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DIRTY BUSINESS: THE UNCHECKED POWER OF MAJOR ACCOUNTANCY FIRMS

Association for Accountancy & Business Affairs

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Working for an Open and Democratic Society

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DIRTY BUSINESS: THE UNCHECKED POWER OF MAJOR ACCOUNTANCY FIRMS

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ISBN 1-902384-07-5

First published in 2002
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EXECUTIVE SUMMARY

External auditing is promoted as a service that enables stakeholders to manage, control and prevent risks. However, a steady stream of audit failures shows that it also harms people. Audit failures are routinely implicated in the loss of jobs, homes, savings, pensions, taxes and investment. The institutionalisation of audit failures draws attention to the culture and values prevalent within major accountancy firms which are geared towards advancing their narrow economic interests, often at the expense of wider social interests.

Accountancy firms enjoy a state guaranteed monopoly of external auditing and insolvency markets. Yet no independent regulator regulates them. Major accountancy firms will do almost anything to make money. In pursuit of profits they operate cartels, launder money, devise tax avoidance/evasion schemes, bribe officials and obstruct inquiries into their affairs. They use external audits as a loss leader to sell other services. The internal organisation of accountancy firms encourages falsification of audit work. The absence of 'duty of care' to individual stakeholders affected by audits dilutes the economic incentives to deliver good audits. The longevity of auditor appointments encourages personal relationships with company directors. Frequently, audit staff are auditing their own former senior colleagues and partners, now enjoying a directorial position in a client company.

In everyday life, people encounter numerous varieties of auditors ranging from immigration control officers, Inland Revenue, Customs & Excise, Health and Safety inspectors and many more. In no case does the auditee appoint and remunerate the auditor as they do in company audits. The basic audit model fails because it expects one set of capitalist entrepreneurs (accountancy firms) to regulate another (company directors). Profits, income and appeasement of clients measure the success/failure of both. Serving the public interest does not form any part of this equation.

Legal, educational and regulatory environments could check such predatory practices, but they are weak. Accountancy trade associations, rather than an independent regulator, regulate accountancy firms. The main responsibility for the poverty of auditing practices rests with the Department of Trade & Industry (DTI) which has done little to check the anti-social practices of accountancy firms. Indeed, it colludes with the firms to protect and advance their narrow economic interests.

CHAPTER 1
DANGER: ACCOUNTANCY FIRMS AT WORK

In modern societies, people enter into transactions (e.g. investments, pensions, savings, food, and transport) with faceless strangers. There is a recurring danger that the strangers may be untrustworthy and may abscond with the resources and/or indulge in harmful activities. So to manage risks[1], people are increasingly encouraged to value surveillance technologies and place trust in socially accredited specialists with expert knowledges (Power, 1997). Following a 19th century spate of financial scandals, the state invested in systems of surveillance and external auditing came to be institutionalised as a trust engendering technology (Sikka et al., 1998). Auditing increasingly functions as a political technology enabling the state to regulate banks, insurance companies, pension funds and markets (Arnold and Sikka, 2001; Mitchell et al., 2001).

Auditing has been a real boon for accountancy firms. There are no state guaranteed monopolies for engineers, scientists, mathematicians, computer experts and other wealth creators, but audit work is reserved for accountants belonging to a handful of accountancy trade associations. Nearly 600,000 limited companies plus hospitals, universities, local authorities, pension funds, schools, trade unions, housing associations and charities need to have their books audited by an accountant. Not surprisingly, accountancy is an attractive career. Britain has around 250,000 qualified accountants, more than the rest of the European Union put together. Between 10% and 20% of all university graduates are making a career in accountancy. This huge investment in economic surveillance has produced neither superior corporate governance nor freedom from frauds, better protection for stakeholders or business accountability.

Today accountants rather than Parliament decides what counts as solvency, liquidity, asset, liability, equity, debt, income, expense, profit and loss. Their decisions affect pensions, wages, dividends, prices, jobs, taxes and the daily life of shareholders, creditors, employees, pension scheme members and other stakeholders. This huge social investment in economic surveillance gives accountants security of income, job and status. On the back of the state guaranteed market of auditing, accountancy firms have become consultancy supermarkets. Despite making decisions that affect the daily lives of people, accountancy firms are not required to publish any meaningful information about their affairs. To ensure public legitimacy, a President of the Institute of Chartered Accountants in England & Wales (ICAEW) said that

[1] ‘Risk’ is a fairly loose term. In everyday language ‘risks’ tend to be associated with hazards, dangers, threats or harms.

"there is an explicit responsibility to report publicly (whether or not required by law or regulation) incumbent on every economic entity whose size or form renders it significant. By economic entity we mean every sort of organisation in modern society, whether a department of central government, a local authority, a co-operative society, an unincorporated firm .... By significant we mean that the organisation commands human and material resources on such a scale that the results of its activities have significant economic implications for the community as a whole."

We consider that the responsibility to report publicly .... is separate from and broader than the legal obligation to report and arises from the custodial role played by economic entities"

Source: Accounting Standards Steering Committee, 1975, p. 15.

