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Full length research paper

The impact of strengthening the judicial accountability of corporate governance in order to combat corruption in the companies listed in the financial markets

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The aim of this study is to discuss and analyse the reasons for the collapse of one of the huge energy companies (Enron), which resulted in the collapse of the auditing firm Arthur Andersen, therefore proving their involvement in manipulations of financials, and then see recent changes to corporate governance because of those collapses, and the views of the surrounding environment in the United States, and the possibility of the application of those changes on ground. The study concludes that the collapse of Enron and Arthur Andersen is due to specialised ethics, Arthur Andersen did double job to Enron, which was a clear violation of the rules, the financial market authorities were responsible for those collapses due to a lack of control, most of the companies and auditors face difficulties in applying new rules of corporate governance, and the main problem arise in ethics not in the rules controlling corporate governance.

Keywords: Judicial accountability, Corporate governance, Corruption, Financial markets

JEL Classifications: G0, G10, G15, F43

INTRODUCTION

The world is trying to find appropriate solutions to prevent collapses, since the collapse of the leading companies in the world. Therefore, the subsequent collapse of the auditing firm "Arthur Anderson" following that of Enron Energy. The government is looking for the reasons that led to those unexpected breakdowns. All the analyses showed a defect mainly occurred in the ethics and practice of accounting and auditing. The U.S. government in 2002 developed a legislation called the Sarbanes-Oxley Act that obliges listed companies in financial markets in the U.S. to implement it (AICP, 2002).

All the legislation in governing companies stem from sociology and developed tests for the discovery of errors. However, this is what actually happened in working legislation of USA companies, There was a lack of such legislation to develop effective roles that efficiently addressed past mistakes, This study will therefore find answers to the following questions:

- How did the collapse of the auditing firm "Arthur Anderson" happen?
- What does corporate governance mean and its modern concept, according to the U.S. legislation, which was developed in 2002?
- Is corporate America able to apply the new legislation?
- What are the obstacles they faced in its application?

Objectives of the study

It is known that existing legislation in the environment of listed companies in financial markets need constant renewal, especially if what emerged out of any deficiencies or lack of success threatens the continuation of those companies, on the basis of this fact, this study aims to:

- Identify the causes of the collapse of the auditing firm “Arthur Anderson” and of Enron Energy.
- Identify the nature of corporate governance, the modern concepts and the U.S. legislation, which was developed in 2002.
- Identify America’s corporate ability to implement the new legislation, and what obstacles they face in the light of its application.

The importance of the study

The importance of this study, is found from the importance of the role played by companies in the development and strengthening of the economy in general, and the collapse of companies will have negative effect on financial markets, and thus declining rates of development, worsening unemployment and subsequently worsening the problems of poverty and political instability, and all the facts mentioned above. The knowledge of the reasons for the collapse of global companies in developed nations like the USA, and knowledge of legislation issued in the prevention of landslides in the future, will be an important lesson for a developing country such as Jordan to take advantage of without charge, and utilise it to avoid such evils.

METHODOLOGY

This study is based on the descriptive analytical deductive approach, therefore identifying the reasons that led to the collapse of the leading companies in the USA, and to identify the corporate governance concepts, and the ability of companies to apply the corporate governance concepts, and to identify the problems encountered during such application. As the researcher will investigate information and facts as much as possible, due to the recent emergence of corporate governance concepts, and thus the lack of local results on the implications of their application in Jordan, the researchers will therefore depend mainly on research and global studies via the Internet, and analyse the results, and then propose some recommendations that may contribute to give useful reference for Jordanian companies, and thus protect the local economy from any future risks.

Emphasis will be placed on all possible sources of the sites available on the internet and by focusing on sites of world leagues in general, and sites of universities in particular, to derive the latest developments of the collapse of the companies in the USA, and corporate governance concept application by U.S. companies.

Reasons for the collapse of some companies in the USA

The collapse of Enron and subsequently the collapse of Arthur Andersen audit raised several questions at the level of the profession of accounting and auditing, most importantly, “how did they collapsed?” “Why?” and “who was responsible?”.

