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Honest Beginnings

On November 8, 2001, the day the SEC issued a subpoena to Arthur Andersen, it was business as usual at the firm. The firm had built a reputation for being tough and honest as it expanded into a network of approximately 350 freestanding local offices in 84 countries throughout the world. Andersen's 85,000 employees were aware of Enron's troubles but few anticipated the extent or severity of the outcome. Andersen had weathered rough storms in the past, and most staff assumed this one would pass, too. Andersen's staff shared a common understanding that the acts of one office or one individual were not a reflection of the entire firm.

As one of the top accounting firms in the world, Arthur Andersen had gained a reputation as a tough, competent, and honest firm. It earned its world-class status and influence over the course of its 89-year history. Large clients paid millions in fees to have Andersen audit their financial statements. An Andersen partner could stride into an executive office or boardroom in any of the world's major companies with confidence. Their clients listened when Andersen partners or staff talked. Andersen auditors had the authority to approve or question the books of publicly held companies, and a negative Andersen opinion might trigger scrutiny from the SEC.

To understand the extent to which Arthur Andersen changed over its 89-year history, you can benefit from a look back to the firm's beginning. As you become acquainted with the blunt, candid man who founded the firm and gave it his name, the differences in the firm at the time of its demise will be all the more striking. Many attributed the establishment of Andersen's reputation directly to Arthur E. Andersen, the firm's founder. His life story is the embodiment of the American belief in an individual's ability to succeed through strong values and hard work. The extent to which his experiences and principles were exemplified in his firm 50 years after his death is a study in how to expand a professional firm.

Founding Father, Founding Values

Arthur Andersen, the fourth of eight children, was born in 1885 in Plano, a small, rural Illinois town, to John and Mary Andersen. His parents were Norwegian immigrants who came to the U.S. in 1882. Arthur's father eventually found a job as a foundry foreman at Fraser & Chalmers.

His family's dreams of a better life came to an end with the early death of both parents. Arthur was an orphan by the age of 16. The children were separated, and Arthur's four younger siblings went to live with relatives. Arthur and his three older brothers were left on their own, and Arthur needed a job. One of his father's employers, William Chalmers, took Arthur under his wing. He gave Arthur a job in the mail room and helped him out financially so he could finish his education at night. Arthur never forgot the support he received from his patron, and throughout his life, he tried to help other bright, working-class young men who needed a hand up. He was known to particularly favor those who had overcome adversity by hard work.[1]

Arthur E. Andersen's early experiences shaped his personality. He did not develop trust easily. His contemporaries described him as a stern, demanding man who set himself high standards for hard work and long hours that would later be expected from the accountants who worked for him. While working at Fraser & Chalmers during the day, he attended high school, then took college courses at night. After graduation, he taught at Northwestern University's new School of Commerce. At the same time, he was working his way up from mail-room clerk to assistant controller of the company.

Although he worked long hours at his job and was studying for his certified public accountant (CPA) exam, he made time in his life to court Emma Barnes Arnold. He married her in 1906, when he was just 21 years old. They had two daughters, Ethyl and Dorothy, and one son, Arthur Arnold. It is not clear how much time he actually had for his family during the early years. "He was a stern, no-nonsense man who focused entirely on business and did not mix easily with others—not even his partners," one of Arthur's partners, Leonard Spacek, would later reminisce.[2]

In 1907, he left Fraser & Chalmers to join Price Waterhouse & Co. His wife, Emma, was horrified to learn he had taken a significant pay cut to join the accounting firm. She worried that Arthur was putting his ambition ahead of his new family's security.[3] A year later, in 1908, he became Illinois' youngest CPA at the age of 23. He was well on his way to a successful accounting career. After three years with Price Waterhouse, he left to become controller for Schlitz, the Milwaukee, Wisconsin brewing company. While working for Schlitz, he commuted 180 miles round trip daily to Northwestern to complete his education and to teach.

Arthur's commitment to bettering himself through drive and hard work continued to be rewarded, not only in his day job but in academe, as well. By 1912, Arthur was appointed Assistant Professor and Head of the Accounting Department when the accounting professor holding those positions left Northwestern. By 1915, he was a full professor. With typical confidence and vision, he reorganized the department and in 1917 published his *Complete Accounting Course*. He continued to teach at Northwestern until 1922 when he resigned because his growing firm required more of his attention. He was elected to Northwestern's board of trustees in 1927 and was president of the board between 1930 and 1932. In 1941, he received the honorary law degree from Northwestern. Other honorary degrees came from Luther, St. Olaf, and Grinnell Colleges.

