

Funding the Future

For GAAP read CRAP

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There's [much discussion today](#) about whether the [alleged professional negligence](#) by Ernst & Young with regard to the audit of Lehman Brothers — where it appears they turned a blind eye to the rigging of the balance sheet — might be their Enron and lead to the demise of the firm.

I'm on record as saying I think the end of at least one of the Big 4 is nigh — and with it the whole audit market.

But let's be clear — Ernst & Youngs' defence — that their audit complied with US GAAP (Generally Accepted Accounting Principles - pronounced 'gap') may be true. But that's not the point. The point is US GAAP is crap and the Big 4 engineered that their audits do not need to report either truth or fairness.

As the rules of the [IAASB](#) (International Auditing and Assurance Standards Board), which sets auditing standards [says, an audit is](#):

The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework. An audit conducted in accordance with ISAs and relevant ethical requirements enables the auditor to form that opinion.

The wording is not a chance: the emphasis is on compliance with the financial reporting framework first; the consequence of being true and fair is assumed to follow, but is consequential, not the goal.

So, E & Y influence the International Accounting Standards Board that sets the framework.

And they influence the IAASB which limits the scope of the audit to the point it's

useless.

And although financial statements are meant to be produced for the benefit of the providers of capital to a business (in itself far too narrow a requirement) the auditors in the UK (by reason of the [Caparo decision](#)) and in the US under Delaware law basically can't be sued by those providers of capital.

In other words the auditors charge a lot for doing a job badly for which they know they have almost no liability. It's not surprising they don't really care.

It's not E & Y who have erred here — it's all those who let this situation develop that have erred. The accounting structures we use are rotten to the core and so is auditing. Unless both are reformed we are heading for collapse after collapse after collapse as the prevailing mood of society to promote expedient short term greed will destroy entity after entity without any check or balance in place to stop it happening.

This can be tackled.

It needs to be tackled.

Without the political will to tackle it just watch society collapse like a pack of dominos as big business begins to fail all round us.

And I think I'm underselling the melodrama in saying that.