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MARKET CALLS

Harvey, We Hardly Knew Ye

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Donald Luskin

Harvey Pitt and Robert Herdman were helping companies transition to higher levels of regulatory compliance -- it will be a riskier market without them.

With yesterday's resignation of **William Webster** as head of the new **Public Company Accounting Oversight Board**, the media is taking the opportunity to once again vilify the **Securities and Exchange Commission** for being an ineffective watchdog in this year of high-profile corporate scandals. But while the media demands more police-raid photo-ops with CFO's and auditors perp-walked in handcuffs, no one has given the SEC the credit it deserves for quietly going about the urgent business of helping public companies deal with the dangerous transition to a new higher level of scrutiny in financial reporting. Last week's resignation of **Commissioner Harvey Pitt** and **Chief Accountant Robert Herdman** -- triggered by a trivial but very public political error in the appointment of Webster -- throws a wrench in those important efforts, and increases the risk that there will be more accounting bombshells in the future.

The timing couldn't be worse. Most public companies have December year ends, so this is the time when they are gearing up to work most intensely to make sure that their 10-k's conform with new higher standards for reporting and disclosing matters pertaining to related-party transactions, special-purpose entities, non-recurring items, options expense, and other post-**Enron** issues. Pitt and Herdman had established a cooperative working style designed to make their requirements very clear and objective, and to get issues and conflicts to be revealed and resolved ahead of filings. While critics might reflexively say that this indicates excessive coziness with the companies the SEC is supposed to regulate, this approach in fact raises the level of overall regulatory compliance by helping regulated companies to comply. It's like a traffic cop encouraging motorists to slow down so that he doesn't have to give them speeding tickets.

The traditional SEC approach has been to keep the requirements fuzzy and subjective -- "rulemaking by speechmaking" many SEC-watchers have called it -- and to resolve issues only after filing. That's like a traffic cop setting a speed-trap in the hope of being able to issue more speeding tickets. But in today's volatile environment that's a dangerous stratagem -- under the **Sarbanes Oxley Act**, a post-filing issue, however innocent, is potentially a felony. Now with Pitt and Herdman out, there won't be empowered leaders at the SEC to resolve issues before they happen in the first place -- and year-end is fast approaching. Who knows when Pitt and Herdman will be replaced, and whether their replacements will take the view that the traffic cop is supposed to stop motorists from breaking the law, rather than writing a lot of tickets when they do break it? The media may get its perp-walks after all -- and that's one of the biggest reasons why the market has been so choppy this week. TM

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