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Off-Balance Sheet Financing: A Weapon to Commit White-Collar Crime

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ABSTRACT

Off balance-sheet financing is an accounting technique in which a debt for which a company is obligated does not appear on the company's balance sheet as a liability. Keeping debt off the balance sheet allows a company to appear more creditworthy but misrepresents the firm's financial structure to creditors, shareholders, and the public. The sudden collapse of energy-trading giant Enron Corporation is attributed in large part to the firm's off-balance-sheet financing through multiple partnerships. Off-balancing financing is an aspect of creative accounting. In this paper an attempt has been made to highlight various aspects of off-balance sheet financing as well as to provide some suggestive measures so that such mal practice can be eradicated.

Keywords: On-balance sheet financing; Off-balance sheet financing; Liabilities; Debt; Accounting Standards; Disclosures.

I. INTRODUCTION & BACKGROUND

'*Off the books*' is a term associated with transactions which do not appear in any of the financial records kept by a business. Strictly speaking, 'off the books' implies cash payments received for assets (products and services) which are not officially recorded in the accounting system of the business.

Off balance sheet financing: Debt financing that is not shown on the face of the balance sheet is called "off balance sheet financing". Recently there has been a proliferation of financial arrangement that have been enabled companies to raise finance without increasing their apparent indebtedness on their balance sheet. The practice of using finance without the involvement of the balance sheet is known as off-balance sheet financing. In fact off-balance sheet financing is a descriptive phase for all the financial arrangements that result in the exclusion of debts and associated assets from the balance sheet. The Institute of Chartered Accountants of England and Wales (ICAEW) has defined off balance sheet financing as "the funding or refinancing a company's operations in such a way that, under legal and existing accounting conventions, some or all of the financing may not be shown on its balance sheet" (ICAEW, 1985).

Off-balance sheet financing is an aspect of creative accounting. Companies have the habit of being creative in the generation of financial reporting numbers; they innovate financial reporting numbers by taking advantage of the flexibility and loopholes in accounting rules and regulatory requirements. Keeping finance off the balance sheet is one of the ways creativity is cultivated in corporate financial reporting. There is a significant difference between off balance sheet financing and other forms of creative accounting. In off balance sheet financing figures are completely left out, while

in other forms of creative accounting efforts are made to manipulate figures. The transforming of a debt into an off balance sheet item requires either a reduction in one or more of the existing assets or an exclusion of one or more of the newly created assets. This balancing activity needs to be performed in order to preserve the identity of the balance sheet.

On-balance sheet financing vs. off-balance sheet financing:

On-balance sheet financing is any form of direct debt or equity funding of a firm. If the funding is equity, it appears on the firm's balance sheet as owners' equity. If it is debt, it appears on the balance sheet as a liability. Any asset the firm acquires with the funding also appears on the balance sheet.

Off-balance sheet financing, by comparison, is any form of funding that avoids placing owners' equity, liabilities or assets on a firm's balance sheet. This is generally accomplished by placing those items on some other entity's balance sheet.

Companies are motivated to keep debts off the balance sheet for the following reasons:

- Off balance sheet financing allows a company to borrow being without affecting calculations of measures of indebtedness such as gearing. This is a form of borrowing in which the obligation is not recorded on the borrower's financial statements.
- The motives may include misleading investors and remaining within the terms of debt covenants. It raises debt in a manner that is not visible to investors.
- To obtain funding which the company would not have otherwise been able to achieve.
- To reduce the exposure to debt.
- To make the financial statement more attractive and stronger-looking by removing debts from the liability side.
- To structure the duration and repayments of the debts to suit the requirements.
- Debt interest is tax deductible and debt financing gives rise to gearing advantage.

