

FACTORS CAUSING ENRON'S COLLAPSE: AN INVESTIGATION INTO CORPORATE GOVERNANCE AND COMPANY CULTURE

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Abstract

This paper investigates and evaluates the weaknesses of Enron's corporate governance structures, weaknesses that lead to the collapse of the company. Overall, poor corporate governance and a dishonest culture that nurtured serious conflicts of interests and unethical behaviour in Enron are identified as significant findings in this paper.

Employing the case study method, the paper synthesises, analyses, and interprets all aspects of corporate governance that lead to Enron's collapse based on three main reports: *The Powers Report* (Powers, Troubh and Winokur 2002), *the Testimony of Chief Investigation* (Roach 2002), and *The Subcommittee's Report* (United States Senate's Permanent Subcommittee on Investigations 2002).

Firstly, Enron's Board of Directors failed to fulfil its fiduciary duties towards the corporation's shareholders. Secondly, the top executives of Enron were greedy and acted in their own self-interest. Thirdly, many of Enron's employees witnessed the wrongdoings of Enron's top executives, and quite a few whistleblowers came forward. Lastly, Enron outsourced external auditing for its internal audit function instead of establishing a functionally internal audit mechanism and its external auditor acquiesced in the application of questionable accounting and fraudulent financial reporting.

Although Enron's collapse has been widely discussed in the literature, no paper has been found that synthesises the various aspects of corporate governance that resulted in the Corporation's collapse. This paper contributes to the literature on the numerous weaknesses of Enron's corporate governance structures, including the following: the role of the Corporation's board, especially its top executives; the Corporation's corporate culture and whistle-blowing system; and the Corporation's internal auditor and external auditors.

Keywords: Enron, Corporate Governance, Corporate Culture, Board of Directors, Executives

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1. Introduction

This paper has examined and assessed the corporate governance mechanism of the Enron Corporation in an attempt to provide a better understanding of why the Corporation collapsed.

As is widely known, Enron was one of the largest US-based companies, mainly providing wholesale services, retail energy services, broadband services and transportation (Enron Corp 2001). However, the corporation became well-known because of its failures, which resulted from poor corporate governance. It is publicly acknowledged that the event of Enron filing for bankruptcy (December 2, 2002) marked a new period of revolutionary changes to corporate governance worldwide, mainly focusing on law reform to prevent, or at least mitigate, future corporate collapses.

In terms of innovation, Enron's transition from an old-line energy company to a high-tech, globally trading energy enterprise is widely recognised.

However, Enron was fraught with problems throughout the 1990s, resulting mainly from the creation of online energy, which aimed to carry out contracts to supply energy products. The first problem was that Enron was required to access substantial lines of credit as a means of guaranteeing that it had sufficient funds at the end of each day to settle its signed contracts traded on its online system. Additionally, Enron was also suffering due to considerable fluctuations in earnings from this business. Consequently, with the intention of maintaining its investment-grade credit rating in order to access low-cost financing and stimulate investment, Enron employed numerous strategies aimed at increasing its financial and operating performance (United States Senate's Permanent Subcommittee on Investigations 2002). Of these, 'prepay' transactions, 'syndicating' assets, and hedging contracts with its special purpose entity (SPE) are worthy of attention.

As for prepaid transactions, in accordance with the United States' generally accepted accounting

principles, prepayments must be recorded as debt and cash flow from financing. However, in the case of Enron, with an attempt to improve its credit ratings and boost its share price, prepayments were booked as a trading liability and cash flow from operations (Roach 2002). Because the value of these transactions is extremely high in comparison with Enron's cash flow from operations¹⁰, prepaid transactions had an enormous influence on the picture of Enron's performance. Further, Enron's energy trading was considered as its crown jewel (Gordon 2002). In this sense, when such manipulated transactions were discovered and the financial statements were adjusted, Enron's share values declined dramatically as an inevitable consequence. Consequently, Enron could not carry out contracts to buy and sell energy, and accordingly no partners would continue to trade with the corporation (Gordon 2002).

