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TAMING THE CORPORATIONS

Association for Accountancy & Business Affairs

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

Corporations dominate all aspects of our lives. Their power affect quality of life, food, water, gas, electricity, seas, rivers, environment, schools, hospitals, medicine, news, entertainment, transport, communications and even the lives of unborn babies. Corporations form 50 of the world’s biggest economies. Their turnover exceeds the gross national product of many nation states. In pursuit of profit, companies roam the world and owe no loyalty to any nation, community or people, but their decisions can undermine and even scupper government policies. The people have little say in their affairs.

Corporations seem to be accountable to no one. Company executives play their selfish games, enriching a few and impoverishing many. Shareholders, employees and consumers are routinely ripped-off, sold worthless pensions, endowment mortgages and other financial products. Despite huge public subsidy, the privatised railway system does not deliver; consumers get unhealthy food and pay excessive prices for cars and other goods and services. Companies form cartels to fix prices and cheat people by charging excessively for medicines and other essentials.

Corporations must be brought under democratic control. Yet the political system is unable or unwilling to call them to account. Political parties, governments and pressure groups are bought off. Unaccountable corporate power is damaging the fabric of society, the structure of families, the quality of life and even the very future of the planet. Taming the corporations is a major issue.

The proposals in this monograph are intended to ensure that corporations are brought under democratic control. The necessary precondition for good corporate governance is to invigorate the institutions of democracy, and this needs to be accompanied by reforms relating to the governance of corporations and rights for all stakeholders to call companies to account. This monograph sets out over 100 reforms to democratise major corporations and enhance their public accountability. These include the creation of independent regulators, the end to the unitary board structure, stakeholder elected audit committees and non-executive directors, ending of proxy voting, tackling organised tax avoidance, stakeholder votes on executive pay, requiring corporations to safeguard human rights, major reforms to accounting/auditing practices to provide a new framework for social accountability and reforms to institutions of democracy.
CHAPTER ONE
The Power of the Corporations

The power of corporations has increased, is increasing and ought to be diminished by making them accountable. They bestride our globalising world. They provide jobs, products and services, control scarce resources and affect huge areas of our lives, from the quality of air we breathe and the water we drink, to the food we eat, the news we get, and the medicines we take. They control our savings, pensions and investments. They can damage our health (Thalidomide, BSE, smoking and diet related diseases) and influence our destinies in jobs, credit ratings, pay and product prices. They can boost, or destroy, whole communities by closing mines, mills, offices, factories, and call centres, or opening the superstores and fast food outlets of the low-wage, shelf-stacking economy.

There is no doubting their power nationally or internationally. Fifty-one of the hundred largest economies in the world are corporations, not countries\(^1\). The turnover of companies, such as Ford, General Motors or Wal-Mart, is bigger than the Gross Domestic Product (GDP) of Greece, Poland, Hong Kong or South Africa. The largest hundred corporations control 20% of global foreign assets and some 60% of world trade is within multinational corporations (OECD Observer, April 2002), giving them enormous scope for controlling markets and prices, operating cartels, shedding jobs, laundering money, moving capital and tax avoidance. Governments privilege them and they influence power by financing political parties, politicians, regulators, policymaking bodies, academic research, think tanks, NGOs and media. Global pursuit of profit and the weakening of the nation state give them the power to act irresponsibly, or as they choose, in pursuit of profit and their own interests. They blackmail elected governments to ensure that their freedom to maximise profits and minimise responsibilities is a centrepiece of state policy.

The people have little say in corporate power. The World Bank, the World Trade Organisation (WTO), the International Monetary Fund (IMF) and the Washington consensus are dedicated to making the world fit for corporations to profit in. The WTO’s General Agreement on Trade in Services (GATS), supported by the European Union (EU) and the UK, commits governments to open virtually everything to privatisation, often with minimalist regard for health and safety and the wishes of the electorate. This social engineering prioritises the needs of capital markets over the welfare of citizens.

