THE GOVERNMENTAL AFFAIRS PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
UNITED STATES SENATE

"THE ROLE OF THE FINANCIAL INSTITUTIONS IN ENRON'S COLLAPSE"

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Written Statement

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Mr. Chairman, Ranking Member, Members of the Subcommittee, my name is Lynn Turner. As I believe you are aware, I served as the Chief Accountant of the Securities and Exchange Commission (SEC) from July of 1998 through August of 2001. I also served on the staff of the SEC from June of 1989 through July of 1991. Currently I am a professor of accounting and Director of The Center For Quality Financial Reporting at Colorado State University.

From June of 1996 to June of 1998, I was Vice President and Chief Financial Officer of Symbios, Inc., an international manufacturer of semiconductors and storage solution products. Prior to joining Symbios, I served as a partner at one of the then "Big Six" international accounting firms, Coopers & Lybrand (C&L). While at C&L, I served as an auditor and partner who reviewed SEC filings.

Restoring The Trust

Mr. Chairman, the capital markets in the United States are vitally important to the health of the U.S. economy. Maintaining the confidence and trust of the investing public in the integrity of the markets is critical to the ability of the markets to continue to attract capital. Capital that is invested by 85 million Americans. Capital that fuels the expansion of plants, creation of jobs and development of new technologies that has made our great country *the* leader in innovation.

Yet as recently as this past week, polls show many Americans have lost trust in Corporate America, the accounting profession, analysts, Wall Street firms and other market participants. The recent downward spiral of market indexes is a strong indicator that confidence in the markets has ebbed. That loss of confidence, if not stemmed, may well have a profound and lasting effect on this country, its economy and its citizens.

To restore the trust, all market participants must once again fulfill their roles in a responsible fashion. Corporate executives must make full and fair disclosure of their financial information, the corporate board must oversee the financial reporting process with the keen eye of an eagle, auditors must once again become unbiased and independent so as to ensure the numbers are accurate, and Wall Street must provide real due diligence on behalf of the markets and meaningful analysis to investors.

Those market participants who fail in their respective roles, and thereby aid and abet a fraud being perpetrated on thousands, if not millions of investing and hard working Americans should be dealt justice in a swift and appropriate manner.

The foundation of the markets rests on the integrity of the numbers reported to analysts, credit rating agencies and investors. Numbers that are necessary in assessing a company's financial health and prospects for the future.

When it comes to integrity and honesty in financial reporting, the buck starts and stops with the Chief Executive

Officer (CEO) and Chief Financial Officer (CFO). But others also play a key role. For example, investment bankers and auditors will often carry out due diligence, learning much about a company and its business. They also read the filings made by public companies. It is important that the corporate executives, auditors and investment bankers ensure that the financial statements and other disclosures included in offering documents, include ***all*** the material information that those market participants would want if they were investing in the company themselves. Unfortunately, I have seen all too often where that has not occurred. Enron only confirms that concern for millions of investors.

Enron has raised many issues, questions and doubts in the minds of the public. One issue in particular those members of this committee are to be commended for addressing today, is: what role was played in Enron's demise by the various financial institutions that helped finance or raise capital for its operations? Did these institutions have knowledge of information that could have been a red flag to investors, analysts or the credit rating agencies, if properly disclosed? Was there information available that if made transparent would have warned investors an iceberg was lurking ahead that would inevitably sink the ship? Did the institutions assist or otherwise aid and participate in the structuring and execution of transactions for the purpose of reducing the transparency of disclosures to investors?

Determining the Proper Accounting

I would like to focus in particular on the accounting for a series of transactions I will call the Mahonia and Delta transactions. But before I delve deeper into these, allow me to outline some basic accounting ground rules that, I hope, will better frame the issue.

The statutory responsibility for establishment of generally accepted accounting principles, or GAAP, resides with the SEC. However, since almost from the inception of the SEC, the Commission has looked to the private sector for the establishment of GAAP. As a result, GAAP has been promulgated by or under the oversight of the Financial Accounting Standards Board (FASB) or one of its predecessors.

However, businesses enter into billions of transactions. In the past couple of decades, the number of these transactions involving complex financial contracts and off-balance sheet transactions has increased exponentially. As a result, it is virtually impossible to write accounting standards for each particular type of transaction. Unfortunately, during the bull market of recent years, some companies with the assistance of their external auditors and investment bankers, have improperly taken advantage of this.

