

**Austin Mitchell**

**Prem Sikka**

**Patricia Arnold**

**Christine Cooper**

**Hugh Willmott**

---

---

**THE BCCI COVER-UP**

---

---

**Association for Accountancy & Business Affairs**

*Shedding light on darker practices*  
*Working for an Open and Democratic Society*

The **Association for Accountancy & Business Affairs** (AABA) is an independent and non-profit making body limited by guarantee (company number 3480632). AABA is funded entirely from donations and subscriptions from individuals concerned to make the world a better place. AABA is devoted to broadening public choices by facilitating critical scrutiny of accountancy and business affairs. AABA will publish monographs and papers to advance alternative analysis and public policy reforms. Its principal objects are:

- (i) to advance the public interest by facilitating critical scrutiny of commercial and non-commercial organisations *inter alia* companies, partnerships, sole traders, public bodies, local authorities, charities, non-profit making organisations and any other form of commercial or non-commercial organisation;
- (ii) to facilitate critical scrutiny of professional bodies, regulatory bodies, employer organisations, employee organisations, government departments and business organisations;
- (iii) to campaign for such reforms as will help to secure greater openness and democracy, protect and further the rights of stakeholders and to make disclosures where necessary;
- (iv) to engage in education and research to further public awareness of the workings, the social, political and the economic role of accountancy and business organisations.

Please support AABA to achieve its aims. All donations and inquiries should be addressed to the **Association for Accountancy & Business Affairs**, P.O. Box 5874, Basildon, Essex SS16 5FR, UK.

# **THE BCCI COVER-UP**

**Austin Mitchell**  
**Member of Parliament for Great Grimsby**

**Prem Sikka**  
**University of Essex**

**Patricia Arnold**  
**University of Wisconsin-Milwaukee**

**Christine Cooper**  
**University of Strathclyde**

**Hugh Willmott**  
**University of Manchester Institute of Science & Technology**

**ISBN 1-902384-05-9**

**First published in 2001**  
**Association for Accountancy & Business Affairs**  
**P.O. Box 5874, Basildon, Essex SS16 5FR, UK.**

**© Association for Accountancy & Business Affairs**  
**All rights reserved.**

**No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying or otherwise, without the prior written consent of the publishers.**

**<http://www.aabaglobal.org>**

**THE BCCI COVER-UP**  
**CONTENTS**

<b>Chapter</b>		<b>Page</b>
	SUMMARY	2
1	APING THE UNWISE MONKEYS	3
2	AUDITORS AND FRAUD	10
3	BRIEF HISTORY OF BCCI	25
4	BCCI's AUDITORS	30
5	SHIELDING THE AUDITING INDUSTRY 36	
6	SUMMARY AND DISCUSSION	48
	BIBLIOGRAPHY	52
	AABA PUBLICATIONS	58

## SUMMARY

Amidst allegations of fraud, the Bank of England belatedly closed down the Bank of Credit & Commerce International (BCCI) in July 1991. It was the biggest banking fraud of the twentieth century. The losses are estimated to be more than \$10 billion. Rather than directly employing a force of government auditors to regulate banks, the Bank of England had regulated BCCI by relying upon audits conducted by 'global' accountancy firms who owed a 'duty of care' neither to the Bank of England nor to any bank depositor.

At the time of its closure, BCCI operated from 73 countries and had some 1.4 million depositors. The extent of losses and the folly of relying upon commercial accountancy firms for 'public interest' work should have led to an immediate independent inquiry into the quality, role, efficiency and effectiveness of the BCCI audits. It did not. Successive governments have failed to order any such inquiry. After the closure of BCCI, the government ordered an independent inquiry into the role of the Bank of England by Lord Justice Bingham. The same inquiry considered any scrutiny of BCCI audits to be beyond its terms of reference. Before the closure of BCCI, the Bank of England commissioned a report (Sandstorm Report) into the massive frauds at BCCI. The report had the potential to enable innocent BCCI depositors to secure some redress from regulators and auditors. Yet successive UK governments have suppressed this report even though most of it is freely available in USA. A US Senate inquiry into BCCI noted that there was a deep relationship between BCCI management and auditors who also acted as advisers and consultants to BCCI management. Yet the UK regulators have failed to mount any investigation into this relationship.

Instead of mounting an open and independent inquiry into the real/alleged audit failures at BCCI, successive governments have continued to indulge the auditing industry. They have passed the buck to accountancy trade associations expecting them to mount an investigation. The accountancy trade associations have no independence from the auditing industry and have a history of sweeping things under their dust-laden carpets. They are financed and controlled by the auditing industry and are in no position to call multinational firms to account. The organised cover-up may appease the auditing industry. Its cost is borne by savers, investors, employees and other stakeholders who lost their savings, homes, investments and jobs.

# CHAPTER 1

## APING THE UNWISE MONKEYS

All over the world there is a concern that governments are captured by the organised business interests. To advance their narrow economic interests, they finance political parties and provide lucrative consultancies for potential and ex-Ministers. They dominate public policymaking arenas and have organised their own accountability off the political agenda. Such issues are highly visible in the world of auditing where auditing firms shun public responsibilities and have organised their own accountability off the political agenda.

In the UK, there are no state guaranteed markets for engineers, scientists, mathematicians, designers, information technology experts, or other wealth generators. In sharp contrast, accountants monopolise the state guaranteed market of external audits. This has not been accompanied by independent regulation, exacting standards of performance, any performance measurement requirements, or a 'duty of care' to the individuals affected by auditors. Unsurprisingly, auditing is an attractive career. It provides job security, steady income and minimal public accountability. The number of qualified accountants in the UK has swelled past the 250,000 mark, the highest number per capita in the world. Yet this huge social investment in economic surveillance has not resulted in any special advantage in corporate accountability or freedom from scandals. On the contrary, scandals in the UK are bigger and are robbing people of their savings, investments, jobs, homes and pensions.

Almost all UK quoted companies are audited by one of the Big-Five accountancy firms. Their income runs into hundreds of millions pounds.

<b>INCOME OF MAJOR ACCOUNTANCY FIRMS (2000)</b>	
<b>FIRM</b>	<b>TOTAL FEES (£ms)</b>
PricewaterhouseCoopers	1,843
KPMG	1,038
Ernst & Young	713
Deloitte & Touche	684
Arthur Andersen	563

**Source:** Accountancy Age, 6 July 2000.

The audit monopoly has provided them with stability of income<sup>1</sup> and a

---

<sup>1</sup> The worldwide income of the Big-Five accountancy firms is \$64 billion. Most

springboard for selling other services ranging from executive recruitment, opinion polls, actuarial services, advise on mergers, tax avoidance, trade union-busting, downsizing, and almost everything else.

Auditors collect huge fees. Yet audit stakeholders have no way of checking the efficiency and standards of audit work. Much of the audit work is falsified by trainees who find the work boring and uninteresting, and are encouraged to cut-corners (Willett and Page, 1996). In an ideal world, one might expect the regulators to bring the auditing industry to book. But we do not live in an ideal world. Instead, the auditing industry is regulated by accountancy trade associations rather than by an independent regulator. There is no independent complaint investigation system and no ombudsman to adjudicate on complaints of poor audit work. Rather than developing policies to advance and protect the interest of stakeholders, the accountancy trade associations have mobilised their financial and political resources to protect auditing firms from lawsuits issued by injured stakeholders (Cousins et al, 1998). The audit regulators are adept at covering up auditor non-compliance with legislation (Dunn and Sikka, 1999) and accountancy firm involvement in money laundering (Mitchell et al, 1998).

In this system of chaps regulating the chaps, no accountancy firm has ever been prosecuted for delivering poor audits. Train companies can lose franchises for shoddy service, but no major firm has ever lost its license for delivering poor audits. People expect governments to investigate audit failures and introduce reforms. Yet successive governments have done the opposite. The final responsibility for regulating the audit industry rests with the Department of Trade and Industry (DTI), which has a history of suppressing critical reports into audit failures and has failed to take any action against audit firms implicated in audit failures (Sikka and Willmott, 1995a, 1995b). The organised cover-up is highly visible in the closure of the Bank of Credit and Commerce International (BCCI), considered to be the “world’s biggest fraud” (Killick, 1998, p. 151).

Only glaring evidence of fraud, persuaded the Bank of England to close down BCCI, audited by Price Waterhouse (now part of PricewaterhouseCoopers), on 5th July 1991. At the time of its closure, BCCI had some 1.4 million depositors. It operated from 73 countries. In the USA, a Senate Committee led by Senators John Kerry and Hank Brown investigated the closure of BCCI. The resulting report, published in December 1992, reached the following conclusions.

BCCI's decision to divide its operations between two auditors, neither of whom are headquartered in offshore havens, such as Bermuda. The firms sponsored candidates for the 2000 US Presidential elections.

had the right to audit all BCCI operations, was a significant mechanism by which BCCI was able to hide its frauds during its early years. For more than a decade, neither of BCCI's auditors objected to this practice.

BCCI provided loans and financial benefits to some of its auditors, whose acceptance of these benefits creates an appearance of impropriety, based on the possibility that such benefits could in theory affect the independent judgment of the auditors involved. These benefits included loans to two Price Waterhouse partnerships in the Caribbean. In addition, there are serious questions concerning the acceptance of payments and possibly housing from BCCI or its affiliates by Price Waterhouse partners in the Grand Caymans, and possible sexual favors provided by BCCI officials to certain persons affiliated with the firm.

Regardless of the BCCI's attempts to hide its frauds from its outside auditors, there were numerous warning bells visible to the auditors from the early years of the bank's activities, and BCCI's auditors could have and should have done more to respond to them.

By the end of 1987, given Price Waterhouse (UK's) knowledge about the inadequacies of BCCI's records, it had ample reason to recognize that there could be no adequate basis for certifying that it had examined BCCI's books and records and that its picture of those records indeed a "true and fair view" of BCCI's financial state of affairs.

The certification by BCCI's auditors that its picture of BCCI's books were "true and fair" from December 31, 1987 forward, had the consequence of assisting BCCI in misleading depositors, regulators, investigators, and other financial institutions as to BCCI's true financial position.

Prior to 1990, Price Waterhouse (UK) knew of gross irregularities in BCCI's handling of loans to CCAH, the holding company of First American Bankshares, was told of violations of U.S. banking laws by BCCI and its borrowers in connection with CCAH/First American, and failed to advise the partners of its U.S. affiliate or any other U.S. regulator.

There is no evidence that Price Waterhouse (UK) has to this day notified Price Waterhouse (US) of the extent of the problems it found at BCCI, or of BCCI's secret ownership of CCAH/First American. Given the lack of information

provided Price Waterhouse (US) by its United Kingdom affiliate, the U.S. firm performed its auditing of BCCI's U.S. branches in a manner that was professional and diligent, albeit unilluminating concerning BCCI's true activities in the United States.

Price Waterhouse's certification of BCCI's books and records in April, 1990 was explicitly conditioned by Price Waterhouse (UK) on the proposition that Abu Dhabi would bail BCCI out of its financial losses, and that the Bank of England, Abu Dhabi and BCCI would work with the auditors to restructure the bank and avoid its collapse. Price Waterhouse would not have made the certification but for the assurances it received from the Bank of England that its continued certification of BCCI's books was appropriate, and indeed, necessary for the bank's survival.

The April 1990 agreement among Price Waterhouse (UK), Abu Dhabi, BCCI, and the Bank of England described above, resulted in Price Waterhouse (UK) certifying the financial picture presented in its audit of BCCI as "true and fair," with a single footnote material to the huge losses still to be dealt with, failed adequately to describe their serious nature. As a consequence, the certification was materially misleading to anyone who relied on it ignorant of the facts then mutually known to BCCI, Abu Dhabi, Price Waterhouse and the Bank of England.

The decision by Abu Dhabi, Price Waterhouse (UK), BCCI and the Bank of England to reorganize BCCI over the duration of 1990 and 1991, rather than advise the public of what they knew, caused substantial injury to innocent depositors and customers of BCCI who continued to do business with an institution which each of the above knew had engaged in fraud. From at least April, 1990 through November, 1990, the Government of Abu Dhabi had knowledge of BCCI's criminality and frauds which it apparently withheld from BCCI's outside auditors, contributing to the delay in the ultimate closure of the bank, and causing further injury to the bank's innocent depositors and customers.

**Source:** United States, Senate Committee on Foreign Relations, 1992b, p. 4-5.

The 1992 US report<sup>2</sup> should have prompted speedy and open hearings and investigations by the UK authorities. It did not. Today ten years after the closure of BCCI, no independent investigation of the work of auditors has taken place.

---

<sup>2</sup> The entire report can be downloaded from a link established at AABA's web site at <http://visar.csustan.edu/aaba/aaba.htm>.

None will. Successive governments have hushed up reports (e.g. Sandstorm Report) that would have enabled innocent bank depositors to secure redress from BCCI's regulators and auditors.

The DTI, unable to reconcile its conflicting roles of the defender, the prosecutor, the judge and the jury of the auditing industry, passed the buck to the Institute of Chartered Accountants in England & Wales (ICAEW), an auditing industry dominated trade association<sup>3</sup> with a history of anti-social activities (Puxty, Sikka and Willmott, 1994). The ICAEW has no capacity to mount independent investigations into the work of giant multinational audit firms. To further confuse the public, the ICAEW passed the buck to one of its side-shoots, the Joint Disciplinary Scheme (JDS), an organisation controlled and financed by the accountancy trade associations. As part of a regulatory ritual, the JDS will eventually publish a half-hearted report. But the writing is on the wall. Audit failures will be individualised. There will be no scrutiny of the values driving the auditing industry. Most likely, some retired or dead audit partner<sup>4</sup> will be blamed. The public relations machine will go into overdrive. The firm will pay a derisory fine<sup>5</sup>. The accountancy trade associations will keep these fines and thus reduce their (and accountancy firm) contribution to the regulatory structures. The victims of BCCI will get nothing – just empty rhetoric.

Why? Because the auditing industry has secured a powerful role in politics. To advance its interests, the industry has an 'inside track' to policymaking apparatuses<sup>6</sup>. It funds professorships, academic conferences and research grants

---

<sup>3</sup> PricewaterhouseCoopers partner Graham Ward is the 2000-2001 President of the ICAEW. A former PwC partner, John Collier, is its chief executive.

<sup>4</sup> For the audit failures in the Maxwell empire, most of the blame was placed on a 'dead' partner of Coopers & Lybrand (Sikka, 1999)

<sup>5</sup> For the Maxwell audit failures Coopers & Lybrand were fined £1.2 million, which amounts to £2, 000 per UK partner. To put this in context, for the period under investigation, Coopers received £25 million in fees from Maxwell. The UK fee income of PricewaterhouseCoopers is estimated to be around £1,843 million and the firm's world-wide income was more than £8 billion (Financial Mail on Sunday, 7 February 2000, p. 6).

