (Fowler, 2002d).
- Andersen attorney Rusty Hardin requested 6 or 7 weeks delay until publicity from illegal government leaks died down. Lawyers had examined hundreds of questionnaires from potential jurors and determined that one-third believe Andersen is guilty. Motion denied (Fowler, 2002d).
- House Energy and Commerce Committee refused Andersen's subpoena on April 30, 2002 to turn over documents regarding interview of David Duncan. Andersen wanted to know when Duncan decided that he committed a crime (Associated Press, 2002h).
- Judge Melinda Harmon (an appointee of President George H.W. Bush) admitted evidence from prosecution regarding settlements regarding Waste Management and Sunbeam. Hardin argues that these cases are irrelevant because they concerned accounting issues, not document shredding. Also, different individuals were involved (Flood, 2002b). Ruling

could be grounds for reversible error. The 5th Circuit Court of Appeals has overturned Harmon before on the issue (Flood, 2002c).

- Prosecutors told Kate Agnew, former Manager on Enron audit team that she could be subject to a criminal investigation . . . one week after she voluntarily talked with prosecution. Andersen attorney said her information wasn't harmful to Andersen so prosecutors changed her status from "witness" to "subject" which means she could be subject to criminal investigation. Agnew then took the Fifth Amendment. Andersen attorney said other witnesses have been threatened in the same manner (Fowler, 2002e).
- Hardin wrote to Michael Chertoff, Chief of the Justice Department's Criminal Division, formally requesting an investigation into possible witness tampering by the prosecution, a crime that falls under the same statute as obstruction of justice (Viles, 2002a).
- Carl Bass, Andersen Professional Services Group (PSG) partner removed from the Enron audit testified that he did not believe Andersen or Enron were committing fraudulent accounting when there was internal debate about how to record a set of failing partnerships, the Raptors (Fowler, 2002f). The Raptors were not an audit client of Andersen.
- Judge blocked Andersen access to Duncan's notes that may have shown Duncan claimed innocence in some meetings and then admitted guilt under pressure from prosecutors (Fowler, 2002g).
- Prosecutors asked Judge to sanction Rusty Hardin, saying he violated pre-trial agreement to refrain from sharing personal information about either himself or prosecutors with jury. Hardin had commented about how many times prosecutors had asked witnesses if they were aware last fall that Andersen had hired "a big law firm from New York" to investigate Andersen's dealings with Enron. In cross-examining a Chicago Andersen partner, Hardin asked if she thought there was anything wrong with hiring a big New York firm. "No, I don't." "Nothing any more wrong with it than the government having prosecutors from Brooklyn and Boston?" Prosecution objected. Sustained (Fowler, 2002h).
- In open court, Hardin pointed out that "the Judge is allowing prosecution all sorts of evidence speaking to the intent and state of mind of Andersen" (Viles, 2002b). Hardin said he "hasn't been allowed to bring in any evidence like that to establish another state of mind and a more innocent intent" (Viles, 2002b).
- Duncan testified that he "did not believe he broke the law when he shredded papers. He began to change mind in late January or early February." Duncan said he told staff to comply with policy but did not order document destruction (Viles, 2002b).
- "Soul searching" led to plea. Duncan decided in late March that he had obstructed justice 5 months earlier. He had maintained his innocence to his lawyers, prosecutors, colleagues and friends throughout January, February and most of March. Duncan signed plea agreement on April 6, 2002 (Fowler, 2002i).
- According to Duncan's testimony, a condition of his plea agreement was to cooperate with the Internal Revenue Service on any issues that had to do with a mistake in reporting income for a domestic employee. Duncan said he had paid her tax but "wasn't sure whether all relevant forms were in order" (Fowler, 2002i).
- Judge said she would review notes that Duncan made about alleged inconsistencies between government summaries of his interviews with investigators months ago and his recollection of what he said. Duncan testified on the stand that the interview notes contained errors that were "fairly voluminous" while prosecution said errors were minor (Fowler,

- 2002j). The FBI had failed to change their written reports, known as 302s, to conform to Duncan's requests for corrections despite the fact that the FBI is required to do so (Dobbs, 2002a).
- Prosecutors asked Judge to block Hardin from mentioning instances where Andersen employees have "acted without corrupt intent to destroy documents" which is what the government must prove. Judge would not allow Hardin to ask Duncan if he thought there was any inappropriate document destruction going on at Andersen all during October (Dobbs, 2002a).
 - Duncan testified that he preserved several potentially embarrassing records that documented mistakes Andersen made in accounting (Dobbs, 2002a).
 - Legal test is whether one or more people destroyed documents not just to follow policy about extra copies and early drafts but to intentionally keep them from government investigators (Flood, 2002d).
 - Duncan testified that the meeting on October 23 with about 100 employees was "a pep talk." He didn't specifically say that employees should destroy documents. He recalled saying "We believed we had done everything appropriately and everyone should rest assured." Duncan didn't destroy anything until later. He ordered a pile of papers about one foot high to be shredded. He saved 21 boxes (Fowler, 2002k).
 - Duncan (2002) said he destroyed *duplicate* memos, old magazines and requests for charitable contributions. Duncan did not say anything about trying to hide documents from the SEC or why duplicate memos, old magazines and requests for charitable contributions could possibly be of interest to the SEC.
 - FBI Agent Raju Bhatia told Hardin on cross that he wrote a draft of his interview with Michael Jones (Andersen partner—London) and threw it away when he produced a final copy. "You followed the FBI's document retention policy, didn't you?" Prosecution objected. Sustained (Associated Press, 2002i).
 - "In a supposedly private sidebar conference between the attorneys and Judge Harmon, the Judge said to Hardin, waving her finger at him, 'You are so far off base it's unbelievable.' Now these are things the jury is not supposed to hear. We (the press) sit further away than the jury. It was loud and clear to us."—Peter Viles, reporter (Viles, 2002c).
 - At Hardin's request, FBI Agent Barbara Sullivan identified the August 23 Andersen memo regarding Sherron Watkins' concerns, various memos regarding financing vehicles credited with helping fuel Enron's failure and memos and e-mails between Enron audit team and in-house Andersen consultants about the balance sheet treatment of those vehicles. Judge repeatedly sustained prosecution objections when Hardin asked if documents used by government as evidence were retained by Andersen (Viles, 2002c). If Agent Sullivan had been required to answer Hardin, she would have been forced to admit that all of the documents used by the government as evidence had been saved by Andersen and voluntarily turned over to the government.
 - Sharon Thibault, Andersen Records Supervisor, said that amount of material from Enron engagement team around October 23 was "unusually high." She had also received about 40 boxes from someone who had been cleaning out a training room or library totally unrelated to Enron. The combination of the papers from Enron plus library cleanup prompted Ms. Thibault to call for additional pickup from mobile shredding truck. She also received from the Enron engagement team several trunks of coded files