In terms of the issue of being 'asset light' or 'syndicating' the assets, Enron transferred several billion worth of its assets to its 'unconsolidated affiliates'. As a result, such assets that slowly generate cash flow were syndicated throughout its numerous SPEs, and a vast amount of earnings were recorded (United States Senate's Permanent Subcommittee on Investigations 2002). Therefore, the corporation could not avoid encountering difficulties when the reality of these structured transactions unfolded.

Forming and making use of SPEs also got Enron into difficulty. Hundreds of SPEs were established in order to hedge Enron's investments (Millon 2003). Through Enron-SPE transactions, Enron's revenue, earnings, and cash flow were generated, which helped Enron to improve its credit rating and maintain creditability in the energy trading business, while a burden of debt to debt investors was imposed on unconsolidated SPEs (Powers, Trough and Winokur 2002; Schwarcz 2002). The reality, however, is that the treatment of Enron's SPEs as unconsolidated affiliates was unlawful¹¹; its consequences were extremely serious. Ultimately, a massive deduction in its reported net income and a massive increase in its debt occurred when Enron retrospectively consolidated its SPEs (Powers, Trough and Winokur 2002).

Briefly, instead of making profits by buying and selling energy services as usual, Enron manipulated its profits, which ultimately led to its collapse by

structuring numerous questionable entries through prepay and merchant investment hedge transactions. As a consequence of Enron's collapse, both the regulators and the accounting profession took disciplinary action as a response to the accusation of insufficient requirements for corporate disclosure and lack of guidance on the treatment of SPE transactions. In particular, the U.S. government passed the Sarbanes-Oxley Act 2002 that aimed to address the corporate disclosure of accurate financial information (Dnes 2005); and the American Institute of Certified Public Accountants had to publish a toolkit for accounting and auditing for related parties and related parties' transactions¹² (The American Institute of Certified Public Accountants 2001).

The remainder of the paper is organised as follows. Section 2 explores and evaluates the weaknesses of Enron's corporate governance. Enron's corporate governance system and culture as a whole is analysed and then the contribution of individual participants in Enron's corporate governance, including the Board of Directors, the top executive officers, the internal auditor, the external auditor, and the whistleblowers, is examined. Section 3 concludes by identifying practical implications for corporate government concerns.

2. Discussion

2.1. Enron's governance system and culture

Although corporate governance may be viewed in different ways by various disciplines (Turnbull 1997), this term commonly refers to a set of relationships among the firm's management, Board of Directors, and stakeholders (Organisation for Economic Co-operation and Development 2004). In other words, corporate governance describes all the influences that have effects on the institutional processes of a firm (Turnbull 1997). Corporate governance is a system designed to direct and manage a firm that affects three main aspects used for judging a firm's success: objectives, risks, and performance (ASX Corporate Governance Council 2003). More clearly, corporate governance is about the responsibilities of a firm's board in managing the firm and the board's relationship with stakeholders (Pass 2004).

Given these definitions, it is easy to agree with the point that good corporate governance enhances not only accountability but also the creation of wealth

¹⁰ The value of prepay transaction at a rate of one or two per year from 1992 to 2001 was \$8.5 billion, while cash flow from operations in 1999 was only \$1.228 billion (Enron Corp 2001; Roach 2002).

¹¹ Concerning this issue, the U.S. Senate's Permanent Subcommittee on Investigations (2002) reveals that the Enron collapse resulted from a billion's worth of off-the-books transactions that were conducted in Enron through its unconsolidated affiliates, ultimately leading to material off-the-books liabilities which are deliberately undisclosed.

¹² According to the American Institute of Certified Public Accountants (2001), the toolkit provides an outline of existing selected authoritative accounting and auditing literature, the Securities and Exchange Commission's requirements, and non-authoritative best practice guidance involving related parties and related party transactions. This implies that the treatment of Enron-SPEs transactions is unlawful.

