


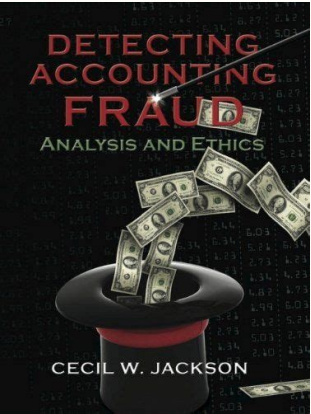
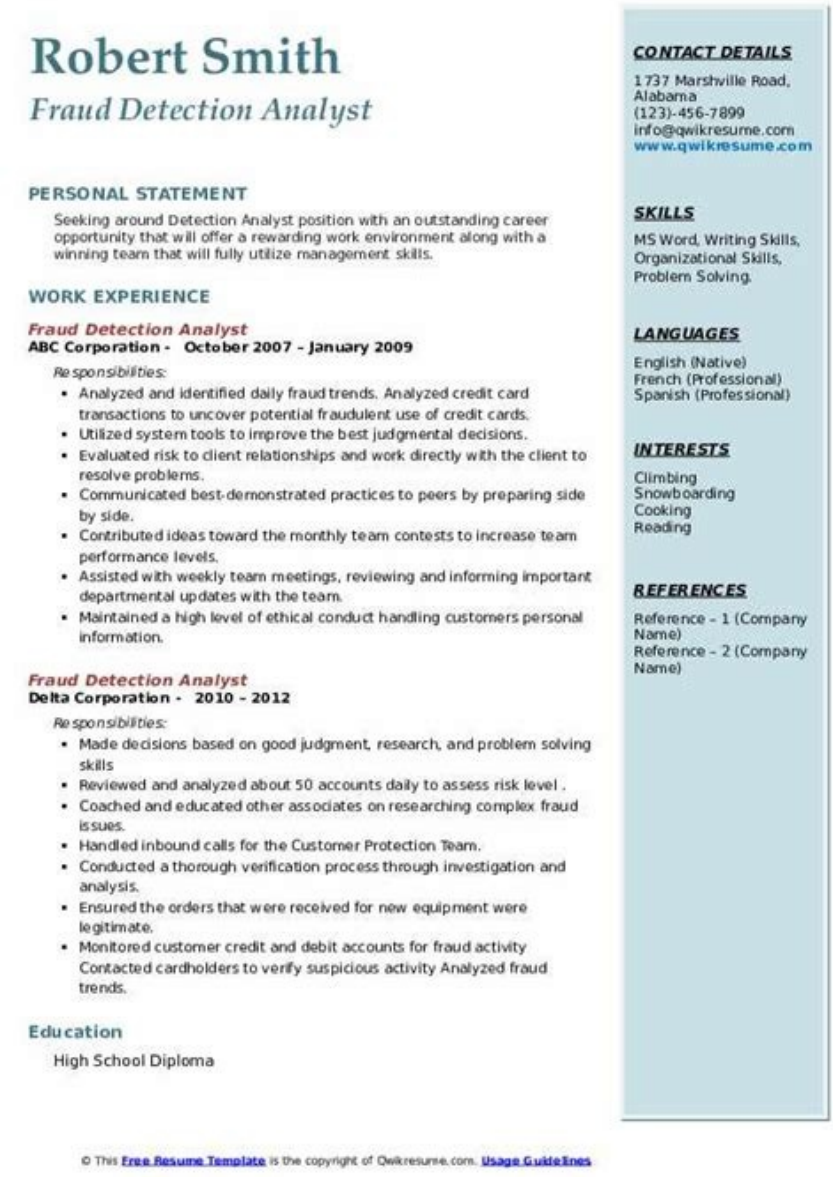
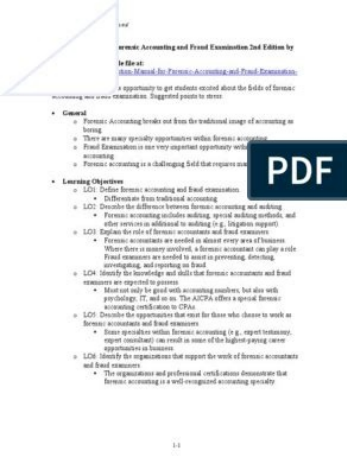
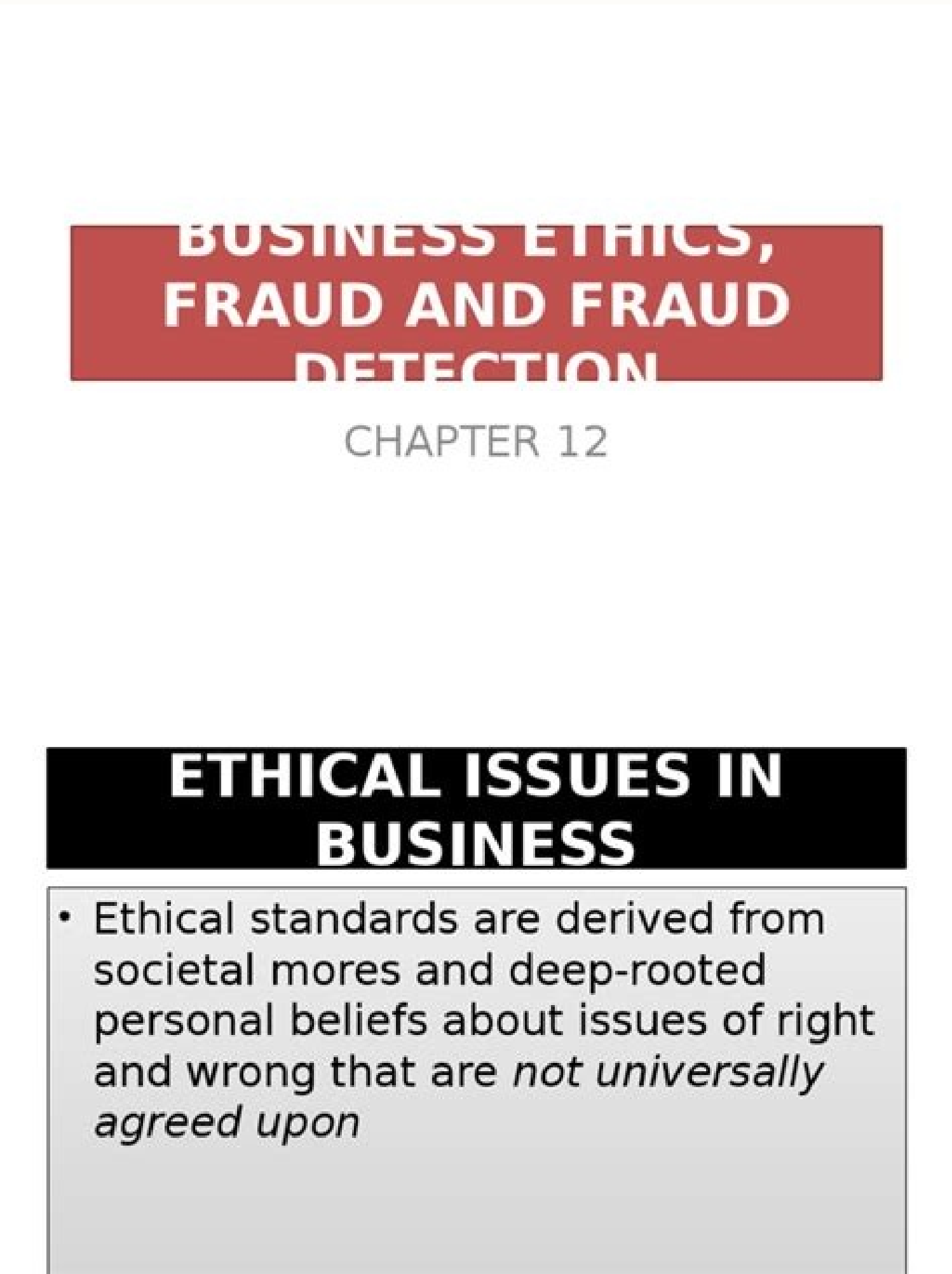
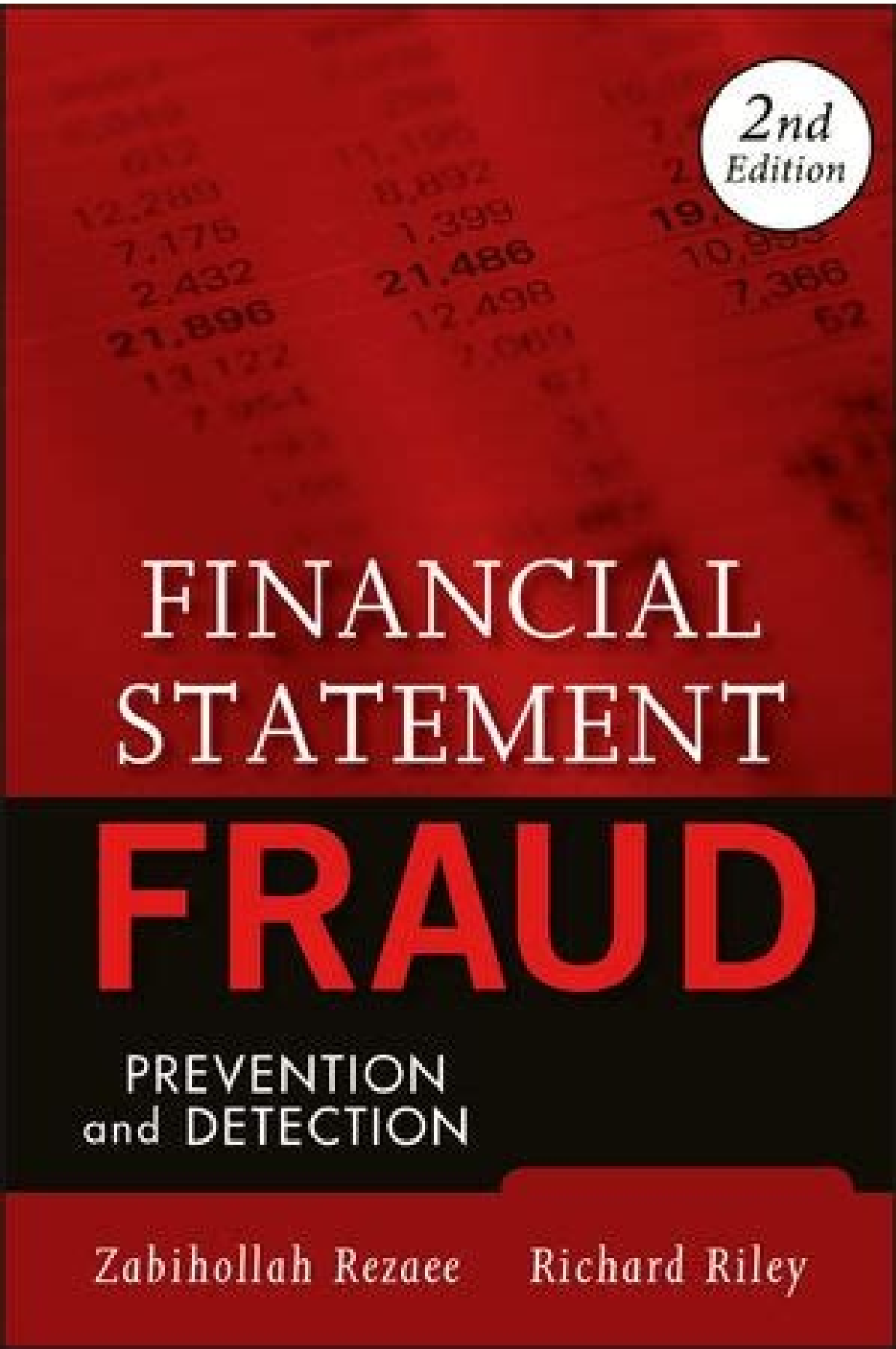
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Enron and the Tale of the Golden Goose 277 However, trading profits are extremely erratic, and Jim Chanos, a broker and shortseller, called Enron a "hedge fund sitting on a pipeline." Chanos also noted that "Enron was at a speculative trading shop, which meant that, at an absolute minimum, its outside price-to-earnings ratio was too high." (Ole G. Dahl, *Enron: The Inside Story*, 1999, p. 186.) Enron's dramatic price decline in 2001 was the result of a number of factors, including the SEC's final judgment "without admitting or denying the allegations," Assaf, Pardue, and Simmons were ordered to pay "civil money penalties of \$50,000, \$40,000, and \$50,000, respectively" (AER 1020, 1998). Numerous executives have been exposed in cases of greed and betrayal, of blatant duplicity and moral bankruptcy. • A breakdown in responsibility and ethical standards. In dealing with the problem of how to teach and cultivate the virtues, virtue ethics often uses narratives to illustrate how a virtuous person ac 059402, 01 ch4 p117-143.indd 139 7/7/14 9:02 AM 140 Chapter 4 • Hocus Pocus MARCH 31, 2001 MARCH 31, 2000 82,717,293,537,192,855,233,504 Property and equipment, net Goodwill, net of accumulated amortization of \$334,178 and \$544,066, respectively. According to the December 31, 2007, 10-K, "TierOne Corporation ("Company") is a Wisconsin corporation headquartered in Lincoln, Nebraska. Unqualified audit opinion on erroneous financial statements could result in the audit firm being sued for monetary damages. Production of these engines was continually delayed by the Automaker until October 2002, when it cancelled the Agreement and discontinued its V-6 engine program with Navistar. "Ex-Cendant CFO Avoids Prison." CFO.com. This acceleration of future quarters' sales into the present quarter "provided a misleading impression of the Company's results of operations for the present period." A worse consequence, of course, was that it "also resulted in the erosion of the company's profit margins and impoverished sales in later periods." In a nutshell, this began a death spiral because the play would have to be repeated in the future in order for the company to announce success in the future. Failing to do this, Enron's CEO would have been forced to announce a restatement of the company's financial statements, which would have had a devastating effect on the company's stock price. The company's financial statements were audited by Arthur Andersen, a firm that had been accused of "operating in the gray area between legitimacy and outright fraud." He observed, "Integrity may be losing out to illusion." In order to achieve these illusory earnings and fabricated balance sheets, many companies resort to what Levitt described as "hocus pocus." This chapter presents a brief overview of, at worst, some of the lesser-known, intentional revenue-recognition accounting frauds or, at best, misguided attempts to "improve" a company's financial statements with aggressive accounting. However, the Commission found that at least \$6 million of this reserve was overstated. "Lockheed 1-1011," Super70s.com. In the early 1970s, Lay's undergraduate economics professor, Pinkney Walker, was appointed to the Federal Power Commission, and Walker selected Lay as his chief aide. Second, knowing that a new firm would be arriving the following year and reviewing the work papers and the client's financial statements would have been an added incentive for external auditors to resist management's pressure to compromise their audits. It reported restated revenue of \$13.1 million in the first quarter, compared to \$14.7 million previously reported. As the Bankruptcy Report pointed out, "It is the inappropriate release of these reserves that results in one form of earnings