The FASB does have a task force, comprised of representatives from accounting firms and Corporate America, which establish accounting principles for emerging accounting issues. This is an effort to accomplish "real time" accounting standard setting. This task force is known as the Emerging Issues Task Force (EITF). A significant amount of its efforts since its inception in 1983 has been devoted to determining the accounting for transactions structured by Wall Street and the accounting firms. Many of these structured or engineered transactions are done to circumvent existing accounting rules and reduce transparency through such ingenuity as off-balance sheet financings or avoiding classifying financings as debt as we have seen done by Enron.

I can't tell you Mr. Chairman, how often as an audit partner or the Chief Accountant as the SEC I heard the common refrain – "Where does it say in the accounting literature I can't do it." In fact, I recall on more than one occasion when investment bankers suggested an accounting treatment that I believed was absolutely and without a doubt, black and white, and wrong! Sometimes they would even show partners in my firm filings with the SEC that contained what we believed was improper accounting while at the same time saying since one Big Five firm accepted it, my firm was also obligated to agree to it. This type of behavior contributes to a lack of a "level playing field" for the majority of those in business who "do the right thing." It quickly degenerates into "lowest common denominator" financial reporting and disclosures.

When there is not an accounting standard written for a specific transaction entered into by an entity, the accountant and/or auditor often will look to accounting principles for similar types of transactions or economic events. In accounting, this is sometimes referred to as determining accounting principles by analogy.[1]

Financial executives and auditors must determine that the accounting principles selected by a company "present fairly" the financial condition, results of operations and cash flows, including operating cash flows, of the company. In making this determination, one has to consider whether the accounting principles selected have (a) general acceptance, (b) are appropriate in the circumstances, (c) the financial statements, including the related notes, are informative of matters that may affect their use, understanding and interpretation by users, and (d) that the numbers in the financial statements are properly classified (e.g., presented as a trading liability versus bank financing).[2]

It is important that numbers are properly classified in the financial statements. Classification of assets and liabilities into the appropriate line items and as short or long term in nature will provide investors, analysts and credit rating agencies with a transparent picture of the assets that will provide cash that can be used to extinguish liabilities, when those assets will give rise to cash and when there will be a demand for cash to pay off the debt. For example, trading companies may "match" their asset and liability positions and use the settlements of each to offset one another. However, bank loans cannot be repaid from offsetting positions and require the use of cash generated by ongoing business operations. Accordingly, if bank loans are disguised as trading liabilities, investors and other users of the financial statements, such as credit rating agencies, can easily be misled as to the demands on cash and other liquid assets the company will incur, the timing of those demands, and pending shortages in liquidity. I strongly agree with the testimony of John Diaz of Moody's Investor Service that "If such transactions had been accounted for as a loan, Enron's operating cash flow would have been reduced and its debt would have been greater. The disclosure of these transactions as loans would have exerted downward pressure on Enron's credit rating."

Accounting For The Substance of A Transaction

The accounting profession's guidance notes that GAAP recognizes "the importance of reporting transactions and events in accordance with their substance….Because of the developments such as…the evolution of a new type of business transaction, there sometimes are no established accounting principles for reporting a specific transaction or event. In those instances, it might be possible to report the event or transaction on the basis of its substance by selecting an accounting principle that appears appropriate when applied in a manner similar to the application of an established principle to an analogous transaction or event."[3]

Consistent with the guidance in the professional literature, Judge Friendly ruled in U.S. of America versus Simon, United States Court of Appeals for the Second Court, that it was proper for Judge Mansfield to have directed the jury that mere adherence to GAAP was not sufficient. Mansfield stated "that the 'critical test' was whether the financial statements as a whole 'fairly presented the financial position of Continental…and whether it accurately reported the operations…Proof of compliance with generally accepted standards was 'evidence which may be very persuasive but not necessarily conclusive…that he acted in good faith, and that the facts as certified were not materially false or misleading.'" Judge Friendly went on to say that "Generally accepted accounting principles instruct an accountant what to do in the usual case where he has no reason to doubt that the affairs of the corporation are being honestly conducted. Once he has reason to believe that this basic assumption is false, an entirely different situation confronts him…At least this must be true when the dishonesty he has discovered is not some minor peccadillo but a diversion so large as to imperil if not destroy the very solvency of the enterprise."