(ASX Corporate Governance Council 2003; Bowden 2004; Organisation for Economic Co-operation and Development 2004). In achieving good corporate governance, it is required that all participants in corporate governance systems ensure there is accountability for their actions and that they fulfil their responsibilities (Rezaee 2002). In the Enron case, the weakness of corporate governance that ultimately led to Enron's demise was caused by all participants, including the Board of Directors, top executive officers, the internal auditor, the external auditors, and whistleblowers as well.

Enron's Board of Directors significantly contributed to Enron's failures. The Board inadequately oversaw key business and transactions in the corporation. Further, the Board ineffectively controlled the implementation of the Corporation's code of conduct or policy, which enabled self-interested managers to make profits at the Corporation's expense. Also, the Board did not build up an environment in which the external auditor, the internal audit function, and the whistleblowers could operate effectively.

Enron's management was greedy and acted in its own self-interest, which seriously harmed the Corporation. Of the managers, the role of Enron's chief executive officer (CEO) and chief financial officer (CFO) need to be examined. They both secured vast sums of money in the form of compensation whilst the Corporation was in the process of running into difficulties and on the verge of bankruptcy.

Further, Enron's whistleblowers were not encouraged to come forward. This can be easily understood as the corporation culture was 'lacking in integrity to a surprising degree' due to the senior executive's role in supporting and nurturing wrongdoings (Brooks 2004). For example, it is totally implausible that the senior executives did not know of the establishment of 'a sham energy trading floor' being 'completed with computers, desks, chairs, and traders' (Brooks 2004). In such a culture, all internal corporate governance attributes definitely become weaker. In this instance, the situation had become worse because the external auditor simultaneously served as the internal auditor and acquiesced with the wrongdoings of Enron's management.

2.2. The contributing roles of Enron's stakeholders

2.2.1. The role of directors

The contribution of Enron's directors to the Company's demise can be briefly described as unfulfilled fiduciary duties. Generally, directors are wholly responsible for governing and directing the company's affairs in the best interests of the company as a whole and its shareholders (Shailer 2004). Therefore, they are required to act in honesty,

reasonable care, and competence (Brooks 2004; Kemper and Levine 2003; Shailer 2004). As the highest level of the hierarchical corporate governance structure, Enron's Board of Directors not only must have known about but also supported the Company's questionable strategies, criticised policies, and devious transactions (Clark and Demirag 2002).

Accepting high risk accounting practices

All Enron's Board members were well aware of and supported Enron's strategies, which aimed at maintaining its investment-credit rating, increasing cash flows, and reducing its debt burden (United States Senate's Permanent Subcommittee on Investigations 2002), although they claimed to be victims of a cruel hoax and to be misled and uninformed about key activities and plans of the company. The Board not only was well-informed but also authorised numerous 'hedging' transactions that were handled by Enron's SPEs (Powers, Troubh and Winokur 2002). The Board, especially Kenneth Lay (the Chairman and also the CEO), was warned of the risk of 'accounting scrutiny' by performing these transactions at the Finance Committee in May 2000, yet the Board completely neglected 'red flags' and approved a series of hedged contracts with its SPEs¹³ that were designed to help Enron avoid reflecting losses caused by falls in its merchant investments on its income statement (Millon 2003; Powers, Troubh and Winokur 2002; Schwarcz 2002). Moreover, it was the Board that allowed Andrew Fastow - the CFO - to establish, and even worse, to become the sole manager of the private equity fund (named LJM Cayman LP and known as LJM1) to do business with Enron, which apparently lacks economic substance (Brooks 2004; Powers, Troubh and Winokur 2002; United States Senate's Permanent Subcommittee on Investigations 2002). He was also approved to become the general partner of some other partnerships that were deliberately set up to make profits at Enron's expense. The significant effects of these breaches on Enron's financial position were that debts were moved off Enron's balance sheet and earnings and cash flows were inflated.