management" (First Interim Report, 2002, p. Specifically, reflect on the Supreme Court statement from almost 50 years ago and discuss how it applies to the crisis of 2008. In his First Interim Report (2002), Richard Thornburgh, WorldCom's Bankruptcy Examiner, presented a list of the gatekeepers who failed WorldCom. The majority of corporate fraud cases pursued by the FBI involve accounting schemes to deceive investors, auditors, and analysts about the true financial condition of an entity in the form of manipulation of: (a) Financial data in the statement of financial position and income statement. But ultimately, they were gamblers, and they bet—on anything" (Swartz & Watkins, 2003, p. In what ways did Livent understate the expenses in the financial statements? With Livent's help, Enron had a "hocus pocus" strategy that was designed to increase its earnings and to avoid the negative consequences of a restatement of its financial statements. The company's financial statements were audited by Arthur Andersen, a firm that had been accused of "operating in the gray area between legitimacy and outright fraud." He observed, "Integrity may be losing out to illusion." In order to achieve these illusory earnings and fabricated balance sheets, many companies resort to what Levitt described as "hocus pocus." This chapter presents a brief overview of, at worst, some of the lesser-known, intentional revenue-recognition accounting frauds or, at best, misguided attempts to "improve" a company's financial statements with aggressive accounting. However, the Commission found that at least \$6 million of this reserve was overstated. "Lockheed 1-1011," Super70s.com. 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discuss to second-quency which of this is the view that morality possesses and which universality goes, if any. To test for an indication of a fictitious receivable, one should add the amount of the securitization—the cash received by selling a receivable that would normally be paid to the company later—back to the receivables (accounts receivable or, in Enron's case, "assets from price risk management activities") before calculating the ratio of the receivables-to-sales. Which of the following is not true regarding disclosure by Enron in its financial statements? Stanaway, who had no direct role in acquiring the rebate, then approved an entry recording the \$6.2 million as income in 2003. Signal #1: Increase in Accounts Receivable as a Percentage of Sales Once again, accounts receivable as a percentage of sales as captured in such measures as DSO is a leading signal of this fraud. Scheme #1: Overstating Ending Inventory Values to Reduce Cost of Goods Sold One of the three most significant methods that Rite Aid used to understate its cost of goods sold amount was that it overstated its ending inventory by failing to write down its inventory amount for the full amount of the shrinkage that it suffered. Instead, the company's accounts receivable increase. 5-8) Over the next few days, Dunlap fired five more executives. Case Study NAVISTAR INTERNATIONAL CORPORATION • Read the extracts from AER 3165, August 5, 2010. Although not actively involved in the schemes, he was nevertheless accused of neglecting to report the Rite Aid fraud. According to a recent Cornerstone Research article, "In 2012, the proportion of securities class action settlements involving accounting allegations increased to almost 70 percent from less than 50 percent in 2011" (qtd. November 17, 2005. Feinberg, Joel. (C) The packing case should be included in Ace's December 31 inventory. • Sensomartac was acquired by Tyco Inc. As consequentialist philosophy has developed over the years, different philosophers have specified different definitions of the good, or what ought to be maximized, but the utilitarian case for Enron's actions is clear. In 2004, Countrywide's dramatic transformation as follows: In 2004, Countrywide's reported production of conventional conforming loans dropped to 38.2%, its production of