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RACE TO THE BOTTOM: THE CASE OF THE ACCOUNTANCY FIRMS

Association for Accountancy & Business Affairs

Shedding light on darker practices
Working for an Open and Democratic Society

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RACE TO THE BOTTOM:
THE CASE OF THE ACCOUNTANCY FIRMS

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EXECUTIVE SUMMARY

The growing power of big business operating in an environment where countervailing power has been severely weakened has unleashed a race-to-the-bottom. Its aim is to reduce rights of employees, consumers, investors, pension scheme members and citizens.

Major accountancy firms are at the forefront of this race-to-the-bottom. Nelsonian audits and insolvency abuses cause misery to many. Evidence published by US regulators shows that the firms ignore rules on auditor independence and market aggressive tax avoidance schemes, shifting the tax burden from companies to individuals. The same is happening in the UK.

In the UK, major accountancy firms are engaged in the downhill race for auditor liability. The state guaranteed monopoly of external auditing was given to accountancy firms on the condition of ‘joint and several’ liability, creating incentives for partners to police each other and accept consequences of poor work. Steadily, this has been diluted. Now firms can limit their liability by trading as limited liability companies or as Limited Liability Partnerships (LLPs). They don’t owe a ‘duty of care’ to any individual affected by audit failures. Accountancy firm partners share the profits, but don’t have to suffer the consequences of negligence by firm or fellow partners.

Not content with lobbying and financing political parties to get their way, accountancy firms have hired entire governments to advance their interests. Price Waterhouse (now part of PricewaterhouseCoopers) and Ernst & Young hired the legislature of Jersey to enact a LLP Bill, which they themselves had drafted. They awarded themselves protection from lawsuits, with little public accountability. They demanded the same from the UK government with the threat that if it did not oblige they would cause economic and social turmoil. The UK government gave way. Major firms are seeking even more anti-consumer laws by demanding ‘cap’ on liabilities and ‘full proportional liability’, both already ruled out by the Law Commission. Such changes would make it impossible for injured stakeholders to secure appropriate redress from negligent auditors. They would remove incentives for delivering good audits, but protect firm profits.

The case of accountancy firms shows that in pursuit of profits and private gain big business cares little for the rights of stakeholders.

CHAPTER 1
RACE TO THE BOTTOM

Unregulated globalisation has changed the balance of social forces. Fifty-one of the hundred largest economies in the world are corporations, not countries. The five largest companies have combined sales greater than the total incomes of the poorest 46 nations. The combined sales of the top 200 corporations are bigger than the combined economies of all countries minus the big ten, and account for over a quarter of world economic activity (Anderson and Cavanagh, 2000), giving them enormous power and scope for controlling markets, prices, jobs, flight of capital and tax avoidance and evasion.

Elected governments may be mandated to fight poverty, social exclusion, environmental degradation, and provide decent health, education and housing, but major corporations discipline governments through tax avoidance and threats to move jobs. With increased government dependence on private capital to stimulate economic activity, the power of corporations relative to other social institutions has increased. As Naomi Klein puts it, "corporations are much more than purveyors of products we all want; they are also the most powerful political forces of our time. ….. corporations have become the ruling political bodies of our era, setting the agenda of globalization" (Klein, 2001, p. 339-340). Governmental authority remains confined to defined territorial jurisdictions. Big business roams the world looking for the quick buck, owing loyalty to no nation or community.

Through lobbying, PR, friendly journalists and by financing think-tanks, academic research and political parties, corporate priorities dominate domestic and foreign policymaking. All over the world, populations are pitted against each other as corporations demand low costs, subsidies and lax regulation with the threat that if their demands are not met they will uproot, causing economic and social damage to the host communities (Korten, 1998). Increasingly, governments oblige. In the US, the Sarbanes-Oxley Act 2002 and various Congressional Committees have helped to highlight some of the corporate abuses though it has not curbed the appetite for a quick buck. Little attempt is made in Britain to expose or effectively control corporate power. The result is rampant fat-cattery at the top, low wages and job shedding at the bottom, weakening of hard won work and welfare rights, and scandals, ripping off consumers, savers and investors.

The race-to-the-bottom is about profit, private gain and power. Accounting is central to all calculations about institutionalised abuses, tax and responsibility avoidance. Major accountancy firms have unsurpassed expertise.

Accountancy Firms

With over 250,000 professionally qualified accountants, Britain is in the grip of 'accounting think'. Almost everything ranging from companies, utilities, hospitals, schools, government departments and trade unions is regulated by accounting even though accounting and auditing routinely fail and are implicated in scandals. The major beneficiaries are accountancy firms, now considered to be part of the ruling elite. They set the new standards in the race-to-the-bottom (Sampson, 2004). Enron's Auditor, Arthur Andersen, shredded crucial documents. After a criminal conviction it was closed down. In the US, almost all major accountancy firms are facing criminal and civil action by the state and federal authorities for audit failures, tax dodging and other anti-social activities. UK citizens have been subjected to numerous audit failures and abuses by accountancy firms, causing loss of jobs, homes, savings, pensions and investment (Sikka and Willmott, 1995a, 1995b; Cousins et al., 1999, 2000). They usually escape retribution because of a poor regulatory system. Major firms have enriched themselves by specialising in avoidance of rules and regulations. They launder money, devise novel tax avoidance schemes and advise in creating complex corporate structures to obfuscate accountability and responsibility (Mitchell et al., 1998; US Senate, 2003)

The accountancy business is dominated by just four firms, headquartered in secretive tax havens without information sharing treaties with other countries (Arnold and Sikka, 2001). In the UK, the Big-Four firms audit all of the FTSE 100, and 343 of the FTSE 350 companies. Their interests, values, vocabularies and agendas dominate the structures regulating accounting, auditing and insolvency. Ministers and policymakers seek their advice and are more likely to meet the barons of big accountancy firms than the victims of their practices.

TABLE 1
2003/2004 FEE INCOME OF MAJOR ACCOUNTANCY FIRMS

Firm	**UK Income £ million**	**Global Income US$ billion**
PricewaterhouseCoopers	1,505	14.7
Deloitte	1,248	15.0
KPMG	1,008	12.2
Ernst & Young	812	13.1

Sources: Annual Reports, press releases

On the back of their statutory monopolies, the Big-Four have an income of nearly £4.6 billion. Audits are devalued to get a foot-in-the-door and sell all sorts of more profitable services, including recruitment of directors, design of systems of internal control and director remuneration packages. They will operate internal audits, form subsidiaries, design tax avoidance schemes and then pretend to audit them. They print T-shirts, badges, lay golf courses, and even check that the toilets are clean[1].

The $55 billion global income of the Big-Four eclipses the gross domestic product (GDP) of many nation states. Only 52 nations have GDP greater than their combined fee income, which is greater than the GDP of oil-rich Nigeria, or Kuwait[2]. In common with other big businesses, this economic power has been translated into social power and used to advance its own selfish games, oppose change and organise their own accountability off the political agenda (Levitt and Dwyer, 2001). Their glossy brochures and self-congratulatory statements proclaiming high standards, quality, excellence, ethics and the burning desire to serve people and communities are reassuring but unmatched by reality. This monograph provides evidence to show their anti-social activities.

Structure of the Monograph

This monograph consists of six further chapters. Chapter 2 shows that major accountancy firms flout rules on auditor independence and devise aggressive tax avoidance schemes. The retribution, particularly in the UK, is always ineffective and inadequate.

Chapter 3 provides a brief history of developments in auditor liability in the UK. It shows that major accountancy firms, with the full support of their trade associations who also masquerade as regulators, are devoted to destroying stakeholder rights. Their aim is to eliminate stakeholder rights of redress against negligent auditors and make themselves bankruptcy proof. Major firms have used their financial resources to hire politicians, PR agencies and television commercials to ensure that injured stakeholders have little recourse against them.

Accountancy firms and tax havens, such as Jersey, have collaborated to open a new chapter in "regulation hopping". Jersey hired its legislature to Ernst & Young and Price Waterhouse (now part of PricewaterhouseCoopers) to 'fast track' a Bill that the two firms had

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[1] Ernst & Young made US$4 million from HealthSouth for checking cleanliness of parking lots and toilets.

[2] http://www.worldbank.org/data/databytopic/GDP.pdf; accessed on 1 August 2004.

drafted at a private cost of "more than £1 million" (The Accountant, November 1996, p. 5). The Bill was not drafted to advance the rights of innocent stakeholders or provide effective regulation, but to ensure that the big beancounters did not face the full consequences of their own failures.

This Jersey excursion was accompanied by the threat that if the UK government failed to match the liability concessions, the firms would relocate their operations to Jersey, causing considerable turmoil in the UK. The government eventually obliged[3]. To understand this excursion, chapter 4 provides a brief background to Jersey, an attractive place because in the absence of the checks and balances associated with liberal democracies, it facilitates the global race-to-the-bottom. Chapter 5 provides details of the events in Jersey. The aim of the excursion was to hold the government to ransom by using Jersey as a lever and demand liability concessions from the UK government. The UK government obliged.

Chapter 6 shows that the major firms are continuing with their downhill race. Not content with trading through limited liability companies and LLPs whilst retaining the lucrative partnership tax concessions, they want to make themselves bankruptcy proof and eliminate the rights of audit stakeholders affected by their negligence. They want their liabilities 'capped' and also want full proportional liability, already ruled out by the UK Law Commission. Chapter 7 concludes the monograph with a summary and reflections on the accountancy industry's race-to-the-bottom.

[3] Fuller analysis of the politics of the UK LLP legislation is beyond the scope of the present monograph.

CHAPTER 2
DOWNHILL RACERS

The public rhetoric of major accountancy is integrity and professionalism, the reality is shabby practices. Public statements mention ethics and morality, the reality is self-interest and questionable practices. Accountancy firms preach accountability to others but ensure that little of their real practices come to public attention. However, occasionally a few crumbs fall into the public domain and their carefully cultivated veneer of respectability is shown to be an elaborate charade.

Rules - What Rules?

According to its website, Ernst & Young stands for "People who demonstrate integrity, respect and teaming"[4]. In 1995, following allegations of violating the US rules on auditor independence, Ernst & Young gave undertakings to

> "comply with standards and guidelines issued by the Commission (i.e. SEC) and the accounting profession regarding the independence of public accountants that audit financial statements of any issuer whose securities are registered ….".
>
> **Source**: United States of America before the Securities & Exchange Commission "In the matter of Ernst & Young LLP", Initial Decision Release No. 249 Administrative Proceeding File No. 3-10933", 16 April 2004.

However, for the period 1994 to 2000, contrary to the US rules on auditor independence, Ernst & Young (EY) entered into a business relationship with software giant PeopleSoft, one of its audit clients. Since the mid-1990s, the two organisations had a joint marketing agreement which earned Ernst & Young hundreds of millions of dollars in royalty payments for selling the management software. At the same time Ernst & Young was auditing PeopleSoft's books. A judge found that the agreement violated SEC rules that forbid auditors from having anything more than a "consumer" relationship with businesses whose books they audit.

In mid-2002, the SEC prosecuted the firm. A judge fined the firm $1.7m (about £1m) and banned it from securing new public audit clients for six months. The withering 69-page judgement included the following:

[4] http://www.ey.com/global/content.nsf/UK/About_EY_-_Values.

"The most outrageous were the joint marketing and joint sales activities that occurred across the board. ……. I find equally improper the fact that EY and PeopleSoft salespeople held meetings in the field ……. and targeted customers based on shared information; that EY and PeopleSoft regularly shared confidential, proprietary information as to customers, business plans and sales …. No evidence that EY was sensitive or concerned about EY's appearance of independence. … EY committed repeated instances of unreasonable conduct, each of which resulted in violation of applicable professional standards, that indicate a lack of competence to practice ……. EY's day-to-day operations were profit driven and ignored considerations of auditor independence in business relationship with PeopleSoft. EY's partners shared in the pooled revenues of the firm's three practice areas, and each EY partner was evaluated annually on his or her achievement toward five preset goals, one of which was sales. EY did not give its employees any formal training on a regular basis concerning the independence rules on business dealings with an audit client. ….. EY had no procedures in place that could reasonably be expected to deter violations and assure compliance with the rules on auditor independence with respect to business dealings with audit clients.

….. the evidence shows that EY has an utter disdain for the Commission's rules and regulations on auditor independence. ….. EY committed repeated violation of the auditor independence standards by conduct that was reckless, highly unreasonable and negligent. ….. They were committed by professionals throughout the firm, who exhibited no caution or concern for rules on auditor independence in connection with business relationships with an audit client ……. The firm paid only perfunctory attention to the rules on auditor independence in business dealings with a client, and that EY reliance on a "culture of consulting" to achieve compliance with the rules on auditor independence was a sham. EY has offered no promises of future compliance. …. EY partners acted recklessly and negligently in committing wilful and deliberate violations of well-established rules that govern auditor independence standards in connection with business relationships with an audit client. EY's misconduct was blatant and occurred after the Commission and a court accepted EY's representations that it would observe the same independence rules, that it now claims are too vague to be followed.

Source: United States of America before the Securities & Exchange Commission *"In the matter of Ernst & Young LLP", Initial Decision Release No. 249 Administrative Proceeding File No. 3-10933"*, 16 April 2004..

