FIVE BROTHERS

THE RISE AND NEMESIS OF THE BIG BEAN COUNTERS

new economics FOUNDATION

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"Your have a great brew of greed, and hubris, and excesses, and financial wishful thinking, and that adds up to a weakening of the auditing process. They've been infected."
Paul Volker, Financial Post, February 16, 2002.

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PREFACE

This report began life at least 18 months ago when accountancy firms had an arcane, esoteric and mostly ignored place in the public imagination. It's purpose was to chart a sector whose meteoric rise in the global economy was matched only by its relative invisibility and lack of accountability. The over-heated humming of paper shredders in the US offices of audit firm Andersen during the collapse of energy giant Enron changed all that. Reform of the quiet but hugely influential professional services firms is now considered overdue. Industry insiders once blamed the lack of a 'burning platform' for the failure to act. With Enron, here was one. Ironically, as a relative of the old *Seven Sisters* oil giants, Enron has helped propel what we call the *Five Brothers* – the accountancy giants of the new service economy – into public view.

Some of the issues we planned to raise are now top of the reform agenda. Corporations ranging from food multinational Unilever, to insurer CGNU and Walt Disney are all talking of barring their auditors from also working as consultants.[1] A seemingly unstoppable trend toward behemoth 'multidisciplinary partnerships' is running into trouble. A business press more usually associated with arguing the case for a lighter regulation now calls for tighter control.

Embarrassing moments for auditors are becoming all too familiar. Lessons from the spectacular collapse of Barings bank failed to prevent a subsidiary of Allied Irish Bank (AIB) subsequently losing $750 million through fraudulent currency speculation, something that its auditors, PwC, failed to notice.[2]

Over half of the $52 million Andersen earned from Enron in 2000 came from non-audit fees. Such potential conflicts of interest were supposed to have been dealt with by the separation of consultancy from audit work. Yet, confusingly for the ordinary observer, Andersen had long before spun-off its consultancy arm, formerly Andersen Consulting, now known as Accenture.

Under threat of regulation from the US Securities and Exchange Commission, most of the Five Brothers grudgingly conceded the separation of their consulting and audit work by the year 2000.[3] One, Deloitte Touche Tohmatsu, held out until after the Enron debacle making the decision "very, very reluctantly" and seeing it as a "step backwards."[4] But perceived conflicts of interest continue as the auditors still offer a range of other services to the companies they audit. Now, some of the Five Brothers are promising to go further and support tighter rules.[5] The *Financial Times* suggests the profession is gambling that, "a calculated concession or two may make regulators less likely to introduce sweeping restriction," but concludes, "the pace and degree of change inspires little confidence."[6]

But recently exposed conflicts of interest are only a small part of the picture for the 'Five Brothers'. Their rise to worldwide influence occurred virtually uncharted. Yet to the emerging global service economy they stand much like the oil giants once stood astride the world economy in the 1960s and 70s. They enjoy a huge, ranging and subtle influence. The Enron affair has helped re-ignite the debate about the role of big corporations in the new era of globalisation. Unusually it has thrown an uncomfortable spotlight on a profession – accountancy – that has profited and grown in the shadows thrown by their corporate clients with household names.

This report is another torch to reveal what lies in the cellar. It is aimed at increasing awareness of one of the least accountable, yet most influential players in corporate-led globalisation – the accountants.

Andrew Simms
March 2002

EXECUTIVE SUMMARY

Operating previously unnoticed behind the scenes of the global economy is a group of pallid professionals whose role has, in recent years, expanded from checking the company books, to advising on everything from filing taxes, to managing their employees, and swallowing up competitors. Who are they? The accountants, and they are far from the retiring bean-counters of popular myth.

Spearheading the rise of the accountant has been a core of mega-firms, the Five Brothers of Andersen, Deloitte Touche Tohmatsu, Ernst & Young, KPMG and PricewaterhouseCoopers. Together they audit all the FTSE 100 top companies, and many more besides. They employ over half a million people and generate $65 billion in revenue. No longer restricted to the remit of auditors, these 'professional services' companies quietly exert a staggering influence over the business world. They also create and nurture the managerial culture that permeates corporate globalisation. At least in theory, they hang the principles of efficiency, competitiveness and fiscal rectitude like the Sword of Damocles over even the largest global companies.

But their rise to prominence may have uninvited consequences. Already the focus of regulators, the anti-globalisation movement might be next. Popular protest against multinational corporations that are household names could move on, up the food chain of finance and corporate led globalisation, to the powers behind the company thrones – the Five Brothers.

Enjoying the benefits of partnership status means that less information is publicly available on the Five Brothers than on the companies that they audit. For that reason this report draws on information that has made its way into daylight. In the report, NEF investigates the Five Brothers, rooting through their chequered pasts and exploring how deep their power really lies. On the evidence thrown up, the report makes the following charges:

- That history is passing by orthodox accounting, leaving it almost redundant. Though still a legal requirement it is increasingly meaningless. So-called intangibles now make up at least 70 per cent of the value of the FTSE 350 companies. Yet there is no meaningful measure of many intangible assets such as trust and human capital. Where intangibles are measured, their accounting lacks transparency and consistency. Additionally, new public expectations of social, ethical and environmental corporate performance have raised the profile and importance of elements that never make it on to the balance sheet. The conventional financial statement is increasingly irrelevant;
- That the Five Brothers are actively facilitating the consolidation and *concentration* of *corporate* power;
- That the Five Brothers have expanded to the extent that their relationship as both service providers and auditors to their clients represents a dangerous and inefficient *conflict of interests*
- That the close relationship between the Five Brothers and their corporate clients means that they can slip into a *'spin doctor'* role. This situation may be more likely to conceal information that could damage shareholder confidence, or that could reflect badly on a company's social or environmental accountability
- That, through their intimate knowledge and ability to work the international financial system, the Five Brothers are aiding in aggressive tax minimisation that ultimately undermines democratic government; implicitly supporting dubious financial regimes and other forms of *sleaze.*
- That the combination of political contributions from the Five Brothers and a revolving door linking these firms to government departments leads to *collusion* and *cronyism* between the professional services industry and the state.

The combined weight of these charges demands that drastic steps are taken to curb the extraordinary power wielded by the Five Brothers, and to reshape the world of auditing so that it reflects new expectations of corporate performance and the modern global economy. The report finishes with recommendations to begin such a process, including: counter-cronyism measures, re-regulation, improving auditor self-governance, and redefining the legal reporting duties of corporations.

Yet, ultimately, more radical and creative solutions may be needed. The Five Brothers have become too big for their own good and seem incapable of acting genuinely in the public interest. Somehow, their market domination will need to be broken up. The outstanding question is how to give real ownership of such a vital public interest function back to its diverse stakeholders, rather than just to company shareholders. Perhaps it is time to mutualise the profession, or for it to take on a new not-for-profit form. With fewer distractions, perhaps then the accountants will be able to concentrate more on counting what matters.

1. WHAT IS GOING ON IN ACCOUNTS?

From Bean-Counters to Nurse Maidens of Corporate Globalisation

A big five global accountancy firm is never far away and always willing to please. Taking them at their word, and for a suitable fee, they will appoint a companies' staff, rearrange its structure to get rid of staff, tell it how to take over other companies and how to dispose of businesses it no longer wants, devise a business strategy, give legal advice to help it through the courts, protect its intellectual property and guess the value of its intellectual capital. The typical firm will minimise a companies' tax bill, plug it into the internet age, trouble shoot against changes in the political climate, and through 'reputation assurance' it will play the role of corporate spin doctor. It will deal with every aspect of corporate finance. Oh, and it will also audit the books.

In fact so many services are provided proudly by the big five firms that the average corporate chief executive must wonder what is left for the rest of his or her staff to do, and whether it is even worth them turning up at the office.

Multinational corporations, nearly all clients of the big five, have been heavily criticised in recent years for the unaccountable power, privilege and super-profits they enjoy in the global economy. Many of the companies attacked by campaigners are household names. They do things that bring them instantly under public scrutiny and are easy to identify , such as operating oil pipelines and petrol stations, genetically modifying the food we eat, or propagating ubiquitous fast-food burger bars. Their capacity to defy democratic control and act with impunity across national boundaries has given them an air of almost imperial supremacy.

Very little attention, however, has gone to the powers behind the throne. Virtually every aspect of corporate operations are now either directed, influenced or excused by a tiny number of very large 'professional services' firms – or what we used to call accountants. As *The Economist* pointed out, "The big five are, in effect, the back office of the global markets." They have also been dubbed a, "private police force… hired, fired and paid for by company management," the very people they are supposed to watch over.[7] But in reality they are even more than that. They embody the culture of managerialism that pervades business. They set the framework within which 'front office' decisions are made.

A recently published academic survey of chartered accountants concluded that they, "in effect run corporate Britain." It also showed that the profession is dominated by a "male elite". Just 2.7 per cent in the survey of the accountancy's high achievers were women.[8] Just a handful of firms, dubbed the Big Five, now provide all the FTSE 100 companies with a huge range of professional services ranging from statutory audits, to 'reputation assurance,' tax advice, legal work, risk assessment and innumerable others.

In the 1960s, with many countries emerging from colonialism, there was a wave of protest about the influence of multinational corporations. Big oil companies in particular, dubbed the *seven sisters*, were criticised for the unbalanced concessions they took from developing countries. Mostly unseen behind the second wave of concern over the role of corporations is the rise and rise of professional service industries. The *seven sisters* have been replaced by the *Five Brothers* of the accountancy profession. They are the voices whispering in the ear of corporate globalisation. The extent to which they push commercial propriety, act as corporate nurse-maidens and spin doctors, or operate like Rasputin behind the throne, is the question asked in this report.

Advising on strategy and (one hopes) ensuring that corporations meet their basic legal duties, the five brothers manipulate the puppet strings of all the major multinational corporations (see Table 1). Their privileged access to information also makes them morally responsible when information about a corporation that is in the public interest is not disclosed. The consequences of poor auditing or the failure to ring loud enough alarm bells when corporations behave improperly is not just a social and environmental issue. In the case of major bank failures it has brought global financial systems to the edge of collapse and ruined countless lives. As more of the people angry at the actions of major multinationals realise the accountant's discrete but crucial influence, the Five Brothers are being forced to stare into an uncomfortable and questioning interogation lamp.

Danger signs need to be raised because the rise to power of the Five Brother has happened without any similar growth in their accountability. The charge sheet is long, but for our purposes we have grouped them into five areas: consolidation, conflict of interests, concealment, sleaze and collusion and cronyism. Within these areas, scrutiny will fall on their role in the future of government's ability to raise tax to pay for public services, the further concentration of corporate power, corporate spin, bribery and corruption, allegations of money-laundering, influencing legislation, conflicts of business interests, disclosing information in the public interest, and the social and environmental performance of companies.

> "The big five are, in effect, the back office of the global markets."
> *The Economist*

Table 1: Auditors of the World's Largest Public Companies, 1999 **(ranked by market value)**

Firm	Retailer	Rank	Market Value ($ mill)
PWC	Exxon	5	174,640
	Nippon Telegraph & Telephone	9	131,863
	Bristol-Myers	12	114,397
	Lucent Technologies	13	109,140
	IBM	15	108,257
	Glaxo Wellcome	16	107,944
	Novartis	17	102,698
	American International Group	18	102,147
	Johnson and Johnson	19	99,505
	Philip Morris	21	99,656
	Cisco Systems	22	95,427
	AT&T	23	92,782
	Unilever Group	24	85,502
E&Y	Coco-Cola	3	211,129
	Wal-Mart Stores	8	136,069
	Intel	10	125,716
	British Petroleum	25	84,896
D&T	Microsoft	2	267,044
	Procter & Gamble	11	136,069
	Berkshire Hathaway	14	125,716
KPMG	General Electric	1	84,869
	Royal Dutch Shell	4	296,073
	Pfizer	7	187,763
AA	Merck	6	141,906
Itoh Audit Corp	Toyota Motor Corp.	20	98,730

Source: Public Accounting Report. March 15, 1999.

Corpocrats – the Growth of Global Managerial Culture[9]

"KPMG, We're strong as can be. A dream of power and energy. We go for the goal. Together we hold. On to our vision of global strategy"

Our Vision of a Global Strategy – KPMG song

The global managers have arrived. They meet in identical glass-walled rooms in corporate headquarters, travel in first class and business cabins on intercontinental flights. They read the same international newspapers and watch the same global TV channels. They stay in hotel suites in business centres around the world, eat in international restaurants and always demand the best service. They obey the uniform dress code of the business suit. They relate to each other as competitors in the shared project of corporate global command and control economics.

Globalisation has created a new ruling elite. It might be called the 'global managerial class'.[10] It goes beyond the CEOs of big multinationals in manufacturing, services and finance. It includes supporting agents in public relations, software design, the news and entertainment media, what Charles Leadbeater has dubbed *'The Weightless Society'*. The new class imagines and projects itself as truly 'global'. Their members see themselves as avant-garde, living in a brave new world of performance-driven individualism and the unrestrained operation of market forces. They see the real problems of society not as a consequence of global free enterprise, but the failure of mundane societies, embroiled in national politics, to step out of the dark ages of the mixed economy.[11]

The global managerial class clusters in the business centres of truly 'world' cities, floating above nationally defined geography like stations is cyberspace. Their identity is built around a quasi-religious belief in orthodox economics, pushing the universal truism of unrestrained free market economics on a global scale as the ultimate organisational principle for a 'rational' human society.

Critics point out the clash between global business and the social, historical and natural constraints of the human condition. More than ignoring its critics, the cult condemns them as ignorant at best, and dangerous at worst. Even flirting with unorthodox criticism would signal a loss of competitive focus punishable by equal loss of status and remuneration.

Dialogue between the global managerial class and the critics of globalisation is contained in a 'spin' operation, a public relations attempt to co-opt. Ultimately, like all ideologues, the global managers have to condemn criticism as heresy.