<sup>6</sup> For example, Stuart Bell MP was the Labour Party's official spokesperson on accountancy matters. He supported accountancy firms' demands for liability concessions and for Limited Liability Partnership legislation became part of Labour's 1997 election manifesto. After Labour Party's victory, he did not secure ministerial office. Within days, he became a consultant to Ernst & Young. Soon the government found time to introduce the Limited Liability Partnership Act 2000, but no time could be found to reverse the *Caparo*

to dampen enthusiasm for critical research. Major accountancy firms fund political parties, advise government departments<sup>7</sup> and provide jobs for potential and ex-ministers<sup>8</sup>. At times of scandals, the press scrutinises their role, but otherwise it too is bought off by threats to loss of advertising revenues. They populate the UK government and the European Union (EU) think tanks, advise on privatisations, the sale of public assets and the public-private partnership. Indeed, governments have become far too dependent upon accountancy firms, none more so than New Labour. Anxious to curry favour with corporate interests it seeks accountancy firms' approval for tax, finance, social security and other initiatives. In return, accountancy firms enjoy minimal public obligations. As the BCCI case shows, government departments are all too keen to cover-up audit failures and shield audit firms from independent public inquiries.

This monograph draws attention to the cover-up of the BCCI scandal. It shows how successive governments have shielded BCCI auditors. It provides extracts from Price Waterhouse's working papers (as found in the US Senate's Report) to pose further questions about the close relationship between BCCI management and auditors. The monograph is divided into five further chapters. Some issues about the detection and reporting of fraud are central to any appreciation of the BCCI scandal. Therefore, chapter 2 provides some background to show that audits have always been associated with the detection/reporting of fraud. Early auditors willingly accepted such duties. However, as the auditing industry grew in strength, it has sought to abdicate its social responsibilities. This cost of this has been borne by stakeholders who have lost their savings, homes, investments and jobs. Chapter 3 provides a brief history of the operations of BCCI. Chapter 4 looks at the conduct of BCCI audits by 'global' accountancy firms. Chapter 5 shows that successive UK governments and the auditing regulators have been engaged in an organised cover-up to shield BCCI audits from critical public scrutiny. Successive

---

judgement or to curb the excesses of insolvency practitioners (Cousins et al, 2000).

<sup>7</sup> Major accountancy firms have consultancy contracts with most government departments (for example see, Hansard, House of Commons Debates, 17 July 1996, col. 537, 542, 587; 18 July 1996, col. 621, 19 July 1996, col. 656-657, 674-675, 686, 698; 22 July 1996, cols. 30-32, 71-72, 80; 24 July 1996, cols. 501, 596-597; 17 Oct 1996, col. 1116) giving them easy access to policymakers.

<sup>8</sup> In 1999, the then Secretary of State for Trade and Industry, Peter Mandelson resigned in controversial circumstances (Robinson, 2000). Whilst a Minister, he negated Labour's commitment to independent regulation of the auditing industry. He favoured self-regulation for auditors. Within days of his resignation, he became an adviser to Ernst & Young.

governments have suppressed critical reports relating to the closure of BCCI, and have shielded auditors from independent inquiries. Chapter 6 provides a summary and discussion of the arguments and evidence cited in this monograph.

## **CHAPTER 2**

### **AUDITORS AND FRAUD**

At the heart of the BCCI affair are issues about the social obligations of auditors, particularly about detecting and/or reporting irregularities and fraud to regulators. This chapter shows that the auditing industry, led by the accountancy trade associations, exploited people's fears about fraud to secure a state guaranteed monopoly of external auditing. The auditing industry portrayed itself as a bulwark against fraud. But as accountancy firms began to grow and people called the auditing industry to account for its claims and promises, it gradually sought to distance audits from the detection/reporting of fraud. Despite making a huge investment in propaganda, the auditing industry has been unable to either displace the common sensical understanding that auditors should report fraud and other irregularities to regulators, or live up to it

Accountancy trade associations have a long history of opposing reforms<sup>9</sup>, which have sought to make corporations accountable (Puxty, Sikka and Willmott, 1994). Their antisocial conduct is highly visible in relation to auditor obligations for detecting/reporting fraud. They have aligned themselves with wealthy and powerful directors and corporate elites to oppose obligations for auditors to report anything to the regulators. The cost of such a pursuit of 'private' interests has been borne by ordinary people who have lost their savings, investments, homes, pensions and jobs, whilst the auditors never lost the chance to collect their fees.

#### **Early Audits and Fraud Reporting/Detection**

The origins of auditing can be traced back to Greek, Egyptian and earlier civilisations (Worthington, 1895; Brown, 1905; Woolf, 1912). Audits were associated with detection of fraud. The modern relevance of audits began to grow with the emergence of large-scale businesses. Eventually, a large number of company failures and an increase in fraud prompted the appointment of a Select Committee on Joint Stock Companies, chaired by William Gladstone. This prepared the way for the Joint Stock Companies Acts of 1844 which replaced the medieval system of incorporation by charters with a standardised method of incorporation through registration. This included a responsibility to present an audited set of accounts for inspection and comment at an annual meeting of shareholders, a requirement that was intended to minimise unsound companies.

---

<sup>9</sup> For example, the need for companies to publish balance sheets, group accounts, turnover, non-audit fees and have audit committees.

The dominant concern of the Select Committee was to create a legal obligation on the company in such a way as to protect the subscriber in a new venture from the company promoter who was either deliberately fraudulent or upon whom there were insufficient controls. The report comments that fraud perpetrated through the very objects of the promotion of the company (rather than failure through inadvertent mismanagement subsequently) may be allayed by the 'periodical holding of meetings, by the periodical balancing, audit and publication of accounts. .... Periodical accounts, if honestly made and fairly audited cannot fail to excite attention to the real state of the concern; and by means of improved remedies, parties to mismanagement may be made more amenable for acts of fraud and illegality' (p.v).

In the years following the first Companies Act of 1844 there was considerable 'free market' resistance to the preparation and auditing of public accounts. Some argued that it placed illiberal demands and restrictions upon the freedom of individuals whose privacy was violated by the disclosure of information about their business interests. Nonetheless, by the mid-nineteenth century a common conception of the audit as a means of fraud detection had been established. In 1855, the principle of limited liability was introduced for registered companies (though not for banks and insurance companies). This was accompanied in 1856 by the abolition, though not for Parliamentary companies e.g. railway companies, of the accounting and auditing requirements, originally introduced in 1844.

Speculation and fraud were the bogeymen that had prompted the formation and recommendations of the Select Committee and the contents of the 1844 Act. The introduction of limited liability itself indicates the depth of the entrenchment of these tendencies in the free-market capitalist system (Todd, 1932). Of the first 5,000 companies formed during 1856-1865, almost 36% ceased to exist within the first five years. Within the first ten years of their formation, 54% ceased to exist (Shannon, 1932). Of the 6,240 companies registered during 1866-83, only 729 survived by 1929 (Shannon, 1933). During the 1860s, following a prolonged recession, there was a string of highly visible collapses: the West Hartlepool Railway Company in 1863; the Great Eastern Railway Company <sup>10</sup> in 1865; London Chatham and Dover in 1866. In May 1866, Overend Gurney, a reputable bank, collapsed owing some £8.5 million to investors, coinciding with other major failures such as the Joint Stock Discount Company and the Quaker Discount Company resulting in the failure of twenty banks, ten discount houses, three railway contractors and many merchant banks. A & W Collie collapsed in 1875 with debts of £3 million soon to be followed in 1878 by the City of Glasgow

---

<sup>10</sup> Prominent accountants of the day claimed that the speculative nature of "the rail mania of 1845 brought us a very great acquisition of business not only in audits, but also in the winding-up of companies" (Jones, 1981 p.30).

Bank, with liabilities of some £12.4 million <sup>11</sup>.

The 1836 Select Committee on Joint Stock Banks considered the issue of audits for banks but these were not made compulsory. Now the state responded by passing the Companies Act 1879 and external audits became compulsory for all banking companies registered with limited liability. The emphasis is once again on audits as a means of detecting fraud. However, at this time, an organised accountancy profession was in its infancy and its auditors did not necessarily have to be 'independent' of the company or its management. They were frequently selected from among the shareholders. Nevertheless, under the patronage of the state, auditors began to increase in numbers. Forty-three years earlier, In 1836, out of 107 banks, only nine had auditors whilst 14 had power to appoint auditors but chose not to exercise it. After the Companies Act 1879, out of 159 banks 128 appointed auditors. Of these 99 were professional auditors (Cooper, 1886). The Building Societies Act 1874 required the Society's rules to have provisions for an audit but these were not compulsory and professional accountants <sup>12</sup> were not used. Spokespersons for the emerging accountancy trade associations made considerable capital (and of course profits) by associating fraud detection with the assumed skills of accountants and auditors. For example, Cooper (1886) argued that the "connection between this fact and the frequent disclosure of frauds on Building Societies is significant" (p. 646) and that "In cases of fraud and defalcation he [a Chartered Accountant] is called in to trace with more or less no assistance ...." (p. 648).

Due to the policies of the state, accountants, who on occasions acted as auditors, grew steadily in number during the late nineteenth century. Their work on bankruptcy and liquidations enabled them to convince the wealthy elite and the state that they were useful in protecting and legitimising the interests of finance capital. This encouraged them to petition for Royal Charters <sup>13</sup> in 1854-5 and

---

<sup>11</sup> To stave off insolvency, the bank issued false balance sheets. Anxious to reassure the depositors, other banks made public statements about their financial propriety (Collins, 1989). But this did not stave off a chain reaction since other banks, such as Caledonian, had accepted the City of Glasgow shares as loan collateral which proved to be worthless.

<sup>12</sup> Jones (1981) remarks that 'A further pressing reason for the need to employ professional accountants as auditors was the prevalence of fraud. The popular image of Victorians as righteous and reliable, if rather dull and phlegmatic, is upset by a study of the welter of nineteenth-century frauds and failures ... Fraud was a disease endemic in the Victorian economy, and public accountants were the physicians employed to drive it out' (pages 55-6).

<sup>13</sup> The 1854 petition for a charter for the Edinburgh Society made no mention of audit as one of the accountant's functions.

1867 (Edinburgh, Glasgow and Aberdeen) and 1880 (England and Wales).

Although the audit requirement of the 1844 act was repealed in 1856, demand for audited accounts was maintained by anxious shareholders fearful of fraud. External audits were also required by statute for some of the specialist businesses (railways, banks) before it became a general requirement in 1900. The real boon for auditors was the large increase in limited liability companies which rose from the 1864 figure of 891 to 14,445 in 1880 (Cooper, 1921). The emerging auditing industry promoted itself by disseminating the 'common sense' meanings of audits. As Brown (1905), writing on the 50th anniversary of the Scottish Institute, noted,

"In this advance, however, we cannot point to any striking revolution. The development has not been characterised by any startling discoveries of new principles or the introduction of entirely novel methods, but rather by the steady working out, with modifications suited to changing conditions, of those principles and methods which were already well understood and practised ....."

**Source:** Brown, 1905, p. 315.

At a time when professional accountants were not a major organised occupational group, they tended to associate audits with fraud detection/reporting. In an environment of increase in the number of limited liability companies and some well-reported frauds, Cooper (1886) argued

"It is hardly conceivable that such a state of things as was disclosed in the disastrous failures ..... could have arisen or been continued if the certificate of a qualified auditor had been required ..... In contrast with these misfortunes we may place with some satisfaction the discovery by the auditor, an eminent chartered accountant, of the extensive embezzlement of securities ..... in time to prevent the defalcations reaching a sum beyond the Bank's means"

**Source:** Cooper, 1886, p. 649.

The involvement of accountants in auditing encouraged publication of auditing textbooks. In one of the earliest books, Lawrence Dicksee, described as "the most influential nineteenth century accountant" (Brief, 1975, p. 287), argued that

"The detection of fraud is a most important portion of the Auditor's duties, and there will be no disputing the contention that the Auditor who is able to detect fraud is -other things being equal- a better man than the auditor who cannot.

Auditors should, therefore, assiduously cultivate this branch of their functions  
....."

**Source:** Dicksee, 1892, p. 6.

Another text-book author described audits as a "wise precaution against fraud and embezzlement" (Worthington, 1895, p. 62). Indeed, Lee (1986, p. 23) argues that "during the first twenty years or so following the Companies Act 1900, fraud and error detection continued to be the dominating feature of company audits". Whilst it is probable that many laypersons, like today, saw fraud detection/prevention as the significant audit function, some 'significant parties' were less sanguine that it could be achieved by the extant audit technologies. Consider, for example, an early example of scepticism concerning the potency of the audit as a means of preventing or disclosing fraud. In a testimony to the Select Committee on the Companies Acts 1862 and 1867, the Master of the Rolls, Sir George Jessel, opined that:

... the notion that any form of account will prevent fraud is quite delusive. Anybody who has had any experience of these things knows that a rogue will put false figures into an account, or cook it, as the phrase is, whatever form of account you prescribe. If anybody imagines that will protect the shareholders, it is simply a delusion in my opinion ... I have had the auditors examined before me, and I have said, "You audited these accounts?" "Yes" "Did you call for any vouchers?" "No, we did not; we were told it was all right, and we supposed it was, and we signed it.

**Source:** Edwards, 1986, p. 17.

The above testimony called into question the whole basis of external audits. It drew attention to the fact that auditors rely upon standardised routines and reliance upon management representations. It should have prompted a rethink on the ability of the emerging auditing industry to detect/report fraud. But it did not.

As long as companies had been limited in size and auditors used limited technologies, it was still conceivable that the auditor could check such a high proportion of vouchers, and undertake sufficient investigations, as to be satisfied that there had been no fraudulent activity of any significance. But the increasing concentration of industry into large units and auditor reliance upon management representations, particularly at a time when the audit was not always required under law, posed challenges to the traditional approaches to audits. Alternative

technologies could have been developed to check director probity, but the period is not notable for any advances in auditing technologies. In this environment, auditors began to argue that they should not be held responsible when frauds or defalcations escaped detection. In *re London and General Bank (No. 2) (1895) 2 Ch. 673*, Lord Justice Lindley argued that the duty of an auditor is to

"ascertain and state the true financial position of the company at the time of the audit and his duty is confined to that. But then comes the question, How is he to ascertain that position? The answer is, by examining the books of the company. But he does not discharge his duty by doing this without an inquiry and without taking the trouble to see that the books themselves show the company's true position. .... An auditor, however, is not bound to do more than exercise reasonable care and skill in making inquiries and investigations. .... Where there is nothing to excite suspicion very little enquiry will be reasonably sufficient, and in practice I believe business men select a few cases at haphazard, see that they are right, and assume that others like them are correct also".

