Criminal masterminds: the real 'Big Four'

By Robert Barwick

As dramatised in the film *The Untouchables*, US Treasury agent Eliot Ness took down Chicago mobster Al Capone's criminal empire by going after the only people who could prove his crimes: his accountants. A new report commissioned by the UK's Shadow Chancellor of the Exchequer, Labour MP John McDonnell, has dared to finally get serious about cleaning up the financial system by taking on the guardians of the corruption and criminality in the banks and big companies, the Big Four global accounting firms.

Released in December 2018, the report, *Reforming the Auditing Industry*, was prepared by a team of experts led by retired accounting professor Prem Sikka, who advised the British parliamentary inquiries into the collapses of the large retailer BHS and contractor Carillion. It exposes how the Big Four—PricewaterhouseCoopers (PWC), Ernst & Young (EY), KPMG, and Deloitte—are more influential and pervasive in their criminality than even the banks in the City of London and Wall Street, or Australia's Big Four. These four firms "audit almost all of the UK and the world's major banks and leading corporations", the report notes; independent Australian investigative reporter Michael West in 2016 put the figure at 98 per cent of the world's largest multinational companies. The Big Four have therefore signed off on the illegal activities and fraudulent accounting that is rife in the banking system, and which caused all the major financial crises of recent decades, including the 2008 global financial crash. They have protected the predatory practices by which corporate executives and large shareholders have been able to loot companies for their own personal wealth, which has bankrupted companies and robbed employees, pension funds and small business creditors. They have also designed and overseen the world's tax avoidance/evasion infrastructure and practices, which collectively robs governments of trillions of dollars and equivalent of revenue that could otherwise be spent on services and infrastructure. Amazingly, they have never seriously been held to account for their role in these financial disasters, crimes and schemes.

The report proposes to break the stranglehold of the Big Four in the UK in one fell swoop through the creation of a statutory auditor, which is backed by the government and works closely with financial regulators, to conduct the audits for all major financial companies, including banks, building societies, credit unions, insurers and major investment firms. This recommendation has implications far beyond the UK. It is guaranteed to enrage the Big Four and their clients all over the world, including Australia's major banks, out of fear that if enacted, other governments will feel pressure to follow suit. It happens that the release of this report and its central recommendation coincides with the Citizens Electoral Council of Australia preparing a proposal for Australia's Commonwealth Auditor-General to conduct an independent audit of Australia's Big Four banks, as the only way to get a true picture of their financial position in light of the falling property values that comprise the collateral for the majority of their assets.

A fundamental conflict of interests

As Australia's Financial Services Royal Commission repeatedly highlighted throughout 2018, the financial system is riddled with conflicts of interests, which are at the centre of virtually all instances of crime and misconduct. The Big Four accounting firms are structured around a fundamental conflict of interests.

Auditing is a state-mandated function—companies are required by law to have their books audited by an external auditor. Accounting firms thus enjoy a state-mandated market, in every country. Auditing the biggest banks and corporations is such a large task that only the largest accounting firms have the capability to do it, which is how the Big Four came to so comprehensively dominate the auditing of large corporations worldwide.

The purpose of audits is to give stakeholders—shareholders, customers, regulators, etc.—confidence in the companies' financial accounts; the integrity of the audit is therefore all-important. However, the Big Four accounting firms don't just audit big corporations, they also provide consultancy services to the same corporations, which actually comprises a bigger part of their business than auditing. In general, one third of the Big Four's revenue comes from auditing, and the rest from consultancy services. This means there is no way that their audits can be trusted as independent.

Reforming the Auditing Industry states in its Executive Summary: "Auditors have been unable to deliver independent and robust audits and the auditing industry is in disarray, dysfunctional and stumbles from one crisis to another. Auditing firms are mired in conflict of interests and have shown willingness to bend the rules at almost any cost to increase their profits. A steady parade of scandals has followed and auditors' silence has been a major factor in loss of people's pensions, jobs, savings and investments."

The steady parade of scandals includes:

• Carillion, the British multinational facilities management and construction services company which won many government contracts. The report summarised: "Carillion entered liquidation in January 2018. It had about 43,000 employees (19,500 in the UK) and £7 billion of liabilities to 30,000 small businesses, most of whom will lose almost everything owed to them. The pension scheme deficit of £2.6 billion will force employees to lose some of their pension rights. Carillion had non-current assets of £2,163 million, and £1,571 million of this was goodwill, which had not been amortised for years and this helped to overstate the profits which was a boon for executives collecting profit-related pay. For the period 2009-17, Carillion's debts rose by 297 per cent, whereas the value of its long-term assets grew by just 14 per cent. From December 2009 to January 2018, the total debt owed by Carillion increased from £242 million to an estimated £1.3 billion. In the five-and-half-year period from January 2012 to June 2017, Carillion paid out £333 million more in dividends than it generated in cash from its operations. *None of this aroused any interest from auditors*. KPMG audited the company for 19 years and always gave the company a clean bill of health." Other British scandals involve BHS, Tesco, BT, Quindell, Autonomy, Rolls Royce, Cattles, Conviviality, and Patisserie Valerie.