Before going into the subject and its details, the researchers would like to ask spontaneously, if a thief could break into a fortified bank’s best protection systems and escape without being noticed only after a long period, should the responsibility for the theft rest with thief only or the protection system? Having briefed researchers on the details of the collapse of Enron, showing that the subject dates back to 1993 and not the attack, which happened in the United States on 11/9/2001, this damage to the financial market has remained the thief on the run . This is the case and the scandal involving contemporary issues important enough to have had a terrible effect on, not just the United States, but the entire world. On the one hand, Enron has many branches and on the other hand, it is known that Arthur Andersen audit was one of the world’s largest auditing firms, it was the first in terms of size, prevalence and estimated number of employees around the world nearly a hundred and sixty thousand employees (Powers Report, 2002; Eichenwald, 2002; Basilico et al., 2012), Thus making it difficult to restrict losses at the time, not to mention the workers and employees who lost their jobs as a result of the collapse. The researchers believe that the collapse of these two companies and despite the great tragedy, serves as a very important lesson and requires many studies on its causes coming from specialised agencies that return the accounts, and most important of these entities include:

- All governments, particularly the United States.
- Companies in various forms and types.
- Accountants and auditors.
- Company owners and creditors.
- Laws and regulations related to corporate and capital markets

Report of the committee of inquiry on Enron

The Board of Directors of Enron set up an investigation committee to find out exactly what happened, the report shed light on the processes that took place between Enron and some investment companies, which were managed by Andrew S. Fastow, who was also working as Assistant Chairman of the Board and President of the company for the financial section of Enron (Benston and Hartgraves, 2006).

It is important to mention that the report focused heavily on operations of two main aspects, the first aspect being accounting for such operations, and the second side being disclosure. Note that it did not authorize inquiry into the case of bankruptcy or express any opinion or judgment about the external conditions that contributed to the bankruptcy. We must mention here that the most important determinants faced by the commissions were (Powers Report, 2002):

Table 1. The restructuring of the financial statements from 1997-2001

year	Profit before reduction	Profit reduction	Owners' equity reduction	Amount of increased indebtedness
1997	105	28	258	711
1998	703	133	391	561
1999	893	248	710	685
2000	979	99	754	628
Total	2,680	508	2,113	2,585

Note: amounts in million US$. Source: Powers Report (2002).

- There is no validity to force external parties concerned and subject them to interrogation or force them to make any kind of documents relevant to the topic available.
- The refusal of some former employees involved in a lot of calculations that led to the collapse of cooperation with the commission to disclose needed information.
- Although the committee was able to reach some of the auditing firm's (Andersen) documents but they could not reach the investment firms' documents that caused the collapse.

Summary of the event as stated in the securities' commission (Powers Report, 2002): 16/10/2001, Enron announced reduced profits of 544 million US$ resulting from transactions with investment company (LJM1 & LJM2), with the knowledgement that these companies are partnered with Enron, this was created and managed by Fastow (Enron employee), Enron also announced a reduction of shareholders' equity of 1.2 billion US$, associated with the same previous operations (Emshwiller, 2001). The real problem began a few months after the first announcement, that Enron, restructuring its financial statements for the period between the years 1997-2001, reason being because of errors in accounting and related companies, partnership and investments managed by Fastow and Kopper (former employee of Enron and the owner of the company Chew Co.), and the companies Chew Co., LJM1 and LJM2. It is worth mentioning here that the restructuring of the financial statements for the period from 1997-2001 showed reductions than the first on 16/10/2001 as illustrated in Table 1.

In that period, Enron detected that Fastow received 30 million US$ from the two companies LJM1 and LJM2. Restructuring of the financial statements as mentioned above indicates that amounts received by Fastow made the market lose confidence in Enron, which led to its collapse in less than a month.

After the committee examined the key processes related to the investment firms mentioned earlier, which caused lower profits and property rights, the following questions came up:

- What are the processes regarding the subject?
- Why these operations?
- What went wrong?
- Who is responsible?

No need to mention here that the most important finding of the commission, which was not disclosed is that some of the staff involved in such transactions suddenly became rich and received several sums exceeding tens of millions as follows:

- Fastow received 30 billion US$.
- Kopper received 10 billions US$.
- Others received several hundreds of thousands US$ names not disclosed.