The FASB has developed general broad principles contained in Statements of Financial Accounting Concepts (SFAC) that are useful in determining the appropriate accounting principles to be applied to a particular transaction. Often the staff of the SEC has referenced these concepts when asked by a public company or its auditor as to the staff's views on the proper accounting for a particular transaction. These concepts or principles provide an accountant and auditor with a framework for determining transparent accounting. [4] One of the concepts set forth is that the accounting principles selected for a transaction should faithfully represent the underlying "economic resources and obligations and the transactions and events that change those resources and obligations."[5]

Andersen set forth it views on accounting for prepay transactions in a memo dated June 1999.[6] In simple terms, the transaction described in the memo involves a public company (Enron), a special purpose entity (SPE – e.g., Mahonia and Delta) and a swap counter party (such as a financial institution). Enron receives a fixed payment from the SPE and agrees to sell a fixed amount of a commodity such as gas at a specified future dates. The SPE also enters into an agreement with the financial institution and receives a fixed payment amount which is used to fund the SPE's payment to Enron. In turn, the SPE enters into a swap agreement that will result in it making the same floating payments to the financial institution that it is receiving from Enron. Finally, Enron and the financial institution enter into an agreement whereby Enron will pay a fixed amount to the financial institution through periodic settlements (payments) and in turn receives floating payments in a swap, that are the same as those it will make to the SPE. In the case of Mahonia, the SPE also becomes the beneficiary of a surety bond from an insurance company.

Andersen appropriately referred to various analogous accounting literature in trying to determine the appropriate accounting for the prepay transaction. Andersen appropriately concluded that if there is linkage between the various contracts among the three parties, such as cross default provisions, then "all three transactions must be considered one and therefore be accounted for as a financing. EITF 88-18 provides guidance on whether certain factors of the transaction indicate debt or deferred revenue. We reviewed the factors indicating debt vs. deferred revenue and believe the transaction would meet several factors that would indicate debt if the contracts contained cross default provisions." Andersen's memo also goes on to note that the terms of the contracts should have basic criteria to avoid being treated as debt including the counterparties have price risks, each contract must be de-linked, and the contracts should be standard normal swaps.

In a separate Andersen document titled "Prepaid Transactions Discussions," Andersen states that for prepays to be treated as trading contracts they must meet four criteria. Those criteria are:

- None of the individual agreements are linked commercially or make reference to any of the other documents; in effect, each is a stand-alone, normally occurring derivative instrument which continues to be in effect even if other pieces of the transaction are terminated for any reason.

- The PGA (contract agreements) and each swap are settled at current market values, and the PFA includes provisions typical of trading instruments such as replacement cost provisions with monthly settlements

- Price risk related to the PGA is transferred from the gas supplier to the purchaser without the gas supplier further affecting the purchaser's management of this risk or the purchaser's other PGA-related economics, and

- The purchaser of the gas must have an ordinary business reason for purchasing the gas, not in-substance be an SPE established just to effect a secured investment in a debt instrument from a gas supplier.

In essence, Andersen established criteria to assess and determine if the Enron prepay transactions were with independent entities with economic substance, entering into substantive business contracts, or merely "sham" transactions without any business purpose other than to hide financings from the investor. If the transactions were sham transactions and financings, Enron would have been required to report and disclose the transactions in their financial statements as bank debt. They would also need to report the cash received from the financings, as well as the repayments, in the financing section of the statement of cash flows rather than as cash flows from operations. However, when Enron reported these contracts as trading activities and liabilities, they also reported the receipts of cash as if they were generated by normal business operations and as a component of operating cash flows. When a company improperly reports cash flows generated by or used in financings as cash generated from typical business operations that investors, analysts and credit rating agencies will be misled as to the financial health of a company and its ability to meet future commitments on cash. In developing the standard for how to report cash flows, the FASB specifically decided that for cash flow information to be useful and relevant to investors, cash flows from operations, investing activities and financing activities should be separately reported. To do otherwise violates GAAP and accordingly, the rules and regulations of the SEC.

I agree with the factors Andersen has used in determining whether the prepay transactions have real economic substance or are "sham" transactions structured to avoid treating prepays as financing transactions in the financial statements. Based on my experience as an audit partner, CFO and Chief Accountant of the SEC, I would also consider the following factors, some of which are encompassed within the Andersen factors:

