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CORPORATE GOVERNANCE: Why good accountants do bad audits

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as presented by

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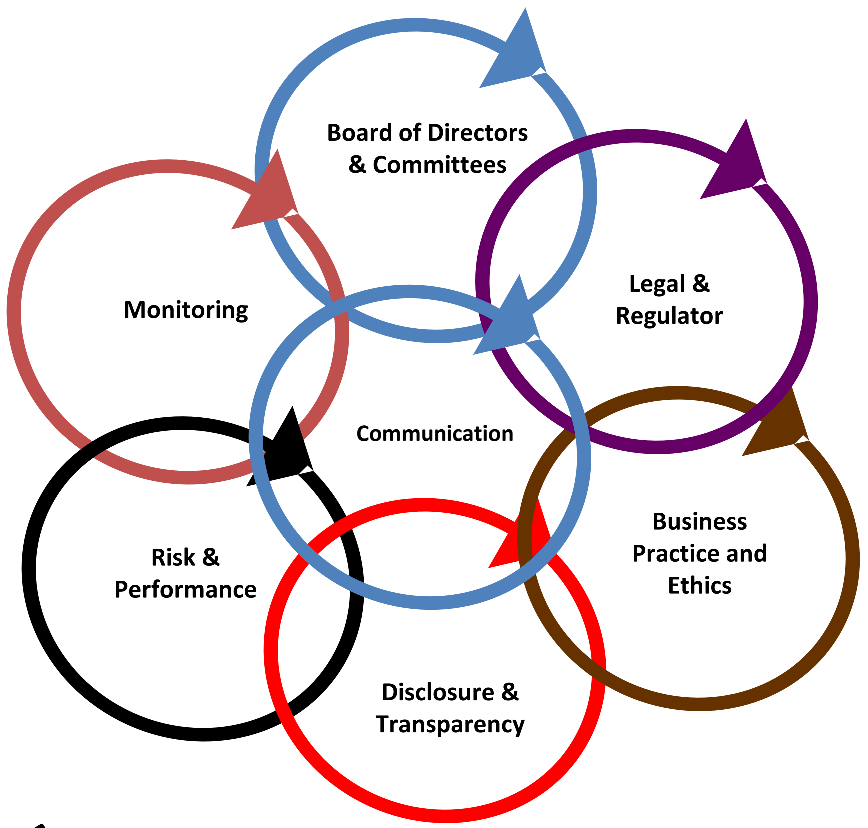
...enter to learn, leave to achieve

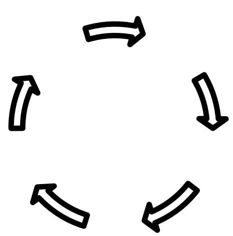
Highlights

- Corporate governance
- Audit, good audit and its role in corporate governance
- Why bad audits happen
- Recommendations

Corporate Governance Defined

CORPORATE GOVERNANCE relates to the systems and processes which an organization has in place to protect the interests of and add value to its diverse stakeholder groups, e.g. shareholders, employees, customers, vendors, community, etc.





Why are we all under pressure?

Today, organisations are under serious pressure to show good governance from both internal and external factors -

- SOX in the USA
- Basel II/III and,
- Internal policies that ensures compliance with organisation's policies.

Big Scandals !

HEALTHSOUTH

ENRON

Adelphia

tyco

Ahold

parmalat

ANDERSEN

WORLDCOM

The Lacunas

This presentation attempts to discuss these lacunas:

- Why Corporate Governance ?
- Why Audit?
- ENRON - a classical case study
- Remember Arthur Anderson (AA)

- A certain sad occurrence of death at about a particular time daily in a Hospital in the US.
- After series of investigations (conventional and forensic) including autopsy reports, cause was traced to a life-saving machine….

Role Players

Enron

Kenneth Lay –
Founding and last CEO

Jeff Skilling –
CEO from 2/2001 to 8/2001

Andrew Fastow –
CFO

Michael Kopper –
Assistant to Fastow

Andersen

David Duncan –
Audit Partner

Michael Odom –
Risk Management Partner

Nancy Temple –
Firm Attorney

So, what happened at Enron?

- Enron was a Houston-based natural gas pipeline company formed by merger in 1985.
- By early 2001, Enron had metamorphosed into the 7th largest U.S. company, and the largest U.S. buyer/seller of natural gas and electricity.
- Revenues climbed to $101b (2000) from < 10b a decade earlier!
- Accounting Scandal lies at the heart of the saga
- It involved one of the BIG 5 Audit firms – AA
- The scandal was the first in a series that hit the world headlines between 2001 and 2003

Fall out!

