

Learning from Enron

The unexpected bankruptcy filing of **Enron Corporation** in December 2001 was only a preamble for other major corporate failures to come. But there was a silver “lining” in this storm cloud.

In Enron’s aftermath, many boards overhauled their practices, the major stock markets proposed new listing standards re board governance, and Congress passed a fairly comprehensive package of corporate reforms—all positive developments. (Some of changes may create red tape or challenges, but overall, they seem like good news for directors and shareholders.) Furthermore, the crisis generated some valuable books.

One such book is *Enron: A Professional’s Guide to the Events, Ethical Issues, and Proposed Reforms* (Chicago: Commerce Clearing House, 2002), by **Arthur L. Berkowitz**, a CPA and ethics consultant based in Orange County, California (artbcpa@aol.com). Berkowitz, who has published and lectured widely on ethics for accounting and auditing groups (including state CPA societies and the **Institute of Internal Auditors**) summarizes what happened, and then, using original documents from Enron and its investigators, explains why it happened.

Documents reprinted here include excerpts from the *Report of the Special Investigative Committee of the Board of Enron Corp.* (called the Powers report, after **William C. Powers, Jr.**, chairman of the special committee). *Enron* also summarizes suggested reforms—including some advanced by NACD president **Roger Raber** and the NACD board.

At the end of the book is a quiz for those who wish to earn credits in “continuing professional education” according to the guidelines set forth by the **American Institute of Certified Public Accountants**. The exam is basically a comprehension test for those who read this book, so it seems like an easy way to get continuing education credits. As such, it makes the idea of director certification, although still controversial, a little more feasible. ▀

Why CFOs Make Good Directors

In the wake of Enron, corporate boards and their audit committees have become a focus of reform efforts. The major stock exchanges have proposed to take last year’s governance-tightening initiatives several steps further. Among other changes, the **New York Stock Exchange** plans to require that the audit committee chair have accounting or other related financial management expertise.

Financial Executives International, the organization I lead, defines this expertise in terms of three criteria.

▀ The first is an understanding of the generally accepted accounting principles (GAAP) to which financial statements are expected to conform.

▀ Second is experience in preparing or auditing financial statements.

▀ Third is prior experience with audit committee procedures, either as a member, a senior executive reporting to the audit committee, or an external auditor.*

These three qualifications typically converge in a corporate CFO.

Today’s CFOs have the type of financial expertise that was always needed—and is now required—of audit committee chairs and members. In addition, by virtue of both education and experience, they can contribute valuable insight on non-financial issues as well.

Within the past 15 years, CFOs and other financial executives have commonly received comprehensive leadership and management training. As the finance function has become integrated throughout the corporate enterprise, today’s CFO is involved not only in financial reporting but also in cash management, pensions and benefits, investor and public relations, information technology, operations, and human resources (including compensation decisions). Suc-

*Note: The FEI has published a “financial literacy test” based on these three criteria. To obtain a copy of the test, visit www.fei.org.

cess as a CFO depends not just on quantitative talent but also on the ability to think strategically, innovate, manage risks, and build teams—skills that are also essential to successful independent directors. CFOs know how to focus on capital allocation and economic value, enabling them to see the company from the shareholder’s point of view.

The search for CFOs can begin in a company’s own backyard, especially in cases where geographic proximity is an advantage. Experience with companies of similar size and complexity is usually more relevant than industry experience; the ability to understand sophisticated transactions and the way they should be reflected in financial statements is a skill that translates well across all industries. Search firms can be useful, but direct contact from the board chair may prove equally efficient. To facilitate director searches, FEI publishes the *CFO Registry*, which profiles 200 current and former CFOs qualified by experience to serve as independent directors on the boards of other companies.

Affiliation with a professional organization can also be a plus. FEI’s code of ethics requires those who join to “proactively promote ethical behavior as a responsible partner among peers, in the work environment and the community.” FEI members are asked to sign the code of ethics when they join the organization and recommit to it each time they renew their membership.

Recruiting CFOs from other companies as directors allows boards to simultaneously achieve two key objectives— independence and financial expertise—while potentially adding more value in other aspects of corporate governance. ▀

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