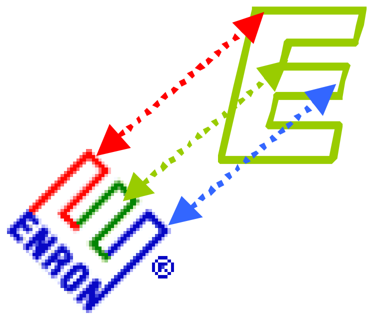
LESSONS FROM ENRON — EXAMINING THE PARALLELS TO ENVIRONMENTAL GOVERNANCE

By Richard MacLean



Enron is all about systemic governance failure. The public initially reacted in disbelief, "How could something so far reaching have happened with so little warning?" The early warning signs were there, but they were lost among the flood of upbeat, self-serving company boosters. Are there parallels to the current state of environmental governance? I think so. Maybe it is time for a critical self-examination – "See the world as it is, not as you would wish it to be," as Jack Welch would relentlessly espouse to his managers, (this writer included). So what might these lessons be?

Sandra Waddock, in Ethical Corporate Magazine, analyzed Enron's track record for green accolades: six green awards in 2000 alone; highly acclaimed written social responsibility policies; and issuance of a triple bottom line report covering social and environmental performance.

LESSON ONE: DON'T START BELIEVING YOUR OWN PR.

Gregg Pascal Zachary, a journalist with the Wall Street Journal, professed the need for "hope journalism" – the need for the American press to find positive stories when reporting on sustainability. When it comes to business management, the messages must be taking hold. Environmental issues have reached a new plateau of calm in the eyes of managers who lived through the 1970's and 1980's, when regulatory issues and "crisis du jour" were the orders of the day.

Most major corporations support at least one major leadership or excellence program. These get heavy play in the boardroom and in the public relations press kit. I have lost track of the number of self-congratulatory awards given out by various organizations. Industry demonstration projects are heavily showcased by publishers such as Karen Laughlin of Green@Work, who explicitly professes an editorial bent to accentuate the positive.

Sandra Waddock, in Ethical Corporate Magazine, analyzed Enron's track record for green accolades: six green awards in 2000 alone; highly acclaimed written social responsibility policies; and issuance of a triple bottom line report covering social and environmental performance. The company may have been fully deserving of these accolades; the point is that executive management can sometimes myopically focus on the positive and assume that all is well with the environment.

Based on my own experiences working on the inside of corporations I have found that the outward image projected, more often than not, does not reflect the spectrum of issues that environmental staff members struggle to resolve. I am not suggesting that companies should start airing their soiled green laundry, but officers and directors must have a balanced understanding of both the successes and the weaknesses. If your organization is living in a self-delusional world of positive spin, as Enron clearly was, it is headed for eventual trouble.

LESSON TWO: DO NOT ASSUME THAT ENVIRONMENTAL MANAGEMENT SYSTEMS, SUCH AS ISO 14001, GUARANTEE GOOD GOVERNANCE.

AHC Group work product demonstrates again and again that solid governance requires more, not less, high level reviews.

Beginning in the mid 1990s, ISO 14001 became very much in vogue as the tool to demonstrate environmental responsibility in the global marketplace. Consultants jumped on ISO as the next opportunity in a mature market that was no longer driven by regulatory dynamics. Business managers began to view the environment as an issues-based systematized process, controlled by a small, less experienced staff. But then, reality started to surface.

The 2000 University of Sussex study of 280 companies turned up no link between management systems and performance. Professor Marc Epstein of Rice University summarized the situation, "Although the framework of useful and enhancing environmental management systems is beneficial, the adoption of ISO 14001 alone will not provide maximum company benefits."