In addition, the Board also supported an 'asset light' strategy, or 'syndicating' the assets, which allowed Enron to transfer several billion dollars worth of its asset with a slow generating cash flow to its 'unconsolidated affiliates' and record exorbitant earnings (United States Senate's Permanent Subcommittee on Investigations 2002). However, such 'unconsolidated affiliates' did not meet the requirements for being unconsolidated. Further, the Board was adequately informed of the increases in

¹³ For example, Enron-Rhythms transactions helped Enron keep its loss of \$95 million in LJM1, which was unlawfully treated as an independent controlling partner, to avoid being consolidated.

making use of 'prepay' transactions, of which prepayments were wrongly treated as a trading liability and cash flow from operations, instead of debt and cash flow from financing (Roach 2002).

By reviewing such facts, there is little doubt that Enron's Board knew about, and officially approved of, the application of high risk accounting practices, specifically billions of dollars in off-the-books activity, which aimed at significantly improving its financial position as concluded by the Permanent Subcommittee on Investigations (2002).

Failure to avert conflicts of interest

Enron's directors must be responsible for their permission for Enron's CFO to establish and manage partnerships that ultimately brought them millions of dollars by engaging in self-dealt transactions with Enron (Emshwiller and Smith 2001; Kranhold and Schroeder 2002). The conflicts of interest were clearly shown when the CFO was approved to become the sole manager and also the general partner of LJM1, allowing him to make millions of dollars by performing Enron-Swap Sub transactions (Powers, Trough and Winokur 2002). Surprisingly, it is difficult to understand why Enron's directors would believe the CFO's claim, with his role as the general partner of LJM1 that owned part of Swap Sub, that there was no benefit when he entered into negotiations on the Enron-Swap Sub negotiations. The failure to avert conflicts of interest can be understood by taking the Corporation's culture into consideration - a cut-throat culture pitting one employee against another (Fusaro and Miller 2002). In this sense, it is possible to argue that Enron's culture was a risk taking one placing too much reliance on Andrew Fastow. Consequently, this is why he profited from his schemes. The failure may have been due to the Board having this same conflict of interest, with the view to sharing in the profits from these schemes, given that the self-deal transactions with Enron earned Fastow millions.

When it comes to the case of Chewco, though, Enron's directors chose alternative oversight measures for conflicts of interest relating to the proposed role of Fastow in Chewco, and the conflict of interest still remained. In fact, the appointment of Kopper, who was at that time an Enron worker, as the manager of Chewco did not comply with Enron's Code of Conduct of Business Affairs, which requires that his role and his participation in Chewco must be approved by the Board (Powers, Trough and Winokur 2002). Further, as the person working for the CFO in the finance area, his role in Chewco, as the sole person dealing with this partnership and having complete authorisation over this partnership transaction, induced him to act in the best interests of the CFO rather than Enron's shareholders.

Briefly, the role and benefits of Fastow and Kopper in LJM partnerships can be regarded as

typical examples of unresolved conflicts of interests that had long existed in Enron and enabled self-interested managers to make huge profits at their company's expense¹⁴.

Inadequate oversight of key business transactions and executives' compensation

In addition to the issue of inappropriate conflicts of interest, the Board also failed to fulfil its responsibility for adequately overseeing compensation. Firstly, compensation of the CFO from the partnership was mandated to be reviewed by Enron's Compensation Committee; even so, there had been no review conducted until the time when the role of CFO in LJM was publicly known (Powers, Trough and Winokur 2002). Based on the interview conducted by Dr. LeMaistre, a member of Enron's Executive Committee, Fastow's compensation from LJM was incredible - 45 million dollars (United States Senate's Permanent Subcommittee on Investigations 2002). Despite realising the danger to Enron's shareholders of Enron-LJM transactions with the involvement and ownership of Fastow, the Board failed to exercise adequate oversight over those transactions. Hence, if the Board had adequately reviewed and overseen Fastow's compensation and properly controlled Enron-LJM partnership transactions, hundreds of millions of dollars may have stayed with Enron's shareholders instead of flowing to Fastow and his associates (United States Senate's Permanent Subcommittee on Investigations 2002).

