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CASE 1.3

Enron Corporation

John and Mary Andersen immigrated to the United States from their native Norway in 1881. The young couple made their way to the small farming community of Plano, Illinois, some 40 miles southwest of downtown Chicago. Over the previous few decades, hundreds of Norwegian families had settled in Plano and surrounding communities. In fact, the aptly named Norway, Illinois, was located just a few miles away from the couple's new hometown. In 1885, Arthur Edward Andersen was born. From an early age, the Andersens' son had a fascination with numbers. Little did his parents realize that Arthur's interest in numbers would become the driving force in his life. Less than one century after he was born, an accounting firm bearing Arthur Andersen's name would become the world's largest professional services organization with more than 1,000 partners and operations in dozens of countries scattered across the globe.

Think Straight, Talk Straight

Discipline, honesty, and a strong work ethic were three key traits that John and Mary Andersen instilled in their son. The Andersens also constantly impressed upon him the importance of obtaining an education. Unfortunately, Arthur's parents did not survive to help him achieve that goal. Orphaned by the time he was a young teenager, Andersen was forced to take a fulltime job as a mail clerk and attend night classes to work his way through high school. After graduating from high school, Andersen attended the University of Illinois while working as an accountant for Allis-Chalmers, a Chicago-based company that manufactured tractors and other farming equipment. In 1908, Andersen accepted a position with the Chicago office of Price Waterhouse. At the time, Price Waterhouse, which was organized in Great Britain during the early nineteenth century, easily qualified as the United States' most prominent public accounting firm.

At age 23, Andersen became the youngest CPA in the state of Illinois. A few years later, Andersen and a friend, Clarence Delany, established a partnership to provide accounting, auditing, and related services. The two young accountants named their firm Andersen, Delany & Company. When Delany decided to go his own way, Andersen renamed the firm Arthur Andersen & Company.

In 1915, Arthur Andersen faced a dilemma that would help shape the remainder of his professional life. One of his audit clients was a freight company that owned and operated several steam freighters that delivered various commodities to ports located on Lake Michigan. Following the close of the company's fiscal year but before Andersen had issued his audit report on its financial statements, one of the client's ships sank in Lake Michigan. At the time, there were few formal rules for companies to follow in preparing their annual financial statements and certainly no rule that required the company to report a material "subsequent event" occurring after the close of its fiscal year—such as the loss of a major asset. Nevertheless, Andersen insisted that his client disclose the loss of the ship. Andersen reasoned that third parties who would use the company's financial statements, among them the company's banker, would want to be informed of the loss. Although unhappy with Andersen's position, the client eventually acquiesced and reported the loss in the footnotes to its financial statements.

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Two decades after the steamship dilemma, Arthur Andersen faced a similar situation with an audit client that was much larger, much more prominent, and much more profitable for his firm. Arthur Andersen & Co. served as the independent auditor for the giant chemical company, du Pont. As the company's audit neared completion one year, members of the audit engagement team and executives of du Pont quarreled over how to define the company's operating income. Du Pont's management insisted on a liberal definition of operating income that included income earned on certain investments. Arthur Andersen was brought in to arbitrate the dispute. When he sided with his subordinates, du Pont's management team dismissed the firm and hired another auditor.

Throughout his professional career, Arthur E. Andersen relied on a simple, four-word motto to serve as a guiding principle in making important personal and professional decisions: "Think straight, talk straight." Andersen insisted that his partners and other personnel in his firm invoke that simple rule when dealing with clients, potential clients, bankers, regulatory authorities, and any other parties they interacted with while representing Arthur Andersen & Co. He also insisted that audit clients "talk straight" in their financial statements. Former colleagues and associates often described Andersen as opinionated, stubborn and, in some cases, "difficult."¹ But even his critics readily admitted that Andersen was point-blank honest. "Arthur Andersen wouldn't put up with anything that wasn't complete, 100% integrity. If anybody did anything otherwise, he'd fire them. And if clients wanted to do something he didn't agree with, he'd either try to change them or quit."¹

As a young professional attempting to grow his firm, Arthur Andersen quickly recognized the importance of carving out a niche in the rapidly developing accounting services industry. Andersen realized that the nation's bustling economy of the 1920s depended heavily on companies involved in the production and distribution of energy. As the economy grew, Andersen knew there would be a steadily increasing need for electricity, oil and gas, and other energy resources. So he focused his practice development efforts on obtaining clients involved in the various energy industries. Andersen was particularly successful in recruiting electric utilities as clients. By the early 1930s, Arthur Andersen & Co. had a thriving practice in the upper Midwest and was among the leading regional accounting firms in the nation.

The U.S. economy's precipitous downturn during the Great Depression of the 1930s posed huge financial problems for many of Arthur Andersen & Co.'s audit clients in the electric utilities industry. As the Depression wore on, Arthur Andersen personally worked with several of the nation's largest metropolitan banks to help his clients obtain the financing they desperately needed to continue operating. The bankers and other leading financiers who dealt with Arthur Andersen quickly learned of his commitment to honesty and proper, forthright accounting and financial reporting practices. Andersen's reputation for honesty and integrity allowed lenders to use with confidence financial data stamped with his approval. The end result was that many troubled firms received the financing they needed to survive the harrowing days of the 1930s. In turn, the respect that Arthur Andersen earned among leading financial executives nationwide resulted in Arthur Andersen & Co. receiving a growing number of referrals for potential clients located outside of the Midwest.

During the later years of his career, Arthur Andersen became a spokesperson for his discipline. He authored numerous books and presented speeches throughout the nation regarding the need for rigorous accounting, auditing, and ethical standards for the emerging public accounting profession. Andersen continually urged his fellow

1. R. Frammolino and J. Leeds, "Andersen's Reputation in Shreds," *Los Angeles Times* (online), 30 January 2002.