For global enterprise to be managed, whether telecommunication, banking or media, management has now to *live* globalisation. This creates for the global manager a thin virtual-reality of his own, detached from the rooted local existence lived by most people.

The global manager not only lives for business, his life is business. His personal narrative of survival and success is in a barren, performance driven world of global competition. His identity is shaped by 24-hour exposure to a narrow range of 'objective' imperatives, like the task of increasing shareholder value, regardless of context. He is a hard-pressed and time-constrained, crucial decision-maker, central to an international web of connections. Treated like small children not to be confronted with the harsh realities of life, no price is too high to save the time and energy of the executive. Exclusivity is, in this view, a sign of efficiency, legitimising the arrogance of managerial success. He name drops, and hints casually at successful deals in all possible corners of the world, suggesting important insider knowledge. He can talk forever about the problems of being the best in a mediocre world. He also complains endlessly about substandard services in planes and hotels, and exchanges anecdotes about where to eat in Shanghai, spend quality time in Moscow, or find the fastest route to the airport in Sao Paulo.

The global managerial elite is essentially a class of parvenus, driven by ambition for social advancement and fear of social decline. Its cultural trappings are the badges of membership: limousines to airports and personalised valet assisted check-in facilities; 24 hour links to top range IT facilities in air-conditioned executive offices and hotel suits; household, restaurant and hotel servants and security guards for reassurance. A success has nothing to fear, even if he does business in an African environmental disaster zone, with no infrastructure, and civil war.

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Like religious cultists who submit to one rigid interpretation of god on the promise of redemption and everlasting life, global managers insist that by handing over their destiny to the unrestrained forces of the market, they have actually gained full control over the restrictions and limitations of real life. But their comfortable detachment is an illusion. In the hire and fire practice of investment banking, stock market crashes can mean anybody becomes instantly redundant, including top analysts. Also, no one is immune to insecurity and social upheaval. Being wealthy in an increasingly unequal society means ever-greater paranoia about crime and violence.

Where do they come from ?

A small number of elite universities, the LSE, MIT, Oxford, Cambridge, Harvard and Yale, reproduce the elite. Parents expect it. Success is measured in graduates taking up top positions. To produce dissidents means to produce failures. It means to fail as a top institution. By their very nature elite universities become the Jesuit order of the free market church.

But students and academics see themselves in a neutral, objective, open and critical institution, not as instrumental in propagating the free market project. The contradiction is explained by the devotion to 'problem solving science', distinct from 'critical science'. To veer from one to the other would be like an engineer, expert on improving the performance of cars as a response to growing road traffic, starting instead to question the future of transport and the power of the car industry. Big accountancies are in the engineer's shoes but in the world of commerce. They focus on performance not purpose and consequence.

Those in charge are right because they come from top universities, and top universities are top because they produce those who are right. Only by recruiting its members from 'objective' elite institutions can market liberalism claim to represent universal scientific truth. In short, students and teachers see their budding acceptance by the managerial elite not as being corrupted by special interests, but as confirmation of their status as independent experts.

But problem solvers act as technocrats: concerned only with the detailed implementation of a given set of ideas. They allow themselves only the illusion of objectivity. Asking not, how the conditions for an optimal operation of the laws of market competition can be created, but for and against which interests these laws operate, is considered abandoning science in favour of politics.

Business schools, alternately, are the training grounds for the marine corps of managerialism, for the everyday ground war of profit making. Business schools simply teach a consultant approach to problem solving in the market, justified as a way to get rich fast. Universities educate the mandarins of capitalism, business schools its generals. The great irony is that free market principles are not upheld by their greatest champions. Pioneers of liberal economic theory promoted markets that were diversified, competitive and nation-based. Today's business managers seek to integrate, consolidate and globalise. Hiding behind 'free-markets', corporate leaders and their consultants are driving the concentration of market power amongst a handful of global conglomerates.

Corporate Prehistory and the Evolution of the Profession

To understand the role of accountancy requires a basic grasp of the history of corporations. According to historian Pat Conaty the corporation begins with the break away by the Tudors from the Papacy. Henry VIII needed revenue and he used his new nation state to give Royal trading rights to merchants in the City of London. In this way grew the Levant company, the Baltic Company and others. Later, under Elizabeth I, out and out pirates operating in the Caribbean followed. Adventurers like Hawkins were knighted to pillage the Spanish Armada, colonise overseas territories and bring back gold and plunder.

This 'reformed piracy' evolved into mercantilism. In the 17th century, the first political economists like William Petty developed national accounting systems to put the tracking of world trade on a more scientific basis. Their other concern was how to issue charters most efficiently to bring in maximum income for the crown. Sir Issac Newton developed his calculus to solve some of these Treasury problems. The earliest form of corporatism under mercantilism, therefore linked up big business and the nation state - much as it does still today. From Colombus and Hawkins in the sixteenth century up until Elizabeth II, corporate law has a continuous historic evolution.

Monopoly rights in trade within empires came under Adam Smith's successful intellectual assaults. Clearly for maximising profit, monopoly (or oligopoly in Joan Robinson's economics of the 1930s at Cambridge) wins out against competition all the time. That is why the British monarchs preferred royal charters, as taxation was a percentage cut of corporate profits. Smith was the mouthpiece of industrialists, not the earlier mercantile capitalists in the City of London. Smith's manufacturers were frustrated by the global trade barons and could not get on without breaking down trading's special interests in order to develop their own autonomy (laissez faire) to trade their goods internationally.

Prior to Smith, the only corporations were those with Royal Charters - each of which required its own act of Parliament to create. These ranged from the famous ones like the Hudson Bay Company and the East India Company to domestic ones such as cities whose charters governed taxation, and especially the means of domestic transport from turnpikes and canals and, later, rail. Most other commercial activity was governed by Partnership Law. The 1844 Companies Act enabled businesses to be incorporated without having to seek a royal charter and legal statute. Limited liability came later and was not conceded to entrepreneurs, allowing them to take commercial risks without risking also personal ruin as well, until the mid to late 1850s (see Box).

Following the 1844 Act, English law required shareholders to appoint an auditor. Frequently, the auditor was one of the shareholders and would also check to see that the firm's owners were not being defrauded. Originally, the accountancy profession emerged to mediate the system of limited liability that lubricated the growth of the firm – in the case of insolvency, arbitrating among creditors, and between creditors and shareholders. All public companies enjoying the limited liability privilege had a legal obligation to publish annual accounts and have them audited. In this system, the auditors had considerable influence. In Britain and America, although the auditors had to provide a 'full and fair view' of the state of the business, what that meant was open to their judgement and interpretation.

The first royal charters for accountants were granted to the Society of Accountants in Edinburgh. From six thousand in 1904, the number of British and Irish chartered and incorporated accountants grew to over 38,000 by 1957. In 1999 the Institute of Chartered Accountants in England and Wales alone had a membership of 109,000.

The simple numbers, however, are rather misleading. Today the distinguishing feature of the profession is its global domination by just a handful of firms. Already by the 1960s there were only eight major firms, reduced to six by the mid-1990s. The number is now down to five and on the brink of further consolidation. These firms have grown to provide all-embracing business consultancy services and to advise on everything from privatisations, to mergers, acquisitions and aid projects.

Playing by Their Own Rules?

There is a deep historical irony concerning what accountants do and how they actually organise their own affairs. While ensuring the financial transparency of audited firms, typically, as partnerships, the accountants did not have to publish their own accounts or profit margins. The counterbalance, and long viewed by the industry as an inconvenience, was that they were individually liable in lawsuits. Recent regulatory change in the UK has seen the industry manoeuvring to retain the secretive benefits of partnership whilst losing the uncomfortable liabilities. Dr. Susan Strange observed that:

> *"In business in the real world, important kinds of information are often not freely available, so the assumption that the market in accounting services is a free market, and therefore so efficient that it needs no regulation of any kind other than the competition of buyers and sellers, is totally unrealistic."*
> Susan Strange. The Retreat of the State.

The Lost Purpose of Limited Liability

According to Strange, the lack of information concerning individual firms meant that the market for accountancy services operated counter to standard economic theory. The market could work only on the basis of reputation rather than cost or efficiency. In time, the growing influence of highly risk averse institutional investors like the pension funds, imposed the services of a small group of auditing firms on companies of any size, as de facto a condition to attract investment.

How high are the stakes? The disintegration of the energy giant Enron and the subsequent investigations into Andersen prove that even the largest corporations can fall if there is a lack of transparent auditing. Nor is Enron alone in the annals of corporate accounting disasters. The Bank of Credit and Commerce International (BCCI) and Barings Bank both collapsed in spectacular fashion. Each had been audited by firms among the Big Five and in both cases "the auditor's size and reputation provided a cloak for financial dealing" that threatened the "whole international financial system", as well as the many individuals who were personally ruined. according to Strange, Following the Enron scandal Professor of accountancy Prem Sikka issued a public challenge, "I ask accountants to name me one financial scandal which has been brought to public attention by auditors blowing the whistle. They never can because it has never happened."[14]

Writing on the great financial crash of 1929 in the United States, J.K. Galbraith saw it as a symptom of a wider problem. He believed that the world of finance was incapable of expressing even the most basic and necessary self-criticism. "The sense of responsibility in the financial community for the community as a whole is not small," He observed. "It is nearly nil."[15]

Galbraith also saw the problem with regulators. They were, he thought, vigorous in their youth, moving to complacency in middle age, until they became in old age either senile, or arms of the sector they are supposed to regulate.

The advent of limited liability created obligations that the accountancy profession grew to meet. Today, the privilege of limited liability and the protection it provides from market forces is taken for granted. But originally it had a specific purpose to benefit the public. Legislators in the 19th century worried that, without the protection of limited liability, few would risk investing in major public works. Their concerns were borne out of a patriarchal sense of public service and responsibility that was prevalent at the time.

In England, it was not till the mid 19th century that the protection of limited liability was granted for most trading purposes. In 1852 a Mercantile Law Commission was set up to consider permitting limited liability. Views were sharply divided. There were those who feared moral hazard, and an increase in the risk of fraud. The Commission was cautious, but supported limited liability for two purposes:[12]

(a) for those "many useful enterprises calculated to produce benefit to the public and profit to those who engage in them" which are "of such magnitude that no private partnership can be expected to provide the funds necessary…. of which docks, railways, and extensive shipping companies may be taken as examples:

(b) "there are others of a more limited character, from which benefit to the humbler classes of society may be expected to accrue… such as baths and wash-houses, lodging-houses and reading rooms, to the establishment of which by large capitalists there is little inducement."[13]

Major infrastructure and social service investment both needed limited liability for the developer. Eventually, the wider case for protecting developers and investors won out – except for sovereign states and a few international operators, such as Lloyds of London, whose guarantors (the Names) felt that the profits they could make outweighed any risks of loss. Today the debate on corporate citizenship has returned with a vengeance.

Corporations still enjoy limited liability. But their modern global structures also allow them to minimise the amount they contribute to public investment through clever tax avoidance strategies. Strategies that their tax advisors, the Big Five, ably help them with. It is a lasting historical irony that legislation designed to facilitate public service began a long chain of events that would eventually enable corporations to shrink from public social responsibility.

Haunted by Intangibles

One of the hardest realisations for orthodox accounting to grapple with is the profession's increasing irrelevance to the real world of business. In recent years, the traditional measures used to understand a company's performance have become more and more inadequate. Retrospective financial accounting worked well enough in the days when most of a company's value was based on its physical assets, but those times are gone. Between 1990 and 1995, the gap between share prices and companies' tangible asset base - known as the 'market-to-book' ratio - increased from 149 per cent to 202 percent. By 1998, an incredible 71 per cent of the value of investment in FTSE 350 companies represented intangible assets.[16]

Yet, the way in which these intangible assets are valued and recorded remains largely a mystery. Accountants use traditional brand valuation methods as part of the mysterious equation, but other variables are far from obvious. Important indicators such as innovative capacity, and trust amongst investors and stakeholders, have not been adequately measured. As a result, investors must play a dangerous game of 'guess-timating' the unaccounted value of a company's reputation through rumour, gossip, company reports and any other information they can lay their hands on.

Without proper and transparent non-financial information, investment decisions rely on trusting to how companies manage their intangible assets. If done badly, the result can be hidden instability, leaving the company open to a sudden and devastating loss of investor confidence. For the accountancy profession it means that even by helping companies to fulfil their legal reporting duties, they are engaging at best in a meaningless exercise and at worst are colluding in an legal deception. This trend links to rising public expectations on corporate social and environmental performance that, sooner or later, will result in new mandatory reporting requirements. The task of really measuring corporate well-being, has already slipped well beyond the competence of the Five Brothers.

2. The Five Brothers

"I am not very comfortable with the fact there are only five big accounting firms in the world. Collusion among five is easier than collusion among 25."

Frits Bolkestein EU commissioner, Financial Times, February 21, 2002.

According to their reports for the fiscal year 2001, the Big Five accountancy firms employed a total 514,000 staff worldwide, and netted a combined global revenue of over $65 billion. This reflected an average increase of 13 per cent over 2000, although the pace of growth declined for the second successive year after previously enjoying a seven-year run of accelerating growth rates. Their profits in 1999 were a very healthy $12.6 billion.

Over recent years, the Big Five have diversified into a wide range of 'professional services'. In addition to their traditional auditing work, these companies now offer tax services (including corporate, individual and strategic global planning), consulting in human resources management, process improvement, systems design and e-commerce support, and legal advice. In 1998, the value of these other professional services surpassed that of traditional auditing work, a trend that has accelerated since. In 2001, the U.S. Securities and Exchange Commission (SEC) stated that professional services companies earned an average of $2.69 from non-audit services for every $1 they received for audit fees.[17]

This is a snapshot of the Five Brothers. As they all carefully manage the flow of information about themselves, most of the data presented here has been gathered from available sources in the public domain. Treating pieces of available information in isolation retains the familiar, rather dull public image of the traditional accountant. But when that information is brought together a different and more disturbing picture emerges of a sector with potentially frightening influence, poor transparency and, ironically, little accountability.

