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How the Big Four Got Big: Audit Culture and the metamorphosis of International accountancy firms

Cris Shore and Susan Wright

Abstract

New calculative techniques of management and accountancy are having a transformative effect on organisations, individuals and society. These processes are often associated with contemporary neoliberal capitalism, but what exactly is driving the proliferation of these measurement systems and how is this change actually occurring? We address these questions by exploring the history of the Big 4 international accountancy firms and their role in spreading audit culture and the rationalities of financial accountancy. Since the 1990s, the expansion of their remit from traditional auditing to a growing emphasis on consultancy services has increasingly blurred the boundary between their public watchdog role and their commercial interests. Combined with the changing values, career trajectories and ‘habitus’ of audit company professionals, and the weaknesses of self-regulation, this has resulted in problems for ethics and corporate social responsibility. Using ethnographic examples, we examine the metamorphosis that occurs as accountants, originally trained in the disciplines of financial probity, become more entrepreneurially oriented when they ascend to senior positions as company managers and partners. If the calculative practices of accountancy are central to modern forms of audit, we argue they are also transforming accountancy firms themselves into ever-more calculative and financialised entities. We conclude by showing how the post-1990s shift from auditing to advisory services leads these companies to tread an ever-finer line between entrepreneurship and fraud.

Keywords: audit culture; anthropology; accountancy; Big ; capitalism; calculative practices; professional identity

Introduction: Accounting and Society

‘The calculative technologies of accountancy do more than transform the capacities and attributes of the self. They also construct the calculable spaces that individuals inhabit within enterprises and organisations by making visible the hierarchical arrangement of persons and things’ (Miller, 1992: 75).

‘Fortunes have been made and lost through the reinterpretation of financial categories; heroic entrepreneurship and criminal embezzlement may be distinguished by no more than a subtle point enunciated a few years back by the regulatory agencies’ (Porter, 1995: 97).

As Peter Miller (above) observed over twenty-five years ago, there is a growing emphasis on indicators, rankings and the calculative technologies of accountancy that is fundamentally changing the nature of work, subjectivity and society (see also Merry, 2013). Given that calculative measurement and instrumental reasoning have been integral to processes of governing in Europe since at least the late Middle Ages (Crosby, 1997) - or even earlier if one considers the Sumerian abacus in Mesopotamia as the starting point - what exactly is new or distinctive about the contemporary world of accounting? How are practices of ‘rendering accounts’ and ‘being accountable’ changing? Why have they become entrained with indicators, measurement and rankings and how are these changing contemporary society? In exploring what is driving the seemingly relentless expansion of auditing and accountancy identify two important reasons for giving renewed critical attention to the principles and practices of accountancy.

First, there is an increasingly important link between accountancy’s objects of enumeration and financialisation that is central to contemporary capitalism. As Gavin Smith (2014; 2015) notes, new forms of surplus value are being created by using numbers and indicators to disaggregate and disembody phenomena - for example, student loans, securities, financial derivatives, and sub-prime mortgages - and then reassemble them in packages that are tradeable (see also Tett, 2009). As these numbers gain value, they also become less traceable and reliance on auditing to lend legitimacy to these practices increases. As auditing has gained new political power, we ask whether professional auditing has maintained its traditional position as a distanced guardian of probity, or if it has become enmeshed in these new forms of capitalism itself.

Second, the diminishing financial return from auditing has precipitated a major reorientation in the priorities of the major international accountancy firms, prompting them to create new markets and

adopt ever-more risky business strategies. We focus on the changing nature of the accounting profession itself, particularly the rise of the Big 4 international audit firms: Deloitte, PricewaterhouseCoopers (PwC), Ernst and Young (EY) and KPMG. The history of these companies, which dominate the international accountancy industry, highlights key moments and trajectories in the transformation of contemporary capitalism, major shifts in the role and practice of audit, and continuing struggles to regulate the financial sector.

Our argument is that the concept of audit culture provides a useful framework for analysing these developments and, more importantly, for examining the interplay between the economic and cultural logics that underpin them. As we use the term, 'audit culture' refers not to a type of society or social formation but rather to a set of economic practices, political technologies and modes of thinking that seek to apply the principles of accounting to ever-wider domains of professional and social life (Rose, 1999: 151-2; Strathern, 2000; Shore and Wright 2015a and b). As Michael Power (2009: 8) argues, a key feature of the 'audit explosion' is the principle of 'auditability', the capacity to render people or organisations 'auditable' as objects of external scrutiny, inspection or evaluation. Audit culture, in this sense, is about systems of control that create new assemblages and auditable subjects with the aim of enhancing organisational legibility and trust. It entails a set of processes and rationalities that exert power through the normalisation and naturalisation of particular kinds of disposition and forms of accountability. As we illustrate below, those dispositions are increasingly associated with the contradictory logics of accounting and financialised forms of subjectivity in contemporary capitalism.