- Does the transaction have a legitimate business purpose other than avoiding presenting the financing as bank debt on the balance sheet?
- Does the SPE engage in normal business operations? For example, does it undertake normal trading activities for the purpose of making normal trading profits? Does it assume the typical risks and rewards associated with a trading entity?
- Does the SPE have more than nominal capitalization? Where does the SPE receive its funding from? Apart from that source of cash, could it operate on its own and engage in the transactions? Does the SPE undertake trading activities with parties other than Enron and the Wall Street Bank? If not, why not? Who determines what transactions the SPE can and does enter into? Does the SPE have full control over the transactions and contracts it enters into, or by contract, does it give up some of its control to Enron or the Wall Street Bank?
- Does the SPE have officers and directors who function as they would in any normal trading company?
- Does the sponsor of the SPE or the entity it enters into transactions with have all the risks and rewards of the transactions or does the SPE have them? Is there any economic substance to the SPE or is it placed into the transaction merely as a third party to facilitate false and misleading financial reporting?
- Do the transactions between Enron, an SPE and the Wall Street Bank actually transfer economic risk from or to Enron, the SPE or bank? Are the transactions structured as a "round trip" whereby the cash flows and risks merely move in a circle and end up with the same party as they began with?
- Are the transactions linked in such a manner that risks or the ultimate obligations to repay financings are not really transferred? Are they linked in a manner such that they show lack of independence of one of the parties or any of the "legs" of the transactions?
- Are the forward sales contracts more like debt than a forward sale of a commodity or product? Do the terms of the contracts result in the parties earning trading profits for taking on trading risks or are the returns to the contract parties limited to an interest rate of return or limited in some other fashion?
- Are the contracts linked in such a fashion that Enron ultimately has the obligation to repay the funds used in the transaction? Does the Wall Street bank, via cross default provisions or other contract terms, such as termination arrangements, have the ability to obtain payments from Enron? If Enron goes into bankruptcy, can the Wall Street bank by contract or otherwise control the SPE in such a fashion it demands payments or assets from Enron?
- Does the SPE have the ability to make the payments if Enron does not? What is the continuing involvement of Enron in ensuring the Wall Street Bank is repaid?

Analogous Accounting Literature

In EITF Topic D-14, *Transactions involving Special-Purpose* Entities, the SEC staff stated it has "objected to a proposal in which the accounting for a transaction would change only because an SPE was placed between the two parties to the transaction. The SEC staff believes that insertion of a nominally capitalized SPE does not change the accounting for the transaction." EITF Issue 90-15, *Impact of Nonsubstantive Lessors, Residual Value Guarantees, and Other Provisions in Leasing Transactions*, addresses accounting for SPE's created to keep lease financings off the balance sheet. As a result of EITF Issue 90-15, the SEC staff sent a letter to the EITF and accounting profession that stated the "…equity investment should be comparable to that expected for a substantive business involved in similar leasing transactions with similar risks and rewards." EITF 90-15 also requires that if an SPE engages in activities only for a single company, where that company has the risks and rewards of the transaction as opposed to the SPE and the SPE has only nominal capital, the SPE will not be considered substantive and will have to be consolidated by the sponsoring company. EITF Issue 96-21, *Implementation Issues in Accounting for Leasing Transactions involving Special-Purpose Entities*, which provides further guidance on accounting for lease transactions involving SPE's, notes that cross-collateralization provisions that give two parties access to the same leased assets should be collapsed and assuming all other criteria are met, the lease is treated as financing on the balance sheet.

EITF 88-18 *Sales of Future Revenues* sets forth criteria for assessing when a forward sale is to be treated as debt. Some of the criteria include:

- Whether the enterprise (Enron) has significant continuing involvement in the generation of the cash flows due the investor (Wall Street Bank),
- Whether the investor's rate of return is implicitly or explicitly limited by the terms of the transaction, and
- The investor has recourse to the enterprise relating to the payments due the investor.

Andersen notes in their June 1999 memo that when cross defaults exist in transactions, the Enron prepays would be treated as debt on the balance sheet based on the criteria in EITF 88-18. I concur with Andersen's conclusion that prepays with cross defaults should be reported and disclosed in the balance sheet as loans from the lending financial institution.

EITF Issue 98-10, *Accounting for Contracts Involved in Energy Trading and Risk Management Activities*, sets forth a number of criteria for determining if an entity is in substance involved in energy trading activities. It states that energy trading contracts that are not derivatives should be reported in the balance sheet at their fair value. The 98-10 consensus established a framework for evaluating the treatment of energy-related contracts that assesses the facts and circumstances surrounding the various activities of an entity rather than solely on the terms of the contract. It states: "Inherent in that framework is an evaluation of the entity's intent in entering into an energy contract."[7]

EITF Issue 98-15, *Structured Notes Acquired for a Specified Investment Strategy* addresses when should two separate structured note transactions should be collapsed and considered a single transaction for accounting purposes. The consensus lists factors such as the following that would lead to the conclusion that accounting treatment as a single combined transaction is appropriate:

