REVIEW & OUTLOOK

Volcker's Andersen Triumph

So it appears that Paul Volcker won't be able to save Arthur Andersen from either itself or the Justice Department. The former Fed chairman certainly has succeeded, however, in educating the rest of us about what ails the accounting profession.

We started out as reform skeptics, and in an ideal world we'd still prefer that corporate audits be a competitive product without a federal mandate. But after watching many Andersen partners sabotage Mr. Volcker's rescue effort, and seeing Andersen's Big Four competitors circle their wagons to block reform, we wonder if these fellows can be trusted with the grocery money, much less with restoring public confidence in shareholder capitalism.

Paul Volcker

The accountants have become their own worst advocates. Their lobby's chief theorist, Barry Melancon of the American Institute of Certified Public Accountants, came by to see us and was going on about all of the schemes that auditors expose but the public never learns about. So, someone quipped, you're just like the CIA; to which Mr. Melancon replied, all too seriously, "Yes, that's right." Trouble is, while the CIA runs on secrets, capitalism is supposed to run on information and public accountability.

Then, just days after defending auditors who also do consulting for the same corporations, Mr. Melancon had to acknowledge a conflict of interest of his own because he had profited from the commercial ventures of what was supposed to be his nonprofit institute. It's as if the boxing reform commission had sent us Don King.

The self-immolation of Andersen has been even more revealing. The government played a role with its shoot-first-ask-later indictment of the entire Andersen firm for shredding documents. But even Justice was willing to defer prosecution if Andersen's partners had been willing to admit some culpability. They refused, making it seem as if the firm's partners, or at least many of them, are more afraid of Mr. Volcker than they are of federal prosecution.

We hear that one clause in the draft Justice settlement would have required Andersen to implement Mr. Volcker's proposed reforms. Most notably, this would have meant making Andersen an "audit-only" firm, without lucrative consulting services, the way accounting partnerships once operated. The partners reacted as if they'd rather have Andersen collapse, as it now probably will, leaving them free to jump to one of the remaining Big Four. They seem to believe that if they jump ship they'll also be shielded from liability suits from Enron shareholders, which may be wishful thinking since that has never been tested in court.

As for the remaining Big Four, most of their partners want nothing to do with Mr. Volcker either. They realize that if Andersen fails they'll have less competition, not to mention the ability to cherry pick Andersen partners and clients. They also know there's little chance that Mr. Volcker's proposals will be picked up inside the Beltway.

SEC Chairman Harvey Pitt used to work for the accounting industry, and he's a big fan of auditing and consulting for the same client. He seems content to put former Xerox chief Paul Allaire in the public stocks as a lesson to other CEOs—while letting accountants continue business as usual. The industry also seems justified in its confidence that the White House won't lobby for reform; its campaign contributions in 2000 went heavily to George W. Bush.

Normally we find "conflict of interest" stories duller than public television. But as long as the government mandates public audits, they ought to be credible. In recent years they haven't been, what with more earnings restatements in the past three years than in the previous 10. Yes, in the wake of Enron the market is now enforcing a new earnings discipline on corporate America.

But we see no such self-reflection in the culture of the accounting industry, which has blamed Enron and other debacles on everything but its own standards. The federal audit mandate gives accounting firms some guaranteed business but in return for holding a public trust. The credibility of their audits matter more than their ability to offer other services that let them live like investment bankers.

The accountants may think they've outsmarted everyone by sinking reform along with Andersen. And they may be right. On the other hand, if there's another Enron out there, they may yet wish they'd taken Mr. Volcker's advice.