How Much Distance Does An Auditor Need These Days?

"Thou shalt not invest in corporate audit clients."

This rule that binds auditors seems as rock-solid as the Ten Commandments. If it didn't exist, regulators say, auditors would be more inclined to turn a blind eye to accounting flimflams to protect their own interests. But as the rule has evolved over the decades, it has expanded to cover investments held not only by employees of auditing firms, but by their spouses, children, siblings, in-laws, even grandparents. One curious permutation, the "500-mile" rule, could prove a headache for PricewaterhouseCoopers LLP Chief Executive James Schiro, one of the defendants in the Emcore Corp. lawsuit.

The rule says that if a "non-dependent" child of an auditing-firm partner has a "material" investment in an audit client, and the partner knows of that investment, the partner and the relative can't live within 500 miles of each other. Moreover, the partner can't live within 500 miles of audit-client headquarters.

A person close to the matter says that until the summer of 1998, Mr. Schiro thought his restricted Emcore shares were worthless, based on what the company had told him, and he had written them off on his 1992 taxes. When Mr. Schiro, who lives in Princeton, N.J., later found out from Emcore that the stock had value, the person close to the matter says, he transferred his 165 shares, then valued about $1,629, on Aug. 26, 1998, to his daughter, who lives in New York City. But since both Princeton and New York and Princeton and Emcore's Somerset, N.J., headquarters are within 500 miles of each other, Mr. Schiro still might be in violation of the auditor-independence rules.

That's might with a capital M; the value of the shares must be material to the daughter's net worth for there to be a violation. Mr. Schiro had "no reason to know what her net worth was," or is, says the person close to the matter. Based on gifts her parents have given the daughter, the value of the shares aren't material, this person says, but he says he doesn't know when these gifts began.

In any event, it looks like the 500-mile rule isn't long for this world. The Independence Standards Board is moving to abolish it. "In a day of e-mail and airplanes, the rule doesn't work the same as it did in the days of horses and carriages," says Art Siegel, a board official.

--Elizabeth MacDonald

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