Not everything is smooth on the path to power, however. It is still too soon to estimate the fall-out from the profession's 'Enron shock'. Prior to the Enron affair, retrenchment in the sector saw firms shedding employees to increase profitability. Unusually, staff were not sacked because of financial problems; on the contrary, one firm in question, PwC, reported a 15 per cent rise in global revenue. According to one national newspaper it led PwC to come up with the silliest way to say 'you're fired' when it announced that 100 partners "will be leaving to pursue careers elsewhere."[18] Inside, the water appears far from warm. One anonymous PwC employee comments that the work doesn't feel like a place where people are valued and respected, but rather they get treated like client fodder.

For those who do keep their jobs, on the other hand, the picture looks rosy in the UK. Qualified accountants with five years experience earn around £76,000, over 50 per cent more than their nearest rivals in France according to a survey by Management Today magazine. The survey commented, "These grey-suits have been hard at work, but – appropriately enough for a country that favours those who count the beans over and above the people who design, make or market things in the first place – we now have the lowest-paid manufacturing employees as well."[19]

A CURRICULUM VITAE FOR THE FIVE BROTHERS[20]

KPMG

Global Employees: 102,000
Scope: 152 countries
Sales (FY 2001): US $11.7 billion
Brief History:
1870 – William Barclay Peat founds William Barclay Peat & Co. in London.
1897 – James Marwick establishes Marwick, Mitchell & Co. with Roger Mitchell in New York.
1911 – William Barclay Peat & Co. and Marwick Mitchell & Co. join forces to form Peat Marwick International (PMI).
1917 – Piet Klynveld founds the accounting firm Klynveld Kraayenhof & Co. in Amsterdam.
1979 – Klynveld joined forces with Deutsche Treuhand-Gesellschaft and the international professional services firm McLintock Main Lafrentz to form Klynveld Main Goerdeler (KMG).
1987 – PMI and KMG join forces.

Services Offered:
- Assurance
- Tax and Legal advice
- Consulting
- Corporate financial services
- Corporate Recovery
- Forensic and Litigation Services
- Transaction services

Industries Serviced:
Automotive, Banking, Chemicals, Communications, Consumer Markets, Electronics, Energy and Natural Resources, Industrial, Insurance, petrochemical and Pharmaceuticals.

FTSE 100 Audit Clients:
Allied Domecq, Associated British Foods, AstraZeneca, BAE Systems, Billiton, Boots Co., Cable & Wireless, Diageo, Electrocomponents, Enterprise Oil, Granada Media, HBOS, HSBC Holdings, Imperial Chemical Industries, Innogy, International Power, Morrison Supermarkets, Old Mutual, Prudential, Rolls-Royce, Scottish and Southern Energy, Standard Chartered, United Utilities.

Embarrassing Moments:
In October of 2001, KPMG agreed to pay $9 million to settle a US government lawsuit that alleged the firm helped Columbia/HCA Healthcare Corp. prepare and later conceal false claims in Medicare ‘cost reports’ that defrauded the programme of millions of dollars. It is the first time that the federal government has held a Big Five accounting firm liable under a civil fraud law known as the False Claims Act for aiding and facilitating Medicare fraud committed by a client. The settlement, filed in a Florida court, was the largest-ever civil penalty in a Securities and Exchange Commission action against such a firm.[21]

KPMG has also faced allegations of improper auditing. In 2000, Rite Aid acknowledged that it had overstated earnings by more than $1-billion over two years. Shareholders launched a class action suit against the company and its directors, as well as KPMG. According to the Washington Post on December 5th, 2001, the suit alleged that Rite Aid's then-chairman, Martin L. Grass, awarded KPMG consulting engagements worth more than $1.5 million "as a sweetener and to ensure the accounting firm's continued cooperation." During the late 1990s, audit fees were allegedly less than 20 percent of what Rite Aid paid KPMG for consulting work. The accountancy firm denied any wrongdoing.

PricewaterhouseCoopers (PwC)

Global Employees: 160,000
Scope: 150 'countries and territories'
Sales (FY 2001): US $22.3 billion
Brief History:
1849 – Samuel Lowell Price establishes practice in London
1854 – William Cooper establishes practice in London
1957 – Cooper Brothers & Co (UK), McDonald, Currie and Co (Canada) and Lybrand, Ross Bros & Montgomery (US) merge to form Coopers & Lybrand
1998 – Price Waterhouse and Coopers& Lybrand form PricewaterhouseCoopers

Services Offered:
- Audits
- Assurance
- Global Risk Management
- Dispute investigations
- Project finance and privatisations
- Human Resources solutions
- Securities
- Management consultancy
- Tax services

Industries Serviced:
Aerospace and Defence, Automotive, Chemicals, Consumer Goods, Education, Energy, Engineering and Construction, Entertainment and Media, Financial Services, Paper, Government, Healthcare, Hospitality and Leisure, Insurance, Freight, Metals and Mining, Pharmaceuticals, Real Estate, Retail, Technology, Telecommunications, Transport.

FTSE 100 Audit clients:
ARM Holdings, Amersham, BG Group, BOC Group, Barclays, Brambles Industries, British Telecom, CGNU, Centrica, Daily Mail and General Trust, Friends Provident, GKN, Gallaher, GlaxoSmithKline, Great Universal Stores, Imperial Tobacco, Kingfisher, Land Securities, Lattice Group, Legal and General, Lloyds TSB, Logica, MAN Group, Marks and Spencer, National Grid Group, Northern Rock, Pearson, Powergen, Reckitt Benckiser, Rentokil Initial, Reuters Group, Rio Tinto, Royal and Sun Alliance, Sage Group, Sainsburys, Schroders, Scottish Power, Severn Trent, Shell Trans Trading Co., Smiths Group, South African Breweries, Tesco, Unilever, United Business Media, Wolseley.

Embarrassing Moments:
In 2000 PwC were the subject of a major investigation by the US Securities and Exchange Commission. There were 140 cases of staff at the auditor holding financial interests in the companies they were auditing. In February 2001, the *Financial Times* reported that, "The appointment… of PwC, the leading accountancy firm, to investigate the relationship between Gazprom, the Russian gas giant, and Itera, the fast-growing gas company, has raised eyebrows among even hardened Moscow investors." The *FT* cited estimates that PwC had earned $15 million in fees working for Gazprom, and would now be investigating its own past work for the company. The chief suspicion was that unacknowledged 'below market price' transactions had been taking place between Gazprom and Itera, something which, if true, PwC should have known about. The FT concluded, "The PwC appointment is the latest example of behaviour by international auditing firms in Russia that raises concerns about potential conflicts of interest."

PwC have also been the subject of several investigations by the Securities and Exchange Commission. In May 2001, the firm agreed to pay $55 million to settle a class action suit raised by shareholders of MicroStrategy, Inc. The software manufacturer had admitted to telling investors it was still profitable while it had in fact been losing millions. A report filed in court said the audit firm "consistently violated its responsibility" to maintain an appearance of independence. It cited an e-mail from a PwC auditor seeking a job at MicroStrategy while he was the senior manager on the team that reviewed the company's accounting. PwC also received money for reselling MicroStrategy software and recommending it to other clients, and was working on setting up a business venture with its audit client, according to the report . Only the previous year, PwC had settled with 350 plaintiffs who had invested in the California-based company First Pensions Corporation. The settlement came after Coopers & Lybrand and partner Hal Hurwitz had been found liable by a jury of misrepresenting First Pensions' financial condition, concealing material information and abetting the company's managers in fraud. Although the terms of the eventual settlement were not disclosed, the suit filed in Orange County Superior Court had sought damages of $136 million[24].

Ernst & Young

Global Employees: 84,000
Scope: 130 countries
Sales (FY 2001): US $9.9 billion
Brief History:
1903 – AC and Thomas Ernst establish the accountancy firm Ernst and Ernst in Cleveland
1906 – Arthur Young founds the firm Arthur Young and Co. in Chicago
1974 – Ernst and Ernst merge with the British firm Whinney Smith & Whinney. 1989 – The firms combine to create Ernst & Young.

Services Offered:
- Internal Audit Services
- Enterprise Risk Management
- Fraud Investigation
- International Accountancy Standards
- Technology and Security Risk Services
- Transaction Support
- Corporate Finance
- Entrepreneurial Services
- Legal Services
- Tax Advice

Industries Serviced:
Automotive, Chemicals, Communications, Energy, Entertainment, Financial Services, Health Sciences, Real Estate, Retail and Consumer Products, Technology, Utilities IT.

FTSE 100 Audit clients:
3i Group, British Petroleum, British Airways, Capita Group, Celltech Group, EMI Group, Hanson, Hilton Group, Invensys, Next, Scottish & Newcastle, Six Continents, Smith & Nephew.

Non-Audit Clients (2001)
Applied Materials, AXA, Brocade, Citigroup, Cisco, DaimlerChrysler, Disney, eBay, Ericsson, Genome Express, GlaxoSmithKline, Goldman Sachs, GPC Bio Ag, Interbrew, Johnson & Johnson, Levi Strauss, Oracle, Siebel, Soltec, Swiss Reinsurance, Vivendi, Vodafone Airtouch

Embarrassing Moments:
In 2000 E&Y, agreed to pay Cendant shareholders $335 million, the largest such settlement by a Big Five firm. Cendant alleged that E&Y had a significant part to play in one of the largest frauds in US corporate history, by failing to expose false financial statements issued by CUC International Inc, later merged with company HFS to form Cendant. Four months after the merger was announced, the accounting irregularities were revealed. Company executives recalled that an independent audit in 1998 by Arthur Andersen uncovered accounting irregularities in CUC's financial statements, including fictitious pre-tax income exceeding $500 million. The consumer and business services company alleged in a statement that "rather than exposing the fraud, E&Y chose to facilitate it and to continue to reap millions of dollars in audit fees."[25]

Meanwhile, Ernst & Young was also fending off claims by La Salle National Bank, Bank of America, Fleet Business Credit and others to recoup $65 million which they had invested into the now bankrupt Kent International Associates. The lending institutions contend that this money was effectively lost by Ernst & Young after the firm allegedly conducted a faulty audit of Kent.[26]

Deloitte Touche Tohmatsu

Global Employees: 95,000
Scope: 140 countries
Sales (FY 2001): $12.4 billion
Brief History:
1895 – Charles Haskins and Elijah Watt Sells open offices in New York City.
1898 – George Touche establishes a London-based accounting company
1900 – John Ballantine Niven established the offices of Touche Niven alongside Haskins & Sells in New York. The firm later becomes called Deloitte, Haskins, Sells.
1947 – Touche & Niven merges with the firms of George Bailey and A.R. Smart to form Touche, Niven, Bailey & Smart. After another merger in 1967 this becomes Touche Ross
1989 – Touche Ross and Deloitte Haskins Sells merge, simultaneously joining with the Japanese audit firm of Tohmatsu Awoki Sanwa to become Deloitte Touche Tohmatsu Ser

Services Offered:
- Assurance and Advisory
- Consulting
- Corporate Finance
- Enterprise Risk Services
- Forensic Services
- Human Capital Advisory Services
- Management Solutions
- Reorganisation Services
- Tax Advice

Industries Serviced:
Automotive, Communications, Construction, Consumer Business, Financial Services, Health Care, Manufacturing, Media, Mining, Pharmaceuticals, Professional Practices, Public Sector, Real Estate, Retail, Sport, Technology, Utilities.

FTSE 100 Audit Clients:
Abbey National, Alliance and Leicester, Anglo American, BAA, Compass Group, Dixons Group, Hays, Reed International, Royal Bank of Scotland Group, Vodafone AirTouch.

Embarrassing Moments:
On the 21st of March, 1997, the Kansas City Business Journal reported that Deloitte & Touche had agreed to pay J.C. Nichols $4.6 million the previous year to settle potential claims arising from insider transactions at the real estate company. The settlement grew out of a legal row touched off in late 1994 by New York investment banking firm Allen & Co.'s $40 million offer to acquire Nichols. Nichols rejected the offer, and Allen & Co., then a 6 per cent shareholder of Nichols through its AHI Metnall subsidiary, sued the company on behalf of shareholders alleging improprieties by top company officials. The company's Employee Stock Ownership Trust (ESOT) subsequently filed its own suit against Nicols, focusing on CEO Lynn McCarthy's 1992 acquisition of two-thirds of Nichols' common stock from the ESOT. McCarthy assumed the ESOT's $124.5 million debt to the company, but made no payments on that debt while collecting $4 million in dividends. Deloitte was Nichols' auditor at the time and issued clean opinions on Nichols' financial statements. While Deloitte was never sued, many believed that the accounting firm was vulnerable to legal action by Nichols. Deloitte denied any negligence or liability, saying it was settling "solely to avoid the further substantial expense and inconvenience of potential litigation."

The settlement also contained a confidentiality provision, but was disclosed in documents filed by Nichols with the US Securities and Exchange Commission after the company decided to list its stock on the NASDAQ. Deloitte's concern about the settlement being publicised may have been heightened by revelations of a previous embarrassment, when Deloitte agreed to pay Tarkio College $6 million to settle claims arising from the small Missouri college's closure in 1991. Like its settlement with Nichols, the Tarkio deal was meant to be confidential. But because Tarkio had filed for Chapter 11 bankruptcy, the terms of the agreement were required to be filed with the bankruptcy court.

Andersen

Global Employees: 85,000
Scope: 84 countries
Sales (FY 2001): $9.3 billion
Brief History:
1913 – The accountancy firm of Andersen, Delaney and Co. is established in Chicago
1918 – Clarence Delaney resigns, and the firm is renamed Arthur Andersen & Co.
1989 – Arthur Andersen spin off their accountancy practice, Andersen Consulting.
1993 – Already the largest accountancy firm in the Americas, Arthur Andersen merges with the Japanese firm Asahi and Co, to become the leader in the Asia Pacific region
2000 – The company completes a global restructuring process, rebranding itself as simply Andersen, whilst Andersen Consulting formally splits and is renamed Accenture.