In September 2003, a former EY partner was arrested on criminal charges for allegedly altering and destroying audit working papers and obstructing investigations relating to NextCard (SEC press release, 25 September 2003). The firm is also facing a US criminal probe into the sale of tax shelters (Financial Times, 24 May 2004). In May 2004, the firm "admitted it had settled a multimillion-dollar tax claim over income splitting through service trusts" with the Australian authorities (Sydney Morning Herald, 18 May 2004).

What of other firms? In 14 January 1999, the SEC censured PwC for violating auditor independence rules. A subsequent investigation found:

> "excusable mistakes, but also attributed the violations to laxity and insensitivity to the importance of independence compliance. .... PwC acknowledges that the review disclosed widespread independence non-compliance that reflected serious structural and cultural problems in the firm.
>
> Almost half of the PwC partners -- 1,301 out of a total of 2,698 -- self-reported at least one independence violation. The 1,301 partners who reported a violation reported an average of five violations; 153 partners had more than ten violations each. Of 8,064 reported violations, 81.3% were reported by partners and 17.4% by managers; 45.2% of the violations were reported by partners who perform services related to audits of financial statements. Almost half of the reported violations involved direct investments by the PwC professional in securities, mutual funds, bank accounts, or insurance products associated with a client. Almost 32% of reported violations, or 2,565 instances, involved holdings of a client's stock or stock options.
>
> Six out of eleven partners at the senior management level who oversee PwC's independence program self-reported violations. Each of the 12 regional partners who help administer PwC's independence program reported at least one violation; one reported 38 violations and another reported 34 violations. Thirty-one of the 43 partners who comprise PwC's Board of Partners and its U.S. Leadership Committee self-reported at least one violation. Four of these had more than 20 violations; one of these partners had 41 violations and another had 40 violations.
>
> Despite clear warnings that the SEC was overseeing the self-reporting process, the random tests of those reports indicated that 77.5% of PwC partners failed to self-report at least one independence violation. The combined results of the self-reporting and random tests of those reports indicated that approximately 86.5% of PwC partners and 10.5% of all other PwC professionals had independence violations.
>
> **Source:** US Securities and Exchange Commission, 2002.

PwC promised to improve its compliance, but was fined $5 million for independence violations (SEC press release, 17 July 2002). An Arkansas judge fined PwC $50,000 for destroying documents related to a lawsuit in which the firm was accused of fraudulently overbilling clients (Wall Street Journal, 19 September 2003).

Hand in Your Pocket

Organised tax avoidance robs nations of social investment and shifts taxes from companies to ordinary individuals. Senator Joe Lieberman told the US Senate Committee on Governmental Affairs (18 November 2003) that

> "ranks of lawyers, accountants, and financial consultants have abused the law and their own professional ethics simply for the sake of huge sums of money to be made helping their clients evade taxes".
>
> **Source:** US Senator Joe Lieberman to US Senate Committee

Organised tax avoidance has reached epidemic proportions. No country is safe. Major accountancy firms are the epicentre of the worldwide tax avoidance industry that enables major companies and millionaires to escape taxes, which have been shifted to ordinary individuals. Tax havens are central to the tax avoidance industry. Big Four accountancy firms operate in tax havens, even those blacklisted as 'harmful' by the Organisation for Economic Co-operation and Development (The Observer, 13 July 2003).

Due to the activities of major accountancy firms, some 60 percent of major US corporations did not pay any federal taxes for 1996 to 2000 (US General Accounting Office, 2004). The US may be losing more than $170 billion and Britain between £25 billion and £85 billion each year in tax avoidance (Mitchell et al., 2002), big enough to make a real difference to social investment in education, transport, pensions, housing, and healthcare. Developing countries could be losing more than $50 billion each year, large enough to free them from poverty and provide much needed social investment (Oxfam, 2000). Deprived of essential social investment, the average life span in some African countries now stands at just 33 though the big beancounters still make profits there.

Unlike timid UK institutions, a US Senate inquiry focused on KPMG (US Senate Committee on Governmental Affairs, 2003). The firm admitted to having over 500 "active tax products" (p. 2). Just four of these schemes, three of which may have been illegal, may have netted the firm $180 million in fees, but lost the US Treasury $85 billion in taxes. Senator Carl Levin cited an internal KPMG memo which stated that “in most cases, it will be "difficult or impossible" for KPMG to be the "sole provider" of a "tax-advantaged product" – i.e., a tax shelter – "due to restrictions placed on the firm’s scope of activities by authorities." The memo described KPMG’s "dilemma" as follows. To avoid IRS scrutiny, KPMG had to market its tax products as investment strategies, but if it characterized its services as providing investment advice to clients, it could attract SEC scrutiny and have to comply with federal securities regulations.

The memo explains:
"[I]t is clear we cannot openly market tax results of an investment. Rather, our clients should be made aware of investment opportunities that are imbued with both commercial reality and favorable tax results. Conversely, we cannot offer investments without running afoul of a myriad of Firm and Securities rules. Ultimately ….. KPMG recognized that, to make its tax products work, KPMG itself could not provide "investment advice." It also knew it could not issue loans or provide financing, and had no authority to practice law. It needed assistance from other professionals with these capabilities to carry out its tax schemes, and it found them …

Source: US Senate Committee on Governmental Affairs, 2003.

The firm’s sales strategies showed considerable thought and planning.

“KPMG required some potential purchasers of the tax products to sign “nondisclosure agreements” and severely limited the paperwork used to explain the tax products. Client presentations were done on chalkboards or erasable whiteboards, and written materials were retrieved from clients before leaving a meeting. Another measure taken by senior KPMG tax professionals was to counsel staff not to keep certain revealing documentation in their files or to clean out their files again, to limit detection of firm activity”.
The fees charged to KPMG clients raise several concerns. Some appear to be “contingency fees,” meaning fees which are paid only if a client obtains specified results from the services offered, such as achieving specified tax savings. More than 20 states prohibit the payment of contingency fees to accountants and SEC, AICPA, and other rules constrain their use ….. Internal KPMG documents suggest that, in at least some cases, KPMG deliberately manipulated the way it handled certain tax products to circumvent contingency fee prohibitions. ……. evidence of those thoughtful discussions was virtually non-existent and considerations of professionalism seem to have had little, if any, effect on KPMG’s mass marketing of its tax products”.

Source: US Senate Committee on Governmental Affairs, 2003, p. 14, 18.

The Senate report concluded that

> "KPMG has devoted substantial resources to, and obtained significant fees from, developing, marketing, and implementing potentially abusive and illegal tax shelters that U.S. taxpayers might otherwise have been unable, unlikely or unwilling to employ, costing the Treasury billions of dollars in lost tax revenues.
>
> KPMG devotes substantial resources and maintains an extensive infrastructure to produce a continuing supply of generic tax products to sell to multiple clients, using a process which pressures its tax professionals to generate new ideas, move them quickly through the development process, and approve, at times, potentially abusive or illegal tax shelters.
>
> KPMG uses aggressive marketing tactics to sell its generic tax products, including by turning tax professionals into tax product salespersons, pressuring its tax professionals to meet revenue targets, using telemarketing to find clients, using confidential client tax data to identify potential buyers, targeting its own audit clients for sales pitches, and using tax opinion letters and insurance policies as marketing tools.
>
> KPMG is actively involved in implementing the tax shelters which it sells to its clients, including by enlisting participation from banks, investment advisory firms, and tax exempt organizations; preparing transactional documents; arranging purported loans; issuing and arranging opinion letters, providing administrative services, and preparing tax returns.
>
> Some major banks and investment advisory firms have provided critical lending or investment services or participated as essential counter parties in potentially abusive or illegal tax shelters sold by KPMG in return for substantial fees or profits.
>
> Some law firms have provided legal services that facilitated KPMG's development and sale of potentially abusive or illegal tax shelters, including by providing design assistance or collaborating on allegedly "independent" opinion letters representing to clients that a tax product would withstand an IRS challenge, in return for substantial fees.
>
> Some charitable organizations have participated as essential counter parties in a highly questionable tax shelter developed and sold by KPMG, in return for donations or the promise of future donations.
>
> **Source:** US Senate Committee on Governmental Affairs, 2003, p.4**.**

The Senate hearing obtained internal memos, letters and e-mails of the firm. The firm's attitude towards compliance with rules and fear of retribution was reported thus:

"senior KPMG tax professional advocated in very explicit terms that, for business reasons, KPMG ought to ignore federal tax shelter requirements and not register the OPIS [acronym of a tax shelter] tax product with the IRS [Inland Revenue Service], even if required by law. In an email sent to several senior colleagues, this KPMG tax professional explained his reasoning. In that email, he assumed that OPIS qualified as a tax shelter, and then explained why the firm should not, even in this case, register it with the IRS as required by law. Among other reasons, he observed that the IRS was not vigorously enforcing the registration requirement, the penalties for noncompliance were much less than the potential profits from selling the tax product, and "industry norms" were not to register any tax products at all. The KPMG tax professional coldly calculated the penalties for noncompliance compared to potential fees from selling OPIS: "Based upon our analysis of the applicable penalty sections, we conclude that the penalties would be no greater than $14,000 per $100,000 in KPMG fees. ... For example, our average [OPIS] deal would result in KPMG fees of $360,000 with a maximum penalty exposure of only $31,000." The senior tax professional also warned that if KPMG were to comply with the tax shelter registration requirement, this action would place the firm at such a competitive disadvantage in its sales that KPMG would "not be able to compete in the tax advantaged products market." In short, he urged KPMG to knowingly, purposefully, and willfully violate the federal tax shelter law".

Source: US Senate Committee on Governmental Affairs, 2003, p. 13.

Senator Carl Levin said, "Our investigation revealed a culture of deception inside KPMG's tax practice" (The Observer, 25 January 2004). KPMG now claims no longer to sell such tax products and claims to have changed its organisational structures. However, the New York Times reported that the firm's tax avoidance factories are still busy designing newer versions of the abusive tax shelters (26 August 2004). Rivals say that KPMG is "overly aggressive on tax" (Sydney Morning Herald, 18 May 2004) and the Australian authorities hit the firm with A$100 million in unpaid taxes and penalties for allegedly breaching anti-avoidance tax laws (Sydney Morning Herald, 17 May 2004)

The above practices are likely to be taking place in the UK and elsewhere because the firms have the same predatory culture and competitive pressures to make easy money. They claim to have "common" global "policies" and "agreed standards". PricewaterhouseCoopers tell us that

"Upon joining the PricewaterhouseCoopers global network and becoming members of PricewaterhouseCoopers International Limited, member firms win the right to use the PricewaterhouseCoopers name and gain access to its resources, methodologies, knowledge and expertise. In return, each firm is bound to abide by certain common policies and maintain agreed standards. This arrangement confers significant strengths – a coherent global vision combined with a robust local identity, a deep understanding of both local and global markets and the acute sense of responsibility that goes with local ownership".

Source: http://www.pwc.com; accessed 11 August 2004

The Untouchables

An insight into the culture of "responsibility" at major UK firms is provided by a former president of the Institute of Chartered Accountants of Scotland (ICAS), who said:

"All of the failures we looked into would have been found if anyone other than the audit junior had looked at the bank statements. ….. One public company failed with a £50 million black hole in one of its subsidiaries. The subsidiary had net assets of £5 million – and the auditors did not find it. If they had looked at the bank reconciliation, they would have raised so many enquiries they would have found the black hole".

"Big firms are no longer carrying out audits. They audit in helicopters and circle clients from a few thousand feet and take pictures. No one gets out of the helicopter and kicks tyres. It's no longer audit, it's more akin to due diligence".

Source: http://accountingweb.co.uk; accessed 10 October 2003.

In a survey, 54% of the Finance Directors of major companies felt that the quality of audits had declined noticeably (Accountancy Age, 6 November 2003). The views included, "The days when the auditors used to carry out stringent checks are well gone …. These days the auditors ask questions to the company accountant and accept their word ….. Audits try to avoid "dangerous" areas and have more opt-out clauses to put the onus on the management. Many are concerned about the use of audit as a means of getting into a company to sell other services". "The problem has always been the Big Four's way of auditing", said another. "Medium and smaller firms have always undertaken more comprehensive audit work". Yet regulators ask no questions about the culture of the big firms.

In late 2003, the UK government considered 'capping' fat cat pensions to a fund of £1.4 million. Within a very short time, KPMG and other consultants were understood to be marketing schemes designed to get round the 'cap' (The Observer, 7 December 2003). In May 2004, the UK Treasury was thought to be investigating a number of Big Four firms for selling tax avoidance schemes to 30 companies, resulting in more than £1 billion in lost tax revenues. According to The Times (5 May 2004), "E&Y, which is regarded as an aggressive promoter of tax avoidance schemes, defended its position. It said, "Businesses are taxed under the law and are entitled to plan within the law". In pursuing fess and the race-to-the bottom, a partner of another major UK firm said that

"No matter what legislation is in place, the accountants and lawyers will find a way around it. Rules are rules, but rules are meant to be broken"

Source: The Guardian, 18 March 2004.