that needed to be refiled and several trunks of workpapers that needed to be recoded. Ms. Thibault testified she had not received papers to be destroyed from Enron engagement team in 10–11 months and that the amount received in October was equivalent to a 10–11-month backlog, approximately 1/2 box per member of the engagement team (Thibault, 2002).

- Michael Patrick, General Manager of Mobile Shredding Co., said his company performed work for government agencies and even “shredded for the FBI.” Prosecution objected. Sustained (Fowler, 2002l).
- Special Agent Paula Schanzle had testified in front of the grand jury that “the vast majority” of the deleted files were Enron-related. On cross-examination, she admitted that she had never reviewed over half the documents presented. Hardin asked her if it would surprise her to learn that over 90% of the documents deleted did not pertain to Enron. Special Agent Schanzle did not know when the documents had been deleted, or how many of the documents may have been accidentally deleted and then recovered by Andersen employees prior to the Enron investigation (Schanzle, 2002).
- Special Agent Schanzle admitted that she had never reviewed the audit workpapers to determine whether documents introduced as “deleted” were preserved in other forms (Schanzle, 2002). Since CPAs routinely copy everything into the audit workpapers, this constitutes gross negligence.
- Special Agent Schanzle had been told by Roger Willard, Andersen partner, in his interview that he had accidentally deleted all his e-mail and that Andersen’s technology group had had to restore it over a period of a couple of days. These e-mails were included in an exhibit of deleted documents prepared by Schanzle. She contended no one had informed her of this mistake. Hardin used Schanzle’s own notes to show this issue had been made clear well before exhibit was prepared. Hardin then asked Schanzle why she was trying to mislead the jury. Prosecution objected. Sustained (Schanzle, 2002).
- Jury was instructed that government must prove that an Andersen employee, as part of his work, intentionally and “corruptly” persuaded others to shred in order to keep the information from the SEC. “Corruptly” was defined as being “with an improper purpose” (Flood, 2002e).
- Testimony showed that the video of Michael Odom was taped on October 10, 2001 at a New Orleans training meeting and viewed by 10–12 of the 100 people on the Enron engagement team (Viles, 2002d). Two of the managers on the Enron engagement later testified they “sat through the training meeting but they had no memory of Mike Odom even getting up to speak, let alone Mike Odom giving them advice on when it’s appropriate to destroy documents” (Viles, 2002e).
- Judge announced that juror instructions would not include the statement that if anyone at Andersen knew something, the whole company is assumed to have known it (Viles, 2002e). In this instance Judge Harmon ruled in favor of Andersen. It was apparently the only substantive ruling against the prosecution and the fact that it was even considered in reference to a firm of 85,000 employees is indicative of the tenor of the proceedings.
- Sharon Adlong, administrative assistant to David Duncan, “broke down in tears when she told the story of how David Duncan was fired in January over the shredding, said she spoke to him then and he told her, ‘nobody did anything wrong, he didn’t do anything wrong’ ” (Viles, 2002f). Adlong “said Duncan told her when he was cleaning his own

files, ‘I wouldn’t want our bosses to see our files in a mess’” (Viles, 2002f).

- On May 27, 2002 prosecutors requested copies of actual workpapers or final documentation that accompanies finished audits, to determine what is deemed necessary to keep. Defense lawyers responded that prosecutors have had access for months to 500 boxes of workpapers under guard at Andersen’s Houston office (Associated Press, 2002j). Obviously the Justice Department team had never seen any audit workpapers, much less Andersen’s files on Enron. This is a blunt admission that the Justice Department destroyed Andersen and impoverished thousands without any knowledge or curiosity about either auditing or the facts of the Enron audit.

If the prosecution had examined the audit workpapers of Enron or indeed any set of audit workpapers, they would have seen papers meticulously assembled, each page and number cross-referenced to indicate where the number or note originates and how it fits into the whole. To remove papers from the audit workpapers would mean changing all the cross-references, a task impossible to accomplish by group project and time-consuming for one or two individuals.