Our article is set out in three parts. First, we trace the development of the Big 4 auditing companies through three historical phases from their nineteenth century origins to the present, highlighting in particular their link to emerging forms of capitalism since the 1990s. Second, we explore some of the consequences and tensions arising from their expanded remit and changing profile, particularly the shift from traditional accounting to consultancy. These tensions, we argue, stem from wider shifts in the political economy of global finance and international system of financial regulation. We focus on the conflicts of interest and proliferation of fraud that have arisen with the blurring of the boundaries between audit companies' role as watchdogs serving the public good and their commercial interest in serving their clients. Following Theodore Porter (cited above) we show how the pressures on accountancy firms to find new clients and revenue streams strained the already thin line between heroic entrepreneurship and criminal embezzlement. What are the implications for democracy and

society when ‘gamekeepers’ turn ‘poachers’ and turn ‘gamekeepers’ again in a revolving door between governments and accounting firms? Finally, we examine the internal drivers of these processes including the changing values and career trajectories of audit firms’ senior personnel. We show how the professional formation of the chartered public accountant – a figure traditionally steeped in the disciplines of financial probity and detailed number checking – has changed since the 1990s. Accountants are now required to become more entrepreneurial and demonstrate their ability to grow the business if they hope to ascend to positions of leadership in the company. This has resulted in what some call the ‘deprofessionalisation of the accounting profession’ (Van Der Pijl and Yurchenko, 2014: 496). Ethnographic studies of the changing professional habitus of employees of international accounting firms, we suggest, offer novel insights into the tensions and dynamics caused by the metamorphosis of these companies and the corresponding rise in incidences of fraud and regulatory failure. Against the claim that this is simply a reflection of the culture of capitalism at its self-regulatory heart, we suggest that what it highlights are not only the failures of self-regulation but the absence of meaningful financial oversight as audit firms have aligned themselves to the heartbeat of capitalism.

From the Joint Stock Company Auditors to Global Value Creators: A Brief History of the Big 4

Look up at the central business district of almost any major city today and four names – or global brands – dominate the skyline: Deloitte, PwC, EY and KPMG. While these Big 4 audit companies are typically seen as single firms, they actually comprise a network of independently owned and managed companies that share a common brand, name and quality standards. Between them, these firms employ over 750,000 staff, operate across 150 countries and, in 2014 alone, generated a massive \$113.7 billion in revenues (Doherty, 2014). These firms dominate the market and collectively audit 99% of the FTSE 100 and more than 95% of the FTSE 350 companies (Sikka, 2013; 2014). Even the smallest of the Big 4, KPMG, is larger than the next four accounting firms combined (Economist, 2014). A striking feature of their revenues is the growing percentage of income that now comes not from traditional auditing but from consulting and from tax, legal, and financial advisory work. In 2012, Deloitte estimated that its consulting work would overtake auditing by 2017 (Economist, 2012). Indeed, by 2016 its US subsidiary, Deloitte LLP, earned less than 30 percent of its income from ‘Audit and Enterprise Risk Services’, while consulting accounted for 48.4 percent (Deloitte US, 2017). This combination of market dominance and shift of *modus operandi* towards financial and management services creates major tensions and conflicts of interest that have long been recognized but are far from resolved.

From the Roots of the Profession to Post-War Expansion: 1880s-1970s

As most histories of accounting note, modern auditing in the UK began with the development of the joint stock company in the mid-nineteenth century. The 1844 and 1845 amendments to the British Companies Act required public companies to conduct an annual audit with an auditor selected by shareholders. Notably, when the Great Western Railway's (GWR) stock price slumped in 1849, William Welch Deloitte was appointed as the independent auditor of the company (Coffee, 2005: 208). According to Deloitte (2014), GWR directors found his work so helpful it produced a boom for people skilled in understanding and solving complex business problems. The equivalent legislation (the 1933 Securities Act) was not brought into American law for another 88 years when, in the wake of the 1929 Wall Street crash, it was thought that proper accounting practices could have prevented some of company bankruptcies. This Act made it mandatory for public corporations to have independent audits done by disinterested, certified public accountants.

In the U.S., the eponymous ancestral heroes of the accounting profession originated not in the private sector (as in the UK) but in public sector accounting. In the U.S., the rise of accounting occurred in 1893 against a background of economic decline and worries about government inefficiency. Accountants Haskins and Sells were appointed to investigate department by department how the U.S. government carried out its work. They simplified the operations, increased efficiency, improved quality and saved the government what was then a hefty sum - \$600,000 a year. Furthermore, the 1913 amendment to the U.S. constitution that allowed income tax to be levied on U.S. citizens for the first time meant that people had to prepare statements of income and expenditure, which heralded a new era of expanded work for public accountants (Deloitte, n.d.). Each of the websites of the big accounting firms is graced with an origin story and the point to take from them is that their famous founders initially gained appointments as accountants not just for their heroic independence, accounting skills and fearless probity but also because they were seen to generate advice on how to improve organisational efficiency. According to these stories, no tension existed between these two roles.

A second key point to note is that these individual accountants, while setting up firms in London or New York, soon also opened branches in those countries that were the destinations of capital flows. From a very early stage, they mirrored the international organisation of capital, operating largely across the Atlantic between London, many U.S. cities, Canada and Brazil. Like other capitalist industries, these firms were also early exponents of the use of information technologies. In the post-

Second World War period, one of the main drivers of change was the application of new data-processing technologies to automate book keeping. For example, Touche Ross pioneered the early use of computer technology for audits for leading corporations and government agencies. This freed up accountants to start focusing more on the way clients managed their firms and heralded the later move towards the expansion of consultancy.