Services Offered:
- Assurance
- Business Consulting
- Corporate finance
- EBusiness
- Human Capital Advice
- Legal Services
- Outsourcing
- Risk consulting, business consulting and e-business
- Tax advice

Industries Serviced:
Automotive, Aviation, Communications, Energy, eBusiness, Federal Defence Agencies, Financial Sector, Healthcare, Higher Education, Hospitality, Industrial Construction, International Lending Agencies, Manufacturing and Distribution, Media, Pharmaceuticals, Real Estate, State and Local Agencies, Technology, Utilities

FTSE 100 Clients:
Amvescap, British Land Company, BSKYB, Cadbury Schweppes, Canary Wharf Group, Safeway, Shire Pharmaceuticals, WPP Group.

Embarrassing Moments:
In May 2001, Australia's second largest general insurance company, HIH collapsed with net liabilities of up to A$ 4 billion. It emerged that many HIH executives and their employees had been enjoying luxury holidays and extravagant entertainment, while a PA to one of the directors spent two-years living in a five-star hotel at HIH's expense.[27] Arthur Andersen signed off on HIH's statement of value late in 2000 as "true and fair". Just 6 months later, HIH was found to be worth A$2 billion less than that stated.[28] Worse still, AA had signed off the accounts despite knowing about the existence of a trust owned by one of the directors that was illegally buying and selling HIH shares, and which moved A$10 million out of HIH on the eve of its collapse. Questions have also been asked about the fact that the chairman of HIH, Geoff Cohen, was a former senior partner at AA, as were two other HIH directors.[29] AA received A$1.7 million in audit fees from HIH to end of June 2000.[30] Shareholders are seeking a negligence claim against AA. The Australian government has been left to pick up the bill to the tune of A$500 million of bailing out the some 50,000 affected policy holders.[31]

Andersen has been involved in a number of other legal scandals. Most notable have been the settlement for $110 million with the shareholders of Sunbeam Corp in April of 2001, and a $7 million payment relating to the company's handling of the accounts another one of Andersen's corporate casualties, Waste Management, Inc[3233]. However, it is for its role in the dramatic collapse of the energy giant Enron that Andersen will be most closely associated over the coming months (see Box on Enron). Whether or not the company can survive the fall-out from Enron's spectacular meltdown remains to be seen.

Why do they matter?

One of the most scathing critics of the accountancy profession is the Labour MP Austin Mitchell. He says that, "The UK accountancy bodies have always behaved like trade associations, not guardians of the public interest. They seek economic advantages for their members. They lobby government departments to protect their interests. They aim to shift the tax burdens from the rich to the poor. ... Rather than ethics, social responsibility and professional judgement, accountants shelter behind the latest accounting and auditing standards and their self-protecting ingenuities."[34]

Mitchell's views are supported by the late academic Susan Strange. She described the partiality of the 'professions' generally for the rich and powerful in society. In the tension between security and stability versus economic growth and wealth accumulation, Strange believed it is the latter that takes priority under the current economic system. It is this monetary master that the accountancy profession ultimately serves under globalisation. The performance of the global economy, and the increasingly unequal distribution of wealth within it, back such claims.

The four classic questions of political economy seem to apply:

- *Who pays?* Business and governments pay for the Five Brother's services
- *Who benefits?* The Five Brothers benefit from the fees and, in theory, the clients benefit from the advice they get
- *Who carries the risks?* Given the degree of immunity enjoyed by accountancies, risks are largely carried by all the stakeholders in the companies, staff, customers, shareholders and communities, and taxpayers where the government is the client.
- *Who gets the opportunities?* Opportunities accrue, again in theory, to those who can afford the fees of the Big Five. And, also to the increasingly dominant Big Five themselves as they take more market share and penetrate new markets for professional and legal services.

The growth of the profession owes most to its corporate clients. Similarly the power of patronage enjoyed by senior management in appointing the auditors carries the consequent benefits. Accountants will tend to serve the short-term self-interest of the firm over its employers, suppliers, consumers or 'society at large.'

Such close collusion can lead to action against the public interest. The US savings and loans debacle resulted in part from a conspiracy to hide a $5 billion loss by the agency guaranteeing S&L deposits. That episode, according to Susan Strange, led to a $300 billion bill to the US taxpayer.

Many believe that bad accounting also played a prominent role in the 'surprise' economic crashes in Asia of the late 1990s, which left millions of people across the region in long-term unemployment.[35] Poor accounting left too few aware of the fragility of many Asian banks and businesses, consequently no proper contingency plans were made for the events or their consequences. These problems point towards a wider set of challenges that will need to be tackled head on if the potential for the Five Brothers to exacerbate economic and social instability under globalisation is to be checked.

3. THE CHARGES: CONCENTRATION OF POWER, CONFLICT OF INTEREST, CONCEALMENT, SLEAZE, COLLUSION & CRONYISM

Charge 1 – Concentration of Power and Consolidation

Facilitating Global Monopolies

> *"Being able to provide our international clients – for instance, those who are making acquisitions – the one-stop shop is critical. Our goal is to be able to offer them not only the tax advice or consulting advice on integration of the merging companies, but also the legal structuring around those transactions."*
> Russ Robertson, managing partner of Arthur Andersen.

> *"Mergers and acquisitions are a good way of hiding underlying business trends and confusing markets,"*
> Liam Pagliaro, Gartmore Investment Ltd[36]

The drift toward fewer, larger and more powerful corporations is a key characteristic of economic globalisation. Although small and medium enterprises constitute the major source of employment, the commercial world is both structured in favour of and distorted by the interests of large companies. While competition policy theoretically provides checks and balances against the distortion of markets by monopolies and price-fixing cartels, the lack of international anti-trust rules, and the weakness of national regulations, leaves SMEs, as well as the general public, virtually defenceless against the exponential rise of corporate power.

What drives this process and its consequences can be difficult to separate. As business observers point out, "the greater commonality in standards and in business across national borders, enhanced profits and market share can be achieved through mergers and acquisitions more quickly than through building operations in different countries. Massive, new horizontal mergers that combine firms with similar competencies are especially likely to occur."[37]

Professional services firms are not the only players in mergers and acquisitions; investment banks and legal firms also take a major role. But, so-called M&A work is an important source of income for them, and is increasingly a part of the integrated strategic advice they offer their clients.

Yet perversely, the advice on mergers given by the major professional service firms to multinational companies and financial services firms does not always equate to benefits for those companies' shareholders; in fact, quite the opposite. KPMG exposed the poor deal that most shareholders received when M&As happened. According to their report *Unlocking shareholder value: the keys to success,* "83 per cent of mergers were unsuccessful in producing any business benefit as regards shareholder value." Perversely almost the same percentage of people involved in negotiating mergers, 82 per cent, subjectively felt that their deals had been successful. Yet, according to the report, over half of such deals "actually destroyed value."[38]

The full social, economic and environmental impacts of mergers and acquisitions are never explored. Neither is the impact on the shifting balance of power in the global economy considered. The five brothers have grown in tandem with their corporate clients and carry vested interests in the process. As corporations get bigger their ability to negotiate with host countries gets stronger. Significant M&A activity between first world corporations and poor countries is centred around privatisations and carries the usual fears of asset stripping.

UNCTAD in its 1999 *World Investment Report* described how the balance of power in negotiations over inward investment was crucial to host countries receiving a proper share of benefits. The re-emergence of monolithic multinationals with the five brothers in largely unacknowledged attendance, in the footsteps of old colonial trading companies, shifts the balance of power further away from the least developed countries.

The Five Brothers are more than passive observers of this central feature of globalisation, they are active agents. Moving into China, E&Y declared a desire to join up with Chinese accounting companies, "in order to seize opportunities offered by Beijing's probable accession to the World Trade Organisation," E&Y Chairman for regional operations was reported as saying that the, "WTO entry would certainly generate a lot of co-operation, mergers and acquisitions" between Chinese and foreign companies. Now that China has entered the WTO, the Five Brothers will be wasting little time in identifying potential targets for takeover to their multi-national corporate clients.[39]

DTT also takes pride in its role of consolidating the power of big business. The company has specialised, outside of its normal auditing and tax work, in servicing the 'unprecedented merger and acquisition activity' since the 1980s. The firm quotes Emerson's *Professional Services Review,* "When it comes to acquisition services, no one rivals the Deloitte & Touche infrastructure, commitment, expertise, or reputation." Its work emerged alongside what the firm calls "a new style of management… in corporate America", which became "increasingly globalised (as) the rate of mergers and acquisitions accelerated." What must sound like a proud boast in friendly company, rings alarm bells to others in a global economy where ever fewer and larger corporations are taking over whole markets, and driving out, or buying out, competitors.

Behemoths Walking in Glass Stilettos

- **Banking**

  Consolidation is an international phenomenon affecting the financial sector and banking in particular. By 1999, the world's top ten investment banks had cornered 77 per cent of business in the global capital markets, the top 20 controlled 97 per cent of business.[40] In just one example, SBC Warburg took over the bank Dillon Read in the US and was then merged with Union Bank of Switzerland. A study of 13 major industrialised countries by the *Group of 10* found a 'noticeable acceleration' in consolidation over recent years, creating 'a significant number of large' and 'increasingly complex financial institutions'.

  Rising interdependence between large and complex financial institutions such as has happened in the US, Japan and Europe makes *systemic* failure more likely. The report found that even medium-sized banks could become a 'potential source of instability' in a relatively small country, and that due to consolidation 'non-bank financial institutions, not just banks have the potential to be sources of systemic risk.' Increased complexity also makes assessment of a firm's financial condition more difficult, while companies increased size 'has the potential to augment moral hazard problems.'[41]

  In Britain, the Competition Commission accused the big four banks (Lloyds, HSBC, Barclays and the Royal Bank of Scotland) as well as the mortgage banks Abbey National and Alliance and Leicester of operating a 'complex monopoly' in services to small businesses.[42] Before becoming chairman of the Stock Exchange Don Cruickshank produced a report accusing the banks of profiteering. He alleged that they abused their market position in relation to small businesses to make up to £1.5 billion 'excess profit'.[43]

- **Legal Services**

  The legal profession has long been criticised for its use of restrictive practices. In March 2001, the Office of Fair Trading (OFT) in Britain attacked lawyers and barristers for anti-competitive behaviour. The OFT announced a 12 month 'grace' period in which the profession could reform itself – opening up to fee-sharing partnerships with other professions.

  Ironically, one consequence of the proposed reforms could be to increase the monopoly power of the big five accountants. The five brothers lobbied for such reforms as 'part of their drive to build global legal services arms.'[44] The 'Worldwide Managing Partner' of Andersen Legal welcomed the OFT report as an 'opportunity' to create 'integrated' providers of professional services.[45]

- **Insurance**

  Prudential's £14.6 billion takeover of American General last year was just the largest in a series of big US acquisitions by the European-based companies than now dominate the global insurance industry. Speaking of the Prudential's takeover bid, its chief executive said, 'It gives us a tremendous scale position in the US and gives us the opportunity to continue the expansion in Asia and Europe.'

  Compared with Europe, the only reason that the US insurance sector is 'relatively unconsolidated' is due to its 'huge size,' with an estimated $20,000bn worth of assets being managed.[46] Consolidation appears to be a process that feeds off of itself. After the announcement of the Prudential take-over bid, one shareholder predicted that the Prudential itself could be exposed to a hostile take-over bid, similar to how National Westminster, weakened by its merger with Legal and General, was bought by the Royal Bank of Scotland.[47] Reflecting on this sequence of mergers, the *Financial Times* commented that, 'The age of knocking on doors to sell life insurance is past. Hello multi-billion insurance giant, girding the world from Texas to Tokyo.'[48]

Fewer, but bigger, Brothers?

> *"If you merged all the firms outside the Big Five in Accountancy's Top 60 League Table they would still only be number 2 in the UK."*[49]
> Accountancy Magazine

Apart from actively facilitating the trend towards fewer and larger companies, the professional services industry is itself undergoing the very same process. Anglo-American firms dominate the accountancy profession and are rapidly expanding around the globe. In a single year Arthur Andersen increased revenues from the Asia/Pacific region by 35 per cent.[50] It is partly a result of their history. Partnerships followed the companies they audited as those companies expanded overseas to become multinational corporations. As they did so they grew and swallowed up the smaller firms who had less ambitious clients. One side effect of this process is that already dominant Northern-based multinational partnerships are in the best position to milk increasingly lucrative professional services markets in developing countries. Southern countries then miss out on yet another opportunity in the global economy to nurture domestic firms to take a share of a profitable market for services.

The pressures for continuing consolidation have also not gone away. A proposed merger between E&Y and KPMG in 1998 designed to challenge the formation of PwC fell through one week after the European Commission launched a major investigation into the anti-competitive impact of the deal. Prominent observers said that a merged firm would have too many internal conflicts of interest, representing companies that were direct competitors such as Coca Cola and Pepsi. EC competition commissioner Karel Van Miert said the merger, together with the creation of PwC, would leave businesses with too few choices, reducing the number of major firms from 6 to 4.[51] The Commission ultimately had no power to block any merger but could have imposed certain conditions. The firms blamed regulatory obstacles.

As the big five increasingly diversify the services they offer they will encroach ever more into new markets. Legal firms are not yet running scared, but warning flags have been raised. There are regulatory barriers to the growth of so-called 'multi-disciplinary partnerships' between lawyers and professional services firms including the accountancies. But professional boundaries, reports the Financial Times, are being eroded "slowly but surely." Already the Five Brothers have been able to get around constraints to their ambitions by making "parrallel partnerships". If the attraction of multi-disciplinary partnerships catches on with clients, the power of the Five Brothers will grow still further. A lawyer with the firm Eversheds warned, "You have to respect the accountants – if you choose to ignore them, you do so at your peril."[52] The Enron scandal has, however, been a bump on the road to new partnerships. Whilst a new caution might not last, the Chairman of one law firm commented that it would be difficult in the Enron aftermath, "To persuade partners in a law firm that forming a partnership with an Andersen or KPMG would make sense."[53]

“You have to respect the accountants –
if you choose to ignore them, you do so at
your peril.”

