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Transparency in Corporate Governance: A Comparative Study of Enron, USA and Cadbury PLC, Nigeria

[1]Muraina Abdullahi, [2]Okpara Enyinna and [1]Ahunanya Stella
[1]Nigerian Army School of Finance and Administration, Apapa Lagos, Nigeria
[2]Department of Accounting, School of Postgraduate Studies, University of Lagos, Lagos, Nigeria

Abstract: This study examined the topical issue of corporate governance in the area of transparency in the preparation and presentation of financial statements to various stakeholders and the public at large. This is against frightening revelations that the financial statements of many corporate entities were mere cosmetics and far from showing a true and fair view of the real state of things. In particular, this study took a close look at the financial misrepresentation of Cadbury Nigeria and Enron United States of America. Cadbury Nigeria was discovered in 2006 to have overstated its accounts to the tune of 13 billion naira (85 million dollars). This resulted in the sacking of the Managing Director and the Finance Director of the company. The auditors of the company Akintola Williams Delliotte was also fined to the tune of 130,000$. Enron's case was that its purported growth from 10 billion dollars in the early 1990s to 101 billion dollars in 2002 was discovered to be mere cosmetics. Financial statements were tampered with to create a false or deceptive impression leading to its collapse and litigations against the key officers. The effect of lack of transparency in the corporate governance of both organizations was discussed in this study. Using a comparative analysis of their financial statements before the fraud was uncovered, the similarities and differences were highlighted with lessons for developing economies on how to ensure transparency in their corporate governance.

Key words: Transparency, corporative governance, business, minimum tax payment, stock valuation, Nigeria

INTRODUCTION

Corporate governance has become a very critical issue in the running of business organizations. Time was when the issue of corporate governance could not attract more than a casual look. However, the increasing and alarming rate of business failures has changed all that. A glance at the list of failed business giants such as Johnson Mattheys Bank (JMB), Bank of Credit and Commerce International (BCCI), Baring Brothers, Nomura Securities, Brex and Long Term Capital Management (LTCM) in the 1980s and 1990s reveals why corporate governance has taken the centre stage in every intellectual gathering on how to run a business.

The evolution of corporate governance can be traced to the introduction of public ownership of businesses as larger capital required to run the organizations resulted in diffusion of ownership across individuals who gave rise to corporate personality and corporate organizations.

The corporate personality which stands for these different individual interest in making sure that their investments yields the desired return is personified in the management of these organizations. As noted by Steger and Amann (2008), every organization has a governance system which concerns the distribution of power and responsibilities and consequently, accountability for its performance. They traced the theoretical framework for corporate governance to the Neo-classical Principal Agent theory. The principal (owners of the company) cannot trust the agent (management of the company) to act in the principal's best interest. The principal's problem is that the agent knows the situation much better than he does due to information asymmetry.

Alo (2008) stated that the rise in interest in the subject of corporate governance could be traced to the fact that there is now an increasingly clear separation of ownership from management. The disconnection between the ownership of a business and its management which shields the management from the day to day activities of the business has created the need for the installation of an appropriate and effective framework for insuring transparency and accountability in the management of businesses.

This study therefore seeks to the issue of the failure of corporate governance as demonstrated in the financial scandals Cadbury Nigeria and Enron United States. It will

Corresponding Author: Muraina Abdullahi, Nigerian Army School of Finance and Administration, Apapa Lagos, Nigeria

also touch on the challenges these scandals posed to the economies of the affected countries and some strategic options that would help tame what is increasingly becoming a global threat to corporate organizations.

Background to the study

Cadbury Nigeria: In October 2006, the Board of Directors of Cadbury, Nigeria PLC (Public Limited Company) informed the world of the discovery of overstatement in its accounts spanning a period of years. This overstatement was to the tune of between 85 and 100 million dollars. Historically, Cadbury Nigeria, was founded in 1965 as a subsidiary of Cadbury UK. It produces and markets cocoa based beverages and confectionery and food products. The company offers glucose syrup and tomato paste and provides cocoa beans processing services. It distributes its products under the brand names of Bournvita, Tom Tom, Ecclairs, Bubba and Trebor Mints. As at December 31, 2006, the company is owned 50.02% by Cadbury Schweppes plc and 49.98% by Nigerian individuals and institutional holders. In 2005, the Company was adjudged Nigeria's most respected company just as its chief executive was rated as Nigeria's most admired chief executive officer according to Adeyemi (2007).