Dioxin compliance problems at Ebara Corporation, a Japanese facility certified in 1997 triggered questions about ISO's effectiveness. This was followed by the largest Brazilian pollution incident in 25 years at the certified Petroleo Brasileiro S.A. facility. Again in 2000, two Taiwanese ISO-certified facilities were involved in a hazardous waste dumping scandal. The EPA raised concerns over the third party auditing of ISO 14001; this prompted the 2001 Registration Practices Report, published by the National Academy of Public Administration. The 2000 University of Sussex study of 280 companies turned up no link between management systems and performance. The debate on the benefits of ISO continues even now. Professor Marc Epstein of Rice University summarized the situation, "Although the framework of useful and enhancing environmental management systems is beneficial, the adoption of ISO 14001 alone will not provide maximum company benefits." The questioning has now moved beyond ISO to other well known environmental systems.

Responsible Care® has come under attack as a program that is implemented well in some companies, but is practically a farce in others. The International Chamber of Commerce Business Charter for Sustainable Development was examined by Flavio Cotrim; "ICC Project 2001" found that twenty nine percent of the 2,300 signatories – a figure repeatedly touted by the ICC - came from Malaysia, thus raising "questions about the credibility of voluntary initiatives that are not enforced or monitored by their sponsoring organizations."

Systems alone will not save the day. Enron had lots of systems and Arthur Andersen consultants became specialists at identifying loopholes in accounting systems, as a way to hide problems.

Systems alone will not save the day. Enron had lots of systems and Arthur Andersen consultants became specialists at identifying loopholes in accounting systems, as a way to hide problems. The accounting profession is based on a foundation of voluntary standards (generally accepted accounting principles or "GAAP") and it is an order of magnitude more codified and mature than those representing environmental standards.

Systems are a good starting point, but they are neither the endpoint nor the substitute for strategic environmental thinking and rigorous governance.

LESSON THREE: EXPECT A GRADUAL RATCHETING UP OF GOVERNANCE REQUIREMENTS.

This past February, the EPA announced that seventy-four percent of US publicly traded corporations surveyed have openly violated US SEC environmental accounting regulations. For those of us who have spent decades inside companies, this comes as no surprise. "Booking reserves" for environmental liability are about as welcome as activist boycotts.

Companies can use the SEC requirements to justify not booking reserves, since environmental liabilities can easily be rationalized as not precisely falling within the materiality guidelines of Regulation S-K. The loopholes, critics claim, are big enough to house a hazardous waste truck. Not surprisingly, the financial services industry largely ignores the environmental disclosure statements in financial statements.

But, for how long? At the American Bar Association's 2001 meeting, the SEC announced it would begin screening 10-Ks for violations in environmental disclosure requirements. The Corporate Sunshine Working Group, a longstanding proponent of environmental disclosure, is gaining stature since the Enron debacle. More significantly, the insurance underwriting industry is taking note. The asbestos issue – more significant in its financial impact than even Enron's fall – has made this industry re-think the impact of environmental liability.

At the American Bar Association's 2001 meeting, the SEC announced it would begin screening 10-Ks for violations in environmental disclosure requirements. The Corporate Sunshine Working Group, a longstanding proponent of environmental disclosure, is gaining stature since the Enron debacle.

The concern for "truth in disclosure" extends beyond liabilities. The Bush administration is pushing for market mechanisms, such as emission trading, to replace traditional regulations. Dennis King, a natural resources economist, warns (in an Environmental Forum interview) that, "Enron created markets and conducted trades in commodities that had never existed before, so no one knew what to expect in terms of norms — a perfect parallel to trading in natural resources."

See **Corporate Strategy Today,** *Issues 1-3 available at www.ahcgroup.com for coverage of disclosure trends.*

If these market mechanisms go forward, one must expect a whole new level of scrutiny in the wake of Enron. Maybe it is time to cross check those Toxic Release Inventory numbers against your Title V air permits…before someone else does.

LESSON FOUR: PREPARE FOR THE DAY WHEN ENVIRONMENTAL REPORTING BECOMES A HARDBALL, COMPETITIVE ISSUE.