Expansion, Mergers and Acquisitions: 1970s-1990s

From the 1970s, with the emergence of a new form of globalisation, a new style of management came to prominence in corporate America. Large firms sought synergies and economies of scale through mergers and acquisitions in order to turn their companies into ever larger and more multinational corporations. According to the way that the Big Four narrate themselves, at this time corporations began looking to their accountants not just for audit and tax skills, but for expertise as business consultants to help them expand their enterprises and assets through mergers and acquisitions, new technologies, financial services, and business strategies (Deloitte, n.d.). As accountancy firms increasingly recast themselves as management consultants, their role also expanded to cover advising companies on their global operations and strategies.

At the same time, these accountancy firms were themselves engaging in an unprecedented wave of mergers and take-overs worldwide, which resulted in the emergence of the so-called 'Big 8' (see KPMG, 2015; PwC, 2015; EY, 2015; Deloitte, n.d.). For example, Touch Ross and Deloitte Haskins Sells merged to form Deloitte and Touche in 1989. The company's leaders, J. Michael Cook and Edward A. Kangas, 'shared the belief that successful accountants of the future would combine strong professional abilities with a deep understanding of their clients' industries, situations and needs' (Deloitte, n.d.).

Just as in the earlier era, whilst one strand of accountancy was developing in the private sector, another was being pioneered in the public sector through the new opportunities being created by privatisation and managerialism. During the 1980s, particularly in the UK, the remit of the auditing firms was massively expanded through the Thatcher government's policies to revolutionise and rein in the public sector. The aim was to create an 'enterprise culture' through a sustained programme of cost cutting, competitive tendering, creating internal markets and turning each government department into a cost centre with performance targets. As the Conservative Minister Michael Heseltine declared,

When the literacies of the Civil Service and the generalities of their intentions are turned into targets which can be monitored and costed, when information is conveyed in columns instead of screeds, then objectives become clear and progress towards them becomes measurable and far more likely (Heseltine, 1987:21).

Employees and professionals were recast as ‘units of resource’ whose performance was to be managed, measured and incentivised through targets and regular performance appraisals. Audit became an even more prominent profession and increasingly visible instrument of political rule with the creation of the national Audit Commission, an institution established by the Local Government Finance Act of 1982. Initially, this body was just responsible for auditing local authorities. Later its remit was extended to include a vast range of other public services including the national health service, the fire and rescue services, social benefits and social housing. The Audit Commission was to be ‘a driving force in the improvement of public services’ and in the process of fulfilling that remit the meaning of audit itself expanded from scrutinising the accounts and ensuring financial regularity to promoting ‘good government’. The language of audit also began to embrace terms such as ‘monitoring performance’, identifying ‘best practice’, producing ‘league tables’, ‘improving value for money’ and ‘ensuring the effectiveness of management systems’ (Audit Commission, 1984:3). The establishment of the Audit Commission and the expanding remit of auditing were tightly connected to the growing operations of the big audit firms. When it was launched, a quarter of the Audit Commission’s 500 staff were drawn from the major private accountancy firms Price Waterhouse, Touche Ross, Coopers and Lybrand and Peat, Marwick, Mitchell. When the Audit Commission was finally disbanded in 2012 its work was transferred to four private sector firms. Between them, Ernst and Young and KPMG won 5 contracts for taking over the Audit Commission’s public sector work, and the largest single share (4 contracts) went to Grant Thornton, the world’s sixth largest audit firm, which also took on about 350 of the Commission’s former staff (Audit Commission, 2012).

To sum up, the period 1970–1990 was one in which major changes were occurring in the global economy, from the breakdown of the Bretton Woods monetary management system and the abandonment of Keynesian policies of macro-economic planning, to the deregulation of financial markets and the privatisation or so-called marketization of much of the public sector. These changes created the conditions in which very large international corporations formed to organise industrial production and to take over the operations of the public sector. The audit companies, as crucial advisors to changes in both sectors, became exceptionally large corporations themselves.

Going Global: 1990s - Present

Against a backdrop of the collapse of the Soviet Union, the transition of Eastern Europe – and later China – to a market economy, the rising economic power of Pacific-Rim countries and the development of ever-more complex trade agreements, international firms changed their mode of operating. No longer organised as corporate behemoths headquartered in the U.S. or UK, they reduced their fixed costs of plant and permanent staff and outsourced not just production, but most aspects of their operations in ‘enterprise webs’ (Reich, 1991) or chains of contracts to the cheapest, independent companies anywhere in the world (Harvey, 1990, Tsing, 2006). Notably through OEM (Original Equipment Manufacture) corporations could own a brand and licence firms to produce a product or a component to its specifications without owning or operating a factory itself. Starting in car and computer manufacturing, NIKE perfected the art of creating and marketing branded products without having their own production units (Allinson, 1988, Lammimg, 1993, Lin, 2004). This system was also used by corporations who licenced production of their branded goods to another company where a country’s laws prohibited local ownership of assets by foreigners – a significant strategy for the audit companies themselves, as discussed below.