Dike (2007) said that a leading stock broking firm, Maxi fund investments and securities a group of shareholders numbering about 300 have taken Cadbury and Akintola Williams Delloitte, its auditors to court over what they described as flagrant negligence and disregard to duty by the board and management of the company. They are also suing for access to a review carried out by Pricewaterhouse-Coopers instigated. The suit number FHC/L/CS/198/07 was filed in a Federal High court on February 28, 2007. The investors claimed they have lost over 94.0% in capital gains as the stock of the company fell from 54.15 per share as at December 12, 2006 to 27.90 following the disclosure of the issue of financial misfeasance in the company.

According to Omoregie (2006), Cadbury had to review its 2006 accounts to reflect about 2 billion naira losses as well as making adjustments of up to 15 billion naira in its balance sheet. He contended that the genesis of all financial misstatements is the attempt to cover up management inability, deliberate or otherwise to manage cost resulting in deceit. Misstatement of a company's account can be in the form of an understatement or overstatement depending on the objective of the manipulator. If the objective for instance is to evade tax expenses will be overstated to trim down the profitability for minimum tax payment. If on the other hand, the objective of the manipulator is to paint a rosy picture of the company's performance, expenses will be understated while revenue is overstated. This can come about by turnover manipulation, changing asset depreciation method, changing stock valuation method as well as capitalizing expenses that are supposed to be written off. Sometimes, it may involve the use of off balance sheet financing. The share price of Cadbury dipped, losing as much as 2.70 and in 2009 the share price of Cadbury is trading for <15 naira.

Enron United States of America: Kenneth Lay founded Enron (now Enron Creditors Recovery Corporation) in 1985 through the merger of Houston Natural Gas and Internorth, a Nebraska Pipeline Company. The merged company owned 37,000 miles of intra and interstate pipeline for transporting gas between producers and utilities according to Healy and Palepu (2003). The business collapse of Enron Corporation, following a series if disclosure of accounting improprieties has led many to question the soundness of current accounting and financial reporting standards.

Healy and Palepu (2003) noted that from the beginning towards the end of the 1990s, Enron's stock rose by 311%. It increased by 56% in 1999 and a further 87% in 2000 with a market capitalization of $60 billion. Enron was able to raise large sums of capital to fund a questionable business model, conceal its true performance through a series of accounting and financial maneuvers and hype its stock to unsustainable level.

According to Albretch (2005), Enron delivered smoothly growing earnings but not cash flows and wall street took its words but did not understand its financial statements. Enron avoided million of dollars in taxes by its use of the stock option. When corporate executives exercise these options, the company claims compensation expenses on tax returns. Accounting rules let them omit that same expense from the earnings statement. The options only needed to be disclosed as note to the accounts. Options allow them to key in lesser taxes and report higher earnings while at the same time motivating them to manipulate earnings and stock prices. Enron's principal methods of financial statement fraud involved the use of Special Purpose Entities (SPEs), namely Chewco, Bob west Treasure, Jedi among others. He noted that Enron crisis happened because of individual and collective greed as the company, its analysts, its auditors, bankers, rating agencies looked too good to be true.

A Houston Jury found Anderson guilty of obstructing justice. It provided a moment of vindication for investors who lost >$60 billion in the spectacular collapse of Enron whose books have been audited by Andersen. Andersen said it would stop auditing publicly held companies by August 31, essentially closing that business.

The Enron scandal was allowed to happen because members of the Enron board including former British Energy Secretary Lord Wakeham, a chartered accountant-failed to spot the abuses so too apparently did accountants Arthur Andersen.