subprime loans had risen to 11%, its production of home equity loans had risen to 8.5%, and its production of conventional non-conforming loans had risen to 38.7%. EdisonLearning, 295 Edison Schools, Inc., 293-295 80/20 subprime loans, 336-337 Einstein, Albert, 48 EITF (Emerging Issues Task Force), 265 Electricity deregulation, 224-247 Electricity trading, by Enron, 236 Emerging Issue Task Force (EITF), 265 Employees, 54 England, Azurix water project in, 238-239 Enron, 30-32, 34, 37, 226-280 above of special purpose entities by, 248-263, 265-272, 276 accounts receivable as percentage of revenue, 273t Andron Fastow and, 234, 243, 250, 252, 254-263, 277, 279-280 California electricity fiasco, 244-247 cash flow from operations, 273t debt-to-equity ratio of, 275, 276t fictitious financial reporting schemes, 247-264 Gas Bank, 231-232 Jeffrey Skilling and, 231-235, 239, 242, 246, 256, 274, 277, 278 Kenneth Lay and, 227-231, 243, 278 losses sustained by, 236-244 mark-to-market accounting, 232-234, 235, 247-248, 256, 263 outcomes for, 278 prepayment transactions, 263-264 7/7/14 9:15 AM Glindex 398t prepay gains on sales of merchant assets, 268t, 269t Rebecca Mark and, 236-239, 278 signals of fraud at, 265-272 start of, 227-235 times interest-earned ratio of, 274-275, 278t Enron Broadband Services (EBS), 241-244 Enron Capital and Trade (ECT) Resources, 241-244, 245, 246, 247, 248, 249, 250, 251, 252, 253, 254, 255, 256, 257, 258, 259, 260, 261, 262, 263, 264, 265, 266, 267, 268, 269, 270, 271, 272, 273, 274, 275, 276, 277, 278, 279, 280, 281, 282, 283, 284, 285, 286, 287, 288, 289, 290, 291, 292, 293, 294, 295, 296, 297, 298, 299, 300, 301, 302, 303, 304, 305, 306, 307, 308, 309, 310, 311, 312, 313, 314, 315, 316, 317, 318, 319, 320, 321, 322, 323, 324, 325, 326, 327, 328, 329, 330, 331, 332, 333, 334, 335, 336, 337, 338, 339, 340, 341, 342, 343, 344, 345, 346, 347, 348, 349, 350, 351, 352, 353, 354, 355, 356, 357, 358, 359, 360, 361, 362, 363, 364, 365, 366, 367, 368, 369, 370, 371, 372, 373, 374, 375, 376, 377, 378, 379, 380, 381, 382, 383, 384, 385, 386, 387, 388, 389, 390, 391, 392, 393, 394, 395, 396, 397, 398, 399, 400, 401, 402, 403, 404, 405, 406, 407, 408, 409, 410, 411, 412, 413, 414, 415, 416, 417, 418, 419, 420, 421, 422, 423, 424, 425, 426, 427, 428, 429, 430, 431, 432, 433, 434, 435, 436, 437, 438, 439, 440, 441, 442, 443, 444, 445, 446, 447, 448, 449, 450, 451, 452, 453, 454, 455, 456, 457, 458, 459, 460, 461, 462, 463, 464, 465, 466, 467, 468, 469, 470, 471, 472, 473, 474, 475, 476, 477, 478, 479, 480, 481, 482, 483, 484, 485, 486, 487, 488, 489, 490, 491, 492, 493, 494, 495, 496, 497, 498, 499, 500, 501, 502, 503, 504, 505, 506, 507, 508, 509, 510, 511, 512, 513, 514, 515, 516, 517, 518, 519, 520, 521, 522, 523, 524, 525, 526, 527, 528, 529, 530, 531, 532, 533, 534, 535, 536, 537, 538, 539, 540, 541, 542, 543, 544, 545, 546, 547, 548, 549, 550, 551, 552, 553, 554, 555, 556, 557, 558, 559, 560, 561, 562, 563, 564, 565, 566, 567, 568, 569, 570, 571, 572, 573, 574, 575, 576, 577, 578, 579, 580, 581, 582, 583, 584, 585, 586, 587, 588, 589, 590, 591, 592, 593, 594, 595, 596, 597, 598, 599, 600, 601, 602, 603, 604, 605, 606, 607, 608, 609, 610, 611, 612, 613, 614, 615, 616, 617, 618, 619, 620, 621, 622, 623, 624, 625, 626, 627, 628, 629, 630, 631, 632, 633, 634, 635, 636, 637, 638, 639, 640, 641, 642, 643, 644, 645, 646, 647, 648, 649, 650, 651, 652, 653, 654, 655, 656, 657, 658, 659, 660, 661, 662, 663, 664, 665, 666, 667, 668, 669, 670, 671, 672, 673, 674, 675, 676, 677, 678, 679, 680, 681, 682, 683, 684, 685, 686, 687, 688, 689, 690, 691, 692, 693, 694, 695, 696, 697, 698, 699, 700, 701, 702, 703, 704, 705, 706, 707, 708, 709, 710, 711, 712, 713, 714, 715, 716, 717, 718, 719, 720, 721, 722, 723, 724, 725, 726, 727, 728, 729, 730, 731, 732, 733, 734, 735, 736, 737, 738, 739, 740, 741, 742, 743, 744, 745, 746, 747, 748, 749, 750, 751, 752, 753, 754, 755, 756, 757, 758, 759, 760, 761, 762, 763, 764, 765, 766, 767, 768, 769, 770, 771, 772, 773, 774, 775, 776, 777, 778, 779, 780, 781, 782, 783, 784, 785, 786, 787, 788, 789, 790, 791, 792, 793, 794, 795, 796, 797, 798, 799, 800, 801, 802, 803, 804, 805, 806, 807, 808, 809, 810, 811, 812, 813, 814, 815, 816, 817, 818, 819, 820, 821, 822, 823, 824, 825, 826, 827, 828, 829, 830, 831, 832, 833, 834, 835,