The judgement also stated that an auditor

"is not an insurer; he does not guarantee that the books do correctly show the true position of the company's affairs; he does not even guarantee that his Balance-sheet is accurate according to the books of the company. If he did, he would be responsible for error on his part, ever if he were himself deceived without any want of reasonable care on his part, say, by the fraudulent concealment of a book from him. His obligation is not so onerous as this".

Similarly, in *re Kingston Cotton Mill Company (No. 2) (1896) 2 Ch. 279*, Lord Justice Lopes added that

"Auditors must not be made liable for not tracking out ingenious and carefully laid schemes of fraud where there is nothing to arouse their suspicion, and when these frauds are perpetrated by tried servants of the company and are undetected for years by directors."

Thus, by the turn of the century, fraud detection/reporting was considered to be a major purpose of company audits though in view of the contemporary economic developments, 'significant others' were suggesting that in the light of the extant audit practices it was unreasonable to expect the auditor to find all fraudulent transactions.

Despite the above tensions, judges in the early twentieth century court cases, advised auditors to adopt procedures which would facilitate detection of frauds and irregularities. To ascertain the existence of irregularities, the auditors were advised to verify correctness of cash balances in *Fox & Son v Morrish Grant & Co (1918) 35 T.L.R. 126*; pay attention to cut-off procedures and post balance sheet events in *Irish Woollen Co. Ltd v Tyson and Others (1900) 26 Acct. L.R. 13*; make use of third party circularisations in *re Thomas Gerrard and Son Ltd (1968) Ch. 455*; *(1967) 2 All E.R. 525*; *Armitage v Brewer and Knott (1932) 77 Acct. L.R. 28* expected auditors to detect fraud by noting altered entries in the petty cash book. In his judgement in *Fomento Limited v Selsdon fountain Pen Company Limited and Others (1958) All E.R. 11*, Lord Denning said that

"The auditor's vital task is to take care to see that errors are not made, be they errors of computation, or errors of omission or commission, or downright untruths. To perform this task properly he must come to it with an inquiring mind - not suspicious of dishonesty, I agree - but suspecting someone may have made a mistake somewhere and that a check must be made to ensure that there has been none".

Yet, during the same period, the growing auditing industry decided to marginalise and obfuscate the association between audits and fraud detection/reporting (ICAEW, 1961; Lee, 1982, 1986). From the 1940s onwards, the accountancy trade associations unilaterally downgraded fraud detection as an audit objective (Lee, 1986; Lee and Parker, 1979) even though this was not specifically sanctioned by legislation (e.g. Companies Act 1948, 1967, 1976, 1981, 1985). The professional examinations and professional pronouncements (ICAEW, 1961) were used as a tool for inculcating generations of students into believing that fraud detection/reporting was not a major audit objective. This pursuit of self-interest at the expense of wider social interest was not necessarily accepted by investors (Beck, 1973), auditees and even accountants (Lee, 1970). For example, Waldron (1969), a leading accountant, argued that "an ordinary audit always aims at the discovery of fraud ....." (page 386). The difficulty for those who sought to marginalise or even exclude fraud detection as an audit objective was that, it did not match or confirm the expectations of many users of financial statements. Moreover, auditors' claims to pay attention to matters such as internal control, inventory counts, cash counts, bank balances, creditors, debtors and many other items, operates to confirm the common-sense understanding that auditors must necessarily be looking for fraud and irregularities.

## **Late Twentieth Century Developments**

The abdication of auditor responsibilities for detection and reporting of fraud was strongly highlighted during the mid-1970s property and secondary banking crisis. The cost of this pursuit of self-interest was borne by the British taxpayer. The government had to spend some £3,000 million to rescue the ailing property and banking sectors (Reid, 1982). A large number of DTI inspectors' reports associated audits with fraud detection and reporting and were highly critical of major audit firms (Sikka and Willmott, 1995a). Yet, despite the frequency and embarrassment of revelations relating to fraudulent corporate activities, the government made no attempt to either challenge the auditing industry's narrow self-interest or to impose any explicit statutory duty/right upon auditors to detect and report fraud/irregularities to any regulatory body.

The question of fraud and auditor obligations became more critical in the early 1980s, following the election of the Conservative Party under the leadership of Margaret Thatcher. The government was keen to fight off competition from Tokyo, Zurich, New York and the European Union countries, and to promote London as an international financial centre. To restore London's tarnished position, it wanted to show that there were adequate measures for detection and reporting of fraud. Government resolve was tested by revelations of major reinsurance frauds at Lloyd's of London (Hodgson, 1986; Davison, 1987), a major insurance underwriter. This threatened the position of London in an increasing competitive market and led to government sponsored investigations (DTI, 1990a; 1990b). In the Lloyd's Act 1982, self-regulation survived within a statutory framework, but it was not accompanied by any obligation upon auditors to specifically detect/report fraud.

An early indication of the government's intentions was revealed by the introduction of the Local Government Finance Act 1982 which required local authority auditors to report specifically on matters relating to fraud and the legality of operations. This move was welcomed by the auditing industry as the local authority sector was previously closed to them. In the rush to earn additional fees and possibilities of selling consultancy to local authorities, neither auditing firms nor accountancy trade associations voiced their opposition to any association between audits and detection/reporting of fraud.

Following the recommendations from Professor Gower (Gower, 1984), the UK government moved simultaneously on three fronts; banking, building societies and insurance and pensions companies. In each case, auditors were to be in the

front line of the public defence against fraud (The Accountant, 19th June 1985, page 3). The Ministers wanted "to make the profession think again about its role in fraud detection and investigation" (Accountancy, December 1984, page 9). But the auditing industry and accountancy trade associations were not keen to prioritise the public interest over their narrow self-interest. The government proposals were opposed tooth-and-nail by the accountancy trade associations and the auditing industry.

## **Banking Regulation**

Following the mid-1970s secondary banking crisis, the Thatcher Government introduced the Banking Act 1979. The Bank of England now acted as the supervisory authority for all deposit-taking banks (Metcalf, 1986). However, rather than taking on direct powers to examine the books and affairs of banks, the regulators chose to rely upon the audit reports addressed to shareholders. In some banking countries (most notably Switzerland), banking legislation required auditors to communicate knowledge of irregularities to relevant banking supervisors (Hall, 1987), but this requirement was not explicitly introduced in the UK. The auditing industry resisted such duties by referring to the age-old duty of confidentiality (or priority of 'private' interest over 'public' interest) owed to their clients. In the final event, there was no formal relationship between banking supervisors and auditors though it was expected that some informal relationships would suffice. The Johnson Matthey affair soon highlighted the inadequacy of the regulatory arrangements.

Johnson Matthey Bankers (JMB), a subsidiary of Johnson Matthey was one of the five London gold bullion dealing banks. At twice weekly meetings, these banks fixed the gold price for the world market. In October 1984, JMB ran into difficulties (Clarke, 1986; Reid, 1988). Its problems appeared to lie in its spectacular growth. Between 1980 and 1984, its loans grew from £34 million to £450 million. In the wake of declining rates of profitability of British industry (according to British Business, September 1988, page 32, the rate of return before interest and tax for British manufacturing companies declined from 14.8% in 1960 to 2.3% in 1981), JMB turned attention to developing countries and lent heavily to businesses in Nigeria and the Indian sub-continent. Prior to its demise, JMB had been experiencing difficulty in collecting loans from two groups of companies in Pakistan. Each of these loans amounted to more than 10% of its capital and further advances continued. By June 1983, the loans accounted for 26% and 17% of the capital. By December 1983, the loans represented 51% and 25% of its capital and by June 1984, the figures reached 76% and 39%

respectively. The loans were not secured. Up to half of the JMB's portfolio consisted of doubtful debts and losses were estimated to be in the region of £250 million. Under the Banking Act 1979, loans exceeding 10% of the issued capital were supposed to be notified to the supervisory authorities, but this had not been done. The published accounts gave no indication of the financial problems and the audit reports made no mention of such matters either. The bank was over-gearred and under-capitalised but received unqualified audit opinions from auditors Arthur Young (now part of Ernst & Young).

There was concern that the crisis could spread to other banks, especially as JMB had £1.94bn of deposits and £4.6bn of forward contracts in foreign exchange, all of which would have gone into default. The Bank of England rescued JMB and in July 1985, the fraud squad was called in to investigate the bank's affairs. The collapse of JMB posed questions about the regulation of banks through reliance upon auditors who were neither appointed by the regulators nor the depositors. The government indicated its unhappiness with the role of the auditors (Hansard, 20th June 1985, cols. 454-465) and new legislation was introduced.

The Banking Act 1987 streamlined the supervision of banks giving further powers for the Bank of England. Provision of false or misleading information to the supervisors (i.e. the Bank of England), or withholding relevant information was now to be a criminal offence. Banks were to be required to inform the supervisors of any large exposures to single or connected borrowers. Yet the Bank of England did not get any statutory powers to enable it to examine any bank's books and records. The government wanted to impose upon auditors a 'duty' to report fraud (actual or suspected) to the Bank of England. This covered not only matters relating to the affairs of the client bank but also any other company within the same group, of which the auditor had some awareness. The reports could be made without the knowledge of the client organisation. Such policies challenged the way the auditing industry had been distancing itself from fraud reporting/detection objectives.

## **Building Societies**

In the UK, Building Societies are an important part of the financial markets. For generations they have operated as 'mutuals' in British towns and villages to enable people to make deposit of small amounts of their savings and borrow monies to finance purchase of houses. But, their audits were regarded "within the profession as being relatively undemanding and ..... largely routine" (Registry of Friendly Societies, 1979, page 167). However, a number of well-publicised

frauds, usually by senior management, drew attention to the regulatory problems (Boleat, 1982). One of the most celebrated related to the Grays Building Society. Its chairman had been perpetrating frauds totalling some £7.1 million for some 40 years. The society had inadequate accounting records and ineffective internal controls. Fraud was rife, but the auditors failed to spot any problems (Registry of Friendly Societies, 1979) and the regulators had no awareness of the problems. With 7,000 investors and 2,000 borrowers, the fraud attracted considerable press attention. Further discoveries of frauds at the Glamorgan Building Society, Kingston Building Society and New Cross highlighted the ineffectiveness of regulation. In response, the government introduced new legislation.

The Building Societies Act 1986 introduced a considerable number of accounting and auditing requirements. Unlike the Companies Act requirements, the legislation required auditors to report directly to the regulators on the systems of control on the Society's business, adequacy of accounting records, systems of inspection and report on the system of safe custody of documents. The intention was to require auditors to report matters relating to fraud, malpractices and investor protection and the Society's business to the newly proposed Building Societies Commission even without client knowledge. The traditional arguments about duty of confidentiality were to be swept away. Under pressure, the government eventually compromised and the Act permitted (rather than required) auditors to communicate certain information about the Society's business to the regulators with or without the Society's knowledge. Such matters were left to the auditor's discretion. In answering any questions from the regulators, the auditors could no longer cite a duty of confidentiality to the Society.

### **Financial Services Companies**

The professed aim of the Financial Services legislation was to protect what one commentator called "old ladies from Tunbridge Wells" (Accountancy, July 1986, page 6). The legislation applied to thousands of businesses offering financial services. Yet it excluded Lloyd's of London (a major insurance underwriter). The main thrust of the 1986 Act was the "protection for clients' assets, whether money or documents of title" (DTI 1985a, page 19). The key safeguard for investors and other users of financial services against fraud and malpractice was to be the application of a 'fit and proper' test applicable to anyone selling financial services. Those carrying on the investment business had to be specifically authorised by the regulatory agencies and only 'fit and proper' persons could be authorised. All authorised investment businesses regardless of their legal status (e.g. company, partnerships, sole traders) had to have an auditor and agree to submit to

monitoring by a designated regulator. The government rejected the idea of setting up an independent statutory body to regulate the financial services industry. Instead, a variety of self-regulatory organisations (eventually 24) were to be permitted to authorise and monitor the work of their member organisations. However, this still posed questions about who was going to be in the front line for investor defence against malpractices and how the supervisors were going to get the necessary information. The auditors were singled out for this role (DTI, 1985b) especially as similar roles were already being planned for them under the Building Society and Banking legislation.

Surveys (Accountancy Age, 12th December 1985, p. 3) suggested that the public expected company auditors to take primary responsibility for detecting fraud. The government acknowledged that primary responsibility for fraud prevention lay with the management. It also argued that in reporting fraud "the auditor has an important supporting role to play" (DTI, 1985b, para 3.1). They were expected to furnish the supervisors with necessary information. It was envisaged that contact between auditor and supervisors would normally be at the supervisor's initiative. For some matters, the auditor might raise issues with the client and suggest that supervisors be informed, but if the client refused then the auditor was expected to do so. In deciding whether to contact the supervisors, the auditor had to consider "whether for the supervisor *not* (emphasis in the original) to be aware of his concerns, or the information which has come to his attention, could be detrimental to the interests of investors" (DTI, 1985b, para 5.3). The DTI argued that the auditor should consider contacting the supervisors where "the auditor had reason to believe that fraud had been or was about to be committed by the directors of the authorised business and might put the interests of investors at risk" (DTI, 1985b, para 5.4).

The government proposed that the auditor should be able to contact the supervisors, even without the knowledge of the client. To give muscle to auditors, it promised to enact legal provisions to enable auditors to override their traditional concern with business confidentiality.

### **The Auditing Industry's Response**

For the accountancy firms, the government's policies were double edged. The emerging investor protection legislation offered opportunities for additional work in a stagnant auditing market and possible opportunities for selling consultancy services. The acceptance of an obligation to report/detect fraud could also enhance the social status of the auditing industry. It was appreciated that the

"public wanted protection against fraud" (The Accountant's Magazine, February 1987, p. 19) and the government to some extent was attempting to enact policies to reassure the public. Some urged the auditing industry to accept a duty to report fraud as it was a way of showing "that the profession acts in the public interest" (The Accountant, 10th July 1986, p. 6). But the accountancy trade associations consider themselves to be primarily "responsible for protecting and promoting the interests of [their] members" (Certified Accountant, September 1991, p. 12), and inevitably opposed any requirement for auditors to detect/report fraud to the regulators.