Conceptual framework: According to Olumide Fusika (2009), the establishment of the first security and exchange commission in 1934 was as a measure to curb abuses inherent in mismanagement of businesses that led to the great depression of the 1930s in the United States of America. In order to regulate the corporate organizations across the world, every country has established its own agency to enforce good, transparent and accountable management practices which is the basis of corporate governance.

Private ownership of businesses does not necessarily preclude corporate governance but so long as ownership and management are vested in the same person, the basic criteria of corporate governance namely transparency and accountability cannot be enforced as there is no public interest to protect.

Olumide-Fusika (2009) defined corporate governance as the set of processes, customs and policies, laws and institutions, affecting the way a corporation is directed, administered and controlled. It includes the relationship among the many stakeholders involved and the goals for which the organization is governed. The Organization for Economic and Corporation (OECD) in Steger and Amann (2008) stated that corporate governance is the system by which business corporations are directed and controlled. Corporate governance to most people means the way a company manages its business in a manner that is accountable and responsible to someone usually the shareholders. It entails that the responsibility and accountability be seen by both the public and stakeholders of the organization which includes employees, suppliers, customers, government as well as the host communities.

Transparency according to Alo (2008) is the ease with which an outsider is able to make meaningful analysis of a company's transactions, its economic fundamental and non-financial aspects pertaining to that business. It has become increasingly significant in recent times that an organization give detailed information about its activities that can not readily be quantified in financial terms at that point in time but which nonetheless has far reaching implications on the organizations. To this Alo (2008) added that transparency is a measure of how good management is at making information available in candid, accurate and timely manner, not only in audit data but also in general reports and press releases. Transparency according to U4 in Hallak and Poisson (2007) requires clearness, honesty and openness. It is the principle that those affected by administrative decisions should be informed and the duty of civil servants, managers and trustees to act visibly, predictably and understandably. Transparency encompasses and describes the increased flow timely and reliably economic, social and political information. It enables institutions and the public to make informed political decisions as it improves the accountability of public officials to the citizens thereby reduces the rate of corrupt practices. It has been observed that corrupt practices have been on the increase in public quoted companies across the world as shown in Table 1.

Table 1: Corporate governance scandals

Companies	Countries	Years	Nature of scandals
Daewoo	South Korea	1998	Fraud/Embezzlement
Flowtex	Germany	1999	Insolvency
Enron	United States	2001	Fraud to bankruptcy
Marions	United Kingdom	2001	Bankruptcy
Swissair	Switzerland	2001	Insolvency
H/H	Australia	2001	Stock market manipulation
Allied Irish Bank	Ireland	2002	$691 million lost to unauthorized trading
World Com	United States	2002	Fraud
Vivendi	France	2002	Budget overstretch
Parmalat	Italy	2003	Undisclosed debt
Volkswagen	Germany	2003	Abuse of corporate funds

Adapted from Steger and Amann (2008)

Earlier, Albretch (2005) noted that the number and size of financial statement frauds are increasing and many investors have lost confidence in the credibility of corporate results. As a matter of fact, the recent spate of scandals globally has called to question the role of the accounting profession as well as regulatory bodies in the issue of attesting to financial statements. The most unfortunate aspect of the whole financial melodrama is that sometimes these scandals go on for years without being detected and the accounting firms keep certifying these falsified reports as showing a true and fair view of the state of affairs.

Problem: The abuse of trust inherent in the cases of Cadbury and Enron portrays the extent to which the principal-agent relationship has deteriorated as the cases of corporate governance scandal have increased world wide in the first decade of the 21st century. The effects of the two cases on the capital market and their economies as well as the steps taken to forest all future occurrences are highlighted.