Charge 2 – Conflicts of Interests

Too many fingers in too many pies?

> *"If you are doing an audit of a firm for a $300,000 fee and you have a consulting contract with the same firm for $1 million, it's hard to see how you can maintain being independent with that audit,"*
> David Costello, President and CEO of the National Association of State Boards of Accountancy in the US[54]

It's common practice among the Big Five to offer various different services to their clients at the same time. Although the precise shape of the industry is changing as consultancy wings are spun off, there is no question of the Big Five contracting to only offer straight auditing services. The reason is that non-audit work is simply too profitable. Many firms tended to offer bargain basement prices for conducting audits and then recoup costs on lucrative consultancy contracts for other services, such as installing IT systems.[55]

Research by *Accountancy* magazine showed that auditors currently make over £900m a year in fees from FTSE 350 clients. But only 30 per cent comes from the statutory audit (see Table). Non-audit work is growing at 21per cent a year while audit fees are falling.[56] For example, KPMG billed electronics manufacturer Motorola Inc. $3.9 million for auditing and $62.3 million for other services. Meanwhile, Ernst & Young billed the telecommunications company Sprint Corp. $2.5 million for auditing and $63.8 million for other services, while AT&T paid PwC $7.9 million for auditing and $48.4 million for other services[57].

According to KPMG's international chairman, the pressures pushing the industry are hard to resist, "The value attaching to audit reports on historical financial statements will decline so significantly that it could amount to the disappearance of our traditional core business", he predicts. "In its place a different market will develop, not based on traditional accounting skills, but information assurance and risk, significantly greater in skill, but with many more and diverse competitors."[58] As a recent Securities and Exchange Commission enquiry in the US found, this raises serious questions about how independent the audits that the firms offer can really be. Arthur Levitt, chairman of the SEC, wondered, "how can auditors remain independent... when their fee income is just 30 per cent of their firms' total revenues?"[59]

Just as serious is the personal conflict of interests that arise when staff at the Big Five hold financial stakes in companies they are involved in auditing. A Securities and Exchange Commission investigation in January 2000 found 140 cases where partners or employees at PricewaterhouseCoopers had taken part in audits of 52 companies in which they personally had investments.[60] This was in violation of rules (meant to be administered by the firms themselves) dating back to the 1930's that auditors should not have investments in companies audited by their firms.

In February and March 2000, *Brand Finance* surveyed 292 City of London analysts and 47 UK plcs on auditor independence. The findings were striking, "A stunning 94 per cent of analysts stating an opinion believe that significant non-audit fees are likely to compromise audit independence. Three-quarters of companies felt the same". *Brand Finance's* research also shows that marketplace concern extends beyond consultancy. A significant percentage of respondents believed audit independence would tend to be breached where the audit firm was also involved in asset valuation, corporate finance, treasury management and accounting outsourcing.

The Accountant however, a leading journal for the sector, sees only greater opportunities from diversification, "Multidisciplinary firms are in the public interest. There is no evidence that consulting is linked to audit failures. Audit quality is enhanced by a deep understanding of the business... In the new economy, companies will need to continuously measure and report on all their assets at fair value to all users."[61]

Officials from the US government's Securities and Exchange Commission disagreed. Concerned that accounting firms providing a host of other professional services may not be able to provide truly independent bookkeeping, the SEC proposed to sharply limit the consulting services that accountancy firms can offer the clients they audit.[62] Not surprisingly, KPMG denounced the regulators intentions, "The SEC is sadly out of touch with the European approach to regulation and auditor independence," chided the company. "This would not necessarily matter but the effects of their proposed restrictions on the provision of non-audit services are now clearly going to extend beyond the boundaries of the US."[63] Since then, and since Enron, KPMG have recanted in what was described in the press as a "cynical and risky volte-face."[64]

Despite lambasting efforts to control their power, the Five Brothers face an uphill struggle in their battle against the regulators. Even before Enron, an editorial in the *Financial Times* suggested that consensus for greater regulation was growing, citing a report commissioned by the SEC which revealed that "…almost half of PricewaterhouseCooper's partners have broken the SEC's rules concerning share ownership in companies that PwC audits. These are the people who are supposed to be in charge of the internal codes of conduct. If this is their understanding of independence, radical remedies are surely called for."[65]

"How can auditors remain independent... when their fee income is just 30 per cent of their firms' total revenues?"

Confidence in the European approach, or at least the British approach, is also misplaced according to Sir Howard Davies, chairman of the UK Financial Services Authority. He was reported saying that the British system could not "stop an audit firm becoming too close to a client and misleading investors."[66]

Who audits the FTSE 350?

Firm	FTSE 100	FTSE 250	FTSE 350
PwC	48.5	87	135.5
KPMG	23	55	78
E&Y	11	34	45
D&T	12.5	29	41.5
AA	5	28	33
Others	-	17	17

Fee analysis

Category	FTSE 100		FTSW 250		FTSE 350	
	£m	%	£m	%	£m	%
Statutory audit	175	27	93	38	268	30
Other work	481	73	153	62	634	70
Total	656		246		902	

Enron: Power Over Numbers

For perhaps the first time in its history, the accountancy profession is facing a crisis of confidence. The reason? One of the Big Five firms, which have previously managed to skip relatively unscathed through a field of fallen corporate giants, is now at risk of being dragged under by the most dramatic collapse in modern corporate history. On December 2nd, 2001, the energy company Enron filed for bankruptcy. Enron was the 7th largest corporation in the United States before its sudden implosion, and its collapse has resulted in a $50 billion bankruptcy file, $32 billion in lost market capitalisation and the loss of $1 billion in employee pension funds.[67]

Many of the company's shareholders were also Enron employees, who had been encouraged to buy stock. According to documents filed in court, a group of 29 Enron directors and senior executives cashed in on 17.3m shares worth millions of dollars before the company fell, while other staff with pensions invested in the company were prevented from selling even as share prices plummeted from $90 to $1.[68]

As the scale the Enron crisis became apparent, attention turned to the company's auditors. Enron was Andersen's largest account, and several top Enron executives, including its chief accounting officer, were former Andersen employees. Andersen had been Enron's auditors since the 1980s, and in the 1990s was also given the role of conducting Enron's internal accounts. But Andersen did much more than check the energy company's books, providing management consultancy and tax advice as well. In fact, of the $52 million Andersen earned from Enron in 2000, $27 million came from non-audit fees. And they didn't do a bad job either, at least in one sense: in only one year, 1997, did Enron pay any federal tax at all on its profits.[69] "In effect," writes Business Week, "the firm was working on the accounting systems and controls with one hand and attesting to the numbers they produced with the other."

In February 2001, Andersen gave Enron a clean bill of health on its annual financial report. What the accounts hadn't shown, however, was that Enron had shifted much of its liabilities off the books through more than 3,500 partnership ventures. These outside entities, set up by Enron's chief financial officer, enabled hundreds of millions of dollars to be channelled into overseas tax havens, allegedly enabling Enron executives to amass huge personal fortunes. As the months passed, the gap in the balance sheets widened to the extent that no amount of creative accounting could hide the disastrous state of the company's finances.[70]

The suspicion for many is that Andersen's multiple role as both client and auditor meant that the company was, at best, slow to pick up on any financial irregularities and, at worst, complicit in these activities. The company's behaviour since the scandal broke has done little to allay these suspicions. As soon as Andersen executives caught wind of what was afoot, they pressed the panic button. The firm has admitted that its Houston office shredded dozens of documents relating to the company's Enron account as early as October of 2001.

The extent of Andersen's complicity in covering up Enron's debts remains to be seen. Up to mid-January 2002, the firm had only admitted one professional misjudgement in auditing, amounting to relatively small portion of Enron's earnings restatements. Nonetheless, Andersen is being targeted in the various Congressional hearings underway in the United States, appointed to uncover who was to blame for Enron's collapse, determining if criminal behaviour was involved, and identifying who is liable for the assets lost by shareholders.

Yet the impartiality of these committees itself remains in question. Both Andersen and Enron were substantial donors to both political parties, and very few of the country's Congressmen can claim financial links with neither company. According to the Washington-based Center for Responsive Politics, out of the 248 Congressmen sitting on those committees, 212 have received campaign contributions from Andersen and/or Enron.[71] Republican Senator John McCain admitted "We're all tainted by the millions and millions of dollars that were contributed by Enron executives, which…. creates the appearance of impropriety."[72]

Andersen is also a defendant in some forty Enron shareholder lawsuits, in which damages totalling over $32 billion are being sought. If Andersen decide to settle, it will almost certainly cost them more than the $110 million they paid to the shareholders of Sunbeam Corp.[73] The outcome of a settlement on such a scale would be ruinous for the company. But the ripples of the Enron scandal extend far beyond Andersen – a fact that the profession was quick to grasp. As early as December 4th, 2001, the Big Five issued an unprecedented joint statement, attempting to assure legislators that self-regulation of the industry remained the best policy for "investors, the profession and the financial markets."[74] Since then, several senior figures within the profession several have issued similar warnings against hasty reactions. Peter Wyman, chairman of the British Institute for Chartered Accountants in England Wales, cautioned

“We’re all tainted by the millions and millions of dollars that were contributed by Enron executives”
Republican Senator John McCain

“ We just need to clarify things and have a rational, sensible debate rather than just knee-jerking into something for the sake of it.”[75]

Yet on this occasion such words may fall on deaf ears. Calls for more stringent rules are coming from several quarters, including the financial press. According to the journal *Business Week,* reform of the accountancy industry is urgent. It recommends a number of steps including barring consulting to audit clients, imposing mandatory rotation of auditors and blocking the revolving door between accountancy firms and the companies they audit.[76] In the wake of the Enron scandal, many politicians on both sides of the Atlantic now support such recommendations. The stage is set for a colossal showdown between the Five Brothers and government regulators in what could prove to be a decisive battle for the future of the accounting profession and the culture of corporate management as a whole.

To ward off SEC moves to set up a statutory regulator of the profession with real powers of enforcement, the Five Brothers agreed an enhanced role for the existing body the Public Oversight Board.[77] While in normal circumstances, such a move may have been sufficient to hold the regulators at bay, recent events mean that stronger measures to curb conflict of interests are almost inevitable. The spectacular collapse of the US energy giant Enron, and subsequent unveiling of serious financial mismanagement by their accountants, Andersen, has cast an unprecedented spotlight upon the profession. What this translates into in terms of concrete new legislation in the US or Europe remains to be seen. One response from the sector has been an ‘uncharacteristically high-profile’ attempt to ward off stricter regulation. A move to the British system of self-regulation with independent assessment by a Review Board chaired by the auditor general is likely now to seem inadequate. The Review Board has only two members with an accountancy qualification.[78]

Charge 3 – Concealment

Lack of Disclosure

> *"We cannot depend on the market to discipline promptly companies that are free to choose what and how to report to investors. Even if good accounting can be relied on to drive out bad in the long run, investors may suffer too much damage in the short run to permit freedom from regulation."*[79]
> David Solomons

Transparency and disclosure have become synonymous with good corporate citizenship. However, not all companies find it in their interests to be crystal clear about their incomings and outgoings, and rely on thaeir auditors to keep sensitive information under wraps. While accountants should have a key role in combating corruption by asking hard questions while carrying out audits, they generally do not have a good record on blowing the whistle on fraud. A British parliamentary report in March 2001, noted that there was serious "under-reporting of suspicious transactions by certain professional groups, in particular lawyers and accountants". Of 14,129 suspicious transactions reported in 1998, a mere 0.7per cent came from accountants.[80] Even if accountancies wanted to behave as good public citizens, their obligations of confidentiality to clients would create problems.

However, accountants often play a more active role in deception than simply obscuring data. Through their audit work, the five brothers have a highly privileged insight into what happens behind the closed doors of major corporations. The trouble is that they are often too concerned with keeping other business with the firms they audit to ask searching questions. Auditors can present information on a company in a favourable light or hold back information that may be in the public interest. There is also a culture among accountants of signing off on what they're told to by the directors of the companies they are auditing; directors who happen to be paying their fees.

It is easy to see how conflicts arise. Contrary to the impartial public image of the auditor, the problem with the five brothers is their lack of independence. As one big five firm told the New Economics Foundation, "Our approach is always to advise people to implement their strategy. Whatever we're employed to do, we do it… We will not question it… We don't think of ourselves as independent."

The consequences of non-independent reporting can be huge. Misleading figures and budgetary reports can give investors false confidence in the state of a company's finances. This can ultimately lead to huge losses when the true extent the company's troubles come to light. Lynn Turner, former chief accountant of the SEC and now a professor at Colorado State University, estimates that investors have lost close to $200 billion in the last six years through financial restatements and lost market capitalisation following audit failures. Between 1997-2000, the number of restatements doubled from 116 to 233.[81] For just 9 of those cases, the combined cost to investors was $41billion.[82]

Expectations of disclosure are rising at the same time that new regulatory opportunities are opening up for audit firms to take their own initiative. Some within the industry do acknowledge the legitimacy of this concern. "There are understandable questions being raised", admitted Kieran Poynter, a senior partner of PwC's British arm. "We in the profession ought to be more proactive about explaining what we do."[83]

However, most insiders maintain that non-disclosure is still the universal reaction of the management that pays the accountant when information puts a company in a bad light. As one senior partner in a big five firm said, where public interest issues arise, "Voluntarism does not work, management does not want to disclose." Arthur Levitt, the former head of the SEC, agrees. "The whole culture of auditing is based on disclosure," Levitt observers. "Yet the practices of the industry have defied this in recent years by embracing a fortress mentality."

Corporate Spin

The largest of the five brothers, PwC, packages a number of its corporate services in response to an increased awareness of 'intangible assets,' chief among which is reputations. As companies get larger and take over smaller companies, the cost of damage to the parent companies' reputation grows in tandem.

