Four Years Later, Enron's Shadow Lingers as Change Comes Slowly

The New York Times
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January 5, 2006

WASHINGTON, Jan. 1 - America's corporate chieftains would prefer that Enron just go away.

But four years after the company's ignominious collapse, Enron's former top executives are about to head to a climactic criminal trial later this month, serving as a reminder that changes in the behavior of many American companies have been more muted than many once expected.

Despite an array of new and expensive laws and regulations that were adopted to tighten corporate oversight after the wave of scandals earlier in the decade, serious accounting problems continue to trouble publicly owned companies. In the last year, a record number have been forced to correct erroneous earnings statements, which often led to sharp stock declines.

Moreover, for all the widespread criticism of high pay of executives at Enron and other companies that later proved derelict, studies show that there is still little overall correlation between the performance of many companies and the executive compensation set by their directors.

Meanwhile, the Public Company Accounting Oversight Board - the agency created by Congress three years ago to oversee the accounting profession after the collapse of Arthur Andersen for its role in the Enron debacle - has yet to bring a significant enforcement action. It has filed only four disciplinary cases against tiny firms in Texas, New York and California.

"We certainly have seen some improvements in governance, but we've also seen some areas of no improvement, and some areas where things have gone backwards," said Lynn E. Turner, a former chief accountant at the Securities and Exchange Commission who is now the managing director of research at Glass, Lewis & Company.

Christopher Cox, the chairman of the Securities and Exchange Commission, said in an interview last week that a number of benefits have flowed from the laws adopted after the major corporate scandals that plagued companies like WorldCom, Tyco, Adelphia and Qwest, as well as Enron. But he agreed that more should be done. In the interview, he disclosed that he intended to lead a commission effort early in 2006 to rewrite the rules to force companies to provide more details about executive pay.

Despite a recent backlash by some corporate interests against the tighter rules, Mr. Cox said it "would be a mistake" to roll back the major provisions of the Sarbanes-Oxley Act of 2002, the Congressional response to the corporate scandals, which imposed new obligations on directors, accountants and lawyers.

"The shocks were so big that no director could miss the lesson," Mr. Cox said. "And if they did miss it somehow, the significant changes in law made it absolutely certain that they are now more focused."

"With just a few years of Sarbanes-Oxley under their belts," he added, "most companies are begrudgingly admitting that the exercise has produced benefits."

Still, Mr. Cox and some others have said, the changes have not come without significant cost. They have begun asking, as he put it, "whether we are getting everything we're paying for." Certainly there were fewer large corporate scandals in the last year. Surveys at large companies show that boards have more outside directors, and slightly better qualified audit committees.

But the lack of major debacles lately is due as much to the current stage in the economic expansion - which has not been going on long enough to encourage the financial excesses and inflated stock prices that often lead to trouble - as to major changes in corporate governance. And the collapse of Refco three months ago showed how short the memories of previous scandals are at the boards of some companies.

Alan G. Hevesi, who as New York comptroller is one of the nation's largest institutional investors, has been leading a group of other top state pension fund managers seeking to make companies more accountable to shareholders.

"We've had some successes in corporate governance reform," he said, but "in other areas - such as giving a greater voice to shareholders to elect independent directors and curbing excessive executive compensation - we haven't been as successful. I worry about whether the necessary reforms have really been institutionalized."

Corporate executives say audit committees generally have been spending more time going over problems. They also say that auditors have become more emboldened since the collapse of Enron and are less likely to be in the conflicting situation of serving as both consultant and auditor to the same company. Those changes have come about even though the accounting industry has become so consolidated that four large firms do the work for more than 90 percent of publicly traded companies.

Yet problems remain.

Earnings restatements, for instance, were more than 50 percent higher in 2005 than in the previous year. The restatements often involved plain-vanilla accounting issues, such as when to recognize earnings or properly calculate interest accruals. About a quarter of the restatements were related to a failure by companies to follow accounting rules issued more than 30 years ago on how to account for leases.

