

From the Foxhole to the Boardroom
America's soldiers live by a code of honor. So should its executives.

By Uwe Reinhardt
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After Sept. 11 and the Enron fiasco, we have a rare opportunity to observe, in real time and on TV, both the heroic and the pathetic in adult American society.

The heroic images are those of soldiers ducking bullets and mortar in Afghanistan, of police and firemen who risked and lost their lives on Sept. 11, and of journalists who venture into harm's way to inform their fellow citizens about faraway wars and peoples. These brave souls reassure us that a good number of contemporaries carry on the tradition of an earlier generation of Americans, whom we honor as the Greatest Generation.

Compare these brave folks with the morally flexible ones whose shenanigans helped fuel the recent asset bubble in what was supposed to be the most efficient and trustworthy financial market in the world. Picture such executives, and their auditors, lawyers, consultants and bankers, gathered around a conference table for but one purpose: to devise structures, transactions or accounting techniques designed to deceive shareholders and prospective investors. Behold the pathos as some of these swashbucklers now appear at the congressional hearings on Enron, taking the Fifth or seeking refuge behind openly professed ignorance and incompetence.

Comes Jeffrey Skilling, for example, a former McKinsey consultant with an M.B.A., swearing before God and country that he had at best a poor grasp of what was going on in the company he led as CEO, and that he knew not enough accounting to appreciate its precarious financial condition!

Fortunately, and this must be emphasized, such questionable behavior is not typical of the nation's business leadership. Probably the bulk of our corporations are still led by executives guided not merely by what is permissible, but by what is decent. The problem is that during the roaring 1990s, the market welcomed too warmly an ever-growing cadre of accounting entrepreneurs--as distinct from product entrepreneurs--who abided by the now infamous Al Gore maxim that anything not expressly forbidden by a "controlling legal authority" is, ipso facto, moral.

It seems implausible that the huge asset bubble on the Nasdaq in the late 1990s was driven purely by innocent "irrational exuberance." Can there be that much incompetence on Wall Street? More probably, the bubble was inflated further by serious conflicts of interests on the Street, and with the help of legally permissible but ethically dubious financial reporting.

My students wonder why traders on Wall Street routinely trash the stock of companies merely for having actual earnings per share in one-quarter fall short just a few pennies of projected earnings. The best explanation is that the traders see it as the portent of an imminent balance-sheet laundry, on the assumption that the company has run out of accounting tricks to create the coveted extra pennies out of thin air. It speaks volumes about what traders in the trenches think these days of audited financial reports.

With their reckless behavior, the accounting entrepreneurs harm not only shareholders, creditors and employees who repose trust in them. They impair one of the nation's most precious assets: an efficient, accurately informed capital market known for impeccable integrity. Can we ever trust Wall Street again?

Congress seems in a mood now to rewrite the rules of corporate governance and finance. If it confines itself to limiting the most glaring conflicts of interest and merely mandates full and

prompt disclosure of absolutely all stock option grants and insider trading by corporate executives--and of trading by financial analysts--that might be to the good.

Yet as former Securities and Exchange Commissioner Arthur Levitt Jr. has often lamented, Congress itself has been a paid shill for opaque accounting. If Congress appointed itself guardian of the Generally Accepted Accounting Principles, those principles would soon come to resemble nothing so much as the Internal Revenue Code, whose confusing, narrowly targeted provisions tend to be sold retail on the Hill, year after year, to favored lobbyists. May America be spared this punishment!

A more productive approach for Congress would be to help convert the Financial Accounting Standards Board into a genuinely independent, permanently endowed research- and rule-making body, akin in power and stature to the Federal Reserve, and accountable only to the SEC. Its activities should be absolutely beyond the direct influence of the corporate executives for whom FASB makes rules (although corporations should, of course, be allowed to present their perspectives to FASB). More important, FASB should be absolutely beyond the direct influence of any member of Congress. Finally, Congress should mandate the SEC to list on its Web site all communications on corporate governance between individual members of Congress and the SEC.

It will, of course, be impossible to write rules that would keep on the straight path those executives and their consultants who are inclined to stray. Therefore, it would be helpful if every corporation and investment bank, as well as accounting, law and consulting firm, were to establish a formal department of corporate ethics, headed by a senior vice president, and tasked to certify that any proposed novel structures, contracts or accounting techniques are in conformity with the firm's ethics code as well as with the signatory's own sense of decency. Many dubious deals and techniques of the 1990s probably would have failed that test.

Our soldiers on the front live by a remarkable code of honor and decency. The nation takes it for granted. Why, then, should we not demand impeccable honor and decency also from all of the extraordinarily well-paid executives and their consultants to whom we entrust the management of the nation's resources on the home front?

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