Protest against multinationals has forced them to engage more with their critics and the people affected by what they do. Promoting their 'reputation assurance' package PwC say:

> *"Corporate leaders are discovering that by engaging stakeholders, adopting rigorous business strategies, and implementing reputation management systems, they can more effectively establish trust with stakeholders, gain a competitive advantage, mitigate the impact of crises, and preserve a company's most important asset – its reputation."*[84]

In early 2001, PwC was called-in by the Canadian firm Talisman Energy to verify a corporate responsibility and human rights report of its operations in Sudan. Talisman was accused by human rights and development organisations, including Christian Aid and Amnesty International, of being complicit in human rights abuses around its

“Our approach is always to advise people to implement their strategy. Whatever we’re employed to do, we do it… We will not question it… We don’t think of ourselves as independent.”

oilfields in Sudan. These included forcible displacements and murder of civilians by government troops.

The company’s report was criticised by these organisations. Amnesty International noted that it failed to respond to concerns they had raised that the Sudanese government continued to commit human rights abuses in order to clear areas for oil exploration.[85] It also criticised Talisman for failing to take the necessary steps to properly implement a code of ethics that it had signed up to. Yet rather than get a human rights or development organisation to verify its report, Talisman called in PricewaterhouseCoopers. PwC itself commented that it was “not conducting an in-depth study either of the effects of Talisman's presence in the Sudan or of the impact of oil production on the country.”[86] It also intended to travel only within the areas covered by Talisman’s concession and controlled by the government. Its ability to conduct a serious verification of Talisman’s operations was thus severely limited, and questioned by human rights and aid organisations.[87]

In the words of Jennifer Woodward, responsible for overseeing the verification, PwC saw its role as “adding independence and credibility” to Talisman’s corporate responsibility report. From a human rights and development perspective however, verification and monitoring should be about establishing the facts and upholding human rights standards, not about rubber-stamping what companies say about themselves.

There are also conflict of interest questions. At the same time that PwC was verifying Talisman’s Sudan report, it was acting as a consultant to Talisman on how to design and implement a corporate responsibility strategy.[88] At a broader level, PwC is seeking to move into environmental and social audits and verification processes of corporate responsibility reports just as it enters the public relations market.[89] PR and independent verification do not go very well together, and this will raise even more questions about the suitability of the constantly hybridising and diversifying accountancy firms to offer services in which their expertise is limited.

Social Accountability

In recent years, there has been growing recognition within the corporate sector of the need for companies to develop open and transparent systems for monitoring their impacts on the wider community. In response, global accountancy firms have been developing a new area of expertise to add to their expansive list of services: social, ethical and environmental accounting.[90] Although the development of performance measures beyond the traditional financial domain has been welcomed, questions have also been raised about the legitimacy of the accountancy profession to deliver such services.

Social and environmental accounting finds its roots back in the early 1970’s, but has only seen a wider take-up in the latter half of the 1990’s. In response to the failures of financial accounting to identify and respond to risk, social and ethical accounting was developed by the New Economics Foundation and others as a more useful method to engage with stakeholders and understand the external impacts of business activities.

Social and environmental accounting can often reveal information that organisations might rather keep hidden: from serious environmental hazards to labour standard violations. Progressive companies willingly put out the information in a non-biased manner and involve the NGO sector widely in discussions. Sadly, these are few and far between. As one journalist has argued, “so far, most multinationals are happy to leave this to friendly corporate accountancy firms instead of bodies with no commercial conflict of interest.”[91] This results in the presentation of limited information that fails to disclose a companies relevant activities and risk, not only to investors, but to its stakeholders and society as a whole.

The voluntary nature of social accounting means that there has been a proliferation of methods and approaches, many of these proprietary of the large accountancy firms. As the investment community is requiring more sophisticated levels of corporate governance to reduce investor risk, social and ethical accounting is becoming more and more mainstream. But the failure of governments to mandate social accounting means that conflicting methodologies continue to proliferate; and there is no driving impetus to arrive at a consensus on what social and ethical accounting really means.

While NGOs, social investment firms and human rights groups have been demanding more accountable auditing practices through mandatory schemes; standardised practice and greater scrutiny by an independent regulator, none of these have yet come to fruition. Case studies of labour standards monitoring have revealed severe weaknesses in accountancy firms approaches (see box, below). “Accountancy firms such as Ernst and Young simply do not have the training, independence, or trust of workers, to perform comprehensive, unbiased audits of working conditions,” wrote D. O’Rourke, author of *Smoke from a Hired Gun.*[92]

The UK Company Law Review will create some new reporting requirements. All PLCs worth and private companies worth over £5 million will need to issue an operating and financial review (OFR). The OFR will cover social and environmental issues where ‘relevant to an understanding of the performance of the business’.[93] Although concerted industry lobbying weakened the proposed legislation, auditors will now be able to pass comment on a company director's judgement in revealing, or not, social and environmental information that might be 'material'.

In the long run, it is in the interest of the Big Five to see such regulation, as it provides a huge business opportunity, a fact recognised by some industry players. However, whether or not this means these companies are best placed to fulfil this role is seriously in question. The five brothers will still have to prove their independence and competence to comment on social and environmental issues.

Failure to Monitor

Consumer goods have long been manufactured in developing countries, but globalisation has brought an increasing awareness of the faces behind the products we like to buy. Global campaigners have successfully challenged big brands including Nike, Adidas, Gap and Disney to provide a living wage and better working conditions for their workers. The challenge to the traditional "sweatshop" has resulted in a demand for methods to monitor global supply chains and the implementation of voluntary labour standards and codes of practice.

Global accountancy firms have been more than ready to step in to fill the gap to supply the expertise. PwC, for example, performed over 6,000 factory audits in 1999, including monitoring for Nike, Disney, Walmart and the Gap. PwC led the commercial development of corporate monitoring systems. But recent studies have revealed significant weaknesses with both PwC and Ernst and Young's labour and environmental monitoring practices which raise serious concerns about the competency of global accountancy firms to fill this role. As long ago as 1997, Ernst and Young was found guilty of missing key labour violations in its assessment of a Vietnamese manufacturer for Nike, including violations of labour laws on pay and overtime; strike breaking and physical and verbal abuse of workers.[94]

This study should have been the driving force behind improvements in monitoring techniques by accountancy firms. But as late as 2000, similar problems continued to prevail. In spite of the fact that PwC had developed a very sophisticated method for monitoring labour standards, an independent evaluation of the auditors, who were accompanied on factory inspections in China and Korea found much the same pattern repeated.

PwC gathered information from management not workers and based their assessment on information provided by the managers. They also interviewed workers who had been selected by management inside the factories – thus failing to provide them an adequate and safe opportunity to voice their concerns. This also meant that factory managers were scrutinising the interviewees.

Consequently, the factory audits missed some vital information, including the use of hazardous chemicals such as the carcinogen benzene; health and safety violations, such as not using safety equipment; barriers to freedom of association and collective bargaining rights and falsification of employee time cards. On the issue of freedom of association, it was even noted that as there was no union, there was no need to ask questions. The report failed to address issues of sexual harassment, discrimination and disciplinary practices. PwC's final report, nonetheless, states that the factory is in "acceptable" legal compliance.[95]

Dara O'Rourke, author of the study, concludes that PwC auditors did not have adequate knowledge of occupational health issues or hazard recognition and even failed to use a checklist for health and safety issues. In his opinion, "these problems go beyond the level of poorly trained auditors and flawed audit protocols. The significant and seemingly systematic biases in PwC's methodologies call into question the company's very ability to conduct monitoring that is truly indendent."[96]

Monitoring is an important means to enforce labour laws and codes of conduct. However, flawed monitoring can do far more harm than good. In 1998, following the results of the E&Y study, the Transnational Resource and Action Center (TRAC) argued that NGOs should be the ones leading any monitoring activity. Labour practices, they said, "cannot simply be analyzed the same way that a company's accounts can be audited. Workers must be interviewed away from the factory about sensitive issues. Research must be conducted into the conditions which exist on the days the inspectors are not at the plant. Monitoring must be both technically rigorous and political sophisticated."[97]

Peter Knight and Simon Propper argue that, "It is difficult to believe that domination by the Big Five is good for reporting. Yes, we need the frameworks and the methodologies. But what we need most are verifiers with a strong commitment to the environment and the technical expertise to see where huge businesses are going wrong... What accountants - and some of those who employ them - fail to understand is that critical audiences trust accountants even less than the companies they audit."[98]

There is currently no requirement in law for labour monitoring to be done, let alone by an independent organisation with no corporate interest in the outcome. Any audits performed are the property of the company and do not have to be revealed to anyone outside the company, including shareholders. Companies involved in the UK-based Ethical Trading Initiative, which is aiming to improve on labour standards monitoring in developing countries, require NGOs and Unions participating in the initiative to sign a confidentiality agreement when they review any of the company reports emerging from pilot projects.

Upcoming changes in UK Company Law may help to change this. If poor labour practices results in risk to corporate financial performance auditors will have the authority to require Director's to report on these issues. However, given the lack of skills, awareness, and knowledge of the auditors themselves, any positive impact in this area is likely to be limited.

Charge 4 – Sleaze

Tax Avoidance

> *"Richer taxpayers tend to be more mobile than poorer ones. If tax competition becomes stronger, using the tax system to redistribute money from rich,mobile taxpayers to poor, less mobile ones may become worryingly hard."*[99]
> The Economist

A disquieting irony is that while on the hand the Big Five represent the height of accountancy standards, they also provide the most comprehensive corporate advisory services on how to avoid tax and take advantage of loopholes. In an effort to hang on to profits, major corporations are increasingly hungry for advise about how to reduce tax payments. With their comprehensive knowledge of different financial regimes, the Big 5 are ideally placed to make suggestions to their clients about how to minimise tax losses. Assuming the work is done well, the clients will benefit from minimising their tax bill and the five brothers will benefit from the fees they receive. The UK government estimated that it loses between £10 - 25 billion every year in tax avoidance.[100] *The Economist* notes that "Footloose capital is free-riding on less mobile taxpayers, getting the benefit of services provided by governments in higher-taxing countries while paying taxes in low-tax jurisdictions, if at all."[101]

A range of risks emerge from calculating tax bills. If the tax advisor gets it wrong and the taxman finds out, the client is in trouble. The client may, in turn, seek compensation from her or his advisor. On a larger scale, the cost of complex strategies devised to minimise a clients' tax contribution, such as those of Rupert Murdoch's News Corporation, falls on the public purse. By implication it then passes a greater burden of paying for essential services onto individuals not in a position to have experts negotiating their tax returns for them. Greater financial opportunities then accrue to wealthy individuals and companies that avoid tax.

Arranging Holidays in Belize?

One of the most notorious tax havens for TNCs is the small Central American country of Belize. The country's offshore Bank Act of 1996 ensures overseas investors enjoy secrecy and confidentiality, as well as exemption from taxes, stamp duties and exchange controls. Not surprisingly, Big Five firms have set up offices in the country in order to assist company's looking to take advantage of the country's investor-friendly environment. One of these, Deloitte Touche Tohmatsu, proudly advertises the following benefits on its website for corporate clients who wishing to establish an "international business company" in this "offshore haven":

- Full exemption from all local taxes including stamp duty.
- IBC directors may be corporate and need not reside in Belize.
- Information pertaining to the identity of shareholders or directors need not be filed on public record.
- No exchange controls.
- Little or no office overheads, as a fully manned office in Belize is unnecessary.
- The income of the company; its dividends and other distributions are exempt from income tax.
- No statutory accounting or audit records need to be kept.[102]

In early 2001, another of the Big Five, KPMG, was commissioned by the UK's Department for International Development (DfID) to investigate the offshore tax exemption system in Belize. DfID has been delaying debt relief to Belize on the grounds that it is losing millions of pounds of tax revenue every year. DfID paid KPMG £132,424 out of total paid to KPMG for consultancy services of £5.41 million for the year 2000-2001 for doing the report.[103]

The problem is, KPMG also has a branch based in Belize advising clients on how to get full benefit out of the offshore tax system there. Among other things it offers advice on how to get "Economic Citizenship", which has the attraction of no capital gains tax and no death taxes. It also acts as an agent to people or companies wanting to set up an offshore International Business Company (IBC) that is exempt from "all forms of local taxation", as well as any need to provide an audit of accounts or filing of annual returns.[104]

This raises serious questions about how independent or critical KPMG's report to DfID was ever likely to be.[105] Much to the annoyance of officials at DfID, KPMG's report failed to analyse the tax exemptions available to multinationals in Belize – a fundamental part of KPMG's remit.[106]

A review of tax havens in the mid 1990s found that they accounted for only 1.2 per cent of world population and 3 per cent of world GDP, but were irresistably attractive to the assets and profits of US multinational companies. While only 4.3 per cent of the multinationals staff were to be found there, the havens accounted for 26 per cent of assets and 31 per cent of the corporations' profits.[107]

Nearly 60 per cent of US controlled corporations and 74 per cent of foreign firms doing business in the US paid no federal taxes at all in 1991.[108] Between 1965and 1995, overall tax on corporate profits in the OECD fell as a proportion of total taxation from 8.9per cent to 7.5per cent. According to the economist Harry Shutt, "The tendency to cut corporate tax rates has been given great impetus by the 'globalisation' of markets, which has compelled governments to hold down corporate taxation in order to try to attract or retain investment." In the European Union, says Shutt, this has resulted in enterprises "receiving more in state aid than they have paid in direct taxes."[109]

Another strategy used by US multinationals to avoid paying tax in either their home or host country is by conducting transactions between 'holding companies' in tax havens and 'hybrid branches' in third countries. When the Internal Revenue Service decided to close the loophole it was opposed by the big accountancy firms. Ernst & Young worked alongside lobbying firm The Washington Counsel, which represented a 'coalition of multinationals.' Deloitte & Touche and PwC acted on behalf of other groups of multinationals.[110]

The result of such tactics, of course, is that vast sums of corporate profits are avoiding taxation. One subsidiary of News Corp based in Bermuda, with no employees or source of income from outside the company family, registered a $1.6 billion profit over seven years. Basic tax rates in News Corp's three main countries of operation were 30 per cent yet the company managed to pay only 6 per cent tax.[111]

The battle between tax authorities and corporations is becoming ever harder for the authorities in an age of progressive capital liberalisation. Avoiding tax through complex strategies of transfer pricing and deferral of payments, not to mention double-dip leasing and the Dutch sandwich, does however create one clear winner – the accountants who sit happily on the battlefield feeding on the confusion of the regulatory war.[112] Without external checks and balances the Five Brothers will find themselves cheerleading in a race-to-the-bottom of tax regimes. A further consequence of complex tax strategies is the increasingly muddy waters of multinational corporate accounting. In this environment, greater transparency, universally endorsed in public as an aim for business, becomes impossible.