MATERIALS AND METHODS

A comparative method in which the accounts of the two organizations before and after the scandal were scrutinized and the extent of the after effect of the

Table 2: Enron's revenue and income

Years	Revenue ($ billion)	Income ($ million)	Income restated ($ million)
1997	20.2	105	9
1998	31.2	1703	590
1999	40.1	893	643
2000	100.0	979	827

Adapted from Albretch (2005)

Table 3: Dupont analysis of Enron performance from 1991-2000

Statistical analysis	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
ROE	11.20%	11.16%	12.03%	15.22%	15.93%	15.26%	1.57%	9.73%	8.64%	7.81%
Asset T/O	0.53%	0.59%	0.69%	0.69%	0.69%	0.82%	0.87%	1.07%	1.20%	1.54%
P-M ratio	3.90%	4.49%	3.96%	3.96%	5.49%	4.27%	0.43%	2.19%	2.06%	0.89%
Leverage ratio	5.40	4.19	4.39	4.15	4.18	4.33	4.17	4.16	3.49	5.71

Research Insight supplemented with data from 10 K annual filings in Catanach and Rhoades Catanach

Table 4: Cardbury Nigeria plc extract of annual report 2007

Eoconomy parameters	2007 f' 000	2006 f' 000	2005 f' 000	2004 f' 000	2003 f'000
Turnover	19,937,000	19,215,152	29,454,185	22,152,651	20,576,177
(Loss)/profit on ordinary activity before/tax	(4,197,948)	(5,762,809)	3,853,094	3,849,273	3,792,506
Tax on ordinary activities	3,470,970	1,097,350	(1,142,173)	(1,036,650)	(1,107,579)
(Loss)/profit on ordinary activities after tax	(726,978)	(4,665,459)	2,710,921	2,812,623	2,684,927
Minority interest	5,674	292	(6,434)	(3,934)	(3,493)
Dividend	-	-	(1,303,154)	(1,601,345)	(1,313,603)
Retained (loss)/profit for the year	(721,304)	(4,665,167)	1,401,333	1,207,344	1,367,831
Assets employed					
Non current assets	17,741,068	14,949,699	7,964,695	6,230,817	3,759,882
Current assets	8,170,776	14,714,529	24,100,447	14,641,195	10,970,650
	25,911,844	29,664,228	32,065,142	20,872,012	14,730,532
Funds employed					
Share capital	550,420	550,420	500,420	500,420	375,315
Share premium	7,230,891	7,230,891	2,523,383	2,534,669	2,534,669
Reserve for bonus issue	-	-	-	-	125,105
Revaluation reserve	4,522,234	5,947,229	11,286	-	-
General reserve	(12,268,723)	(11,547,419)	7,813,680	6,411,470	5,198,766
Minority interest	-	5,674	19,402	13,168	9,234
Shareholders' fund	34,822	2,186,795	10,868,170	9,459,727	8,243,089
Current liabilities	21,073,233	24,096,391	14,264,910	10,325,526	5,892,165
Non-current liabilities	4,803,789	3,381,042	6,932,062	1,086,759	595,278
	25,911,844	29,664,228	32,065,142	20,872,012	14,730,532
Per-share data					
Basic earning per share (kobo)	(66)	(428)	270	281	357
Adjusted earnings per share (kobo)	(66)	(424)	246	255	244

Cadbury Nigeria Plc 2007 Annual Financial Reports and Accounts

scandals on the stock exchange from the media were considered. Furthermore, the actions taken by the various regulatory agencies of the respective host countries of the two companies to rectify and build public confidence in both economies were compared.

There is notably difference between the first in come and the restated income $96 million, 1113, 250 and 152 in 1997, 1998, 1999 and 2000, respectively (Table 2). There is a remarkable difference from the ROE of the years before the crisis 1991-1996 and after 1997-2000 and also in the Asset T/O (Table 3).

Balance sheet related numbers for 2006, reflects the effects of the adjustment made in respect of the accounting misstatement. This can be attested to by the significant drop in the figures of 2006 reporting year when compared with that of 2005. Take the case of turnover that was over 29 billion naira in 2005 and fell to an abysmal low of slightly >19 billion naira. In the same vein basic and adjusted earnings fell from 270 and 246 kobo to a negative figure of 428 and 424 kobo, respectively (Table 4).