None of this has been followed by any concrete action. The ICAEW has opposed all calls requiring firms to publish any meaningful information about their affairs. Only scandals reveal anything about the composition of the audit team, standards of work, predatory practices, conflicts of interests, nature of the audit contract and their collusive relationship with company directors.

In the pre-Enron world, five secretive firms dominated the global accountancy scene. Their income is greater than the Gross National Product (GNP) of many nation states.

FEE INCOME OF ACCOUNTANCY FIRMS

FIRM	UK INCOME £millions	GLOBAL Income US$ billions
PricewaterhouseCoopers	2,120	22.3
KPMG	1,160	11.7
Deloitte & Touche	796	12.4
Ernst & Young	626	9.9
Arthur Andersen	619	9.3

Sources: Accountancy, July 2001, p. 16; February 2002, p. 13.

In pursuit of profits, major accountancy firms conduct "consultancy audits". They receive as much as 73% of their income from selling consultancy services to their audit clients (Accountancy, October 2001, p. 7). They hire company directors and management, create systems of internal control, director remuneration packages, transactions (e.g. tax figures), operate internal audits, form subsidiaries and design complex financial schemes, and then pretend to audit the same. In the name of efficiency, audit work is often falsified or not done at all (Willett and Page, 1996). Firms openly flout the rules on auditor independence (Securities Exchange Commission, 2000). The economic incentives for delivering good audits are weak. Unlike the producers of sweets and potato crisps, auditors do not owe a 'duty of care' to any individual stakeholder affected by their negligence. Despite major scandals, the Department of Trade and Industry (DTI) has never prosecuted any UK auditing firm for negligence.

Ordinary people are suffering from failures of accounting firms. Audit failures played a part in a crisis for 30,000 Maxwell pensioners (House of Commons Social Security Committee, 1992). They played a part in the closure of Polly Peck, valued at £1.7 billion, and the loss of 17,227 jobs (Mitchell et al., 1991) and facilitated losses to 11,000 shareholders of Sound Diffusion Plc (Department of Trade and Industry, 1991a). Auditors failed to note the frauds that led to the conviction of five officials of the Baptist Foundation of Arizona on 32 counts of fraud, racketeering and theft. 11,000 investors lost £400 million (Daily Mail, 2 April 2002). The US Senate's report on the closure of the Bank of Credit and Commerce International (BCCI) concluded that auditors were a party to a "cover up" (US Senate Committee on foreign Relations, 1992, p. 276) and caused "*substantial injury to innocent depositors and customers* [emphasis added] of BCCI" (US Senate Committee on foreign Relations, 1992, p. 5). Audit failures were associated with the loss of 14,000 jobs and losses to over one million bank depositors with deposits of US$1.85 billion.

In the aftermath of audit failures at secondary banks, property and insurance companies, in the 1970s, the UK taxpayer had to spend £3,000 million to bail out the ailing sectors (Reid, 1982). The frauds and audit failures at Barlow Clowes required the British taxpayer to spend £153 million in compensation to investors (Department of Trade and Industry, 1995; Parliamentary Commissioner for Administration, 1989). The real/alleged audit failures in the US Saving and Loans industry may have cost $400-$500 billion in bailouts (Pizzo et al., 1990). The collapse of Enron, the world's largest bankruptcy, is associated with audit failures where the audit firm devised corporate structures, created numerous subsidiaries (including 900 offshore) and financial transactions. Numerous investors, employees and creditors lost their investment, pensions and savings. The company routinely massaged its accounts to conceal liabilities and report high profits. Enron auditors, Arthur Andersen, performed consultancy services, including (since 1990) internal audits. As the regulators were poised to examine the Enron bankruptcy and Andersen audit failures, the firm shredded a number of relevant electronic and paper documents (Financial Times, 11 March 2002). The US Department of Justice (press release, 14 March 2002) charged Arthur Andersen with criminal conduct. On 15th June 2002, a federal jury convicted Andersen of obstructing justice by shredding key documents of its audit client, Enron.

Given the power and influence of major firms, their activities should be scrutinised and regulated by a powerful independent regulator. Instead, the UK government has delegated regulation to accountancy trade associations. This policy of appeasement has resulted in 23 overlapping regulators (see Appendix 1). Even then there is no independent complaints investigation procedure and no ombudsman to provide speedy and cost effective adjudication of complaints. None of the regulators owes a 'duty of care' to any individual affected by their activities. Unsurprisingly, audit failures are institutionalised and continue to damage the lives of ordinary people.

Almost every week, newspapers report some new incidence of audit failure, all brought to public attention by whistleblowers and investigative journalists or by victims of frauds rather than by accountancy firms, accountancy trade associations or any government department. The auditing industry's standard response to audit failures is to blame someone else, claim that the failures are the work of 'bad apples', tweak auditing standards, codes of ethics, regulation and make calls for better training of accountants (Sikka and Willmott, 1995a). These tactics are designed to deflect attention away from the culture and values of accountancy firms. Failures are not just the result of 'bad apples'; the 'bad apples' are the product of a rotten orchard, and the trees need a good shake. Accountancy firms are engaged in 'dirty business' and their power is unchecked because they colonised and captured the regulatory and political scene to protect their economic interests.