- John Stewart, Andersen partner on the Professional Services Group (PSG), emphasized that his positions on accounting issues were the same as those of Carl Bass, Andersen PSG partner who had been removed from the Enron engagement at Enron’s request. John Stewart then assumed the PSG responsibility regarding Enron. David Duncan had documented his summary of discussions with the PSG concerning the proper accounting for Raptors. Because the documentation did not properly reflect the views of Mr. Bass, the memos were later revised. Both the original and the corrected memos were saved by Andersen and turned over to the government (Stewart, 2002). According to Andersen sources, the PSG always had veto power over the local offices. That being the case, did Mr. Duncan willfully ignore the PSG as has been suggested? It seems unlikely that Mr. Duncan would have deliberately assumed the entire risk for a position contrary to the PSG only to later reverse his position, documenting the reversal in the audit workpapers. We don’t have sufficient facts to reach a conclusion regarding Mr. Duncan’s motivations.

Stewart said that at times Enron directly consulted with the SEC and that at times SEC agreed with the more aggressive Enron positions rather than those of Andersen’s PSG. He testified that Nancy Temple, Andersen in-house attorney, had told him that original inaccurate memos as well as newly corrected memos should be retained (Stewart, 2002).

- Judge denied lawyers the opportunity to question Andersen’s Records Clerk about over 1600 boxes of Enron-related papers stored in Andersen’s Houston office. Prosecution argued that what was kept was irrelevant (Associated Press, 2002k).
- Hardin entered into evidence reminders sent to Andersen staff on the Enron engagement in March and August 2002 to get in compliance with document retention policy (Trial notes, 2002).
- John Riley, Andersen National Audit Practice manager and formerly SEC accountant for 11 years, did not conclude that the SEC would have serious interest in Enron audit until November 5, when he and others determined that Enron needed to restate financial results back through 1997. Subpoena arrived November 8. He had just been “concerned

with Enron's financial statements and making sure they were right. What happens after that is beyond my control" (Associated Press, 2002).

- Judge told jurors they can convict even if they disagree on exactly who at Andersen had criminal intent (Flood and Fowler, 2002).
- Judge Harmon sided with prosecution in 96% of her rulings (Dobbs, 2002b).
- Alternate juror, Gloria Antia, stated after being released at the end of closing arguments that she thought Duncan was innocent.

The focus should have been on Enron and it should have stayed on Enron. I think they just used Andersen as a scapegoat. (Antia, 2002)

- Jury announced on the seventh day of deliberations that it could not come to a decision. Judge Harmon issued a so-called Allen charge (also known as "dynamite charge") which is typically given to a deadlocked jury, hoping to get jurors to rethink their positions. Harmon "removed a sentence from the Allen charge that reminds jurors they must render a not-guilty verdict if 'evidence fails to remove reasonable doubt'" (Austin American Statesman, 2002). Why would a supposedly impartial judge delete from jury instructions a sentence so fundamental to the American concept of justice?¹³
- Guilty verdict.
- Jurors say that document shredding "was not the issue. They were convinced that it was not intended to hinder a government inquiry but was a good-faith, if misguided effort to comply with internal policies at the accounting firm." (Glater, 2002). "I don't think we even talked about whether he (Duncan) committed a crime or not," said David Schwab, juror (Glater, 2002).
- "The issue of proportionality, the fact that a guilty verdict would be against a firm of 26,000 [in the U.S., 85,000 worldwide instead of against individuals who may have committed some wrong], was expressly ruled out by [the Judge's] jury instructions."—Oscar Criner, Jury Foreman (Criner, 2002).
- Jurors' decision was based on an e-mail from Nancy Temple (Criner, 2002), a second-year in-house lawyer who was not a partner. In editing a draft of an internal memo regarding unaudited quarterly earnings she suggested to David Duncan that her name be removed because it would "increase the chances that I might be called as a witness, which I prefer to avoid" (Criner, 2002). This revision is considered standard legal practice to maintain attorney–client privilege (Gillers, 2002).

The statute regarding obstruction of justice specifically allows the advice of counsel in the ordinary course of business (Gillers, 2002). Thus, Andersen was convicted for an action specifically permitted under law.

Further, one would have to surmise that for a corporation or a partnership to be found guilty of obstruction of justice, prosecutors would be required to prove that senior management was involved. How could any second-year person who was not a partner be considered to have attained the requisite level of responsibility?

¹³ It is interesting to note that Judge Harmon's shifting of the burden of proof from the prosecution to the defense was not mentioned in the *Wall Street Journal*, the *New York Times* or the *Washington Post*.