• In the 2007-08 financial crisis, the UK banks that crashed had all received cleans bill of health from the auditors; some, like Northern Rock, within days of going under. British taxpayers eventually put up £1.162 trillion to rescue and prop them up.

• The bank that triggered the September 2008 global banking meltdown, Lehman Brothers, was audited by EY, which signed off on its annual accounts in January 2008, and gave its quarterly accounts a clean bill of health on 10 July 2008, two months before it declared bankruptcy. Lehman Brothers had disguised its extreme vulnerability, which came from being leveraged more than 30 to 1, by an accounting gimmick which involved selling US$50 billion worth of assets just before year's end at a 5 per cent discount under a repurchase agreement, using the cash to temporarily pay down debt, and then immediately buying back the assets and booking up its debt again after the books were closed. The New York Attorney General accused EY of assisting Lehman Brothers to "engage in a massive accounting fraud".

"Yet no questions have been asked of auditors", the report notes of the UK's financial authorities. Neither the UK's Financial Reporting Council (FRC), Financial Conduct Authority (FCA), or Prudential Regulation Authority (PRA) has examined audit failures or brought action against the firms. While the FDIC in the United States has taken some action against PWC, it is minor in relation to the scale of the problem. The reason for this is that the Big Four are also massively intertwined with governments and regulators. In a damning passage, the report reveals:

"As a consequence of the closeness of the ties and the capaciousness of the revolving doors, successive governments have indulged the firms by giving them liability protections and shielding them from the consequences of their failures. This has diluted incentives to deliver good audits. Their partners have colonised HMRC [Her Majesty's Revenue and Customs—the tax office] and are permitted to write laws which ensure that they and their clients always win. They advise government departments and promote accounting-think to promote more demand for their services. *They have colonised regulatory bodies*. They hire legislators, former and potential ministers to advance their business interests. Unsurprisingly, they have been highly influential in determining and preserving the rules of the game in which they are the most highly rewarded players. In 2007, the combined global revenues of the big four firms was US$89 billion and by 2017 it reached nearly US$142 billion, a growth of almost 60 per cent, making them the 56th largest economy and dwarfing the gross domestic product of countries such as Hungary, Kuwait and Ukraine. The rents from the state-guaranteed market and revenues from services sold on its back have swelled the coffers of the UK arms too. In 2007, the big four firms had combined revenues of £6,354 million and by 2017 they reached £11,864 million, an increase of nearly 87 per cent at a time when the UK economy hardly grew and workers' share of GDP plummeted to all time low of 49.14 per cent. In [financial year] 2017/18, the average profit per partner at Deloitte was around £832,000; £712,000 at PwC; £677,000 at Ernst & Young, and £519,000 at KPMG (rising to £601,000 in 2018). *This represents a return of around 200 per cent on their capital*." (Emphases added.)

Australia too!

Michael West reported on 20 August 2016 that the Big Four accounting firms enjoy the same pervasive influence over Australia. He quoted Martin Lock, formerly the head of withholding tax for the Australian Tax Office (ATO), on the pervasiveness of the four firms in formulating laws:

"These same stalwart firms are ensconced on the Board of Taxation, its Working Groups, CPA Australia, the Institute of Chartered Accountants (since renamed CAANZ) and the ATO's very own National Taxation Liaison Group, which the ATO describes as 'one of the ATO's eight stewardship committees which addresses strategic issues to benefit Australia's taxation and superannuation system' and which 'drives improvements … to … tax law interpretation, administration, design and policy (including technical issues); confidence in and compliance with the tax system; and ATO service delivery'."

West continued: "Then there are the dozens of millions of dollars lavished yearly by governments upon the Big Four for consulting reports and advice, and staff 'secondments' between the mega-firms and bureaucracies such as the Tax Office and the corporate regulator." West contacted each of the Big Four auditors to ask the obvious question, "Who audits your firm?", but they wouldn't tell him. West posed the rhetorical question, "Who is guarding the guards?", and answered: "The short answer is nobody. The guards are guarding themselves. And not only are they guarding themselves but they are writing the laws of nations."

On 29 November 2017, the Australian Greens and the National Party agreed to include the Big Four accounting firms in the terms of reference for the Financial Services Royal Commission, to be investigated along with the banks. The next day the Turnbull government hurriedly called a royal commission with different terms of reference approved by the banks, in which the Big Four firms were not included. As PWC audits CBA and Westpac, EY audits NAB, and KPMG audits ANZ, which banks were subsequently exposed as criminal enterprises, this decision to exclude the auditors was a conscious cover-up. With the royal commission now concluded, the CEC is calling for an independent audit of the Big Four banks, which will not only expose their true financial position, but also the failings of the Big Four auditors.

On notice

Reforming the Auditing Industry is not yet UK Labour Party policy, but it is a submission to the party's policy-making process. It is a signal to the country's financial apparatus that a Jeremy Corbyn Labour government intends to push through serious changes to the financial system, which has implications for the whole world. Political parties in every country who talk about financial reform, such as the Australian Labor Party, should prove they are serious by adopting the policies in this report.