This monograph argues that the ability of accountancy firms to cause substantial injury to depositors, customers, employees, creditors, shareholders, pension scheme members and other stakeholders is, amongst other things, the product of their organisational values and cultures[2]. The prime responsibility for scrutinising

[2] The term 'culture' is subject to considerable debate. Things in themselves rarely have any meaning. It is the participants who give meaning to practices and situations. In the context of this paper, 'culture' is understood as the production and exchange of meanings within an accountancy firm. It is constantly produced

the organisational practices of accounting firms and curbing their capacity to do social harm rests with the government, which granted them a monopoly of the external auditing and insolvency industries. However, successive UK governments have shown little willingness to undertake such investigations. They have delegated the responsibilities to the accountancy trade associations, which act as sponsors, promoters, defenders and regulators of the UK auditing industry (Sikka and Willmott, 1995a, 1995b). The auditing regulators pay little attention to the role of organisational practices and values in institutionalising audit failures and social harms.

This monograph is divided into seven further chapters. Chapter 2 argues that whilst society has made considerable investment in auditing technologies, auditing knowledge continues to fail. It fails because the knowledge base of auditing is unsound. It also fails because auditing firms are primarily profit seeking businesses. In their pursuit of profits, they bend the rules and engage in numerous questionable practices. Chapter 3 shows that in pursuit of money accountancy firms operate cartels, indulge in money laundering, tax evasion and bribery. They also exploit their labour force, threaten clients and use audits to sell other services. Chapter 4 shows whilst legislation continues to strengthen auditor's legal rights, auditors fail to meet their legal obligations. Despite laws, auditors walk away quietly from problem clients. They also reach prior arrangements with company directors and avoid giving meaningful answers to questions at AGMs. Chapter 5 shows that rather than ensuring that accountancy firms meet their social obligations, auditing regulators are very economical with information. We draw attention to research that has problematised auditor's claims of independence. Firms do not respect self-regulation. In pursuit of profits, they have no difficulty in flouting rules. Chapter 6 shows that major firms secure business by claiming to be 'global' organisations, but when their actions are called into question by international regulators, their claims of globalisation evaporate. Chapter 7 shows that since the late 1960s, the auditing industry has mediated public scrutiny by tweaking the regulatory arrangements, the ethical guidelines, the disciplinary processes and by issuing soothing reports which always promise major reforms. However, major reforms never take place. Through these tactics, self-regulation is retained and the auditing industry's accountability is organised off the political agenda. Chapter 8 concludes the monograph by suggesting some reforms.

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and exchanged in personal and social interaction. Meanings also regulate and organise the conduct of daily life (Hall, 1997).

CHAPTER 2
THE SEEDS OF FAILURES

Auditing is frequently promoted as a risk management technology. The very idea of 'risk', in a modern context, assumes that nothing is preordained and fixed and that the social arrangements are the outcome of human action rather than the invisible hand of fate (Lupton, 1999). Modernity creates the feelings that future misfortunes, threats, harms, hazards and dangers can be prevented, controlled or managed by investment in suitable technologies, modes of government, forms of surveillance, accountability, bureaucracy, institutional structures and trust engendering technologies (Douglas, 1986; Giddens, 1991; Beck, 1992). Modernity encourages the belief that the social world can be controlled by investment in modes of objective knowledge and rational thinking and that the risks can be calculated and predicted.

Many of the risks associated with modern life cannot easily be seen, smelt, observed, or felt. So rather than relying upon local knowledges, traditions, habits, or observations, the construction of risks is mediated and regularised by reliance upon specialist knowledges and experts that people rarely meet or encounter in everyday life (Giddens, 1991). By appealing to their status, education and socially constructed credentials, experts seem to hold out the promise of certainty and bringing the future under control. People are encouraged to look to assumed experts to diagnose problems and offer advice. As a result, 'risk' analysis, risk management and surveillance is big business, providing employment for thousands of consultants, advisers, auditors and experts.

The limitations of expert knowledge are often highlighted by unexpected events (e.g. diseases, corporate failures) which show that the concepts and theories advanced by experts cannot adequately grasp reality. As modernity is accompanied by intense fractures and fragmentation of daily life, it also produces social conflicts. In societies marked by social divisions and antagonisms emanating from inequalities relating to class, gender, age, ethnicity, wealth and income, the significance and meaning of expert knowledge cannot be fixed in any permanent sense. The meanings are open to intense struggles, especially by those who claim to have a direct interest in promoting particular interpretations of risk objects and practices. The experts often deflect public criticisms by denouncing critics/victims and arguing that the public expects too much, or that they had been misled by someone else (Douglas, 1982).