Moreover, there is evidence that the Board poorly governed the executives' compensation. Enron's executives were not only granted large salary packages, but were also awarded with huge annual and special bonus plans (United States Senate's Permanent Subcommittee on Investigations 2002). It is also worth acknowledging that executive stock option granting is one of management's economic incentives to practice earnings management, and this has been documented in the audit literature (Healy and Wahlen 1999; Said 2003). Surprisingly, the Board of Enron did not take any action when witnessing a large number of stock options distributed to Enron's executives and the huge amounts they earned from exercising stock options grants¹⁵. Although there is no consensus on the relation between executive stock option compensation and the future performance of a

¹⁴ The LJM partnership was reported as a highly profitable venture with a 69 per cent rate of return in the first year of operation and transacted business basically only with Enron. Therefore, profits of LJM, ultimately, profits of their owners, were made at Enron's expense (United States Senate's Permanent Subcommittee on Investigations 2002).

¹⁵ For example, in 2000, Lou Pai exercised stock options and quitted the company with more than \$265 million in cash, and Kenneth Lay gained \$123 million from exercising a portion of its stock option.

firm as well as management earnings (e.g. Core et al., 1999; Henry, 2003; Jensen and Meckling, 1976; Raġopal and Shevlin, 2002; Yermack, 1995), the Board should have considered the executives' high compensation driven by stock option compensation packages as a red flag for fraudulent financial reporting. Even worse, its executives earned \$750 million in annual bonuses when the Corporation's total net income for 2000 was \$975 million. A significant figure was Kenneth Lay's total compensation package in 2002 of over \$140 million, which was ten times higher than the average payment of CEOs in U.S publicly-traded corporations (United States Senate's Permanent Subcommittee on Investigations 2002).

Due care and outside directorship

It is argued that the frequency of meetings held by the Board of Directors does not necessarily reflect its effectiveness and that outside directorships of the board members may increase oversight of the board over the company because of incentives to protect their reputation (Song and Windram 2004; Yang 2002). However, what occurred in Enron shows the need to take these issues into consideration¹⁶. As discussed earlier, the failures of Enron's directors mainly stem from failing to exercise adequate oversight; therefore, Enron's directors should have spent more time on the significant issues of the company despite the fact that there is no benchmark for this measure¹⁷. The efficiency of the Board of Directors may have been impaired by outside directorship, resulting from time constraints - even though it is not easy to measure such factors; however this, still, is an implausible excuse given the many warning signs in this case.

Enron's Board of Directors' economic bond

The corporate governance literature has emphasised the role of outside directors and documented how increasing the percentage of outside directors on the board and on the audit committee could enhance the effectiveness of corporate governance (Bhojraj and Sengupta 2003; Davidson, Goodwin-Stewart and Kent 2005; Dechow, Sloan and Sweeney 1996; Klein 2002; Peasnell, Pope and Young 2006; Richardson 2000; Sharma 2004; Yang 2002). Therefore, the presence of outside directors on Enron's Board of

Directors may have been beneficial for the company. On the other hand, the corporate governance literature has also reported that auditor objectivity is likely to be impaired by the economic bond between the external auditor and its audit client (Brandon, Crabtree and Maher 2004; Frankel, Johnson and Nelson 2002; Hay, Knechel and Li 2006; Krishnan, Sami and Zhang 2005). This economic theory is generally applicable to outside directors serving on the board. The evidence as to Enron's economic bond is that certain Enron board members had financial ties with Enron (United States Senate's Permanent Subcommittee on Investigations 2002). Thus, it is reasonable to suggest that the independence of Enron's Board of Directors was impaired, ultimately contributing to the ineffective oversight over management activities that lead to Enron's demise.

2.2.2. The role of executive officers

The role played by executive officers in contributing to the Enron fiasco is significant. The previous section has exemplified the contributing role of Enron's CFO. Hence, this section focuses on discussing the contributing role of the CEO, Kenneth Lay.