Objectives:

With this backdrop an attempt has been made:

- to discusses about the various techniques used in off-balance sheet financing
- to provide an insight into various aspects of off-balance sheet financing
- to shows how off-balance sheet financing leads to the collapse of Enron.
- to discuss the general remedial aspects of off-balance sheet financing

II. Techniques of Off-Balance Sheet Financing:

Off balance sheet financing can employ several different techniques, which include development arrangements, leasing, product financing arrangements or recourse sales of receivables. Off balance sheet financing does raise concerns regarding the lenders' overall risk, but it improves their debt to equity ratio, which enhances their borrowing capacity. As a result, loans are often easy to arrange and are given lower interest rates because of the improved debt structure on the balance sheet. Off balance sheet financing is a technique often used by multinational businesses in order to secure additional loans on the worldwide loan market. Off balance sheet financing involves raising money in a way that it does not appear on the financial statement as loan or cash flow. Some of the most widely used ways to achieve that is to go by joint ventures, leases and R&D partnerships. The lesser-used methods are trade receivables securitization and passing tax benefits to investors.

The principle techniques of off balance sheet financing can be summarized as follows:

The company forms a joint venture with a partner company. One party provides the technical know how while the other provides the funding. The smart way to structure off balance sheet financing is to obtain royalties from the proceeds of the venture.
2) The company can lease equipment or other facilities for its operations; rather than buying them. The lease equipment is not considered company asset, and it can save the business from having to buy equipment. Many businesses lease assets that are used in their business instead of purchasing them. There are five major reasons why a business might find it more advantageous to lease versus purchase property, plant and equipment:
i) *100% financing* – The company do not have the large initial cash outlay that would be required to purchase the piece of equipment.
ii) *Obsolescence of the asset* – this is a big deal with computer equipment. Many companies turn in their leased computers yearly to get the new, faster models. Basic purpose of this is to maximize productivity while working on their computer.
iii) *Flexibility* – for example if a company gets sick of the car, the company is leasing or the employee for whom it was leased – the company need not have to worry about advertising the car for sale and trying to find a buyer – the company just turn the car back into the leasing company.
iv)*Tax advantages* – an operating lease is a total business expense. The entire lease payment reduced taxable income. There is no split of the payment between interest and principal. Nor do the companies will have to worry about depreciating the asset.
There are two different ways to structure a lease agreement: capital or operating.
The operating lease is the easiest lease to account for and understand. The transaction is totally straightforward - each month the company will have a rental payment for using the equipment that is taken straight to the income statement as an expense. This transaction reduces gross income by the total amount of the payment.
Company's cash account is reduced when the lease payment check is written and that is the sum and total of what is needed to be done to account for operating leases. This is why operating leases are an example of off balance sheet financing. The value of the asset is not placed on the balance sheet; the associated liability of the lease payments is also not placed on the balance sheet.
However, there is a very specific criterion that must be met in order to classify a lease as an operating lease versus a capital lease.
Additionally, there is also the question of the time value of money. Prior to making any decision an analysis would need to be done to compare the relative cash outlay in a straight purchase of an asset versus a capital or operating lease.
Lease is a form of financing in which large capital expenditures are kept off of a company's balance sheet through various classification methods. Companies will often use off-balance-sheet financing to keep their debt to equity (D/E) and leverage ratios low, especially if the inclusion of a large expenditure would break negative debt covenants.
Contrast to loans, debt and equity, which do appear on the balance sheet. Examples of off-balance-sheet financing include joint ventures, research and development partnerships, and operating leases (rather than purchases of capital equipment).
Operating leases are one of the most common forms of off-balance-sheet financing. In these cases, the asset itself is kept on the lessor's balance sheet, and the lessee reports only the required rental expense for use of the asset. Generally Accepted Accounting Principles (GAAP) in the U.S. have set numerous