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1. This would give WorldCom an additional source of false reserves to reverse back into earnings. He appealed the sentence but lost the appeal and was ordered to serve his original ten-year sentence (Farrell, 2006). Powers Report. As head of ECT, Skilling was an Enron star on the rise. The complaint further alleges that, apart from its acquisition activities, Tyco improperly established and used various methods of reserves to make adjustments at the end of reporting periods to enhance and smooth its publicly reported results and to meet earnings forecasts. Finally, if she follows virtue ethics, she will use her character and virtues to guide her. 232). Ace should not recognize a sale in the form of a sale of the company. The BellSouth Warning BellSouth is presented mainly as an example of Improper Accounting for Foreign Payments in Violation of the Foreign Corrupt Practices Act (FCPA). Do you think you are happy when you are acting ethically, or do you think morality is sometimes a hassle with your well-being? In a typical repurchase transaction (repo), a firm "sells" securities for cash with the understanding that the "buyer" will return the securities for a specified price (usually at a 5 percent discount) at a specified future date. So perhaps the real story of Enron starts with the story of Kenneth Lay. Then beginning in the first quarter of 1997, profits were overstated as these inventories were sold at amounts above the amount recorded in 1996. Nevertheless, GSE loans still dominated the MBS market. Give reasons for your response. Current liabilities that decline significantly as a percentage of current assets and sales. July 2004. "Remarks at the 45th Annual Rocky Mountain Securities Conference." U.S. Securities and Exchange Commission. With the rumors of Uzz's departure, as well as the resignation of Richard Goudis, head of corporate planning, Shure thought he had to take the risk of downgrading Sunbeam's stock on a "conference call that linked analysts in New York with more than 5,000 stockbrokers around the world. There were only two telecommunication companies left of such magnitude: Sprint and AT&T. Moly Mortgage Corp. 64). "Home Prices Post Record 18% Drop: The 20-City S&P Case-Shiller Index Has Posted Losses for a Staggering 27 Months in a Row." CNNMoney. The task force is working to improve efforts across the federal executive branch and, with state and local partners, to investigate and prosecute significant financial crimes, ensure just and effective punishment for those who perpetrate financial crimes, combat discrimination in the lending and financial markets, and recover proceeds for victims of financial crimes. (c) Improper accounting for payments in violation of the Foreign Corrupt Practices Act. Allegheny (AHERF) is presented mainly as an example of understatement of reserves for bad debts. Meeting with Gadel About Accounting Abuses 33. (a) To enter into a contrived sale of a percentage of Enron's ownership in the Cuaba Power Plant to LJM1. Which one of the following statements does not describe the transformation in Enron's equity? (b) To enter into a contrived sale of a percentage of Enron's ownership in the Cuaba Power Plant to LJM1. Which one of the following statements does not describe the transformation in Enron's equity? (c) To enter into a contrived sale of a percentage of Enron's ownership in the Cuaba Power Plant to LJM1. Which one of the following statements does not describe the transformation in Enron's equity? (d) To enter into a contrived sale of a percentage of Enron's ownership in the Cuaba Power Plant to LJM1. Which one of the following statements does not describe the transformation in Enron's equity? 