As outlined earlier, the establishment and operation of SPEs was to best serve the self-interests and satisfy the CFO and some other Enron employees, and ultimately lead Enron to slide into bankruptcy. However, it is arguable that difficulties arising from the SPEs could have been avoided if the CEO had acted in the interests of Enron's shareholders. Under Enron's Code of Conduct, the CEO had to examine, approve, and control the establishment and operations of Enron-LJM's partnership transactions to ensure that these transactions were fair to Enron (United States Senate's Permanent Subcommittee on Investigations 2002). What the CEO did was not only to approve the CFO to do business with Enron but also to improperly control transactions between his partnerships and Enron, thus enabling hundreds of millions of dollars of Enron's expenses to be converted into his and his associates' benefits (United States Senate's Permanent Subcommittee on Investigations 2002).

Additionally, the CEO also made use of his credit line to draw sums of money (\$77 million) from Enron and repay it with Enron's own stock (United States Senate's Permanent Subcommittee on Investigations 2002). This action does not only reflect the Board's lack of control over Enron's business and compensation, but also reflects the high level of self-interest of Enron's CEO.

In this context, it could be convincingly argued that the dual role of Ken Lay, over a long period, significantly contributed to the lack of proper governance that ultimately lead the firm to go into bankruptcy. This conclusion, firstly, is fully supported by the recommendation that it would be ineffective if the company's management was dominated by a

¹⁶ Power, Troubh and Winokur (2000) reported that Enron's Board held five regular meetings per year. The United States Senate's Permanent Subcommittee on Investigations (2002) documented that Enron's Board of Directors spent relatively little time reading material and preparing for board meetings (1 to 2 days) and little time in attending board meetings (1 to 2 hours).

¹⁷ Australian listed companies' boards hold meetings between 4 to 10 times per year (Shailer 2004).

single person without compensation (Auditing and Assurance Standards Board 2006). Further, corporate governance literature also suggests that the separation of the role of CEO and chairman enhances corporate governance effectiveness (Johnson and Jianbo 2004; Organisation for Economic Co-operation and Development 2004; Sharma 2004).

2.2.3. The role of whistleblowers

As noted previously, the culture of Enron was dishonest and unethical. Consequently, this culture discouraged Enron's whistle-blowers to come forward. Additionally, within this context, it is not difficult to understand why some of Enron's employees came forward; however, there was no action taken to follow this up. Besides the corporate culture, it is also important to note that Enron's employees 'blew to the wrong people', including the CEO and the CFO, who were directly involved in such wrongdoings and acted in their own interests. Accordingly, although Enron's CEO did consult with the law firm Vinson & Elkins, there was no follow-up action undertaken (Powers, Troubh and Winokur 2002). In fact, Ms Sherron Watkins, the vice president for corporate development at Enron, blew the whistle by writing an 'anonymous' memo to Ken Lay on an elaborate accounting hoax at the Corporation and another to the public relations department on how the CEO should handle the financial mess. Nonetheless, her whistle-blowing letters were not followed up (Fusaro and Miller 2002; Zimmerli, Richter and Holzinger 2007).

In order to enhance the effectiveness of whistle-blowing as an internal control mechanism, it is crucially important to create an environment in which individuals are able to freely provide upstream communication, not only within but also outside the organisation (Hooks et al. 1994). U.S regulators support this view by stating, in the Sarbanes-Oxley Act of 2002, that audit committees must establish procedures, referred to as 'whistle-blowing systems', to deal with employees' complaints and concerns about internal accounting control, and accounting and auditing matters, especially questionable accounting and auditing matters ('Sarbanes-Oxley Act of 2002').