The committee adds that the management of Enron used these investment companies in several operations, most of these operations were designed very nicely in order to manipulate and demonstrate financial statements to serve special interests opposed to the goal of economic benefit or hedging for future risks. Some of these processes were thoughtfully designed, did not follow the procedures and generally accepted accounting principles, and as a result not shown in the list of investments in Enron's financial assets and liabilities (Countryman, 2002; Lavelle, 2002; Basilico et al., 2012), other processes were also applied incorrectly and incorrect approval of financial advisers, where they were extinguishing some of the losses resulting from the hedge phantom, with the knowledge that those operations if true would have to result in a profit for Enron, showing Enron as prudent, the investment companies must therefore compensate for the losses, but this was not possible as Enron was the owner of these investment companies, this concealment led to the collapse (Weil, 2001).

This process contributed the most to the collapse of the company, as they showed in previous years, the fake profits. It became clear to the commission, after examination and investigation that the original accounting transactions that took place with the companies Chew Co, LJM1 and LJM2 led to the collapse, structured

operations which were false and contrary to generally accepted accounting principles, those operations were conducted under the approval and supervision of auditors and the consultant company Andersen, evidenced by payment of 507 million US$ to those consulting, and which was mentioned in the report of the Board of Director (Benston and Hartgraves, 2006). It must be noted here that the operational misconceptions regarding the structuring of the so-called special purpose entities(companies with special purpose), state laws and accepted accounting principles, the company dealing with these kind of companies (Special purpose entity) can be treated as independent.

Summary of operations that have been reviewed and analysed

The operations of Chew Co.

This company is an investment company owned and managed by Kopper (former employee of Enron) and is one of the main causes of the failure of the financial statements of Enron from the years 1997-2001 in addition to the powers granted to Kopper, where Enron's joint venture worth 500 million US$, with the California public employee retirement system from 1993 until 1996, was controlled. Up to 1996, Enron did not include the assets and liabilities of the project in its consolidated financial statements, but merely showed gains and losses on the project in the lists of income and disclosed in the notes to its financial statements (Simpson, 2002). At the beginning of 1997, Enron reduced contribution to partner projects to urge investment in new projects, here emerged a new issue, Enron owned the lion's share in the project where it became bindingin accordance with generally accepted accounting principles to show assets and the joint venture within their financial statements.(Beranek and Ronnie, 1985; Wilke and Nicholas, 2002).

The only solution to avoid showing the assets and liabilities of the project in their lists, was to search for a new partner in the project, and to achieve this goal, according to the statement by Fastow, one of Enron's employees (Kopper) helped Enron in the establishment of the investment company Chew Co, which in turn purchased the old partner's share to the joint venture. But the major obstacle was for Enron to show the assets and liabilities of the joint venture and the company's new investment in its financial statements with Enron investing 3% at the very least in the assets of the company (Aqil, 2004; Lisman et al, 2002).

Despite the explicit violation as mentioned above, Enron continued not to include the assets and liabilities of the joint venture and the new investment company in it's consolidated financial statements. It is clear here that there are some serious matters taken by the management of Enron:

- The establishment of an investment company owned by Enron's staff.
- That the company purchased shares of the joint venture with Enron's indebtedness complete without the existence of any right of ownership and guarantee of Enron.
- Enron's financial statements did not include all the assets and liabilities of the joint venture and investment company which is a serious violation.

Notes of the commission of inquiry

All of Kopper's (director and owner of Chew Co. Former) processes to be rejected and Andersen to justify or explain these processes, and why they were restructured contrary to accounting standards. The commission has said very clearly that they do not know whether those errors were caused by miscalculation or negligence by Enron's management and financial advisers Andersen or as the result of Kopper delaring his interest in the parent company (White, 2002). The committee noted that, when Andersen reviewed operations of Enron in 2001and found that the company Chew Co. was not subject to the laws set forth in accordance with generally accepted accounting principles and advised corrective measures, Enron announced the restructuring of its financial statements retroactively from 1997 to include the company's (Chew Co) assets and liabilities, as the consolidated financial statements which led to massive reduction of income and rising indebtedness.