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profits generated by LJM1 for Enron, by artificially hedging the Rhythms stock gain, was preparation for Fastow's far more ambitious manipulations of earnings with his next SPE creation—LJM2. She raised the issue with the Andersen auditors, who brushed her off. New York: Mariner Books/Houghton Mifflin. (An acquisition occurs when one business entity issues stock or pays cash or other assets for the voting stock of another business entity. 6 The background information for this section is mainly from Brooks (2004), Maremont and Brooks (2005), O'Sullivan (2005), "Scott Livengood, CEO, Krispy Kreme" (2004), and "Summary of Independent Investigation" (2005). (d) Operating income will be stated as \$25,000. In the year, the Dodd-Frank Act established the Financial Stability Oversight Council (FSOC) as well as the Consumer Financial Protection Bureau (CFPB) in response to the financial crisis of 2008. No question about it. The financing of revenue on the effective loans to the lessees. United States v. He even started copying accounting information on CD-ROMs in case others tried to remove the evidence by destroying the financial records. The jokers at Enron were laughing all the way to the bank. During this period, the company usually exceeded Wall Street's expectations, as annual revenue grew from \$220 million to \$665.6 million. • "KPMG consented to the entry of the Order without admitting or denying the SEC's findings" (LR 19191, 2005). 7/7/14 9:15 AM 372 References Crawford, Krysten. Legend has two competing stories about how the company's initial name was concocted. June 2003. "No Cause for Alarm," The Daily Deal. Moral relativism, 53 The view that morality possesses no universal appeal and is not 7/7/14 9:17 AM Glindex 395 tethered to any truth claims; right action and the good are wholly dependent on, and relative to, the situation, actors, culture, group, or time period. And they did raise eyebrows." Taken as a whole, they did not reflect well on the company's ethical culture but were minor transgressions, Noonan concluded. The special charge is likely to be regarded as 059402\_01\_ch3\_p069-116.indd 84 7/7/14 9:01 AM Chapter 3 • The Sizzling Saga of Sunbeam 85 something that will not recur; therefore, it often does not impact the stock price negatively when recognized. United States Bankruptcy Court Southern District of New York in re:WorldCom, Inc. Arthur Andersen, the external auditors, began a review of Sunbeam's previous financial statuts. The Powers Report identified three sources of false earning streams: 1. • Improper use of Non-GAAP Financial Measures, Gilliland, Donald. This is a prime signal. The plunge in house prices marked the beginning of the financial recession and the 2008 Wall Street crash that spread its tentacles into the global economy for years to come. WorldCom's bankruptcy was soon to follow in 2002, and staggeringly, it topped Enron's3. (Note that WorldCom is examined in this text as an illustration of the fraudulent use of merger acquisition reserves.) The CUC Scheme of Reporting Fictitious Revenue via Top-Side Adjustments For the hands-on part of the scheme that required actually making the top-side adjustment (adjustments made in the financial statements and not in the general ledger), the alleged role of Polverari was important. After WorldCom acquired UUNet, it had broadband and networks all over the world and had become a provider of Internet access and data transmission. His chest was puffed out and his face flushed bright red. Papyrus Company should not have recognized the sale to Zee Company as a bill and hold sale in its December 31 financial statements because: (a) The buyer must have a substantial business purpose for ordering the goods on a bill and hold basis. Specifically, Beazer knowingly departed from GAAP and misstated its net income for certain periods in its registration statements and other filings with the Commission and other investor disclosures by using certain reserves