2.2.4. The role of the internal auditor

One of the most important mechanisms in internal corporate governance is the internal audit. It is important to note that Enron's internal auditors were outsourced from Arthur Andersen for several years (Brooks 2004; Smith 2002). The lack of a strong and capable internal audit department also significantly contributed to Enron's collapse because of the high probability of undetected wrongdoing, unnoticed questionable transactions and dealings, and earnings management (Smith 2002). Also, outsourced auditors may have influenced the effectiveness of the

audit department as their reports were based on a limited understanding of the business. Therefore, Enron should have established its own audit department so that the internal audit could have made a greater contribution to enhance the integrity of corporate governance. In doing so, internal auditors should achieve the following objectives: overseeing the effectiveness of internal control, performing risk assessment and management processes, ensuring procedural compliance including IT systems integrity, producing audit committee briefs, and getting involved in other corporate governance issues (Leung, Cooper and Robertson 2003).

2.2.5. The role of the external auditor

In addition to Enron's internal corporate governance structure, Enron's external auditor, Arthur Andersen, also played a key role in contributing to the Enron fiasco. The role of the auditor, generally, is to provide reasonable assurance that audited financial reporting is free from material misstatement, as well as truthfully and fairly presented by management. In doing so, the external auditor is required to be impartial and free from any financial interest in the audit client (Foldvary 2002). With Enron, the external auditor acquiesced in Enron's financial reporting and so deliberately withheld information about the Company's difficulties. Firstly, this could have resulted from the economic bond, as discussed earlier. It is a fact that Arthur Andersen was paid \$27 million for non-audit services and \$25 million for audit work from Enron, and this firm was attempting to raise its revenue (Brooks 2004). Hence, it is probable that the quality of Arthur Andersen's audit work for Enron was impaired by conflicts of interest between protecting its professional reputation by fulfilling its professional responsibilities and being willing to risk such a reputation as a means of keeping its largest client by acquiescing with Enron's management (Brooks 2004; Foldvary 2002; Lipton 2006; Millon 2003). Moreover, it is also argued that their acquiescence was caused by Arthur Andersen's lack of competence in detecting extremely complicated financial vehicles designed by its client's management. Regardless of the reasons, Arthur Andersen failed to produce a quality audit report; and the action of shredding tons of Enron's documents reflects its failures to fulfil its fiduciary duty.

3. Conclusion

It is widely accepted that the high profile collapse of Enron was caused by numerous factors. Congruent with widely-held perceptions, this paper has found that the deciding factor in Enron's demise was the corporation's allowance of poor governing structures and processes. Specifically in relation to the directors, evidence revealed that Enron's Board of Directors did not fulfil their fiduciary duties towards the

corporation's shareholders. These failures were proved by evidence that the Board approved high risk accounting practices, failed to avert conflicts of interest, and did not adequately oversee key business and executives' compensation decisions. Moreover, with regard to Enron's top executives, this paper strongly supports the suggestion that executives were greedy, as well as acting in their own self-interest so as to seriously harm Enron's shareholders. Enron's CFO proposed (and this was approved) to establish private equity funds in the form of SPEs to make huge profits at the Corporation's expense. Not unlike CFO, Enron's CEO did not act in the interests of the Corporation's shareholders, evident by the fact Fastow was allowed to enjoy vast amounts of profit by undertaking unfair transactions with Enron that seriously harmed Enron's shareholders. In addition, a number of Enron's employees witnessed the wrongdoing of Enron's top executives, but only a few came forward. Nevertheless, this situation is understandable because the constraints resulted from the extremely dishonest culture. Ultimately, the weakness of Enron's corporate governance could not be offset as the corporation's whistleblowers' system was improperly maintained. Concerning the audit mechanism, not only did the internal audit not function properly, but also the external auditor acquiesced with Enron's management in the application of questionable accounting and fraudulent financial reporting because of its economic dependence on the Corporation. The combination of all these internal corporate governance attributes resulted in Enron's difficulties, and ultimately the Company went into bankruptcy.