Some pressures to change the predatory culture of accountancy firms could be generated by UK accountancy regulators but they are weak, ineffective and lack independence. Successive governments have been devoted to shielding major accountancy firms rather than punishing them for their anti-social activities. This encourages regulators to sweep things under their dust-laden carpets.

There has been no independent investigation into the audit of twentieth century's biggest banking frauds at the Bank of Credit and Commerce International (BCCI), which resulted in the loss of 14,000 jobs as well as $1.85 billion for 1.4 million bank depositors, despite the fact that the US Senate concluded that BCCI's [British] auditors were a party to a "cover up" and had caused "substantial injury to innocent depositors and customers of BCCI" (US Senate, 1992). There has been no independent investigation of the real or alleged audit failures at Polly Peck, Levitt Group of Companies, The Accident Group, Resort Hotels, or the UK parts of the Enron, WorldCom, Ahold, Parmalat, WestLB, Hollinger and Xerox episodes. Major British accountancy firms routinely refuse to co-operate with international regulators safe in the knowledge that their UK regulators will do nothing (Mitchell et al., 2002).

After a ten-year wait Maxwell's auditor, Coopers & Lybrand (now part of PwC), was fined £1.2 million and ordered to pay costs of £2.1 million; a total of just £6,000 per partner, tax deductible, with most blame placed on a dead auditor (Sikka, 1999). After ten years, BDO Stoy Hayward were fined £75,000 for audit failures at Polly Peck with the blame placed on two dead auditors. In 2002, some seven years after the event, Coopers & Lybrand, were fined £250,000 for audit failures at Barings. In May 2004, Arthur

Andersen was fined £400,000 for delivering poor audits at Wickes for the period 1992 to 1995 (Joint Disciplinary Scheme, 2004a). In June 2004, the founder of the Versailles Group Plc was sentenced to six years in prison for fraud but the auditors, Nunn Hayward, were fined only £50,000 for their "lamentably poor" audit (Joint Disciplinary Scheme, 2004b). In June 2004, Bird Luckin, the former auditors of Queens Moat Houses got a fine of just £17,000 for allowing the company to boost its profits by recognising the following year's earnings in the current year, capitalising maintenance expenditure and showing loss making properties as generating a profit, with the result that the 1991 profits of £90.4 million turned out to be a loss of £1 billion (Joint Disciplinary Scheme, 2004c). The UK Treasury will be frightening the firms by fining them £5,000 for failure to register tax avoidance schemes, equivalent to just 48 seconds of PwC's UK income, with predictable results.

The firms involved in scandals supply presidents of the accountancy institutes and individuals to populate the regulatory structures. The firms are rewarded with lucrative government contracts, PFI deals and 'insider' track to legislation. Their partners become DTI inspectors pontificating standards to others (Sikka and Willmott, 1995b). Their reports individualise failures and never raise questions about the predatory culture of the firms, in case questions are raised about their own.

Some individuals criticised in regulatory reports have become leaders of the auditing industry. At a salary of £2.9 million, John Connolly is Britain's highest paid accountant. In 1998, he became a senior partner at Deloitte & Touche (which includes Touche Ross). In the 1980s, Connolly was personally implicated in the Barlow Clowes scandal, which forced the government to pay £153 million in compensation to thousands of elderly investors. Connolly was heavily criticised in the 81 page Joint Disciplinary Scheme (JDS) report on the Barlow Clowes audits and related services provided by his firm, though the firm [Touche Ross] rejected the findings. Connolly was censured and ordered to pay £40,000 in costs. The report said that the "professional efficiency, conduct and competence of Mr. John Patrick Connolly fell below the standards that should be displayed by, and may properly be expected of, a chartered accountant who is the second partner on work done and services provided as reporting accountants. … As a result of such failure there were serious and material omissions in the information contained in the Touche long form reports and in the circular sent …… the circular did not give a true and fair view of the profits record or liabilities of the relevant Barlow Clowes entities. …..[Mr. Connolly's failures] resulted in fictitious income being included in the accountants' report" (The Independent, 12 January 2004; Joint Disciplinary Scheme press release, 7 July 1995).

Summary and Discussion

Major accountancy firms are engaged in anti-social activities. They will do almost anything to make a quick buck. They have little hesitation in violating rules and laws. The race-to-the-bottom is carefully planned and executed from plush City centre offices by highly paid and educated partners. Regulatory action is factored into business calculations as just another business cost.

The firms devise novel transactions to avoid rules and regulations and taxes. They may become rich but as a result ordinary people pay higher taxes, or have to put up with crumbling social infrastructure. Major firms use their considerable financial resources, not for the advancement of ethical business conduct, but for their own narrow purposes. Powerful US regulators are challenging the predatory culture of major firms. In comparison, the puny UK regulators rarely take any effective action. They are funded and dominated by the firms and have failed to investigate the overall standards of any major firm.

The UK accountancy industry's race-to-the-bottom is most visible in issues relating to auditor liability. Major firms and their trade associations have devoted unprecedented effort and money to evading the consequences of their own failures. The remainder of this monograph, therefore, focuses upon issues relating to auditor liability.

CHAPTER 3
ONE-WAY TRAFFIC OF AUDITOR LIABILITY CONCESSIONS

Auditor liability exemplifies the UK accountancy industry's race-to-the-bottom. Auditing firms, aided by auditing regulators and accountancy trade associations, have used their financial and political resources to deny injured stakeholders redress against negligent auditors and insulate the firms from the consequences of their own failures. Successive governments have indulged them, producing a massive wealth transfer from ordinary people to accountancy firms ensuring that the losses from negligent practices will be borne by innocent stakeholders whilst accountancy firms collect their fat fees.

Reducing Stakeholder Rights

The Companies Act 1948 gave accountants belonging to a select few trade associations (e.g. the Institute of Chartered Accountants in England & Wales) the monopoly of the state guaranteed market of external audits. The *quid pro quo* was that in return accountancy firm partners would have 'joint and several' liability and be liable for each other's negligence and omissions. This legal arrangement gave partners incentives to police each other's work with the knowledge that the negligence of one partner would have serious financial consequences for the others. Auditing firms were forbidden to trade as limited liability companies because this weakened the incentives for good audits. The arrangements were welcomed by accountancy firms and their patrons (Napier, 1998). They enabled the firms to become giant multinationals.

Armed with the state guaranteed monopoly and huge income, the firms began to make demands and shed obligations. Since the 1970s, they have campaigned to secure liability concessions even though very few individuals or organisations have the resources to sue multinational firms. Between 1968 and 1988, only two cases alleging negligent audits reached the courts. In both, the plaintiffs failed (Gwilliam, 1988). Nevertheless, the government obliged. Contrary to the 1948 bargain, the Companies Act 1989 permitted auditing firms to trade as limited liability companies. However, major accountancy firms were reluctant to give-up the considerable tax benefits associated with the partnership structures (Accountancy, April 1994, p. 26; February 1998, p. 14). Very few major firms formed limited liability companies[5]. Most continued to trade as partnerships as they were not keen on any form of public accountability.

[5] Amongst major accountancy firms, only KPMG chose to incorporate its auditing business in 1995.

“the obligation on companies to publish their accounts is perceived as a considerable drawback” [and] “firms have always stood out against revealing any financial information except their annual fee income”.

Sources: The Accountant, September 1991, p. 2; Accountancy, April 1994, p. 26.

Section 310 of the Companies Act 1985 (originally introduced in 1929) prohibits ‘capping’ of auditor liability in respect of the opinions given under the Act. Yet in response to more pressures from the auditing industry, a study (Likierman, 1989) recommended that subject to shareholder approval companies and their auditors should be able to agree a limit on auditors’ potential negligence liability. Such a luxury is not available to doctors, dentists, engineers, surveyors, or anyone selling goods and services. But once again the secretive accountancy firms were to be treated as a special class. Any appeasement of accountancy firms would have required major revisions to the general law of contract, especially the Unfair Contract Terms Act 1977. The nonsensical nature of a ‘cap’ can be demonstrated with a simple example. Suppose, auditor liability is ‘capped’ at £75 million, a figure advocated by major firms. A typical FTSE 100 company has more than 500,000 investors. That means that the maximum average compensation would be £150 per investor, regardless of the extent of auditor negligence or the loss suffered by investors. Any ‘cap’ inevitably reduces the deterrent effect implicit in full liability and reduces the incentive to improve audit quality. All ‘caps’ are arbitrary and cannot be fixed for all times and would therefore require considerable bureaucracy to monitor their appropriateness. The government’s response was to introduce Section 137 of the Companies Act 1989 (which became Section 310(3)(a) of the Companies Act 1985), enabling companies to buy insurance to cover their auditor’s liability, should they so wish. No major company is known to have taken advantage of this legal provision.

Help was at hand from the House of Lords. Whilst the domestic and international accounting standard setters told people that the purpose of published company accounts is to enable investors and creditors to make predictions of future cash flows, earnings and performance, the Law Lords reached different conclusions. The judgement in *Caparo Industries plc v Dickman & Others [1990] 1 All ER HL 568* stated that generally auditors owed a ‘duty of care’ to the company only (as a legal person) rather than to individual shareholders. The Law Lords decided that the audit report was prepared to enable shareholders to exercise their rights as members of the company (e.g. vote at annual general meetings), and not to enable them to make any investment decisions. Subsequently, the courts applied the *Caparo* principle to cases such as *McNaughton (James) Paper Group Limited v Hicks Anderson & Co. [1991 1 All ER 134 and [1990] BCC 891* and *Berg*

Sons & Co. Limited & Others v Adams & Others [1992] BCC 661, and did not award any damages against auditors, even where the audits were deficient, on the grounds that auditors did not owe a 'duty of care' to third parties. Capital markets, tax authorities, government departments and investors might rely on audited financial statements, but ensuring that such information has any value is apparently not part of auditor responsibility.

The case of *ADT v Binder Hamlyn [1996] BCC 808* held that auditors may be liable to third parties where "the purpose of audit work has been widened so that it is no longer confined to the statutory one … and the auditor in all the circumstances ought to have regarded himself as carrying out the audit for the plaintiff's purpose as well the company's". Such circumstances are rare. Thus, in the absence of exceptional circumstances auditors owe no 'duty of care' to any individual shareholder, creditor or any other stakeholder. Only the company can properly act as plaintiff, with no automatic liability to individual shareholders, or any other party relying upon audited accounts to make investment decisions All claims against auditors are subject to three formidable tests: foreseeability of loss suffered by the plaintiff, proximity between claimant and defendant, and that it is just and reasonable to impose liability. There is little or no "evidence suggesting that the courts in the UK have made, or are liable to make, excessive damages awards against auditors" (Office of Fair Trading, 2004, para. 1.2).

Despite the favourable case law, auditing firms have continued their escalating demands. In the early 1990s, they claimed that lawsuits from alleged audit failures at the Bank of Credit and Commerce International (BCCI), British and Commonwealth, Maxwell, Polly Peck, Levitt Group of Companies and Atlantic Computers threatened their existence. The campaign did not acknowledge that the actual settlements, whether through the courts or otherwise, tend to be a fairly small proportion of the original claims, or that most lawsuits are from liquidators (usually another major accountancy firm) who tend to be the major beneficiaries from such lawsuits (Cousins et al., 1998, 1999). Ordinary stakeholders receive little or nothing.

Following a report by the Law Commission (UK Law Commission, 1993), the UK accepted wider application of the principle of 'contributory negligence' (which can be traced back to the Law Reform Contributory Negligence Act 1945), which is a form of 'modified proportional liability'. This permits auditors to defend themselves by arguing that others (e.g. directors, bankers) contributed to their negligence and the loss suffered by the plaintiffs, and should therefore bear a fair share of the damages. The UK courts accepted the principle of 'contributory negligence', as evidenced by the House of Lords judgement in *Banque Bruxelles Lambert S.A. v Eagle Star Insurance Co. Ltd [1997] AC 19.* The principle was applied to the Barings case to reduce the damages awarded against auditors (see *Barings PLC v Coopers & Lybrand [1997] 1 BCLC 427*; (*In Barings plc (in liquidation) v Deloitte & Touche; Chancery Division 11 June 2003*). By applying the concepts of causation, contributory negligence and Section 727 of the Companies Act 1985, the court concluded that auditor negligence was "limited in extent and technical in nature". Most of the losses due to fraud were attributed to mismanagement of Barings by its directors. In October 2003, Mr Justice Evans-Lombe ruled that application of the principles set down in his judgment meant that Deloitte & Touche (Singapore) is liable for only approximately £1.5 million of the £791 million losses incurred by Nick Leeson. The original claim brought by the liquidators, KPMG, was for £1.3 billion (also see Accountancy Age, 19 June 2003).

The auditing industry's ultimate aim is to use the state to shield it from the consequences of its own failures. So it continued with its campaign for more liability concessions even though the ICAEW acknowledged that the principle of 'contributory negligence' has a "dramatic effect on limiting the consequences of negligence" (The Accountant, August 1996, p. 11). The then Big Eight accountancy firms produced a joint report claiming that liability related costs were eating up 8% of the accounting and auditing revenues[6] (Big Eight, 1994). The government immediately responded by inviting the Law Commission (UK Department of Trade and Industry, 1996) to conduct a feasibility study on the possibility of replacing partners' joint and several liability with full proportional liability and/or a 'cap' on auditor liability. The Law Commission rejected the call for a 'cap' on auditor liability, concluding that "we can find no principled arguments for a 'capping' system" [and that it] "cuts across a principle that a wrongdoer should compensate the plaintiff for loss caused by its tort or breach of contract ...... [and that it] would put the plaintiff at a disadvantage, since the cap would represent the upper limit in negotiations for a limit" (UK Department of Trade and Industry, 1996, pp. 48-49).

