STATEMENT OF DR. ROBERT K. JAEDICKE

Before the Permanent Subcommittee on Investigations
The Committee on Government Affairs
U.S. Senate
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Chairman Levin, Senator Collins, and Members of the Subcommittee. Good morning, and thank you for the opportunity to address the Subcommittee.

My name is Robert Jaedicke. I served as the Chairman of the Audit Committee of the Board of Directors of Enron Corporation. As part of an overall restructuring of the Board, I recently resigned as a director, having served since the mid-1980s.

Let me briefly tell you about my background. I joined the faculty of the Stanford Graduate School of Business in 1961. I served as Dean of the Business School from 1983 until 1990. At that time, I returned to the faculty of the Business School, and retired in 1992.

I. THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS

Throughout my tenure as Chairman of the Enron Board's Audit Committee, I was committed to ensuring that it was an effective and actively functioning body. Over the last few years, we undertook to review and strengthen our already vigorous control systems. In 1999, we began a number of initiatives to ensure that we remained a "best practices" Audit Committee. Throughout 2000 and into 2001, our Committee worked with Arthur Andersen to make certain we complied with the recommendations of the Securities and Exchange Commission, the New York Stock Exchange, and the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees. That effort culminated in February 2001, when the Audit Committee drafted a new charter that was approved by the full Board. Throughout that lengthy process, involving both Enron management and Arthur Andersen, we implemented a series of further refinements to our corporate policies and controls.

The lifeblood of the work of any Audit Committee is the development and implementation of adequate controls, many of which cross check each other. The Committee's responsibility is to receive reports from management and the outside auditors, to review the adequacy of internal controls, and to oversee the filing of financial statements. The Committee's effective oversight also depends on the full and complete reporting of information to it. Without full and accurate information, an Audit Committee cannot be effective. The Committee does not manage the Company and does not do the auditing. It is my understanding that the audit committees of most corporations like Enron typically meet for a few hours several times a year. As Warren Buffet wrote to New York Stock Exchange Chairman and CEO Richard Grasso in 1999, "An audit committee that meets for a few hours several times a year is simply not going to pick up anything that is missed by the outside auditors. . . . Therefore, the task of the audit committee should be to hold the feet of the outside auditors to the fire." In that same letter, Mr. Buffett also stated, "Simply put, audit committees cannot act as auditors. Their true job—and I would argue the only important function that they can adequately discharge—is to make sure that the auditors do their job instead of becoming subservient to management."

I agree. As Chairman of the Audit Committee, I believe that our duty was to ensure that the outside auditors were in a position to perform their independent auditing function with full cooperation from management and with no management-imposed constraints on the audit scope. We regularly reviewed Arthur Andersen's independence, whether they had disagreements with management, and whether they had the appropriate control over access issues and accounting treatment.

We held regular meetings at least four—and usually five—times a year at which we received reports from a broad range of senior management and Arthur Andersen personnel. Audit Committee meetings regularly included three Arthur Andersen partners, the chief accounting officer, the chief risk officer, the general counsel, the chief internal auditors, Mr. Lay, Mr. Skilling, and other senior Enron officers and outside advisors as appropriate. We were entitled to rely on the representations made to us by management, our outside auditors and advisers about the appropriateness of the accounting for the partnerships, and the adequacy of our disclosures. We asked questions, provided oversight, received several special reports on accounting policies, and continually discussed the adequacy of our internal controls. I respectfully submit that we did our job.

Three Arthur Andersen partners regularly attended each Audit Committee meeting and reported on issues of interest or concern. It was my invariable practice to hold—or at least offer to hold--an executive session with the Arthur Andersen representatives where they could meet with us without management present. There, Arthur Andersen could freely report to the Committee any matters of concern that made the auditors uncomfortable, including; whether they had had any significant disagreement with management; whether they had full cooperation of management; whether reasonably effective accounting systems and controls were in place; whether there were any material systems and controls that need strengthening; and whether they had detected instances where company policies had not been fully addressed.

Arthur Andersen did not raise concerns about the partnerships in these executive sessions. In fact, they normally reported to us that the structures and transactions were complex and required judgment, but that they were in at an early stage to understand and review the transactions and that they were comfortable with the accounting treatment.

Over the last several months, however, through the media and other public disclosures, I have learned that within the management of Enron and within Arthur Andersen, there was substantial turmoil about the related party partnerships. For example, until recently, I was unaware that:

- In February 2001, Arthur Andersen officials met among themselves and raised concerns about the accounting for the partnerships and whether the related party transactions were fair to Enron;

- In the summer of 2001, an Enron in-house attorney was sufficiently concerned about the partnerships that he consulted with a separate law firm;

- In early October 2001, Arthur Andersen retained outside counsel in anticipation of possible litigation arising from Enron's financial statements;

Contrast what Arthur Andersen knew and was doing during that time with what it was telling the Audit Committee. In a February 12, 2001 Audit Committee meeting, Arthur Andersen reported:

- Arthur Andersen's financial statement opinion for the 2000 financial statements would be unqualified. The 2000 statements would cover the first full year of existence of the LJM partnerships.

- Arthur Andersen's opinion on the company's internal controls (which should have included an assessment of the internal controls in place for related party transactions) would be unqualified and they noted no material weaknesses.

- The use of structured transactions and mark to market accounting required significant judgment, but Arthur Andersen did not suggest that anything about the judgments being made was inappropriate.

- Arthur Andersen was present when we reviewed the related party transactions, and did not indicate any impropriety or major concerns with the accounting or the fairness of the transactions.

