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Jim Peterson, former Arthur Andersen lawyer and blogger at Re:Balance

Could a collapse like Arthur Andersen's happen again? That's the question raised by former Andersen lawyer Jim Peterson, who recently

published a book, **“Count Down: The Past, Present and Uncertain Future of the Big Four Accounting Firms,”** on the accounting industry's history and the possibility that a federal penalty or massive litigation judgment could drive one of the Big Four firms out of business.

A professor of risk management who blogs at **Re:Balance** and splits his time between Chicago and Paris, Peterson spoke with Crain's about auditor independence, what companies and investors might want instead of the traditional audit report and what happens if “the black swan flies.”

You come out swinging against the traditional pass-fail auditor's report. You call it obsolete. Why is that?

The empirical evidence is that it's a commodity that nobody pays attention to. The model that Mr. Deloitte invented and was deeply embedded in American regulation in 1933 and 1934, it's something that's been there so long that everybody just assumes it always will be there. It's like, you go into a room and flip the light switch, you expect electricity to power your lights. Knowledgeable investors have long since stopped paying attention to the standard pass-fail auditors report. . . .What would capital markets really like to have? My view is there is a broad spectrum of assurance-related work that companies themselves would love to have, and they would do it today if they didn't have to get that one-page report.

You also don't think there's much value in auditors being independent of the clients that they're auditing. Considering they have gotten into trouble for having cozy relationships with their clients already, wouldn't it simply be worse if the expectation of independence were removed?

Since independent audit was invented, the auditors have always been engaged and paid by the companies. So you've got a direct financial relationship between clients and auditors, and

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that's always been the case. So the whole structure about the rules of independence is also based on this notion of the appearance of independence, which is an incredibly elusive, slippery concept. (Auditors) can do much better quality work if they're allowed to get as deeply into the relationship with their clients as it's possible to get.



Photo by Bloomberg

Arthur Andersen's Houston offices in 2002, the year the firm collapsed.

But aren't they supposed to be doing a job for the investors?

I don't necessarily agree with that. The original premise is you did work for the original shareholders, you did work for people who were the owners of the company.

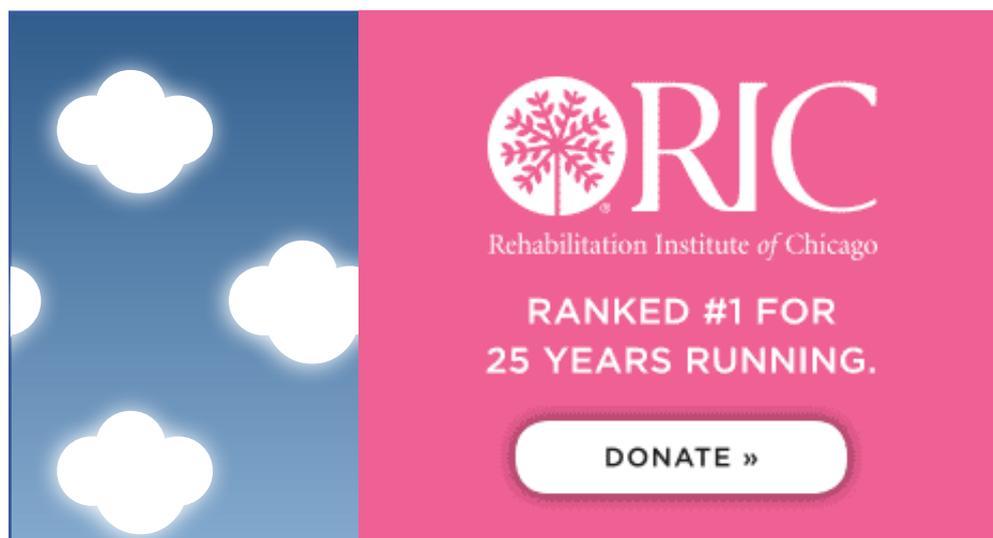
Today, you've got kind of an agency problem in the fact that auditors are engaged by executives or the audit committee on behalf of today's investors. But the auditors are not doing work for the investor community, or they shouldn't be. It's a misdescription of their relationship to talk about this duty to the public. This goes back to this **“watchdog” notion that Chief Justice Burger pronounced** decades ago, which was a mistake then, and I think it's a mistake now.

Do you anticipate a “black swan” event for one of the remaining Big Four firms, like the obstruction of justice conviction that drove Andersen out of business?

I can't say for sure that one will happen, but nobody can say for sure that it won't. . . .The big firms are just as fragile against that kind of shock today as Andersen was. Nobody had ever disagreed with my calculations about what the tipping point would be that would destroy one of the large firms. It's a shockingly small number that nobody ever wants to talk about: It's between about \$1 billion and \$3 billion. It should not be ignored because the size of the **(liability) exposures** are every bit in the range that would expose one of these firms to a death blow.

They don't have that kind of money. They can't pay it. The reason they can't is they're individual partnerships. They don't have public shareholder investment, and they keep working capital at a transparently thin level.

(This interview has been condensed and edited.)



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Dano Sulik • 3 months ago

Sounds like he thinks foxes should guard henhouses and thinks those who question that are the villains. Am I missing something?

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sundevilpeg31 → **Dano Sulik** • 3 months ago

You're not missing a thing, unfortunately. That's precisely what this fellow is saying.

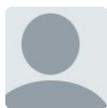
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Dano Sulik → **sundevilpeg31** • 3 months ago

Ugh. That confirms my suspicions about Andersen and its demise (and my doubts about the supposed wisdom of its alumni).

1 ^ | v • Reply • Share ›



Gerry • 2 months ago

Andersen deserved what it got. It was the auditor for some of the largest and most significant accounting scandals, Enron, WorldCom, Waste Management, and the Arizona Baptist Foundation. Not much substance in what he is proposing (typical of Andersen's work)

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