

**PART I**

**PROFESSIONS AND  
PROFESSIONALS  
IN TURMOIL**



# IF SOMETHING CAN CHANGE, IT WILL

## *Strategic Factors in a New Environment*

*In this world of change naught which comes stays and naught which goes is lost.*

—Anne Sophie Swetchine, Russian author

To any accountant or lawyer who entered the twenty-first century with a few years of experience as a professional, the events of the first two years of the new century delivered profound shock. Even before the tragic events of September 11, 2001, the assault on the business world—the very source of professional practice—turned that world topsy-turvy. The universe in which the professional must practice today is markedly different from the traditional world in which the professions thrived for generations.

First came the failure of the dot-coms. A huge financial and stock market bubble that had grown at the speed of a malignancy finally burst, with failure and loss spewed all over the landscape. Then came the rash of frauds, defalcations, misuse of corporate funds—a kaleidoscope of events that virtually destroyed the stock market and investor confidence. Each day brought a new scandal. Many major accounting firms were shown to have departed from the traditions of probity, objectivity, and integrity. Law firms were devastated, with trust, integrity, and reputation eroded. Arthur Andersen, for generations one of the greatest accounting firms in the world, was totally destroyed as quickly as if it had been struck by lightning. And finally, the new administration in Washington, concentrating on the new war on terrorism, failed to stem what became a sharp downturn in the economy. Ultimately, recovery began to emerge, like crocuses bursting through the snow as a precursor of spring, but lacking the vigor and the heft of the earlier dot-com years.

As if these events were not enough to alter the nature of the economy, and most cogently, the practice of every professional, the outcry to stem the tide of disaster—to regulate the markets to forestall further disaster—created a helter-skelter regulatory rush that was at least as punitive as it was appropriate. It would seem that the regulatory garment was cut to fit all, when all don't wear the same size.

The result was to create an environment that called for a reexamination of traditional legal and accounting practices. New strategies and new approaches, fed by the changes in the business world, were dictated. What actually happened?

- The growing anxiety of a vast number of investors, both corporate and individual, and their skepticism about the information supplied by corporations and the accountants and lawyers became rampant. The value and integrity of brokers and analysts were sternly questioned. The financial markets were decimated. Regenerating lost trust and understanding in the legal, accounting, and financial professions now becomes a major concern and responsibility for corporations, for professionals, and for those responsible for marketing and communications.
- New regulations and law, promulgated by the Sarbanes-Oxley Act of 2002, the new regulatory structures of the Securities and Exchange Commission, and the stock exchanges, put greater controls on corporate governance, and on the independence of accountants and Wall Street researchers, and dictate strong civil and criminal punishments for violations. The decades-old battle to preserve self-regulation is lost. And although new regulators won't find it a cinch to control the professions, self-regulation is out. Oversight is in.
- Stronger controls on auditors, including separation of auditing and consulting practices, reexamining partnership structures, and new measures to detect corporate fraud, shift the burden of assuring integrity from within a firm's practice to outside bodies (although the responsibility to project integrity remains with the professionals and the corporations).
- Greater focus on the legal profession, and its responsibility in dealing with miscreant clients, pushes lawyers farther away from the comfortable residence of client-attorney privilege.
- Greater controls on corporate boards and audit committees are being put in force, altering the very nature of the corporation and its forms of governance. Gone are the days of the rubber-stamp board. And fading are the days of the despotic but charismatic leader.
- CEOs now have responsibility to sign off on financial statements, which puts a greater burden on CEOs whose specialties and experience, while appropriate to the needs of their companies, may be in nonfinancial areas, such as marketing or production.

- Potential reform of executive compensation structure is clearly in the works—a reaction to disproportionate executive compensation packages.
- Not exempt from this revolution are brokerage firms, security analysts, and sources of capital. Greater regulation, under a bright spotlight, substantially alters the structure and management of financial institutions. Wall Street and environs must now form a new accord with Main Street.
- The New York Stock Exchange, struck by exposure of the awesome compensation of its chief executive, and driven by the new U.S. Securities and Exchange commissioner William Donaldson (himself a former NYSE chairman), faced a massive structural reorganization.

As a counterpoint to these events, there is the role played by technology, which is no longer simply a phenomenon, but is now an integral part of business in all its aspects, and makes a significant difference.

- The increasing importance of the Internet in all aspects of communication—to shareholders, analysts, and other influentials in the investment community, and the business and financial press—redefines the access to information by investors and brings a new dimension to investment practice. This means new transparency for once-opaque professional firms and the companies they serve. The Internet also gives access to a new target audience for professionals and their marketers.
- Access to an overwhelming abundance of data and online databases, and problems in managing the data for value, effectiveness, and communication, gives investors more information than they ever had before—although still without meaningful interpretation, and now, with questionable accuracy and integrity.
- Consolidations of sources of data and external communications control the flow of information through new structures and alliances.
- More extensive business and financial news is available online, on radio and television, and in the press, putting a spotlight on events that may be more sensational than rational.