In addition to each of the above, the committee found another violation, according to Enron and instructions regarding business management, Kopper was not authorized for any type of administrative control or as financial officer for Chew Co. In one case, a written approval from the chairman of the Board of Directors Enron, noted that the commission did not find such approval by any party. The best proof was that the company, during those years, received a commission from the management of Chew Co, amounting to two million dollars in agreement with Fastow (assistant chairman of the Board of Director of the accounts of Enron). According to Gary and Jean (2002), in March 2001, Enron bought stakes of Chew Co. In the joint venture, but after negotiation between Kopper and Fastow which received US $10 million in exchange for ceding its stake, we must recall that the contribution Kopper in the 1997 investment in the company, did not exceed 125 thousand dollars. We must also note, that the waiver process was a deliberate move to create two new companies along the lines of the first investment company, the two companies being LJM1 and LJM2, finally with regard to Chew Co, capital restructuring is as follows:

- US$ 240 million (unsecured loan from Barclays bank guaranteed by Enron).
- US$ 132 million (submitted by the joint venture).
- US$ 1105 million (of the company's partners in the 3%).
- US$ 125 thousand dollars (Kopper).

The operations of companies LJM1 and LJM2

In 1999, with the consent of the Board of Directors, Enron and Bakadi entered into partnership with two people, Fastow was largest investor of them, the company disclosed unreal profits of almost one billion dollars and gave Fastow and his associates several millions of dollars. The governing council accepted the companies for the following reasons:

- The Board of Directors believed that this type of company and the direct relationship to one of its employees may benefit the company's operations in terms of absolute loyalty of the employee to the parent company.
- Through these companies, they would get buyers for assets that they wish to sell including those of Fastow, being familiar with the bulk of the things he or she can speed up operations and make it serve the interests of the parent company.
- The Board of Directors believed that fair disclosure of the financial statements can control the dangers of disloyalty and stop any possible manipulation.
- The reason the Board of Directors actually reassured the performance of these two companies was based on good reports that were received from the financial adviser to the company Andersen.

It was observed that Enron entered nearly 20 processes with the two companies during the period from 6/1996 until 6/2001, those operations are classified into two types: The sale of assets and Hedging operations.

Damage to Enron

It should be noted here that these operations caused the greatest damage to Enron for example, but not limited to:

- The time for one of the processes before the end of the fiscal year period is too short for Enron company to sell some of its assets, which it wanted to get rid of to LJM1, and the following question arises "is this process actually quoted in the risks?" first and finally that these risks remained linked to the same parent company.
- Other processes before the end of fiscal year 1999, where Enron sold seven investment contracts to LJM1 and company profit resulting from the process after the end of the fiscal year brought five investment contracts.
- One of the most serious deceptive hedging operations is as follows:

In the 3/1998 Enron had purchased 504 million shares at a price of 1085 dollars for shares of Rhythms (the total amount of 10 million US$) and on 7/4/1999 when Rhythms company turned to a public company, increased its share value from 21 to 96 million US$, and Enron investment value became 300 million US$ which was reversed profits in the company's income. Although, the investment contract was provided for, but for the inability of Enron to sell off these shares before the end of 1999. Enron retained some future contracts in some banks to protect its shares from price fluctuations. Sequel to the preceeding, Fastow suggested a plan to hedge, to maintain investments of Enron at Rhythms through the establishment of an investment company LJM1, comprising capital of future contracts for Enron, and after the establishment, Enron hedged against the risk of lower prices for shares of the company Rhythms.

In addition, Fastow actually managed to get the approval of the Board of Directors of Enron to convert all futures of the company LJM1 exchange for notes receivable, and entered decades later a swap with Enron to protect their investment in Rhythms, this process affected the profits and losses Enron declared, but the process is not real, because this type of hedge is not economical but an accounting hedge, if Enron's shares maintained a good price you will be able to control their investment returns, despite the low share price of Rhythms, but what would be the situation if the share price declined, Enron and Rhythms at the same time?What is the benefit of this type of swap contract and the guarantor is the same? The researchers found that there were many other irregularities, but the foregoing comprise the major irregularities that actually led to the collapse of and the subsequent collapse of Andersen (Ronnie et al., 2002).

Corporate governance in the modern sense

What is corporate governance?

Researchers found that there are several definitions of corporate governance, at the institutional level, some say it is the field from the fields of the economy, looking for ways to ensure or stimulate efficient management in joint stock companies by using the mechanical stimulus, such as contracts, legislation, designs and organisational

structures, and is often confined to the question of improved financial performance, for example, how the capacity and the impact of public shareholding company owners ensure and motivate the company's managers to perform and achieve the best return on their investment (Dahmash and Abubutton, 2004). Also, some definitions say that corporate governance can be defined on a small scale to represent the company's relationship with shareholders, or more broadly, the company's relationship with everyone (Financial Times, 1999).