But the numbers still suggest there is more work to be done. Through the end of October, there were 1,031 restatements, compared with 650 for all of 2004 and only 270 in 2001, the year that Enron collapsed, according to figures compiled by Glass, Lewis. Mr. Turner said he expected

that by the time all the restatements through the end of the year had been counted, the total number for 2005 would reach around 1,200.

The increasing number is partly attributable to the greater vigilance of auditors and the new requirements of the Sarbanes-Oxley Act, which has prompted more than 1,250 public companies, out of a total of around 15,000, to report by the end of last October that they had material weaknesses in their internal controls. Another 232 companies reported deficiencies in their internal controls that were less serious, though significant.

Some executives see a silver lining in the earnings restatements.

"I don't mean to sugarcoat the figure on restatements, but I think it is positive - it shows a healthy system," said Steve Odland, the chief executive of Office Depot and head of a task force on corporate governance at the Business Roundtable, an organization of chief executives from the nation's largest companies.

"The general impression of the public is that accounting rules are black and white," Mr. Odland said. "They are often anything but that, and in many instances the changes in earnings came after new interpretations by the chief accountant of the S.E.C."

For large investors, an even bigger concern is executive pay. Even as the scandals highlighted expensive compensation packages that prompted regulators to require stricter accounting of executive pay, surveys showed that large investors were particularly upset by underperforming companies that continued to provide outsize compensation to their top managers.

One study, by Lucian A. Bebchuk of Harvard and Yaniv Grinstein of Cornell, found that corporate assets used to compensate the top five executives at companies grew from less than 5 percent to more than 10 percent of aggregate corporate earnings between 1993 and 2003. The result was a large decline in company and portfolio values with no associated strengthening of management incentives.

A second study, by Mark Van Clieaf, managing director of MVC Associates International, a management consulting firm, and Janet Langford Kelly, a Northwestern University law professor, found that 60 companies in the bottom 10th of the Russell 3000 index lost $769 billion in market value and $475 billion in economic value in the five years through 2004. They paid their top five executives more than $12 billion over the same period.

"The good news is we've seen more happen in the last 36 months than the last 30 years, as boards start to recognize they have a job to do that is not just ceremonial," Mr. Van Clieaf said. "The bad news is they haven't always figured out exactly what that job should be."

In the case of executive compensation, "there is a high level of denial on the performance problem," he added. "In part it is because low performance reflects on the board."

Mr. Cox of the S.E.C. said that he expected the commission would begin proceedings early this year to change the disclosure rules so that executive compensation became more transparent.

"It's been over a dozen years since we've last revised these" rules, Mr. Cox said.

Mr. Odland said the Business Roundtable had long advocated that boards do more to assure that the pay of senior executives is closely tied to company performance and that it is set by a compensation committee of independent board members.

"Shareholder value creation should be rewarded," he said.

Under Sarbanes-Oxley, senior executives are required to certify income statements personally. Audit committees must include at least one person with expertise in financial matters. Companies can no longer give cheap loans to senior officials.

Enron's collapse also spurred major accounting rule changes, including one requiring that stock options be counted as a normal business expense on company books.

Some executives have complained that the mandated changes have come at too high a cost, and a growing movement to create new exemptions, at least for many smaller businesses, is gaining influence in Washington.

Those complaints have had some resonance at the Securities and Exchange Commission. Mr. Cox, who took over last August, has promised to maintain the policies of his predecessor, William H. Donaldson, and has moved cautiously in re-examining the regulations that were adopted after Sarbanes-Oxley. But he has suggested that changes may be warranted in some areas.

"As we work together to protect investors and stimulate capital formation, we've got to be sure we don't choke on our own medicine," Mr. Cox said at a recent speech in Florida before the Securities Industry Association. "We understand that regulation that's intended to improve the competitiveness of our markets can - if we're not careful - have the opposite effect."