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MAJOR CASES OF CORPORATE GOVERNANCE FAILURE IN USA

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Abstract: Corporate Governance - Before 1990, it was an unknown subject. But after 1990, it emerges as a new area of knowledge for improving accountability and transparency in corporate system. In UK, it was emerged in 1991, with the formation of Cadbury Committee on account of failure of Maxwell, BCCI and Polypack.

Keywords: Major Cases , Corporate Governance Failure , BCCI and Polypack ,Junk Bond Scam .

INTRODUCTION :-

Cases of Corporate Governance failure in USA

Junk Bond Scam

First Executive Corporation (affected by scam, it was engaged in Life Insurance Business), has its business in USA (Two Principle Subsidiaries one at California and other at New York) and it was a public company incorporated in 1969 and failed in 1991. Michael Milken head of Junk Bond firm was responsible for this scam.

Amount of Scam/Failure - More than 12 billion dollars

Detailed Reasons for Failure

In 1969, the company was rationalized as First Executive Corporation. Over the next five years, the company struggled to develop. By 1974, it had an irrelevant investment portfolio and was unable to pay its interest payments, still losing money, and about to default on a $15 million loan. Fred Carr, then a much-publicized mutual fund manager, left his own consulting business to take over the pedals of First Executive. Carr invested some of his own money in the company, renegotiated the loan, and was soon became the CEO of the company. Within nine years, First Executive became one of the fastest-growing insurance firms in the United States.

First Executive Corporation was a largest/ top insurance company in New York. The company (First Executive Corporation) was failed because it was the super most buyers of junk bonds and company became a top buyer of bonds from Michael Milken, head of California operation of Drexel Burnham Lambert (Junk Bond Firm). Drexel went bankrupt in 1990 and the First Executive Corporation failed in 1991.

State regulators were locked up First Executive's main subsidiary in California on 11th April'1991 and its smaller New York unit on 16th April'1991. The complete size of the tragedy makes answers difficulty. First, there is the question of valuing the huge junk bond that is supposed to maintain payments on the policies. Then, there are the lawsuits and investigations that add millions to the company's liabilities.

First Executive Corporation invests its money in Junk Bonds which were considered as high yield and low grade securities.

Fake Transaction - In December' 1989, First Executive Corporation formed six new firms. The company gave them some cash and junk bond holding and in return received bonds. After one month, January '1990 $15 Million dollar was write off against loss in junk bond but after writing off bonds was overvalued by $1.4 billion. First Executive Corporation (New York Unit) was fined by the U.S Authority $250,000

After failure, Michal Milken - fined $600 million and 10 years sentence with a mandate of not returning back to the security market

Enron

Enron Corporation (Energy Company) had its business in Houston, USA founded by Kenneth Lay in 1985 (by merging two American gas pipeline companies; Houston Natural Gas and Inter North). Enron was failed in 2001. Enron was a prominent company in its time and ranked in the US top fortune ten companies based on turnover. In 2001, it became largest bankrupt company in the history of US.

Person Responsible for Failure - Kenneth Lay (CEO), Jeffrey Skilling (Chief Operating Officer), Anderson (Auditor of the company).

Amount of Scam/Failure – More than $618 Million

DETAILED REASONS FOR FAILURES

Enron was incorporated in 1985 and became bankrupt in 2001, during a period of 16 years the company transferred a small concern involved in gas pipelines, oil and gas exploration to the World's largest energy trading company.

From the pipeline sector, Enron began moving into new-fangled fields. In 1999, the company started its broadband services unit and Enron Online, the company's website for buy and sell commodities, which shortly became the largest business site in the world. About 90% of its income eventually came from trades over Enron Online.

Growth for Enron was rapid. In 2000, the company's yearly revenue reached$100 billion US. The company's stock price peaked at $90 US. However, faults began to appear in 2001. In August of that year, Jeffrey Skilling, a driving force in Enron's overhaul and the company's CEO of six months, announced his exit, and Lay resumed the post of CEO. In October 2001, Enron reported a loss of $618 million— its first quarterly loss in four years.