A survey sponsored by the auditing industry claimed that there was "little support for the suggestion that the auditor should accept a general responsibility to detect fraud and other irregularities" (Allan and Fforde, 1986, p. 5). A survey by the Chartered Association of Certified Accountants<sup>14</sup> (CACA) showed that business organisations wanted the auditors to have a legal duty to detect fraud (CACA, 1986a), but at no additional financial cost. The ACCA opposed government proposals, arguing that they would "open the way for unnecessarily detailed intervention by the Government" in the affairs of the auditing industry (Certified Accountant, May 1984, p. 18). It further claimed that "The responsibilities now being attributed to auditors have already become too great for them to sustain ..... Any further increase in auditors' responsibilities will only exacerbate the situation ....." (Certified Accountant, February 1986, p. 19). It described the proposed relationship between auditors and supervisory authorities as unsatisfactory and the proposals on fraud detection/reporting as misguided<sup>15</sup>. The Institute of Chartered Accountants of Scotland (ICAS) claimed that extending the auditor's role in detecting fraud or irregularity would be impracticable and inefficient (The Accountant, 17th July 1985, p. 4). The ICAEW decided to scupper government policies by demanding liability concessions for auditors. Its in-house magazine Accountancy (March 1986, p. 3) noted that the government's desire "to see accountants take on increased responsibilities for reporting fraud and the financial services sector, will provide them [accountants] with a lever for change" (p. 3). The ICAEW President argued that "It is no coincidence that we are linking our two submissions on liability and fraud" (Accountancy Age, 13th February 1986, p. 17).

In December 1984, the ICAEW set up a working party under the chairmanship of

---

<sup>14</sup> Now known as the Association of Chartered Certified Accountants (ACCA).

<sup>15</sup> When the government threatened to abolish small company audits, the ACCA (majority of the practising members of the Association are sole practitioners, dealing with small companies) argued that "The statutory audit has always seemed to the association to be an important weapon against fraud ..... and provide a continuing protection against fraud" (Sansom, 1986).

Ian Hay Davison to consider the auditor role on fraud detection and reporting. The report (ICAEW, 1985a) emphasised management's responsibility for preventing fraud and argued that auditors should only have a statutory responsibility (and receive higher fees) to report on the adequacy of internal controls. It rejected any statutory duty for the auditor not only to detect but also to report fraud to any regulator. The ICAEW sent the report with a covering letter by its President to the Minister for Corporate and Consumer Affairs on 2nd October 1985, arguing that "it would be wrong to legislate to require auditors to report such suspicions [fraud] to the authorities".

To legitimise their partisan policies, accountancy trade associations also wheeled out other grandees. The ICAEW set up a working party, under the chairmanship of Lord Benson (former ICAEW President and a Treasury adviser), to examine the auditor's role on reporting fraud. The Benson Report (ICAEW, 1985b) was rushed out to "pre-empt a consultative paper .... by the Department of Trade and Industry" (Account, 5th December 1985, p. 1). It opposed any obligation upon the auditors to report matters to the regulatory authorities. In the prevailing environment, the conclusions of Benson were described as "unrealistic and unsustainable" by the ICAEW's parliamentary adviser (Smith, 1985).

Rather than standing up to the auditing industry and its anti-social policies, the government caved in. The Building Societies Act 1986, Financial Services Act 1986 and the Banking Act 1987 did not impose a 'duty' to detect fraud upon auditors. The legislation did not impose a 'duty' to report fraud and irregularities to the regulators either. Instead, the Acts gave the auditors a 'right' to report matters to the regulators without the client's knowledge, if necessary. In return, the auditors secured some immunities from litigation provided that the matters were reported to the regulators in good faith. This compromise appeased the auditing industry, but failed to do anything to protect the interests of the wider public. The cost was borne by investors, depositors and pension scheme members at Maxwell, Levitt, Polly Peck, Dunsdale, Wallace Smith, Garston and BCCI who lost their homes, jobs, savings, and investments.

## **SUMMARY AND DISCUSSION**

Fraud detection and reporting have historically been identified as a major function of the external audit. Early auditors played on people's fear of fraud to secure markets and niches for themselves. But as the auditing industry grew in status and influence, it sought to distance itself from its duty to detect/report fraud. Despite its huge investment in political lobbying and propaganda, the auditing industry

has been unable to expunge the association of audits with fraud detection/reporting. 'Significant others' - regulators, politicians and financial journalists - have continued to resist the meanings promoted by the auditing industry, as evidenced by a plethora of books, surveys, court cases and DTI reports. However, it was not until the 1980s that legislation sought to make explicit reference to fraud reporting/detection as an audit objective.

In the 1980s, the state became particularly concerned with issues of 'law and order', 'white collar crime' and investor protection. Well publicised affairs, such as Guinness, De Lorean, Grays, Glamorgan, New Cross, Johnson Matthey and others made press headlines. Such episodes threatened the centrality of London as an international financial centre and confidence in the ability of the state to protect investors. In view of possible competition from other financial centres, the state pressed forward with legislation designed to promote London as a clean and desirable place to trade. To attract money, it took statutory measures to combat fraud and introduced legislation for investor protection. The spotlight fell on auditors.

By asking auditors to accept responsibilities for reporting fraud, the government supported the meaning of audit privileged by the wider public. Yet in the ensuing debate, it gave-in to the auditing industry's lobbying and did not impose a 'duty' upon auditors requiring them to detect/report fraud and irregularities to the regulators. It only gave auditors a 'right' to report fraud and irregularities to the regulators, even without client knowledge. The folly of such a policy was soon to be highlighted by the BCCI scandal.

## **CHAPTER 3**

### **BRIEF HISTORY OF BCCI**

BCCI began as a small-scale family owned operation in pre-independence British India. After independence and partition of the Indian sub-continent in 1947, it moved to Pakistan (US Senate, 1992b, p.23). In 1958, BCCI's founder, Agha Hasan Abedi, formed a new bank known as United Bank which was licensed by the Pakistani government. Within 10 years, and with considerable political patronage, United Bank became the second largest bank in Pakistan and its operations expanded in other countries, including the Middle East. In the early 1970s, just as United Bank was poised to become the largest bank in Pakistan, the political climate became far more turbulent. To promote its economic policies, the incoming government was keen to maintain control over financial institutions and decided to nationalise all banks. Abedi's efforts to move the bank outside Pakistan were viewed with suspicion and he was placed under house arrest.

During his house arrest, Abedi developed schemes for making the bank international and locating it outside Pakistan. The international bank he envisaged would bridge the gap between economically developed and developing nations and compete with Western banks, not only in financial services, but also in areas as diverse as shipping, insurance, commodities, real estate and even charitable works. To realise his international ambitions, Abedi needed financial support. Towards this end, he cultivated a relationship with the Sheikh Zayed bin Sultan al Nahyan, the ruler of the oil-rich state of Abu Dhabi. This relationship with the Sheikh became "the foundation of the establishment of the bank without which BCCI never would have come into existence" ( US Senate, 1992b, p. 30). Indeed, at times as much as 50% of BCCI assets came from Abu Dhabi and the family of the Sheikh.

To secure business in the Western world, BCCI needed acceptability and special links with Western financial institutions. This was facilitated by the Bank of America<sup>16</sup>, which hoped to use Abedi's connections to expand its activities in the Middle East. The Bank of America became a 25% shareholder (\$625,000 out of \$2.5 million start-up costs) and, in September 1972, BCCI was launched (Bingham, 1992, chapter 2). On the strength of its Bank of America connections, BCCI was allowed to operate from its six offices in London<sup>17</sup>,

---

<sup>16</sup> Abedi's first choice was American Express, but the company wanted much more say in BCCI's management.

<sup>17</sup> It had a considerable clientele of Asians expelled from East Africa by the Ugandan dictator Idi Amin.

Luxembourg, Lebanon, Dubai, Sharjah, and Abu Dhabi (Bingham, 1992, chapter 2).

To continue with expansion and avoid regulatory supervision, Abedi decided to incorporate in Luxembourg, a place known in financial circles as a “loosely-regulated banking centre” (Financial Times, 1991, p. 10). Initially, BCCI was incorporated solely in Luxembourg, but soon a holding company, BCCI Holdings, was created and the bank was split into two parts -- *BCCI SA* with head offices in Luxembourg, and *BCCI Overseas* with head offices in the Grand Cayman Islands<sup>18</sup>. The Luxembourg office handled European and Middle East operations while the Grand Cayman office dealt with developing countries. This organisational split was also accompanied by a series of parallel entities which meant that relatively few people were in a position to take an overall strategic view of BCCI as a whole (US Senate, 1992b, p. 38)

BCCI’s expansion was rapid. In 1973, it operated from 19 branches in five countries and in 1976 it moved its head office to London although it remained incorporated in Luxembourg. By 1977, BCCI became the world’s fastest growing bank, operating from 146 branches (including 45 in the United Kingdom) in 43 countries. Its balance sheet assets, for the same period, increased from \$200 million to \$2.2 billion. In the late 1970s, BCCI expanded into Africa, the Far East and the Americas. By the mid-1980s, it was operating from 73 countries with balance sheet assets of around \$22 billion.

Establishing operations in the United States was crucial to the expansion and development of BCCI since all its activities were in US Dollars. The absence of a base in the United States forced BCCI to rely upon the Bank of America as its correspondent bank, but this relationship began to sour as BCCI officials were not always forthcoming with information requested by the Bank of America. In the mid-1970s, the US authorities<sup>19</sup> rebuffed BCCI’s attempt to buy the Chelsea National Bank and set up operations in New York (Bingham, 1992, Ch. 2). A major cause of concern was the absence of a primary designated regulator and lender of last resort to supervise BCCI’s consolidated banking operations. Undeterred by the resistance of New York regulators, Abedi enlisted the help of senior political figures and in the late 1970s acquired four major banks,

---

<sup>18</sup> Bank secrecy is promised in Grand Cayman where there are more companies registered on the islands than there are people, with one bank for every 31 residents (*Financial Times*, 1991, p. 14).

<sup>19</sup> Responsibility for banking regulation in the United States is shared by several agencies including the Office of the Controller of the Currency (OCC), the Federal Reserve, and banking authorities in each of the fifty states. BCCI initial attempt to enter the United States was blocked by state regulators in New York.

including the National Bank of Georgia and Financial General Bankshares/First American, operating from seven states and Washington DC. (US Senate, 1992b, Chapter 6). Following these initial acquisitions, BCCI set in motion plans to expand throughout major US markets and build First American into one of the 20 largest American banks. In violation of US laws, the US acquisitions were made in the names of secret nominees in order to conceal BCCI's involvement and circumvent requirements to file financial information and to have a recognised regulator. US regulators suspected BCCI involvement in the bank purchases. In at least two cases, state banking regulators blocked proposed purchases. The purchases of Financial General Bankshares/First American was eventually approved by the Federal Reserve (Kapstein, 1994, US Senate, 1992b, Ch. 6).

The Bank of England welcomed BCCI's presence in the United Kingdom even though it was concerned about the absence of a single international regulator and lender of last resort. BCCI did little banking business in Luxembourg and the Luxembourg Banking Commission felt that "it was impossible to supervise BCCI SA effectively from Luxembourg" (Bingham, 1992, pp. 32-33). The Luxembourg Banking Commission recommended removal of the whole group, including the holding company to the UK. The Bank of America was also far from happy with its relationship with BCCI and eventually sold its stake in 1980 although it remained BCCI's US clearing bank. As early as 1978, an audit by US bank regulators in the Office of the Controller of the Currency (OCC) determined that Bank of America's investment in BCCI was sufficiently risky as to require classification as a questionable asset (US Senate, 1992b, p. 45 and p.283). Despite these warnings and the misgivings of US regulators, the Bank of England did not object to BCCI's UK operations.

To manage the \$10 billion pool of cash in its international network, BCCI decided to centralise its treasury operations in 1982. However, the Banks excursions into the money markets were spectacularly unsuccessful and its officials resorted to manipulations to cover trading losses. One of their techniques was to sell large quantities of 'options' to purchase currency or securities at a set price at a later date. The proceeds of these sales were shown in the books as profits. As liabilities materialised, BCCI was forced to sell even more contracts to keep the cash flow and profits running. The value of its outstanding contracts in 1985 was estimated to be \$11 billion compared to the \$3 billion of a leading specialist London merchant bank. As BCCI's internal operations were split, it was also possible for executives to move the accounts around and cover-up their losses. The huge volume of trading generated by

BCCI's dealing room sent signals to other banks, but instead of reporting the unusual activity to the authorities, they took advantage of the situation and made profits at BCCI's expense<sup>20</sup>. Information eventually reached the Luxembourg regulator and it asked BCCI, who then asked one of its auditors, to conduct a review of its Treasury operations. As a result of the review neither Luxembourg nor the Bank of England was anxious to have the BCCI treasury within their direct jurisdiction and it was allowed to relocate to Abu Dhabi in late 1986.

In 1987, concerned by BCCI's extensive treasury losses, the whispers of irregularities, and the inability to find a single regulator willing to act as lender of last resort, the Basle Committee established a "College of Regulators"<sup>21</sup> to scrutinise BCCI's operations (Bingham, 1992, pp. 52-53). The College, however, proved ineffective as members were often preoccupied with the pursuit of their respective national interests. The College and the Bank of England took no action when US authorities indicted BCCI and its officers on charges of fraud, money laundering and falsifying bank records in October 1988. In January 1990, BCCI pled guilty to the money laundering charges following an elaborate sting operation conducted by US customs officials. (US Senate, 1992b, p. 61). In the wake of the money laundering scandal, the Bank of England learnt that 72 major banks had suspended credit lines to BCCI, threatening the bank's liquidity. Yet it still refrained from taking any decisive action. Although BCCI was headquartered in London, UK regulators undertook fairly limited supervision even though the Bank of England became aware of

---

<sup>20</sup> In the Sandstorm investigation, Price Waterhouse (UK) uncovered "circumstantial evidence" that BCCI's "brokers did not always trade with Treasury at arms length, and may have facilitated [name deleted] in manipulating profits." (US Senate, 1992a, p. 118; Sandstorm Report, 1991, p. 21).

<sup>21</sup> The formation of the International College of Regulators was permitted by the Basle Concordat, primarily for regulating banks which might otherwise escape effective regulation. Under the principles established by the Basle Committee, of which the UK and Luxembourg were members, the Institut Monetaire Luxembourgeois (IML) was established to regulate BCCI. In 1987, the College of Regulators was formed. Its first meeting in June 1988 was also attended by Spain and Switzerland (BCCI had minor operation in these countries). In July 1989, the UAE declined but Hong Kong (then a British colony) and the Cayman Islands became members. The College's meeting in April 1991 was also attended by supervisory bodies from the UAE and France. Its meeting on 2nd July 1991 was also attended by US observers. India, Pakistan, Bangladesh and countries from Africa, where BCCI had much larger operations, were neither part of the College nor invited to attend any of its meetings (Bingham, 1992).

BCCI involvement in drug money laundering<sup>22</sup> and financing of terrorism during 1988 and 1989 (US Senate, 1992b, p. 8).