2. Conclusions

- Andersen could not have participated in the frauds because Andersen was never auditor of the SPEs where the frauds were committed. The frauds were committed by Enron officers within SPEs in collusion with numerous supposedly reputable financial institutions who were also not Andersen clients.
- The government should have known no later than December, 2001 that Andersen was not the auditor of the fraudulent SPEs—before the smear campaign against Andersen was initiated in the House Committee on Energy and Commerce “fact finding” hearings, before the Suicide Bridge meeting, before the government threatened Andersen clients and before Andersen’s indictment on obstruction of justice.
- Both Republicans and Democrats smeared Andersen to distract attention from the fact that Enron had spent lavishly on both parties and received special favors in return. One of those special favors allowed Enron an SEC exemption to the law that would have prohibited Enron from using SPEs. If not for the SEC exemption, Enron officers would not have been able to commit the fraud. Those most vocal against Andersen—former SEC Chairman Arthur Levitt, Congressman Billy Tauzin and Congressman Jim Greenwood—are the individuals most responsible for the SEC’s decision to grant Enron the exemption that allowed Enron to set up the SPEs.
- Rival accounting firms, whose clients included the SPEs where the frauds occurred and the financial institutions who aided and abetted the fraud, agreed to “push Andersen off the bridge.” They subsequently acquired most of Andersen’s clients and employees.
- By April 13, 2002, it was reported that congressional investigators had concluded that Andersen had not committed obstruction of justice. Yet the government made no effort to halt the trial which commenced on May 6, 2002.
- While Andersen was under gag order, the Department of Justice engaged in a stream of leaks to pressure and defame Andersen, thereby violating codes of conduct. The Department of Justice (specifically FBI Special Agent Schanzle) misled the grand jury (and later the trial jury) in order to secure the indictment of Andersen. The Justice Department refused to correct interview form 302s as required, threatened Andersen witnesses and failed to investigate even the most basic facts before making accusations. Thus the Department of Justice undermined the rule of law.
- In a trial supposedly focused on whether documents were destroyed with criminal intent to keep them from government investigators, the judge ruled to hide from the jury all testimony from participants as to their intent, criminal or otherwise, or the fact that Andersen had saved all the documents being submitted by the prosecution. The Judge’s ruling that what was kept was irrelevant is clear indication that she was not requiring the prosecution to show criminal intent. Otherwise, why wouldn’t the preservation of at least one copy of each memo satisfy the requirements of the law?
- Duncan’s testimony that he decided in late March that he had obstructed justice 5 months earlier demonstrates another flaw in the verdict. Criminal intent means that the person thought he was doing something wrong *at the time he did it*. How can criminal intent be retroactive? Isn’t that a contradiction in terms?

- The attribution of criminal intent to a corporation or partnership (both of which are mere legal agreements documented on paper) is nothing more than a smear tactic used by prosecutors unable to find evidence of crime by any individual.

The Andersen case is a watershed case for reasons far more important than its effects on Andersen people or on public accounting. The facts show that in rushing to scapegoat Andersen, individuals in all three branches of our government acted to subvert the rule of law. Along with most in the media, they ignored the presumption of innocence and failed to examine the most basic facts before making wild accusations. Further, some individuals in our government did examine the facts and certainly should have known the truth even as they were condemning Andersen people. To my knowledge, none of these individuals has shown the integrity to admit that their rush to judgment was not supported by the facts. Whether their actions were due to gross incompetence or dishonesty, these individuals are guilty of assisting in the lynching of Arthur Andersen & Co.

3. Aftermath

- Neither Enron nor its SPEs have been charged with fraud.
- While under subpoena, Enron engaged in document shredding from November, 2001 until January, 2002 ([Associated Press, 2002m](#)). Neither Enron nor any individual at Enron has been indicted for obstruction of justice.
- None of the financial institutions that assisted Enron SPEs with their fraud by hiding written or oral side agreements has been indicted.
- The 10 (or more) non-Enron companies that Chase and Citibank assisted in setting up phony “prepay” schemes to hide debt from auditors and shareholders have not yet been publicly identified by congressional investigators. Those frauds appear to have been quietly “swept under the carpet” and could be ongoing.
- None of the common sense ideas for improvement of financial statement presentation advocated by former Andersen CEO Joseph Berardino have been adopted.
- There has been no change in the required presentation of SPEs. The FASB has proposed that the 3% residual equity threshold be increased to a 10%, a change of little consequence.
- Companies are still granted exemptions from the provisions of investor protection laws by the SEC.
- JP Morgan Chase has collected US\$ 600 million from a group of 11 insurance companies to compensate Chase for part of the US\$ 1 billion loans where Chase chose to rely on oral rather than written loan agreements ([Berger, 2003](#)).
- Merrill Lynch agreed to pay the SEC US\$ 80 million to compensate for Merrill Lynch’s decision to use oral rather than written loan agreements ([Fowler, 2003a](#)).
- Andersen’s summary execution has severely disrupted the lives and livelihoods of 85,000 Andersen employees and their families worldwide. Many employees joined rival accounting firms. Others abandoned public accounting after concluding that the demonstrated lack of integrity in business and government has made public accounting no less risky than Russian roulette. Some former Andersen employees, especially those with experience in training, human resources or secretarial work, have been unable to find comparable jobs.

Some have had to live off their 401(k) accounts and sell homes and other assets in order to live. Several former Andersen employees have committed suicide, leaving behind wives and young children.

