Auditing the auditors

In post-Enron world, companies rethink relations, shift to smaller firms

By PAOLA TUPA

A growing mistrust in financial reporting in the wake of the Arthur Andersen scandals is causing some corporations to rethink their relationships with external auditors, restructure or change to regional accounting firms.

"Accounting firms are being looked at differently after the numerous corporate failures," said Marta Alfonso, principal with Lewis B. Freeman & Partners, forensic accountants and consultants in Miami. She cited the recent collapse of Enron Corp. and tax-evasion allegations against Tyco International Ltd.'s chief executive.

Enron and accounting firm Andersen's failure to predict its sudden financial collapse has prompted proposals for new regulations in Congress and with the Securities & Exchange Commission. The new rules could limit the amount of consulting that accounting firms can provide to clients whom they also are auditing. Proposed regulations also call for creating an oversight board to set bookkeeping standards.

While most of the companies now making headlines are public ones, Ms. Alfonso said private companies, especially with multiple owners and governed by a board, are also tightening audit control of the auditing process.

In an effort to prevent conflicts of interest, companies are hiring independent auditors, some private companies are considering creating an audit committee or an advisory board, Ms. Alfonso said. She said their job is to hire and fire the auditors and keep an eye on the auditing process.

All public companies have audit committees, consisting of members selected from and by their board of directors, Ms. Alfonso said. She said the goal is to strip top executives of the power to hire, firing and supervising CPAs producing financial reports.

"Conflict of interest existed in the historical management structure of a corporation where executives in chief didn't hire the 'auditors,'" said Ms. Alfonso, who trains audit committees in governance and operations and educates audit committee members on proper financial reporting.

Monte Kane, partner with Kane Hoffman & Danner, a CPA and business consultant with offices on Brickell Avenue, said he has not seen many private groups create such committees but notices a reshaping in the function of existing audit committees.

Mr. Kane said their responsibilities have been gradually increasing in the past three years and even more lately. Audit committees seem to be more serious about their role, being more top of the independent CPAs' auditing practice, he said.

"One thing that is interesting is that more corporations are looking closer at how they make decisions," said Faith Gay, a white collar criminal defense lawyer in the Miami office of the law firm of White & Case. She said private and public companies are focusing more on having strict control over policy compliance, financial reporting and internal auditing.

"Many are restructuring their corporate governance by centralizing the decision-making function in just a few executives," said Ms. Gay, a former federal prosecutor in New York.

Some companies have many layers of management and "decisions are made so spread out that it makes it hard to make anyone accountable," she said.

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Audit committees seem more serious about eyeballing the independent auditors, says Monte Kane.

Mr. Kane, whose firm's services includes audit, accounting, wealth management, financial planning and business consulting, said he has noticed in the past six months that clients are asking to meet accountants more often and are asking more questions.

He said corporate executives now want to understand the implications of financial statements and be able to pass on that information to their superiors.

"Before they were concerned about sales and revenues," he said, "Now they want to know all aspects of their operating statements. We are going through a confidence crisis."

He said many stakeholders, investors and the general public lack confidence in the state of financial reporting.

Dana Forgione, director of Florida International University's school of accounting, said understanding financial reports is very difficult. She said the industry needs to find a way to educate clients on how to read the reports.

"We train our students for five years to write audits," he said. "There are some reports that sometimes not even accountants can understand. We need to do more consumer education."

Mr. Forgione said education could put an end to some misconceptions.

"A lot of people think that an audit guarantees there is no fraud," he said. "Audits only say the accounting was done following bookkeeping standards."

Alan Rosen, a partner with accounting firm Gerson Preston & Co., said there has been some discussion in the industry on how to change the way reports look to make them more transparent.

"Today accountants can not change the audit format, the way they look," he said. "What you do is you have a personal relationship with your clients and explain everything to them."

Mr. Kane said medium and small accounting firms are often able to provide personalized services.

Some company executives seem to want to be closer to a CPA senior partners in case they need to meet with them or ask them to review their staff's work, he said.

"Former Andersen clients are contacting us for our services," Mr. Kane said. "Many say they want to be able to have contact with senior partners."

Ms. Alfonso said she would not be surprised if regional offices benefit out of the recent highly publicized accounting and auditing scandals.

But Ms. Gay said corporations with coast-to-coast operations would continue using national firms.

"The sad thing about Andersen," she said, "is that it went from the Big Five to the Big Four firms."

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