Corporate power and how to make it socially responsible and accountable have long been a central problem for democracy. In the days of the robber barons, the state was slowly mobilised to protect labour, consumers and citizens from corporate abuses. Western European nations tackled some of the abuses through public ownership, consumer and labour protection laws. Reflecting its history and politics, the US sought to check corporations through regulation, trust-busting and independent regulators, such as the Securities & Exchange Commission (SEC). The US approach may have endured better, but neither approach democratised the corporations so that with globalisation, the triumph of market capitalism and the roll back of the state, corporate power has grown substantially. With laissez-market-faire an orthodoxy, public intervention discounted, publicly owned industries sold off to become private monopolies, and governments more anxious to appease the corporations than control them, we now live in an era of competition to ease regulation, reduce corporate taxation and lessen company social obligations.

Major industries built by taxpayers’, such as railways, mines, buses, steel, shipping, gas, water, engineering, petrochemicals, airlines, motor vehicles, biotechnology, electricity, telecommunications, computers, armaments, space and medicines have been handed to companies at knockdown prices, further concentrating economic, social and political power in relatively few hands. Governments have not only surrendered the commanding heights but invited the corporations to permeate the public service by providing experts and advice and even running public services. The state has become dependant on them, even anxious to propitiate and appease triumphant capitalism. The countervailing power of labour is seriously weakened and globalisation undermines national controls and allows corporations to play fast and loose with governments and regulations.

Ultimately, only the people and elected governments can tame the corporations and it has become vital to do so because the growth in unbridled corporate power threatens democracy, hard won welfare rights, social stability and government’s ability to run the economy for the purposes of the people. Yet while Old Labour saw itself as the protector of the people against abuse by private or corporate power, New Labour enthusiastically espoused laissez faire. Any aspiration to democratise companies by requiring consideration of stakeholder interests was abandoned. Even mild European proposals for two tier boards were resisted, ensuring that company power stays in the hands

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Major accountancy firms are some of the world’s biggest corporations. Behind the veil of secrecy and through global networks they have diversified into tax avoidance, consultancy and anything else that will make a quick-buck. Despite numerous audit failures they have escaped effective regulation and retribution and have colonised senior civil servants, current and former ministers to ensure that governments continue to indulge them. In opposition, the major accountancy firms, the Big Six, Five, now Four, provided money, services and jobs for New Labour’s boys and girls, a relationship consummated in power. Arthur Andersen was brought back into the public fold even though the Tories had refused to give the firm public contracts for botching the audits at John DeLorean’s Belfast car company. Despite numerous audit failures, no UK accountancy firm has ever been prosecuted or closed down. Announcing that there was no legislative time for the independent regulation of accountancy, promised in its 1997 Business Manifesto, Labour nevertheless rushed through Limited Liability Partnership (LLP) legislation to protect the Big Bean Counters from the consequences of their own failures. Unlike the US and the EU, New Labour proposed the ‘capping’ of auditor liability and further limit the public’s redress against negligent auditors. The Office of Fair Trading (OFT) found no case for such indulgence, the EU warned of the dangers and Treasury feared that it will cause the compensation claims to fall back onto the state sponsored regulators. Nevertheless the Department of Trade and Industry (DTI), ever under the influence of the Big Boys, obstinately persists and has promised to introduce ‘proportional liability’ even though it has been rejected by the Law Commission.

In the US the SEC has its critics, but it can still strike quick and powerfully at scandal and crisis: witness the contrast between American