- Over 5000 retirees have lost retirement benefits. Fortunately, non-partner retirees are covered by a pension plan secure under ERISA laws. Retired partners, on the other hand, set aside funds during their earning years in a deferred compensation plan to pay for their old age. These funds are gone. Many of our elderly have lost their main source of income and some, including the chronically ill, are destitute.
- Andersen people, retirees and alumni, have worked countless hours at no pay to help others, especially the most vulnerable—the elderly, the unemployed, the widowed, the impoverished and the ill—to find jobs and health insurance and solve a host of problems ranging from taxes to reinvestment decisions. Most important are their efforts to reach out to Andersen people they may never have met to provide emotional support in the face of an atmosphere that has been aptly described as a “witch hunt” (Fowler, 2002m) or “corporate McCarthyism” (Fowler, 2002m).
- The House Energy and Commerce Committee notified the Justice Department that they believe the e-mail reminder by Nancy Temple, Andersen lawyer, saying that it “might be useful to consider reminding the engagement team of our documentation and retention policy” (Temple, 2001) was really a hidden signal to destroy documents (Associated Press, 2002n). According to the unusual “logic” of politicians (and the Justice Department), Ms. Temple’s instructions to be sure to follow company policy were instead a secret signal to flout company policy.
- U.S. District Court Judge Melinda Harmon ruled that Nancy Temple should be dismissed from the civil lawsuit filed by Enron shareholders. This absolves her of civil responsibility but she is still subject to a 5-year statute of limitations on a possible criminal charge of obstruction of justice (Flood and Fowler, 2003). The jurors’ conviction of Andersen turned on the supposed criminality of Ms. Temple’s e-mail. Yet the same judge who could have thrown out that verdict as a miscarriage of justice subsequently ruled that the e-mail does not rise to a matter worthy of even civil litigation.
- Rusty Hardin, defense lawyer for Andersen, said he “will never again represent a client who [like Andersen] agrees to waive attorney–client privilege to cooperate with the government. They don’t mean wrong,” Hardin said of prosecutors asking that cooperating defendants waive attorney–client privilege, “but they are dangerous as hell” (Flood, 2003a).
- SEC indicted four former Merrill Lynch executives with civil fraud on the grounds that they “aided and abetted” Enron’s efforts to make false statements that would be used in the sale of securities and SEC filings (Fowler, 2003b).
- Andersen has yet to be allowed to tell the facts of the Enron audit in court. However, in his Third Interim Report on Enron, Neal Batson, Bankruptcy Examiner, reports on his examination of Andersen’s audit workpapers in addition to documentation within both Enron and six of the financial institutions that participated in SPEs with Enron—Citigroup, JP Morgan Chase, Barclays Bank, BT/Deutsche, Canadian Imperial Bank of Commerce and Merrill Lynch. His report is also based on interviews and sworn testimony from individuals at Andersen, Enron and the various banks. The Bankruptcy Examiner concludes,

Evidence suggests that certain [Enron] officers entered into side agreements with Financial Institutions that they knew would have precluded the desired accounting and concealed the existence of those agreements from Andersen.

The evidence also suggests that certain officers concealed from Andersen particular aspects of transactions that the officers knew would have an adverse effect on the desired accounting treatment. In other instances, evidence suggests that certain Enron officers had actual knowledge that Andersen's advice regarding the accounting for SPE transactions was based on a mischaracterization of material facts or that the transactions lacked any business purpose.

The evidence also reflects numerous instances in which Enron officers carefully controlled the flow of information to Andersen in order to achieve a specific accounting result. In an e-mail to [Michael] Kopper regarding Chewco, Shirley Hudler of ENA [Enron North America] states, "I don't know how we are going to 'manage' the Arthur Andersen questions re[garding] Chewco's ability to repay—will work with Clint Walden ([Accounting] Support) to craft a story." (Batson, 2003b, pp. 32–33)

- Regarding Citibank, Chase, Barclays Bank, B/T Deutsche, Canadian Imperial Bank of Commerce and Merrill Lynch, the Bankruptcy Examiner concludes:

There is evidence . . . that certain Financial Institutions, assisting Enron officers:

- (i) participated in or were aware of side agreements or undisclosed understandings that they knew would invalidate Enron's desired accounting treatment if known by Andersen;
- (ii) participated in or were aware of misrepresentation of facts to Andersen that they knew would have invalidated Enron's desired accounting treatment if known by Andersen;
- (iii) participated in or were aware of specific aspects of the SPE transaction that they knew would invalidate Enron's desired accounting treatment if known by Andersen;
- (iv) knew, based upon their own independent analysis, that Enron's desired accounting treatment was improper; or
- (v) knew that Enron's disclosure of the SPE transaction in which they participated was materially misleading to third-party creditors, investors and other users of Enron's financial statements, regardless of technical compliance with GAAP (Batson, 2003b, pp. 38–39)

Consequently, the Bankruptcy Examiner concluded that each of these financial institutions "aided and abetted" (Batson, 2003b, p. 4) Enron officers in their fraud.

- JP Morgan Chase (Chase) and Citigroup agreed to pay US\$ 300 million to settle charges they helped Enron and Dynegy fraudulently manipulate financial statements. Chase is to pay US\$ 135 million and Citigroup US\$ 120 million to settle with the SEC. In addition, Chase will pay US\$ 27.5 million and Citigroup US\$ 25.5 million under a deal with New York State officials which includes a provision that the New York district attorney will not prosecute either the firms or their employees (Fowler, 2003c).
- "To avoid prosecution for its deals with Enron, Merrill Lynch entered into a deferred prosecution agreement with the Justice Department, saying company employees violated criminal law and helped Enron do the same, and knowingly caused others to make false

statements to a grand jury, Congress, the SEC and the Enron Bankruptcy Examiner. Under the agreement, Merrill Lynch accepted responsibility for its employees' actions and pledged to avoid any similar problematic transactions, form a committee to ensure strict compliance, report to independent outside auditors and allow a prosecutor-appointed lawyer to monitor their work. Should Merrill Lynch violate the agreement, the government could file criminal charges." (Flood, 2003b)

- The New York Stock Exchange chose former Citigroup Chairman and CEO John Reed as its interim leader. Mr. Reed said "there had been some failures in corporate governance at the exchange [NYSE] and he would make the issue a priority" (McClam, 2003).