Most important for this story, Arthur E. Andersen was an entrepreneur. During the first half of the 20th century, there was a slow decline of family farms as people moved to the cities to work in the growing number of factories being built. The growth of manufacturing meant a rise of publicly traded companies. Those companies needed more competent accountants than were available, so independent auditing firms began to offer their services. On December 1, 1913, Andersen and Clarence M. DeLany opened a small accounting practice, Andersen, DeLany & Co. Arthur E. Andersen was only 28.

The practice that Andersen and DeLany opened had been founded by Clarence W. Knisely, who had built up a small audit practice in Chicago between 1901 and his death in 1913. Arthur E. Andersen knew Mr. Knisely and had worked with him on several accounting engagements. At Knisely's death, Andersen and DeLany purchased The Audit Company from Knisely's estate for $4,000. They took over Knisely's Chicago office on West Monroe Street, his client records, client relationships, and even the office building's maintenance staff. They had seven staff members and one secretary. They were officially in business.

There was tremendous demand for the dependable skills that Arthur Andersen's company could bring, and the Chicago office was the beginning of many other offices to come. In 1915, Andersen and DeLany established a second office in Milwaukee to be near the Schlitz Brewing Company, one of the firm's largest clients and Arthur E.

Andersen's former employer. Some of their other early clients included ITT and Palmolive.

Income tax, like Andersen, DeLany & Co., had been born in 1913, and very soon the partners added tax services to their list of offerings. Tax was initially a hook to reel in clients—the kind of clients who would also purchase audit services. But tax gradually assumed a more independent role within the firm as the new system of taxation expanded in the U.S. and became increasingly significant. To be near the Internal Revenue Service, an office was established in Washington, DC in 1921.

Andersen, DeLany & Co. was one of the earliest accounting firms to offer consulting services in addition to accounting, audit, and tax. Tax had proven to be an important client hook; investigations and business advisory services could give Andersen, DeLany & Co. an even bigger hook.[4] Many of the other accounting firms were skeptical of such a daring move. Concerned about potential conflicts of interest, George May, the head of Price Waterhouse, warned that auditors should do audits and only audits.[5] But Arthur E. Andersen confidently moved ahead, ignoring May's caution. He believed that the right people with training in his very specific methods would make the difference and set about building a workforce he could trust to do the right thing.

The firm found its employees from the growing pool of students that Andersen taught. Many came from rural communities, and most were recruited from Midwestern state colleges. In 1917, his classrooms included business and professional men who were interested in taking his new course on wartime income and excess profits taxes. Andersen found himself teaching potential clients. Many of these students were involved in the new industries created as the U.S. mobilized to enter World War I. The need for public and certified financial reporting was essential to protecting the public interest. The students, as well as Andersen and DeLany, saw opportunities in the new industries that would require monitoring and "greater publicity to the financial operations of such businesses."[6] With its credentials in accounting and expertise in audit, Andersen, DeLany & Co. stood ready to fulfill this growing need. Between 1912 and 1920, the firm grew rapidly as client billings went from $45,000 to $322,00 per year.[7]

Five years after purchasing the accounting firm, DeLany resigned. In the official histories of the firm, there is very little written about DeLany, and he is a shadowy figure in Arthur E. Andersen's life. He was a licensed CPA and had worked for Price Waterhouse before going into partnership with Arthur E. Andersen. It is likely that the two men met at Price Waterhouse when Arthur E. Andersen worked there. He may have left the partnership for personal reasons, or he may have had a falling out with his partner, Arthur E. Andersen. He resigned in 1918. One account suggests that Arthur E. Andersen did not think that DeLany fit with his vision of the firm and forced DeLany out. "DeLany was more of a bookkeeper but he was useful to Arthur Andersen at the time. He soon got rid of him," Leonard Spacek, an Arthur Andersen & Co. partner, remembered.[8] With DeLany's departure, the firm was renamed Arthur Andersen & Co. Arthur E. Andersen dominated the firm for the next 30 years.

After DeLany's departure, Arthur E. Andersen turned to his younger brother to run the Chicago office. Walter H. Andersen had joined Andersen, DeLany & Co. in 1916. In contrast to Arthur E. Andersen, who could be strict in his views[9] and had a reputation as being "often autocratic and sometimes arbitrary,"[10] Walter was kindly and personable but had a streak of independence. The differences in temperament between the brothers did not deter Arthur E. Andersen from giving his brother opportunities to succeed. Walter agreed to oversee the Chicago office and took over responsibility in 1919.