and other accrued liabilities to recognize profits in 2006 and 2007 that were earned from 2000 through 2005. Around this time, the HNG board of directors started searching for a dynamic chief executive officer (CEO), and they believed that they had found such a man in Kenneth Lay, who was appointed CEO in 1984. The schemes in which he engaged also allowed Bernie Madoff to evade his tax obligations. Enron used LJM1 to create a false option hedge for its investment in Rhythms NetConnections, "Examining the Ethics Process: A Conversation with PEEC Chair Wes Williams," CPA Journal, www. (2) Real estate owned balances are shown net of related loss allowances. 7/7/14 8:59 AM 65 Chapter 2 • Ethics at Work Press Release on Peter Madoff Peter Madoff, Former Chief Compliance Officer and Senior Managing Director at Bernard L. 28) Under this decision-making model, Fleming describes four approaches to Step 5 (i.e., the ethical evaluation of the alternatives): • The consequentialist/utilitarian model • The rights approach • The duties approach • The justice approach The rights approach is often combined with the duties approach, so we will examine three distinct approaches to the ethical evaluation of alternative actions. Standards and procedures. The plant 059402\_01\_ch3\_p069-116.indd 78 7/7/14 9:01 AM Chapter 3 • The Sizzling Saga of Sunbeam 79 manager and Donald Uzzi, senior vice president for sales (who had replaced Newt White), as well as general manager William Kirkpatrick, fought to keep the McMinnville plant open and managed to save some of the jobs. Where conflicts of interest are concerned, eternal vigilance and independent oversight are warranted in order to protect an institution's reputation and brand. By 2000, the prepays were disguising the cash-flow problem so heavily that the reported CFFO was positive—and greater than operating income—even after this adjustment. 059402\_01\_ch7\_p226-291.indd 287 7/7/14 9:09 AM 288 Chapter 7 • Enron and the Tale of the Golden Goose Basin Water, Inc. Ebbers and Grubman had an instant rapport. They did so even though Buca's assistant controller had raised questions with Skrypek about the nature of various vaguely worded invoices submitted by High Wire and EDP. Extracts from Zeddy Company's quarterly income statements and balance sheets for quarters 1–4 are as follows: Exercises 37. Neither Gadel nor Skrypek ever took steps to ensure disclosure of the related-party transactions between Buca and High Wire in Buca's proxy statements or in its Forms 10-K for the years 2000 and 2001. The existence of both signals could be a strong alert that there has been a failure to record expenses and the corresponding liabilities. Time after time, he chose from a menu of justifications: he was helping shareholders, "it was just a timing problem," everyone was doing it. The SEC further claimed that for each of Livent's years as a U.S. public company, Livent either reported inflated pretax earnings or understated its pretax losses: For fiscal 1995, Livent reported pretax earnings of \$18.2 million. Wall Street was finally catching on to Dunlap's "turnarounds," and so was the media. Sullivan had moved to south Florida to become CFO of a telecommunications company. Munroe Foundation. Munroe Regional Medical Center. Sunbeam's amazing resurrection had been nothing more than a "manufactured illusion" (Byrne, 2003, p. AAER 1394. In spite of their differences (or perhaps because of them), Sullivan and Ebbers got along extremely well, and Sullivan became "the real force" behind Ebbers's deals (Malik, 2003, p. • If at any time a transmission line's electricity flow exceeded its capacity, the ISO would pay a premium fee for removal of the congestion. When a company overstates reserves at the time of acquisition, in later periods, it can release the reserves back into earnings. So the "cash flow from operations" (CFFO) should not show an amount of cash generated that is significantly less than the profit from o perations—listed as "operating income" or "operating earnings" in the income statement—without a very specific explanation. WorldCom improperly accounted for its line cost expense by: (a) Allocating line-cost expense to PPE in its first recording of the line-cost transactions. 