Mr. Reed was Chairman and CEO of Citicorp from 1984 until 1998 and was Chairman and co-CEO of Citigroup from 1998 until April, 2000. It was during his tenure as CEO that Citigroup entered into the following phony transactions with Enron:

NIGHTHAWK/US\$ 500 million minority interest financing (closed 12/29/97);
 RAWHIDE/US\$ 750 million minority interest financing (closed 12/18/98);
 ROOSEVELT/US\$ 500 million prepay transaction (closed 12/30/98);
 TRUMAN/US\$ 250 million prepay transaction (closed 6/29/99);
 JETHRO/US\$ 337.5 million prepay transaction (closed 9/29/99);
 YOSEMITE I Prepay/US\$ 800 million (closed 11/18/99);
 NIXON/US\$ 104 million prepay transaction (closed 12/15/99);
 NAHANNI/US\$ 500 million minority interest financing (closed 12/29/99); and
 YOSEMITE II/US\$ 331.8 million prepay transaction (closed 2/23/00) (Batson, 2003b, Appendix D, pp. 12–14).

The Bankruptcy Examiner reviewed the above transactions (among others) and concluded that there is sufficient evidence for "a fact-finder to conclude that Citigroup aided and abetted certain Enron officers in breaching their fiduciary duties" (Batson, 2003b, Appendix D, p. 148).

- Enron and Enron North America sued JP Morgan Chase, Citigroup, Merrill Lynch, Canadian Imperial Bank of Commerce, BT/Deutsche Bank and Barclays Bank, seeking:
 - (i) to recover US\$ 3 billion from the banks in connection with the financing transactions;
 - (ii) to have the banks' claims as Enron creditors subordinated to claims of other creditors; and
 - (iii) unspecified "enormous damages" for the banks' participation in the schemes (Hays, 2003).
- U.S. District Court Judge Melinda Harmon dismissed the following parties from the lawsuit on behalf of employees and their pension plan: Vinson & Elkins law firm, outside directors of Enron's board, former Enron CEO Jeff Skilling, former CFO Andrew Fastow, Citigroup, Salomon Smith Barney, JP Morgan Chase & Co., CreditSuisse First Boston Corp. and Merrill Lynch (Flood, 2003c).
- Michael Chertoff, Chief of the Criminal Division of the Department of Justice, has been nominated by President Bush (and subsequently confirmed) to the U.S. Court of Appeals for the 3rd Circuit (Schmidt, 2003).

One would think that an individual who has trampled the rule of law would be censured, disbarred or prosecuted rather than rewarded with a lifetime appointment to sit in

judgment of others. Clearly the end justifies any means, especially when the end is to maintain political power and the steady gush of campaign contributions. Evidently this is what passes for integrity and justice in today's America.

The Enron fraud was orchestrated by individuals at Enron in collusion with individuals at various financial institutions by means of: (1) omission of material facts and (2) dishonest representations. Similarly, the destruction of Andersen was engineered by means of: (1) omission of material facts and (2) dishonest representations. Both are frauds, one no better than the other. How can any person of reason and integrity condemn one fraud and endorse the other?

4. Methodology

The foregoing discussion is based solely on facts regarding Enron and Andersen found in the public record prior to November 11, 2003. This document is extremely time-sensitive. Therefore subsequent developments will be covered in future analyses. I analyzed documents regarding Enron and Andersen and reports of those who reviewed such documents, weighing their conclusions in light of the documents examined and the relevance of those documents to audit conclusions. In addition I reviewed news items regarding the trial and subsequent events. Thus the foregoing article is based on facts analyzed from the perspective of a CPA.

There has been much discussion in the media regarding culture at Andersen. Such a discussion necessarily is a matter of opinion. An intelligent discussion of culture at Andersen would address the issue in the context of the culture of our society.

Analysis of Andersen management decisions would need to address strategy in response to ballooning litigation exposure for circumstances beyond a CPA's control as well as the implications of specific changes within public accounting such as the profession's change from principle-based 'generally accepted accounting principles' (GAAP) to rules-based GAAP.

The topics of Andersen culture and Andersen strategic decisions may be of interest but they remain outside the scope of this study.

Many questions remain:

(1) Prior to the indictment, Andersen was under gag order but since then, why has Andersen not effectively told its story?

Did Andersen partners presume that in America they would be entitled to a fair hearing before execution? Did Andersen have reason to believe that Citigroup would call their notes due from Andersen, driving Andersen and individual Andersen partners into bankruptcy if Andersen told the facts of the Citigroup participation in the fraud? Did Andersen try to tell the facts but were unable to penetrate the closed minds of the media? During the meltdown when Andersen partners and staff were joining the Final Four firms, did Andersen feel compelled to sign a non-disclosure agreement with those accounting firms, whose clients included LJM and the financial institutions who aided and abetted the Enron officers in their fraud? Did Andersen also sign an agreement with the Final Four firms precluding Andersen from suing the various financial institutions, clients of the Final Four firms, for participating in the fraud?

We don't know the answers to these questions.

(2) Where were the auditors of the SPEs and the financial institutions? Where were the Bank Examiners?

At Enron, the Bankruptcy Examiner found no documentation (other than a few e-mails which would not be subject to examination in a normal audit) of the hidden side agreements. This is not surprising in that Enron's role in the fraud was to persuade financial institutions to accept oral assurances of repayment instead of standard written loan documents.

