# WHY CONGRESS IS WRONG ABOUT ENRON

BY JOHN O. WHITNEY

The problem uncovered by the accounting scandals at Enron is not—as congressional questioning suggests—the sullying of auditor independence by consulting fees. The audit firm loses its independence the moment the client writes it a check. Instead, the problems are a lack of transparency and a need for timeliness, compounded by overreliance on audited financial statements.

First, the overreliance problem: financial statements are nothing more than a fuzzy approximation of a distant past. They do not give answers. They merely suggest what questions to ask. Enron's financial statements clearly posed questions that analysts failed to ask. Were they lazy, tired, greedy, coerced? Time will tell.

We obviously need greater transparency in financial reporting. All related party transactions (RPTs) and special purpose entities (SPEs) should be disclosed in the beginning of the 10K or any financial report. So should anything related to the company's debt load or capacity and nonoperating income. The same goes for the audit firm's activities and the fees it receives.

Derivatives, currency translations, joint ventures and other RPTs and SPEs can mitigate risk and enhance profitability. But they complicate reporting and have promulgated 144 FASB statements. I wrote once that man can defeat any system that man can devise: "The more controls you have, the less control you have." Years ago there were 31 basic guidelines issued by the Accounting Principles Board. Perhaps today there are as many people trying to subvert the FASB pronouncements as there are people writing them.

The knee-jerk reaction of Congress and some regulators that the audit firm should be prevented from performing certain consulting assignments is wrong. I serve on the audit committee of a $6-billion company that employs the audit firm to certify our statements, lead the internal audit and help with tax work and other non-audit-related activities. The fact that they understand our systems' strengths and weaknesses helps them perform superbly (by the way, the initials of the firm are A.A.). I also serve on the board of a firm that long ago decided the audit firm should not perform extensive consulting services. The company is in the best position to decide—not Congress, the SEC or the media. Transparency, not micromanagement, will improve financial reporting.

Finally, timeliness in financial reporting would help. The Internet and the ubiquity of financial news provide the opportunity for more timely disclosure. Information about key financial indicators could be shared with creditors and shareholders more than once per quarter. Transactions by executives or directors should be reported immediately. Of course, companies should not be compelled to divulge information that aids competitors. And we need to insulate companies from lawsuits that might arise from so-called forward-looking statements.

The observations and suggestions above might patch a flawed system. We must also make certain that wrongdoers face severe penalties. Those who mislead through fraudulent financial reporting are stealing money from lenders and shareholders. They should be punished as thieves.

The fundamental problem, however, is divided responsibility. Radical as this might sound, the system of certified audits should be discarded. It means almost nothing. A company produces financial reports, and through sampling and analysis, the auditor certifies them. Most of the big bankruptcies in the United States have followed a "clean" opinion from auditors. The company probably will still need to hire an accounting firm to assist in the preparation. But only the company knows fully what it is doing. And the company should take responsibility.

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