The type of fraud committed by Enron was misleading financial statement while that of Cadbury was overstatement. The loss of Enron was over 60 billion of investors fund while Cadbury lost about 13 million. The share of Enron fell from 90-50% while Cadbury's share fell from 0.34 to according to news report by Egene and Olusola-Obasa (2006), the market capitalization suffered a dip of N20.9 billion as investors continue to dump the shares in response to the overstatement in the company's account over some years. The equity has dipped by 18.99 or 37% from N51.45 per share to close at 32.46 per share by Thursday of the week of the report of the scandal. An analysis by Meristem Securities Limited showed that in

Table 5: Comparison between enron financial scandal and cadbury's financial manipulations

Comparative study	Type of fraud	Losses	Effect on share price	Effect on capitalization	Action taken by regulatory bodies	Repercussions	Duration	Legal action taken
Enron	Misleading financial statements	Over $60 billion of investors funds	From $90.00 to <50 cents	Bankruptcy	Fined $100 million	Dip in share price	1997-2001	Conviction of key players by the state
Cadbury	Overstatement by f 13 billion ($74 million)	f 2 billion ($13 million)	From 51.45 ($0.34) to f 37.84 ($0.25)	From f 56.69 billion ($378 million)	Fined f 20 million naira ($117,640)	Dip in share price and loss of investors' trust	2002-2006	Suspension of key board members pending full investigation

Exchange rate at the time of writing was f170 to $1

correcting the financials, Cadbury's net asset per share dropped from 10.86 as at December 2005 to about 0.99 as at September 2006, resulting in about 91% drop. Earnings per share have entered the negative zone from a positive figure of 2.70 as at year end December 2005 (Table 5).

RESULTS AND DISCUSSION

As noted by Healy and Palepu (2003), a well functioning capital market creates appropriate linkages of information incentives and governance between managers and investors. This process is supposed to be carried out through a network of intermediaries that include profession investors such as banks, mutual funds, insurance and venture capital firms, information analysts such as financial analysts, rating agencies, assurance professionals such as external auditors and internal governance agents such as corporate boards.

These parties who are themselves subject to incentives and governance are regulated by a variety of institutions that includes SEC, bank regulators and private sector bodies such as Financial Accounting Boards, the American Institute of Certified Public Accountants and stock exchanges.

Albretch (2005) said that financial statement frauds causes a decrease in market value of stocks approximately 500-1000 times the amount of fraud. According to Muraina (2005), the low level of transparency in the public and private institutions in Nigeria has contributed to the erosion of national values. Its absence encourages the misallocation, misapplication, misappropriation and wastage of financial resources, resulting in low growth rate and increased poverty.

RECOMMENDATIONS

One of the greatest impetuses for financial scandals in business establishments is the absence of effective punishment that will serve as deterrence to potential corporate financial fraudsters. When immorality is not punished, there is no incentive for morality. Time seems to be ripe to ensure that Board of Directors are compelled to observe the laid down guidelines to ensure the protection of the interest of investors. More importantly, there appears to be some serious lapses on the part of the regulatory bodies both in the developed and in the developing countries. It is so shameful that Enron and Cadbury have been filing their returns to the stock exchanges and yet these financial manipulations went on for years. There is the need to strengthen the regulatory agencies and clearly define their tasks. In the case of Nigeria, there appears of be a conflict of functions between the Nigeria Stock Exchange and the Securities and Exchange Commission (SEC). This should be streamlined. The agencies ought not to be working at cross purposes but should complement each other's responsibilities. It is now apparent that the world has become a global village and consequently the exchange of information between regulatory authorities of friendly nations has become imperative.

It is now clear that the problem of financial improprieties in business organizations is not limited to the developing world. The issue of manipulation of financial statement has become a global embarrassment. This has led many people to begin to ask the continued relevance of the input of accounting firms in attesting to the true and fair view of financial statement. The accountancy profession world wide, need to come together and review accounting standard practices and also to ensure compliance with Generally Accepted Accounting Practices (GAAP).

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