Numerous theories have been put forth to explain BCCI's unregulated growth, ranging from claims that the Bank of England was reluctant to close BCCI because of possible diplomatic repercussion in the Middle East, to speculations that BCCI was untouched because of its ties to ongoing intelligence activities (Kapstein, 1994, p. 158-159). By the early 1980s, the US Central Intelligence Agency (CIA) was making intensive use of BCCI's facilities for covert operations to support Afghan guerrillas in their war against the Soviet Union (US Senate, 1992b). BCCI was also used to finance illegal US arms sales to Iran in what became known as the Iran Contra affair. (US Senate, 1992a, p. 356-357). Irrespective of the reasons for BCCI's unchecked expansion, its growth as an international bank with no lender of last resort worried regulators and made it vital for BCCI to show strong financial results. Price Waterhouse, BCCI auditors, acknowledged that "given the bank's vulnerability as a result of the absence of a lender of last resort, and its relationship with the rest of the banking community, (BCCI officials) believed that profitability was essential and it could not show a weak balance sheet or poor operating results" (US Senate, 1992a, p. 98; Sandstorm Report, p. 1). The auditors' perceptions played a critical role in assuring depositors and savers of the bank's financial integrity and solvency.

---

<sup>22</sup> Some of the proceeds passed through the Channel Islands. As New York District Attorney John Moscow put it, "My experience with both Jersey and Guernsey has been that it has not been possible for US law enforcement agencies to collect evidence and prosecute crime. In one case we tracked money from the Bahamas through Curacao, New York, and London, but the paper trail stopped in Jersey ..... it is unseemly that these British Dependencies should be acting as havens for transactions that would not even be protected by Swiss banking secrecy" (The Observer, 22 September 1996, p. 19).

## **CHAPTER 4**

### **BCCI'S AUDITORS**

The public is led to believe that bank auditors exist to safeguard depositor and stakeholder interests. Despite the international institutional differences, external audits play a major role in international banking regulation within the framework of consolidated home country supervision. Many international regulators, including the Bank of England, rely extensively on audit reports issued by private sector accountancy firms auditing the consolidated financial statements issued by transnational banks.

Yet in the UK, the auditing obligations remain highly deficient. Despite the mid-1970s secondary banking crash and the 1980s Johnson Matthey banking crisis, the UK government made no attempt to radically overhaul the banking auditing structures. Instead, successive governments appeased the auditing industry and at best only tweaked an already failed system. The main responsibility for regulating banks rests with the Bank of England, but it does not employ a force of government bank auditors. It does not directly 'appoint' bank auditors, but relies extensively on the opinions of external auditors actually selected and remunerated by a bank's directors, though formally appointed and remunerated by bank shareholders. Bank depositors are encouraged to draw comfort from audit reports, but they have no say whatsoever in the appointment of auditors, or the scope of their duties. Bank stakeholders have no access to any audit files. They are not made aware of any discussions between directors and auditors. Following the House of Lords judgment in *Caparo Industries plc v Dickman & Others [1990] 1 All ER HL 568*, UK auditors do not owe a 'duty of care' to any individual, present/potential shareholder, creditor, employee, bank depositor or any other stakeholder. They only owe a 'duty of care' to the company - as a legal person.

In the case of BCCI, the regulators placed considerable reliance upon BCCI's audited financial statements even though they had no direct say in auditor appointment and the auditors did not owe them any "duty of care". Reflecting the BCCI's organisational split between Luxembourg and Grand Cayman, BCCI named two auditors to cover its international operations: Ernst and Whinney (subsequently part of Ernst and Young) auditing the Luxembourg operations and the holding company, and Price Waterhouse (now part of PricewaterhouseCoopers) auditing the Grand Cayman operations. The appointment of two auditors, presumably with the full knowledge of the Bank of England, limited the scope of each auditor's authority.

By the late 1970s, UK banking circles were concerned that BCCI's drive for growth neglected prudential matters such as solvency ratios and bad debt provision. Its UK branches were also thought to be overtrading, trading at a loss, excessively lending to too many businesses, and doing too little business with other banks. Nonetheless, in 1979, the UK government licensed BCCI SA as a deposit-taking institution<sup>23</sup> citing as justification the fact that the "auditors were not qualifying the reports" (Hansard<sup>24</sup>, 6 November 1992, col. 527). In 1979, the Bank of England persuaded BCCI SA to commission an investigation of its loan book, and auditors Ernst & Young produced a reassuring report in March 1981 (Bingham, 1992, p. 39). The Bank of England remained concerned about BCCI's operations, structure, ownership and absence of a lender of last resort, but took no action to force BCCI to curtail its operations.

By the mid-1980s, in view of BCCI's huge treasury losses, the Luxembourg regulator asked BCCI to conduct a review of the Treasury operations. The review was undertaken by Price Waterhouse who uncovered irregularities, but attributed it to "incompetence, errors made by unsophisticated amateurs venturing into a highly technical and sophisticated market" (Bingham, 1992, p. 44)<sup>25</sup>. As the *Financial Times* (1992, p. 17) subsequently argued, "Price Waterhouse audited both the treasury and some Cayman-based accounts which were being robbed to fund the losses: it was therefore theoretically in position to detect both sides of the manipulation". Price Waterhouse's report was made available to BCCI, Ernst and Young, and subsequently to the Luxembourg regulators. The Bank of England eventually learned of the report from the Luxembourg authorities.

Around the mid-1980s, Ernst and Young wrote to Abedi raising serious concerns about poor internal controls, accountability, scrutiny of accounts and availability of information. They were particularly concerned that the appointment of multiple auditors precluded anyone from viewing the overall operations. Ernst and Young declined to be re-appointed unless they were given responsibility for auditing the entire BCCI group, and unless BCCI

---

<sup>23</sup> BCCI never formally re-applied for recognition under the Banking Act (Bingham, 1992, p. 39).

<sup>24</sup> Hansard is the official record of all written and oral exchanges in the British House of Commons.

<sup>25</sup> Later the auditors stated that "We had formed the conclusion that the accounting methods adopted were due to incompetence. However, with the benefit of hindsight it appears more sinister in that it now seems to have been a deliberate way to fictitiously inflate income" (US Senate, 1992a, p. 114; Sandstorm Report, 1991, p. 17).

implemented major improvements to deal with their criticisms. The Bank of England supported the need for a single group auditor (a “world firm”) and in May 1987, Price Waterhouse<sup>26</sup> became the sole group auditor. The firm, however, was not responsible for auditing a number of BCCI affiliates, and bank secrecy laws continued to obstruct its ability to obtain details of accounts from BCCI subsidiaries in places such as Switzerland and Kuwait, which it later transpired were major channels for fraud.

Throughout the 1980s, BCCI’s auditors continued to issue unqualified audit reports on the Bank’s financial statements despite several warning signs of potential problems in the bank’s accounts (US Senate, 1992b, Chapter 10). When US authorities indicted BCCI and Abedi for fraud and money laundering, and 72 major banks suspended lines of credit, the auditors might have issued going concern audit qualifications (American Institute of Certified Public Accountants, 1981; Auditing Practices Committee, 1985), but unqualified audit reports continued to be given. In 1987, the Bank of England received reports of fraudulent activity by BCCI (Bingham, 1992, p. 56), but no decisive action was taken, in part, because the auditors did not suspect BCCI’s management of fraud (Bingham, 1992, p. 57). In May 1988, Price Waterhouse prepared a substantial report for the College of Regulators. The report drew attention to the heavy concentration of BCCI loans to certain customers, several of whom were shareholders. The report also included information concerning BCCI nominee companies and possible illicit investments in the United States. The information provided to regulators, however, was minimal because auditors “faced the dilemma of seeking to reconcile their duty to make appropriate disclosure to the (bank) supervisors with the need to retain confidence of their client” (Bingham, 1992, p. 59).

The auditors’ responsibility to report to the banking authorities was further circumscribed by jurisdictional boundaries. Although, Price Waterhouse(UK) was aware that BCCI may have acquired ownership of First American Bank illegally through nominees, the auditors did not inform US banking authorities or Price Waterhouse-USA (US Senate, 1992b). U.S. investigators found that prior to 1990, Price Waterhouse (UK) was aware of

---

<sup>26</sup> Price Waterhouse was aware of Ernst and Young’s concerns when they accepted the group audit. In 1988, its first full year as group auditor, the firm received audit fees of \$4.7 million.

“gross irregularities in BCCI’s handling of loans to Credit and Commerce American Holdings (CCAH), the holding company of First American Bankshares, and was told of violations of US banking laws by BCCI and its borrowers in connection with CCAH/First American, and failed to advise the partners of its US affiliate or any US regulator”

**Source:** US Senate, 1992b, p. 5 and 259.

Eventually, the US Federal Reserve heard rumours of a report prepared by BCCI’s auditors that indicated the bank had outstanding loans to shareholder of CCAH which were secured by shares in CCAH. Although Price Waterhouse (UK) initially refused to give US authorities access to the report, the Federal Reserve pressed its demand and was allowed to review Price Waterhouse’s report in BCCI’s London office in late 1990 (US House of Representatives, 1991b; US Senate, 1992b, p.349). Based on evidence contained in the auditor’s report, the Federal Reserve initiated a formal investigation into BCCI’s US acquisitions<sup>27</sup>.

Price Waterhouse’s relationship with BCCI changed dramatically in April of 1990 when the auditors, acting under the authority of the 1987 Banking Act, notified the Bank of England of lending problems and possible fraud at BCCI without informing BCCI of their action (US Senate, 1992b, p. 271-173). According to a testimony by BCCI’s chief financial officer, the problems that Price Waterhouse identified in 1990 were the same as they had been identifying for years, but suddenly “the auditors attitude was completely different” (US Senate, 1992b, p. 271-271). One interpretation attributes the auditor’s shift to new information provided by a senior official of BCCI who contacted Price Waterhouse in late 1989 and informed them of various frauds and manipulations, thus, causing the auditors to seek higher levels of assurance. Another attributes the auditor’s change to the fact that BCCI’s financial problems had become so severe that the auditors feared that they might be held liable if they did not report to the authorities. However, despite notifying the Bank of England of possible fraud at BCCI, the auditors (in May 1990) issued an unqualified audit report on BCCI’s 1989 financial statements. Possibly

---

<sup>27</sup> According to a Congressional report (US Senate, 1992b, p. 8), the Federal Reserve did not act to close the bank globally because it needed “to secure the co-operation of BCCI’s majority shareholders, the government and royal family of Abu Dhabi, in providing some \$190 million to prop up First American Bank and prevent a collapse”. This suggests that US banking authorities concealed problems at BCCI in order to secure national interests in a First American Bank rescue.

fearing that a qualified opinion would prompt a run on BCCI and undermine confidence in the banking system<sup>28</sup>, UK regulators wanted the 1989 BCCI accounts to be published with an unqualified audit opinion and the Abu Dhabi guarantees to recapitalise the bank made this possible<sup>29</sup> (Bingham, 1992, p. 82). Price Waterhouse continued to defend its decision to sign the accounts by arguing that the Bank of England and Luxembourg regulators had been informed and wanted BCCI to continue operations. The auditors believed the extent of fraud was limited, the royal house of Abu Dhabi had agreed to recapitalise the bank, and the audit report disclosed that the auditor's opinion was based on guarantees provided by Abu Dhabi (US Senate, 1992b, p. 275).

The US Congressional investigators, however, were severely critical of Price Waterhouse's decision to sign the accounts and accused the auditors of collaborating with bank regulators to deceive the public. According to the US Congressional report,

By agreement, Price Waterhouse, Abu Dhabi, BCCI and the Bank of England had in effect agreed upon a plan in which they would each keep the true state of affairs at BCCI secret in return for cooperation with one another in trying to restructure the bank to avoid a catastrophic multi-billion dollar collapse. Thus to some extent, from April 1990 forward, BCCI's British auditors, Abu Dhabi owners, and British regulators, had now become BCCI's partners, not in crime, but in cover up.

**Source:** US Senate, 1992b, p. 276.

During the remainder of 1990 and early 1991, BCCI, the Bank of England and Abu Dhabi worked quietly on plans to save the bank by restructuring and recapitalising it, while Price Waterhouse continued to provide them with more evidence of fraud.

On March 4 1991, the Bank of England asked Price Waterhouse to prepare a confidential report on irregularities at BCCI. The report was commissioned under the UK Banking Act of 1987 which allowed regulators to direct external auditor to conduct such probes in situations where bank depositors might be at

---

<sup>28</sup> In 1999, PricewaterhouseCoopers issued a qualified report on the 1997-98 accounts of the Meghraj Bank, a major Asian bank operating in the UK (Financial Times, 19 May 1999, p. 23).

<sup>29</sup> In return, the Bank of England permitted BCCI to move (in 1990) its headquarters, officers and records out of British jurisdiction to Abu Dhabi. It believed that all problem accounts could best be centralised in Abu Dhabi, a decision that subsequently hampered the Bank of England's inquiries.

risk. The report, codenamed *The Sandstorm Report*<sup>30</sup> (Price Waterhouse, 1991), was completed on 22 June 1991 and presented detailed evidence of massive frauds by BCCI officials over several years. A meeting of the College of Regulators was called to consider four major frauds explained in the Price Waterhouse report. According to the *Sandstorm Report*, some \$633 million of losses related to treasury trading and \$346 million related to the illegal acquisition through nominees of several US banks were identified. BCCI's accounts and balance sheets had been manipulated to cover-up a loan of \$725 million to a Pakistan based shipping company. In addition, BCCI had used \$500 million of its own resource to acquire 56% of its own shares through a series of complex transactions. The final losses may well be in excess of \$4 billion and Abu Dhabi's exposure to BCCI and related activities is estimated to be some \$9.4 billion (Financial Times, 1991 pp. 5-6). As the Sandstorm Report was being completed, US officials were also completing their investigations into BCCI activities. Less than two weeks after the completion of the Sandstorm report, on 5 July 1991, the College of Regulators, led by the Bank of England, formally closed down BCCI's worldwide operations. BCCI closure had a domino effect. To maintain confidence in the banking system, the Bank of England had to step in to support some 60 banks subsequent to BCCI's closure in 1991 (Daily Mail, 26 March 1993, p. 71).

This chapter has provided some background to the BCCI audits by 'global' audit firms. The closure of BCCI resulted in loss of savings and deposits. It also raised questions about the quality of audits, especially as auditors had also been acting as advisers to BCCI management. The next chapter shows that rather than mounting a speedy independent investigation of the audits, successive British governments have gone to considerable lengths to shield the auditing industry from critical public scrutiny.

---

<sup>30</sup> The report used code names to maintain secrecy. Sandstorm is the code name used to identify BCCI in report.

## CHAPTER 5

### SHIELDING THE AUDITING INDUSTRY

The BCCI story is one of cover-ups. The UK has a long history of appeasing the UK auditing industry and shielding it from public scrutiny (Sikka and Willmott, 1995, 1995b; Mitchell, Sikka and Willmott, 1998). In the immediate aftermath of scandals, the Department of Trade and Industry (DTI) appeases public opinion by the ritualistic appointment inspectors (one of whom is usually an accountant from a major firm) to investigate malpractices. Some of these reports are published so long after the events<sup>31</sup> that they rarely form the basis of any informed reforms. A large number have been suppressed without any public explanation. Some have been given privately by the DTI officials to the ICAEW, but denied to British Parliament (Sikka and Willmott, 1995a). Rather than cleaning up the auditing industry, its accountability continues to be organised off the political agenda. Perhaps, as a reward for financial contributions to political parties and closer links with major corporations, wealthy elites, government departments and senior civil servants<sup>32</sup>.