rules for companies to follow in determining whether a lease should be capitalized (included on the balance sheet) or expensed.
This term came into popular use during the Enron bankruptcy. Many of the energy traders' problems stemmed from setting up inappropriate off-balance-sheet entities.
3) The company can pass off some tax benefit to an investor in order to keep the funding off the balance sheets.
4) Trade receivables securitization is another technique of off balance sheet financing. This standard approach is to form a special purpose vehicle (SPV) and place assets and liabilities on its balance sheet. It can also be termed as special purpose entity (SPE). An SPV is a firm or legal entity established to perform some narrowly-defined or temporary purpose. The sponsoring firm accomplishes that purpose without having to carry any of the associated assets or liabilities on its own balance sheet. The purpose is to achieve "off-balance sheet."
Under most accounting regimes, if a sponsoring firm wholly owns an SPV, the SPV's balance sheet is consolidated into its own. Rather than have the SPV appear on its balance sheet as an asset, the sponsoring firm has all the SPV's individual assets and liabilities appear on its balance sheet just as if they were the sponsoring firm's assets and liabilities. This is on-balance sheet financing, which largely defeats the purpose of the SPV. For this reason, a sponsoring firm typically takes only a partial ownership position in the SPV. In other arrangements, it takes no ownership interest in the SPV whatsoever.
SPVs are used in a variety of transactions, including securitizations, project finance, and leasing. An SPV can take various legal forms, including corporations, US-style trusts or partnerships.
Off-balance sheet financing is attractive from a risk management standpoint. When assets and liabilities are moved from one balance sheet to another, the risks associated with those assets and liabilities go with them. For example, if a firm transfers credit risky assets to an SPV, the credit risk goes with those assets.
Off-balance sheet financing also affords considerable flexibility in financing. An SPV doesn't utilize the sponsoring firm's credit lines or other financing channels. It is presented to financiers as a stand-alone entity with its own risk-reward characteristics. It can issue its own debt or establish its own lines of credit. Often, a sponsoring firm overcapitalizes an SPV or supplies it with credit enhancement. In this circumstance, the SPV may have a higher credit rating than the sponsoring firm, and it will achieve a lower cost of funding. A BBB-rated firm can achieve AAA-rated financing costs if it arranges that financing through a sufficiently capitalized SPV.
Off-balance sheet financing is often employed as a means of asset-liability management. Obviously, if assets and liabilities are never placed on the balance sheet, they don't have to be matched. They do need to be matched on the SPV's balance sheet, but the SPV can be structured in a way that facilitates this. A pass-through is a security issued by a special purpose vehicle. The SPV holds assets and pays the pass-through's investors whatever net cash flows those assets generate. In this way, the SPV's assets and liabilities are automatically cash matched, so there is no asset-liability risk. Many securitizations are structured as pass-throughs.
Off-balance sheet financing has other applications. SPVs can be used in tax avoidance. Banks use off-balance sheet financing to achieve reductions in their regulatory capital requirements. This is a compelling reason for many securitizations. It is also the purpose of trust preferred securities.

While SPVs and off-balance sheet financing have many legitimate purposes, they can also be used to misrepresent a firm's financial condition. Prior to its bankruptcy, Enron created numerous SPVs and used them to hide billions of dollars in debt. That abuse, as well as other scandals during 2001-2002, prompted a reexamination of SPVs. Laws, regulations and accounting rules were tightened as a result.
5) A third party provides synthetic leases to the company. The third party purchases property in its name and leases it out to the company. The company is considered as a tenant or debtor of the third party.

III. Various Aspects of Off-Balance Sheet Financing:
To manage their real estate portfolios effectively and obtain funding for strategic development, the companies should consider adopting off-balance-sheet financing strategies, such as sale-and-leaseback transactions, synthetic leases, and joint-venture arrangements. Under these approaches, real estate assets are moved off of the organization's balance sheet via a partial or complete transfer of ownership to a third-party entity. The organization typically retains a satisfactory degree of control over the assets as lessee in sale-and-leaseback and synthetic-lease arrangements, or limited or minority partner in a joint venture, while freeing up cash to use for other strategic purposes.
Attractive financing options are available to finance these essential real estate development projects using off-balance-sheet approaches, whereby an organization transfers ownership of a real estate asset to a third party, while retaining sufficient control over use of the asset. Such approaches include sale-and-leaseback transactions, synthetic leases, and joint-venture or partnering structures.
These approaches offer the following advantages:

- One hundred percent financing, which frees up cash for alternative investments for core business operating and capital spending needs;
- Long-term control over the use and tenancy of the transferred facility;
- Improved accounting ratios (eg, return on assets, return-on-fund balance, debt-to-fund balance);
- Potential to be structured as an operating lease in accordance with generally accepted accounting principles (GAAP); and
- Potential to be structured to achieve off-credit treatment.

