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Andersen: lessons for general counsel

A year on from the collapse of Arthur Andersen, Tony Williams gives an insider's view of what went wrong and outlines the lessons general counsel should learn from the experience.

The rapid and complete collapse of Arthur Andersen (Andersen) last year illustrated just how critical an organisation's reputation is to its business. Indeed in a professional services business it is the only asset.

In just five years, Andersen went from being the most profitable, integrated and professional of the Big 5 accounting firms to a pariah. So how did it happen?

In my view, three main things went wrong:

- The culture of Andersen moved and in effect the values became an empty mantra.
- The handling of problems was flawed and no lessons were learnt from past difficulties.
- The firm misunderstood the impact of politics and public perception on its business.

Andersen's culture shift

The culture of Andersen as laid down by the founder, Arthur Andersen, was clear and uncompromising – “think straight, talk straight”. Business integrity was all important. This was drummed into young recruits, and no deviation from those standards was acceptable. Andersen was the most integrated international professional services firm. Indeed, its training facility at St. Charles in Chicago was in effect the Andersen University.

However, the industry was changing rapidly. Ernst & Whinney merged with Arthur Young, Deloitte merged with Touche Ross, Price Waterhouse with Coopers. A Big 8 became a Big 5, which dominated the audit work for any major international company. Andersen's growth, particularly its profit growth, was from consulting (Andersen Consulting) or from tax, rather than from audit. As the industry consolidated, Andersen's determination not to merge in order to retain its culture led to its share of the audit market declining as against its peers. The consultants grew resentful of a management and thinking which was audit dominated. The arbitration and subsequent total split with Andersen Consulting (now Accenture) was a turning point for Andersen.

The cash cow of consulting was lost. Andersen was now the smallest of the Big 5.

As the industry changed, almost imperceptibly the culture of the organisation shifted. Financial performance, growing client fees and growing profits (which had increased annually for 20 years) were rewarded far more than adherence to values.

Meeting budget was a “covenant” with the firm, failure to do so was severely career limiting whatever the reason. With the Andersen Consulting split, the financial pressures became even more intense.

This culture shift combined with the arrogance and complacency of a successful organisation of 85,000 people left the firm unprepared financially and in its leadership to confront the storms that lay ahead.

Flawed problem handling

The seeds of Andersen's downfall were sown in 2000, when the firm was widely criticised for its handling of the Waste Management audit. The US Securities and Exchange Commission (SEC) was on its case. Waste Management starkly showed the dangers when auditors compromise their objectivity in an effort to keep their clients happy. Unfortunately Andersen slept through this wake up call. It did not fundamentally review its audit or risk management procedures. It believed that this was a one off and dismissed it as such.

But worse was still to come. In October 2001, Enron, an aggressive child of the 1990s boom, announced a major restatement of its results. Despite the fact that the US is the most litigious country in the world and shareholder class actions are normal following a major share price fall, no comprehensive steps appear to have been taken by Andersen's risk management team, general counsel or outside counsel to take control of the relevant papers, including electronic data, in a timely manner. Instead, the general counsel's office appeared to engage in cryptic exchanges with the client partners on the firm's euphemistically titled "document retention policy". Taking control of the documents at an early stage would probably have saved Andersen.

Having thrown away its get out of jail free card by permitting documents to be destroyed, the firm was on the back foot. It had to prove a negative; that it had not shredded any sensitive documents. By definition, an almost impossible task. Whatever it may or may not have done wrong was now irrelevant.

The impact of politics and public perception

Almost as crucially, the firm failed to understand the political implications of the collapse of Enron and its admission of shredding. Enron was a major Texan company. President Bush is from Texas. Enron was the first major crash of the bear market, shareholders lost billions, someone had to be to blame. Media and public interest and outrage was high.

Company directors, advisers, bankers, politicians, analysts, lawyers, rating agencies and regulators were all exposed. Suddenly Andersen put its hand up and said that it had done something wrong. In current parlance the smoking gun had been found. Andersen did it.

Retribution in the media and politics was swift. In the court of public opinion Andersen was convicted well before the Department of Justice acted.

In an after dinner speech President Bush said: "Ladies and gentlemen, I have good news and bad news. First Saddam Hussein has agreed that we can count his weapons of mass destruction. But he wants Andersen to count them." The firm was finished. Lessons to be learnt.

As a general counsel you may be tempted to assume that the collapse of Andersen was a one off which could never happen to your company.

This is, however, a dangerous assumption to make. To ensure that such a situation does not arise, you should consider the following:

- Does your company have a clear culture and/or set of values? By this I do not mean a worthy mission statement in the annual report. Instead, does your company have a clear understanding as to the business it will and will not conduct and the manner in which it will conduct it? Most crucially, is your company prepared to do a potentially profitable deal which is inconsistent with its culture or values?

If the answer to this is yes, then do not kid yourself that you have strong values in your company. Many companies will have no such clear cut principles, and if you are a general counsel in such a company you need to be particularly vigilant as to the business and reputational risks that your business faces.

- Are you able to monitor corporate and individual behaviour? Are you regularly consulted as to the business that your company does, do you understand it and are you able to have any particular line of business explained to you? In this regard the old test applies: if a product cannot be explained in one page or 30 seconds it probably contains much more risk than your colleagues think. If you do not know what is happening, your role will be post-event damage limitation.
- Would your chairman, CEO or board heed your advice as to sanctions against those who behave inappropriately?
- Are you seen as an integral part of the decision making process or is the legal department seen as the “stop everything” group to be avoided if at all possible and, if used, only consulted at the last possible moment? Can you stop a transaction proceeding and will the management support you?
- Are you aware of the legal and reputational risks for your company? As general counsel you should know the legal risks that confront your business.

However, a “legal” transaction may have significant reputational consequences for your company. As an additional test, ask yourself how comfortable your CEO would be explaining your company’s position to a Senate Committee, a Commons Select Committee or other government watchdog. Permitting your CEO to find himself in that position could be severely career limiting for both of you.

- Can you control the handling of these matters (well before they are formally litigious) including the safeguarding of all documents and data? Will you receive full co-operation and frank explanations from those involved?

There is no difficulty that you find yourself in that cannot be made infinitely worse by a bungled attempt at a cover up.

- Following on from this last point, does your company have a credible crisis management policy? This must include key directors, internal and external PR advisers, brokers, and external lawyers. Are you fully involved in this team? Inevitably problems arise outside business hours and there is now an insatiable appetite for instant news. It is important that any response is clear and correct. Subsequent “clarifications” will damage the credibility of your company. The news spotlight needs to be turned away from your company as quickly and completely as possible.

Increasingly, the general counsel is expected to spot and deal with issues before they become a crisis. He needs to know what is happening in his company, have the respect of his colleagues and be open and constructive so that consultation is encouraged.

For a general counsel the defence “I didn’t know, they didn’t tell me” will not wash. Others may have financial risk responsibility but the general counsel is responsible for the company’s legal and reputational risk.

A general counsel’s job has never been easy. It just got tougher.

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