Such strategies meant corporations demanded more sophisticated knowledge of international business and integrated cross-border services. The accounting firms rose to this challenge by greatly expanding their remit, creating deeper knowledge of particular industrial sectors and markets, and developing expertise in the specificities of accounting and company law required in different countries. The larger audit companies engaged in radical restructuring as they sought to become global brands and one-stop shops providing everything their clients needed for their global operations. In this period audit companies echoed the moves made by their corporate clients, shifting from being large corporate structures to more flexible and agile forms of organisation. This typically entailed turning themselves into new entities that, rather than directly providing services to clients around the world, contracted with legally independent firms in different countries to provide locally informed advice under the flag of the corporate ‘brand’. As PwC (2015) acknowledges, ‘[I]n many parts of the world, accounting firms are required by law to be locally owned and independent’. Responding to these new constraints and opportunities, Deloitte’s 200,000 or so professionals are now employed in independent firms, each of which is a registered member of Deloitte Touche Tohmastu Ltd, a UK private company limited by guarantee, and each services a specific geographical area. These firms provide audit, business consulting, financial advisory services, risk management and tax advice to their clients, either through offering these services themselves or through subsidiaries and affiliates in their area.

In many respects, the Big 4 have helped to pioneer a new form of business entity that is neither a multinational corporation, a global partnership, nor a single firm. Their role, instead, is to act as coordinating entities for their network of global affiliates, who are to be unified around 'brand', 'risk', 'quality', 'values' and 'ethics' by adhering to a common code of conduct (Ernst and Young, 2013; KPMG, 2015b). This echoes the trend noted elsewhere in the internationalisation of service industries towards what has been termed the 'virtual corporation' in which firms rent out most of the services they need and rely on 'computer-based systems to create an interrelated network of suppliers, providers or vendors, each of which is an expert in some specific function, operating only in the area of it "core competence"' (Aharoni, 1999: 27).

The New Audit Regime: Issues, Effects and Case Studies

As the above account suggests, the changes in the structures and business models of corporations engaged in global capitalism were also being mirrored in the reorganisation of the Big Four themselves. While this new organisational form was designed to make the firms more flexible and responsive to their globalising clients and able to capture new markets, it also made them increasingly vulnerable to fraud, malpractice and dangerous risk-taking. This was evidenced in the spate of high profile scandals involving fraud, false accounting, manipulation of share value, money laundering, tax evasion, and corruption. For example, KPMG failed to warn directors of the Canadian company Hollinger about violations of fiduciary standards that investigators described as 'corporate kleptocracy'. Its founder, Lord Conrad Black, was shown to have syphoned off \$400 million from 1997 to 2003, which was more than 95% of Hollinger's adjusted net income (Somers, 2006; Coffee, 2005: 207). In India's biggest ever accounting fraud, the chairman of the computer services firm Satyam confessed in 2009 to falsifying the company's accounts by a massive \$1.47 billion. Because the auditors were five Indian-based affiliates of PWaterhouseCoopers (Lovelock & Lewes, Price Waterhouse Bangalore, Price Waterhouse & Co. Bangalore, Price Waterhouse Calcutta, and Price Waterhouse & Co. Calcutta), the case went to the US Securities and Exchange Commission (SEC). The SEC found that these companies had conducted repeatedly deficient financial audits that had allowed this massive accounting fraud to go undetected for several years. They also found that the audit failures 'were not limited to Satyam, but rather indicative of a much larger quality control failure throughout PW India' (SEC, 2011). PwC's offending affiliates received a \$6 million penalty fine and

a prohibition on accepting any new US-based clients for 6 months whilst they retrained their staff and revised their audit procedures.

Another recent case of massive fraud involved the Japanese company Olympus, whose executives stole \$1.7 billion from the company, resulting in the company's shares losing half their value. An independent report criticised the auditors, KPMGAZSA and Ernst and Young ShinHihon, for failing to expose the fraud at the company (Tabuchi and Bradsher, 2011). In yet another recent case involving the theft of millions of dollars by trustees of the Australian Aboriginal land trust (called GEAT), KPMG and Deloitte were sued in the Northern Territories Supreme Court for undisclosed millions for failing to detect substantial 'irregularities' in the Trust's accounts between 2010 to 2012. In this case, KPMG auditors *did* identify the misuse of funds. They told the trust members that they should immediately cease diverting money intended for community members and stop spending it themselves on cars (\$2.4 million in one year) boats, casino gambling, purchasing property for friends, and inflating their own wages. Yet the auditors failed to take action to stop these irregularities, arguing that their company had no 'contractual duty to prevent loss to the trust of trust money or other property by fraud or breach of trust' and that 'any losses arising from KPMG's actions were caused by false, misleading or incomplete information given to the firm by GEAT's trustees' (Wild, 2014).

