ENRON "GUIDANCE" IN THE ACCOUNTING CURRICULUM

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ABSTRACT

This paper defends the pedagogical value of the Enron story in the accounting curriculum and suggests junctures where introduction of key concepts would be most timely and productive.

Introducing Key Qualitative Characteristics

The Enron story provides a multitude of examples where accountants have strayed from the essence of accounting theory, and these deficiencies can be used to instruct students about qualitative characteristics throughout the accounting curriculum. Often students view these characteristics only as definitions (i.e., "must memorize for test") and do not internalize their importance to the ability of accounting to reflect economic reality in reporting business activity. Spending a brief moment at key junctures would give the students an opportunity to "internalize through example," an activity that might attract the better students to further study in the discipline.

The characteristics most appropriate to cover at the introductory level include understandability, relevance, reliability, revenue recognition, full disclosure, and the associated term "transparency." For example, consider the following excerpt from an Enron annual report footnote: "Enron and the third party amended certain forward contracts to purchase shares of Enron common stock, resulting in Enron having forward contracts to purchase shares of Enron common stock at the market price on that day." ["Accounting Alchemy," *NewsHour with Jim Lehrer*, OnlineNewsHour, Jan. 28, 2002] The students need know nothing about forward contracts or treasury stock to realize that this disclosure lacks transparency and understandability. In another example, Enron transferred assets that had lost value along with associated liabilities to their "special purpose entities" and recognized a gain with an entry similar to the following:

Investment in SPE	500000	
Liabilities (transferred to SPE)	250000	
Assets (net of depreciation)		600000
Gain		150000

With little explanation, students would see that no real economic exchange took place (since the SPE and the assets were under Enron's control), no gain should have been recognized, and that Enron actually should have written the assets down and recognized a LOSS. This is not a bad lesson in relevance, reliability, revenue recognition, and "economic substance over legal form."

At the intermediate level, the "economic substance over legal form" mantra can become a guiding light for discussing the off-balance sheet financing, revenue recognition (including both acceleration and misstatement), and derivatives abuse included in Enron's reporting. Note that this discussion should go beyond simple accounting fraud and should center on the "gray" areas--where appropriate accounting choice becomes essential to reporting economic reality. We would be well advised to arm our students with some knowledge of scandalous accounting; they might just learn something about what NOT to do as practicing accountants, managers, and regulators. There is no better place than in the accounting curriculum--from start to finish.