

An hourglass-shaped graphic with a globe in the top bulb and another globe in the bottom bulb. The hourglass is light blue and has a dark blue cap at the top. The globe in the top bulb is dark blue, while the globe in the bottom bulb is light blue. The text is centered within the hourglass.

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*Accounting Problems Reported in Major Companies Since  
Enron*

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**Abstract.** This report presents summaries of the accounting problems that have been reported at major corporations since Enron.

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# CRS Report for Congress

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## Accounting Problems Reported in Major Companies Since Enron

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### Summary

Since the sudden collapse of Enron Corp. in the fall of 2001, and the series of accounting scandals that followed, the integrity of corporate financial accounting has emerged as a public policy concern. Over 100 U.S. companies, including several of the largest, restated (or corrected) their previously-announced financial results in the first half of 2002. During the 1980s and early 1990s, by contrast, there were an average of about 50 restatements per year. Does the increase represent a decline in the quality of corporate accounting, the inevitable fallout from the end of an easy-money stock market boom, or is it the result of more intense, post-Enron regulatory scrutiny? Do accounting scandals reflect a few rotten apples in the corporate barrel, or has “gaming the numbers” become standard practice at many U.S. companies? The 107<sup>th</sup> Congress enacted fundamental auditor and accounting reform legislation (the Sarbanes-Oxley Act, P.L. 107-204, summarized in CRS Report RL31483). This report presents brief summaries of the accounting problems that have been reported at major corporations since Enron. It will be updated as developments warrant.

This report provides a list of major companies where accounting problems have surfaced since the collapse of Enron Corp. in late 2001. The companies are identified by name and by their rank in the Fortune 500 (except for two – Tyco International and Global Crossing – which are registered in Bermuda and not included in *Fortune*'s survey). Also included is a brief summary of the substance of the accounting problem, derived primarily from press reports. Because many of the firms listed are involved in ongoing investigations and/or litigation, information available to date may be incomplete or incorrect.

Company	Fortune 500 Rank	Particulars of Accounting Problem
Adelphia Communications	456	Three members of the Rigas family, Adelphia's founders, and two others, face criminal charges of conspiracy, securities fraud, wire fraud and bank fraud, in what the SEC describes as "one of the most extensive financial frauds ever to take place at a public company." The company has disclosed that it guaranteed loans of \$2.3 billion to off-the-books partnerships controlled by the Rigas family. Much of this money was used to purchase Adelphia stock. The share price has fallen sharply, and \$1.6 billion of the \$2.3 billion has been written off by the company.
Allegheny Energy	185	In November 2002, Allegheny announced that it could not file its third quarter earnings report on time because of accounting errors in previous statements. The firm has sued Merrill Lynch, for allegedly inflating the revenues of an energy trading unit purchased by Allegheny in 2001.
AOL Time Warner	37	In July 2002, the SEC and Department of Justice launched investigations of AOL's accounting. No details of the probes have been made public, but press reports have raised questions about AOL's accounting for advertising and Internet commerce revenue. In October 2002, the firm announced that it would restate earnings for the 2 years ended 6/30/02 by \$190 million.
Bristol-Myers Squibb	96	In July 2002, Bristol-Myers Squibb announced that the SEC was investigating sales tactics that may have boosted reported revenues: drug wholesalers were offered discounts to purchase excess inventory above and beyond market demand. In October 2002, the firm announced that it would restate 2000-2 results, reducing revenues by about \$1.5-\$2 billion.
Cendant	217	In December 2002, Cendant officials were charged with accounting fraud, related to accusations that the firm's reported operating income was improperly inflated for nearly a decade. The charges supplemented indictments issued in February 2001.
Duke Energy	14	In October 2002, Duke Energy Corp.'s regulated electric utility, Duke Power, agreed to pay \$25 million to its customers to settle allegations by regulators in North and South Carolina that it had underreported net earnings by about \$123 million between 1998 and 2002, in order to avoid having to cut its electricity rates.
Dynergy	30	In September 2002, Dynergy agreed to pay a fine of \$3 million to settle an SEC investigation of its accounting and trading practices. Dynergy and several other energy firms have admitted making "round-trip" transactions with no economic substance intended to boost revenues or create the illusion of market liquidity. Also under investigation was a complex series of transactions called "Project Alpha," which boosted reported earnings via purchases and sales of natural gas between Dynergy and its affiliates. The SEC described Project Alpha as "a loan masquerading as operating cash flow." In May 2002, Dynergy restated 2001 earnings, reducing reported income by \$79 mil. In November 2002, the company restated 3 years of results.