059402\_01\_ch7\_p226-291.indd 268 7/7/14 9:08 AM Chapter 7 • Enron and the Tale of the Golden Goose 269 Table 7.2 Enron's Pretax Gains on Sales of Merchant Assets and Investments as a Percentage of Operating Income\* Year Percentage 1997 906% 1998 46% 1999 94% 2000 5% \* Derived from Enron's Notes to the Financial Statements. 63). Still high from that deal, Ebbers and Sullivan went on to acquire a company that had undergone a very interesting change to its core business. Wall Street Journal. • The financial statements fairly present, in all material respects, the financial conditions and results of operations. Bronto Company invested in 10,000 shares in Saurus Company, which it purchased in June 2012 for \$1 per share, before Saurus went public. "The No-Money-Down Disaster," Barron's, August 21, pp. • Enron was selling its assets to itself. . In its income statement, Edison "recorded the entire amount invoiced, \$7.5 million, as gross revenue for FY 2001, also recording expenses of \$8 million" (AAER 1555, 2002). Shecter, Barbara, Ebbers was a starter on the varsity basketball team at Victoria Composite High School in downtown Edmonton, Canada. 31-2000 June 30-2000 Sales 46,110 51,605 57,807 67,544 76,344 94,324 Accounts Receivable 38,947 43,737 51,058 59,629 69,940 127,845 \*Case No. 03 CV. At the tender age of 36, he had been appointed the CFO of Enron, the hundred-billion dollar energy company. While many struggling homeowners were victims of unscrupulous mortgage lenders who had sold them seriously flawed loans, some were victims of their own greed and belief in the mistaken myth that the housing market would continue to rise forever. If the loans become troubled and the price of houses declines, there is an increased likelihood that the lender will suffer a loss on the loan. "Accounting in Crisis," Business Week, Special Report, 44, 5p, 1c. The company that had once been regarded as a golden goose was, in fact, a cooked goose! Are They Living Happily Ever After? 059402\_01\_ch5\_p144-190.indd 179 7/7/14 9:04 AM 180 Chapter 5 • WorldCom Wizardry: From WorldCom to WorldCon The Commission's complaint alleges that Tyco inflated its operating income by at least \$500 million as a result of improper accounting practices related to some of the many acquisitions that Tyco engaged in during that time. (a) Some borrowers of pay-option ARM loans choose to make monthly payments that are not large enough to cover the interest that accrues on the loans each month. A few years later, in Gwyn's divorce complaint, she alleged that once, while cleaning his gun collection, Dunlap had remarked, "You better watch out and toe the line." He would become enraged if she had not cleaned the apartment to his satisfaction. These measures deteriorated into a concerted program of manipulation that gave rise to a smorgasbord of fraudulent journal entries and adjustments. It is more formally referred to as cash flows from operating activities. McCafferty, Joseph. Snider, Shane. \*\*\*\*\* I & T = interest and tax. 6 3. The SEC release noted the following: In the release and related conference call, Sunbeam management did not disclose: • the inadequacy of Sunbeam's reserves for returns, • bill and hold sales that pulled \$35 million in net sales into the quarter, and • the extension of the quarter by two days, which added \$20 million in net sales to the quarter. Countrywide is presented as an example of: • Inadequate loan disclosures in SEC filings • Underestimation of allowance for loan losses Chapter Outline • The Housing Bubble • Easy Credit: Securitization • Easy Profit: Tranching • Easy Banking: Regulations Repealed • Easy Investing: Credit Default Swaps 059402\_01\_ch9\_p325-360.indd 325 • Hard Times • The Countrywide Story • Countrywide's Misleading Description of Loans in SEC Filings 325 7/7/14 9:11 AM 326 Chapter 9 • Mortgage Mayhem • Countrywide's Underestimation of Allowance for Loan Losses • Signals of Countrywide's Underestimation of Allowance for Loan Losses • An Overview of Countrywide's Notes to Its Financial Statements • Accounting Lessons from the Mortgage Crisis • Key Terms • Ethics at Work • Assignments • Case Study: TierOne Bank The Housing Bubble ... [I]t is in the nature of a speculative boom that almost anything can collapse it. Weak board. 