In modern societies, expert knowledges and specialists reside in capitalist organisations. These generate pressures to prioritise fees, income, profits and market shares over compassion, care and social responsibility. In pursuit of private gain, some organisations facilitate expertise that causes death and genocide (Black, 2001) and generally promote profit over people (Chomsky, 1999). In pursuit of private gains, food experts have sanctioned the consumption of unfit food (Schlosser, 2001; House of Commons, 2000). Financial experts have sanctioned the sale of undesirable pension schemes (House of Commons Treasury Committee, 1998). Accountants have laundered money (Mitchell, Sikka and Willmott, 1998). Auditors put appeasement of company directors above the interests of employees, pension scheme members and investors (Department of Trade and Industry, 2001). The reliance upon experts is double-edged. It oils the wheels of economy and society, but it also facilitates physical, economic and social injury to a large number of people and to society generally. The social production of wealth, certainty and regulation is systematically accompanied by social production of risks (Beck, 1992), but rarely by reflections upon the organisational values and practices of the assumed experts.

Concerns about risk and regulation are mirrored in the processes of auditing. There is a strongly held view that audit risks can be managed or minimised by the development of objective knowledge in the shape of probabilities and statistical sampling (for example, see Auditing Practices Board, 1995a, 1995b). Auditors are encouraged to make predictions about the future by using past accounting numbers and mathematical models (Altman, 1968; Altman and McGough, 1974; Auditing Practices Board, 1995c) and shield themselves from threats through insurance cover. Alternative forms of knowledge and social understandings have been driven off the educational schema and rulemaking considerations. No amount of sampling, analytical review, or predictive models can persuade auditors to reflect upon the social consequences of their actions. These technologies may help to minimise or direct audit effort, increase profits, and possibly protect audit firms/partners from the consequences of real/alleged audit failures. They rarely encourage reflections upon the negative social consequences of the organisational practices of accountancy firms.

Since company audits are performed by capitalist organisations, their success/failure is measured by fee income, profits, number of clients and market share. Within accountancy firms the emphasis is “firmly on being commercial and on performing a service for the customer rather than on being public spirited on behalf of either the public or the state” (Hanlon, 1994, p. 150). Accountancy firms enjoy a monopoly of the state guaranteed market of external auditing, but the procurement of clients and fee income is heavily dependent upon personal relationships with company directors who need to be persuaded to hire a particular accountancy firm. Securing the office of the auditor is important because it enables the firms to sell lucrative consultancy services. Accountancy firms are part of an ‘enterprise culture’ that persuades many to believe that `bending the rules' for personal gain is a sign of business acumen (Partnoy, 1997). Stealing a march on a competitor, at almost any price, to make money is considered to be an entrepreneurial skill, especially where competitive pressures link promotion, status, profits, markets and niches with meeting business targets.

The expansion of the entrepreneurial accountancy firm has not been accompanied by moral constraints that require consideration of the social consequences of their organisational practices. In such an environment, numerous practices are considered to be acceptable as long as they generate private profits. The ‘failure’ is not seen to be connected with using dishonourable, predatory or anti-social practices but in being exposed or caught, as it can damage the carefully cultivated veneer of respectability and professionalism and limit the possibilities of securing fees and profits. The likelihood of being caught and punished can stimulate reflections upon organisational practices. Such possibilities can be created by developing strong and effective regulatory arrangements. However, the state's ability to intervene is constrained by deregulationist ideologies that seek to limit its ability to monitor the internal practices of accountancy firms. The increasing reliance of political parties and governments upon private monies also constrains the state's ability to institute regulation when it is opposed by major businesses (Chomsky, 1999; Monbiot, 2000). Faced with such constraints, the state has delegated the regulation of auditing to accountancy trade associations. Following the Companies Act 1989, the accountancy trade associations regulate the auditing industry and investigate real/alleged cases of audit failures. They are expected to promote, defend, regulate and prosecute auditing firms. Yet they have no independence from the auditing industry. Rather than examining the organisational values and cultures giving rise to the audit failures the accountancy bodies individualise the failures (Joint Disciplinary Scheme, 1999). This way attention is deflected away from the organisational practices and values. In the weak regulatory environment, malpractices by accountancy firms go unchecked and audit failures remain institutionalised.

The remainder of this monograph draws attention to some auditing practices that offer insights into the organisational culture and practices of accountancy firms. These may help to increase profits and revenues, but are rarely accompanied by reflections upon their consequences for the welfare of audit stakeholders.

CHAPTER 3
MONEY, MONEY, MONEY

Paralleling a fateful remark of Gerald Ratner's to the effect that his shops sell `crap', the chairman of Coopers & Lybrand (now part of PricewaterhouseCoopers) stated that "there is an industry developing, and we are part of it, in [accounting] standards avoidance" (Accountancy Age, 19 July 1990, p. 1). In this environment, firms will do almost anything to make a fast buck.

Double Digit Growth

An analysis of the fees paid by the FTSE 350 companies shows that only 27% of the fees paid to auditing firms are for audits (Accountancy, October 2001, p. 7). The consultancy income from some clients companies dwarfs the audit fees.