- The two securities are issued contemporaneously and in contemplation of one another or are issued separately but the terms for their remaining lives result in off setting changes in fair value.
- The two securities are issued by the same counterparty and/or the same issuer (or issued by different issuers but structured through an intermediary).
- The two securities were purchased by the investor for the sole purpose of achieving a desired accounting result, and the transaction considered individually would serve no valid business purpose or would not be entered into otherwise.[8]

SEC Regulation S-X, Article 3A-02 states the Commission will look to factors other than just ownership in determining if an entity is independent or really under the control of another party. For example, an entity may appear independent because of separate ownership but still be controlled through a contract that stipulates what the entity can or cannot do.

The FASB has provided guidance on accounting for prepaid interest rate swaps in implementation guidance it has published on accounting for derivatives. In its Derivative Implementation Group Issue A9, the DIG states that the prepaid interest rate swaps in the described transactions would be reported at fair value as a derivative instrument in the balance sheet. However, underlying this conclusion is that the described transactions are not "sham" transactions but rather swaps with a legitimate business purpose between independent parties who have assumed the risks and rewards of their respective transactions.

Accounting for Mahonia and Delta Transactions

I have read the testimony of the subcommittee's chief investigator and various documents the staff of the subcommittee have provided to me. These documents lead to the conclusion that the Enron prepay transactions described therein should have been accounted for as bank or credit financings, rather than as liabilities from price risk management activities in the financial statements of Enron. The cash flows from these transactions should also have been reported in the financing section of the Enron statement of cash flows. Specific considerations set forth by the chief investigator that I agree support this conclusion include:

- Mahonia and Delta are nominally capitalized and lacking economic substance apart from the Enron transactions. Their purpose was not to engage in ongoing competitive trading operations as a trader but rather to facilitate less than transparent reporting by Enron.
- Mahonia and Delta lack price exposure and earning fixed fees rather than trading profits.
- Mahonia and Delta were established for the benefit of Chase and Citibank and only engaged in transactions with those respective banks. They did not engage in ongoing competitive trading activity with other independent financial institutions.
- The level of control over Mahonia and Delta exercised by Chase and Citibank, by contract or otherwise.
- The linkage of legal agreements among the involved parties.
- All three "independent" legs of the prepay transactions were contemplated and executed simultaneously.
- Deal terms that in form referenced commodities indexes were in substance calculated using borrowing rates.

I also share the concerns of the staff of the subcommittee on the Yosemite transaction. The role of the investment bankers in creating what appears to have been planned in advance as a unitary transaction, for the purpose of reducing Enron's transparency to investors and the investment bankers risk, should be the subject of investigations by both the SEC and the Department of Justice.

Lessons To Be Learned

There are important lessons that can and should be learned from the Enron Mahonia and Delta structured financings. First, GAAP must be considered a minimum reporting benchmark for financial statements and disclosures. Ultimately, the financial statements and disclosures must fairly present in all material respects, the financial condition, cash flows and operations of the issuer.

Second, professionals within or external to a company that mislead auditors should be held accountable for false statements. All parties, including investment bankers, who aid and abet fraudulent reporting to investors should feel the sharp blade of the sword of justice.

Third, independent accountants should not help Wall Street facilitate the structuring of transactions so as to reduce the transparency of financial reports. Twice during my term as chief accountant I requested the accounting profession to cease their participation in this process. My successor has also requested auditors reduce their involvement with Wall Street in this dubious process. Despite these requests, the profession has not acted in a timely and responsible fashion, instead choosing to continue to generate fees at the expense of investors. This behavior is simply at odds with the purpose of the public franchise Congress granted the accounting profession by government mandate in 1933.

The role Wall Street has played in structuring and executing transactions to reduce transparency to investors, in exchange for fees that may run into tens of millions, is also inconsistent with honest due diligence and integrity in the market place. If Wall Street was serious about reforms, they would stop providing this service and start serving investors. Wall Street needs to remember that the U.S. capital markets cannot, and will not, effectively function if investors believe that investment bankers have “rigged the tables.” Today, too many investors are concerned they are playing with a “stacked deck.”

Fourth, there needs to be greater enforcement of existing accounting rules. In Enron, the existing accounting rules were not complied with and as a result, the financial statements provided to investors were materially misleading. However, to accomplish increased enforcement by the SEC and the Justice Department, these agencies will need to be provided with significantly increased funding and resources.