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3 Soon after leaving office, Peter Mandelson, former Labour Secretary of State for Trade & Industry, became adviser to Ernst & Young. Since 2003, Sir Malcolm Rifkind, the former Conservative foreign secretary, has been an adviser to PricewaterhouseCoopers (PwC). In September 2004, former Inland Revenue chairman Sir Nicholas Montagu joined PwC. In November 2004, the former head of the Treasury’s transport team, Lewis Atter joined KPMG


response to scandals and Britain’s lax and dilatory culture of trust the chaps. In the face of huge corporate scandals (Enron, World.Com, Adelphia, Xerox etc) the SEC brought powerful retribution to bear to check abuses and bring corporations to heel. A criminal conviction was secured against Arthur Andersen within five months of the Enron scandal. The firm was closed down. All major accountancy firms are facing lawsuits and inquiries for dodgy audits and selling dubious tax avoidance schemes. The Sarbanes-Oxley Act 2002 requires company executives to personally attest to the authenticity of company accounts or suffer the consequences. Within a year, over 250 corporate fraud conviction or guilty pleas were secured, including at least 25 from former CEOs and 354 companies were persuaded to restate their accounts⁶, rising to 414 for 2004⁷. The same companies operate in Britain but little has been done to check any of the abuses which brought down so many big American corporations even though all are both available and extensively used here. Weaker UK regulatory structures lack US powers for enforcement and punishment. Government lacks both the will and the urgency.

Treasury Select Committee reports have documented the same systematic biases and abuses by the UK merchant banks, insurance companies, analysts and stockbrokers. The Financial Services Authority (FSA), dominated by corporate influences, declines to act. Creative accountancy to hype profits and transfer liabilities off the balance sheet are widely used. Indeed they are the basis of the Private Finance Initiative (PFI) accounting which not only transfers debt off government balances but in many cases off company balance sheets too with a new “Off-Off” accounting. All of this is sanctioned by accountancy regulators dominated by corporate interests. Profit related pay and executive share options provide the same incentive to cook the books and are commonly used in the UK. Most of the FTSE500 companies use offshore tax havens to avoid taxes and create impenetrable corporate structures, just like Enron, WorldCom and Parmalat. Yet auditors remain silent and the Companies Act 2004 failed to address any of these problems.

Turning a Nelsonian blind eye to all this, UK ministers responded to the US disasters by claiming that our accountants are such sound chaps, our companies so socially responsible, our “regulators” so skilled that it

couldn’t happen here even though we have a steady stream of major scandals. They even lobbied in the US for British multinationals to be exempted from the Sarbanes-Oxley Act on the grounds that they are good citizens and were already adequately regulated in the UK. “Trust the Chaps” is Labour’s message, as it was for the Conservatives.

This reversal of Labour’s traditional approach of subordinating private power to the public interest has proved more rewarding for the companies than the public. Unchecked corporate power has failed to produce economic regeneration, good governance, full employment, freedom from scandals, cleaner environment, ethical behaviour or corporate responsibility. Mission statements proclaim high ideals, but practice is all too often shabby with massaged financial statements\(^8\), fleeced customers, exploitation, job shedding and the high prices of “rip off Britain”.

The long list of corporate failures and scandals, already including Maxwell, British and Commonwealth, Ferranti, BCCI, Barings, Barlow Clowes, Coloroll, Guinness, Homes Assured and London United Investments lengthened with Marconi, Transtec, Versailles, Equitable Life, Hollinger, Independent Insurance, Aberdeen Trust, the Accident Group, Mayflower, Shell, BSE/CJD and the mis-selling of both pensions and endowment mortgages. Non-executive directors were too close to executive directors, held too many jobs and did little to check corporate abuses. Lavish fat cat rewards and salaries were boosted enormously though CEOs who could write their own rewards, showed a preference for low pay and job shedding at the other end of the company.

All this is inevitable in a free market jungle which is increasingly dominated by giant multinationals. There profit is the driver and self enrichment and greed the ethos. Good intentions and public claims to virtue are not enough to check abuses or corporate power. Only government and pursuit of collective interests can do that. If it abdicates that responsibility to phone companies, supermarkets, banks, credit card companies, financial services, car dealers, garages, utilities or drug companies, they will all develop ever more elaborate ways to rip-off people and enrich themselves.