Sale and leaseback: In a sale-and-leaseback arrangement, a property is sold to a financial intermediary which, in turn, leases the property back to the seller under a 15 to 20-year operating lease, as opposed to a financing or capital lease. Leases typically represent less than 75 percent of the expected useful life of the asset and are noncancellable. No transfer of ownership of the property back to the seller is permitted over the course of the lease, nor may the lease contain a bargain purchase option in favor of the seller/lessee at lease end.
However, the seller/lessee typically retains the right of first refusal to repurchase the property Lease rental payments are "triple-net-lease"; that is, the seller/lessee remains responsible for paying all of the property's associated taxes, insurance, and routine and non routine capital expenditures in addition to rental payments made to the purchaser/lessor.
Sale-and-leaseback structures offer several unique advantages:

- The property is sold at the current fair market price, which is enhanced based on the credit rating of the seller/lessee. When a seller/lessee has a high credit rating, the buyer's borrowing costs are lower, which allows the seller/lessee to negotiate attractive rental rates.

- The buyer pays cash, which the seller can use to pay down its own debt and enhance its debt-to-capitalization ratio.
- The seller/lessee maintains satisfactory control over how it operates the facility.
- The seller/lessee does not have the right to exercise a purchase option at lease end, but usually retains the option to sign a new lease with any new owner that might purchase the property.

  Sale-and-leaseback arrangements also have drawbacks:
- Any repurchase by the seller/lessee at the end of the lease term must be at the then-current fair market value, which normally is at a higher price than the selling price obtained at the initiation of the sale-and-leaseback transaction.
- The interest factor embedded in the lease rate usually will be somewhat higher than the interest rate of the seller/lessee's debt burden on the property.
- The seller's borrowing capacity may not be enhanced if credit rating agencies impute a debt service coverage factor to the lease payments.
- Any significant subleasing to an independent third party would require the transaction to be treated as refinancing debt rather than as a sale.
- Vacancy and subleasing default risk is retained by the seller.

Disposing of nonstrategic real estate assets via a sale-and-leaseback transaction can strengthen a balance sheet. Even on a triple-net-lease basis, the positive benefits of eliminating depreciation and amortization of mortgage debt outweigh the impact of lease payments on operating income. Debt-service-coverage ratios and days-cash-on-hand increase while debt leverage ratios decline. In addition, sale-and-leaseback arrangements are attractive because they offer a long-term opportunity to reinvest net sale proceeds.

It is important that sale-and-leaseback arrangements be structured to comply with financial accounting regulations. Rental rates must be based on fair market value. In addition, leases to physicians cannot be based on the volume of physician referrals, which, if done, would be in violation of the Stark laws. Noncompliance with these laws can expose an organization to possible severe civil monetary penalties.

Synthetic leases: A synthetic lease is a method of financing used to finance to-be-built real estate projects. Under a synthetic lease, the property owner retains all the benefits and burdens of ownership, while transferring title (for financial accounting purposes only) to an unrelated third party that serves as the lessor. The lessor typically is a special-purpose entity, created to facilitate the financing of a real estate project, but it also may be a trust or an affiliate of the lender's leasing subsidiary.

A synthetic lease thus qualifies as an operating lease for financial accounting purposes, but as a loan for tax purposes. The assets and attendant financing are moved off the balance sheet, improving return on assets and capitalization ratios. A synthetic-lease structure is similar to a sale-and-leaseback structure, except that it has a shorter term (five to 10 years) and its use is restricted to to-be-built projects only. Notable advantages include:

- A lower cost of capital than is typical of a third-party ownership structure
- More flexible buy-back/lease-cancellation provisions than with a sale-and-leaseback transaction; and
- Tax benefits retained by the lessee.