The Law Commission recommended that joint and several liability regime should not be replaced by full proportionate liability (p.16), and added, "we regard the policy objections to joint and several liability to be at worst unproven and, at best, insufficiently convincing to merit a departure from the principle" (p. 35). It responded to accountancy firm's propaganda by stating that it was "misleading to say that defendants can currently be called on 'to provide 100% of the damages even though they are only 1% at fault' since the principle of joint and several liability is that *relative to the plaintiff* each defendant is 100% responsible for the whole of the loss" (p.

[6] Cousins et al. (1998, 1999) show that this actually amounted to only 2.67% of their total revenues.

v). It raised a number of objections to full proportionate liability because it was unfair for a legally blameless plaintiff to have to bear the risk of a defendant's insolvency. The Law Commission examined and rejected three forms of modified proportionate liability. The first provides for the reallocation of the share of an insolvent defendant between the other defendants and the plaintiff where the plaintiff is contributorily negligent; the second applies proportionate liability to a person whose fault is secondary when compared to that of the other wrongdoers; the third allocates the uncollected share of an insolvent defendant, but only up to 50% of each defendant's proportionate share.

Accountancy firms were unimpressed by concerns about stakeholder welfare and immediately looked for other ways of advancing their interests. They were encouraged by developments in the US where Limited Liability Partnerships (LLPs) initially started as tax avoidance vehicles but had been crafted as vehicles to limit the liability of professionals (Alberta Law Review, 1998). In general, LLPs shielded individual partners from personal liability claims against the firm arising from any future malpractice by other partners of the firm. The general rule was that the liability claims would be met by the assets of the firm and any applicable liability insurance, followed by the assets of the partner responsible for the action/inaction creating the liability. Thus the assets of the other partners were protected even though they set the policies and standards of the firm and shared the profits generated by all partners.

Following their success of securing LLPs, US accounting firms ran television commercials, lobbied policymakers and built alliances with other occupational groups (e.g. lawyers) to demand even more liability concessions (King and Schwartz, 1997; Goldwasser, 1997; Financial Times, 13 July 1995, p. 10). The Presidential veto on the Private Securities Litigation Reform Act[7], which shielded auditors (and other professionals) by replacing 'joint and several' liability with forms of 'proportionate' liability[8] and by enacting barriers which made class-action litigation more difficult, was overridden by a multi-million dollar campaign (Boyle and Knopf, 1996). However, auditors had to accept greater duties for detection and disclosure of frauds. The Act holds auditors responsible not just for fraudulent financial reporting, but for all illegal acts by audit clients with financial consequences. So auditors have to detect illegal acts, consider the

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[7] This was the only Bill vetoed by President Bill Clinton during his eight years in office (Clinton, 1995). His veto was overridden by the Congress.

[8] The Act established proportionate liability except in cases where defendants engage in "knowing" securities fraud (in such cases the principle of 'joint and several liability' remained).

financial implications of these acts, monitor whether management have taken remedial action and report the results to the SEC.

Back in Britain, Ernst & Young and Price Waterhouse identified Jersey as a suitable base for the next stage of their campaign. Just before the UK Law Commission finalised its report (on 29 December 1995) rejecting full proportional liability and a ‘cap’, Price Waterhouse and Ernst & Young spent £1 million to draft a LLP Bill, awarding themselves protection from lawsuits with no public regulation or accountability requirements. The firms asked Jersey to enact the Bill (Hansard, House of Commons Debates, 23 May 2000, col. 901).

Summary

Auditing firms and their trade associations have long been engaged in a race-to-the-bottom. The aim is to enjoy the state guaranteed monopoly of external auditing with little or no obligations to stakeholders. Such a state of affairs has been brought about by developments in case law and legislation. This is far removed from the 1948 bargain which gave accountancy firms the lucrative monopoly of audit. With reduced liability, auditor incentives to deliver good audits are diluted. Nothing has been done to make auditors responsible for the consequences of their shortcomings or enhance stakeholder rights. It is all one-way traffic against stakeholder rights.

Auditing firms have a history of accepting dodgy clients (Maxwell, BCCI, Enron, WorldCom, etc.) and keeping quiet about the consequences of their practices. Their quest for profits was not checked by ‘joint and several’ liability. Instead of increasing the standards of responsibility and liability, the incentives for good audits have been diluted by the development of Limited Liability Partnerships (LLP) which removed incentives for partners to police each other. In an environment where audits are ‘lowballed’ and partners are incentivised to sell consultancy services to audit clients, lax liability rules are bound to make firms reckless and lead to more scandals.

In market economies, the interests of big business shape all social policies as it uses its financial and ideological muscle to ensure that it gets its way. However, in the case of LLPs, the firms went a stage further. They drafted their own law and asked the government of Jersey to enact it. Their strategy was to use Jersey, a tax haven, as a lever to secure LLPs in the UK. It paid rich dividends.

Chapter 4
RACE-TO-THE-BOTTOM: VIA TAX HAVENS

Tax havens are central to the race-to-the-bottom. A body of literature concludes that by “prostituting their sovereign rights, tax havens provide important legal platforms for globalizing financial and, increasingly, other types of services” (Palan, 2002, p. 172). Tax havens undermine societies and people by enabling companies to operate aggressive tax avoidance schemes that have little commercial substance. They enhance the power of major corporations by enacting “laws with the sole purpose of getting around the laws of other countries [and] sell their sovereignty and their law to the highest bidder” (The Guardian, 2 May, 2000).

Major accountancy firms became DIY legislators by using Jersey, a place simultaneously considered to be in the “top division” of offshore financial centres (UK Home Office, 1998), a “harmful” tax haven (OECD, 1998), a place with an “ugly reputation as an offshore home for controversial cash” (The Guardian, 4 November 2002) and “a pariah’ state” (Jersey Evening Post, 30 October 1998, p. 2) flying the “flag of piracy” (The Times, 27 June 2000, p. 23), to enact their law to shield them from lawsuits and reduce stakeholder rights.

Perhaps, Jersey was chosen because of its proximity to the City of London, or perhaps its quaint system of government is best suited to silence debate, discussion, public scrutiny, and opposition to their race-to-the-bottom.

Jersey’s Social and Political Context

Jersey, a Crown Dependency, is neither part of the UK nor a member of the European Union (EU) and is therefore not subjected to British or EU laws though the UK has negotiated a special status (known as Protocol 3) to enable Jersey to enjoy favourable trading terms with the EU without the commensurate social, economic and political obligations (Plender, 1990). Under the evolved constitutional arrangements, “the United Kingdom Government are ….. ultimately responsible for their good government” (Hansard, House of Commons Debates, 3 June 1998, cols. 471 and 465; also see Kilbrandon Commission, 1973).

Jersey neither separates the functions of legislature, executive and judiciary nor has a formal ‘opposition’ in parliament in its single chamber Parliament, the States of Jersey, which consists of 53 elected members (12 Senators, 29 Deputies and 12 Connétables), plus representatives of the UK Crown, the Bailiff (i.e. Speaker of parliament who in his capacity as President of the Royal Court also acts as a judge), the Lieutenant Governor (resident representative of the Crown), the Dean of Jersey, the Attorney

General and the Solicitor General (both appointed by the Crown). Members of parliament are not elected on any common cycle and so Jersey has never held a general election in the sense that all parliamentary seats are simultaneously contested. Jersey does not have political parties and the policy choice that accompanies them. It is difficult to develop a coherent programme of reform, or contest government policies.

To oversee the Island’s £400 billion finance industry, part-time members of the States of Jersey meet on average 6-7 days a month. They are poorly resourced and lack researchers to support them in their efforts to scrutinise the policies of the executive. They could be advised by pressure groups (e.g. environment, trade unions), but these are not well organised. The no-party state is effectively a one-party state, where big business and its lackeys rule the roost, and campaigners for change are ostracised by the ruling elite. Jersey’s only newspaper, the *Jersey Evening Post* (JEP), and its radio and television find it easier to follow the official line and rarely subject the government to critical scrutiny (Mitchell and Sikka, 1999).

Jersey has no formal cabinet, prime minister or president. The day-to-day government is in the hands of a series of Executive Committees. All members of the Jersey States are members of one or more of the 24 Committees governing the island. In most cases, there is no formal definition of their responsibilities and the public cannot attend their meetings or examine minutes. All Committees have a President who is the visible face of power and supported by civil servants. Each Committee seems to be driven by the aspirations of its leading members. They “have tended to work in isolation from one and another, there being no co-ordinating centre to bring them together” (States of Jersey, 2000, para 6.6). There is no effective doctrine of loyalty or collective responsibility within Committees (States of Jersey, 2000, chapter 4). A report reviewing Jersey’s machinery of government noted that

“many decisions are taken by a small number of Committee members, perhaps only the President, or by the chief officer under delegated powers, and that other members are passengers, perhaps voluntarily, or perhaps because they are starved of information necessary for them to make informed decisions, or perhaps because they are overwhelmed by the masses of paperwork prepared for their meetings”.

Source: States of Jersey, 2000, para 4.2.7.

Jersey has no official ‘opposition’ in parliament and there is little effective scrutiny of legislation, or government policies[9]. There is no equivalent to the US Senate hearings or UK Parliamentary Select Committees to scrutinise legislation, government policy or the executive. There is no written record of parliamentary debates relating to major Bills.

Once agriculture and tourism dominated the Jersey economy, but since the 1960s the Island has taken active steps to become a tax haven and entice capital by offering secrecy, little/no tax, weak consumer/employment protection laws and regulation (Hampton, 1996). The official statistics show that by 1996 financial services contributed 55% of gross domestic product (States of Jersey, 1997a, p. 50) though others suggest as much as “90 per cent of the island’s gross domestic product” (The Independent, 18 July 1998, p. 5). That dependency required Jersey to search for alternative sources of revenue (Hampton and Christensen, 2002). It expanded the market for “regulation hopping” and hired out its legislature to big beancounters to enable them to escape regulation and responsibility by enacting LLP legislation specifically drafted by major accounting firms. The objective of the venture, according to the president of the Island’s powerful Finance and Economics Committee, was that “its implementation in due course would encourage leading accounting and solicitors firms to be registered in Jersey …. [Jersey] will be the first jurisdiction this side of the Atlantic to provide this facility for partnerships of this size and stature” (The Accountant, November 1996, p. 5). The legislation was described by a member of Jersey parliament as

> “not offshore tax avoidance, on which our finance industry is built, but offshore liability avoidance”.
>
> **Source**: Jersey Evening Post, 25 July 1996, p. 1.

Summary

For a considerable period Jersey has sold itself as a tax haven specialising in rules avoidance and enabling companies to avoid accountability. Jersey is attractive because it lacks the institutional infrastructures, effective government, parliamentary scrutiny and social movements to check its prostitution. With considerable secrecy, it hired out its entire legislature to major accountancy firms so that a Bill drafted by them could reduce stakeholder rights and shield the big beancounters from the consequences of their own failures.

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[9] Following a critical review (States of Jersey, 2000), Jersey is slowly moving towards a ministerial system of government, but most changes are cosmetic with little of the characteristics of liberal democracies.

CHAPTER 4
JERSEY LEGISLATURE HIRED TO ACCOUNTANCY FIRMS

"Jersey's legal framework is 'languishing in the dark ages, in terms of consumer protection. The Island's laws are also deficient in matters of racial and sexual abuse, the mentally ill, and petty debts provisions, with legislation on competition regulation and employment law still waiting in the wings" (Jersey Evening Post, 29 December 2003). Jersey's ruling elite lack the political will to introduce laws to protect employees, consumers, or the environment, address issues relating to child labour, gender and racial discrimination, or even offer a decent system of government. However, Jersey hired out its legislature to accountancy firms by enacting their preferred law. When this persuaded some to object rather than welcoming scrutiny and debate, Jersey sought to silence the critics.

The LLP Politics

Major accountancy firms hired Ian Greer Associates, a prominent political lobbying firm, to find ways of securing liability concessions. The firm had a close relationship with the then UK Trade & Industry Minister, Neil Hamilton[10], who allegedly "continued to work on behalf of Mr. Greer's firm while he was a Minister. City sources say he played a key role in a Greer campaign to change the law on accountants' unlimited liability" (The Observer, 6 October 1996, p. 1). The actual involvement of the Minister and the lobbying firm, if any, in selecting Jersey as a possible jurisdiction for enacting the LLP legislation, is not known. Nevertheless, that became the objective, once the UK government had declined to jump to the auditing industry's tune.

On 6 June 1995, Mr. Ian James, a partner in the local law firm of Mourant du Feu & Jeune, met the Director of Jersey's Financial Services Department to discuss the proposals developed by a London law firm, Simmons & Simmons, acting on behalf of major accountancy firms. On 15 September 1995, the Director discussed the matter with Senator Pierre Horsfall, the President of the Finance and Economics Committee (FEC), and this was followed (3 October 1995) by a discussion with the Attorney General to seek legal advice.