SOME EXAMPLES OF FEES PAID TO MAJOR AUDIT FIRMS

Company	Audit Firm	Audit Fee £m	Non-audit Fee £m
AstraZeneca	KPMG	2.14	9.31
BAE Systems	KPMG	3.03	16.21
BP Amoco	E&Y	18.70	34.20
British Airways	E&Y	1.25	4.07
CGNU	PwC/E&Y	6.70	43.00
Cable & Wireless	KPMG	2.70	17.00
Kingfisher	PwC	1.60	8.30
Lloyds TSB	PwC	4.00	32.00
Prudential	KPMG	1.90	18.80
J. Sainsbury	PwC	0.70	12.90
Scottish Power	PwC	1.50	11.40
Shell T &T	PwC/KPMG	11.40	31.50
Unilever	PwC	8.17	39.00
United Business	PwC	0.60	13.30
Vodafone	D&T	3.00	22.00
WPP	AA	3.70	6.40

Source: Accountancy, October 2001, pp. 72-73.

Audit gives accountancy firms easy access to company directors and a competitive ‘inside’ advantage over their consultancy rivals. They use audits as a stall to sell executive recruitment, internal auditing, financial engineering, advice on mergers, downsizing, information technology, trade union busting and tax avoidance. For a fee, some firms will front shell companies, act as company directors, post boxes, print T-shirts and badges and lay golf courses. In pursuit of money they have become part of client companies and an extension of their finance and personnel departments. Instead of conducting 'independent audits', major firms offer 'consultancy audits' where the aim is to maxmise the opportunities to sell consultancy services. All this has enabled them to achieve double-digit growth in profits and fees.

The carefully constructed veneer of professionalism conceals anti-social practices. They operate cartels to carve-up and control markets. Italy's competition authority has fined five leading accountancy firms £1.4m for anti-competitive practices between 1991 and 1998. The competition authority said it was fining Ernst &Young, PricewaterhouseCoopers (PwC was formed by the merger of Price Waterhouse and Coopers & Lybrand in 1998), Deloitte Touche Tomatsu, KPMG and Arthur Andersen for "consistently distorting market competition in Italian accountancy services", in particular by standardising prices co-ordinated to win clients. The firms admitted the charges and provided information which helped the Italian competition watchdog in its inquiry. The antitrust body said that it had taken this into account when imposing the fines (Financial Times, 22 Feb 2000, p. 8).

All over the world, ordinary people bear a higher share of tax to finance essential social infrastructure. This burden is increasing because a rich elite and many major corporations are avoiding taxes through novel avoidance schemes. Major accountancy firms charge around £500 per hour to devise elaborate schemes for tax avoidance. Accountancy firms, such as Arthur Andersen, KPMG, Deloitte & Touche, PricewaterhouseCoopers (PwC) and Grant Thornton have become multinational enterprises by advising companies on strategies for avoiding taxes (New York Times, 16 April 2002). A favourite tactic is to advise major corporations and the rich to escape to secretive offshore tax havens. Developing countries are losing some US$50 billion due to tax avoidance. The UK taxpayer is estimated to be losing some £85 billion of tax revenues (Mitchell et al., 2002). Inevitably, ordinary people bear the cost of this by paying a higher proportion of their income in taxes and receiving worse public services.

With the rise of information technologies, deregulation, globalisation and easy transfer of money, accountancy firms have added money laundering to their list of profitable services. More than US$1.6 trillion (roughly equivalent to the gross national product of France) is estimated to be laundered each year. Most of the money comes from tax evasion, illicit trading, narcotics, bribery, smuggling, murder, slavery, pornography, robberies and prostitution. The illicit cash is turned into cybercash and transactions through shell companies and bank accounts. Accountants and lawyers, whose main concern is to secure private fees, front many of these. Their reward is around 20% of the money laundered. No one can launder large amounts of monies without the direct or indirect involvement of accountants. Accountants report less than 1% of the suspicious transactions reported to the National Criminal Intelligence Service (NCIS).

TOTAL NUMBER OF DISCLOSURES MADE TO NATIONAL CRIMINAL INTELLIGENCE SERVICE

YEAR	TOTAL DISCLOSURES	DISCLOSURES BY ACCOUNTANTS	DISCLOSURES BY SOLICITORS
1992	11,289	1	4
1993	12,750	2	4
1994	15,007	6	86
1995	13,710	38	190
1996	16,125	75	300
1997	14,148	44	236
1998	14,129	98	269
1999	14,500	84	291
2000	18,408	77	249

Source: Annual Reports of the National Criminal Intelligence Service.

Each year the NCIS complains that accountants do not report money laundering and suspicious transactions to it. In response, the DTI Ministers wring their hands and the accountancy trade associations make pious statements. The 'Proceeds of Crime Bill' proposes to make it a criminal offence for accountants not to report any suspicions or dubious transactions to the National Criminal Intelligence Service (NCIS), as well as the Inland Revenue. In response, the ICAEW claims that the "government plans to crack down on money laundering could be very damaging economically and pose a serious threat to the role of the accountant" (http://www.accountingweb.co.uk, 6 June 2001).