Enron bankrupt because it was unable to arrange the funds for creditors. One time, it was rated in the fortune 500 list and rated as "Best place to work" but after 2001 it becomes a synonym for corporate scandal. The reasons for its failure was,

•Company's aggressive and costly expansion strategy into the broadband sector.
•Accounting Fraud - Accounting and auditing functions of Enron were unreliable. The company manipulate the EPS and remove the amount of substantial debt from the accounts by using off- balance sheet vehicles.
•Bribery Scandal - company support corruption and using political links for securing contracts in Central America, South America, Africa and Philippines.
•Insider Trading - company's officials and CFO were known about the off-shore accounts of company, but investors know nothing. Officer, even Kenneth Lay & his wife, utilize inside information about the stock prices of the company, and made too-much personal profit.
•High Compensation to Managers and Executives.
•Adopting Bad Practices - The Company had no whistle blower policy, poor rating and wrong accounting policies.

After failure - Kenneth Lay & Jeffrey Skilling went on trial for their part in Enron Scandal. Before the Jail term was announce Kenneth Lay was died and skilling was convicted and sentenced to 24 year and 4 months in federal Jail. Enron's Collapse also contributed to the creations of the U.S. Sarbanes Oxley Act, which was come in 2002.

Corporate Governance failure of Enron

•Board honesty not performed its duties.
•Internal and External auditors failed to control business managers.
•Ethical standards were very poor.
•Audit and Compliance committee failed to perform its duties.
•No shareholders grievance.
•Stakeholders were failed to question Enron and it is financial standards.

World Com

World Com (Telecom Company, initially known as Long Distance Discount Service, 2nd Largest Company) had its business in USA, founded by Bernie Ebbers (Initial Initiator), David Singleton and Murray Waldren in 1983. It was failed in

2002.

Person Responsible for Failure - Bernie Ebbers (CEO of the Company), Scott Sullivan (CFO of the Company)

Amount of Scam/Failure - More than $23 Billion

Detailed Reasons for Failure

WorldCom caused one of the major fraud and bankruptcy scandals in American. In total, more than $11 billion worth of fake accounting entries and misstatements were noticed, which represented 28.9% of total yearly revenue in 2002. This fraud ratio was extensively higher than the 1.1 percent ratio of the epic fraud at Enron.

Fake accounting at WorldCom was a collusive action among top management and a few accountants, in combination with weak controls. According to the ACFE's "2008 Report to the Nation," the conspiracy "resulted in a median loss over four times higher than the amount lost in schemes committed by a sole perpetrator."

•Accounting irregularities and false financial statements.
•False journal entries related to the capitalization of line cost (inter connected expenses).
•Misrepresentation of revenue.
•Not following GAAP – Generally Accepted Accounting Principles (Reported by the KPMG).
•Making fictitious revenues and research management.
•Overpayment of sales commission (reported by Internal Auditor Cynthia Cooper in 2001).
•World Com's loans to Ebbers and Ebbers used these funds for personnel assets.

After failure - All WorldCom fraudsters were sentenced. Ex- CEO Bernie Ebbers received 25 years in Jail – a near life sentence because he was in his mid-60 at that time. The CFO got a five-year Jail sentence and his chief controller one year and one day. In addition, the dishonest senior accountants were also jailed.

The company did emerge from bankruptcy in 2004, renamed as MCI, with better financial structure, new directors and new management (New CEO Capellas). The company also paid $ 500 million fine to Security Exchange Commission in May, 2003.

Corporate Governance failure of World Com

•Lenient internal control and management.
•Board Ignorance.
•Not evaluating the proposals before acceptance.
•Board Committees not functioned effectively.
•Directors did not behave properly when considering personal loans to Ebbers.
•Anderson (External Auditor) failed to detect the accounting discrepancies.

TYCO INTERNATIONAL

Tyco International (Originally an Investment company but, its subsidiaries engaged in security, health care, electronic, plastic and engineering products), (2 subsidiaries, TYCO Semiconductor and Materials Research Laboratory) it was registered in Bermuda, USA, founded by Arthur J. Rosenberg in 1960 and this was a public company (listed in New York Stock Exchange). It was failed in 2002.