All this matters because unchecked corporate power has serious consequences for the whole society. Tax avoidance by corporations is shrinking the tax base and forces ordinary people to pay higher taxes for crumbling infrastructure. The power of corporations and the

\(^8\) 41% of the FTSE 100 CEOs are accountants (Financial Times, 16 July 2003).
weakness of labour have exacerbated poverty, inequality and social exclusion. The protection of limited liability has been used to shield fraud and self enrichment by company executives and to exploit investors, employees, consumers, creditors, pensioners and citizens. Dodgy but officially sanctioned accounting practices have produced profit manipulation, failures and frauds which cause loss of jobs, savings, homes and pensions. All power corrupts and corporate power to negate national policies and priorities and to heighten instability through financial excesses corrupts not only corporations themselves but the whole body politic. Public purposes should prevail. Under the present balances they cannot.

The big corporate beasts can neither regulate themselves, nor check their own greed, self interest and opportunism. As long as profit and self enrichment are the drivers, as they are bound to be in unrestrained capitalism, chaps can’t regulate chaps because they’ll all defer to the common interests of chaps. Corporate governance codes, self-regulation, captive regulators and exhortations have neither checked abuses nor made corporations serve wider interests than their own. A more rigorous approach is now needed. We either tame the corporations or accept abuses, scandals, exploitation and the negation of the public interest.

Gingerly, hesitantly and nearly eight years late Labour government shows signs of looking at the problem. Consultations and tentative proposals\(^9\) have begun, though without, as yet, any considered strategy, or clear purpose. In fact the basic principles of reform are clear. The power of the public opinion and the state must be mobilised to tame the corporations by making them democratic and accountable. The power of corporations is based on the artificial personality and shield conferred by Limited Liability. What the public has given it can take away, or change, to ensure that public purposes prevail. The accountants and auditors charged with policing companies have built their power on a publicly conferred monopoly of audit. They have abused it by colluding with corporate wrongdoers. What parliament has given it can modify or change. Self regulation, chaps regulating chaps, has been tried and has not only failed but been actively abused. This must now be replaced by independent regulation.

It’s time to begin the work of reform. The proposals in this monograph seek to generate and widen debate on corporate governance and on how the principles of democracy and public

\(^{9}\) For example, see the Companies Act 2004 which received Royal Assent on 29 October 2004.
accountability in companies can be advanced. To offer a comprehensive set would take several books. The list of what could, indeed should, be done is long. Our aim is more limited. It is to begin the reversal of priorities from collusion with the corporations to invigilation, to illustrate what needs to be done, both short and long term, and to sketch out proposals which will check corporate power and protect the people by shifting the emphasis from pandering to corporations to making them democratic and accountable.

Reform will be resisted by major companies, their directors and patrons, and by accountancy firms long used to playing their selfish games, as well as by their media claque. These enemies of reform can be defeated by government taking up the case for reform and by building up a coalition for change to bring together the countervailing forces; employees, trade unions, consumers, savers, investors, academics, shareholders, injured stakeholders, trade associations and opinion formers, those who have suffered from the prevailing climate of abuse, those repelled by it, and the sane, sober and all too silent voices of those in the vested interests and in offices, factories, media and politics who know that something has to be done but who have been largely unheeded in their efforts to do it. Backed by that coalition we can begin the task of rebalancing the system.
CHAPTER TWO
The Charge Sheet

Companies and their patrons resist calls for democracy, accountability and any meaningful reform of corporate governance. That complacency is not shared by people whose savings, investments, homes, jobs and pensions have vanished because companies have exploited consumers, employees, shareholders, creditors, savers, citizens and society generally.

Those who attribute scandals to “bad apples” or fraudsters ignore the systemic abuses which arise from an “enterprise culture” which sanctions “bending the rules” for profit or personal gain as symptoms of business acumen. Stealing a march on competitors at almost any price is considered an entrepreneurial skill, particularly when competitive pressures link promotion, status, profits, markets and rewards with manipulable financial targets. All this happens because the power of the corporations has not been matched by appropriate legal, regulatory or moral constraints which require them to consider the social consequences of their practices. Failure is not seen as a result of dishonourable, predatory or anti-social practices but in being exposed or caught. That damages the carefully cultivated veneer of respectability and limits the possibilities of further fees and profits. Only a real prospect of being caught and punished can stimulate reflection on organisational practices and the consequences of what they are doing. In Britain that is very rare because the weak regulatory system lacks independence and operates to protect corporations rather than the people. When it punishes, it does so gently, almost apologetically.