Perverse incentives and revolving doors between government and audit firms

The conditions for these illicit behaviours were largely created by the internal reorganisation of the auditing companies and their growing emphasis on consulting services. The Big 4 not only reorganised themselves into affiliations of independent firms, but within those companies, each partner had his or her own clients, and where large firms were concerned, a partner often became a 'one-client' practice (Coffee, 2002: 1410). During the 1990s as the audit activities of the firms became less important than the consulting arm, the (then) Big Five learned 'how to cross-sell consulting services and to treat the auditing function principally as a portal of entry into a lucrative client' (ibid). Significantly, 'the typical large public corporation now pays its auditor for consulting services three times what it pays the same auditor for auditing services' (Coffee, 2002: 1411). This created a dangerous set of inter-dependencies between auditee and auditor. As Coffee argues, should an auditor refuse to endorse a client's 'aggressive accounting policy', the company executives could threaten to end their consulting contract and the partner would be out of a job.

The most dramatic illustration of this conflict of interest and its implications for the probity of auditing occurred with the collapse Arthur Andersen, then the largest audit firm, following the Enron Corporation scandal of 2001. Through the manipulation of accounting loopholes, the creation of so-called 'special purpose entities' and poor financial reporting, Enron's chief financial officer and other executives were able to hide billions of dollars in debt from failed deals and projects. They deceived Enron's board of directors and audit committee about their high-risk accounting practices. They were able to persuade Andersen to ignore the issues largely because one of the Andersen partners relied on Enron as his 'one-client practice'. A subsequent court case found Andersen guilty of shredding evidence and obstructing justice, a conviction that led to the collapse of the firm and reduction of the Big Five to the Big Four. These scandals led the US Congress to pass the 2002 Sarbanes-Oxley Act, a piece of legislation designed to protect shareholders and the general public from business accounting errors and fraudulent practices. In an attempt to address the problem of the conflict of interest, the Act limited the consulting services that a US accounting firm could offer to an audit client, as well as improving the accuracy of corporate disclosures.

The response of the leading audit firms to such scandals is often to blame offending individual partners, portraying them as 'rotten apples' whose behaviour traduces the company's values and code of conduct. However, the passage of the Sarbanes-Oxley Act points to systemic failures. Indeed, as Prem Sikka (2014) notes, the audit firms have been complicit in almost every major financial crisis since the 1970s and have played a key role in creating fraudulent offshore tax shelters to assist clients evade government taxes. While they are supposed to perform a public service by detecting financial malpractice, their record of regulatory failure is dismal. For example, in 2008 both Lehman Brothers and Bear Stearns (America's fifth largest investment bank) received unqualified audit reports only months before their collapse (Sikka, 2009: 869). The catalogue of failures also includes KPMG's admission of criminal wrongdoing in creating fraudulent tax shelters to help wealthy clients dodge \$2.5 billion in taxes, for which they were fined a mere \$456 million in penalties (IRS, 2005). A U.S. Senate investigation documented that one KPMG professional had urged the firm to ignore Internal Revenue Service (IRS) rules on registering tax shelters.

He 'coldly calculated', a Senate report said, that the penalties for violating the law would be no greater than \$14,000 per \$100,000 in fees that KPMG would collect. 'For example', he wrote, 'our average ... deal would result in KPMG fees of \$360,000 with a maximum penalty exposure of only \$31,000' (Hudson et al., 2014).

Nothing more clearly illustrates the calculative rationalities and ruthlessness of senior leaders in these accountancy firms, or their cavalier attitude towards compliance with government legislation. After the collapse of Anderson, the Big Four soon realised that governments were reluctant to get too tough with them. For example, in the KPMG tax shelter scandal mentioned above, KPMG's lawyer made clear that 'the company could probably survive a tax fraud charge, but an obstruction charge would kill us'. The U.S. government only charged the company on the lesser count of tax fraud and then quickly dismissed the charge under a 'deferred prosecution' agreement that allowed KPMG to put the criminal case behind them with a mere fine. It seems the U.S. government feared that criminal charges would turn the Big Four into an even more powerful oligopoly of three. As with the banking scandals that precipitated the 2008 global financial crisis, the Big Four also seem to have become 'too big to fail' (Hudson et al., 2014: 7).

While the Big Four may appear to stand above elected legislators, they also go out of their way to inform themselves about – and influence – forthcoming legislation. For example, when the U.S. Public Company Accounting Oversight Board (PCAOB) was considering changes to the regulations to compel companies to regularly change their auditors, the Big Four deployed their lobbying resources and orchestrated 260 letters that poured into the PCAOB (Ingram and Aubin, 2012). They regularly devote large sums of money to lobbying on Capitol Hill. In 2011, Deloitte spent \$3 million; PwC \$2.7 million, Ernst & Young \$2.2 million and KPMG \$1.5 million. In addition, these four firms' employees target campaign money directly to members of Senate and House of Representatives committees that oversee the industry. For example, the chairman of the House Financial Services Committee, which oversees the PCAOB, accepted \$370,000 in contributions from people in the accounting and audit industry during his career (Ingram and Aubin, 2012). As a recent investigation by the news agency Reuters illustrates, the accounting industry continues to exert a powerful influence over the PCAOB and undermine America's audit watchdogs (Levinson, 2015).