The greatest potential negative is that rating agencies may overlook the operating nature of a synthetic lease and treat part or all of the base lease payments as equivalent to debt service in the calculations of the user's debt service coverage ratio.

Joint ventures: A joint venture may allow to restructure non strategic assets by contributing to a new entity developed in partnership with another organization or group. The development partner may contribute capital (eg, cash), other similar assets to build economies of scale, and/or operating expertise. The company retains an ownership interest in the partnership and may be able to receive a portion of the profits in return for contributing its assets, such as land or cash. Typically, the company's balance sheet will reflect only its proportionate ownership interest in the partnership, but not any debt of the partnership, while the income statement reflects its pro rata share of the partnership's income.
Although third-party ownership may increase the cost of capital and resulting rental rates by 25 to 30 percent, this approach offers several advantages, which typically include:

- No credit enhancement or guarantees;
- Greater ownership risk borne by the third-party owner; and
- Reduced financial risk, with retained strategic controls.

As with sale-and-leaseback arrangements, joint ventures must be structured in accordance with applicable accounting, tax, and other Federal and state regulations. For example, it is important that not-for-profit organizations considering such an arrangement consult legal counsel to verify that the arrangement does not jeopardize the organization's tax-exempt status.

Assessing Alternatives: When deciding whether to use any of the previously discussed financing approaches versus existing cash reserves to finance a new facility project, a company should:

- Review their five-year sources and uses of capital;
- Calculate whether investment in the new facility will achieve a preestablished hurdle rate or required return on investment;
- Compare the net effect of the selected financing structure on certain financial ratios (eg, debt/equity, return on investment and on fund balance) with the resulting impact on credit ratings and any existing restrictive bond covenants;
- Consider the implications and options of credit support versus no credit support; and
- Determine whether ownership and control of the real estate asset is necessary to achieve the overall strategic objectives.

Disadvantages of off balance sheet financing: Off balance sheet financing has the following disadvantages that relate to the company’s ability to function independently:

- If the company forms a partnership with another party that can provide funds, it means that the company will have to part with technical know how.
- The company may have to pass on tax benefits to investors. This can eat into own cash flow.
- Trade receivables securitization is not possible unless the company has a steady cash flow.
- The off balance sheet financing techniques have a potential for misuse, as the Enron case proved. According to critics, off balance sheet financing is a method of artificially raising return on assets and debt to capital ratios.
- Removal of debts from the balance sheet does not absolve the company of the burden of servicing and repaying those debts.

- Debt financing increases the company's financial risk. Companies with high gearing have an incentive to conceal the extent of their indebtedness by procuring finance and not reporting as such on the balance sheet.

For all its disadvantages, sometimes off balance sheet financing is the only hope for companies that need to raise funds and do not have many options.

Effects of off-balancing financing:

Off balance sheet financing is not any country specific problem. The problem persists in almost all parts of the world. Its presence is felt particularly in those countries where companies depend on the capital market to raise their finance. It has become a source of great headache for the accounting regulators the world over. They are struggling hard to crack down on the unhealthy practice; several measures have already been adopted. The definition of liability has been tightened and definitive rules have also been promulgated to outlaw some specific off balance sheet financing schemes. But problems persist. The issues raised by off-balance sheet financing are perhaps the most troublesome and most complex issues accounting regulatory agencies have ever addressed. The problems being caused about by off-balance sheet financing are different in many significant respects from other accounting problems. At the time an accounting regulatory agency addresses an accounting issue; its objective normally is either to add something new to accounts or to modify the treatment of an item that is already there. But, in off-balance sheet financing. The objective of rule making becomes to stop an item being taken away from the balance sheet.

IV. Collapse of ENRON - Strengthening the Concept of Off-Balance Sheet Financing:

Enron was born in July 1985 when Houston Natural Gas merged with Omaha-based Inter-North.

