Auditors have become parasites feeding off the capital markets

Patrick Hosking, financial editor   THE TIMES   16 October 2017

For most people, £59,000 is an unimaginably large sum of money to drum up at short notice. For others, it's a trifle. On this difference partly turns the question of whether Britain's auditors are being properly policed and whether investors can trust company accounts.

Yesterday the Financial Reporting Council found Julian Gray, a senior Big Four accountant, guilty of a number of failings in the case of the Computer 2000 auditing scandal and fined him just that sum. Mr Gray had failed to make proper checks and had failed to exercise sufficient professional scepticism.

These are not trivial sins. What is the point of auditors unless they can deliver these minimum standards? Standing up to the blandishments and blarney of company managements is the whole point of an audit. In this case, it ended with the owner of Computer 2000 belatedly having to restate its accounts.

It seems likely that Mr Gray belongs to the group for whom £59,000 is a bagatelle. He was a partner at EY for ten years and in 2015, his final year, the average partner salary was £727,000. He's now a partner at PWC, where partners' pay averages £652,000. EY, too, will not have been much troubled by its £1.8 million fine; it scoops in that much in UK revenues every eight hours.

The Big Four are vast organisations, yet still are fined as though they are village book-keepers. As a deterrent against bad behaviour, the penalties are comically low. As a symbol of the regulator's determination to stamp out negligence, they are feeble. Why should accountants believe that the occasional investigation by the FRC is anything more than just another everyday cost of doing business?

As usual with its enforcement cases, the attitude of the regulator has been to minimise the affair, reducing all information to a brief press release. No one at the FRC was allowed to amplify on what actually happened. No one was on hand to criticise EY or warn others tempted to stray.

The City regulator, the Financial Conduct Authority, has long since learnt these lessons. Commendably, its enforcement reports run to dozens of pages of detail of what happened, why the culprit was at fault and how the punishment was decided. It also puts up a senior figure to publicly scold the guilty firm. If you are in the business of naming and shaming, these things matter.

It's as though the FRC thinks of itself as a trade assocation for accountants, not an independent watchdog. That's hardly surprising, given the number of Big Four present and former partners wandering around its corridors.

The response yesterday from PWC, Mr Gray's employer, was even worse — complacent, bordering on arrogant. Apart from scrambling over the weekend to expunge Mr Gray's biographical details from its website to spare his blushes, it regards the matter as closed. He is still the senior partner heading the Southampton office. It has nothing further to say. Its attitude seems to be that if the FRC did not regard his failings as sufficent to ban him, which it could have done, why should they be concerned?

Mr Gray's short biography - seen by *The Times* before it was taken down— speaks volumes: "Bringing a strong commercial perspective, Julian is recognised for working with companies as they prepare for a value realisation event, exploring and supporting the process of an IPO, PE [private equity] buyout or trade sale."

That, in a nutshell, lays bare the chasm between what society expects from an auditor and what the auditor feels under pressure to do. Society wants accounts that paint a "true and fair" picture of a company's financial health; accounting firms know the advantage of taking the most flattering view in order to boost the value of assets or the size of management bonuses. The Financial Reporting Council specifically rebuked Mr Gray for "failure to exercise sufficient professional scepticism", yet PWC until yesterday was pimping him out as a man "bringing a strong commercial perspective". In my view, this is little better than code for telling the client he'll bend over backwards to see things in a conveniently positive way.

This might be alright for an investment bank dealmaker, but Mr Gray is billed as an "assurance partner", the part of PWC doing supposedly objective audits.

In the past few weeks, the council's exoneration of KPMG (over the HBOS audit) and PWC (over checks on Barclays' client asset procedures) have raised eyebrows among investors and MPs. If the FRC hasn't been "captured" by the profession it is supposed to be policing, it's doing a terrible job of advertising its independence and robustness.

It is, however, taking baby steps in the right direction. It is taking more enforcement action. Investigations are being speeded up. It is, it says, going to publish a register of conflicts of interest. And the fines, believe it or not, are bigger than they used to be.

Will this be enough to see off a campaign for more serious reform? There seems to be a head of steam building among some investors and MPs. The clearing of KPMG over HBOS was seen as especially bone-headed and provocative.

Accountants are losing their relatively cuddly image. They used to be seen as useful functionaries, keeping companies honest. Now they are starting to be seen as just another parasitical organism feeding along the capital markets food chain — and producing less of value to society.

They are no longer so far behind bankers and brokers in City demonology. Their blindness before the banking crisis was one thing; their energies in devising tax-avoidance schemes for overseas companies is another. They look more vulnerable to a political crackdown than in some time.

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