Recognition of tax avoidance as serious problem is, however, growing. In October 1997, the UK Inland Revenue Service obtained search warrants and raided the offices of Ernst & Young and Coopers & Lybrand – the first time that any of the accounting giants had been raided. Although no legal action resulted, the message from the government's tax office was clear: we're watching. More recently, in a report published in 2000 the OECD called for its members to eliminate low-tax policies, and announced it would be pressuring 41 tax havens that have "harmful tax regimes" to sign an agreement to amend their financial policies or face protectionism against them. The question is, has this increased level of pressure on governments gone anywhere towards ensuring that companies and their auditors play the tax game by the rules?

Bribery and Money Laundering

Corruption has been a charge most often levelled at developing countries. Increasingly, however, there is an awareness that corruption is a two-sided affair. Attention is now turning to the corruptors as much as the corrupted. Britain, for example, has been named and shamed by the OECD as the country host to the most number of multinational firms that ignore the OECD's convention on bribery and corruption. Organisations like *Transparency International*, which is calling for improved and more transparent accounting standards to be adopted globally, argue that accountants are central to the problem of corruption and its solution. "In many cases the only way you can detect corruption is through the accounts," says Carel Mohn of Transparency International. "The Achilles' heel is if accountants cover it up, then you have little hope of combating it."[113]

But the problem goes beyond bribery. Increased liberalisation of financial markets means that money laundering has emerged as major international problem. Substantial amounts of money flowing through the veins of the global financial system are generated from criminal activity, including drug sales, arms smuggling, bootlegging and human trafficking. In 1994 alone, the UN estimated that $750 billion of 'hot money' passed through Western financial systems[114].

Depending on where you are in the world, accountancy can be a dangerous profession and its competitive tactics 'unconventional'.[115] Indeed, it is common currency among the Big Five that in certain countries money laundering from crime is routine. Speaking anonymously to NEF, one Big Five insider asked rhetorically 'Is anybody not involved in laundering?' The only question according to members of the industry "is whether it is happening in 30, 40 or 50 countries? It depends where you draw the line".[116]

The Five Brothers – Conveniently Located at a Tax Haven Near You![118]

Yet accountants' role in facilitating money laundering is rarely examined or discussed within the profession. Professor Prem Sikka, head of the accounting, finance and management department at the University of Essex, writes; "While some accountants may be unwittingly caught up in money laundering, it is relevant to ask how much of this activity cannot easily take place without the active/passive involvement of accountants. Accountants know the international financial system, can create nominee (shell) companies to receive the proceeds of money laundering and create a labyrinth of misleading audit trails."

Professor Sikka also believes there to be an unhealthy degree of secrecy surrounding government investigations of auditors' roles in money laundering. He claims that for years he and his colleagues faced a "total block" in getting evidence of money laundering involving British-based accountancy firms examined by the government. He remarked, "The reluctance of regulatory authorities to investigate evidence and allegations brought out in this case indicates an alarming degree of inertia and buck-passing within the UK regulatory process."[117] The possible reasons for this reluctance by government officials to upset the accountancy industry are explored in the following section.

List of countries

Andorra	■
Anguilla	■★
Antigua	■★▲
Aruba	●■✱▲
Bahamas	●■✱★▲
Bahrain	●■★▲
Barbados	●■★▲
Belize	●■✱★▲
Bermuda	●■✱★▲
British Virgin Islands	●■✱▲
Cayman Islands	●■✱★▲
Channel Islands	●■✱★▲
Cook Islands	■✱
Costa Rica	●■✱★▲
Cyprus	●■✱▲
Czech Republic	●■✱★▲
Gibraltar	●■✱▲
Hong Kong	●■✱★▲
Isle of Man	●■✱▲
Lichtenstein	■▲
Luxembourg	●■✱★▲
Madeira	✱
Malta	●■✱▲
Mauritius	●■✱▲
Monaco	●✱▲
Netherlands Antilles	●■✱★▲
Panama	■✱★▲
Switzerland	●■✱★▲
Turks & Caicos Islands	●■▲
Vanuatu	■

Charge 5 – Collusion and Cronyism

"Britain isn't a democracy and never will be,"
PricewaterhouseCoopers spokeswoman[119]

Into the Corridors of Power in the US…

One of the most remarkable things about the Big Five, and the professional services industry as a whole, has been the capacity to continually dodge political censure and avoid legislation that could limit their activities. Despite a series of scandals pointing to the need for tighter regulation, and in particular to deal with the growing problems presented by conflicts of interest, the five brothers have managed to use the political machinery to ensure that their activities go unimpeded.

Allegations of political bias among the Big Five are supported by the pattern of party contributions in the US. In the 2000 election cycle, figures released by the Federal Election Commission up to December 1st show just under $13 million was donated by the profession to the two major political parties; 61per cent to the Republicans, and 38 per cent to the Democrats. Partiality is generally much stronger where the profession's giants are concerned, with PwC and Arthur Andersen giving 75 per cent and 73 per cent respectively to the Republican party (see Table).[120]

The reasons for this bias are not hard to deduce. Bill Clinton's choice for chairman of the SEC was Arthur Levitt, a man with a reputation as a champion of small investors. Levitt proved to be a thorn in the side of the professional services industry, banning partners from owning shares in the companies they audit and limiting the consulting work of accounting firms with companies whose books they check. Ultimately, Levitt's most stringent proposals were rejected by friends of the Big Five in Congress. Nonetheless, the entrance of the business-friendly Bush administration and subsequent appointment of lawyer Harvey Pitt as head of the SEC would have been met with warm approval by the profession. Pitt has represented each of the Big Five in the past, and previously questioned the need to curb consulting work[121]. In the words of Paul Brown, head of the accounting department at New York University, "The auditing business is very, very relieved that President Bush is there."[122]

… and Through the Revolving Doors of Government in the UK

The cosy relationship between the professional services companies and policymakers is not, however, confined to the United States. The fact is that essential democratic functions in Britain are increasingly being contracted out to the consultancy wings of Big Five accountancy firms. Under New Labour, accountancy firms have received a new boost to their public sector work. For example, Margaret Hodge worked at PricewaterhouseCoopers between 1992 and 1994, and as education minister oversaw the awarding of a contract to PwC to run Islington schools.[123] Since then, PwC has advised the government on the public-private partnership for the London underground, overseen the privatisation of Islington schools,[124] reviewed teachers' workload for the Department of Education,[125] was responsible for selecting and 'head-hunting' members for the reformed House of Lords, and headhunts people for local government appointments - reportedly taking a cut of 25 per cent of the annual salary of each post in the process.[126]

Trade Secretary Patricia Hewitt was research director of Andersen Consulting, later renamed Accenture. Until Labour came to power in 1997 the separate audit wing of the parent group Arthur Andersen, had been effectively barred from working for the government according to the BBC because of the firms role in the collapse of the De Lorean motor company in 1981.

Meanwhile, Lord Bassam has faced tough questioning in Parliament over the fact that he acted as consultant and political advisor to KPMG just before becoming home office minister. Shortly afterwards, KPMG won numerous tenders for consultancy to the government, including over fifty contracts advising the government on how to increase the role of the private sector in the NHS.[127] At the same time, KPMG has earned fees from advising the private sector on how to move into the NHS market.[128] It has also advised the UK government on privatising the Post Office, British Nuclear Fuels and failing schools, how to reform the Police Complaints Authority and how to regulate Britain's offshore tax havens.

PwC and Ernst and Young are among the financial consultants who have offered free staff (on secondment) to the Treasury, among other government departments. Both went on to win government contracts as well as reportedly to persuade Gordon Brown not to implement plans that would stop multinational companies avoiding tax through offshore havens.[129] One financial consultant to the Treasury boasted; "I did work on policy issues and got amazing access…. It is now much easier for me to ring up Treasury officials and get information I need".[130]

Given the number and extent of these contracts, it is not surprising that public-sector work has become a large and profitable source of revenue for the Big Five. In the UK, public sector work accounted for almost a third of the entire consulting market in 1995.[131] In 1999-2000, the UK government spent £133.5 million on contracting the Big Five for professional services out of a total of £600 million spent on consultants.[132] Of that, £69.8 million went to PricewaterhouseCooper; £30.6 million to Ernst and Young; and £19.2 million to KPMG.

In 1999-2000, the UK government spent £133.5 million on contracting the Big Five for professional services out of a total of £600 million spent on consultants.

A National Audit Office report criticised the government for not being clear about what services had been bought for this money. Nearly half of government departments could not say what the consultant services were actually for. The Department for International Development (DFID) alone spent £16.5 million of UK aid money was spent on the services of four of the big five accountancy firms in 1999-2000 (see Table).

Political contributions in the US by the Five Brothers - election year 2000

Organisation	Amount	Democrats (per cent)	Republicans (per cent)
Ernst and Young	$2,361,186	42	57
Deloitte & Touche	$1,691,661	29	71
PwC	$1,678,811	25	75
Arthur Andersen	$1,210,664	27	73
KPMG LLP	$1,055,039	30	69

Top 20 Contributors to George W. Bush's 2000 Presidential Campaign

Organisation	Amount	Top 20 position
Andersen Worldwide	$187,900	3
Ernst & Young	$176,949	5
PwC	$127,798	8
KPMG LLP	$106,244	14
Deloitte & Touche	$81,600	18

Source: Centre for Responsive Politics

UK aid money spent on services of big accountancies 1999-2000

Company	Amount (£)
PwC	12,500,000
KPMG	6,300,000
DTT	3,300,000
E&Y	36,000

Source: http://www.dfid.gov.uk/

4. CONCLUSIONS

Fresh air – the need for a Corporate Reformation

Once it was considered necessary to rigorously separate the powers of the church and state. Now it has become necessary to separate commerce just as thoroughly from those charged with ensuring its good practice.

In 1984, a British court ruled that that the object of annual accounts is to: "assist shareholders in exercising control of the company by enabling them to judge how its affairs have been conducted." According to the ruling, the purpose of the auditor's report is therefore to provide shareholders with information to question the management and, if necessary, use their voting rights against it.[133]

The new definition of accountancy presented here reflects a bolder vision. Companies have got bigger and more powerful, and true accountability will become more, not less, necessary with the increasing complexity of corporate organisation in the global economy. The rest of society now wants to know how the affairs of a company affect them and the environment they depend upon. At the moment this is an expectation rather than a legal requirement, but changes in law tend to follow shifts in public consensus. The need for trust, transparency and accountability in commerce means that company law is entering a phase of dynamic change. Sooner or later, companies will be held accountable just as much to their stakeholders as to their shareholders. Laws shortly follow after changes in public attitudes.

Already, there are moves to allow stakeholders to place their own requirements onto company directors.[134] The need for trust, transparency and accountability in commerce means that company law is entering a phase of dynamic change. Rising expectations on companies to report on their social and environmental performance and be measured against common benchmarks will reinvent the accountancy profession. The new profession will need to be scrupulously independent to satisfy the new mood. Recent events show that it will also need to be carefully monitored and regulated to be above suspicion.

"The purpose of annual accounts, so far as members are concerned, is to enable them to question the past management of the company, to exercise their voting rights," said Lord Jauncey in the House of Lords in 1990, "and to influence future policy and management".[135] What has changed is that today a member is considered to be anyone who can demonstrate a stake in what a company does. The arm of business is being re-attached to the body of society.

Accounting for the Accountants

> *"Professional accountants need uncertainty, lack of clarity, professional judgement and general mystification to maintain their distinction from ordinary people. But if it were generally realised that accounting principles have more to do with ritual and magic, than with clarity or consistency, there would be a general loss of confidence in the accountancy profession and the financial statements that it produces."*
> R.W. Perks, *Accounting and Society*

Today accountancies are living with the consequences of their diversification into general business services. The greed of the Five Brothers for both market share and integrated service provision has led to some painful indigestion. Conflicts of interest and bad practice are hitting the headlines like flies in summer against the windscreen of a speeding car. It was perhaps inevitable as individual firms sought to act as auditors, brokers and consultants. Further conflicts will arise as firms provide strategic advice to clients that are competitors in the same market place.

A situation in which, "It does seem that the law is excessively protective of auditors,"[136] is unlikely to last as regulators become emboldened by auditing failures. Although the Big Five managed to persuade Congress to rebuff SEC proposals to separate auditing from consultancy services in early 2001, three of the Big Five subsequently decided to do just that. In other words, regulation, or even the threat of it is effective when voluntary action fails to deliver.[137]

In addition to resolving basic conflicts of interest, there is also a growing awareness that a profession that exists to ensure corporate transparency cannot itself hide behind veils of outdated, and secretive business practices. "How can secrecy be justified? How can professional partnerships aspire to be real business advisors if their own businesses are closed books?" said Colin Sharman of KPMG, "I urge you to open your books before regulatory pressures insist, before clients insist, before shareholder organisations insist."[138]

In an editorial called, 'Auditing the Auditors' the *Financial Times* suggested two broad solutions for the mire that accountancies found themselves in. As a champion of laissez faire economics the paper significantly proposed formal regulation but thought that, "the regulator would face an information problem: auditing the auditor is a mammoth task." A second and not exclusive proposal is the one gathering support, to "require firms that do statutory audits to split off their consulting business."[139]

The Economist went even further and considered that, "The most radical change would be to take responsibility for audits away from private accounting firms altogether and give it, lock, stock and barrel, to the government." Yet with government itself a major client of theaccountants similar conflicts of interest could easily emerge. NEF thinks that more creative alternatives may be necessary. No single solution is likely, however, to solve the problem.

