

ENRON

Enron ... took great pains to project an image of being a stalwart and responsible corporate citizen...(it) appeared to have superior internal controls, including most of the elements of an effective ethics management system in place.
(Strategic Finance, Feb 2002)

“The unrelenting emphasis on earnings growth and individual initiative, coupled with a shocking absence of the usual corporate checks and balances, tipped the culture from one that rewarded aggressive strategy to one that increasingly relied on unethical corner cutting. In the end, too much leeway was given to young, inexperienced managers without the necessary controls to minimise failures.” (Business Week, Feb 25, 2002)

Enron's changed from being a small regulated gas company to an huge unregulated trading company. The catalyst was Chairman Ken Lay hiring of Jeff Skilling "to build Enron Finance Corp. into an asset light laboratory for financially linked products and services." (*Business Week*)

- The train was supposed to be kept on the tracks partly by an internal risk management group...to screen proposals and review deals. Many of the unit were MBA's with little perspective and every reason to sign off on deals. Their own performance reviews were partially done by the people whose deals they were approving. The process made honest evaluations virtually impossible.” (*Business Week*)

“Arthur Andersen, the accounting firm, looked the other way while Enron management created “special purpose entities” (that is, complicated financial arrangements that kept hundreds of millions of dollars in losses and debt off the balance sheet, and thus away from the scrutiny of investors. This led to an overstatement of profits of almost \$600 million and an understatement of debt of \$630 million between 1997 and 2000. Enron was hardly “independent” as more than half of its income from its Enron “account” came not from auditing but from lucrative consulting work.” (*America*, Feb 11 2002)

Enron issues

- Corporate governance
- Off the books partnerships
- Auditors also having consultancy interests with clients
- Independent audit committee
- Code of ethics
- Political favours

NYSE Response

Tighten the definition of independent directors

Five audit committees the power to hire and fire auditors

Let shareholders approve all equity based compensation plans

Force CEO's to certify the authenticity of their companies financial statements

Make board compensation committees be composed of all independent directors