Some have argued that the solution to a lack of compliance with today’s accounting rules is to adopt “principled based” rules. However, the predecessor the FASB, the Accounting Principles Board developed several principles based rules during its existence from 1958 to 1973. However, this did not stem a stream of false and misleading financial statements and disclosures that emerged during the 1972-73 bear market. Then as now, the number one issue was a lack of compliance with existing accounting rules. As we saw at the SEC, the principles based approach to rules in foreign countries often did not result in transparent reporting or better compliance with the rules. In fact today, the FASB’s conceptual framework provides a substantial “principal based approach” that all too often is ignored by preparers of financial statements.

Fifth, the existing accounting rules for special purpose entities and off-balance sheet transactions should be improved. While the FASB has recently issued an exposure draft of a new standard, I am concerned that it will not result in a company reflecting all the debt on its balance sheet that will require the use of the company’s assets or resources to pay off. The change in the proposed standard to a rebuttable presumption that there must be not less than 10% equity in the SPE will not result in all public companies which continue to have the risks associated with off balance sheet financings, reporting all of those financings on their balance sheets.

Closing

Let me close by pointing out that the solutions for fixing the systemic problems we have learned from the Enron experience, are included in the Sarbanes bill. Its prohibition on auditors providing certain services to companies they audit, will stop the auditors from participating in reducing the transparency of disclosures to investors. It clearly establishes a new standard consistent with Judge Friendly’s decision of over thirty years ago that all financial statements and disclosures, regardless of GAAP, must fairly present the true economic health of a company. It mandates that new disclosure standards be adopted for off-balance sheet transactions and will study whether the proposed FASB rule for SPE’s will get the job done. The Sarbanes bill provides long overdue and much needed resources to the SEC. Finally, for those scoundrels in corporate America who have painted the many ethical and upstanding American businessmen with a tarred image, it will put them where they belong: Behind bars.

The 97 members of the U.S. Senate who voted for the Sarbanes bill should be loudly applauded by their constituents and investors for supporting this important piece of legislation. I believe if it is passed by Congress without weakening any of its provisions, it will once again restore the trust and confidence investors have had in the U.S. capital markets. For that I say thank you all.

[1] See Securities and Exchange Commission Staff Accounting Bulletin (SAB) No. 99, *Materiality*, August 1999. SAB 99 states: "This SAB and the authoritative accounting literature cannot specifically address all of the novel and complex business transactions and events that may occur. Accordingly, registrants may account for, and make disclosures about, these transactions and events based on analogies to similar situations or other factors….The staff, therefore, encourages registrants and auditors to discuss on a timely basis with the staff proposed accounting treatments for, or disclosure about, transactions or events that are not specifically covered by the existing accounting literature."

[2] Statement on Auditing Standard (SAS) No. 69, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*, Paragraph 4.

[3] Ibid Note 2.Paragraphs 6 and 9.

[4] Statement of Financial Accounting Concepts (SFAC) No. 2, *Qualitative Characteristics of Accounting Information*, states that the FASB conceptual framework "…is expected to serve the public interest by providing structure and direction to financial accounting and reporting to facilitate the provision of evenhanded financial and related information that is useful in assisting capital and other markets to function efficiently in allocating scarce resources in the economy….Careful use of the concepts may also provide guidance in resolving new or emerging problems of financial accounting or reporting in the absence of applicable authoritative pronouncements."

[5] SFAC No. 5, Para. 63.

[6] Andersen memo to the files dated June 1999. Bates No. ECp000094306. The memo references Emerging Issues Task Force (EITF) Consensus 88-18, 90-15, 96-21, EITF Topic D-14 and a December 1997 Speech made the SEC staff at the Annual SEC Conference of the American Institute of Certified Public Accountants analyzing a similar type structure involving fixed payments and a total return swap. The transaction involved a financial institution, special purpose entity and company.

[7] EITF Issue No. 98-10, *Accounting for Contracts Involved in Energy Trading and Risk Management Activities*. Para. 8.

[8] Ibid, Para. 4. Derivatives Implementation Group (DIG) Issue K1 also discusses a situation where two or more transactions have been entered into in an attempt to circumvent the accounting literature for derivatives. The DIG issue states that "the following indicators should be considered in the aggregate and, if present, should cause the transactions to be viewed as a unit and not separately:

a. The transactions were entered into contemporaneously and in contemplation of one another.

b. The transactions were executed with the same counterparty (or structured through an intermediary).

c. There is no apparent economic need nor substantive business purpose for structuring the transactions separately that could *not* also have been accomplished in a single transaction."