Based on the findings of this paper, the first painful lesson drawn from the role of Enron's directors is the failure to avert the serious issue of conflict of interest. Remarkably, Enron's collapse resulted from manipulation by applying high-risk accounting practices, as mentioned earlier and as has been widely discussed in the literature. More importantly, these manipulations thrived owing to the conflicts of interest existing in Enron - especially in that the CEO gained a massive amount of compensation and returns by acting in favour of SPEs and in his own interests (Schwarcz 2002). Thus, enhancing conflict of interest regulations is one of the most effective measures to prevent corporate failure.

Secondly, in terms of top executives' structure, there are some opponents of the suggestion that the role of the CEO should be separated from the role of chairperson. For instance, Dalton and Dalton (2005) note that there is, surprisingly, no evidence in the literature demonstrating the superiority of the separate structure and encouraging the dual roles of the chairman of the board rather than making efforts to advocate for the separate structure. In the same vein,

the U.S legislation had no requirement for the separation of the role of CEO and chairman in the company's organisational structure (Lipton 2006).

However, in terms of expected good corporate governance, it is believed that the dual role of the CEO should not be permitted in a company's organisational structure. Theoretically, it is widely acknowledged that a chairperson is the person who acts in the shareholder's interests. Hence, he or she has responsibilities for monitoring and advising executive officers' activities with the aim of best serving the shareholders. This could be the reason why the Organisation for Economic Co-operation and Development (2004) suggests that the separation of the role of CEO and chairman enables the board to effectively exercise its responsibilities for monitoring managerial performance and preventing conflict of interest. Additionally, in order to successfully fulfil its function of monitoring management and strategic guidance, the Organisation for Economic Co-operation and Development (2005) also recommends that it is necessary for the board to have the power to appoint and fire the CEO. Moreover, the prevalence of CEOs contributing to corporate collapses, such as with Health International Holdings Insurance, has resulted in the necessity to separate the roles of CEO and chairman rather than to formulate a single structure (Johnson and Jianbo 2004). Further, some research suggests that the duality on the board also increases the likelihood of fraud and earnings manipulation (Dechow, Sloan and Sweeney 1996; Sharma 2004). In addition, the Australian Auditing and Assurance Standards Board (2006) also notes that ineffective monitoring of management is a consequence of domination of management by a single person without compensation controls. Therefore, in the case of Enron, it can be logically concluded that the dual role of Ken Lay significantly contributed to the lack of proper governance, ultimately leading the firm into bankruptcy. This case provokes further research into evaluating the effectiveness of the duality of the CEO in the corporate governance mechanism of a firm.

As for the auditor's objective, even though the literature has documented the divergent evidence on the way that an auditor's opinion is affected by economic bonds, many regulations follow the Sarbanes-Oxley Act (2002) to prohibit or at least to restrict the auditor to provide non-audit services to its clients. This paper again calls for future research to be carried out to gain further evidence to access regulations resulting from corporate governance reforms around the world.

In conclusion, the paper theoretically suggests that a business organization should follow the following corporate governance model to prevent an Enron-like collapse happening.

Table 1. The good corporate governance model for Enron-like collapse prevention

Corporate governance attributes	Practicing good governance
- Board structure and processes	- Providing effective oversight of the corporation management actions, such as directly controlling key business transactions, maintaining regular meetings of the Boards, carefully designing and governing executive compensation, establishing proper procedure for whistleblower protection, and separating the role of CEO and the chairperson's.
- Audit function	- Setting up the internal audit department to enhance the integrity of corporate governance, separating internal and external audit functions, not paying higher fees to the auditors for non-audit services than an audit.
- Stakeholders' rights and the corporate culture	- Formulating and strictly complying with the Corporation Codes of Ethics and the Codes of Conducts.

In terms of methodology, even though this paper has been carefully planned and crafted, its findings should be interpreted in the context of the methodology's limitations. As a matter of interest, it could be argued that it is difficult to scientifically generalise from the findings because the paper is based on a single case (Yin 2003). In fact, Enron's collapse not only necessitated changes in corporate governance regulations in the U.S, but also led to many other countries undertaking corporate governance reform. For this reason, the paper's findings can be analytically generalised and proposed for future investigation.

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