- Jeff Skilling (the CEO) resigned in August, 2001
- On October 16, 2001, in the first major ***public*** sign of trouble, Enron announces a huge third-quarter loss of $618 million.
- On October 22, 2001, the Securities and Exchange Commission (SEC) begins an inquiry into Enron's accounting practices.
- In November, Enron restated earnings back to 1997 by $568 billion
- On December 2, 2001, Enron files for ***chapter 11 owing $31.8 b***.
- Enron investors and retirees were left with ***worthless stock***.
- Share price fell from $90 (August 2000) to a worthless $0.40 in December 2001
- 21,000 jobs were lost in Enron, 33,000 in AA

Enron Debacle- Lack of CG?

- Enron fulfilled many of the requirements for good governance
- 13 Directors, out of which only 2 were ED
- The position of Chairman & CEO were split
- Enron has Independent NEDs
- Despite this, bad decisions and lapses in CG led to Enron falling

Executives Abandon Enron

- Rebecca Mark-Jusbasche, formerly CEO of Azurix, Enron's troubled water-services company left in August, 2000
- Joseph Sutton, Vice Chairman of Enron, left in November, 2000.
- Jay Clifford Baxter, Vice Chairman of Enron committed suicide in May, 2001
- Thomas White, Jr., Vice Chairman, left in May, 2001.
- Lou Pai, Chairman of Enron Accelerator, departed in May 2001.
- Kenneth Rice, CEO of Enron's Broadband services, departed in August 2001.
- Jeffrey Skilling, Enron CEO, left on August 14, 2001

The villains of the piece

- **Lax accounting** by Arthur Anderson (AA) Co**?**
- **The "rogue" David Duncan** (fired 1/15/02)?
- AA was convicted of criminal obstruction of justice charges in 2002 (overturned in 2005), *albeit, belatedly*
- **Enron's management** for hiding losses in dubious off-balance sheet partnerships?
- **CFO Andrew Fastow** for setting up these partnerships (10 year prison sentence 1/14/02)?
- **CEO Jeff Skilling** (24 year prison sentence 10/23/06)?
- **CEO Kenneth Lay** (died 7/23/06 with charges pending)?
- **Media exaggeration and frenzy?**
- **Stock analysts** who kept pushing Enron stock?

Heroine in the piece!

- The whistleblower – Sherron Watkins
- Her letter to Ken Lay - reads in part: - “I am incredibly nervous that we will implode in a wave of accounting scandals”
- The whistleblower protection act

The Unwinding of Enron-Notable Events

- Jeff Skilling left in August—gave no reason for his departure.
- By mid-August 2001, the stock price began falling
- Former CEO, Kenneth Lay, came back in August
- Oct. 16…announced $618 million loss but not that it had written down equity by $1.2 billion
- October…Moody's downgraded Enron's debt
- Nov. 8…Told investors they were restating earnings for the past 4 and ¾ years
- Dec. 2…Filed bankruptcy

The Cost of “Bad Press”

ANDERSEN

The Arthur Andersen partner was on his cell phone when he said,

"Ship the Enron documents to the feds,"

but his Secretary heard,

"Rip the Enron documents to shreds."

It turns out that it was all just a case of bad cellular.

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Let's get started

- Like the parabolic elephant and the six blind men, Corporate Governance means different thing to different people
- Cadbury Code – UK Based
- SOX Rule – US Based
- OECD – Global!, yet generic ?
- Which way Nigeria?

Corporate Governance in Nigeria

There were quite a number of sectoral corporate governance codes prior to the commencement of the Steering Committee's work in January 2013

The sectoral corporate governance codes include:

- the Code of Corporate Governance for Banks in Nigeria Post-Consolidation 2006,
- Code of Corporate Governance for Licensed Pensions Operators 2008,
- Code of Corporate Governance for Insurance Industry in Nigeria 2009,

Corporate Governance in Nigeria

- Code of Corporate Governance in Nigeria 2011 and Exposure Draft of the Revised Code of Corporate Governance for Banks in Nigeria 2012. The need for harmonization and unification was informed by the fact that there were not too many nations, and in fact none was observed during the Steering Committee's very extensive corporate governance literature reviews, that have adopted this sectoral multiplicity of governance codes

Corporate Governance in Nigeria

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Corporate Governance

Corporate governance is regulated by rules and principles as an approach to ensuring compliance of corporate governance practice.