In contrast, the banks had widespread documentation of the fraud. In case after case, numerous individuals at the various banks noted in credit applications, credit committee agendas, memos and e-mails the fact that Enron had orally agreed to repay the institutions.

For example, at Citigroup a memo regarding the Enron/ROOSEVELT update states "the paperwork cannot reflect their agreement to repay US\$ 190MM as it would unfavorably alter the accounting" (Batson, 2003b, Appendix D, p. 58). "A July, 2001 analysis of Enron drafted by Citigroup officers stated: 'Enron's total volume of prepaids . . . represents essentially another layer of corporate debt in addition to debt accounted as such'" (Batson, 2003b, Appendix D, p. 73).

JP Morgan Chase "communicated with bank regulators describing prepaids as loans rather than equity" (Batson, 2003b, Appendix E, p. 37). An e-mail described prepaids as "attractive accounting impact by converting funded debt to 'deferred revenue,' or long-term trade payable" (Batson, 2003b, Appendix E, p. 20). "In a taped telephone conversation among several JP Morgan Chase employees concerning Enron and a possible prepay transaction, one of the employees observed: 'I think what we're trying to gauge is . . . how aggressive they are to pay for this stuff now . . . [to] discreetly get, you know, several hundred million dollars and have no market knowledge of what's going on . . .'" (Batson, 2003b, Appendix E, p. 50). "Although JP Morgan Chase arranged the Mahonia transactions and funded them, JP Morgan Chase was not willing to rely solely on Enron for repayment. In the earlier Mahonia transactions, JP Morgan Chase required that Enron obtain letters of credit to protect JP Morgan Chase if Enron did not perform. Later J P Morgan Chase required Enron to obtain surety bonds if Enron did not perform" (Batson, 2003b, Appendix E, p. 29).

A memo to the Barclays Group Credit, regarding a request to increase the loan sanction and commodities trading limits, October 24, 2001 states: "We are also aware that [Enron] enters into off-balance sheet transactions whereby it sells and subsequently has the option to repurchase the assets. (Barclays has currently purchased assets to a value of USD 1.5 billion.) These transactions have the effect of significantly understating the debt level and assets on the balance sheet" (Batson, 2003b, Appendix F, pp. 14–15). A memo entitled "Williams Transaction Comment, November 14, 2000" states: We [Barclays] have had a number of conversations about Enron about the transaction risks and have agreed to go forward on the basis of explicit verbal support from the company's Treasurer. Specifically, Ben Glisan will commit to us that under all circumstances Enron will execute its purchase option at a price sufficient to repay in full the holders of the B notes and Certificates [i.e. the 3% equity]" (Batson, 2003b, Appendix F, p. 23). The September, 2001 Exposures Committee state that "Barclays was even concerned about the effect of the survival of 'verbal assurances from the CFO as support for the Trust's equity if the CFO's tenure was at all at risk'" (Batson, 2003b, Appendix F, p. 26). The minutes of Barclays Operation Committee meeting, October 20, 1997 state that "Barclays was considering a US\$ 5 to 10 million 'quasi-equity' investment in

Chewco that Barclays was trying to structure and record as debt” (Batson, 2003b, Appendix F, p. 43).

CIBC “referred to the equity as ‘trust me’ equity” (Batson, 2003b, Appendix H, p. 6). One e-mail discloses that “we have done many ‘trust me’ equity transactions over the last 3 years and have sustained no losses to date” (Batson, 2003b, Appendix H, p. 6). “Numerous CIBC credit applications state either that ‘executive management at Enron has represented that this money . . . will absolutely be repaid’ or that ‘Enron is Not permitted to ASSURE a repurchase of our equity (though this is our undocumented “understanding” with the CFO)’ ” (Batson, 2003b, Appendix H, pp. 6–7). A June 1999 Credit Application states, “ Like in the Project LEFTOVER transaction . . . this represents true equity risk. Note, however, executive management at Enron has represented that this money (as with Project LEFTOVER equity money) will absolutely be repaid” (Batson, 2003b, Appendix H, p. 79).

“A document entitled ‘Appropriation Request Cover Page’ that was circulated within Merrill Lynch on December 23, 1999 noted that ‘[Enron Corp.] has asked Merrill Lynch to purchase US\$ 75MM of equity in a special purpose vehicle that will allow Enron Corp. to book US\$ 12MM earnings.’ ” (Batson, 2003b, Appendix I, p. 32). “Appropriation Request Regarding the Nigerian Barge Transaction dated December 23, 1999 states: ‘Enron is viewing this as a bridge to permanent equity and they have assured us that we will be taken out of our investment within six months . . . Dan Bayly will have a conference call with senior management of Enron confirming this commitment to guaranty the ML takeout within six months.’ ” (Batson, 2003b, Appendix I, p. 33)

Given the size of the transactions and their importance to the respective financial institutions, one would expect the banks’ auditors to have examined at least some of the transactions. If so, the auditors should have examined all documentation pertaining to the transaction. The lack of written loan agreements and the widespread documentation of verbal side agreements should have immediately triggered an alarm because they raise the likelihood of fraud.

Therefore, questions must be asked: What did the banks’ auditors know and when did they know it? What did the Bank Examiners know? If the banks’ auditors or the Bank Examiners knew anything, what did they do about it? Apparently, nothing.