The power of the Big Four is also facilitated by the proximity of their staff to legislators and the 'revolving door' between private audit firms and government. In 2014, KPMG announced that former Federal Reserve deputy director Deborah Parker Bailey had become managing director in its regulatory risk service network. During her tenure in the Federal Reserve, she was responsible for stress-testing the nineteen largest U.S. bank holding companies and reporting directly to Federal Reserve Chairman, Benjamin Bernanke. KPMG understates the value of her knowledge and networks when it comments that she 'will provide strategic insight' for KPMG's financial service clients.

In the UK, lack of knowledgeable staff sometimes compels the Treasury to second staff from the Big Four who have a much greater range of expertise. The House of Commons Public Accounts Committee (PAC) was shocked to learn that Deloitte, Ernst and Young, KPMG and PwC had provided the government with expert accountants to draw up its new tax laws and then used that knowledge to exploit loopholes for commercial purposes. In a video interview with the Guardian, the Chair of the PAC, Labour MP Margaret Hodge (2013), explained the Committee's concern:

What was particularly galling to us was to see this 'poacher-turned-gamekeeper-turned-poacher' syndrome. It came out with KPMG. They had put somebody into the Treasury to help advise on how to write the law on a new tax relief. This was a tax relief to encourage businesses, who invented new products, to commercialise them. It's called the 'Patent Box'. The guy who wrote the law immediately left Treasury, went back to KPMG and wrote a brochure saying, 'Patent Box – What's In It For You?', and sold it as a tax avoidance scheme to KPMG's clients. And that is just not on. This 'poacher-turned-gamekeeper-turned-poacher' syndrome really should be stopped by government.

As Hodge (2013) went to note, it is fine for government to listen to stakeholders when drafting new laws, but:

What is *not* on is to allow your stakeholders to be so closely involved in writing the law that they then know how to exploit it as a tax avoidance scheme. And it's quite a simple thing for Treasury to do. They can punish KPMG for doing that, or they can have a code of practice that if you are asked in to help government devise a new policy or write a new law, you will *not* engage then in using that law to help your clients avoid tax.

As Hodge illustrates, the problem is that audit firms have exercised institutional capture; they have gained undue influence over those areas of government intended to regulate their conduct, and have been able to commercialise their insider knowledge of legislation and its loopholes.

Factors driving the rash of financial irregularities and fraud

One of the problems with the new regime of audit arises from the relaxation of the rules around what mandatory auditing entails. In the past an audit was expected to certify that an organisation was conducting its financial affairs with probity. An audit was supposed to provide assurance that statements were correct. Today, a company audit offers only a 'reasonable assurance' that, in the opinion of the auditors, the company's statements are in conformity with generally accepted accounting principles (GAAP). As the Economist (2014) notes, 'GAAP is a 7,700-page behemoth, packed with arbitrary cut-offs and wide estimate ranges, and riddled with loopholes so big that some accountants argued even Enron complied with them'.

To add to the complexity, each of the 149 jurisdictions in the world decides on which GAAP or standard framework guidelines to use for financial accounting. Many countries (84%) are converging on the [International Financial Reporting Standards](#) (IFRS) developed and applied by the IFRS Foundation's [International Accounting Standards Committee](#) (IASC). Based in London and set up in 2001, the IASC is made up of former national regulators, and former employees of major companies, bankers and KPMG and the aim of this 'independent, privately organised, not-for-profit organisation' is to 'serve the public interest' and to 'bring transparency, accountability and efficiency to financial markets around the world' (IFRS 2016). The EU has required all listed companies to use IFRS since 2005, and many other countries have either adopted them or local versions, but progress is less evident in the U.S., even though 'the SEC published a statement of continued support for a single set of high-quality, globally accepted accounting standards, and acknowledged that IFRS is best positioned to serve this role' (PwC, 2012: 3).

In the U.S., the Sarbanes-Oxley Act required auditors to report to an audit committee set up by company shareholders rather than to the company's managers, but in practice these audit committees reportedly are still easily captured by management and fail to exercise the desired independence (Economist, 2014). The Economist article notes that the misaligned incentives built into auditing all but guarantee that accountants will fall short of investors' needs. If a company in the U.S. is found to have incorrect accounts, it is required to present a 'financial statement restatement'. In the 1990s, there was a crescendo of such restatements mainly due to what is euphemistically termed 'improper revenue recognition'. The staggering rise in restatements since 1990 is shown in the table 1.

The effect of financial statement restatements on company employees and shareholders has been severe. They have often resulted in SEC enforcement proceedings and in the early 2000s the stock price, on average, dropped by 10% within three

days, and by 25% within 120 days of restatement (Richardson et al., 2002). The biggest adjustments occurred in 2004 and 2005 (\$6.3 and \$5.2 billion, respectively). By 2015 the largest adjustment concerned Alphabet Inc. (Google's parent) but, at \$711 million, it was only 2% of the company's 2014 net income. In 2015, the negative effect of restatements on company net income was over 60% greater than in recent years but the number of days taken to restore stock price had reduced to 3.22, the lowest in eight years (Audit Analytics, 2016),

Table 1. Rise in Number of Financial Statement Restatements, 1990-2015

Year	Number of financial statement restatements
1990	33
1995	50
2000	233
2005	928
2010	245 (circa)
2015	161

Source: Compiled by authors from Huron Consulting Group (cited in Coffee, 2005: 200-201) and Audit analytics 2016.

