

The Big 4 accountants are not culturally neutral

Published: January 13, 2026, 3:53 am

I am pleased to share this guest post:

Professional Chameleons Or Independent Public Auditors And Regulators?

— A Case Study of KPMG and its Regulatory Arbitrage Services

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Recent news regarding tax avoidance and unethical banking cultures are putting an increasing spotlight on the Big 4 Accounting Firms and their independence, professionalism and conflicts of interest. Scholars are beginning to question their huge power and influence in global accounting, auditing and tax, yet little is known about exactly how they practice regulatory arbitrage and the extent to which it is structural and systemic, and how they continue to get away scot free from major financial crises and corporate failures. In the case of the ***[audit failure at HBOS, KPMG have still not been independently investigated eight years after the loss of billions of pounds, thousands of jobs and huge losses for investors, pensioners and retirees.](#)***

My latest research, which looks microscopically at KPMG in the UK and its structures, services and culture, exposes some alarming truths. The paper is entitled '[Systemic Regulatory Arbitrage — A Case Study of KPMG](#)' and was first presented at a Tax Justice Network Research Workshop at City University in June 2015.

In simple terms, regulatory arbitrage occurs when organisations or professionals use their knowledge of the regulations, legislation and administrative procedures to help their clients escape the substance of those rules and thereby benefit commercially. Readers of this blog would be very familiar with the exposes of Richard Murphy about how tax avoidance is practiced and escapes regulatory sanction. My research is broader in spirit and suggests that it is in the very nature of Big 4 firms to help clients

practice regulatory arbitrage, and this is interwoven in their structures and services. The result of this, if true, is that global professional accounting firms appear to help multinationals to escape all kinds of regulatory limits and controls in specific nation states and become a power unto themselves, free from restraint. This is in stark contrast to their public license and image as upholders of truth and fairness and professional firms which are independent and reliable.

Sadly, in spite of the threat such behaviour poses there are huge challenges in getting access to internal systems and processes to determine the scale of this problem whilst interviews with senior leaders and managers about how such arbitrage is practiced and implemented are difficult to secure. Most of our evidence therefore comes largely from published information, either in annual reports or on websites, or from press reports and regulatory/parliamentary investigations. Using a variety of publicly available information, and an interview of KPMG's Head of Audit Quality, Risk Management and Ethics, the research paper unravels how KPMG undertakes this activity and escapes regulatory sanction.

The research paper explains and defines 'Creative Compliance' and 'Regulatory Arbitrage', and analyses in detail the commercial incentives for Big 4 firms to provide arbitrage services. For example, significant multiplier fees might be earned by developing a particular scheme and then cross-selling to a wide range of clients. Fees can also be earned from the on-going creation and administration of off-shore boiler plate subsidiaries in tax havens and generally advising or managing complex group structures.

The result is that the concept of 'Regulatory Dialectic' is introduced, where contacts with regulators, understanding the resources and skill limits of regulators, understanding how slow regulatory investigations can be and how they can be 'managed' in the client interest — are all skills that may be exploited to provide client services. It is then suggested that each of these could be restrained by strong ethical codes and rules of professional conduct, but sadly there are no such rules, let alone indication of willingness to enforce them. Instead having a large and talented workforce from a range of disciplines has helped firms nurture and retain these skills which have proved to be a major commercial strength to them.

The evidence I present exposes flaws in governance, leadership culture, ethics and at times even deliberate and explicit publicity of regulatory arbitrage services on their website. For example, on one occasion it was aid that 'Our training and secondment experience within regulators gives us exceptional insight into their expectations and perspective.' (KPMG Financial Services Website, 2014)

In their annual reports, one of the key risks KPMG identifies is that of 'regulatory risk' i.e. the possibility that they may lose their licence to audit as a result of poor or failed audits. From a big picture perspective, the origins of these Big 4 firms came from a legal requirement to audit, and they were seen as 'regulators' on behalf of the state. How paradoxical its is then that they are now 'managing' their own (KPMG's) regulatory risk!

These and many other significant contradictions in their rhetoric expose the huge commercial bias of these firms, and their desire to grow profits at virtually any cost. For 2014, I calculated the firm's Return on Equity to be 112% - most corporates would be lucky to get a return of 20%: this shows how hugely profitable these organisations are for their partners.

The research also analyses KPMG's Systems, Services and Strategy to see the extent to which these can be used to harness and support clients practicing regulator arbitrage. A detailed analysis of the role of contacts and networks in practicing successful arbitrage exposes the deeply political nature of accounting and its regulatory capture by such firms. There is also a section in the paper that shows how the firm itself uses complexity and secrecy to reduce its transparency and practice information arbitrage. As a result it is concluded that the firm faces fundamental cultural conflicts of interest exposed as ethical contradictions within the firm.

This stresses the need for the public to be aware of what the core values and culture and services of these glamorous Big 4 brands are, so that smart graduates can make informed choices about where to work. For the accounting profession, its reputation and image rests on the good conduct and monitoring of these firms and their partners, given their power and influence within it. Regulators need to be very careful about the extent to which they rely on Big 4 advice and services, and understand the huge conflicts of interest and regulatory capture that may result from working closely with them. Global institutions like the United Nations or the IMF must take an active interest in how the Big 4 firms hinder the creation of a fair and equal society and one which ensures that multinational corporations are held to account, and follow the spirit of regulations.

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