II. THE RELATED PARTY TRANSACTIONS

I want to highlight two critical pieces of information about these related party transactions that management did not reveal to the Board. First, as the Powers Report indicates, it was never disclosed to the Board that Enron employees other than Andrew Fastow had acquired interests in, or become parties to, related party transactions with Enron.

It is also apparent that management's lack of candor was not limited simply to the non-disclosure of related party interests. We now know that certain Enron employees believed that particular transactions with the LJM entities were unfair to Enron, were an improper effort to manipulate the company's financials, or were not properly being disclosed in Enron's proxy statements and financial disclosures. These are serious issues that the employees, management, or both should have brought to the Board's attention. The one time the Board was informed that a concern had been voiced about the related party transactions, we were informed that the matter had been investigated and resolved by outside counsel.

LJM1 and LJM2 were presented to the Board as having significant benefits to Enron. The Office of the Chairman determined that the LJM structure – with Mr. Fastow as the general partner of the LJMs– would not adversely affect the interests of the company. Senior management discussed with the Board the very real and substantial benefits to Enron of such a structure. The Board thought, based upon these presentations, that the LJM partnerships offered real

business benefits to Enron. Many special controls were put in place to manage the related party aspect of the partnerships. Significant and legitimate economic benefits were presented to justify why Mr. Fastow should be permitted to assume the role that we ultimately permitted him to assume.

Enron's Code of Conduct allows a senior officer to participate in a transaction in which he has a potential conflict of interest with Enron if the Office of the Chairman determines that this participation will not adversely affect the interests of the Company. Mr. Fastow was allowed to participate in LJM because the Office of the Chairman made such a determination, and the Board ratified it. This action had no affect whatsoever on Mr. Fastow's obligation to comply with all other requirements of Enron's Code of Business Conduct and its Code of Ethics as a senior officer and fiduciary of Enron.

The Audit Committee executed its responsibility of overseeing management's proper implementation of the controls and was repeatedly assured that they were being followed. The Board was told, and had every reason to believe, that the several parties with the obligation to monitor the transactions were ensuring that the procedures that the Board and the Company had put in place were followed and that transactions with LJM were fair to Enron and were accounted for properly.

The Audit Committee reviewed the LJM transactions with Enron's Chief Accounting Officer each year, in the presence of Arthur Andersen partners, Mr. Lay, Mr. Skilling, the Chief Risk Officer, and in-house counsel, and was assured that all of the transactions were done at arms length and were fair to Enron. The Board and the Audit Committee had no reason not to trust the assurances they received. Despite the existence of these controls, it is now apparent that numerous critical and troubling facts about LJM1 and LJM2 were not brought to the attention of the Board or the Audit Committee. There was ample opportunity to express concerns because the related party partnerships were discussed at meetings of the Finance and Audit Committees.

We had the following understandings about Arthur Andersen's assurances concerning these transaction:

- In the October 1999 Audit Committee meeting before the Board meeting where LJM2 was approved, Arthur Andersen assured the Audit Committee that it "had spent considerable time during the third quarter reviewing a joint venture [Enron] was forming to assist in monetizing investments."

- In presenting LJM2 to the Finance Committee in October 1999, senior management also discussed the fact that Arthur Andersen had reviewed LJM2 and were fine with it.

- In May 2000, Arthur Andersen reported to the Audit Committee that Enron's related party transactions were a "high priority" area, that Arthur Andersen "would be spending additional time" specifically on Enron's "structured transactions related to securitization and syndication and hedging vehicles." Notes that apparently were taken at the meeting reflect that Andersen reported that it "gets involved in the structure on the front end to discuss applicable accounting issues," and that Arthur Andersen typically consults with its Chicago and New York offices.

- In February 2001, Arthur Andersen reported to the Audit Committee that its "financial statement opinion was expected to be unqualified, and that there were no significant audit adjustments, . . . disagreements with management, [or] significant difficulties encountered during the audit." Arthur Andersen also discussed its "opinion on the [Enron's] internal controls and stated that the opinion would be unqualified, the audit was complete, and no material weaknesses had been identified."

Arthur Andersen often mentioned that Enron was utilizing highly complex structured transactions that required significant judgment in the application of the accounting rules. As the Audit Committee minutes reflect, Enron paid Arthur Andersen specifically to address the accounting issues related to these transactions. Arthur Andersen assured us that they were working with their experts in Chicago to make sure that Enron properly accounted for those transactions.

III. CONCLUSION

Last February, Alan Greenspan testified before Congress, "I've served on too many audit committees to know that, even though I would consider myself independent, I would consider myself knowledgeable, I did not know what questions to ask the chief financial officer during meetings to find out what is it that conceivably is going wrong in the corporation, and he wasn't about to tell me. So that there was a very difficult problem that one confronts." I agree with

Mr. Greenspan. We did everything possible to ensure that our controls and procedures were being followed. To my knowledge, we were one of the few major corporations that required Arthur Andersen to give us an attest opinion on management's assertion that our internal controls were adequate.

What happened at Enron has been described as a systemic failure. As it pertains to the Board, I see it instead as a cautionary reminder of the limits of a director's role. We served as directors of what was then the seventh largest corporation in America, which required us to confine our attention to the broad policy decisions. At the meetings of the Board and its committees, in which all of us participated, these issues were considered and decided on the basis of summaries, reports and corporate records, upon which we were entitled to rely. We also reasonably relied upon the honesty and integrity of management, their subordinates and advisers, and on the integrity of the information we were receiving. At the time, we had no reason to doubt the integrity of either the management or our advisors.

We did all of this, and more. Sadly, despite all that we tried to do, in the face of all the assurances we received, we had no cause for suspicion until it was too late.

I am prepared to respond to questions from the Subcommittee.

Thank you.