Driving the rapid increase in the number of restatements in the 2000s, in many instances, was 'premature revenue recognition' (Coffee, 2005: 204). In other words, managers 'stole' earnings from future periods or invented revenues that did not exist to create a spike in their company's reported revenues. A major reason for this was the abrupt shift in the 1990s from cash-based to equity-based remuneration for CEOs. In 1990 the median CEO made \$1.25 million, 92% of which was in cash and 8% in equities; in 2001 the median CEO made \$6 million, of which 34% was in cash and 66% in equities (Hall, 2003). The point here is simply that managers' stock options increased in value as the company's share price rose and those managers could sell them off before the fraud was detected and the company's share price fell. As Coffee (2005: 202, 203) notes, this 'creates incentives for short-term financial manipulation and accounting gamesmanship' and 'absent special controls, more [stock] options mean more fraud'.

The biggest financial statement restatement in history, which exemplified many of the points raised above, involved the Federal National Mortgage Association (FNMA), colloquially known as Fannie Mae. In 2006, three of its directors were accused of manipulating earnings to maximize their bonuses. A few years later, the SEC found that KPMG knew and approved of misleading statements claiming the companies had minimal exposure to subprime loans at the height of the home mortgage bubble.

KPMG had been Fannie Mae's auditor for over 30 years and in the period 2001-2003 it was paid \$28 million for both auditing and providing consultancy advice to Fannie Mae (including on how to comply with new accounting rules *and* auditing the company's compliance with those same rules). The SEC found Fannie Mae's financial statements 'riddled with errors' and declared that it was 'not even on the page' when it came to complying with the new accounting rules, for which it was fined \$400 million (Hilzenrath, 2006). As the same *Washington Post* article notes, 'KPMG rubber-stamped Fannie Mae internal accounting decisions in defiance of KPMG's professional obligations and the purpose for which it was hired'. Fannie Mae's restatement erased \$6.3 billion from the company's profits and it costs a further \$1 billion to re-do its books for those years.

The case studies outlined above highlight at least three main problems with the new audit regime. First, the organisational architecture of the flexible, globalized audit companies and their independent affiliates has in-built drivers that are not adequately constrained by the common company codes of practice. Secondly, the revolving door between government and private sector companies lends itself to institutional capture. Third, despite bodies that can investigate cases and fine companies, such as the US SEC, the companies are able to calculate that the costs of penalties are relatively insignificant when compared to the consultancy fees they earn.

Changing professional habitus of the accountant

The proliferating stories of accounting irregularities, fraud and corruption beg the question, how did a profession once renowned for its accuracy and probity come to be so mired in scandal? If one set of factors involved the changing political economy of the sector and the lucrative new opportunities and incentives opened up through consulting and advisory work, another involves the changing professional habitus of the chartered accountant. As Spence and Carter's (2014: 3) ethnography of partners in the Big Four shows, two institutional logics shape the accounting profession; one technical and bureaucratic, the other commercial and entrepreneurial. They argue that while technical bureaucratic skills are essential for entry into the profession, rising to the top of the company hierarchy requires a very different skill set, one that combines salesmanship, commercial savvy, leadership, coaching, and networking client relationships. Above all, the successful partner must be convivial, able to win work, and cross-sell services to other business functions – and do all this without exposing the company to legal risk (Spence and Carter, 2014: 10). They quote a retired Managing Partner from one of the UK-based firms:

To be a partner in a Big 4 firm these days ... you have to be a hunter, a killer and a skinner.
That means that you have got to be able to go out, get the new work in, identify the

opportunities, secure them and also you have to be able to do the work, so that is the skinning part of it. (Spence and Carter, 2014: 9)

Not only are partners expected to be dynamic, personable, ‘hunter-killers’ and team leaders, it is the *individual partner’s* contribution to the bottom line that counts: ‘Traditional professional rhetoric about serving the public interest and acting with integrity and in accordance with ethical principles as notable only by its absence in the talk of our interviewees’ (Spence and Carter, 2014: 10). The key point of their analysis is that to rise to the position of partner requires employees to transcend their original, narrow professional identity based on technical excellence and adopt the suite of dispositions associated with the commercial-professional logic.

These findings are supported by other empirical studies (Covaleski et al., 1988; Kornberger et al., 2011). As Kornberger et al. demonstrate, the transition from trainee accountant to commercial partner occurs at the level of the manager, a role that they analyse as a ‘rite of passage’ in the traditional anthropological sense. In that ritual process, managers experience a destabilisation of their previous professional identity and acquire a new set of skills (performing, game-playing and politicking) that run contrary to the previous disposition of adherence to fixed procedures and rules. Now they have to compete with each other, become entrepreneurial, take risks, rely on their own judgement, sell themselves, and learn a new set of unwritten rules in which ‘personal performance’ and ‘real performance’ do not necessarily coincide’ (Kornberger et al., 2014: 528).

The point that all these authors stress is that staff in the organisations have little choice but to engage in this transformation of their professional identity. Standing still is not an option: employees must go up the hierarchy or exit the organisation (Kornberger, 2011: 521). As they ascend the hierarchy, employees both distance themselves from, and show disdain for, the dull ‘bean counter’ disposition of the conventional chartered accountant (Carnegie and Napier, 2010: 364).