RECOMMENDATIONS

A light spin on a low temperature will not wash out the stains from events like the Enron scandal. There needs to be a new vision for corporate accountability, the framework for reporting, and the auditing profession. This report does not set out to draw that whole new map. The full task will need to include regulators, auditors, their clients and, most importantly, the people who suffer when things go wrong – the stakeholders.

There is a fundamental conflict between the public interest role of accountancy and the nature of today's profit hungry firms. The public interest voice could, however, be raised in a number of ways. Having a genuinely independent public interest director could be made mandatory for all boards. Companies could be required to go further and have a second regulatory board, like a stakeholder board, one of whose jobs would be the appointment of the auditor. In the short term, and just in order to shake up the Five Brother's complacency, company shareholders could vote on principle against the automatic reappointment of any big five accountancy firm. But it may be necessary to go further.

Once, the idea of a 'profession' had noble connotations. In accountancy that idea has been contaminated by a different kind of 'professionalism', one whose driving force is pleasing the immediate paymaster. The outstanding question is how to give real ownership of such a vital public interest function back to its diverse stakeholders, rather than just to company shareholders. Perhaps it is time to mutualise the profession, or for it to take on a new not-for-profit form. With fewer distractions perhaps then the accountants will be able to concentrate more on counting what matters.

We do however suggest some first steps on the path. "Little is to be hoped or expected of the professional associations," wrote Susan Strange. In the new climate they will have to prove her wrong if they are to win back the trust of companies and the public, and for that matter, government. Here are some proposals to begin the process of reform.

Counter-Crony measures:

- **Fresh air factor:** Companies should be forced to change auditors regularly to avoid 'over-cosy' relationships. The FSA has recommended a five-year rotation, but even five years is a long time in business cycles. Three years could be more appropriate. A trade off must be found between necessary familiarity with the inner working of corporations, and over-familiarity that leads to collusion.
- **Revolving doors:** There should be a minimum three year cool-off period between auditors taking jobs in government (or vice versa) where there is a perceived conflict of interest. And, a similar cool-off period should apply between the recycling of personnel between auditors and the companies that they audit.
- **No buying influence:** As a public statement of commitment to greater transparency, and acknowledgement of their especially sensitive role, the Five Brothers could voluntarily stop making political contributions. It would be a first step towards rebuilding public trust in the profession, and the electoral process as a whole.
- **Conflicts of interest:** As the Big Five reluctantly begin to separate audit and consulting work, the shift should be made permanent and mandatory. Regulators should guard against future backsliding. Past resistance to this move from the profession shows the weakness of self-regulation. Had the profession listened to Arthur Levitt's proposals to separate consulting from audit work, the sector could have avoided the destruction of its reputation said the editor of *The Analysts Accounting Observer.*[140]
- **Reasonable suspicion:** To strengthen the auditors hand, they should be able to report 'reasonable suspicion of fraud to officials' without compromising client confidentiality.[141]

Re-regulation

- EU commissioner for the internal market FritsBolkestein indicated that consolidation among the Big Five has already gone to far. His colleague Mario Monti, commissioner for competition, should launch an inquiry into the impact of existing consolidation in the sector. An alternative approach, and an important precedent, would be to establish a one-off ad hoc **global competition commission** to audit the Five Brothers and investigate the implications of their global domination of the accountancy industry. This commission would examine the nature of the companies' influence and, if necessary, to make recommendations about their break up into smaller partnerships

New beans - redefining the audit

- **Assessing stakeholder not shareholder value – multi-stakeholder evaluation of corporations:** New models are needed to assess the social and environmental well-being, and impacts of corporations. But conventional audit firms lack the skills and experience to carry such audits out.Increasingly orthodox accounting will need to be complemented by other assessments that highlight the kind of information essential to ethical investors, like political, social and environmental risks. It is only a matter of time before new social and environmental reporting measures that orthodox auditors are not competent to fulfil become mandatory, legal requirements.

  The Global Reporting Initiative (GRI) presents a new global framework for corporate reporting. It is only a voluntary initiative but provides a model for stakeholder engagement and reporting on social and environmental impacts, 'externalities'. If the GRI became a mandatory reporting framework, adapted to each commercial sector it would contribute significantly to improved corporate transparency and accountability. Auditors should play a role in the GRI, but without monopolising and becoming its gatekeepers, to the degree that the engagement of wider stakeholders is undermined.

- **Measuring the unmeasurable:** 75 per cent of corporate value is now considered 'intangibles.'[143] All that is currently available is an opaque measurement of the intangible asset base of companies. The scale of value attributed to intangibles and the gross lack of transparency in their measurement means that orthodox accounting does little more than sketch the tips of icebergs. Valuation of a company should be based on clear and transparent measures of the company's real value.

- **Redefining corporate value in the public interest:** Audits are supposed to provide a guide to the health and well-being of a company to its shareholders and, logically, potential investors. New tools are emerging to assess the performance of companies as public economic citizens. One such tool – the Local Multiplier Effect – measures the catalytic effect of a company's activities on local economic activity. Measures like these will become an increasingly indispensable part of any meaningful audit, because they measure a companies' performance in a real-world context. They reveal the link between company and community economic health

- **Grasping the Intangibles:** While the stated value of modern corporations tends to greatly exceed their market capitalisation and hard assets, the basis on which such estimates are made is rarely clear. The formulae accountants use to determine a company's 'true' value therefore need to be made much more visible to the public. However, this would only represent a first step in clarifying the value of intangible assets. Accountants must also learn an entirely new set of skills for measuring and reporting the value of a corporation's social capital. There are two areas in particular through which this can be assessed: through its capacity for innovation, and by the trust it instils amongst its investors and stakeholders. Within these two areas, accountants need to develop a comprehensive and transparent set of indicators to help stakeholders determine the true value of a company's intellectual and emotional capital.

Improving auditor governance

- **Highest common denominator transparency:** To lead by example auditors should at least meet the highest standard of transparency practised by the publicly listed companies they audit. The Five Brothers should also ensure that all partners within the firm and subsidiaries conform to the highest operating standard practised in the firm.

- **Setting up stakeholder councils:** The Five Brothers can show leadership in best practice for corporate governance by setting up stakeholder councils. Only by opening up the ossified rituals of the boardroom can real change happen. The New Economics Foundation proposes new bodies that represent the interests of all stakeholders – employees, customers, suppliers and anyone else affected by the firm – rather than just the interests of partners, directors and shareholders. Real stakeholder councils put firms at the cutting edge of responsible business practice.

Greening accountancy:[142]

Responsibility for improving the quality of corporate financial / environmental transparecy does not rest entirely with the accountancy profession. Nevertheless there is a range of developments where the accounting profesion is probably better placed than other groups to launch initiatives. These might include -

- press to have both disclosure and listing requirements in respect of environmental issues widened and strengthened: applying pressure at both IASC and IOSCO levels
- press for national audit bodies to make explicit the environmental responsibilities of the external financial statement auditor
- focus on developing better measurement techniques to capture and report environ mental benefits as opposed to only reporting costs
- develop environmental cost accounting case studies; present case studies at full company level rather than isolated instances of cost saving
- more prescriptive presentation concerning the non-financial issues to be presented in the narrative part of the accounting package
- explore how recognised accounting techniques, such as consolidated and segmented reporting - can be applied to environmental reporting issues
- green the accounting syllabus so as to integrate environmental issues and thinking into the everyday life of the accountant, in practice or in industry.

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[114] Prem Sikka. "Accounting for the Public Interest: Money, Arms and Tax" *Public Interest* Vol. 26, No. 2. Spring 1998.

[115] Speaking to NEF one insider, half joking, described business practices in some countries ranging from normal to shooting the opposition.

[116] *Ibid Sikka.*

[117] Sue Wheat. "Casting the First Stone" *Developments* Fourth Quarter. 1999.

[118] The countries below were all listed by the OECD as "harmful tax regimes" in the organisation's 2000 report" *Towards Global Tax*

[119] Nick Cohen, *The Observer*, 17/9/00, "This could be you"

[120] The Centre for Responsive Politics point out that,' In many cases, the organizations themselves did not donate, rather the money from the organization's PAC, its individual members or employees or owners, and those individuals' immediate families. Organization totals include subsidiaries and affiliates. All donations took place during the 1999-2000 election cycle and were released by the Federal Election Commission on Friday, December 01, 2000. ' (www.opensecrets.org)

[121] U.S News and World Report, 23/7/01, "Auditors Exposed! Cozy Deals Alleged!"

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[134] See The CoRe Campaign chaired by the New Economics Foundation.

[135] Lord Jauncey in the House of Lords in the 1990 Caparo case: Caparo Industries plc v. Dickman and others, p.49, House of Lords, 8 February 1990 quoted in DR Myddelton *Accountants without Standards?*, ibid.

[136] Perks (1993) quoted in Strange (1996)

[137] *Accountancy* 'Taking the spin off spin-offs' p.18 September 2000. 'Has pressure from the regulator forced the hand of KPMG, E&Y and PricewaterhouseCoopers, the three firms that have decided to dispose of consulting services? KPMG and E&Y decided to spin off the consulting arms months before the SEC began its high-profile campaign. But both admit that pressure from the regulator has shaped the way they structured the disposals. The consulting entities will probably be more independent than was originally planned. Sources say PwC predicted early in the year that the SEC would succeed in forcing a separation of services. According to the rumour, the firm decided to gain a competitive advantage by doing something voluntarily before it was forced by the SEC.'

[138] Speech by Colin Sharman, KPMG's International Chairman, to the Institute of Chartered Accountants of Ireland June 2000.

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[141] Ref: Cadbury Committee 1992, in the Economist 17/10/95

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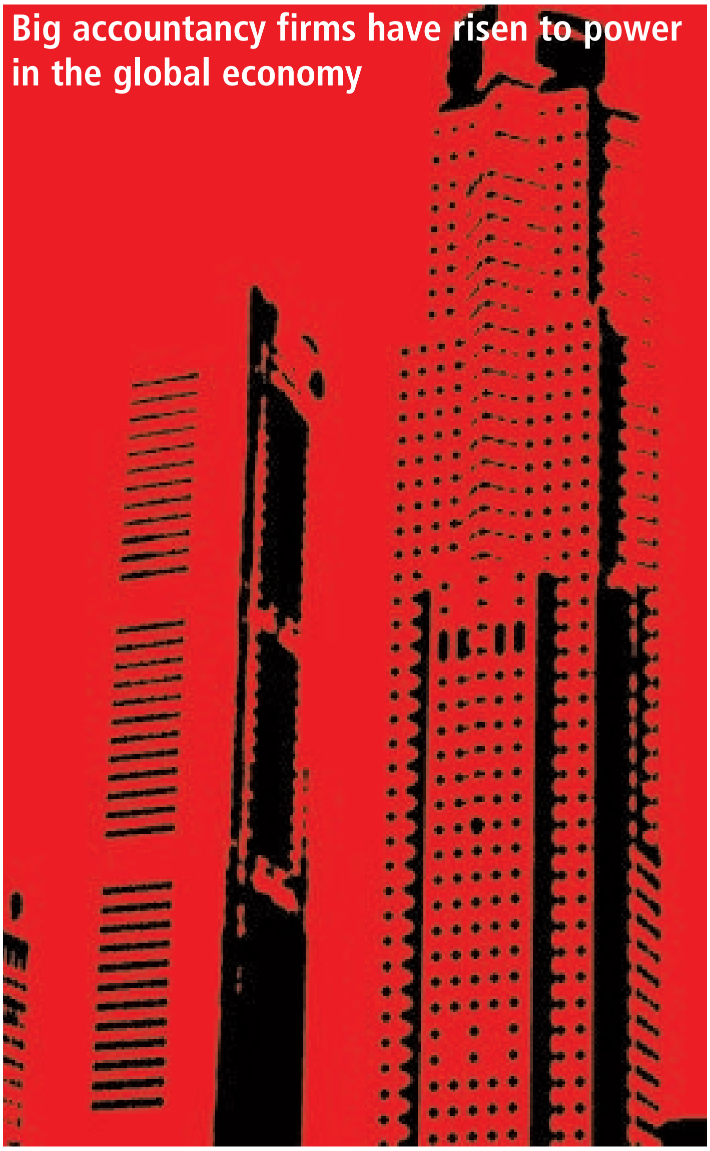
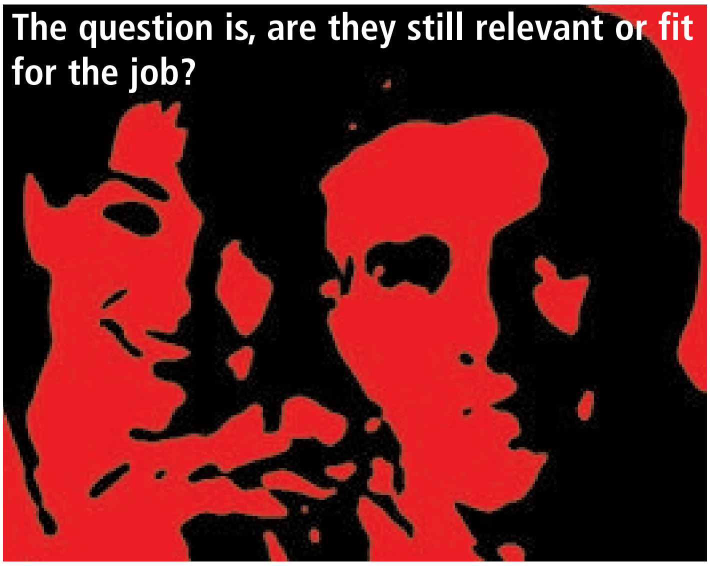
[143] *Economic Sustainability: The Business of staying in business*, by Deborah Doane and Alex MacGillivray, March 2001, published by The SIGMA Project, London.





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