The codes of corporate governance are intended to guide behavior where the law is ambiguous and to improve the general quality of corporate governance practice

Corporate Governance

Corporate governance is the system by which companies are directed and controlled.

Organization for Economic Cooperation and Development (OECD) defined Corporate Governance as a set of relationship between the company‘s directors, its shareholders and other stakeholders. It also provides the structure through which the objectives of the company are set and the means of obtaining those objectives and monitoring performance are determined

Corporate Governance

The very purpose of corporate governance is to monitor those parties within the company that are charged with the responsibility of controlling the resources owned by investors

Financial crisis and corporate scandals: after the financial crisis in 1998 in Russia, Asia, and Brazil government realized that deficient corporate governance endangers the countries stability and health of its financial system. Few years after these global financial crises, accounting scandals at prominent companies in US such as Enron(2001) and its audit firm Arthur Anderson, WorldCom(2002), Tyco(2002), Adeiphia(2002) have shaken the confidence of all domestic and international investors Enron and its audit firm Arthur Anderson became a symbol of poor governance and unethical conduct, because of its well-planned audit fraud and corruption. Enron will be remembered as the biggest bankruptcy in America history.

Corporate Governance

Corporate governance broadly refers to the mechanisms, processes and relations by which corporations are controlled and directed

Corporate governance essentially involves balancing the interests of the many stakeholders in a company - these include its shareholders, management, customers, suppliers, financiers, government and the community

Corporate scandals (Enron, WorldCom) & global financial crisis in recent decades have heightened focus on proper corporate governance

Audit

Corporate governance involves checks and balances; one of which is audit

Audit is an **<u>independent</u>** evaluation of the financial statements of an organization to offer an opinion on accuracy

Good Accountants, Bad Audit

Good accountants are expected to do good audits

However they sometimes do bad audits.

Why?

Usually due to unconscious biased judgments rather than deliberate omissions

Good Accountants, Bad Audit

Ambiguity – This could lead to differences in opinion on the treatment of various complex accounting situations that occur in business.

Good Accountants, Bad Audit

<ins>Client attachment</ins> – Auditors have strong business reasons to remain in the good books of their clients hence enough motivation to approve their accounts

Good Accountants, Bad Audit

<u>Familiarity</u> – People are generally more willing to harm strangers than individuals that they know

Other threats – F.A.I.R.S

Good Accountants, Bad Audit

Small errors in judgement – Some small errors are overlooked leading to big misstatements in later years.

At that point, it may be difficult to correct the error as it would mean accepting that errors were made in the past

Recommendations

To ensure good audit, take note of

- Professional scepticism
- Auditor independence
- Engagement of auditors should rest with the Board not management

PROFILE OF BABAJIDE IBIRONKE, FCA, FCTI, FCCA, M.I.o.D, ACCA DipIFR

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Babajide is a seasoned finance expert with almost 2 decades of highly rewarding experience spanning across every stratum of business endeavours - including manufacturing, banking and non-bank financial institutions and the academics.

He is a Fellow of the Institute of Chartered Accountants of Nigeria, Fellow of Association of Chartered Certified Accountants, UK, Fellow of Chartered Institute of Taxation of Nigeria and a holder of the ACCA Diploma in International Financial Reporting. He is also a member of the Institute of Directors of Nigeria and a regular guest speaker at the Institute of Chartered Accountants of Nigeria (ICAN) Mandatory Continuous Professional Education (MCPE and CPE) and facilitated severally at the Institute's IFRS Certifications.

He was a member of the ICAN Members' Education and Training Committee from 2011 to 2013 and the Chairman of its Ad-hoc Committee on e-Learning (2012/2013) and currently a Board Member of ICAN Financial Reporting Faculty. He is also an external monitor on IFRS Training for the Institute and currently an examiner/assessor for ICAN IFRS certification.

Babajide represented Nigeria at the ACCA International Assembly in the United Kingdom from 2012 to 2014 and elected as the Chairman of the ACCA Nigeria Advisory Committee in July 2014 and still ACCA International Assembly Representative for Nigeria. He is pioneer Director of Studies at Synergy Professionals (since 2006) and currently the Chief Financial Officer of Mantrac Nigeria Limited. He is an active member of the Golf Section of Ikoyi Club 1938.

THANK YOU