Subsequently, Mourant du Feu & Jeune partner, Ian James, sent a five page letter to the President of the FEC.

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[10] The Minister was subsequently involved in what became known as the 'cash for questions' scandal. The accusations and revelations tainted the Conservative government and eventually led to its defeat at the 1997 general election (Major, 1999).

"My firm has been working with the UK partnership of Price Waterhouse (PW) and English solicitors, Slaughter and May, to find a method of obtaining some limited liability protection for the partners' personal assets without completely restructuring PW's business and losing the cultural benefits of a partnership. After considerable research in a number of jurisdictions the most favoured solution would be the introduction of Special Limited Partnership Law in Jersey which would give the partners of a partnership registered under that law limited liability whilst permitting them to take part in the management of the Special Limited Partnership. ….

"It is proposed that, in 1996, PW will establish a limited liability company in England which will take over the business of the UK partners of PW. …… The company will, over a period of time, conduct the majority of the client relationships currently held by the UK practice and the majority of client will contract solely with such company and not with PW partnership. …… The issued shares in the company will be owned by the PW partnership which will continue to exist both to ensure that the partnership culture will remain and also because terminating the partnership would place an increased burden on the partners to an unacceptable level.

PW have been advised that notwithstanding the incorporation of such a limited liability company there still remains a risk that a client, even though he has contracted with a substantially capitalised limited liability company, may in the event of litigation seek to sue an individual partner for his alleged negligence and therefore, could, in theory, continue to have the ability to attack the assets of all the other partners on the basis of their joint and several liability as partners. PW's objective therefore is to find a means by which its partnership can have limited liability whilst retaining the characteristics of a partnership. PW with its advisers has investigated a wide number of jurisdictions for this purpose. The executive committee of the partners of PW are determined that the jurisdiction must be one which has a stable and predictable body of law and which in terms of its reputation will be acceptable both to its partners and also to its clients ….. PW's executive are satisfied that Jersey has all the necessary characteristics which makes it a suitable jurisdiction in which to register their UK partnership if appropriate legislation was passed by the States within the course of the next year.

….. We are therefore seeking support of your Committee for the introduction of a Special Limited Partnership Law in Jersey during 1996. We appreciate that this is a very short time scale and that there are many other legislative matters which have a high priority for the States of Jersey. We would therefore propose that, based on a draft law prepared by Mr. David Goldberg QC for PW, this firm in close co-ordination with the Financial Services Department, will work with PW and Slaughter and May in order to prepare a draft law for consideration by your Committee during December this year with a view to it being debated in the States in January/February 1996. We would also propose that we would prepare any necessary subordinate legislation required in connection with the Special Limited Partnership Law.

……. So far as other professional firms are concerned I can however confirm that my firm is also instructed by the UK partnership of Ernst & Young who, although not as advanced as PW in their planning on this point, have instructed me to confirm to your Committee that Ernst & Young have a strong interest in registering under the provisions of a Special Limited Partnership Law if it was passed in Jersey.

As the plans of the major firms of accountants with regard to incorporations are of considerable interest to the financial press in the event that your Committee is minded to support this proposal it would be very important for PW and I believe, Jersey's finance industry, that the correct messages are sent to the media. I would therefore suggest that if the Committee is willing to proceed with this proposal that the States of Jersey's PR firm, Shandwicks, are instructed to coordinate the publicity together with PW's own PR people".

Source: Letter from Mourant du Feu & Jeune to President of the Finance & Economics Committee, 19 October 1995.

The same letter also explained that "a Delaware limited liability partnership ….. has been ruled out as being an unacceptable jurisdiction". Nevertheless, some features of the Delaware legislation were considered to be attractive. For example, the letter said that

"the Special Limited Partnership Law will follow the Delaware registered limited partnership law which does not provide for a General Partner but requires a registered limited partnership to have liability insurance of at least US$1,000,000 and in the even that such insurance is not held the partners lose their limited liability. Delaware law provides for alternative methods of satisfying this insurance requirement such as by a bank providing a bond of not less than this amount or by the partnership holding a specially designated and segregated fund for the satisfaction of judgements against the partnership. It is intended that similar provisions will be introduced into the proposed Jersey law in an amount of £1,000,000".

On 19 October 1995, the Director of Jersey's Financial Services Department informed the president and members of the FEC of the proposals. His covering memorandum added that the "law drafting would be undertaken entirely at the expense of Price Waterhouse (together, possibly, with Ernst & Young) and what the Committee is being asked to do at this stage is to confirm that it is prepared to sponsor legislation in the States".

On 30 October 1995, at a meeting of the FEC, the proposal for LLP legislation was tabled as an extra item not included on the agenda papers. The seventeen lines of official record said that

> "The Committee having noted with interest the proposals that the law drafting work involved would be undertaken entirely at the expense of one or more of the firms [i.e. Price Waterhouse and Ernst & Young] involved, confirmed that it would be prepared to sponsor the legislation in order to place it before the States".
>
> **Source**: States of Jersey, 1997b, p. 14.

It sent the relevant papers and supporting documents to the Law Draftsman whose involvement in ensuring that the privately drafted Bill met the local requirements was considered to be essential. Such was the secrecy surrounding the legislative proposal that the President of the FEC recommended that the initial draft Act and early papers should not be circulated to the powerful Policy and Resources Committee (PRC[11]), which considers broader issues of desirable policies and resources (including money) devoted to laws.

On 28 November 1995, Senator Reginald Robert Jeune, a former senior partner and a consultant to the law firm of Mourant du Feu & Jeune, chaired a meeting of the PRC and voted, with one member dissenting[12], in favour of the LLP law being given early priority in the legislative cycle, effectively displacing other planned laws. The PRC had no papers on which to base its decision. Instead it had a presentation from its Vice-President, the then FEC President (Senator Pierre Horsfall), and Director of Financial Services. Five days before the PRC meeting, Ian James, partner in Mourant du Feu & Jeune, had informed Senator Jeune that his law firm was involved in the preparation of the law (Jersey Evening Post, 26

[11] The Policy and Resources Committee was established in 1987 "to draw together various committees and regulate their interaction. This has not proved to be a cure for the ills of the system because the P&R Committee do not have the authority which is necessary and so cannot require Committees to follow established policy" (States of Jersey, 2000, para 4.4).
[12] This was Deputy Dereck Carter who "disliked both the content and the purpose of the law and warned of the impact on the law drafting programme" (Jersey Evening Post, 26 February 1997, p. 5).

February 1997, p.5), but Senator Jeune allegedly did not make any personal statement to the PRC Committee about the role of his firm in promoting the LLP legislation.

On 11 December 1995, the States of Jersey announced its intention to introduce LLP legislation. Simultaneously, Price Waterhouse and Ernst & Young announced that they were working with the Jersey authorities to draft a new partnership law (Accountancy Age, 14 December 1995, p. 1 and 3).

The Legislative Proposals

On 21 May 1996, Jersey finally published a much delayed 62-page draft Bill on LLPs (Limited Liability Partnerships (Jersey) Law 199). The Bill ended the principle of 'joint and several' liability. Individual partners would not be personally liable for the liabilities of the LLP unless they actually caused the loss in the course of their work.

The Bill required LLPs to have a registered office address in Jersey, but did not require them to have any agent or partner operating from there. LLPs were required to file an annual return (on 1st January each year) which consisted of the name and address of the partners only. Despite limited liability, giant LLPs would not be required to publish audited accounts. Partnerships registering under the legislation needed to include the words limited liability partnership (or LLP) in their name, but their letterheads and invoices did not need to state that they were registered in Jersey (subsequently amended by Deputy Gary Matthews). The registered office needed to hold a copy of the partnership agreements, but this would only be available to partners and not to the general public. Firms registering as LLPs could conduct, audit, insolvency, financial services (these were regulated in the UK by the Companies Act 1985, Insolvency Act 1986 and the Financial Services Act 1986) and any other kind of business. There was no dedicated regulator and no policies or procedures for investigating the conduct of errant auditors. LLPs registered in Jersey were to be exempt from all corporate/income taxes. The Jersey government, however, hoped to levy £10,000 for an initial LLP registration and £5,000 annually thereafter (The Accountant, August 1996, p. 1).

The Bill did not specify any minimal capital, but introduced a Delaware style £5 million "financial provision" or a bond (see above), which was to be given to the person responsible (which could be a liquidator, another partner or even an ordinary creditor) for winding up the affairs of the partnership who in turn was required to use it in the payment of creditors. In addition, there were 'clawback' provisions to enable a liquidator to recover excessive payments to partners during the six months preceding any declaration of insolvency. There were no public means of knowing the withdrawals of cash by partners. The insolvency clauses of the LLP law were considered to be confused and deficient by experts (Brown, 1996) and would eventually delay the full implementation of the law.

Jersey's senior politicians expected the Bill to be passed quickly and quietly. In fact, it encountered unexpected resistance and fell behind its planned schedule. A senior partner of Price Waterhouse complained,

> "Earlier in the year [1996], we were roundly assured that the draft law would go to the States of Jersey Parliament in March/April, be nodded through, spend the summer with the Privy Council and be back in Jersey in time to be implemented in the statute book by September, Well, here we are in September and the Jersey Parliament is still arguing over its details".
>
> **Source**: Accountancy, September 1996, p. 29.

The LLP law was passed on 24 September 1996, followed by the revisions of the inadequate insolvency provisions in 1998. In the event, there was no rush from any major accountancy firm, including Ernst & Young and Price Waterhouse, to register in Jersey. None eventually registered.

Meanwhile, the LLP proposals met unexpected resistance from Jersey's senior law draughtsman, some members of the Jersey States and politicians and academics from the UK, which generated unwelcome publicity and highlighted the role of tax havens in accelerating the race-to-the-bottom.

Unexpected Resistance: The Law Draughtsman

To appease the accountancy firms, the proposed LLP Bill was to be 'fast tracked' and displace the previously agreed legislative programme. Jersey did not, however, devote sufficient additional resources for scrutinising its contents and ensuring that its contents fitted in with the local conditions and contained cross-references to relevant legislation.

The Law Draftsman complained (9 November 1995) about the additional work burdens arising from the fast tracking of the proposed Bill. He considered the deadline to prepare a Bill by Christmas 1995 to be "wildly optimistic" (Jersey Evening Post, 26 February 1997, p. 5). In his view, "in terms of the drafting resources committed to it, the (draft Limited Liability) Partnerships Law is, without doubt, one of the most significant projects we have embarked upon during the last twelve months" (States of Jersey, 1997b, para 2.2.5). He had "doubts about contracting out the law drafting" and added, "It's like getting a completed crossword and being asked to write the clues" (Jersey Evening Post, 26 February 1997, p. 5).

On 8 January 1996, the Draughtsman informed the FEC president that in view of his workload he would not be able to complete scrutiny of the Bill in the promised 15 to 20 days (Jersey Evening Post, 26 February 1997, p. 5). On 21 February 1996, he complained that “after spending 25 working days on the law, there was no end in sight and it squeezed a number of items off the bottom of the 1996 law drafting programme” (Jersey Evening Post, 26 February 1997, p. 5). The lack of resources slowed down the publication and parliamentary passage of the LLP Bill. A subsequent Committee of Inquiry noted that this was due to “the failure to consult the Law Draftsman at the outset on the level of law drafting required of his office” (States of Jersey, 1997b, para 2.2(a)).

Unexpected Resistance: Members of the States of Jersey

Deputy Gary Matthews “virtually single-handedly fought the LLP law and its fast tracking for several months” (Jersey Evening Post, 18 March 1997, p. 3). Mathews publicly aired his concerns about the ‘fast tracking’ of the Bill, displacement of the previously agreed legislative programme and criticised senior politicians for permitting accountancy firms to write Jersey’s laws and “sheltering from their responsibilities and avoiding public accountability” (Jersey Evening Post, 28 June 1996; 2 July 1996). In late May 1996, soon after the publication of the LLP draft Bill, Matthews contacted Austin Mitchell, a member of the UK House of Commons, and Prem Sikka, a UK accounting academic[13] (Financial Times, 26 September 1996, p. 7). They provided support and analysis, and also suggested possible amendments to the Bill. This alliance helped to foster a critical scrutiny of the proposed law, but also made Matthews a target for personal attacks. Establishment figures repeatedly accused him of inviting outsiders to meddle in the internal affairs of Jersey (see Jersey Evening Post, 19 June 1996, p. 17), a somewhat ironic accusation given the origins of the LLP law (Mitchell and Sikka, 1999).