These trends were already evident in the 1980s and 1990s when Covaleski and his colleagues interviewed 180 individuals from the then Big Six. As they noted, practices such as management by objectives (MBO), mentoring and performance review ‘exemplified techniques aimed at transforming autonomous professionals into business entrepreneurs by duplicating the organization within the individual’ (Covaleski et al., 1998: 294). These ethnographic studies of professional staff in the big audit firms highlight the coercive nature of an audit culture that translated the rationality of a new political economy into political technologies that were designed to reshape the professional ethos of individuals around taking risks to ‘grow the business’ rather than conforming to standards and procedures. Or at least, it reshaped the professionalism of those staff members who joined in the

compulsory competition to rise through the company's hierarchy where the only choice was 'up or out'.

Conclusions: Audit Culture, Accounting and Capitalism

In this article we have examined the growth of audit culture and its relationship with the expansion of the accounting industry and modern forms of capitalism. Our examples showed how historical changes in political economy are reflected in the business practices of accounting firms and their clients, how these are instantiated in new organisational forms with drivers and incentives that, in turn, are producing the conditions for remaking professional identities and rationalities of conduct.

As our cases show, accountancy has long been associated with forms of capitalism, ever since the railroads and the first joint stock companies in the 1840s, the post-war rise of large American corporations and the mergers and acquisitions of multinationals in the 1970s to 1990s. Similarly, audit has long been engaged in international flows of capital and investment and is intimately connected to the current, more flexible forms of globalisation. The extent of this change is perhaps captured by the popular image of the archetypical chartered accountant in the 1880s and 1980s. The Big Four represent the nineteenth century roots of accounting in heroic ancestral figures such as George A. Touch, William M. Lybrand, Adam A. Ross, Arthur Young, Alwin Ernst, Charles Haskings, William Welch Deloitte and Samuel Lowell Price; men who epitomise the ideal of the cautious, conservative accountant with a hard-earned reputation for integrity and financial probity. In contrast, since the 1990s onwards, the ideal accountancy firm partner has become an individualistic, entrepreneurial risk-taker, dedicated to 'growing the business' by using audit as an entrée for selling all sorts of consultancy services (Carnegie and Napier, 2010). If changes in accounting practices both map and mirror forms of capitalism, what can be gleaned about the contemporary capitalist system? One answer is provided by Van Der Pijl and Yurchenko (2014) who point out that the post-Sarbanes Oxley Act era has been characterised by the return of 'predatory neoliberalism' and a resurgence of rentier capitalism on the one hand and, paradoxically, a weakening of the codes of conduction governing certified professional accountancy firms which has provided them with more liberties to maximize self-interest in terms of the marketing and selling of aggressive tax shelters.

Social scientists, echoing Max Weber, have often argued that the rise of bureaucracy associated with instrumental rationality, calculative practices and capitalist modernity would produce ever-greater forms of legal-rational organisation. However, our cases suggest that rather than the dead hand of bureaucratic routine and conformity, the current shift towards financialisation and entrepreneurialism has produced organisational behaviours that are far from legal-rational, rule bound and routine. One of the main problems with the current model of auditing is that it generates conflicts of interest and blurs the boundaries between the private audit firms and the companies they are supposed to audit. As Sikka (2009, 872) puts it:

The auditing firms are capitalist enterprises and are dependent upon companies and their directors for income. The fee dependency impairs claims of independence and has the capacity to silence auditors ... It poses fundamental questions about the private sector model of auditing which expects one set of capitalist entrepreneurs (auditors) to regulate another set of capitalist entrepreneurs (company directors).

Instead of standing at a distance from capitalist operations and holding them to account, post-1990s the Big Four have become deeply integrated into those capitalist operations themselves. With audit becoming more of a commodity, the relationship between accounting firms and their clients has inevitably become more commercialised. The results are institutional capture and a complicit silence (Sikka, 2009). This situation produces a tension between two interacting sets of drivers and incentives. On the one hand, as our examples show, company managers paid in stock options are incentivised to inflate company earnings and create artificial spikes in share prices to boost their personal income. On the other hand, auditors – whose position may depend on selling ever-more lucrative consulting services – are vulnerable to pressure from their clients, who may threaten to end their consulting contracts if financial accounts are not approved. What our study shows is that there are serious flaws in the regulatory system that is supposed to ensure that capitalism abides by the rules of probity and due process. It also highlights a perverse aspect of audit culture itself. The spread of audit has produced a seemingly insatiable demand for ever-tighter scrutiny and control to hold organisations and their employees to account, yet the Big Four appear curiously immune from the accountability mechanisms that audit culture has imposed in other areas of the economy. Like the offshore tax haven or the special purpose zone, the Big Four are relatively free from external oversight and continue to promote the idea that the industry's expertise and highly complex and technical nature require that it regulates itself. If the calculative practices of accountancy are central to modern forms of audit, they also work to transform accountancy firms themselves into calculative entities that straddle the increasingly fine line between criminality and entrepreneurship.

Ethnographies of accounting firms show us how these financialised logics have been institutionalised and the calculative and sometimes perverse behaviours they engender.

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