As motioned by Sweeney and Cynthia in 2002 in an essay entitled "NYSE Sets Audit Committees on New Road" that in August 01, 2002 the Board of Directors of the NYSE got the approval of the proposed amendments to the criteria for listing companies' issuing standard 99 (SAS No. 99). It was discussed that the proposed amendments with the securities and exchange commission on 16/08/2002 were identified in a period of time for comment and objection to the amendments before the commission corrected it and gave a final approval. The amendments became effective on 11/03/2004. Therefore, companies have until their first annual meeting after June 30, 2005 to replace a director who was independent under the prior test relating to audit firm independence.

The task of the proposed amendments focused mainly on making the company's audit committee fully responsible for monitoring the external auditor and give full authority in determining the terms and fees for the audit and other work as well. The proposed amendment exceeded its main focus on the functions of the audit committee; it became a comprehensive guide for listed companies to determine the criteria of institutional control. This affects the proposed standard on all listed companies whose securities are within the NYSE, and also affect all other business organisations and the legal variant form of joint-stock companies, such as limited partnership firms (Dahmash and Alakeca, 2004). This standard has two main objectives, first: determine the authority of audit committees from the perspective of the integrity of the financial business listings, and secondly: focus on the independence of the external auditor, and to keep the audit committee responsible for determining the financial statements or to ensure the external auditor's report.

Member qualifications

Out of a desire to rehabilitate members with a mix of skills and knowledge, in order to enable them to respond actively to address the problems of the company, Andrew S. Grove (Chairman of Intel Corp.) created a series of measures to assess the user three-dimensional three-tire director evaluation process, and included evaluation of the performance of each member of the Board of Directors in a comprehensive manner, and all of the commission and, if necessary, each member individually.

Ethical behaviour

The commission recommended a number of policies and procedures that define the necessary requirements for the process of creating the laws of ethical behaviour, and the mechanism obliging company's laws of behaviour. The commission's report has shown that companies work to strengthen the concept of responsible behaviour and build a suitable environment that enables employees to report wrong actions rather than being silent about it, or report it after it is too late. The commission has noted that its own laws on ethical behaviour are not sufficient, and recommended that the council should include the company's management to discuss ethical issues, and the company must develop appropriate tools and procedures for creating an ethical work environment.

Audit

Out of a sense of the responsibility towards the failures of large audits, we have focused on the importance and necessity of the presence of Jean-checking feature knowledge and independence, and the need to use targeted programs, and continue to educate the audit committees, in order to protect companies from wrong accounting practices, and the risks resulting from conflicts and risk-prone situations, the committee also recommended the use of audit committees as and when needed to help to perform their duties. The committee urges the need for companies to have an internal audit function, and also recommends that the internal auditor shall be connected directly with the audit committee, and to report back to it, as well as to attend all meetings (Delroy, 2001). As for the external auditors, the committee calls on the companies to re-examine and evaluate acts of external auditors and assess the quality of their audit and its performance once at least every five or seven years. On the basis of ensuring the independence of the auditor, the audit committee is to change the external auditor under the following circumstances:

- If the auditing firm audited the company's business for a considerable period of time, such as ten years or more.
- If a company's auditing firm's employee or ex-employee is under scrutiny.
- If the auditing firm performs other services related to the audit of the company that is under scrutiny.

Corporate governance in its modern sense after two years on the application

The author Duffy in his article entitled “Corporate Governance and Client Investing” in January 2004 noted several important things summed up thus:

That due to the growing interest in the subject of corporate governance and its contribution to raising equity values in the financial markets, chartered accountants must exploit the opportunities of this and educate their customers of its importance in terms of activation of corporate governance in any company the right way will contribute to the success of the company in the future.

Chartered accountants become the focus who through their consulting advise their clients to invest in the shares of companies that practice corporate governance.

- Since the disclosure of corporate governance practices in companies is still in its infancy stage, chartered accountants get information about companies through their managers; it is recommended that selected managers are those who enjoy the reputation of honesty.
- Chartered accountants are sceptical of the information that they get for pricing services and it seemed the trend of the so-called need for comprehensive disclosure of the independence of board members, and established strategy.