Evidence relating to the involvement of accountancy firms in money laundering is not hard to find. In a High Court case, Lord Justice Millett pointed the finger at accountants and accountancy firms and said that

"Mr. Jackson and Mr. Griffin knew .... of no connection or dealings between the Plaintiffs and Kinz or of any commercial reason for the Plaintiffs to make substantial payments to Kinz. They must have realised that the only function which the payee companies or Euro-Arabian performed was to act as "cut-outs" in order to conceal the true destination of the money from the Plaintiffs .... to make it impossible for investigators to make any connection between the Plaintiffs and Kinz without having recourse to Lloyds Bank's records; and their object in frequently replacing the payee company by another must have been to reduce the risk of discovery by the Plaintiffs".

"Mr. Jackson and Mr. Griffin are professional men. They obviously knew they were laundering money. .... It must have been obvious to them that their clients could not afford their activities to see the light of the day. Secrecy is the badge of fraud. They must have realised at least that their clients *might* be involved in a fraud on the plaintiffs".

Jackson & Co. were introduced to the High Holborn branch of Lloyds Bank Plc. in March 1983 by a Mr Humphrey, a partner in the well known firm of Thornton Baker [now part of Grant Thornton]. They probably took over an established arrangement. Thenceforth they provided the payee companies... In each case Mr Jackson and Mr Griffin were the directors and the authorised signatories on the company's account at Lloyds Bank. In the case of the first few companies Mr Humphrey was also a director and authorised signatory".

Source: High Court judgement in *AGIP (Africa) Limited v Jackson & Others (1990) 1 Ch. 265 and 275*; also see Mitchell et al., 1998.

In the above case, 27 separate companies were used to launder money, making it difficult to trace the source and destination of the proceeds. The paper trail went from Tunisia, London, the Isle of Man and Jersey to France and beyond. Most of the companies never traded but millions passed through their bank accounts. Accountancy firms collected fees for forming, operating and liquidating the shell companies. Despite the very clear and strong court judgement, there was no independent investigation or inquiry. The ICAEW and the UK government did the usual whitewash. Their main priority, as always, was to shield accountancy firms and their partners (Mitchell et al., 1998). Not surprisingly, money laundering is on the increase and accountancy firms don't bother to report suspicious transactions to the authorities.

To maintain their growth in profits, accountancy firms constantly need to find new ways of making money. Anything and everything is commodified to make money. Some firms have little hesitation in bribing officials to ensure that their ‘private’ interests triumph over the wider social interests.

“In 1996, the US regulators concluded a case involving the bribery of bank officers in U.S. and foreign banks in connection with sales of emerging markets debt, transactions that earned millions for the corrupt bankers and their co-conspirators. In this case, a private debt trader in Westchester County, New York, formerly a vice president of a major U.S. bank, set up shell companies in Antigua with the help of one of the **“big-five” accounting firms**. Employees of the accounting firm served as nominee managers and directors. The payments arranged by the accounting firm on behalf of the crooked debt trader included bribes paid to a New York banker in the name of a British Virgin Islands company, into a Swiss bank account; bribes to two bankers in Florida in the name of another British Virgin Islands corporation and bribes to a banker in Amsterdam into a numbered Swiss account” [emphasis added].

Source: Evidence by Robert Morgenthau, New York District Attorney, to the Permanent Subcommittee on Investigations on 18 July 2001 (http://www.senate.gov/~gov_affairs/071801_psimorgenthau.htm)

The shell company in the above case went under the name of Merlin Overseas Limited. There was no actual physical business in Antigua, named Merlin. It consisted of little more than a fax machine in a Caribbean office of Price Waterhouse (New York Daily News, 10 January 1999). “This accounting company was complicit”, said Robert Morgenthau, the Manhattan district attorney. “They facilitated hiding of bribes that were paid to bank officers, and they provided the officers and directors for those phoney companies”. Morgenthau prosecuted the rogue at the centre of the scheme but could not put his hands on Price Waterhouse. The district attorney’s office asked Price Waterhouse in Manhattan for help in reaching the people behind Merlin, but the help was not forthcoming. They were told that the Price Waterhouse in Antigua is not the same legal creature as the one in New York.

All over the world major accountancy firms are facilitating anti-social activities. They obstruct inquiries into frauds and fiddles and shield money launderers and fraudsters.

