# Enron Scandal: The Fall of a Wall Street Darling

By [Investopedia](https://www.investopedia.com/contributors/0/) | Updated January 3, 2018 — 11:34 AM EST

The story of [Enron](https://www.investopedia.com/terms/e/enron.asp) Corp. is the story of a company that reached dramatic heights, only to face a dizzying fall. Its collapse affected thousands of employees and shook [Wall Stree](https://www.investopedia.com/terms/w/wallstreet.asp)t to its core. At Enron's peak, its shares were worth $90.75; when it declared [bankruptcy](https://www.investopedia.com/terms/b/bankruptcy.asp) on December 2, 2001, they were trading at $0.26. To this day, many wonder how such a powerful [business](https://www.investopedia.com/terms/b/business.asp), at the time one of the largest companies in the U.S,  disintegrated almost overnight and how it managed to fool the regulators with fake holdings and off-the-books accounting for so long.

1. What do you understand by fake holdings and off –the- books accounting

**"America's Most Innovative Company"**

Enron was formed in 1985, following a merger between Houston Natural Gas Co. and Omaha-based InterNorth Inc. Following the merger, Kenneth Lay, who had been the [chief executive officer](https://www.investopedia.com/terms/c/ceo.asp) (CEO) of Houston Natural Gas, became Enron's CEO and chairman and quickly rebranded Enron into an energy trader and supplier. [Deregulation](https://www.investopedia.com/terms/d/deregulate.asp) of the energy markets allowed companies to place bets on future prices, and Enron was poised to take advantage.

The era's regulatory environment also allowed Enron to flourish. At the end of the 1990s, the [dot-com bubble](https://www.investopedia.com/terms/d/dotcom-bubble.asp) was in full swing, and the [Nasdaq](https://www.investopedia.com/terms/n/nasdaq.asp) hit 5,000. Revolutionary internet [stocks](https://www.investopedia.com/terms/s/stock.asp) were being valued at preposterous levels and consequently, most investors and regulators simply accepted spiking share prices as the new normal.

Enron participated by creating Enron Online (EOL) in October 1999, an electronic [trading](https://www.investopedia.com/terms/o/onlinetrading.asp) website that focused on commodities. Enron was the [counterparty](https://www.investopedia.com/terms/c/counterparty.asp) to every transaction on EOL; it was either the buyer or the [seller.](https://www.investopedia.com/terms/s/seller.asp) To entice participants and trading partners, Enron offered up its reputation, credit, and expertise in the energy sector. Enron was praised for its expansions and ambitious projects, and named "America's Most Innovative Company" by*Fortune* for six consecutive years between 1996 and 2001.

By mid-2000, EOL was executing nearly $350 billion in trades. When the dot-com bubble began to burst, Enron decided to build high-speed broadband telecom networks. Hundreds of millions of dollars were spent on this project, but the company ended up realizing almost no [return](https://www.investopedia.com/terms/r/return.asp).

When the [recession](https://www.investopedia.com/terms/r/recession.asp) hit in 2000, Enron had significant exposure to the most volatile parts of the market. As a result, many trusting [investors](https://www.investopedia.com/terms/i/investor.asp) and [creditors](https://www.investopedia.com/terms/c/creditor.asp) found themselves on the losing end of a vanishing [market cap](https://www.investopedia.com/terms/m/marketcapitalization.asp).

1. What was the main business Enron was involved in?
2. What does deregulation mean? Do you think deregulation should be used in all areas of economy? Why yes or no?
3. What does dot com bubble mean? How did Enron benefit from this situation?What was the final outcome for Enron

**The Collapse of a Wall Street Darling**

By the fall of 2000, Enron was starting to crumble under its own weight. CEO Jeffrey Skilling had a way of hiding the financial losses of the trading business and other operations of the company; it was called [mark-to-market accounting](https://www.investopedia.com/terms/m/marktomarket.asp). This is a technique used where you measure the value of a [security](https://www.investopedia.com/terms/s/security.asp) based on its [current market value](https://www.investopedia.com/terms/c/cmv.asp), instead of its [book value](https://www.investopedia.com/terms/b/bookvalue.asp). This can work well when trading securities, but it can be disastrous for actual businesses.

In Enron's case, the company would build an [asset,](https://www.investopedia.com/terms/a/asset.asp) such as a power plant, and immediately claim the projected [profit](https://www.investopedia.com/terms/p/profit.asp) on its books, even though it hadn't made one dime from it. If the [revenue](https://www.investopedia.com/terms/r/revenue.asp) from the power plant was less than the projected amount, instead of taking the loss, the company would then transfer the asset to an off-the-books corporation, where the loss would go unreported. This type of accounting enabled Enron to write off unnprofitable activities without hurting its [bottom line](https://www.investopedia.com/terms/b/bottomline.asp).