As if these events were not sufficient to distort the traditional universe in which the professional and financial world function, there is the economy itself . . .

- The 401(k) accounts, and the more than 50 million Americans who have them, are a powerful influence on the market. Account holders don't always bring sophistication to an orderly market. That's \$1.9 trillion that, says Alicia Munnell, a former member of President Bill Clinton's Council of Economic

Advisors, is not always invested wisely. “People make mistakes at every step of the way,” she says.

- The economic environment, at this writing, has been in decline and is only beginning to show faint signs of recovery. It may or may not be improving. If it improves, it may be two years before it is healthy again, by which time the landscape will have significantly changed.
- The rapid demise of the budget surplus, and the growing deficit, can feed economic downturn and ultimately, perhaps, inflation.
- The cost of the war on terrorism, and the invasion of Iraq, can substantially alter the economic landscape.

Concurrently, the growing recognition by professionals of the role of marketing in a professional practice has brought the marketing practice to a new maturity. Where once marketing was considered optional, that option became a mandate, as the battle to compete became more urgent. Today, the decision to market is no longer an option, but an integral part of accounting and law firm management. Which is not to say that acceptance of marketing is universal, but it’s certainly farther along than it was just a few years ago.

These factors, separately and combined, dictate new strategies in informing and persuading investors, and those who advise them, of the values inherent in investing in a company’s securities. These factors dictate, as well, a new relationship between the professional and the client, the professional and the investor.

The new regulatory environment has been a long time coming. The failure of self-regulation has contributed substantially to Congress’s finally winning the decades-old regulatory battle between itself and the professions. The result is a new structure that will affect every accounting firm, including those that don’t serve public companies.

New regulation brings a new perspective to a trend toward the multidiscipline practice—the MDP, which moves to blur the line between the accounting, legal, and consulting practices, even as it moves professionals into new practice definitions. In some cases, new rules indicate deceleration of the MDP process. The new regulations that attempt to separate auditing from consulting, for example, or that retard the movement of law firms into accounting practices and vice versa, cause a rethinking of the MDP process. But these events don’t necessarily bring the process to a halt. There is a trend that once started is not easily reversed.

The root causes of the new regulatory regimen are complex, and for the professional to prevail in uncertain times, it may be useful to explore some of the events that generated this new regimen. The practices in the accounting and legal professions have emerged through decades of response to business needs and conditions of the time, and despite the best efforts of lawmakers and regulators, no simple

stroke of the pen can erase those practices without ultimately causing damage. The regulatory threat is a high-speed train that can't be stopped on a dime.

It's not sloth and greed alone that created this accounting and legal morass, and to try to correct the situation that brought both law and accounting to this pass without understanding the recent history of professional practice will, more likely than not, burden the good accountant and lawyer as well as the bad.

There's no doubt that, in the current environment and with the anxiety about the integrity of financial statements, revenues of accounting firm SEC practices will increase in the short term. But ultimately, in the long term, the nature of the professions we know today will change. Business entities of all kinds react in their own way to changing environments, and it would be foolish to attempt to predict what the long-range effect of Sarbanes-Oxley and other regulatory initiatives will be. But things will indeed change.

Three economic phenomena, in addition to sloth and greed, brought us to this debacle—obsolescence in the methods to accurately account for the business and economic structures of the modern corporation; the need to find new ways for professional firms to compete; and internal communications structures that are not adequate to the needs of growing accounting and law firms.

The first derives from the fact that the business world changed profoundly in recent decades, and the accounting profession did not. In a *Business Week* interview in 2002, Barry Melancon of the American Institute of Certified Public Accountants said, "We need to move accounting from . . . an industrial age model to an information age model." In today's dynamic technological society, it's virtually impossible for a company or an investor to have a true and current picture of the company's financial condition using traditional static accounting techniques. Obviously, the profession's accounting methods must be made more relevant to modern business needs. It's extraordinarily difficult, as well, for the contemporary company to function in today's world without an array of expertise from many sources, which is the reality behind consulting. Most businesses need and benefit from the breadth of the accountant's expertise.

The second phenomenon began in 1977 with *Bates v. State Bar of Arizona*, in which the U.S. Supreme Court struck down the professionals' Canons of Ethics prohibiting advertising, and, by extension, any kind of frank marketing. *Bates* ultimately changed the nature of all of the professions, and made fertile the ground that created the very problems for accounting and law firms raised up by the Andersen disaster.

