

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 57209 / January 28, 2008

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2774 / January 28, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12937

In the Matter of

MICHAEL ODOM, CPA,

Respondent.

**ORDER INSTITUTING PUBLIC
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO RULE 102(e) OF THE
COMMISSION'S RULES OF
PRACTICE, MAKING FINDINGS,
AND IMPOSING REMEDIAL
SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative proceedings be, and hereby are, instituted against Michael Odom, CPA ("Odom" or "Respondent"), pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.¹

II.

In anticipation of the institution of these proceedings, Odom has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Odom consents to the entry of this Order Instituting Public Administrative Proceedings

¹ Rule 102(e)(1)(ii) provides that:

The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission . . . to have engaged in . . . improper professional conduct.

Pursuant to Rule 102(e) of the Commission’s Rules of Practice, Making Findings, and Imposing Remedial Sanctions (“Order”), as set forth below.

III.

On the basis of this Order and Respondent’s Offer, the Commission finds² that:

A. SUMMARY

Enron Corp.’s (“Enron”) senior executives engaged a wide-ranging scheme to defraud the investing public by materially overstating the company’s earnings and cash flows, and concealing debt in periodic reports filed with the Commission.³ The fraudulent scheme was carried out through a variety of complex structured transactions, related party transactions, misleading disclosures, and a widespread abuse of generally accepted accounting principles (“GAAP”).

Arthur Andersen LLP (“Andersen”) served as Enron’s auditor, and for each year during the relevant time period, issued an auditor’s report falsely stating that Enron’s financial statements were presented fairly, in all material respects, in conformity with GAAP, and that Andersen had conducted its audit of those financial statements in accordance with generally accepted auditing standards (“GAAS”). Odom served as Practice Director in connection with the Enron engagement. As specified in this Order, Odom engaged in improper professional conduct by concurring with the audit engagement team’s faulty conclusions regarding Enron’s accounting for certain transactions and authorizing the issuance by Andersen of unqualified audit reports that were materially false and misleading.

B. RESPONDENT

Michael C. Odom, 65, served as Practice Director at Andersen for the Gulf Coast Region during the relevant time period. According to Andersen’s Audit Objectives and Procedures Manual, Practice Directors had authority to oversee the resolution of client issues and the extent of their involvement was driven by the engagement team’s risk assessments. Consultation was normally required whenever significant, unusual, or judgment issues were encountered during any audit. Odom is currently and was a CPA licensed in the state of Louisiana at all relevant times.

C. OTHER PARTIES

Enron Corp. was an Oregon corporation with its principal place of business in Houston, Texas. During the relevant time period, Enron’s common stock was registered with the

² The findings herein are made pursuant to Respondent’s Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

³ In connection with this fraudulent scheme, several former Enron executives either pleaded guilty or were convicted of felonies, including Enron’s former Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer.

Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange. Among other operations, Enron was the nation's largest natural gas and electric marketer, with reported annual revenue of more than \$100 billion. In 2000, Enron rose to number seven on the *Fortune 500* list of public companies. By December 2, 2001, when it filed for bankruptcy, Enron's stock price had dropped over the course of a year from more than \$80 per share to less than \$1.

Arthur Andersen LLP once was one of the so-called "Big Five" accounting firms in the United States and had its headquarters in Chicago, Illinois. Andersen personnel performed work for Enron during the relevant time period in several cities, including Chicago, Houston and London.⁴

D. FACTS

1. Andersen Identified Enron as a Maximum Risk Client

Odom was aware that the risk of fraudulent financial reporting at Enron was high. In accordance with applicable professional standards, Andersen assessed the risk of fraud at Enron (AU §316, *Consideration of Fraud in a Financial Statement Audit*), and Odom should have known that Enron possessed many of the risk factors that should be considered in making that assessment. For example, Fraud Risk Assessment questionnaires prepared by the audit engagement team documented that Enron placed an "undue emphasis on meeting earnings targets;" used "highly aggressive accounting;" utilized "unusual" year-end transactions that posed difficult "substance over form" questions; possessed a "philosophy of significantly managing (maximizing or minimizing) earnings;" and had a "high dependence on debt, difficulty in meeting debt payments or vulnerability to interest rate changes." In addition, an internal Andersen document prepared each year by the engagement team consistently classified the Enron engagement as involving "maximum risk" and noted that Enron's use of complex "form over substance" and "related party" transactions created an "extreme" or "very significant" financial reporting risk. This document, called a "SMART," was prepared each year to assist with the annual decision whether to retain Enron as an audit client. Odom reviewed the SMART documents and also attended an annual client retention meeting for the 2000 audit during which the risks identified above were discussed.