CorporateRegister.com reports exponential growth in the number of reports issued over the past decade. They appear to pass muster on the public relations test, but are these new reports any better at disclosing the real issues? Peter Knight, Sustainable Development Communications Specialist, does not think so, as reported in Tomorrow. "Pass me the sick-bag! I've just read yet another report on corporate social responsibility."

Even with the Global Reporting Initiative guidelines, these reports present a bewildering array of information that make it nearly impossible to compare companies, even in the same sector.

Peter's gut level reaction is not the same as my own, but we share a common theme: these reports, in their current form, have gone just about as far as they can – and it is not far enough. Even with the Global Reporting Initiative guidelines, these reports present a bewildering array of information that make it nearly impossible to compare companies, even in the same sector. If you have ever had to prepare these reports, you will recognize just how tenuous the data is.

Approximately forty percent have attestation statements. They are all but meaningless in the absence of rigorous standards and more often than not, are prepared by the same firms providing consulting services to the company. If Enron's financial statements were shaky within a mature, well-defined governance structure – just let your imagination run wild over the quality of the current generation of environmental reports.

That may be the way things are today, but what about the future? Shell announced that they would be combining their sustainability report in the same binding as their annual financial report. Mark Goyder, the director of the London-based Centre for Tomorrow's Corporation states, "We want the finance director, not the environmental director, wondering if he has the right social performance metrics."

How is that possible? Industry giants, such as Rio Tinto, are beginning to dominate the mining industry sector by defining the measures of social responsibility. Through initiatives such as the Mining, Minerals and Sustainable Development project, they are setting the thresholds that will become the international benchmarks for this industry. The dominant players will set de facto thresholds and other, weaker companies may not pass muster with stakeholders. From my perspective, the warm and fuzzy term "sustainable development" will be defined in a new set of social responsibility metrics appearing in the financial reports of the winning companies.

Lesson Five: The Secretary Probably Knows What's Really Going on. Talk to the People Doing the Work, not the Ones Spinning the Story.

As reported in the Wall Street Journal, the FBI went after the person who pushed the button on the shredder to find out what really happened. All too often, officers and directors talk to the senior-level managers to find out what is going on. They get answers that are displayed in slick PowerPoint presentations. Jack Welch used to jump six levels and talk to Billy Mack in the extrusion department at the Noryl® plant.

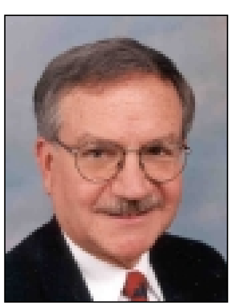
For a governance system to really work, the systems must be in place to promote unfiltered information flow.

For a governance system to really work, the systems must be in place to promote unfiltered information flow. In due diligence reviews with corporations, I am sometimes amazed at the joyous desperation shown by employees who finally get to speak with someone over the issues that have been bothering them. Managers need to "get real" and get out of the office. Superficial "team-building," as engaged by Enron executives, does not reveal the underlying issues. Even when they were in face-to-face discussions, Enron executives ignored the messages that did not fit in with their upbeat message to the directors and financial analysts (review Lesson One).

The Bottom Line

The pressure on environmental managers to deliver positive results is real. These managers can find themselves in the unenviable position of feeling that something is not quite right and feeling pressured to look the other way. It can take the form of a wink-(e.g., "We really do not need to investigate this allegation of contamination too extensively – Right?") or a nudge, ("This is so fuzzy; we really cannot quantify or time its impact – Right?").

There was a lot of winking and nudging going on inside Enron, particularly in governance areas that have direct parallels to emerging environmental issues. The warning signs exist, just as they did years before the fall of Enron. The successful managers will take the initiative to position their companies favorably in critical areas – areas that may receive a good deal more public scrutiny in the future.



Richard MacLean is President of Competitive Environment Inc. and the Director of the Center for Environmental Innovation, Inc. He has supported the AHC Group in its corporate benchmarking and governance assignments on occasion. Email: maclean@competitive-e.com, Website: http://www.Competitive-E.com.