At the end of the article, the writer references based on the statistics, which showed that 33% of companies that have been asked for their application to the terms of the NYSE apply those conditions, and that each of the chartered accountants and their clients face serious difficulties to obtain information about the companies that practice corporate governance in their system. The writer advised at the end of his article, that to know which companies apply corporate governance, we must use the following steps:

- Must be companies that want to evaluate the performance of the investment service or sales and thereby prepare questionnaires that contain several fundamental questions relating to institutional governance.
- Since the information on corporate governance is still elusive, it should focus on those companies that do not suffer from the problems of accounting.
- Must, when choosing a financial manager, focus on the choice of a person with high integrity and ethics.

According to Coustan et al., 2004 in their article entitled “Sarbanes-Oxley: What it Means to Marketplace”, through interviews of a number of professional accountants:

- They agree to some of the requirements stipulated by the new law, particularly in requiring departments in companies to report to external auditors, instead of reporting to the internal auditors, as they hail the decision that provides for the formation of the an Audit Committee, which will contribute to the dimensions of the pressure exerted on the audit fees and focus efforts on audit process and thus improve effectively than ever before.
- The process of involvement of senior management in reviewing the interim and annual reports will make its attention focused entirely on the financial reporting mechanism.
- The new legislation will have a positive impact, despite the confusion that might happen because of the complexity and responsibility contention.
- The operations of the various stages of documentation will be expensive, but it is useless to give the desired credibility of the whole process.
- The fear of non-able listed companies that are managed on a small scale to meet the requirements of internal control due to the large cost thus giving room for only large companies.
- Chartered accountants show their big goal, the fear on their customers from small businesses listed that may not be able to meet the new requirements of the financial markets and in accordance with modern corporate governance.

Conclusions

The key points of this paper are now summarised

The researcher does not believe that there was a possibility to prevent what happened, the problem is not related to the standards of accounting or auditing standards, but the main problem is limited to the ethics of the profession itself.

- One of the most important observations that we found on the subject is that the auditing firm Andersen was carrying out several acts of double standards, on the one hand as external auditor of Enron company and financial advisor on the other hand, strangely enough they were representing the internal control of the company, which monitors itself, and received large amounts exceeding the expected wages, here’s the main question: was Andersen company an independent company?.
- Andersen company was complicit with Fastow, especially that Andersen alerted Enron on the need to restructure its financial statements in advance of the collapse, why warn Enron on the

necessity of restructuring? Why did the Board of Directors of Enron form a committee to investigate and limit its work to know what happened? and under its jurisdiction, we believe that the real accomplice Fastow, later was only a tool for that implementation.

- Returning to the first point regarding ethics, inquires researcher: is there another way to adjust the ethics of the profession? We know that Enron was listed in the US financial market.
- How the company was allowed to double Andersen's operations to commit acts exceeding the audit and financial consulting, and why they asked for high wages that exceeded the conventional? Did Fastow hit degree of cunning and intelligence in order to con everyone? or that the company is collaborating community en masse?
- Did the governing council note the irrational numbers from previous financial reports, especially regarding hedging and profit that exceeded in some cases profits from basic operations of the company.

All of the above-mentioned points, after research and analysis and interpretation we get back to the fact that the problem is not the standards of accounting and auditing standards, but the problem is in the ethics of the profession and the possibility of seizure and consolidation. Equally, all the surveys and information that have been found and learned from the American corporate environment showed that corporate governance in the modern sense is difficult to implement. Finally, the researcher believes that the main problem lies not in any corporate governance laws, ancient and modern, but the problem lies with those that apply the ethics of those laws.

Recommendations

Given the conclusions reached by the researcher, especially which raise in mind a number of questions, the researcher and to enable the implementation of corporate governance in the modern sense and benefit from it, recommend's the following:

- Economic actors should be focused on finding mechanisms to promote and raise ethical behaviour, which is entrusted with compliance with the laws in place.
- Educate stake holders on the need to find a mechanism for the independence of the internal auditor because of its economic benefit back to them.
- Not to limit the absolute powers, however, executive director specific and subject to several other regulators.
- Corporate boards to include members of the professional bodies in the field of financial accounting.
- The need for regulators of the financial market listed companies to be more effective

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