Matthews accused the FEC of “abusing the parliamentary system” and warned that the legislation “could damage Jersey’s reputation as an offshore finance centre” (Manx Independent, 5 July 1996). He sought delay in the parliamentary proceedings to enable him to “carry out further

[13] Mitchell and Sikka visited Jersey to support critics and gain first hand knowledge of Jersey politics. For some evidence, see Mitchell, 1996a, 1996b, 1996c; Financial Times, 3 July 1996, p.7; Accountancy Age, 4 June 1998, p. 9; Jersey Evening Post, 26 February 1997, p.1-2; 16 October 1999, p. 11; 16 March 2000, p. 10; 23 March 2000, p. 2; Hansard, House of Commons Debates, 17 Jun 1997, cols. 218; Sikka, 1996a, 1996b, 1996c; Cousins et al., 1998, 1999; Mitchell and Sikka, 1999; Mitchell et al., 2001).

research", but his request was denied (Jersey Evening Post, 19 June 1996, p. 17). Matthews' interventions in parliament slowed down the passage of the Bill and also sensitised some members. He eventually tabled four amendments (States of Jersey, 1997), of which two were accepted. Without revealing their sources, Ernst & Young and Price Waterhouse were confident that any radical amendments "would be watered down" (Financial Times, 7 August 1996, p. 6).

On 2 July 1996, the States of Jersey approved the initial draft of the Bill by 25 votes to 6. Senator Reg Jeune made a speech supporting the LLP legislation. Deputy Gary Matthews complained that there was inadequate consultation about the purpose and implications of the proposed law. Another member, Deputy Dereck Carter said it was "distasteful that two major accountancy firms could buy into the law drafting programme" (Jersey Evening Post, 17 April 1998, p. 8). During the debate, six members of parliament (including Senator Stuart Syvret) walked out in protest at what they regarded as unacceptable interference by the Attorney-General who unprecedently, and without prior approval from the House, had been given permission by the Bailiff to address the States on some aspects of the law. In the final event, the Attorney-General did not speak, but Senator Stuart Syvret questioned the political motives behind such a move. He was summoned back and admonished by the Bailiff for leaving the House.

In the next debate (23 July 1996), Senator Syvret said that he was 'deeply alarmed and concerned' about the possible financial interests of Senator Jeune in bringing the LLP law on to the statute books (Jersey Evening Post, 17 April 1998, p. 8). He stated that Senator Jeune had used his influence as president of the Policy and Resources Committee to speed up the law drafting process whilst he also had a financial interest in the law firm Mourant du Feu & Jeune, which acted for Price Waterhouse and Ernst & Young. This conflict of interests, Syvret argued, should have precluded Senator Jeune from playing any part in the legislative process. He said that the incident "reeked of sleaze" and called for a public inquiry[14] (Jersey Evening Post, 24 July 1996, p.1, 2, 16 and 17; 17 April 1998, p. 8). The Bailiff objected to such comments being made without prior notice to the House. Subsequently, Syvret (and a group of other critics) sought a meeting with the Bailiff (Jersey Evening Post, 25 July 1996. p. 1), but in the next sitting (30 July 1996), the Deputy Bailiff (who is also a judge; standing in for the Bailiff who in his capacity as a judge was hearing a case in the court) instructed Syvret to apologise for his earlier comments. Syvret refused and was ordered to leave the House. Subsequently, Senator Jeune stated that his only involvement with the drafting of the law arose on 28

[14] The local newspaper provided hostile coverage (see Jersey Evening Post, 25 July 1996, p. 8).

November 1995 when in his capacity as President of the PRC he attended a meeting with Jersey's Law Draftsman and Director of Financial Services. Upon being informed that the President of the FEC had already approved the development of the law, Senator Jeune also approved.

At the next sitting of the House (3 September 1996), by a vote of 36 to 3, Syvret was again required to apologise for making his allegations about Senator Jeune. He refused. The Bailiff claimed that Syvret had not backed his allegations with evidence, but refused him permission to read out a personal statement. The House resolved that "Mr. Syvret be suspended from the service of the States until he has withdrawn, by notice in writing to the Greffier[15], his imputation of improper motives against Senator Jeune". Two other members (including Gary Matthews) tried to support Senator Syvret and speak, but were denied permission by the Bailiff. At the next sitting of the House (23 September 1996), Syvret again refused to issue an apology and was again denied permission to read out a statement. This time he was "indefinitely" barred from the House by the Bailiff (Jersey Evening Post, 17 April 1998, p. 8). As a result Syvret lost all his parliamentary privileges (Mitchell and Sikka, 1999). On 24 September 1996, the LLP Bill finally completed its parliamentary passage by 38 votes to 7, with one abstention.

On 30 October 1996, Austin Mitchell tabled an Early Day Motion (EDM number 100) in the UK House of Commons, supported by 82 members, urging the Privy Council not to approve the LLP legislation passed by the States of Jersey. Nevertheless, it did so. The LLP law received Royal Assent on 19 November 1996. Critics had highlighted deficiencies in the insolvency provisions of the LLP Bill. This created uncertainty and the Bill remained incomplete. Revised clauses were finally introduced on 19 May 1998. Some 95 pages of legislation were nodded through in 30 minutes, with little debate[16] and came into effect on 9 September 1998, nearly two years late (Jersey Evening Post, 20 May 1998, p. 34). Ernst & Young senior partner said,

"Having worked closely with the States of Jersey and Price Waterhouse to bring about the LLP law, we are pleased to see it finally being enacted".

Source: Accountancy Age, 29 May 1998, p. 1.

[15] The Greffier acts as Clerk of the States of Jersey.

[16] Most of the time was spent attacking Prem Sikka by calling him "an enemy of the state". During one of his visits to Jersey, Sikka distributed notes highlighting deficiencies of the LLP law, especially its insolvency provisions (also see Jersey Evening Post, 20 April 1998, p. 8-9).

Following his suspension, Syvret suggested that the States of Jersey conduct an independent inquiry into the processes associated with the LLP law. Eventually, on 8 October 1996, the States established a Committee of Inquiry under the chairmanship of Senator Richard Joseph ("Dick") Shenton[17] to consider "time-tabling, preparation and presentation" of the LLP law. It invited Syvret to make representations. He refused on the ground that the Committee's remit was too narrow and that it lacked the necessary independence to conduct the inquiry. Concerned at the inaction of the States of Jersey in restoring Syvret, Austin Mitchell wrote (18 October 1996, 8 November 1996) to the UK Home Office, inviting it to intervene and ensure good governance of the Islands. The Home Office (5 November 1996 and 18 November 1996) refused. In October and December 1996, Syvret asked the British Home Secretary to intervene and restore his democratic rights. This request was declined. There were no publicly visible signs of any intervention by the UK government (Hansard, House of Commons Debates, 25 February 1997, col. 132). Encouraged by the inactivity of the UK government, on 15 January 1997, the Bailiff's Consultative Panel met to consider the possibility of 'permanently' expelling Syvret from the House. A delegation was sent to the office of the Speaker of the UK House of Commons to ascertain procedures for such a step. It was told that there is no history of an elected member of parliament being "permanently" excluded and that the legality of such a move was doubtful (Mitchell and Sikka, 1999).

Some five months after the initial suspension, on 14 February 1997, Deputy Simon Crowcroft sought to move a resolution to bring Syvret back into the House. The Bailiff refused permission to add this item to the agenda. On 17 February 1997, the Shenton Committee finally issued its report (States of Jersey, 1997b) and said that all sides had made mistakes. The next day[18], the States of Jersey agreed that Syvret should be allowed to make his statement at the next sitting of the House scheduled for 4 March 1997. On 4 March 1997, Syvret finally made his statement and refused to withdraw his remarks about Senator Jeune. He added that the Senator "may simply have failed to understand what he was doing". By a vote of 45 to 2, Syvret was censured and allowed to return to the House on 18 March 1997.

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[17] Senator Shenton retired in December 1999 (Jersey Evening Post, 7 December 1999, p. 27).

[18] On 18 February 1997, Austin Mitchell informed the UK Home Office Minister that unless Syvret was restored he would force a parliamentary debate on his exclusion. On 27 February 1997, he tabled an Early Day Motion (EDM 589) in the British House of Commons, signed by 52 members, condemning Syvret's suspension and demanding his immediate reinstatement. It drew a hostile response in the Jersey Evening Post (3 March 1997).

Some consequences and outcomes

The passing of the 1996 LLP legislation was almost immediately followed by an election to the States of Jersey. Gary Matthews was opposed by candidates supporting 'business' and the local press ran a hostile campaign against him (Mitchell and Sikka, 1999). The FEC President, Senator Pierre Horsfall topped the poll, Deputies Dereck Carter and Gary Matthews lost their seats[19]. The subsequent report by the Shenton Committee (see above) was seen to "vindicate those Members who spoke out in the first place against the principle of laws for sale" (Jersey Evening Post, 18 March 1997, p. 8). This came too late for Gary Matthews who had left Jersey, in early 1997, to settle in England because his life was made difficult and his business opportunities had dried up (Mitchell and Sikka, 1999). Stuart Syvret contested his parliamentary seat in 1999 (after the Shenton Committee report). He topped the poll.

After his reinstatement to the States of Jersey, in July 1997, Stuart Syvret brought a court case against the Bailiff and the Deputy Bailiff for violation of his human rights (*Syvret v Bailhache & Another [1999] 1 LRC 645, 1998 JLR 128*), as enshrined in the European Convention on Human Rights (ECHR). On 28 April 1998, Jersey's Royal Court rejected his complaint as that time Jersey had not formally adopted ECHR[20]. The judgement also said that the "court cannot interfere with the internal proceedings of the legislative assembly". Syvret referred the matter to the European Court of Human Rights, but without adequate financial resources and demonstrating that he had exhausted all domestic remedies (including possibly using the UK courts), his case did not advance.

The sponsors of the LLP legislation may have expected an easy passage. In fact, it led to "one of the most turbulent political debates in living memory" (Financial Times, 26 September 1996, p. 7), receiving international press coverage and highlighting the hire of legislature to two accountancy firms. At the same time, Jersey continued to be implicated in banking frauds and money laundering, possibly devaluing it as a desirable location. It was

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[19] Seasoned Jersey observers have referred to the LLP legislation as "a graveyard for politicians opposed to it" (Jersey Evening Post, 20 May 1998, p. 34).

[20] Following interventions in British Parliament by Lord Lester and Austin Mitchell, the UK government pressurised Jersey to incorporate ECHR into its legal framework (Hansard, House of Commons Debates, 3 June 1998, cols. 465-475. Jersey passed the Human Rights (Jersey) Law 2000 on 8 February 2000. It received Royal Assent on 17 May 2000. It is yet to be implemented.

blacklisted as a 'harmful' tax haven[21] (OECD, 1998) and admonished by the UK government for poor financial regulation (UK Home Office, 1998; Christensen and Hampton 2000; Hampton and Christensen 1999a, 1999b, 2002; Mitchell and Sikka, 1999, Mitchell et al., 2001).

Throughout the Jersey debates, Ernst & Young and Price Waterhouse continued to (re)affirm their intentions to move to Jersey. Commentators forecast a 'boom' for Jersey LLPs (for example, see Accountancy Age, 4 July 1996, p. 1; 12 December 1996, p. 3; 23 April 1998, p. 3; Accountancy Age, 28 May 1998, p. 1; 4 June 1998, p. 9; Financial Times, 25 September 1996, p. 11; Accountancy, November 1996, p. 19). The prospect of migration of accountancy firms (and other businesses) to Jersey alarmed the UK government. It promised equivalent legislation "within a week" (Financial Times, 28 June 1996, p. 22; 24 July 1996, p. 9) and then "at the earliest opportunity" (Hansard, House of Commons Debates, 7 November 1996, col. 617). Eventually, it issued a consultation document (UK Department of Trade and Industry, 1997), followed by a Bill (in 1998), parliamentary debate (in 1999 and 2000) and an Act (Limited Liability Partnerships Act 2000). This came into existence on 6 April 2001. The Big Firms had won.

Accountancy firms were not keen to explain their passion for the race-to-the-bottom publicly. Price Waterhouse senior partner Graham Ward[22], wearing the hat of an ICAEW officeholder gave evidence to the House of Commons Trade and Industry Committee. Such dual capacities provided convenient pegs for obfuscation.

[21] Subsequently Jersey made commitments to improve the transparency of its tax and regulatory systems and establish effective exchange of information for tax matters with OECD countries by 31 December 2005 (OECD Observer, 27 February 2002).

[22] Reflecting the domination of major accountancy firms on regulatory apparatuses: Graham Ward has held many posts; including president of the ICAEW, president of the International Federation of Accountants (IFAC), Vice Chairman of the Auditing Practices Board (APB), member of the City Panel on Takeovers and Mergers, Deputy Chairman of the Financial Reporting Council and a member of the Department of Trade and Industry's team for the development of the Operating and Financial Review (OFR).

[*Chairman*] Good morning. Some people have been saying that this [the UK government's proposals for LLP legislation] is really just a bit of an accountants' ramp. It was suggested that the LLP is a result of the profession's failure to get any change in joint and several liability, and that the passage of the Jersey law is being held over the Government as an alternative. If the British Government does not get its act together then the players will take their ball and bat and go to Jersey to play. Is that a gross misrepresentation of the high ideals and purposes of a distinguished respectable profession?

(*Mr Ward*) I have heard those things said as well, but they were not said by the Institute of Chartered Accountants in England and Wales. As far as we were concerned, the possibility of limited liability legislation within Great Britain was introduced under the previous government, in fact not at our behest or as a result of any pressure which we put on to anybody at all. Once it was suggested, we actually saw the merits of it and we were happy to support it and endorse it.

