Implementing Good Corporate Governance

World Council welcomes Sherron Watkins, the former vice president for corporate development at Enron, to the 2005 World Credit Union Conference in Rome this summer. Watkins is the world famous Enron whistle-blower who predicted that hidden "improper–possibly illegal partnerships" would lead to the energy trading giant's collapse, and informed then chairman Kenneth Lay of questionable financial practices at Enron. Watkins later testified in front of the Unites States Congress and was named one of Time Magazine's Persons of the Year in 2002. Watkins recently spoke with *Credit Union World* on the importance of implementing good corporate governance principles.

In the years since Enron's shocking collapse organizations have come to appreciate the importance of good governance principles—especially their effective implementation. "Enron had it all right on paper, but didn't put good governance into practice. Putting it into practice is the key for all strong organizations," said Watkins.

What issues should these principles address? Watkins offers this overview from Fortune magazine (October 27, 2003, Ten Questions Every Board Member Should Ask). The authors of this article concluded, "Even more critical than [the board] asking the questions is the process of questioning and interacting with the company's management." Their list is not only pertinent to board members but also to company management.

1. How does the company make money?
2. Are our customers paying?
3. What could really hurt—or kill—the company in the next few years?
4. How are we doing relative to our competitors?
5. If the CEO were hit by a bus tomorrow, who could run this company?
6. How are we going to grow?
7. Are we living within our means?
8. How much does the CEO get paid?
9. How does bad news get to the top?
10. Do I understand the answers to questions 1 through 9?

"Question number nine is the most critical, in my humble opinion. Not only the process by which bad news gets to the top, but the steps management follows to deal with the bad news," said Watkins. "The organization must be intent on maintaining its value system, on living within the spirit of existing laws and regulations and not just some form-over-substance compliance. Pay a great deal of attention to question number nine."

Watkins stressed the importance of the role of ombudsman—a role that she played informally at Enron as "... the person who saw the fatal hole in the Titanic and forced the company crisis team to act."

"Typically an ombudsman-type role is established either formally or informally by the head of risk management, the general counsel's office, or the head of internal audit. This group establishes anonymous employee reporting mechanisms and follows up on any alleged problems with a fairly standard tool kit available to root out problems. Depending upon the alleged issue, routine employee surveys within the particular department or division or half a dozen or more interviews with employees at various levels typically identifies whether or not a real problem exists. Next, it is up to management to decide the necessary steps to stop the problem, sooner rather than later."

Whether you work at a Fortune 500 company, a national association or a small credit union, there has to be a method in place to identify and solve potential problems. "Companies that diligently safeguard their value system, their way of doing business and treating members, who report results to members in a transparent fashion, are able to avoid any semblance of corporate scandal, much less Enron-like mega scandal activities," stated Watkins.

Sherron Watkins

In the United States, the Sarbanes-Oxley legislation aimed to improve transparency in corporate financial reporting, enhance the accountability of company executives and strengthen the independence of boards of directors as guardians of the stockholders' interests.

Watkins commented, "Although opponents of the new law claim it is attempting the impossible, to legislate morality, the law actually adds very little in the way of new rules and regulations. Certainly it does add a few, most notably and most personal to me, the private sector whistle-blower protections. But for the most part, the act addresses lapses in business and legal ethics, attempts to better define existing laws and regulations, and constructs a best practices system in the governance arena. The new law also makes it easier to penalize offenders with prison time, which I assume is the scariest part of the Sarbanes-Oxley legislation for CEOs."

The most costly aspect of the Sarbanes-Oxley legislation has been the additional requirements for internal control systems. Watkins continued, "I'm all for improvements in controls; however, a well functioning control system will not prevent fraud. What it will do is identify ethically-challenged employees so the company can rid themselves of them."

"When an organization's leaders discover an employee who has violated the company's control policies or its value system, a zero tolerance policy must be in place; that employee must go. That's a tough one for most, often we feel it's compassionate to forgive and forget and give them a second chance. If the violator is a super star who is great with the customers or generating revenues, then you really want to forgive and forget," she continued.

The trouble is that once you do that you've sent the message throughout the organization that the value system is second to producing the numbers, second to being great with customers. Go ahead, push the edge of the envelope, if you get caught, you'll get a second chance.

Watkins stated, "There is a proven methodology to employ to make sure an organization abides by its stated set of values. It is simple but not easy: ethically-challenged employees cannot remain employed. In the long run, the focus on the value system will pay off in real dollars. Enron-like meltdowns are averted, reputation-killing embarrassments are avoided, customers remain loyal, employees stay motivated and customers or members are attracted to the company."

Organizational behavior is really not so difficult to understand; employees watch how the leaders behave and they pay attention to the reward and penalty system and act accordingly. A system of internal controls is never intended to prevent abuse; it is intended to identify and dismiss ethically-challenged employees.

She continued, "The attitude at the top is critical. The ethical aspects that are almost more important than the law's objective controls will only be as effective as the environment in which they are controlled."

Watkins noted that the fall of 2001 was clearly her bleakest time. She advised, "If you are ever in a similar situation, find others in the organization to help support your cause; don't go it alone."

To hear more from Sherron Watkins join us at the 2005 World Credit Union Conference, where she will explain what drove her to make the decision to come forward at Enron, give advice to others regarding what to do if ever put in a similar situation, and provide more information on Corporate Governance & Ethics—Lessons from Enron.

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