My review of the facts in the public domain regarding Enron and Andersen lead to two inescapable conclusions:

(1) Based on all of the evidence, it is evident that Andersen was used as a scapegoat in order to shift the limelight from the malfeasance of political and financial cronies.

Even if Andersen had become too focused on profits (and that has certainly not been proved by comparison to some appropriate standard, if such a standard exists), the fact that Andersen partners wanted to earn money had no bearing on Andersen’s audit of Enron.¹⁴

¹⁴ The only valid comparison available to date is anecdotal evidence that some Andersen partners believe that Andersen became too profit-driven. Since Arthur Andersen & Co. had been renowned throughout its history for its focus on taking tough stands regardless of profits, the only standard of comparison for Andersen partners is with its extraordinarily altruistic past. There is no evidence that the Andersen of 2001 was any more focused on profits than any other CPA firm. To the contrary, to my knowledge no one has ever associated Andersen people with the lack of professionalism demonstrated by the participants of the “Suicide Bridge” meeting.

Enron's financial statements were wrong due to fraud occurring within entities who were not Andersen audit clients and the fraud was assisted by a host of banks, brokerages and others who also were not Andersen clients. Had the true facts been known, the fraud would have been prevented because Andersen would have required the consolidation of all SPEs.

One can legitimately ask why Andersen retained Enron as a client after 1997 when the SEC allowed Enron to set up SPEs. Andersen was on record as favoring the consolidation of SPEs, a position opposed by the accounting profession. While one might conclude that Andersen should have resigned at that point, one must also concede it is difficult for a firm to survive if it holds itself to far higher standards than either its competitors or government regulators.

Another good time for Andersen to have resigned was in February, 2002. It is always difficult to read a historical document without being influenced by one's knowledge of subsequent events. Thus the Client Retention memorandum dated February 26, 2001 (Jones, 2001) should be read bearing in mind that the memorandum documented a discussion among individuals who had no possible knowledge of either the fraud or Andersen's subsequent destruction. Trying to read the document in that light, I believe that they should have recommended resigning from the work of Enron.

However, even had there been no fraud, Andersen would have been at considerable risk for litigation in the event of resignation. Enron stock was far overpriced relative to any information found in its financial statements and the news of its auditor's resignation would surely have triggered a fall in stock price, inevitably resulting in a shareholder lawsuit against Andersen.

It is certainly possible that a careful examination of the audit workpapers (as opposed to my examination of facts in the public domain) will reveal some kind of error, other than the Swap Sub mistake, made by Andersen. We don't know; Andersen has not been given the opportunity to detail the facts of the audit. In any case, the time for such an examination is before the execution (if any), not after.

(2) The Andersen case exemplifies an extreme degradation of culture in our society.

Who would imagine that we would see such a widespread pattern of fraud among so many companies and, in the case of Enron, assisted by so many banks, brokerages and others? Who would imagine that prestigious international accounting firms would conspire with a politician to destroy a rival? Who would imagine that both our elected politicians and the Justice Department would not only abandon the presumption of innocence but would participate in the lynching of those they knew (or should have known) to be innocent? Who would imagine that a Federal judge would appear to have abandoned even the pretence of impartiality? Who would imagine that most in the media would fail to check the most basic facts and simply yawn in the face of such an egregious abuse of government power?

Having reviewed the facts of the fraud and the events subsequent to its discovery, my own conclusion is that the profession of public accounting is no longer viable. CPAs specializing in either auditing or tax accounting make judgments based on clients' records and assertions and depend on honest confirmations and representations from third parties. Thus a CPA's fate is held hostage to the integrity (or lack thereof) of others.

The judgments of a CPA are painstakingly documented in audit or tax workpapers, the responsibility for each decision delineated by a dated signature. In contrast to the oral

agreements so prevalent in the Enron frauds, those signatures remain on file indefinitely. With every signature a CPA assumes responsibility, risking his career and his family's financial future.

Although CPAs do investigate potential clients before agreeing to a client engagement, investigations cannot uncover all potential problems. When a CPA firm does agree to perform an audit, the most rigorous audit cannot uncover collusion to defraud even if an auditor were to look at every transaction rather than a necessarily small sample. The CPA has at best only a very imperfect window into a client. Yet the CPA bears tremendous risk.

When one considers both the widespread fraud in our society and the fact that the public apparently supports the destruction of the livelihoods of over 85,000 Andersen employees and over 5000 Andersen retirees without ever giving them a chance to speak, why would any rational person be willing to assume the risks of a career in public accounting?

As the facts become known regarding the Enron audit and the summary execution of Andersen, more CPAs will reassess their risk and leave the profession. Others will refuse to audit publicly-traded clients with their increased risk of both shareholder lawsuits and draconian government retribution based on political expediency. Another logical response to Andersen's political execution would be a refusal to sign an audit or a tax return where the client or its management contributes more than a very 'de minimus' amount in total to politicians or political parties on the grounds that politicians have proved that they will "shoot the messenger" in order to distract attention from their own cozy arrangements with supporters.

One thing is certain. The destruction of Andersen and the censure of the accounting profession in response to the Enron fraud have solved absolutely nothing. Real solutions can only be based on a careful examination of the facts and the relevant facts have yet to be examined. This analysis is an attempt to finally start the process.

Acknowledgements

I would like to thank the many retired partners of Arthur Andersen, especially my husband, Dan K. Morrison, who offered both encouragement and suggestions. Andersen people have demonstrated tremendous character by standing tall in the face of vilification and impoverishment. I am proud to stand with them.

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