Kenneth Lay, an energy economist became chairman and chief executive. As the energy markets, and in particular the electrical power markets were deregulated, Enron's business expanded into brokering and trading electricity and other energy commodities.

The deregulation of these markets was a key Enron strategy as it invested time and money in lobbying Congress and state legislatures for access to what traditionally had been publicly provided utility markets. Some of Enron's top executives became frequently named corporate political patrons of the Republican Party. Enron needed the federal government to allow it to sell energy and other commodities. According to the Center for Responsive Politics, between 1989 and 2001, Enron contributed nearly $6 million to federal parties and candidates

It was one of the first amongst energy companies to begin trading through the Internet, offering a free service that attracted a vast amount of customers. But while Enron boasted about the value of products that it bought and sold online – a mind-boggling $880bn in just two years – the company remained silent about whether these trading operations were actually making any money. At about this time, it is believed that Enron began to use sophisticated accounting techniques to keep its share price high, raise investment against it own assets and stock and maintain the impression of a highly successful company. Enron's 2000 annual report reported global revenues of $100bn. Income had raised by 40% in three years.

The sudden collapse of energy-trading giant Enron Corporation caught regulators, politicians, lenders, analysts, and the public by surprise. In large part the surprise resulted from the billions of dollars of debt the company had been able to hide by using off-balance-sheet financing through hundreds of

partnerships. The hidden liabilities allowed Enron to maintain the appearance of a rapidly growing but financially stable company until near the very end, when bankruptcy was imminent. Enron's financial arrangements were complicated and sometimes entailed transferring overvalued assets to partnerships which it had a controlling interest in but was not required to include on its own balance sheet. The partnerships, with minimal equity capital from outside investors, raised most of their capital from loans using Enron stock, transferred assets, or pledges from Enron as collateral. Although Enron used aggressive accounting methods, many of the accounting techniques it employed were not illegal. For this the accounting profession was called to task.

The collapse of Enron caught almost everyone by surprise, from employees and investors to analysts and creditors.

The Enron story comes in three stages.

Stage 1: The Company leveraged itself through debt, which it used to grow its non-core wholesale energy operations and service business. Some of this debt was reportable on the company's balance sheet, and some was not. No problem for the company, as long as the stock price held up.

Stage 2: The stock price fell. When that happened, off-balance-sheet liabilities put pressure on debt agreements, and eventually led to credit downgrades.

Stage 3: The margins in this business are very thin and lower credit quality increased Enron's cost of borrowing to the point where the whole company fell into a liquidity trap.

Movement of Enron's share price (USD)

The Chronology of the fall:

20 Feb, 2001: A Fortune story calls Enron a highly impenetrable Co. that is piling on debt while keeping the Wall Street in dark.

On 14 Aug, 2001: Jeff Skilling resigned as chief executive, citing personal reasons. Kenneth Lay became chief executive once again.