2. Enron's Prepay Transactions

Enron improperly reported structured financing proceeds as operating cash flows by means of "prepay" transactions with various financial institutions. Enron used prepay transactions to improperly report the cash it received from prepay transactions as cash flow from operating activities, rather than cash flow from financing activities. This allowed Enron to hide the true

⁴ David B. Duncan served as the global engagement partner for Andersen's audits of Enron from 1997 until December 2001. Contemporaneously with the filing of this Order, the Commission filed a settled civil injunctive action in the U.S. District Court for the Southern District of Texas, Houston Division, against Duncan, in which Duncan consented to be permanently enjoined from violating Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Upon entry of the injunction by the Court, Duncan has also offered to settle an administrative proceeding by the Commission in which he agrees to be permanently barred from appearing or practicing before the Commission as an accountant.

extent of its borrowing from investors and the national credit rating agencies because sums borrowed in prepay transactions appeared as “price risk management liabilities” rather than additional debt on Enron’s balance sheet.

Enron’s prepay transactions were in substance financings because Enron used a three party structure involving a bank and a bank sponsored SPE that were not independent of each other to remove all commodity price risk from the transaction. The circular nature of delivery and payments with respect to the commodities and the lack of independence between the bank counterparties had the effect of eliminating any material risk or any potential gain with respect to changes in the price of the underlying commodity. In effect, Enron’s prepay transactions involved an investment bank making a large payment to Enron in exchange for Enron’s promise to pay the bank sponsored entity an amount in excess of what Enron received in the initial prepayment.

Amounts borrowed by Enron using the prepay structure were finely tuned each quarter for maximum reporting benefit. Enron simply determined the amount of operating cash flows it wanted to report, projected any “shortfall” as the end of a reporting period approached, and then used prepay transactions to fill the gap. From 1997 through September 30, 2001, Enron, using prepay transactions, received over \$5 billion in funds in this manner.

Enron never separately disclosed in its public filings that it was entering into prepay transactions. Such disclosure was necessary because of the large dollar amounts and volume of prepay transactions entered into by Enron and the significant future obligated cash commitments associated with the transactions. Rather, the prepay transactions were aggregated into Enron’s “price risk management liabilities.” Enron provided a generic and inadequate description of its price risk management activities in the notes to the financial statements and in the management’s discussion and analysis section of its annual reports on Form 10-K and its quarterly reports on Form 10-Q.

GAAS provides that “the presentation of financial statements in conformity with [GAAP] includes adequate disclosure of material matters. These matters relate to the form, arrangement, and content of the financial statements and their appended notes . . .” (AU §431, *Adequacy of Disclosure in Financial Statements*). GAAS also states that “[GAAP] recognize[s] the importance of reporting transactions and events in accordance with their substance” and that the “auditor should consider whether the substance of the transactions or events differs materially from their form.” (AU §411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles in the Independent Auditor’s Report*). Enron’s financial statement presentation and disclosure of the prepay transactions was not in conformity with GAAP because it mischaracterized the nature of the cash flows associated with the transactions, obscured the true economic substance of these financing transactions, and did not address the material impact they had on Enron’s financial statements.

Enron’s disclosures regarding prepay transactions were materially inadequate. In conjunction with both the 1999 and 2000 audits, the engagement team had advised Enron of the need for more robust disclosure of the prepay transactions. David Duncan, the engagement partner for the audits, even proposed to Enron’s senior management specific language used by another

Andersen audit client that would have disclosed the fact that Enron used “prepaid commodity contracts” and also the dollar amount of liabilities associated with the prepay transactions. Andersen’s recommendations to enhance the disclosure for prepay transactions were rejected by Enron’s management. Odom consulted with Duncan and others regarding Enron’s prepay transaction disclosures and they determined, improperly, that Enron’s disclosures complied with GAAP without the proposed enhancements.