Persons Responsible for Failure - L. Dennis Kozlowski for Failure (former Chairperson and CEO) and Mark H. Swartz (CFO)

Amount of Scam/Failure - More than $600 Millions

Detailed Reasons for Failure;

Aggressive Expansions - Tyco acquired hundreds of companies spent over $63 billion from 1994 to 2001.
Decentralized organizational and management structure which lead to control Failure.
Large amount of debt financing which decreased the firm's financial flexibility.
Wrong accounting treatment of acquisition and financial manipulation.
Security and Exchange Commission of USA conducted an investigation against Tyco and found that the company understated the pre-acquisition earnings of a target company, so that the firm could show a boost in earnings after the purchase.
With the global slowdown of 2001, it shows prices were declined and profits were reduced at a very low level.

CEO and CFO of the company use corporate funds for their personal gain. They were also involved in misusing of funds, fraud and tax evasion.

After failure - Kozlowski and Swartz, CEO and CFO of the company resigned and former Tyco CEO John F. Fort became interim CEO until the board make permanent placement. Tyco filed a federal suit against Kozlowski, Swartz and Frank E. Walsh (former director).

Corporate Governance Failure of Tyco

CEO, CFO and other senior management changed with fraud.
Senior Executives behave unethically.
Conflict of interest.
Wrong acquisition strategy.
Wrong accounting practices.
PWC (external auditor) failed to detect company's problems.

Anderson Worldwide

Anderson World Wide (Accounting Firm), it was LLP Firm, one of the big five accounting firm among PWC, E & Y, Deloitte, and KPMG providing auditing, tax and consultancy services to large corporate registered Chicago, USA, founded by Arthur Anderson in 1913. It was failed 2002.

Persons Responsible for Failure - Anderson himself, Nancy Temple (legal department) and David Duncan (Partner for Enron's account)

Amount of Scam/Failure – Totally bankrupt

Detailed Reasons for Failure;

September 2002, the 89-year-old Andersen expects to have more than 3,000 employees on its ever-dwindling payroll shut down its business. The Andersen name is likely to exist on in the popular culture as Watergate did; shorthand means to refer to a certain kind of scandal.

The bitterness between the consultants and accountants, rotting for decades, reached a dramatic high point as Andersen Worldwide entered the 21st century. Andersen Consulting management wanted to separation completely its ties to the accounting and auditing side of Andersen Worldwide and break-up itself from Andersen Worldwide as well. In August 2000, the conflict between the consultants and the accountants reached its end when the International Court of Arbitration in Paris separated the two factions.

The company was spared having to pay as much as $14 billion to complete the separation, but it was ordered to drop the Andersen name from its corporate name. In January 2001, the company changed its name to Accenture Ltd. and began to build brand name identification from scrape.

The scandals ultimately led to the collapse of the Andersen accounting business go off in October 2001. Enron, one of Arthur Andersen's biggest clients, disclosed that the Securities and Exchange Commission was launching an inquiry into the company; the extent of the inquiry included the actions of the company's auditor, Arthur Andersen. Enron filed for Chapter 11 bankruptcy protection in December 2001, the same month Joseph Berardino, chief executive officer of Andersen Worldwide, protected his company's financial accounting practices before the U.S. Congress.

Giving poor attention to clients who had high risk like Sunbeam, Global Crossing, Waste Management and Enron etc.
Anderson was force to pay $110 million to settle civil actions related to mishandling of Sunbeam accounts.
Technical deficiencies
Conflict of interest
Poor auditing work during the late 1990's and its downfall came through its relationship with Enron (Enron was one of the key client of Anderson and it is earning from Enron was more than $1 million a week).
The firm signing- off audit reports, despite suspicious findings.

After failure - The consultancy part of Anderson now knows as Accenture. The firm filed for bankrupting in 2001. In 2002, the firm voluntarily surrendered its license to practice as Certified Public Accountant in US.

Corporate Governance Failure of Anderson

Not concentrating on one function.
Unethical behaviour of senior audit partner's and internal lawyers.

Poor audit work.
Unable to handle high risk companies like Enron, Global Grossing.
Conflict of interest between its top officials.

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