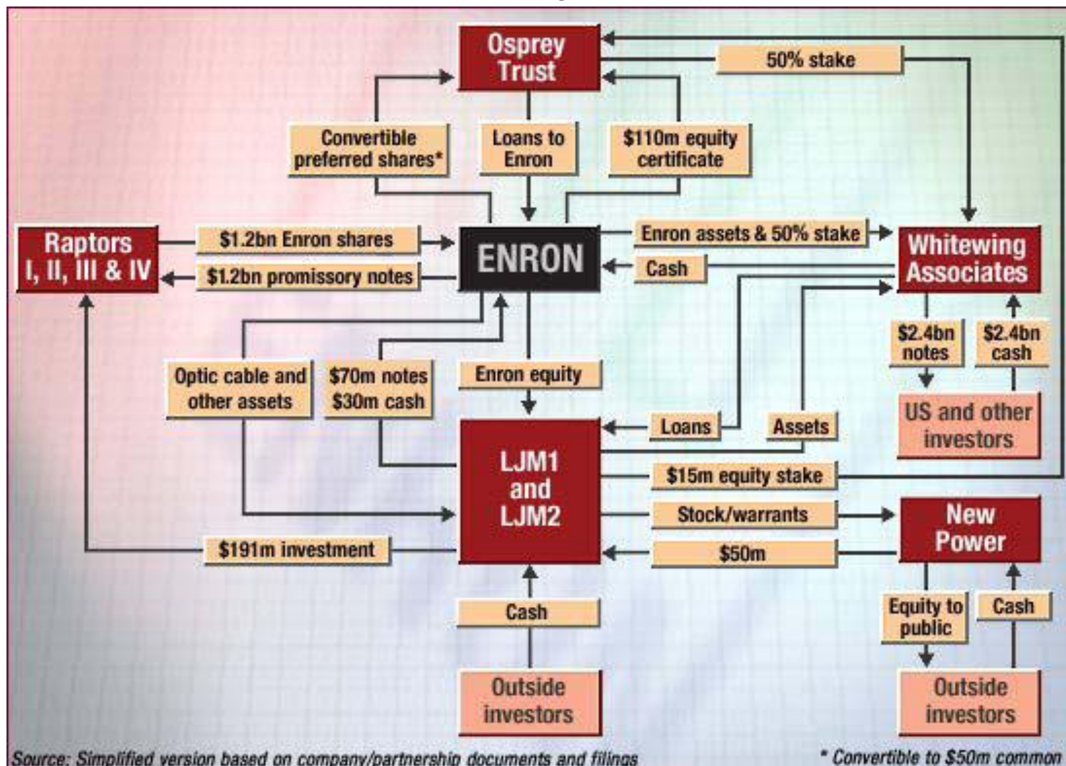
12 Oct, 2001: Arthur Anderson legal counsel instructs workers who audit Enron's books to destroy all but the most basic documents.

16 Oct, 2001: Enron reports a third quarter loss of $618 million.

24 Oct 2001: CFO Andrew Fastow who ran some of the controversial SPE's is replaced.

8 Nov 2001: The company took the highly unusual move of restating its profits for the past four years. It admitted accounting errors, inflating income by $586 million since 1997. It effectively admitted that it had inflated its profits by concealing debts in the complicated partnership arrangements.

2Dec, 2001: Enron filed for Chapter 11 bankruptcy protection and on the same day hit Dynegy Corp. with a $10 billion breach-of-contract lawsuit.
12 Dec 2001: Anderson CEO Jo Berardino testifies that his firm discovered possible illegal acts committed by Enron.
9 Jan 2002: U.S. Justice department launches criminal investigation.
Hence within three months Enron had gone from being a company claiming assets worth almost £62bn to bankruptcy. Its share price collapsed from about $95 to below $1.
Role of Andersen:
Arthur Andersen – one of the world's five leading accounting firms - was the auditor to Enron.
When the scandal broke, Andersen's chief auditor for Enron, David Duncan, ordered the shredding of thousands of documents that might prove compromising. Andersen has dismissed Mr Duncan and Andersen's chief executive at the time of the Enron collapse, Jo Berardino, resigned at the end of March 2002
Besides obstruction of justice, Andersen also faces charges that it improperly approved of Enron's off-balance-sheet partnerships, called "special purpose entities", which the company used illicitly to hide losses from investors.
Creative Accounting: The Special Purpose Entities (SPE's)- At the heart of Enron's demise was the creation of partnerships with shell companies. These shell companies, run by Enron executives who profited richly from them, allowed Enron to keep hundreds of millions of dollars in debt off its books. But once stock analysts and financial journalists heard about these arrangements, investors began to lose confidence in the company's finances. The results: a run on the stock, lowered credit ratings and insolvency.
How Enron used SPE's for off balance sheet financing:



The above flow chart explains how Enron used the SPE's taking most of its debt off balance sheet.