Arthur shifted his attention to building Arthur Andersen & Co. From 1919 until his death, Arthur E. Andersen oversaw the addition of offices in Kansas City, Los Angeles, New York, San Francisco, Detroit, Boston, Houston, Atlanta, Minneapolis, St. Louis, Seattle, Cleveland, and Philadelphia, as well as Washington, DC. The Milwaukee office had been opened in 1915. Although the growth of the firm was impressive, Arthur actually was careful about growth and did not want to sacrifice quality. The people acquired through the 1913 purchase of The Audit Company of Illinois from Knisely turned out not to be up to the standards of Arthur E. Andersen and couldn't be trusted to do an audit to his specifications. He replaced five of the original seven staff. Arthur E. Andersen decided that the only staff he could trust were those he trained. The only offices that would be added to the firm would be those that he would personally establish with his own people. Arthur Andersen & Co. grew slowly and carefully under Arthur's guidance.[11]

Then, in 1932, Arthur E. Andersen experienced a set back. His brother, Walter, resigned. According to Leonard Spacek, who was working in the Chicago office at the time, the two brothers got into a fight, and Arthur E. Andersen ordered Walter out of the office. The two never spoke to each other again.[12]

Arthur E. Andersen also tried to convince his son, Arthur Arnold Andersen, to join Arthur Andersen & Co. Arthur Arnold tried working for his father for a while but apparently his employment with the firm did not work out, either, and he left in 1943 after three years with the firm. Arthur E. Andersen was bright and ambitious but he was also blunt, domineering, and unforgiving.

Think Straight, Talk Straight

From the beginning of Arthur Andersen & Co., the firm used Arthur's experience, reputation, and vision as the foundation of its competitive advantage. But it was not just what Arthur did professionally that was so remarkable; it was the spirit in which he did it. Arthur Andersen could not be bought.

"Think straight and talk straight"[13] was the principle on which Arthur E. Andersen built his accounting practice. It was a phrase his mother had taught him. It became the firm's motto and appeared on many internal documents. The commitment to integrity and a systematic, planned approach to work is what he offered his clients, and this brand of audit proved attractive to both corporate clients and investors.

Within the firm, stories circulated for decades after his death about how he had done the right thing when it was *not* the only choice but when it was the less profitable or more difficult choice. In one such story, Arthur faced a client who had distorted earnings by deferring large charges, rather than reflecting them in current operating expenses. The president of the company flew to Arthur Andersen's office in Chicago and demanded he change the audit certification to suit the client's version of the truth. Arthur replied, "there is not enough money in the city of Chicago to induce me to change the report."[14] Arthur lost the client but gained something more important—a reputation for straight talking.

Another story recounts how Arthur faced up to a lucrative steamship company client. To help attract investors for a bond offering, the steamship company asked Arthur to certify its financial statement as of December 31, 1914. This was prior to the loss of one of the company's new ships in February 1915. Certifying the statement as of the earlier date would camouflage the company's loss and would misrepresent the real financial assets of the company to potential investors. Andersen refused to certify the financial statement without disclosing the loss.

Arthur was a realist and maintained some skepticism of client management. Auditing was founded on the idea that a company's internal accounting cannot be relied on to provide the unvarnished truth. He was well aware that straight reporting meant that auditors needed to check reality and make sure that the material facts reported by the client were accurate and required that an auditor understood "the facts behind the figures." As Paul K. Knight, an early Arthur Andersen & Co. partner, explained, it is the auditor's job "to ascertain the factors that contributed to the operating results and form a business judgment as to how to improve the good factors and eliminate the bad."[15] The Andersen reputation for resisting misleading reporting and telling it like it was grew, and getting the Andersen name on your company audit became increasingly desirable.

Arthur E. Andersen took ownership of the audit and he was prepared to stand behind his work. The generally accepted position on audits the first quarter of the 20th century was that they belonged to the client. But, Arthur E. Andersen reasoned, because audit materials carry the Arthur Andersen & Co. name, audit reports should belong first and foremost to the firm, not the client. As auditor, he was obligated to determine what was in the audit. Arthur E. Andersen had all audit opinions signed in handwritten signature as “Arthur Andersen & Co.” and, later, with “Arthur Andersen & Co.” plus the responsible partner’s name below it. If any errors or problems were found, they would be corrected, and Arthur Andersen & Co. would pick up the associated costs if the firm was at fault.