#### **Pursuit of Private Interests**

In the absence of any government auditors examining the books of banks, the regulators continue to place reliance upon external auditors nominally appointed by shareholders. One of the recurring issues has been the question of auditor obligations to detect/report irregularities. It would be recalled that on previous occasions the government appeased the auditing industry by failing to impose a 'duty' to report frauds and other irregularities upon auditors. Instead, it gave auditors a 'right', something that need not be exercised. Lord Justice Bingham revisited the issue of whether 'auditors should have a "duty" as opposed to a "right" to detect/report fraud to regulators (Bingham, 1992; Mitchell, 1991).

The ICAEW's anti-social policies were once again on full public view. In its evidence (written and oral) to Lord Justice Bingham, the ICAEW opposed the need for auditors to have a statutory "duty" to report fraud and irregularities to the regulators. Lord Justice Bingham rejected the ICAEW's arguments and recommended that a statutory duty to report fraud and irregularities to

---

<sup>31</sup> At the time of writing, some ten years after the event, the DTI report into Maxwell frauds has still not been published.

<sup>32</sup> Coopers & Lybrand (subsequently part of PricewaterhouseCoopers) supplied staff to assist the Serious Fraud Office (SFO) with its inquiries into BCCI (letter from the SFO Director to Austin Mitchell MP, dated 15 December 1993).

regulators be imposed upon auditors. In so doing, he supported the earlier recommendations of the Parliamentary Select Committees (see UK House of Commons, 1991,1992a, 1992b, 1992c, 1992d, 1993).

Subsequently, the government legislated (Hansard, 6 November 1992, cols. 523-594) and a “duty” to report fraud and irregularities to regulators was imposed on auditors of all financial sectors<sup>33</sup>, including banks, insurance companies, financial services, pension funds (Hansard, 15 February 1994, cols. 852-875; Auditing Practices Board, 1994; Sikka et al, 1998). However, a 'duty' to 'actively' detect/search for fraud was not placed upon the auditors even though some MPs suggested this. The government did not spell out the manner in which the auditor ‘duty’ was to be discharged. The detailed formulation of the duties was left to the accountancy trade associations and they responded in their usual way by prioritising their ‘private’ interests over the wider ‘public’ interests.

The auditing industry’s guidance from the Auditing Practices Board (APB), an organisation financed and controlled by the accountancy trade associations, advised auditors to be ‘passive’<sup>34</sup>, rather than ‘active’<sup>35</sup>, (i.e. devise specific audit procedures to meet obligations). It advised that

"The duty to make a report [to the Regulators] does not impose upon auditors a duty to carry out specific work: it arises solely in the context of work carried out to fulfil other reporting responsibilities. Accordingly, no auditing procedures in addition to those carried out in the normal course of auditing the financial statements, or for the purpose of making any specified report, are necessary for the fulfilment of the auditor' responsibilities".

**Source:** Auditing Practices Board, 1994, para 21.

### **The Quality of BCCI Audits: A ‘no go’ area**

---

<sup>33</sup> The same obligations do not apply to auditors of the non-financial sectors.

<sup>34</sup> When referring to the problems associated with establishing whether a business is a going concern, a partner responsible for crafting the going concern auditing guideline explained that the 'passive approach means that "go about your audit and by the way , if something comes and hits you over the head and suggests that the going concern assumption is not appropriate, then you really ought to respond, but you don't actually have to make overt inquiries and you don't actually have to think in an overt way ....." (cited in Sikka, 1992).

<sup>35</sup> According to the APB Secretary, Robert Charlesworth, an 'Active' audit approach would involve carrying out specific audit procedures designed to obtain audit evidence (Charlesworth, 1985).

After BCCI's forced closure on 5th July 1991, the British government announced the establishment of an inquiry under the chairmanship of Lord Justice Bingham (Hansard, 19 July 1991, co. 724). Such an inquiry gave the impression that the government would like to cleanse society of corruption, but the scope of the inquiry was extremely restricted. It was confined to consider “whether the actions taken by all the UK authorities [mainly the Bank of England] was appropriate and timely...” (Bingham, 1992, p. iii). More specifically, Lord Justice Bingham stated that his terms of reference did not invite him to:

“evaluate the professional quality of audits of BCCI’s accounts conducted over the years in London or the Caymans or elsewhere, or to form judgement whether irregularities in its business should have been discovered by the auditors earlier”

**Source:** Bingham, 1992, p. iii.

Amplifying the point, an UK Treasury Minister stated that “Lord Justice Bingham was not asked to investigate the role of BCCI’s auditors” (letter to Austin Mitchell MP, 24 November 1992). Thus unlike the US, there was no immediate independent UK inquiry into the conduct of the BCCI audits. In previous banking frauds, the Department of Trade & Industry (DTI) appointed inspectors (Sikka and Willmott, 1995a) to investigate the frauds. Such investigations, on occasions, also looked at the quality of audit work but the DTI has failed to appoint any inspectors to investigate the real/alleged BCCI audit failures.

### **Non co-operation with International Regulators**

Despite claiming to be a 'global firm' Price Waterhouse remained reluctant to co-operate with international regulators. An investigation of BCCI by New York state banking authorities was frustrated by the auditors’ lack of co-operation. The New York District Attorney told the Congress that

The main audit of BCCI was done by Price Waterhouse UK. They are not permitted, under English law, to disclose, at least they say that, to disclose the results of that audit, without authorization from the Bank of England. The Bank of England, so far -- and we've met with them here and over there -- have not given that permission.

The audit of BCCI, financial statement, profit and loss balance sheet that was filed in the State of New York was certified by Price Waterhouse Luxembourg. When we asked Price Waterhouse US for the records to support that, they said, oh, we don't have those, that's Price Waterhouse UK

We said, can you get them for us? They said, oh, no that's a separate entity owned by Price Waterhouse Worldwide, based in Bermuda.

**Source:** US Senate 1992b, p. 245.

BCCI's auditors also refused to co-operate with the US Senate Subcommittee's investigation<sup>36</sup> of the bank (US Senate 1992b, p. 256). Although the BCCI audit was secured by arguing that Price Waterhouse was a globally integrated firm (US Senate, 1992b, p. 258), in the face of a critical inquiry, the claims of global integration dissolved. Price Waterhouse (US) denied any knowledge of, or responsibility for the BCCI audit which it claimed was the responsibility of Price Waterhouse (UK). Price Waterhouse (UK) refused to comply with US Senate subpoenas for sight of its working papers and declined to testify before the Senate Subcommittee on the grounds that the audit records were protected by British banking laws, and that "the British partnership of Price Waterhouse did not do business in the United States and could not be reached by subpoena" (p. 256). In a letter dated 17 October, Price Waterhouse (US) explained that the firm's international practice rested upon loose agreements among separate and autonomous firms subject only to the local laws:

---

<sup>36</sup> Price Waterhouse (UK) partners did agree to be interviewed by Subcommittee staff in PW's London office. The offer was declined due to staff travel restrictions and concerns that the interviews would be of little use in the absence of subpoenaed documents (US Senate, 1992b, p. 258).

“The 26 Price Waterhouse firms practice, directly or through affiliated Price Waterhouse firms, in more than 90 countries throughout the world. Price Waterhouse firms are separate and independent legal entities whose activities are subject to the laws and professional obligations of the country in which they practice ...

No partner of PW-US is a partner of the Price Waterhouse firm in the United Kingdom; each firm elects its own senior partners; neither firm controls the other; each firm separately determines to hire and terminate its own professional and administrative staff.... each firm has its own clients; the firms do not share in each other's revenues or assets; and each separately maintains possession, custody and control over its own books and records, including work papers. The same independent and autonomous relationship exists between PW-US and the Price Waterhouse firms with practices in Luxembourg and Grand Cayman”.

**Source:** US Senate, 1992b, p. 257.

The Senate subcommittee was eventually able to secure some portions of Price Waterhouse's audit records from the Federal Reserve and other sources, but not enough. The whole episode negated the argument that multinational accountancy firms can perform global audits for multinational businesses.

### **Cover-up of the Sandstorm Report**

Before the closure of BCCI, under its powers in the Banking Act 1987, the Bank of England commissioned a report into BCCI, codenamed "Sandstorm" (Price Waterhouse, 1991). It was prepared by BCCI's auditors, Price Waterhouse. The cost of the report was borne by the British taxpayer.

According to the US Senate Report, the Sandstorm Report describes a massive manipulation of non-performing loans, fictitious profits and concealed losses, fictitious loans set up in connection with repurchases of shares, misappropriation of deposits, fictitious transactions and charges, unrecorded deposit liabilities, nominee arrangements to create false capitalization, unorthodox and apparently illegal repurchasing arrangements for shareholders, the "parking" of loans to avoid recognition of losses, shoddy lending, bad investments, off-book transactions, false confirmations of transactions, misrepresentations with respect to beneficial ownership of shares, fictitious customer loans, falsified audit confirmations, and the drafting of fraudulent agreements.

The Sandstorm Report had the potential to help BCCI depositors raise some uncomfortable questions about the conduct and efficiency of the Bank of England and BCCI auditors. The report might even have helped innocent depositors to secure some compensation from the Bank of England and auditors. By providing crucial background to the BCCI frauds, it could raise the level of debate in British Parliament, so that informed policies can be developed. However, rather than helping innocent depositors, successive UK governments have embarked on an extensive cover-up.

After the closure of BCCI by the Bank of England in July 1991, the US Senate Committee on Foreign Relations led by Senators John Kerry and Hank Brown conducted an investigation into the BCCI affair. The Committee requested a copy of the Sandstorm Report. The UK government rejected the request. The Committee eventually obtained a copy of the report by urging the Federal Reserve to use its influence though even that was highly censored.

“The Sandstorm Report was provided to the Subcommittee solely in a heavily censored form by the Federal Reserve at the insistence of the Bank of England, which forbade the Federal Reserve from providing a clean copy of the report to the Congress on the ostensible ground that to do so would violate British secrecy and confidentiality laws. Later, shortly before the conclusion of the preparation of this report in late August 1992, the Subcommittee obtained an uncensored version of the report from a former BCCI official, which revealed criminality on an even wider scale than set forth in the censored version”.

**Source:** US Senate, 1992b, page 53

In accordance with the US 'freedom of information' laws, the censored version of the Sandstorm Report supplied to the US Senate is publicly available from the U.S. Library of Congress in Washington D.C. This version of the Sandstorm Report<sup>37</sup> is incomplete. The photocopying quality is poor. A number of pages are missing. Some details (names, amounts) have been blanked out whilst others are illegible. However, even this censored version remains a state secret in the UK. Seemingly, the UK state is unwilling to let the UK citizens see the information which is freely available elsewhere. Why are the UK governments engaged in this cover-up?

---

<sup>37</sup> It forms part of the report by the US Senate Committee on Foreign Relations (US. Senate, 1992a) and is found on pages 95-142. The draft Sandstorm Report is dated 22 June 1991.

In view of the public availability of the Sandstorm Report in the USA, the UK government was asked (letters dated 17<sup>th</sup> and 23<sup>rd</sup> June 1998) to make the report publicly available. A Treasury Minister rejected the request and added that

“This report was commissioned by the Bank of England, under Section 41 of the Banking Act 1987. As such, it is covered by the confidentiality provisions in Part V of that Act. The work was undertaken, and contributions obtained, on the clear understanding that the report would not be made public. .... while I appreciate that a version of the report did appear in the US, I believe that the balance of argument is against publication”

**Source:** Letter from a Treasury Ministers to Austin Mitchell MP, 22 July 1998.

Austin Mitchell MP asked (letter dated, 26 October 1998) Prime Minister, Tony Blair, to make the report publicly available. In line with an earlier correspondence with the Treasury, the Prime Minister refused the request and repeated the Treasury litany almost verbatim, suggesting as though he had not even thought about the matter. He said that

"the report was commissioned by the Bank of England, under section 41 of the Banking Act 1987. It is therefore covered by the confidentiality provisions in Part V of that Act. The work was undertaken, and the contributions obtained, on the clear understanding that the report would not be made public"

**Source:** Letter from Prime Minister Tony Blair, 10 December 1998

Subsequently, a Treasury Minister claimed that “Copies of the draft Sandstorm report were made available to the US authorities on the basis that the confidentiality of the information would be protected” (letter to Austin Mitchell MP, 9 December 1999). Would the Sandstorm Report be published once the UK enacted its much hyped ‘freedom of information’ legislation? The same Minister replied (letter to Austin Mitchell MP, 8 December 1999) that “Under the Freedom of Information Bill, therefore, the report would be subject to the exemption relating to information, the disclosure of which is prohibited by an enactment” (the answer is ‘No’).

In keeping with its public service mandate, AABA has, therefore, secured a copy of the Sandstorm Report from the Library of Congress and has made it publicly available<sup>38</sup>.

---

<sup>38</sup> Sandstorm Report and some extracts from Price Waterhouse working papers (as found in the report by the United States Senate Committee on Foreign

**Mr. Mitchell:** To ask the Chancellor of the Exchequer if he will (a) make a statement on the publication on the website of the Association of Accountancy and Business Affairs of the Sandstorm report by Price Waterhouse on BCCI and (b) place a copy of the report in the Library.

**Ms Hewitt:** No.

**Source:** Hansard, 14 June 1999, col. 27.

### **Questions about Auditor Relationship with BCCI**

The evidence examined by the US Senate Committee raises some major questions about the role of BCCI's auditors who also acted as advisers to BCCI management.

The Regulators' reliance on external auditors is premised on the belief that the auditors are public spirited and will act on behalf of either the public or the state, and that auditors are independent of the management. Such propositions are untrue because auditing firms themselves are significant capitalist enterprises. One of their major concerns is to maximise their own profits by pursuing their 'private' rather than 'public' policy objectives. Hanlon (1994) notes that within auditing firms "the emphasis is very firmly on being commercial and on performing a service for the customer rather than on being public spirited on behalf of either the public or the state" (p. 150). In pursuit of their 'private' interests (more profits), auditing firms use audits as a market-stall for selling other wares, whilst the public expects them to perform the more adversarial, quasi-regulatory functions of independent auditors.