Merrill Lynch handled the sales pitch for one such vehicle, LJM2 Co-Investment. According to laims and counter-claims filed in Delaware court hearings; many of the most prominent names in world finance - including Citigroup, JP Morgan Chase, CIBC, Deutsche Bank and Dresdner Bank - were still involved in the partnership, directly or indirectly, when Enron filed for bankruptcy.

Originally, it appears that initially Enron was using SPE's appropriately by placing non energy related business into separate legal entities. What they did wrong was that they apparently tried to manufacture earnings by manipulating the capital structure of the SPEs; hide their losses; did not have independent outside partners that prevented full disclosure and did not disclose the risks in their financial statements.

There should be no interlocking management: The managers of the off balance sheet entity cannot be the same as the parent company in order to avoid conflicts of interest. The ownership percentage of the off balance sheet entity should be higher than 3% and the outside investors should not be controlled or affiliated with the parent: This was clearly not the case at Enron.

Enron, in order to circumvent the outside ownership rules funneled money through a series of management. The scope and importance of the off-balance sheet vehicles were not widely known among investors in Enron stock, but they were no secret to many Wall Street firms. By the end of 1999, according to company estimates, it had moved $27bn of its total $60bn in assets off balance sheet.

V. Suggestive Measures to Eradicate Off-Balance Sheet Financing:

The Securities and Exchange Commission and the Financial Accounting Standards Board have handed down new rules and guidance aimed at improving the transparency of financial statements. The SEC is rewriting its guidance on MD&A disclosure, introducing Regulation G, and rewriting its rules governing Form 8-K. FASB is trained on consolidation of variable interest entities, or VIEs (formerly known as special-purpose entities, or SPEs) and on loan guarantees. Collectively, the new mandates are intended to help investors view companies through the "eyes of management"; detractors say that these initiatives only cloud the issues.

The problem of off-balance sheet financing cannot be tackled in isolation. Reforms should be contemplated in different directions. So following factors may be taken into account as far as remedies are concerned:

- A clear specification as to what should be on the balance sheet.
- Definition of liabilities should be tightened further and the gap that currently exists between definition of a liability and its recognition in accounts should be narrowed down.
- Definitive accounting standards may be necessary to deal with certain specific off-balance sheet transactions.
- Betterment of existing accounting standards and introduction of relevant standards.
- Existence of principles and specific rule based standards.
- Management should be more ethical and maintain integrity.
- Auditors should be more independent and their responsibility is to be enhanced.
- Auditors' appointment should be justified by government.
- Rotation in auditor's appointment should be made.
- Auditor should maintain integrity in discharging duties.
- Disclosure of financial reporting should be made effective and relevant.

- Users of accounting statements should be more alert about their rights.
- Certification of credit rating by credit rating agencies may be made compulsory.
- Companies should be protected from the loss of public faith.

VI. Conclusion:

Conventional wisdom has held that real estate ownership gives a company greater control, protects the facility from inappropriate utilization. A better real estate strategy may be to move nonstrategic or underperforming real estate assets off the organization's balance sheet. The cash obtained through sale of the assets then could be put to more productive, mission-related uses.

Off-balance sheet financing is a complex and contentious issue. It has the potential of destroying the usefulness of corporate financial reporting. It has troubled accounting standard setters and other accounting regulatory agencies for a long time. However the scope for off balance sheet financing has reduced over the years as accounting standards have caught up with loopholes that allowed off balance sheet financing. Considering the present scenario the following conclusions may be drawn:

- The size and complexity of the financial arrangements that are used to avoid reporting debt on the balance sheet has increased over the years.
- Accounting regulatory agencies are trying to cope with the situation but problem persists.
- The approaches accounting regulatory agencies have adopted to increase the visibility of debts on the balance sheet differ from one jurisdiction to another, some have preferred detailed rule making, while others have favoured a conceptual approach.
- Off-balance sheet financing is an ever changing scenario, as one requirement is brought in to better reflect the obligation from a certain transaction on the balance sheet, more sophisticated means are soon devised to take its place.
- In India, more and more companies are recently being lured into adopting various subtle devices to avoid reporting debts on their balance sheet.

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