Ensuring a Quality Workforce

When Andersen and DeLany purchased their firm, people in the accounting profession were seen as low-level, bookkeepers. But Arthur E. Andersen insisted that a CPA could be much more. Auditors, he believed, had a serious personal and professional responsibility to know the facts behind the figures and to protect the public interest. Arthur E. Andersen set out to find and train a pool of reliable young men who could live up to the professional standards he set.

“The thoroughly trained accountant must have a sound understanding of the principles of economics, of finance, and of organization,” he once said. “It has been the view of accountants up to this time that their responsibility begins and ends with the certification of the balance sheet and statement of earnings. I maintain that the responsibility of the public accountant begins, rather than ends, at this point.”[16]

To do their job, accountants had to be well trained. Arthur E. Andersen was convinced that too many unqualified men were getting a

CPA and advocated that all accountants have an undergraduate degree to get a “broader cultural overview.”[17] In 1915, Arthur Andersen & Co. became the first accounting firm to formally recruit college graduates. Arthur E. Andersen had very specific ideas about who he wanted and how he wanted them trained. He recruited impressionable young men with a strong Midwestern work ethic, just out of college, who showed intelligence but could be molded to his ideas. In addition to grades, he looked for people with modest economic and small-town or farming backgrounds. Many of Arthur Andersen & Co.’s recruits were the first members of their family to move off the farm or attend college. Over his lifetime, Arthur E. Andersen gained a reputation for finding and grooming outstanding people while keeping Arthur Andersen & Co. under his firm control.[18]

Once hired, these young recruits were apprenticed under Arthur E. Andersen or one of the other senior CPAs at Arthur Andersen & Co. Originally, aspiring accountants were required to undertake an internship as part of their training for the CPA examination. Becoming a CPA required the mastery of accounting knowledge, and it was typical for people to spend their first two years doing low-level, low-risk work under the direction of a CPA. But Arthur E. Andersen believed that it was the duty of accounting firms to provide staff with the technical tools for the job, and he required that all new staff learn and follow his methods as part of their internship.

Arthur E. Andersen may not have trusted the system that produced accountants but he had a strong belief in his own methods, and learning them became core to Arthur Andersen & Co.’s professional development. As early as 1940, the firm set up a central training program in local hotels to teach these methods. Thirty-five students attended the first week-long training, Firmwide Audit Staff Training School (FASTS).[19] The training that Arthur Andersen & Co. required was not just about helping employees prepare for the CPA exam. It was also about molding and controlling a uniform workforce that could be trusted to work to the high standards set by Arthur E. Andersen, and he personally groomed most of the men who later became early partners in his firm.

The Andersen Partnership

When Andersen and DeLany purchased their accounting practice, partnership was the established organizational structure for public accounting firms. After DeLany's departure, Arthur Andersen & Co. remained a partnership but, because he owned a majority share of the firm, Arthur E. Andersen dominated every aspect of its operation and took over 50% of all profits. In 1925, Arthur's share of profits was slightly over 57%. The firm's organizational structure very much resembled a simple pyramid with Arthur E. Andersen at the very top. The firm's structure was based not just on his majority ownership but also on his seniority in accounting and his accounting expertise. Every one of the partners who reported to Arthur E. Andersen had been carefully selected to his specifications and trained to his methods. He held command through loyalty, as well as ownership. If partners were at the top of the office pyramid, the firm's founder was at the very top of that peak. Each partner might run one of Arthur Andersen & Co.'s local offices, but Arthur E. Andersen ran the show.

In the last few years of his life, Arthur E. Andersen struggled to find a successor. His brother, Walter, had resigned from the firm in anger, and his son, Arthur Arnold, had not picked up the torch. Arthur turned to consider the partners he had groomed. One early possibility was John Jirgal, an Arthur protégé who had joined the firm in 1920. "But when Jirgal started to gain recognition in the accounting profession, Arthur banished him to the New York office and reduced his authority. Arthur E. Andersen could not bring himself to share the limelight."[20]

As Arthur Andersen & Co. expanded between 1919 and 1947, additional partners were added but Arthur E. Andersen remained fully in control, without a designated heir. He was a majority owner within the partnership and could control the outcome of any partnership vote. Even though partners did not always agree with his decisions, his was too strong and authoritative a voice to muffle.