Company	Fortune 500 Rank	Particulars of Accounting Problem
Enron <sup>1</sup>	5	In September 2001, Enron restated its financial results from the 2 <sup>nd</sup> quarter of 2000 through the 3 <sup>rd</sup> quarter of 2001. The major issue behind the restatement was the use of unconsolidated subsidiaries, or “special purpose entities,” to conceal major losses in investments and assets related to Internet ventures and fiber optic networks. Under the restated accounts, those losses were attributed to Enron, rather than to essentially fictitious third parties, and the company’s reported profits dropped significantly. Numerous other accounting irregularities have been disclosed or alleged. A criminal investigation is under way; several indictments have been issued and guilty pleas received.
Global Crossing	NA	The SEC is investigating accounting practices at Global Crossing, now in Chapter 11 bankruptcy proceedings. Specific issues include swaps of fiber optic telecommunication capacity that may have artificially boosted revenues, and the accounting treatment of long-term leases. In October 2002, the firm announced a restatement of 2001 figures, reducing income by about \$19 million, and assets and liabilities by about \$1.2 billion each.
Halliburton	153	The SEC is investigating Halliburton’s accounting practices. Press reports suggest that the issue is an accounting policy – adopted in 1998 – of reporting cost overruns on construction projects as current revenue, even though those added costs might be disputed by customers and never received by the company.
International Business Machines	9	IBM has been criticized for reporting the sale of assets as operating income, rather than as a one-time gain, or extraordinary item. In 1999, the SEC questioned IBM’s accounting treatment of the \$4 billion sale of its Global Network unit to AT&T – proceeds from the sale were used to offset operating costs. IBM did not agree to the SEC’s request that it amend its financial statements. Again, on the last day of 2001, IBM sold a business unit for about \$300 million, and booked the proceeds as operating income rather than as an extraordinary item. IBM continues to defend its accounting practice, but its stock dropped by 5% following a <i>New York Times</i> story discussing the 2001 transaction and its accounting treatment.
Kmart	40	Kmart’s accounting practices are under investigation by the SEC and the FBI. Information about areas of investigation is limited – they may include loans to executives, inventory valuation, vendor allowances, lease obligations, and off-the-books financing. In May 2002, Kmart (now in Chapter 11 bankruptcy) restated 2001 results, increasing reported losses by about \$500 million. In December 2002, the firm restated its earnings back to 1999.

<sup>1</sup> For more information, see CRS Report RS21135, *The Enron Collapse: An Overview of Financial Issues*.

Company	Fortune 500 Rank	Particulars of Accounting Problem
Lucent Technologies	76	In October 2002, it was reported in the press that the SEC was investigating certain accounting practices at Lucent, including the booking of fictitious sales and accounting for equipment sent to distributors on consignment as final sales. The investigation stems from a 2000 statement by the firm that it had overstated earnings in fiscal 2000, but the SEC is reportedly looking at earnings back to the mid-1990s.
Merck	24	In July 2002, Merck disclosed in an SEC filing that it had overstated revenues for the last three years by \$12.4 billion. The amount was reported as revenues to the Merck-Medco pharmaceutical benefits subsidiary even though it was never collected. The West Virginia Public Employees Insurance Agency has filed suit against Merck-Medco, alleging overcharging for pharmacy benefits.
Microsoft	72	In June 2002, Microsoft settled an SEC complaint about its "cookie jar" accounting practices between 1994 and 1998, and agreed to restate its financial results for those years. The SEC found that Microsoft established seven reserve accounts, without providing an accounting justification for them. The reserve accounts were used to manage reported earnings – in some quarters, money would be added to the reserves to reduce reported earnings, while in other quarters, money was withdrawn to boost earnings. The accounts held between \$200 and \$900 million over the 1994-98 period.
Pacific Gas & Electric	87	In February 2002, PG&E announced that it would delay releasing its 2001 results because certain off-the-books arrangements for financing several power plants, called "synthetic leases," may have been improperly reported. Had the synthetic leases been reported as debt, PG&E's balance sheet liabilities would have been about \$1 billion higher. The synthetic leases were transactions between PG&E and an unconsolidated subsidiary, National Energy Group, and part of the accounting dispute is whether National was in fact independently controlled. (If it was not, its liabilities should have been consolidated with PG&E's.)
PNC Financial Services	269	The Federal Reserve and the SEC opened inquiries into PNC's accounting in January 2002. At issue was the sale of problem loans and non-performing assets to three unconsolidated subsidiaries. In 2001, PNC disposed of \$550 million in loans and \$162 million in venture capital investments, removing these assets and liabilities from its balance sheet. The regulators insisted that the subsidiaries were part of PNC and the company restated its 2001 results.