In BCCI's case, the bank hired the Consultancy Division of its auditors Price Waterhouse(UK) to assist them in tackling losses from its treasury operations. The consultants completed their work in 1986 and the auditors [Price Waterhouse] reported that they were satisfied and that their recommendations for improving Treasury controls had been implemented. As a result of its review of the Treasury operations in 1985, the auditors also discovered a potential tax liability to the UK government, and subsequently advised BCCI to move its Treasury operations out of the United Kingdom to avoid payment. So much for public responsibility. In Price Waterhouse's words:

"In our report dated 28 April 1986, we referred to the control weaknesses which

---

Relations, 1992a) are available on <http://visar.csustan.edu/aaba/aaba.htm>.

existed in respect of the group's Central Treasury Division ("Treasury"). During 1986 management engaged the services of the Consultancy Division of Price Waterhouse, London, to assist them in implementing recommendations contained in our earlier report. We reviewed the progress made by the bank on the implementation of revised procedures during the year and in a report dated 5 August 1986 we were able to conclude that most of our significant recommendations had been implemented.

A further feature arising from the review of Treasury operations in 1985 was the potential liability to UK Corporation Tax arising from the Division's activities in the period 1982 to 1985. Following advice from ourselves and from the Tax Counsel during 1986 it was determined that this liability could be significantly reduced if the Bank ceased trading in the United Kingdom and claimed a terminal loss".

**Source:** US Senate, 1992a, p.175.

BCCI's Treasury was moved from London to Abu Dhabi in 1986 with Price Waterhouse assisting with the transfer. The auditors were, thus, in the dual position of acting as private consultants and advisors to BCCI management to further their 'private' interests. Yet at the same time the State was expecting them to perform 'public interest' functions by acting as an external monitor and quasi-regulator<sup>39</sup>. Such potential conflicts of interests compromise auditor independence and raise questions about PwC's closeness to BCCI management.

A full independent investigation of the BCCI audits could reveal the extent of the conflict of interest implicit in Price Waterhouse's role as advisers and consultants, but successive governments have colluded with the auditing industry and accountancy trade associations to prevent this.

### **No independent investigation of the BCCI audits**

In the US, a country with a highly litigious environment, the investigation of

---

<sup>39</sup> The UK's Banking Act of 1987 required regular meetings between bank management, auditors and the Bank of England to discuss matters of mutual interest. The auditors' traditional duty of confidentiality to client companies was relaxed to allow them to report matters to regulators provided they acted in "good faith". Auditors' were required to prepare reports on banks' internal controls, and they were given a "right" (as opposed to a "duty") to report their suspicions to regulators, even without client knowledge (Auditing Practices Committee, 1990a, 1990b).

BCCI frauds and audits was finalised and published within an 18-month period. This investigation took the form of public hearings, testimonies from audit firm partners, BCCI officials and other interested parties. In contrast, the UK authorities have been engaged in an organised cover-up.

The Sandstorm report was suppressed in the UK. The ‘terms of reference’ for Lord Justice Bingham’s inquiry excluded any scrutiny of BCCI audits. To date, there has been no independent investigation of the BCCI audits. Ever keen to shield the auditing industry from critical scrutiny, the government rejected a call for the appointment of DTI inspectors to examine the auditing aspects (letter from the Minister for Corporate and Consumer Affairs to Austin Mitchell MP, 20 November 1992). Instead, the government claimed that “the correct way to make inquiries into the upholding of professional standards by auditing firms is through the accountancy profession’s own procedures” (letter from Treasury Minister to Austin Mitchell MP, 24 November 1992).

The investigations by the Serious Fraud Office (SFO) into the Maxwell frauds, and legal action against the Guinness executives did not preclude the appointment of DTI inspectors. But in the case of BCCI, the Minister for Consumers and Corporate Affairs claimed that “In view of the involvement of the Serious Fraud Office<sup>40</sup> at that time, it would have been wholly inappropriate for the Department [DTI] to investigate the affairs of the company [BCCI]” (letter from the Minister for Consumer and Corporate Affairs to Austin Mitchell MP, 6 March 2001). He also added that even if the inspectors were appointed “the Department could not have acted on the findings other than to disclose them, if the facts justified it, to the ICAEW for it to consider appropriate action”. In the organised cover-up, the obligations to inform Parliament and people count for nothing. The Ministers make pious statements about defending the public interest, but seem unable or unwilling to do anything to call major accountancy firms to account.

The UK government delegated the task of examining the auditing aspects of the BCCI scandal to the Institute of Chartered Accountants in England and Wales (ICAEW), an accountancy trade association, which acts as a regulator of the auditing industry following the implementation of the Companies Act of 1989. The ICAEW delegated the task to the Joint Disciplinary Scheme (JDS)<sup>41</sup> (*The*

---

<sup>40</sup> The SFO is concerned with bringing criminal prosecutions. Its work would not have provided any public information about the conduct of BCCI audits.

<sup>41</sup> The JDS was formed after the mid-1970s banking crisis, by major accountancy bodies, to consider the role of major firms in high profile alleged audit failures. For some information about its background see Sikka and Willmott, 1995b.

*Observer*, 6 June 1993, p. 26). When an investigation appeared imminent, in sharp contrast to any previous investigations, Price Waterhouse objected on the grounds that any action by the ICAEW could prejudice the outcome of lawsuits against it, especially by the BCCI liquidators (*The Accountant*, July 1993, p. 2). Following a series of court actions and appeals, Price Waterhouse won a Court Order prohibiting the JDS from continuing its probe until the legal action brought by the BCCI liquidator was concluded. On 27 July 1993, a Divisional Court dismissed Price Waterhouse's application (See *R v Institute of Chartered Accountants in England and Wales & Ors, ex parte Brindle & Ors* (1993) 736 BCC). Price Waterhouse appealed against this decision and the appeal was upheld on December 1993. On 28 April 1994, the JDS sought to take the case to the House of Lords, but permission to appeal to the House of Lords was refused (*The Accountant*, June 1994, p. 5; *Accountancy*, June 1994, p. 14). In 1998, a £117 million settlement was reached with BCCI liquidators (Deloitte & Touche), and the JDS investigation was said to be in progress (*The Guardian*, 8 January 1999, p. 20).

Any investigation by the JDS cannot be independent, as the JDS is financed and controlled by the UK accountancy trade associations and thus has no independence from the auditing industry. The accountancy trade associations decide the cases that are to be referred to JDS and the 'terms of reference' for investigations. Thus there will be no inquiry into 'independence' aspects of BCCI auditors. The JDS functions as a quasi-court, but its meetings are behind closed-doors. There is nothing in the JDS's constitution to suggest that it owes a 'duty of care' to any of the parties. There are no public hearings. The JDS Panels are made up of partners from other audit firms<sup>42</sup> on the ground that only they have the particular knowledge to enable them to reach a conclusion<sup>43</sup>. Any conclusions reached by them can provide benchmarks for future investigations and thus have a capacity to haunt them. Naturally, they do not want benchmarks which can call them to account. The transcripts of the JDS proceedings are not publicly available. The evidence received and examined by it is not available for public scrutiny. It does not indicate how it filters and weighs various pieces of evidence or why it neglects or downgrades some categories of evidence. The complainants and the parties affected by the conduct of auditors cannot appeal against the decisions of the JDS, but the accountancy firms can. Before

---

<sup>42</sup> A New Zealand court case (*Wilson Neill v Deloitte - High Court, Auckland, CP 585/97, 13 November 1998*) has shown that major accountancy firm "have in place a protocol agreement promising that none will give evidence criticising the professional competence of other Chartered Accountants" (*The (New Zealand) Chartered Accountants Journal*, April 1999, P. 70).

<sup>43</sup> On this basis, only thieves and murderers should in sit in judgement to hear cases of theft and murder. Yet that is never, and should never be, the case.

publication, the contents of the JDS reports are shown and negotiated with accountancy firms, but the same privileges are denied to the complainants. The eventual published reports are designed to discourage reading and analysis (Sikka, 1999). For example, in 1999, the JDS published reports on the role of the Maxwell auditors (Coopers & Lybrand – now part of PricewaterhouseCoopers). Hard copies of the reports are not available and thus not held in public and university libraries for any future reference. Most of the information is on two floppy disks. Thus anyone without a computer cannot read it. With the passing of time and changes in computer hardware and software, the disks will also become unreadable. Another whitewash will be achieved. The writing is on the wall. The whole BCCI investigation ritual will be a major PR exercise. The fines, if any, levied upon BCCI auditors will fill the coffers of the accountancy trade associations<sup>44</sup> and will do nothing to compensate the long-suffering BCCI depositors. Their role in the whole affair has been to suffer. Preferably silently.

In folklore the machinery of regulation, inspection and audit is there to uncover and report inconvenient facts to depositors and other stakeholders. With such myths, people are encouraged to believe that capitalism is not corrupt and that it is safe to invest and deposit their savings and pensions with companies. The BCCI case shows the opposite to be true. All invigilators and regulators have gone to extraordinary lengths to keep the public in the dark. They have engaged in an organised cover-up to shield the auditing industry from critical public scrutiny.

---

<sup>44</sup> The 1999 financial statements of the JDS show that its major shareholders, the Institute of Chartered Accountants in England & Wales (ICAEW) and the Institute of Chartered Accountants of Scotland (ICAS), received payments (profits) of £3,025,000 and £386,000 respectively, out of the fines collected for malpractices. Victims of poor auditing and insolvency practices received nothing.

## **CHAPTER 6**

### **SUMMARY AND DISCUSSION**

The corporatisation of Britain has been gathering pace. Increasingly, governments act to defend organised business interests at the expense of its citizens. Parliament has been denied the sight of crucial reports to enable it to debate and enact legislation that could call big business to account. No laws have been introduced to make auditors accountable to bank depositors. Profits and corporate interests are prioritised over justice, accountability and the wider social interest. Such themes are evident from the organised cover-up relating to the closure of BCCI, one of the biggest banking frauds of the twentieth century. It raises major questions about the wisdom of regulators relying upon commercial auditing firms. With the savings of 1.4 million depositors at stake, a speedy and independent inquiry into the auditing aspects was essential. Yet auditing aspects have not been the subject of an independent inquiry.

To appease public opinion, the government commissioned an inquiry under the Chairmanship of Lord Justice Bingham. The resulting report was not the result of any 'open' hearings. The submissions made to it remain private. Its 'terms of reference' precluded any concern with the quality of external audits. The Sandstorm Report would have enabled depositors to secure some financial redress from the Bank of England and BCCI auditors, but successive UK governments have failed to make it publicly available even though the report is publicly available in the US. The UK authorities were reluctant to supply a full copy of the Sandstorm Report to the US authorities, possibly to shield the UK auditing industry from critical scrutiny. In line with its policy of shielding the auditing industry from critical scrutiny (Sikka and Willmott, 1995a, 1995b), the UK government has failed to mount an independent investigation of the BCCI audits. At best, there will be an investigation by the Institute of Chartered Accountants in England & Wales (ICAEW) and/or other accountancy organisations (e.g. the Joint Disciplinary Scheme) which are not independent of the auditing industry.

The BCCI case raises serious concerns about auditing practices. The concerns about auditor independence, particularly in cases where accountancy firms serve simultaneously as external auditors and management consultants. The case demonstrates the public cost of appeasing the auditing industry, which continued to oppose duties to detect/report fraud. The cost of this is borne by innocent savers, depositors and investors.

With the aid of accountancy trade associations, accountancy firms have sought to cement their claims of being 'global'. This has not been accompanied by any public scrutiny of their 'global' accountability or 'global' organisational structures. The BCCI case shows that major auditing firms market themselves as international and 'global' firms, but such claims dissolve in the face of critical scrutiny. When challenged by subpoenas from the US regulators, Price Waterhouse argued that it is a collection of disparate national firms rather than a 'global' firm. To resist the US regulators, the firm sought refuge in the UK's bank secrecy laws. Price Waterhouse partnership offices did not have adequate arrangements for sharing of sensitive information between offices or with foreign regulators. Price Waterhouse(UK) did not inform either Price Waterhouse(US) or US banking authorities when it learned of BCCI's illicit acquisition of US holdings. Being 'global' is a carefully cultivated myth.

The BCCI case shows that the structure of international accounting/auditing firms is inappropriate to meet the demands of regulating integrated international financial markets. The Limited Liability Partnership Act 2000 gives the firms further protections from lawsuits without demanding any changes in the structure of auditing firms. As part of a social contract, the government could insist that in return for a monopoly of the state guaranteed market of external audits, accountancy firms revise their international partnership agreements and co-operate with international regulators. They could also enact legislation prohibiting banking regulators from relying on reports by foreign auditors who refused to submit to national laws. Yet the UK government has done nothing.

In the banking industry, the stakeholders include not only bank depositors, but also the citizens who may ultimately be required to rescue financially distressed banks with tax subsidies and/or bear the consequences of economic disruptions caused by bank failures. Yet the audit industry does not owe any 'duty of care' to bank depositors, employees or other interested parties. In the BCCI case, the British auditors had no enforceable obligations to depositors, banking authorities, or polities outside the United Kingdom.

The BCCI case raises important political questions about the accountability of the auditing industry and the state/auditing industry alliance. As a result of deliberate political decisions, the governance processes leading up to BCCI's closure remains shrouded in secrecy. The minutes of the College of Regulators' meetings remain secret. The Bank of England was the major regulator, but did not owe a 'duty of care' to any depositor<sup>45</sup>. It sheltered behind the BCCI

---

<sup>45</sup> BCCI depositors have sued the Bank of England for misfeasance and are awaiting the outcome of a "potentially groundbreaking case" (Financial Times, 17 January 2001, p. 2).

external audits and encouraged the public to trade with BCCI. Some might argue that such secrecy is necessary to avoid premature banks runs and might further argue that auditors' responsibility is discharged so long as banking regulators are notified of irregularities. Another interpretation attributes a wider significance to the lack of transparency in the dealings between accountants and regulators. Since the early 1980s, successive governments have been actively restructuring the UK economy by sheltering behind auditing industry's "aura" (Gallhofer and Haslam, 1991) of objectivity, independence and neutrality. The political role of major accountancy firms is evident in processes relating to privatisation of state enterprises, regulation of utilities and surveillance of the public sector (e.g. health, education) and the reform of the taxation system (e.g. self-assessment). During such times, detailed questions about the expertise and independence of BCCI auditors had a capacity to problematise the government policies. In addition, the UK has one of the largest number of qualified accountants per capita in the world (Cousins et al., 1998). A critical scrutiny of the role of external auditors could disrupt the ability of accountancy firms to accumulate profits. Despite these plausible explanations, there is something profoundly disturbing (to democratic sensibilities) in the premise that broader social interests are served by silence, private deals, secrecy and the benevolent deception by governments, central bankers and their auditors.