The mark-to-market practice led to schemes that were designed to hide the losses and make the company appear to be more profitable than it really was. To cope with the mounting [liabilities](https://www.investopedia.com/terms/l/liability.asp), Andrew Fastow, a rising star who was promoted to [CFO](https://www.investopedia.com/terms/c/cfo.asp) in 1998, came up with a deliberate plan to make the company appear to be in sound financial shape, despite the fact

that many of its subsidiaries were losing money

1. How was Enron hiding it losses?
2. What does bottom line mean in this context?
3. Why was Andrew Fastow hired?

## Arthur Andersen and Enron: Risky Business

In addition to Andrew Fastow, a major player in the Enron scandal was Enron's accounting firm Arthur Andersen LLP and partner David B. Duncan, who oversaw Enron's accounts. As one of the five largest accounting firms in the United States at the time, Andersen had a reputation for high standards and quality [risk management.](https://www.investopedia.com/terms/r/riskmanagement.asp)

However, despite Enron's poor accounting practices, Arthur Andersen offered its stamp of approval, signing off on the corporate reports for years – which was enough for investors and regulators alike. This game couldn't go on forever, however, and by April 2001, many [analysts](https://www.investopedia.com/terms/a/analyst.asp) started to question Enron's [earnings](https://www.investopedia.com/terms/e/earnings.asp) and their [transparency](https://www.investopedia.com/terms/t/transparency.asp).

1.What was the role of Arthur Andersen in Enron Scandal?

## The Shock Felt Around Wall Street

By the summer of 2001, Enron was in a free fall. CEO Ken Lay had retired in February, turning over the position to Jeff Skilling; that August, Skilling resigned as CEO for "personal reasons." Around the same time, analysts began to [downgrade](https://www.investopedia.com/terms/d/downgrade.asp) their [rating](https://www.investopedia.com/terms/r/rating.asp) for Enron's stock, and the stock descended to a 52-week low of $39.95. By Oct.16, the company reported its first quarterly loss and closed its "Raptor" SPV so that it would not have to distribute 58 million shares of stock, which would further reduce earnings. This action caught the attention of the [SEC](https://www.investopedia.com/terms/s/sec.asp).

A few days later, Enron changed [pension plan administrators](https://www.investopedia.com/terms/p/plan_administrator.asp), essentially forbidding employees from selling their shares, for at least 30 days. Shortly after, the SEC announced it was investigating Enron and the SPVs created by Fastow. Fastow was fired from the company that day. Also, the company [restated](https://www.investopedia.com/terms/r/restatement.asp) earnings going back to 1997. Enron had losses of $591 million and had $628 million in debt by the end of 2000. The final blow was dealt when Dynegy , a company that had previously announced would merge with the Enron, backed out of the deal on Nov. 28. By Dec. 2, 2001, Enron had filed for bankruptcy.

1. Explain how Enron went bust –make a flow chart

## Criminal Charges

Arthur Andersen was one of the first casualties of Enron's prolific demise. In June 2002, the firm was found guilty of obstructing justice for shredding Enron's financial documents to conceal them from the SEC. The conviction was overturned later, on appeal; however, the firm was deeply disgraced by the scandal, and dwindled into a holding company. A group of former partners bought the name in 2014, creating a firm named Andersen Global.

Several of Enron's execs were charged with a slew of charges, including conspiracy, [insider trading](https://www.investopedia.com/terms/i/insidertrading.asp), and [securities fraud](https://www.investopedia.com/terms/s/securities-fraud.asp). Enron's founder and former CEO Kenneth Lay was convicted of six counts of fraud and conspiracy and four counts of bank fraud. Prior to sentencing, though, he died of a heart attack in Colorado.

Enron's former star CFO Andrew Fastow plead guilty to two counts of [wire fraud](https://www.investopedia.com/terms/w/wirefraud.asp) and securities fraud for facilitating Enron's corrupt business practices. He ultimately cut a deal for cooperating with federal authorities and served a four-year sentence, which ended in 2011.

Ultimately, though, former Enron CEO Jeffrey Skilling received the harshest sentence of anyone involved in the Enron scandal. In 2006, Skilling was convicted of conspiracy, [fraud](https://www.investopedia.com/terms/f/fraud.asp), and insider trading. Skilling originally received a 24-year sentence, but in 2013 it was reduced by 10 years. As a part of the new deal, Skilling was required to give $42 million to the victims of the Enron fraud and to cease challenging his conviction. Skilling remains in prison and is scheduled for release on Feb. 21, 2028.

1. What were the charges against Arthus Andersen?
2. What is conspiracy, insider trading securities fraud and wire fraud?
3. Do you agree with verdict?