Company	Fortune 500 Rank	Particulars of Accounting Problem
Qwest Communications	102	<p>The SEC is investigating Qwest's revenue recognition policies in 2000 and 2001. A central issue is said to involve swaps of fiber optic capacity, which accounted for \$664 million of Qwest's reported 2001 income. In a swap, telecommunications companies exchange optical fiber networks or parts of networks (or rights to use network capacity). A swap may be a legitimate transaction to meet customer demand, or it may be a "wash trade" without economic substance, designed to create artificial revenues. For example, a company (or both parties to the trade) may record one side of the swap as a sale of assets, and report it as revenue, and treat the other side of the transaction as a capital expenditure, which does not appear on the income statement. Enron was the counterparty in several of Qwest's capacity swaps. In September 2002, Qwest restated its financial results for 2000 and 2001, reducing reported revenues by \$950 million. In November 2002, further accounting mistakes were disclosed, reducing earnings by a further \$358 million.</p>
Raytheon	119	<p>In November 2002, the SEC sanctioned Raytheon for violations of Regulation FD, which prohibits release of financial information to Wall Street analysts before that information is made available to the general public. In January 2003, the firm announced that the SEC had begun an informal inquiry into its accounting practices.</p>
Tyco International	NA	<p>Tyco, a conglomerate that has acquired over 700 businesses in the last three years, faces questions about its accounting for mergers. Critics allege that the financial results of acquired companies were manipulated before and after the takeovers to produce a sharp increase in revenues and profits once the acquisitions were completed. Driven partly by accounting uncertainties, Tyco stock has fallen by about 80% since the end of 2001. Tyco defends its accounting practices – the SEC ended a probe in 2000 without action and in mid-2002 a judge dismissed 38 investors' lawsuits. In January 2002, the firm proposed to split itself into four independent companies, in part make its accounting results more transparent. Several Tyco executives have been indicted for tax evasion, enterprise corruption, and/or grand larceny.</p>
WorldCom <sup>2</sup>	42	<p>In June 2002, WorldCom announced that it had overstated 2001 and 1<sup>st</sup> quarter 2002 revenue by about \$3.9 billion. Subsequent announcements brought the total accounting errors to over \$7.1 billion. The firm had classified routine operating expenses – payments to other telecommunications carriers for use of their equipment – as capital expenditures, boosting reported income and assets. On July 31, 2002, WorldCom's former CFO and Controller were charged with securities fraud and conspiracy. Also under investigation are various loans and payments to senior management.</p>

<sup>2</sup> For more information, see CRS Report RS21253, *WorldCom: The Accounting Scandal*.

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Company	Fortune 500 Rank	Particulars of Accounting Problem
Xerox	120	<p>In April 2002, Xerox paid a \$10 million fine (the largest ever imposed in an accounting case) to settle an SEC complaint and restated its reported income since 1997. The SEC found that Xerox had improperly inflated its reported earnings by over \$3 billion, primarily by recognizing future payments as current income. For example, revenue from long-term leases of Xerox equipment was reported immediately, rather than at the time payments were received. The SEC's complaint also noted that Xerox's management had not cooperated with its investigation, which began in 2000.</p>