Funding the Future

The Financial Reporting Councilâ€™s evasiveness te...

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Guest post by [Atul K. Shah]

The failure of the UK's fifth largest bank, HBOS, led to over £52 billion of losses, and had a significant impact on jobs, pensions and savings for thousands of people. In spite of a large number of enquiries and reports, no-one has gone to prison, nor has there so far been *any extensive investigation of the role of the 'Big Four' audit firm KPMG, which was HBOS's external auditor throughout the bank's short life.*

In a country which boasts a healthy democracy and the rule of law, this is a disaster. It shows how flawed and unfair the system is. It also raises serious questions about the ethics and integrity of the ICAEW, one of the oldest professional bodies of accountants in the world. More fundamentally, our research reveals that a much deeper and wider game of "regulatory arbitrage" was being conducted by financial institutions, audit firms and regulators, which is seriously undermining the effectiveness of financial regulation.

Auditors are, by law, meant to ensure that financial statements give a "true and fair view" of their clients' financial position, and our research shows that KPMG fell far short of this, especially in the case of HBOS's accounts for 2007 and 2008. When auditors fail, they are supposed to be investigated by the Financial Reporting Council. This was strongly resisted for several years, partly because the regulator preferred to await a report by the Bank of England's Prudential Regulation Authority and the Financial Conduct Authority, a report which conveniently took years to complete. It finally finally came out in 2015.

Based on this, a very limited investigation was announced, but this was also to be conducted in a preliminary way by internal staff members of the FRC.

The Treasury Select Committee did not like the sound of this, and suggested that a more robust investigation be undertaken, including the engagement of outside independent experts. The detailed correspondence in 2016 between Treasury Select Committee chairman Andrew Tyrie MP and the FRC's chief executive Stephen Haddrill has just been released by the committee, and it makes for shocking reading.

Haddrill's answers to Tyrie's detailed questions are limiting, vague, feeble and weasly, in spite of the urgency of the matter, and fail to make clear how much evidence will be released to the public.

One regulatory strategy in the event of massive corporate failure is to "kick it into the long grass". That's what's happening here, and to KPMG's benefit, in this instance, and it seems the FRC is continuing to kick. In the latest response from the FRC, independent outside experts are being avoided, and there is even a denial of the FRC's regulatory and enforcement powers in material areas. All this shows that, as a regulatory body, the Financial Reporting Council is wholly unfit for purpose, and remains as captured as ever by the audit firms it is supposed to regulate.

HBOS whistle-blower Paul Moore, himself a former KPMG partner and author of Crash Bank Wallop, suggests one key factor is the:

"mysterious fact that the Financial Reporting Council changed the threshold for investigations in 2013 from "conduct which falls below the standards..." to "conduct which falls significantly below".

And Tim Bush, head of governance and financial analysis at PIRC, argues that:

"given the over-riding requirement for auditors to ensure that accounts give a 'true and fair' view, the auditors and the FRC must not simply look at specific accounting standards but the overall picture of financial performance presented in the annual report, which was hugely misleading."

Prem Sikka, professor of accounting at the University of Essex says:

"The correspondence shows shocking inertia by FRC. The very fact that the FRC needs to be pushed is an indictment of its failures. The FRC refers to a number of cases that it has examined, but make no reference to what it has ignored or neglected. It makes no mention of the time taken to report on the cases either. The FRC is unfit to be a regulator."

It is time the public, parliament and media rise to challenge the Financial Reporting Council and KPMG over its audits of HBOS and ensure they key people involved are investigated and punished. Nothing less will do.

Dr Atul Shah is senior lecturer at Suffolk Business School. His research is focused on the areas of business ethics, governance, and financial regulation.

Note: *on its website the FRC says:*

The Financial Reporting Council is the UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment. We promote high standards of corporate governance through the UK Corporate Governance Code. We set standards for corporate reporting, audit and actuarial practice and monitor and enforce accounting and auditing standards. We also oversee the regulatory activities of the actuarial profession and the professional accountancy bodies and operate independent disciplinary arrangements for public interest cases involving accountants and actuaries.

It is also worth remembering that KPMG also audited numerous other failed banks around the world including Bradford & Bingley and Co-operative Bank in the UK. The FRC has supposedly been investigating its audits of the latter since *January 2014. In some countries including the US, Italy, Bulgaria and Nigeria, KPMG has already been penalised for flawed auditing of banks, either by regulators or through the courts.*

* *TierOne Bank Nebraska (USA) — two KPMG partners have been charged by the SEC*

* *BancaMonte dei Paschi di Siena (Italy) — Consob fined KPMG â‚¬450,000 for audit failures*

* *Countrywide (US) — KPMG paid $24m as part of a $624m settlement to resolve class-action litigation*

* *Fannie Mae (US) — KPMG and Fannie Mae jointly paid a $153 settlement of for overstating income and breaching GAAP in 2001 to 2004*

* *New Century Financial (US) — KPMG paid $44.75m as part of a £125m se ttlement to resolve class-action litigation*

* *Wachovia (US) — KPMG paid $37m as part of a $627m settlement to resolve a class-action litigation*

* *Corporate Commercial Bank (Bulgaria) — Bulgaria's Commission for Public Oversight of Statutory Auditors found "significant gaps and inconsistencies" in KPMG's audits. In April 2015 two KPMG Sofia partners were charged for not reporting CCB's shortcomings to the country's regulator*

* *Stanbic IBTC (Nigeria) — Nigeria's Financial Reporting Council has requested that Central Bank of Nigeria and the Economic and Financial Crimes Commission investigate Stanbic IBTC and KPMG over financial misstatements made in 2013-2014*

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