85. It is just a coincidence that some of the major players in the accountancy business, who will doubtless appear in the ranks of your membership, undertook this step to encourage a change in the law in Jersey which could in some people's minds, the cynics perhaps, be a gun at the head of the British Government.

(*Mr Ward*) There were some individual member firms who certainly did take action as far as making representations to the legislature in Jersey was concerned in order to introduce limited liability partnerships there. As far as the Institute was concerned, to say that it was a coincidence I believe actually within the Government's publications they have said that the possibility of firms moving to Jersey was one of the things which was in their minds. To that extent then yes, that is right. Certainly our Institute did not apply any such pressure.

Source: UK House of Commons Trade and Industry Committee, 1999, paras 84-85.

The Labour government had announced early on that it could not find the legislative time to implement the independent regulation of accountancy promised in its 1997 Business Manifesto. Yet it found time to rush through the LLP legislation to enable accountancy firms to limit the liability of partners and to enjoy all the tax concessions associated with partnerships. It gave no concomitant concessions to stakeholders, such as reversal of the *Caparo* judgement, or expansion of auditor duties in return, except to require firms trading as LLPs to publish audited financial statements. The

UK capitulation was "warmly welcomed" by Price Waterhouse (Accountancy, December 1998, p. 124). Ernst & Young senior partner added that:

> "It was the work that Ernst & Young and Price Waterhouse undertook with the Jersey government …… that concentrated the mind of UK ministers on the structure of professional partnerships. ……The idea that two of the biggest accountancy firms plus, conceivably, legal, architectural and engineering and other partnerships, might take flight and register offshore looked like a real threat …… I have no doubt whatsoever that ourselves and Price Waterhouse drove it onto the government's agenda because of the Jersey idea".
>
> **Source:** Accountancy Age, 29 March 2001, p. 22.

In April 2001, Ernst & Young announced its decision to register as a LLP in the UK (Accountancy Age, 12 April 2001, p. 3). It was followed by PricewaterhouseCoopers (Accountancy Age, 15 November 2002, p. 3).

Poor old Jersey was dumped. The President of Jersey's Finance and Economics Committee sadly told the States that

> "At the time the law was passed, there were reasonable grounds for supporting that the registration of LLPs could bring substantial benefit to Jersey. In the event, despite the passage of the legislation, no LLP has been registered".
>
> **Source:** Jersey Evening Post, 29 November 2000.

Summary and Discussion

This chapter showed how two accountancy firms bought legislation in Jersey to advance their narrow economic interests. The legislation gave firms all that they wanted and was not accompanied by any rights for audit stakeholders. Despite some local resistance, Jersey enacted the law designed and drafted by accountancy firms. However, the firms did not eventually migrate to Jersey. They used Jersey as a lever to squeeze concessions from the UK government with the naked threat that if their demands were not met they would migrate and cause economic and social turbulence. They used their economic and political networks to threaten elected governments.

The role of tax havens in facilitating the race-to-the-bottom is highly evident. The externally drafted Bill was "championed by the Island's leading politicians" (Financial Times, 26 September 1996, p. 7) who promised to 'fast track' it, effectively displacing the previously agreed legislative programme. Intentionally, the impact of its Jersey LLP law was designed to fall almost entirely outside Jersey, in that the law was primarily designed to attract business from the UK. As President of the Finance and Economics Committee put it:

"We are fighting for the City of London's business, and we are doing this to prove we can enact legislation which is in the interest of fast-moving corporations"

Source: The Accountant, August 1996, p. 1.

The absence of institutionalised resistance failed to check the race-to-the-bottom pursued by multinational accountancy firms or prevent Jersey from hiring out its legislature. Accountancy firms expressed satisfaction about the enactment of the Jersey LLP law, even though it created considerable local upheavals. They continued to use their (re)affirmation to abandon the UK in favour of Jersey, as "a cosh with which to threaten the [UK] government if it fails to come up with a workable LLP law" (Financial Times, 11 June 1998, p. 11). In the final event, accountancy firms did not register in Jersey. The UK government gave in. Their real intention was to force the UK into extending similar concessions.

In fact, the economic chaos painted by the firms would not have materialised. The letter (19 October 1995) from Mourant du Feu & Jeune to President of the Finance & Economics Committee shows that accountancy firms intended to create complex corporate structures to enable them to shelter behind the "fiction" of Jersey residence. They had no intention of abandoning their highly profitable business in the UK, sacking staff, closing offices and reopening in Jersey (Sikka, 1996a). A move to Jersey would have required the firms to renegotiate all contracts with existing clients and suppliers and persuade them that in the event of dispute, all matters would be resolved according to Jersey law. At best, the firms were likely to set-up 'brass plate' operations in Jersey. To operate in the UK, the firms would have needed to be licensed and subjected to the full application of the UK laws. There would have been little change to the substance of the trade by Ernst & Young and Price Waterhouse and any move to hide behind the Jersey liability laws would have been treated by the courts as a 'sham', designed to disadvantage creditors (Accountancy Age, 19 September 1996, p. 3). Indeed, a legal specialist described the threat of wholesale location to Jersey as "nonsense" (Accountancy Age, 8 August 1996, p. 1) and a past president of the Law Society's Revenue Law Committee stated that "if a Jersey registered partnership and its individual partners were sued for negligence while they still carried on their business in the mainland, an English judge would not listen to the argument that they are a Jersey LLP" (Accountancy Age, 3 October 1996; also see Brown, 1996).

Nevertheless, the Jersey LLP law provides insights into the politics of the race-to-the-bottom and shows the kind of world that major accountancy firms want. The Bill, drafted by two global accountancy firms contained no clauses for the protection of the third parties dealing with accountancy firms. Partnership agreements were not to be publicly available and despite limiting the liability of partners, firms were not required to publish financial statement or any other information. The Bill did not specify any minimum capital for LLPs. The Bill lacked adequate insolvency provisions and did not create any regulator for the firms or had any procedures for investigating the work of errant auditors. There was little prior public discussion about the LLP Bill. Indeed, secrecy was considered to be paramount, even to the extent that some major Committees were deliberately kept in the dark. The Jersey LLP Bill provides authoritative evidence of the downhill race of accountancy firms.

The race-to-the-bottom is facilitated by global networks, financial power and political links. Firms not only hired the Jersey legislature and PR agencies, they also had political friends in high places in the UK. The campaign to enable the firms to form LLPs in the UK was supported by Stuart Bell, Labour spokesperson on accountancy matters until 1997. He did not get a Cabinet appointment but was appointed an adviser to Ernst & Young. The firms had a sympathetic supporter in Peter Mandelson, Trade and Industry Secretary until December 1998. Subsequently, he too became an adviser to Ernst & Young. Previously, the interests of the ICAEW and major accountancy firms had been promoted by Conservative MPs Tim Smith (subsequently resigned in the 'cash for questions' affair) and Jeremy Hanley (former defence minister).

Chapter 6
DOWNWARD EVER DOWNARD

Accountancy firms are not content with being able to trade through limited liability companies, or LLPs. The *Caparo* judgement and the concept of ‘contributory negligence’ give them unprecedented privileges without any quid pro quo for stakeholders. They do not owe a ‘duty of care’ to any individual shareholder, creditor, employee, pensions scheme member, or anyone else placing reliance upon audited accounts. Yet this has not stopped the firms from demanding more liability concessions and blackmailing governments.

The US Private Securities Litigation Reform Act 1995, which replaced ‘joint and several liability’ with ‘proportional’ liability, has lowered auditor vigilance (Lee and Mande, 2003). The lax liability regime introduces new moral hazards. Recent accounting scandals in the US are directly attributed to the lax auditor liability regime secured by accountancy firms (Stiglitz, 2003). Reformers there are now calling for changes to “counter the weakening of self-policing resulting from a shift in the legal form of most professional firms – from partnerships to limited liability partnerships. Under the joint and several liability arrangements, each partner was liable for all acts by all partners, a powerful incentive to enforce compliance with the law. Under the new form, the liability of each partner for misconduct by other partners is limited or even eliminated, provided that he remains unaware of the misconduct” (New York Times, 29 December 2003). Indeed, the Consumer Federation of America is campaigning for changes to the Private Securities Litigation Reform Act so that accountants receiving large fees are held responsible for the opinions that they give.

The US is unwilling to give any further liability concessions to accountancy firms. Donald Nicolaisen, the SEC’s chief accountant said that "no firm is too big to fail. It's up to the firms themselves to improve their quality ... There may be a time when liability reform is appropriate [in the US]. This is not the time. It is really the firms that are going to have to offer something that is helpful to investors that extends beyond what they are offering today" (Financial Times, 21 May 2004).

The EU Perspective

The EU position is summed up by Frits Bolkestein, Commissioner of Internal Market and Taxation. He said that “The Commission considers auditor liability primarily as a driver of audit quality and does not believe that harmonisation or capping of auditor liability in general is necessary” (Bolkestein, 2003). He went on to add that there are four clear reasons for not limiting auditor liability. These are:

Unlimited auditor liability is a quality driver. If the auditor delivers permanently high quality he has no liability exposure. There is no more effective liability risk management than delivering high quality audits.

Liability systems exist for the protection of the persons who suffered damage not for the convenience of those who may be at fault. Therefore, the "deep pocket" approach is principally sound because someone who has suffered damage should not have to shoulder the burden of suing separately all parties which have a partial responsibility for proper financial statements. In any case, all Member States have the concept of joint and several liability as a fundamental element in their civil liability systems.

Increased auditor liability is partly a self-created problem Here, there are two considerations. The growth of audit firms and the branding of one name one firm world-wide has significantly increased the potential damage to the whole network in case of a potential audit failure committed by one of the local firms. This drives the willingness of networks of audit firms to settle for higher amounts. Trends in liability claims should not be considered in absolute terms but relative to the increased turnover and profit of audit firms, figures that are not easily available worldwide.

Claims from potential audit failures have been settled too easily out of Court. As a consequence there is very little case law clarifying the boundaries of auditor liability. An unanswered question for me is whether out of Court settlements are initiated by the audit firms' desire to limit the damage to the brand name or by the risk judgement of insurance companies.

Audit is by its very nature a function which is carried out in the public interest. This implies that 3rd parties should be able to rely on the correctness of companies' financial statements and be in a position to claim damages in case of fraudulent financial reporting. EU company law specifically recognises the protection of third parties such as creditors as one of its major objectives. In this context the Commission is somewhat concerned about the recent modification to some UK audit reports which seem, in response to the ruling in the Bannerman case, to try to limit auditor liability to third parties via wording in the audit report.

Source: Bolkestein, 2003.

‘Cap’ Does Not Fit

Major firms have continued to demand a ‘cap’ and ‘full proportional’ liability though they have remained silent about audit failures and the plight of their victims. The ever obliging Trade and Industry Secretary, Patricia

Hewitt, former Head of Research at Andersen Consulting, issued a consultation paper indicating the possibility of a ‘cap’ (UK Department of Trade & Industry, 2003), even though the idea had been rejected by the Law Commission. Privately the DTI arranged meetings with the barons of the big firms, accountancy trade associations and institutional investors to stitch-up a ‘cap’, but refused to publish minutes of such meetings (Hansard, House of Common Debates, 8 December 2003, col. 251).

In the absence of any increase in audit quality or stakeholder rights, the institutional investors opposed any ‘cap’ on auditor liability (Accountancy Age, 22 January 2004; Richards, 2004). The DTI ignored such concerns. Without publishing the analysis of the 120 responses received for the auditor liability consultations, the Trade Minister, told the ICAEW conference that the government is keen to ‘cap’ auditor liability (Accountancy Age, 6 July 2004). There was silence on DTI policy failures. For example, DTI allowed numerous mergers to create the Big Four, but now expressed concerns about reduced auditor choice for big companies. The Big Four can be undone, but the DTI had no proposals for demergers. Auditor competition can be increased by building up the medium-size firms or inviting new players into the audit market, but this was not on the DTI agenda either. As a quid pro quo for liability concessions, it did not seek reversal of the *Caparo* judgement, or expansion of the scope of the annual audit. It was the usual one-way traffic.

The madcap rush to shield big beancounters from the consequences of their own negligence has other repercussions for regulators. In the event of a future Maxwell, Barlow Clowes, BCCI or Equitable Life, the regulators’ (e.g. the Financial Services Authority) ability to sue negligent auditors would also be constrained, leading to a bigger pay-out by them, effectively the taxpayer. So the Treasury Department forced the DTI to consult the Office of Fair Trading (OFT). The OFT concluded that the “Arguments that allowing caps would be pro-competitive are not compelling. Some forms of cap design could distort competition ……..” (Office of Fair Trading, 2004, para 1.9). It added,

"Alongside regulation and reputation, liability acts as a discipline on audit quality in a context where shareholders and other third parties rely on information from an audit which is paid for by the company being audited. We are not aware of evidence suggesting that the courts in the UK have made, or are liable to make, excessive damages awards against auditors. Professional indemnity insurance is available, and LLP status – the chosen corporate form of many audit businesses – exists to protect partners’ personal assets”.

Source: Office of Fair Trading, 2004, para 1.2.