*Bates*, in creating the ability to do frank marketing, brought that new word—*competition*—into the professionals' lexicon. In the first attempts to compete, battalions of advertising, public relations, and marketing people were hired, only to discover that marketing a professional firm was very different from marketing a product. After all, how do you distinguish one accounting firm from another when

you can't say, "We do better audits"? Or a law firm from others when you can't say, "We write better briefs?"

Thus, the competition had to be fought on a different level, causing great confusion among marketing professionals. The MBA marketers had no solutions, because they had no precedents. The traditional marketers could only bring classic marketing vehicles into play—the press release, the brochure, the seminar, and so forth—without any great sense of marketing strategy or perspective, nor understanding of the intricacies and nuances of the professions. Ironically, it was the accountants and the lawyers—the very same who had swooned at the idea of frank marketing—who came up with the answer.

That answer was to recognize that the audit services alone, as well as legal services, offered little foundation for competing. Therefore, professionals began to compete by concentrating on new kinds of advisory—*consulting*—services. *Help your client install a new computing system. Help your client build a new cash flow system. Do executive search work for your clients. Help your client structure new subsidiaries or acquisitions.* And so forth.

Consulting enabled accounting firms to do what traditional auditing could not do—differentiate themselves from one another by focusing marketing efforts on the consulting services. It worked so well that the consulting work began to overwhelm the auditing work, until the larger firms—those that do the most auditing—persuaded themselves that they were really business consultants that also did audits. When was the last time anybody has seen a large firm tout its CPA credentials?

Law firms, a little better able to distinguish themselves—at least in most areas—from other law firms, also developed a new aggressiveness in seeking to increase market share. They, too, moved in nontraditional directions. Many became investment advisors or management experts. Many moved into areas traditionally held by accountants, such as financial planning, and financial management in estate planning. Firms with specialized practices, such as construction, hired engineers, and then targeted the market based on construction management skills. Law firms with medical malpractice activities (as well as accounting firms serving the health care industry) hired nurses and doctors as staff. And ultimately, accounting firms began to buy law firms as subsidiaries and profit centers, wherever local law didn't strictly prohibit it. Prior to the Enron scandal, the accounting giant Arthur Andersen became the largest law firm in Europe, through acquisition of European law firms. (Not to be overlooked is the acquisition of accounting firms by American Express, to build one of the largest accounting capabilities in the United States.) And while law firms could hardly say, "Hire us because we win more cases," there were many other ways, including advertising and public relations, to promote litigation skills and success.

And so arose the concept of multidiscipline practice—MDP. While the concept of practice beyond the traditional bounds of a law or accounting firm has long run counter to the Canons of Ethics of both professions, the boundaries separating the

two practices—law firms can't practice accounting or share fees with nonlawyers (or make them partners), and vice versa for accounting firms—those boundaries are eroding. They are breaking down, not by mandate (both professional bodies continue to reject measures supporting MDP), but by osmosis through the boundaries' membrane. While the scandals of the first years of the twenty-first century brought regulation that slowed down the process, it is ultimately the needs of the clients that will dictate the course of professional practice.

At the same time, the growth of accounting and law firms began to cause serious internal management problems. If the growing companies they served had to learn new management skills to cope with new size and business configurations, so too did the burgeoning accounting and law firms. Management skills, unfortunately, are not taught in accounting or law schools. There's no management tradition and there's no management training, as there is in corporations. The collegial nature of the traditional partnership began to prove itself inadequate to managing the new demands placed on growing professional firms. The traditional partnership structures began to pose more problems than they solved, and in fact, the total implosion of Arthur Andersen, in which the misdeeds of a few partners destroyed the equity of all the partners, as well as the thousands of staff people, foretells the ultimate erosion of the system. There are now too many issues in professional firm governance for a firm not to look to professional management to replace collegial management.

As the body of knowledge within a firm became vast, internal communications broke down, as seen so clearly in the firms serving Enron, Tyco, and the like, and, obviously, Arthur Andersen. Too much was going on internally that wasn't known by others in the firm who should have known. Failed internal communications has now become a significant cause of major catastrophes of Enron proportions.

The internal communication and management crisis in today's large international professional firms is also a major reason why merely imposing new regulatory structures alone will solve few of these new problems. Without significant changes in internal communications structures, it's impossible to enforce any new rules that seek to protect against obsolete accounting methods. It seems that as firms grow, and as the need to communicate internally becomes more acute, less thought is given to the process than ever before, a situation that later chapters in this book might well serve to rectify.

The music to accompany this chapter is more martial than romantic, so bleak and chaotic is the situation. After decades—generations—of the sanguine and patrician life of the professional, and practice uninhibited by external regulation and fostered by a purity and integrity matched only by Caesar's wife, the professions now find themselves in turmoil.

What, then is the future? What then is likely to work?