“In 1996, the U.S. Department of Justice came into possession of a tape containing computerised records of a defunct Caymans bank, Guardian Bank and Trust Company. The bank was started by John Mathewson, a businessman from Illinois. Years after opening a numbered Swiss bank account whilst vacationing in the Caymans, he was persuaded by a Caymans banker to start his own bank. According to Mathewson, his application for a bank licence asked for little more than his name, address and previous bank history. The bank was set up and used to launder money for its depositors, 95% of whom were U.S. residents. Fake invoices to enable US citizens and corporations to disguise deposits were used. The government of Cayman sought to block the release of banking information and refused to help the FBI to decode computer records. The official Cayman liquidators of the bank (two partners in **another major world-wide accounting firm**) brought a suit in the U.S. District Court in New Jersey seeking the return of the computer tape to the Caymans. In their brief, the liquidators argued that disclosure of the contents of the records to, among others, the U.S. Internal Revenue Service would "Have a significant negative impact on the integrity, confidentiality, and stability of the financial services industry of the Cayman Islands. …. The confidence of the offshore financial community in the privacy afforded to legitimate account holders of Cayman Islands offshore banks is at the heart of the Territory's financial services industry and economy, as a whole. …. Thus, not only would the Bank be irreparably injured by the government's retention of the Tape, but the international bank and Eurocurrency industries of the Cayman Islands (and, indeed, the economy of the Territory), could suffer irreparable injury as well". After decoding the tape without the help of the Caymans government, the US authorities discovered that the Guardian Bank's U.S. depositors had $300 million offshore, hidden from tax authorities, litigants and creditors. In view of his help to the US authorities, Mathewson was given a five year suspended prison sentence and said, "I have no excuse for what I did in aiding US citizens to evade taxes, and the fact that every other bank in the Caymans was doing it is no excuse".

Source: Evidence by Robert Morgenthau, New York District Attorney, to the Permanent Subcommittee on Investigations on 18 July 2001 (http://www.senate.gov/~gov_affairs/071801_psimorgenthau.htm); also see The Times, 4 August 1999, p. 16; Mitchell et al., 2002.

The Pursuit of Private Interests

The Enron scandal has shown that major accountancy firms exert pressures on partners and senior staff to increase revenues and profits. Those doing that are rewarded with status, bonuses and salary increments. Some firms intimidate audit clients in an effort to sell consultancy work. Angered by a client who used the services of an independent consultancy company to value its brands for accounting purposes, the audit firm threatened the client suggesting that audit costs and ‘problems’ would rise if the independent consultancy company was used in preference to the firm's consultancy division (Accountancy Age, 14 February 1991, p. 1 and 17; Accountancy, March 1991, p. 11). The consultancy company complained to the ICAEW by arguing that "We find attempts to cajole clients into using consultancy services by threat of "problems" exceptionally seedy and unpleasant" (Accountancy Age, 14th February 1991, p. 17). The ICAEW did its usual whitewash.

A myth promoted by the accountancy industry is that the purchase of auditing and non-auditing services from the same firm somehow results in lower costs. Such myths are not supported by research (Simunic, 1980, 1984). This shows that when management invite competitive tenders, shop around and purchase auditing and non-auditing services from two separate firms, they get a lower price. As Simunic (1984) concludes, "audit fees for clients who purchased MAS [Management Advisory Services] from their auditors are higher than those of clients who did not do so" (p. 699).

Audits have long been used as loss-leaders to secure non-auditing work (Accountancy Age, 6 June 1991, pp. 1 and 4). Some firms have been offering free audits in the hope of picking up lucrative consultancy work (Accountancy Age, 20 June 1991, 1; Accountancy Age, 24 October 1991, p. 1). Lowballing is rife, with the big firms sometimes undercutting the medium-sized firms by as much as a third (Accountancy Age, 9 May 1991, p. 1; Accountancy Age 23 May 1991, p. 1; Accountancy Age, 9 January 1992, p.1). Price Waterhouse (subsequently part of PricewaterhouseCoopers) undercut the incumbent auditor of RAC by nearly 50% to secure the audit. Outgoing auditors, BDO Stoy Hayward, claimed that “We believe that this demonstrates a determined approach to price their audit work on a predatory basis so as to secure an appointment which might enable them to introduce higher priced consultancy services to RAC in due course” (Accountancy, June 1995, p. 13). As audit quality is neither visible to the public nor monitored by an independent regulatory agency, poor work only comes to the surface when an inquiry follows a company collapse/fraud or some investigative journalist pursues a story.

To maximise profits, firms impose tight time budgets on audit staff even though time constraints have played a major part in audit failures and incompleteness of audit work (Department of Trade and Industry, 1995). The time budgets are squeezed in the hope that audit teams will work free on evenings and week-ends to finish the work (for examples see, Accountancy Age, 24 March 1994, page 1;

Accountancy Age, 24 March 1994, page 1; The Times, 2 November 1995, p. 30). Fearful of losing their jobs and study leave, some oblige, but large numbers of audit trainees either use short-cuts, irregular practices or resort to falsification of audit working papers (Otley and Pierce, 1996). A survey by Willett and Page (1996) found that due to time pressures a large proportion of audit staff rejected awkward looking items. They accepted doubtful audit evidence, failed to test the required number of items in a sample, or simply falsified the audit working papers to give the impression that the work has been done. Such practices were carried out by senior and junior members of the audit teams. As the audit review process cannot completely reperform the audit, irregular audit practices rarely come to light.