The BCCI case shows that the auditing industry remains largely beyond public scrutiny and democratic control. Despite its highly political role, the UK auditing industry is not regulated by an independent regulator representing a wide variety of stakeholders. It is primarily self-regulating, with 'private' accountancy bodies controlling licensing, monitoring and disciplining of the firms. External auditors are often portrayed as public watchdogs, but their public obligations remain limited. They do not owe a 'duty of care' to depositors, employees or individual stakeholders. Despite enjoying a state guaranteed monopoly of external audits, they are not obliged to publish any information about their affairs. Neither the banking regulators nor the representatives of various stakeholders have any unhindered access of auditor files. Despite the proliferation, in the UK, of performance league tables for schools, universities, public sector organisations, government departments and commercial organisations, neither the state nor the accountancy trade associations have devised any mechanism for measuring the performance and effectiveness of audit firms.

The audit of BCCI raises serious questions about the ability of audit firms to combine the roles of independent auditors, advisers of management and agents

of the state. Yet no attempt has been made to examine the issues, especially whether in pursuit of private profits, one set of capitalist enterprises (e.g. major audit firms) have the willingness or ability to secure public accountability of another set (e.g. corporations). The terms of an audit contract and auditor assessment of internal control have a potential role in alerting depositors, employees and individual stockholders of the management-auditor relationship, the effectiveness of auditors and possible risks to investment. Yet no attempt has been made to require either banks or audit firms to make their engagement letters, management letters or working paper extracts available for public scrutiny (Dunn and Sikka, 1999). In return for continued enjoyment of the state guaranteed market of external audit, the state could negotiate a new social contract with audit firms and require them to embrace broader accountability. This has not been done. The public accountability of the auditing industry has been organised off the political agenda.

Big accountancy firms have become a major power in the land, not only in business but also in politics and government. Yet the public has little say in their affairs. Their financial, legal and political resources are being used to shield them from public scrutiny. The BCCI case illustrates the extent of their power and the degree of political patronage enjoyed by major accountancy firms. With the visible hand of the state, they enjoy state guaranteed monopolies. Yet they are secretive, oppose public obligations (e.g. detect/report fraud) and avoid accountability. The cost of this indulgence is borne by all citizens. How many more BCCI's must there be before the auditing industry is called to account?

## BIBLIOGRAPHY

Allan, R. and Fforde, W., (1986). **The Auditor and Fraud**, London, Auditing Practices Committee.

American Institute of Certified Public Accountants, (1981). **Statement on Auditing Standard 34: The auditors' Consideration when a Question Arises about an Entity's Continued Existence**, New York, AICPA.

Auditing Practices Board, '**The Auditors' Right and Duty to Report to Regulators in the Financial Sector**', London, (London: APB, 1994).

Auditing Practices Committee, (1985). **The Auditor's Considerations in respect of Going Concern**, London, APC.

Auditing Practices Committee, (1990a). **The auditor's responsibility in relation to fraud, other irregularities and errors**, London: APC.

Auditing Practices Committee, (1990b). **Communication between auditors and Regulators under sections 109 and 180 (1)(q) of the Financial Services Act 1986**, London: APC.

Beck, G.W., (1973) The Role of the Auditor in Modern Society: An Empirical Appraisal, **Accounting and Business Research**, Spring, , pages 117-122.

Bingham, The Right Honourable Lord Justice, (1992). **Inquiry into the Supervision of The Bank of Credit and Commerce International**, London: HMSO.

Boleat, M., (1982). **The Building Society Industry**, London, George Allen & Unwin, 1982

Brief, R.P., (1975). The Accountant's Responsibility in Historical Perspective, **The Accounting Review**, April, pages 285-297.

Brown, R., (1905). **A History of Accounting and Accountant**, (Edinburgh: T.C. and E.C. Jack.

Charlesworth, R., (1985). Less room for Doubt on the Going Concern Tag, **Accountancy Age**, 29 August, p. 13.

Chartered Association of Certified Accountants, **Attitude Survey Relating to Fraud the Auditor's Responsibility**, (London: ACCA, 1986a).

Chartered Association of Certified Accountants, **The Role of the Auditor in Detecting Fraud and other Irregularities**, (London, ACCA, 1986b).

Clarke, M., (1986). **Regulating the City**, Milton Keynes, Open University.

Collins, M., (1989). The banking crisis of 1868', **Economic History Review**, pages 504-527.

Cooper, E., (1886). Chartered Accountants as Auditors of Companies, **The Accountant**, 13th November, pages 644-649,

Cooper, E., (1921). Fifty-seven years in an Accountant's Office, **The Accountant**, 22nd October, pages 553-564.

Cousins, J., Mitchell, A., Sikka, P., and Willmott. H., (1998). **Auditors: Holding the Public to Ransom**, Basildon, Association for Accountancy & Business Affairs.

Cousins, J., Mitchell, A., Sikka, P., Cooper, C., and Arnold, P., (2000). **Insolvent Abuse: Regulating the Insolvency Industry**, Basildon, Association for Accountancy & Business Affairs.

Davison, I.H., (1987). **A View of the Room - Lloyd's**, London: George Weidenfield and Nicholson.

Department of Trade and Industry, (1985a) **Financial Services in the United Kingdom: A new framework for investor protection** , London: HMSO.

Department of Trade and Industry, (1985b) **Financial Services Legislation: The Auditor's Role in the Financial Services Sector**, London: HMSO.

Dicksee, L.R., (1892). **Auditing: A Practical Manual for Auditors**, London, Gee.

Dunn, J., and Sikka, P., (1999). **Auditors: Keeping the Public in the Dark**, Basildon, Association for Accountancy & Business Affairs.

Edwards, J. R., (1986). **Legal Regulation of British Company Accounts 1836-1900**, Vol II, New York, Garland.

Gower, L.C.B., (1984). **Review of Investor Protection - Cmnd 9125**, London, HMSO.

Hall, M.J.B. (1987). UK Banking Supervision and the Johnson Matthey Affair, in C. Goodhart, D. Currie and D.T. Llewellyn (eds). **The Operation and Regulation of Financial Markets**, Basingstoke: Macmillan.

Hodgson, G., (1986). **Lloyd's of London: A Reputation at Risk**, Harmondsworth, Penguin.

Institute of Chartered Accountants in England and Wales, (1961). **Statement U1: General Principles of Auditing**, London, ICAEW.

Institute of Chartered Accountants in England and Wales, (1985a). **Report of the Working Party on Fraud**, London, ICAEW.

Institute of Chartered Accountants in England and Wales, (198b). **The Auditor and Fraud - Report of a Committee chaired by Lord Benson**, London, ICAEW.

Jones, E., (1981). **Accountancy and the British Economy 1840-1980: The Evolution of Ernst and Whinney**, (London, Batsford.

Kapstein, E.B.(1994), *Governing the Global Economy: International Finance and the State*. Cambridge, MA, Harvard University Press.

Killick, M., (1998). **Fraudbusters**, London, Indigo.

Lee T.A., "The Nature of Auditing and its Objectives", **Accountancy**, April, 1970, pages 292 - 296.

Lee, T.A. (1982) **Company Auditing (2nd Edition)**, London: Gee.

Lee, T.A., (1986). **Company Auditing (3rd Edition)**, (Wokingham, Gee/Van Nostrand.

Lee, T.A., Parker, and R.H., (1979). **Evolution of Corporate Financial Reporting**, (Sunbury on Thames, Nelson.

Metcalf, J.L., (1986). Self-regulation, Crisis Management and Preventive Medicine: the Evolution of UK Bank Supervision", in E.P.M. Gardener (editor), **UK Banking Supervision: Evolution, Practice and Issues**, London, Allen & Unwin, 1986.

Mitchell, A., Sikka, P., and Willmott, H., (1998). **The Accountants' Laundromat**, Basildon, Association for Accountancy & Business Affairs.

Price Waterhouse, (Draft 22 June 1991). **Report on Sandstorm SA under Section 41 of the Banking Act 1987**. The draft Sandstorm Report is publicly available in the US (See US Senate, 1992a, pp. 95-142). This report has not been published in the UK - some extracts can be seen on <http://visar.csustan.edu/aaba/aaba.htm>).

Puxty, T., Sikka, P. and Willmott, H., (1994). (Re)Forming the Circle: Education, Ethics and Accountancy Practices, **Accounting Education**, Vol. 3, No. 1, 1994, pp. 77-92.

Registry of Friendly Societies, (1979). **Grays Building Society (Cmnd 7557)**, London, HMSO.

Reid, M., (1982). **The Secondary Banking Crisis 1973-1975, Its Causes and Courses**, Basingstoke, Macmillan.

Reid, M. (1988). **All-Change in the City: The Revolution in Britain's Financial Sector**, Basingstoke, Macmillan.

Robinson, G., (2000). **Unconventional Minister**, London, Michael Joseph.

Shannon, H.A., (1932). The First Five Thousand Companies and Their Duration, **Economic History Review**, January, pages 396-424.

Shannon, H.A., (1933). The Limited Companies of 1866-1883", **Economic History Review**, October, pages 290-316.

Sikka, P., (1992). Audit Policy-making in the UK: The Case of "The auditor's considerations in respect of going concern", **European Accounting Review**,

December, pages 349-392

Sikka, P., (1999). Maxwell auditors and self-regulation: the verdict, **European Accounting Focus**, March, pp. 13-15.

Sikka, P., Puxty, T., Willmott, H. and Cooper, C. (1998) The Impossibility of Eliminating the Expectations Gap: Some Theory and Evidence, **Critical Perspectives on Accounting**, Vol. 9, No. 3, pp. 299-330.

Sikka, P. and Willmott, H., (1995a). Illuminating the State-Profession Relationship, **Critical Perspectives on Accounting**, pp. 341-369.

Sikka, P. and Willmott, H., (1995b). The Power of "Independence": Defending and Extending the Jurisdiction of Accounting in the United Kingdom, **Accounting, Organizations and Society**, Vol. 20, No. 6, pp. 547-581.

Smith, T., (1985). Benson challenged despite some common ground", **Accountancy Age**, 12th December, page 12.

Todd, G., "Some Aspects of Joint Stock Companies 1844-1900", **Economic History Review**, October, 1932, pages 46-71.

United Kingdom, House of Commons, (1991). **Treasury and Civil Service Select Committee, Second Report, Banking Supervision and BCCI: The Role of Local Authorities and Money Brokers**, London, HMSO.

United Kingdom, House of Commons, (1992a). **Treasury and Civil Service Select Committee, First Special Report, Banking Supervision and BCCI: The Response of Bank of England to Second and Fourth Reports from the Committee in Session 1991-92**, London, HMSO.

United Kingdom, House of Commons, (1992b). **Treasury and Civil Service Select Committee, Second Special Report, Banking Supervision and BCCI: International and National Regulation: The Response of Bank of England to the Fourth Report from the Committee in Session 1991-92**, London, HMSO.

United Kingdom, House of Commons, (1992c). **Treasury and Civil Service Select Committee, Third Report: Banking Codes of Practice and Related Matters**, London, HMSO.

United Kingdom, House of Commons, (1992d). **Treasury and Civil Service Select Committee, Fourth Report: Banking Supervision and BCCI: International and National Regulation**, London, HMSO.

United Kingdom, House of Commons, (1993). **Treasury and Civil Service Select Committee, Second Report 1992-93 Session, Banking Supervision and BCCI: The Implications of the Bingham Report**, London, HMSO.

United States, Senate Committee on Foreign Relations (1992a). **Hearings before the Subcommittee on Terrorism, Narcotics and International Operations, Part 4**. Washington, USGPO.

United States, Senate Committee on Foreign Relations (1992b). **The BCCI Affair: A Report to the Committee on Foreign Relations by Senator John Kerry and Senator Hank Brown**, December 1992. Washington, USGPO.

Waldron, R.S., (1969). **Dicksee's Auditing (Eighteenth Edition)**, London, Gee.

Willett, C., and Page, M., (1996). A Survey of Time Budget Pressure and Irregular Auditing Practices amongst Newly qualified UK Chartered Accountants, **British Accounting Review**, Vol. 28, No. 2, pp. 101-120.

Woolf, A.H., (1912). **A Short History of Accountants and Accountancy**, London: Gee.

Worthington, B., (1895). **Professional Accountants**, London, Gee.

# ASSOCIATION FOR ACCOUNTANCY & BUSINESS AFFAIRS

## PUBLICATIONS

**Insolvent Abuse: Regulating the Insolvency Industry** (ISBN 1-902384-04-0) by Jim Cousins, Austin Mitchell, Prem Sikka, Christine Cooper and Patricia Arnold

**No Accounting for Exploitation** (ISBN 1-902384-03-2) by Prem Sikka, Bob Wearing and Ajit Nayak.

**Auditors: Keeping the Public in the Dark** (ISBN 1-902384-02-4) by John Dunn and Prem Sikka

**The Accountants' Laundromat** OUT OF PRINT  
(ISBN 1 902384 01 6)

**Auditors: Holding the Public to Ransom** OUT OF PRINT  
(ISBN 1 902384 00 8)

AABA monographs are priced at £8.95 each and are available from the **Association for Accountancy & Business Affairs, P.O. Box 5874, Basildon, Essex SS16 5FR, UK.**

UK	£8.95 (post free) each
European Union	£8.95 (add £0.65 to cover postage + packaging)
Rest of the World	£8.95 (add £1.20 to cover postage + packaging)

Subject to a modest licensing fee, educational institutions can secure the right to print unlimited number of copies of all our monographs (including those 'out-of-print') for an unlimited period. Please write to AABA for details.

**<http://visar.csustan.edu/aaba/aaba.htm>**

**The BCCI Cover-up** draws attention to an organised cover-up relating to the biggest banking fraud of the twentieth century. With 1.4 million depositors, BCCI was closed down in 1991. The UK government has suppressed reports, which would have enabled innocent depositors to secure redress. BCCI auditors have failed to co-operate with international regulators. To date, there has not been any independent investigation of the quality of BCCI audits. None will. Successive governments and accountancy trade associations have colluded to shield the auditing industry from public scrutiny.

**Austin Mitchell** is Labour MP for Great Grimsby. He is a former spokesperson for Trade and Industry. He has written extensively on corporate governance, tax havens, accountancy and business matters in newspaper, magazines and international scholarly journals.

**Prem Sikka** is Professor of Accounting at the University of Essex. His research on accountancy, auditing, corporate governance, money laundering, insolvency and business affairs has been published in books, international journals, newspapers and magazines. He has also appeared on radio and television programmes to comment on accountancy and business matters.

**Patricia Arnold** is an Associate Professor in Accounting at the University of Wisconsin-Milwaukee. Her research on globalisation, privatisation, the social and economic consequences of accounting policy, and healthcare cost issues has been published in major international scholarly journals.

**Christine Cooper** is Professor of Accounting at the University of Strathclyde. She has published research on auditing, privatisation, education, environment and gender issues in international scholarly journals, newspapers and magazines.

**Hugh Willmott** is Professor of Organizational analysis at the University of Manchester Institute of Science and Technology. He has written several books, research papers and articles on business management, corporate governance and accountancy.

---

---

**THE BCCI Cover-up**

**ISBN 1-902384-05-9**

**£8.95**