Until the end, Arthur E. Andersen continued to hold his control over the firm's partnership. He openly stated that the partnership had to remain small to maintain the spirit of unity to speak as one firm. During his lifetime, the firm did speak with one voice—the voice of Arthur E. Andersen. Just two months before his death he continued to stress, "We must have, as we have never had before, a united family, whether the office is inside or outside of the United States."[21]

Arthur E. Andersen died in January 1947 at the age of 61. His health had been failing for some time but his death still came as a shock. On the night before Arthur was to be buried, Leonard Spacek, Arthur's protégé and firm partner, arrived at the funeral home to pay his final respects to his employer and mentor. He had convinced the funeral director to allow this late-night viewing in secret, and it was well after midnight. Against the wishes of Emma, Arthur E. Andersen's widow, Leonard Spacek had brought with him Arthur's brother, Walter. Walter and Leonard had worked together in the Chicago office and had remained friends after the unforgiving fight that had forced Walter's resignation from the firm. Since that fight, neither brother had spoken to the other. Now, Walter stood silently over the casket of his brother for several minutes before turning and walking quickly out the door. Emma "found out about it one way or another and never forgave me," Leonard Spacek remembered.[22] But Spacek was a man of integrity, and despite the widow's wishes, he believed in doing the right thing. Within days of Arthur E. Andersen's death, a bitter battle would be fought over his successor.

The Making of a Myth

After his death, Arthur E. Andersen took on a mythical stature as the firm began to celebrate its founder's life and values. Stories about his life were used to explain the Andersen culture and high standards of performance, as well as to promote a standard of beliefs and behaviors modeled on his original example. Long hours, disciplined days, and a code of conduct that existed to the end of the 20th century were the legacies attributed to the firm's founder at the beginning of that century.

Little reminders of his life and work were everywhere. An antique picture or a letter personally written by Arthur might hang in the lobby of a local office. The Andersen training center outside Chicago dedicated a section of the main building to an exhibit of his artifacts, including a pen, a ledger book, and an early time sheet. The halls of Andersen's worldwide headquarters in Chicago were lined with visual reminders too.

If Arthur E. Andersen cast a long shadow on everyday life at Andersen it was because so many aspects of his personal history, experience, principles, and values were still reflected and clearly observable to Andersen staff 50 years after his death. It is not that Andersen people went about their day thinking about Arthur—they did not—but the way his values and self-discipline were embedded in the firm's methods and ways of doing things that affected their daily lives. His example of hard work, willingness to stretch himself to the limits, and insistence on professionalism in all its forms molded daily routine. The extent to which Arthur's experiences and values were made into myth in the firm half a century after his death is a testament to the long shadow he cast at Arthur Andersen & Co.

Arthur E. Andersen's Legacies

Arthur E. Andersen governed his partnership at Arthur Andersen & Co. with a firm hand, and his ideas dominated the organizational practices that he instituted. His values were immortalized. Arthur E. Andersen's legacies that allowed the firm to grow and thrive after his death included:

1. Integrity and Honesty—Think straight, talk straight values that ensured the auditor's duty to protect the public established the firm's reputation.

2. One Firm, One Voice Partnership Model—A model for unity and cooperation that maintained control of the firm and firm values.

3. Training to a Shared Method—A professional development strategy to create a uniform and predictable workforce that could be trusted to do as they were taught.

Arthur E. Andersen also left the firm a Pandora's Box—consulting. He had ignored the warnings of conservative accountants that bundling consulting with audit services posed a potential conflict of interest. Arthur E. Andersen rightly believed that such a conflict could be avoided if consulting was contained. For him, the box had three sides: (1) strong values, (2) a unified partnership, and (3) staff trained to Andersen's methods.

At Andersen's trial, the firm claimed that the audit team had looked for problems but the client had hidden information from them. Whether or not this is true, Enron engaged in what is now described as "financial engineering." But the real issue on trial, both publicly and in the courts, was Andersen's legacy of honesty and integrity. To begin to look for clues that pinpoint when Andersen's Pandora's Box was pried opened, you need to learn how the Arthur Andersen & Co. partnership responded to Arthur E. Andersen's death. "I went back and read *The First 60 Years"* (a history of Arthur Andersen), said one Andersen Human Resource employee, describing her search to find answers. "It was very clear to me that the partnership was completely different back then."[23]

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