In this environment of tight time budgets, competition and pursuit of higher profits, auditing firms look for ways of achieving efficiency. One of the common practices is to use checklists for controlling, planning and recording an audit. Such devices standardise audits and also make the process much more mechanical, predictable and possibly boring. The checklist mentality encourages irregular practices. In a radio programme (BBC Radio 4 – File on Four, 9 October 2001), an auditor with ten year experience said,

> "If you pitch for an audit of certain value, obviously you have to try and do it within that price, so you skip lots of corners. I mean, you've got lots of checklists to fill-in – have you seen this? You just end up ticking 'yes I've seen this, I've seen this,' even though you haven't ….. So you end up with piles of checklists on your audit working papers, which basically are a complete fabrication, because you actually haven't done the work. It's so easy to just sit there and fill in checklists, even back in your hotel room, not even at the client's premises, just so that when the partner rings up the next morning and says, 'I hope you're at least three quarters of the way through the audit', you can say, 'Yes, I am.' The public doesn't know what an auditor actually does. They don't know the mechanics of an audit, so they are not aware of how much work has actually gone on to verify and authenticate the figures in the accounts. If the public were aware of, you know, sometimes how little work goes on, I think they'd be quite surprised and would be less inclined to take a clean audit report as being gospel that the accounts are actually accurate"

In folklore, the final audit opinion should be based upon the audit evidence collected and evaluated. However, in practice the economic interests of auditing firms, including the desire to sell non-auditing services, often prevail. According to an auditor, "There can be various times when you'd want to qualify an audit, when you are not happy with things. The partners or partner responsible would be less inclined than yourself to qualify the report, mainly because they want the continuing business, or they already have a relationship with the client, or to keep the client on board, because there's other aspects to the job as well, not just the audit. There's also the accounts, all the directors' tax returns, there might be a lot of tax planning and financial planning services going on as well, and management consultancy. All those sort of things are being provided to the client, which really ruins any independence you've got as far as being an auditor is concerned, because of all the background services that are also being provided. So there's enormous pressure not to qualify the report, because you don't want to lose the client.

[An example] The client was being very uncooperative indeed about stock, wouldn't give us any stock records or stock level, and indicated that cooperation would only be given once he was aware of what our draft profit figures were. I told the partner that this was unacceptable and really we should qualify the report. However, the partner and the client were friends and, following, I suspect, a dinner or a drink or whatever, I was informed by the partner that this particular stock figure had been agreed and that there would be no qualification on the report. I have to say I was very unhappy about that, because it was obvious that the figure couldn't be validated in any way. [Reporter: So they just went out to dinner together and cooked the books?]. Yes, you could say that. They basically agreed a figure which was put in the accounts, and the audit was signed off. …. In a sense they're defrauding anyone that's lent money to them, you know, their bankers, obviously the creditors, people doing business with them. Obviously also the Inland Revenue. If the tax liability is based on the accounts and those accounts are incorrect – for whatever reason – the correct liability is not being collected"

Source: BBC Radio 4 – File on Four, 9 October 2001.

The public is encouraged to believe that audits are conducted and supervised by experienced individuals. The DTI report on the collapse of Rotaprint plc found that

"The [audit] manager ….. had no previous knowledge of the client. The remaining members of the audit team comprised an unqualified senior who had worked as a junior on the audit ..... and four junior trainee accountants. The junior trainees were all at the same level of experience having joined Arthur Young [now part of Ernst & Young] some months earlier .... The audit team was therefore composed of relatively inexperienced trainees led on a day-to-day basis by an unqualified senior"

Source: Department of Trade and Industry, 1991b, p. 46.

The public is encouraged to believe that auditors collect relevant and reliable evidence form their opinion. The reality is that in pursuit of profits, auditors do not always bother with such niceties. The DTI report on the collapse of London United Investment concluded that

"It was a mistake by KPMG not to have obtained third party confirmations ..... it was a conscious decision by KPMG not to obtain third party confirmations ..... We disagree with this decision"

Source: Department of Trade and Industry, 1993a, p. 281.

The public is encouraged to believe that auditors consider the accounting implications of all material transactions before signing the audit report. The DTI report on irregularities at Edencorp Leisure plc reported that

"Ernst & Young as auditors of the group signed an unqualified audit report on Edencorp's 1989 group accounts without apparently considering the accounting implications of the significant invoice issued .... We are therefore surprised that the accounting treatment adopted for the transaction was given so little attention by the finance director and auditors".

Source: Department of Trade and Industry, 1993b, p. 47.

A 300 page report on the collapse of Vehicle and General, which insured some 10% of Britain's motorists, was highly critical of the auditor's failure even to perform basic arithmetical checks on financial statements. For instance, an investment of £82,040 was shown as £820,040, but was not spotted by the auditors (Department of Trade and Industry, 1976a). Major audit deficiencies were also exposed by the report on London and County Securities (Department of Trade and Industry, 1976b). The company had entered into illegal share dealings and there were also fraudulent transactions between the company, directors and their families. The report described the company's accounts as "misleading to a material extent" (para 234) and criticised poor auditor performance.

The commercial considerations have persuaded auditing firms to remain silent sample content of Dirty Business: The Unchecked Power of Major Accountancy Firms