On 7 September 2004, the DTI issued a statement saying that the idea of a statutory 'cap' on auditor liability would not form part of the Companies Bill which began its passage in the House of Commons on 7 September 2004. The Big Four threatened that if the government did not capitulate they would refuse to audit banks and insurance companies and cause economic and social chaos (Sunday Telegraph, 5 September 2004). The Institute of Chartered Accountants in England & Wales (ICAEW) had threatened to derail the financial reporting reforms. Its chief executive said, "Without [liability] reform, the Operating and Financial Review initiative will be doomed to failure" (ICAEW press release, 6 July 2004).

Britain's financial regulator, the Financial Services Authority, stated "We do not believe that a convincing case has been made for allowing auditors to limit their liability contractually" (Financial Times, 21 May 2004). The DTI consultation paper (UK Department of Trade and Industry, 2003) had rejected the option of proportional liability. The Trade and Industry Minister told parliament that the consultation exercise "did not set out an overwhelming or universally accepted case for urgent [auditor liability] reform" (Hansard, House of Commons Debates, Standing Committee A, 14 September 2004, col. 39). Yet the same Minister announced the

"possibility of limiting liability on a proportionate basis by contract, which can be demonstrated significantly to enhance competition and to improve quality in the audit market".

Source: Hansard, House of Commons Debates, 7 September 2004, col. 642; also see col. 107WS.

The policy change was not accompanied by any information about auditor liability costs, efficiency of the insurance market, or the claims of the Big Four firms. The audited financial statements published by the Big Four do not show any hint of liability problems. Previously, major firms claimed (Big Eight, 1994) to spend 8% of their revenues on liability related costs. This amounts to $4.4 billion of their worldwide income, and £368 million for the UK income. Any motorist knows that a premium of less that £500 buys third party insurance cover of more than £1 million, suggesting that the Big Four have a colossal insurance cover. Yet they complain that they cannot get adequate cover. Either their arguments are wrong or their figures are unreliable. Due to secrecy they are certainly unverifiable.

Some firms own captive insurance companies, usually in secretive tax havens, and claim to pay millions of pounds in premiums, which qualify for tax relief. Arthur Andersen claimed to be paying $100 million each year to Professional Services Insurance Company Ltd. - a Bermuda-based insurer owned by Andersen’s global parent company. In 2002, following allegations of audit failures and frauds, without admitting any wrongdoing, the firm agreed a $ $217 million settlement with investors at the Baptist Foundation of Arizona. However, the insurer could not pay because it claimed not to have adequate resources (USA News, 9 April 2002).

Without examining the impact of LLP legislation on audit quality, the government proposed auditor liability ‘cap’, albeit by contract. Under ‘contributory negligence’, auditors pay damages according to their contribution to the losses suffered by shareholders, but under “proportionate basis” their share would be fixed or ‘capped’ regardless of the auditor contribution to the loss. This is bound to create problems. For example, it might be agreed that auditors would only be 20 per cent responsible for the losses suffered for a fraud that destroyed the company. Who will happily pick up the other 80 per cent?

Suppose the 20:80 agreement suits directors and auditors, but after litigation it is discovered that the one of the defendants is insolvent and unable to pay its share, even though s/he is negligent. The net result is that an innocent party who has suffered damage and shouldered the burden of suing the parties to a contract, which have a partial responsibility for that damage, would bear the loss whilst those gaining from that negligence in the shape of fees would have escaped. One possibility is the insolvent defendant’s share could be allocated to other defendants, who may well object on the grounds of unfairness. Either way, the innocent plaintiff would need to enter further litigation, involving more costs and uncertainty. Frustrated stakeholders might set their sights on regulators (e.g. Financial Services Authority) since their liability is not ‘capped’. So the taxpayer, could end up bearing the real cost of ‘cap’ on auditor liability. The government’s proposals would require the parties (directors, bankers, insurers, regulators, etc.) to enter into complex inter-dependent contracts. A universal contract may be impossible to design. The case-by-case negotiation would need to take place each year, or even continuously, because the circumstances of a company would change. Each party would need information about audit quality as well, something the Big Four have been very reluctant to provide.

Who will approve such contracts? The Minister said that

> “the proposals will provide shareholders with information. They will not require prior shareholder approval specifically because we do not propose cap on liability ….”.
>
> **Source**: Hansard, House of Commons Debates, 7 September 2004, col. 682.

The government will let auditors and directors collude and draw up such contracts. If audit committees are to oversee or design such contracts, then all companies need to have an audit committee. Yet there is no legislative proposal for that. Any legislation on audit committees would need to specify the duties of non-executive directors. Yet that is not on the agenda either. Leaving it to executive directors alone is bound to lead to allegations of ‘conflict of interests’. One proposal being mooted is that the government should pass the ‘hot-potato’ to the Confederation of British Industry (CBI) and the Financial Reporting Council (FRC) to finalise the details. However, the CBI, at best, represents some of the companies and has no mandate to represent shareholders, creditors, employees, pension scheme members and others affected by audit failures. The FRC is dominated by major corporations and accountancy firms. It has neither the independence nor the mandate to mediate the competing claims of various stakeholder groups.

The “contract” would need to be negotiated annually and should be filed at Companies House, but the government has given no such commitment. Without shareholder approval, directors may be considered to have failed in their fiduciary obligations. Under pressure, such contracts would probably eventually be approved by shareholders but with directors able to cast thousands of votes, they would always be in a position to override shareholder interests. No doubt, sensible shareholders would refuse to support a ‘cap’ unless auditors expressly agreed to extend the scope of audits, give value for money and owe a ‘duty of care’ to each of them. Directors may claim to speak on behalf of shareholders, but they are not elected by creditors, employees, pension scheme members and any ‘cap’ agreement cannot be binding on them. The mere hint of a ‘cap’ by contract should send a negative signal, i.e. auditors intend to reduce audit effort and the rights of shareholders for negligent audits. The share price and credit rating of such companies should decline.

The proposed liability concessions will primarily disadvantage UK stakeholders. Many companies are audited by UK firms, but are quoted in other countries (e.g. USA), or the UK companies are subsidiaries of foreign companies (e.g. Parmalat, an Italian company). The limits placed on the liabilities of UK auditors cannot constrain non-UK investors. Neither will they constrain creditors, or the liquidators (usually major accountancy firms) who are primarily appointed by creditors. In addition, the Big Four claim to be ‘global’ for securing business but ‘local’ when facing accountability and liability (Mitchell and Sikka, 2002). Such positions are contestable, especially as the firms win business by claiming to be ‘global’ and a promise to provide international coverage. They have a worldwide board, the same logo, headed paper and have common standards and procedures. It is only a matter of time before lawyers show the Big Four arguments for escaping liability to be a sham and hold all the partnerships to be jointly responsible for the damages. It is difficult to see how a UK ‘cap’, no matter how it is wrapped up, will be effective. Seemingly, the ‘cap’ agreements would be designed to disadvantage UK shareholders only and would ride roughshod over the interests of creditors, employees and pension scheme members, who are also affected by negligent audits.

During parliamentary debates, the ‘opposition’ parties also queued up to grovel at the feet of the Big Four. The Conservative Party tabled a series of amendments to help the big beancounters evade their obligations (Hansard, House of Commons Debates, Standing Committee A, 14 September 2004, cols. 1-46). Nothing was said about stakeholder rights or making auditors responsible for detecting and reporting fraud.

Summary and Discussion

Every 4-5 years, people cast a vote at the ballot box to elect government, but real power is wielded by big business, which demands legislative changes and disciplines governments to get its way. These demands are backed by threats to cause social and economic chaos. Further indulgence of the Big Four without enhancement of stakeholder rights will negatively affect the extent of audit quality and effort and lead to more scandals. With less liability auditors will be more careless.

An interesting feature of the auditing firms’ demands is that they have failed to produce one iota of information about their liability costs, insurance cover, the actual liability settlements, or how, in their capacity as liquidators, they actually receive proceeds of litigation against other firms. The accounts published by major firms do not show any material contingent liabilities or provisions for impending lawsuits.

In pressing their ever increasing demands for liability concessions, major firms have shown little regard for the interest of stakeholders. In an ideal world, their race-to-the-bottom would be checked by regulators, but it is accelerated by accountancy regulators such as the ICAEW who are financed and dominated by major firms. The demands of accountancy firms cannot be seen in isolation. Anything given to accountancy firms must sooner or later be demanded by engineers, doctors, dentists, surveyors, producers of food, cars, medicine, drink, financial services, cigarettes, and everything else. The only sure losers in the race-to-the-bottom are ordinary people.

CHAPTER 7
SUMMARY AND DISCUSSION

The unregulated power of global businesses is undermining democracy and hard won social rights. In pursuit of private profit and power, big business demands lax regulations, low cost and social obligations. They threaten governments, who in turn oblige. A naïve view is that "large [accounting] firms might prove more powerful and willing bedfellows in tempering globalising processes" (Tinker, 2000, p. 13). The evidence cited in this monograph does not support such a view. The public utterances of major accountancy firms allude to ethics, morality, accountability, transparency and service to the public interest. The reality is what the US Senator Carl Levin called "a culture of deception[23]" which inevitably leads to audit failures, dodgy tax avoidance schemes and disregard for rules on auditor independence, laws and ethical business conduct. Within minutes of the annual budget being presented to parliament, partners of major accountancy firms huddle together to find ways of overriding the will of parliament. As chapter 2 shows, the firms have a calculating mentality focusing upon the gains from possible unlawful activities.

Major accountancy firms are at the heart of the global race-to-the-bottom that shows little concern for the rights of stakeholders, openness and accountability. Extant literature shows that major firms launder money (Mitchell, et al., 1998; Mitchell and Sikka, 2002), abuse insolvent businesses (Cousins et al., 2000), blackmail governments (Cousins et al., 1998), harm the interests of stakeholders (US Senate, 1992), refuse to co-operate with regulators (Arnold and Sikka, 2001; Mitchell, 2002), facilitate tax avoidance and evasion (US Senate, 2003), indulge in audit failures and show no respect for rules, laws, ethics and professionalism.

Successive governments have failed to prosecute firms involved in money laundering and audit failures. They have suppressed a number of critical DTI inspectors' reports (Sikka and Willmott, 1995b; Mitchell et al., 1998). Ministers wring their hands and regulators take years to investigate and report on firm misdemeanours. However, they manage to find the resources for consultation exercises and Law Commission studies to advance the interests of accountancy firms. With compliant governments and tax havens plying their trade, the race-to-the-bottom continues as firms seek a 'cap' and 'full proportional liability', in the hope that concessions from the UK would squeeze the same from the EU, the US and other countries.

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[23] http://levin.senate.gov/newsroom/release.cfm?id=217068; accessed 15 January 2004.

Major auditing firms have shown commitment neither to public accountability nor to the rights of stakeholders. When the UK government was not responsive to their demands for further liability concessions, Ernst & Young and Price Waterhouse developed the Jersey LLP law and exerted pressure upon the UK government to do the same. The firms carefully selected Jersey because it lacked inquisitive media, legislators, pressure group activity, co-ordinated government, regulation and formal opposition in parliament.

Major firms have used their financial and political muscle to make themselves liability proof. The social bargain enshrined in the Companies Act 1948 required auditors to accept ‘joint and several’ liability as a *quid pro quo* for a monopoly of the state guaranteed market of external audits. That monopoly has been abused and enabled accountancy firms to sell an ever wider range of consultancy services, boosting their UK income to £4.6 billion. When their financial and political muscle grew, they demanded liability concessions. Successive governments obliged and enabled accountancy firms to trade as limited liability companies and LLPs to limit their liabilities. Case law in the shape of the *Caparo* judgement severely restricted auditor liability, all a far cry from the liability regime introduced by the Companies Act 1948.

The government should respond to the continuing pressures by clipping the wings of major firms. It should investigate their role in tax avoidance and flight of capital. It should appoint regulators who are independent of major firms and able to advance the interests of audit stakeholders. It should ban the sale of other services to audit clients and break-up the Big-Four firms. It can enlarge competition by encouraging mid-tier firms and allowing audits by staff directly employed by the Financial Services Authority and other independent organisations. This way the markets can have responsible competition and the public can enjoy freedom from threats. People can generate pressure for that by boycotting the big firms, demanding independent investigation into the activities of major firms and scrutinising them so that they behave in a socially responsible way.

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Race-To-The-Bottom: The Case of the Accountancy Firms provides evidence to show that in pursuit of profits, major accountancy firms have little respect for public accountability, rights of stakeholders, rules on auditor independence, ethics and professionalism. They have used their financial and political resources to secure a series of liability concessions and erode stakeholder rights. They hired the legislature of Jersey to secure the Limited Liability Partnership (LLP) law and then threatened to cause economic chaos in the UK unless the government gave them the same. The Companies Act 1948 gave accountancy firms a monopoly of the state guaranteed market of external audits in return for 'joint and several' liability. That social bargain has been eroded by a series of one-sided liability concessions without any extension of auditor duties and accountability. Firms can already trade through limited liability companies and LLPs. They do not owe a 'duty of care' to any individual shareholder, creditor, employee or anyone else placing reliance on audited financial statements. Rather than improving the quality of their work, major firms are now demanding full proportional liability and a 'cap' to shield them from the consequences of their own failures. Their demands are accompanied by threats. Unlike the EU and the US, the UK government is keen to oblige.

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