3. Enron’s Raptor Transactions

Beginning in the spring of 2000, Enron and LJM2, a partnership formed and managed by Enron’s then-Chief Financial Officer Andrew Fastow, engaged in a series of complex financial transactions with four SPE structures called Raptor I, Raptor II, Raptor III and Raptor IV (collectively “Raptors”). Enron’s senior management used the Raptors, in part, to manipulate Enron’s financial statements.

By 1999, a large percentage of Enron’s quarterly earnings were attributed to unrealized gains in its merchant energy portfolio and in various technology investments. Many of these assets were extremely volatile. The Raptors were used by Enron to “hedge” the value of those investments with a purported independent third party SPE, so that Enron could offset declines in the value of these assets with the Raptor hedges. Enron capitalized Raptors I, II and IV with Enron stock. Raptor III was capitalized with warrants of an Enron spin-off company. Enron received an economic interest in the Raptors and \$1.2 billion in notes receivable from the Raptors in return for the Enron shares and warrants. Because of the related party nature and complexity of the transaction, the engagement team reviewed the features of the Raptors structures with Odom and the concurring review partner before Enron entered into the transactions and consulted with them both on various Raptors related issues throughout 2000 and 2001.

LJM2 contributed \$30 million of equity to each Raptor. However, through undisclosed side agreements between Fastow and others, the structures were designed so that amounts equal to LJM2’s equity was returned to LJM2 for each Raptor prior to any hedges being put in place. As a result of the side agreements and related effective return of capital, LJM2 had no equity at risk and Enron should have consolidated the Raptors into its financial statements. LJM2’s equity was effectively returned to it through three separate \$41 million put options in Enron stock in Raptors I, II and IV, and through a distribution in Raptor III. These put options provided a return equal to LJM2’s initial \$30 million capital contribution in each Raptor, along with an agreed upon rate of return on such capital, before the Raptor SPEs entered into the hedging transactions. Effectively, Enron was entering into hedging contracts with entities backed solely with its own stock.

Since the Enron engagement was classified as maximum risk, and related party transactions created an “extreme” or “very significant” financial reporting risk, the existence of the put options in the Raptor structures should have triggered increased professional skepticism. The puts were priced at a premium that matched exactly LJM2’s targeted return, and were included as part of aggressive and complex related party transactions that had a material effect on Enron’s reported earnings. Additionally, LJM2 received its \$41 million payout in each Raptor shortly after signing the contracts - resulting in a short-term return on investment in excess of 130% in each case.

Moreover, the payout occurred in each Raptor after Enron settled the put option early and before any hedges were put in place. The timing of settlement by Enron of these out-of-the-money put options should have been an additional red flag that prompted Odom and others to increase their professional skepticism and question why Enron would repeatedly make such economically irrational payments. These payments actually eliminated the supposed protection from a drop in its stock price that the company purportedly had purchased at a premium. Despite the need for greater scrutiny, Odom did not exercise due professional care or professional skepticism with regard to this aspect of the Raptor transactions (AU §230, *Due Professional Care in the Performance of Work*). In addition, Odom and members of the engagement team allowed Enron to avoid recording significant Raptor-related impairment charges at year-end 2000 and for the first quarter of 2001 by improperly allowing Enron to offset losses in Raptors I and III against the excess credit capacity in Raptors II and IV.

4. Violations

Rule 102(e)(1)(ii) of the Commission's Rules of Practice provides, in part, that the Commission may censure or deny, temporarily or permanently, the privilege of appearing or practicing before the Commission in any way to any person who is found by the Commission to have engaged in improper professional conduct. Rule 102(e)(1)(iv) defines improper professional conduct with respect to persons licensed to practice as accountants.

As applicable here, improper professional conduct means a violation of applicable standards that resulted from "repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission." (Rule 102(e)(1)(iv)(B)(2)). As a result of the conduct described above, Odom repeatedly acted unreasonably by concurring with the Enron audit engagement team's faulty conclusions regarding Enron's accounting for certain transactions and allowing the issuance by Andersen of unqualified audit reports that were materially false and misleading.

5. Findings

Based on the foregoing, the Commission finds that Odom engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Odom is denied the privilege of appearing or practicing before the Commission as an accountant.

B. After two years from the date of this order, Odom may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the Respondent's or the firm's quality control system that would indicate that the Respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The

Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Secretary