059402\_01\_REF\_p365-382.indd 366 Lewis, Craig M. For fiscal 1997, Livent reported a pretax loss of \$62.1 million. One would think 1997 had been a busy enough year, but seemingly without taking a breath, Ebbers and Sullivan set their sights on acquiring a company three times bigger than their own—they decided to go after MCI. Krispy Kreme was suffering from a lack of controls, procedures, and resources, but its business was experiencing an explosive growth. On December 31, 2012, Power Company sells 10 percent of its stake in Emperor to P2 for \$4 million. It was immediately apparent to Levin, Arthur Andersen, and the SEC that Sunbeam's financial statements would have to be restated. You have to face reality," he said. Justice, in the ethical sense, is focused more on distributive justice than on retributive justice—which is more the focus of legal justice. The End of the Sullivan Era By this time, a storm was brewing that would uncover the massive accounting fraud of Scott Sullivan and his cohorts. At Enron, the times-interest-earned ratio remained low while the debt-to-equity ratio increased even though Enron understated its debt on its balance sheets. Next, in order to acquire a small telephone reseller in Arkansas, Ebbers convinced his colleagues to do something they would do over and over and over again until WorldCom's final bankruptcy—they issued shares in their company (LDPS) to get the cash to pay for the acquisitions. The Assistant Wizard: Jack Grubman Ebbers now had to interface with investors as well as public institutions. All of these situations could, and often did, influence a director's autonomy in overseeing the direction of the company. In 059402\_01\_ch9\_p325-360.indd 326 7/7/14 9:11 AM Chapter 9 • Mortgage Mayhem 327 addition, throw mortgage-backed securities into the mixture and you have a formula for disaster: the collapse of the bubble that is now known as the financial meltdown of 2008. Sullivan prepared a white paper to try to provide theoretical support for the transfers, but nobody bought his arguments. www.law.com. To test whether CFFO is lagging behind operating income or net income, one must deduct the amount of sold accounts receivable from CFFO before comparing CFFO to operating income or net income. Signal #4: Unusual Capitalization Policy Read the notes to the financial s tatements to compare the company's capitalization policy to the capitalization policy of other companies in the same industry. By how much would LivePlay understate its amortization expense (or its impairment loss) in Q4 of 2012 by falsely transferring the scenery assets from CatTrap to Dogs? Presents background information about the company and its key executives. Let us consider the example of year-end bonuses being distributed in a company. As a result, Enron 059402\_01\_ch7\_p226-291.indd 256 7/7/14 9:08 AM Chapter 7 • Enron and the Tale of the Golden Goose LJM Partners, L.P. General \$1 MM Partner ERNB Ltd (CSFB) \$7.5 MM LJM Cayman, L.P. (LJM1) Andrew Fastow Sole Director LJM SwapCo 257 Campsie Ltd. These conflicts need to be understood both in terms of their practical business implications as well as in relation to relevant legal standards. To propel the stock price much higher, he wanted to produce a spectacular slash-and-burn downsizing plan for Wall Street. Overstatement of Ending Inventory Values in order to understate the cost of goods sold RITE AID 10. T F 8. di Florio, Carlo V. Crawford, Krysten, and Winnie Dunbar.



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