Glossy corporate mission statements and press releases make great play on social responsibility and good citizenship. Neither is borne out in growing inequalities of income, organised tax dodging, or devious practices. Consumers, savers and borrowers entrust their lives and savings to companies and expect them to supply good products and services. Yet too many companies put profits before people and routinely rip people off, all to make higher profits. People have a naïve belief that auditors will invigilate companies and provide an honest account of their financial affairs. This has not been forthcoming because auditors’ first priority is their own fees. Despite daily scandals, companies are not accountable to anyone. Until they are we can’t trust them. Five areas provide a glimpse of the abuses and failures.

FAILURES OF CITIZENSHIP

Marginal corporate philanthropy helps to gloss over failures to reduce pollution, exploitation of employees, consumers and communities. Claims
for corporate citizenship should be built round obligations to stakeholders and society. All too often these are not fulfilled and failures damage both society and individual chances to live a fulfilling life. Poverty wages and tax avoidance are classic instances.

**Income Inequalities**

Chairman and CEO’s of major companies effectively determine their own rewards. They sit on each other’s remuneration committees as non-executive directors (less than 4% of whom have had an interview for their job\(^\text{10}\)) and approve unwarranted high rewards, which in turn set the benchmark for their own pay packet. This collective back scratching has produced an enormous escalation of fat cat pay and rewards. Some company directors collect nearly 300 times the average wage of their employees\(^\text{11}\) (excluding lucrative share options and other perks). For the five years to 2003 pay for company chief executives of large organisations increased by 168%\(^\text{12}\). Pay for CEOs of smaller quoted companies rose by 48% to £187,000. The average annual pay rise for British workers for the same period was 3%-4% per annum, barely keeping pace with inflation. For 2003-2004, director pay rose by 12.8%, nearly three times faster than the employee earnings (The Guardian 27 August 2004). Neither revolts by investors nor corporate governance codes have curbed this culture of lavish rewards at the top and low pay and job shedding at the bottom.

Britain’s company executives are the highest paid in Europe. In 2003-2004, 637 executives took home a whopping £593 million (Labour Research, August 2004, pp. 9-11). Directors of quoted companies collected over £500,000 a year and a record 178 collected more than £1 million. The average pay for chief executives of FTSE100 companies, with bonuses and incentives has ballooned to £2.6m whilst other directors collected £1.7 million. BSkyB’s chief executive pocketed £11.5 million, equivalent to the salary of 447 of his employees. The Chairman of catering company Compass picked up £1.8 million compared to an average salary of just £9,416 for the employees, hardly enabling them to buy decent housing, education, food or pensions for themselves and their families.


In 2003, directors awarded themselves options for 119 million shares, an increase of 133% over the previous year, with Vodafone, Barclays, Tomkins, BT and Reuters leading this gold rush (The Observer Business, 15 June 2003). The chairman, chief executive and finance director of Compass Group stood to gain £8,922,576, £7,712,265, and £3,221,314 respectively from their share options. The chief executive of Vodafone received a rise of 400% and took home a £10 million pension, making a final pay award of £11.4 million for his last year at a company losing money. Invensys sacked 14,000 workers but gave its chief executive a golden handshake of £3.2 million. The stock market value of GlaxoSmithKline declined by a third, the US regulators have accused the company of concealing the results of clinical trials of its drugs and its past tax liabilities have been queried, but its chief executive picked up £6 million in 2004.

Are the fat cats worth it? The rewards all too often go for exploitation, failure or mediocrity. Shell misled the people about the extent of its oil and gas reserves, but its ousted chairman got a £1.09 million severance package and the head of its exploration and production picked up a severance cheque of £2.5 million. In 2002, Barclays Bank reported a 6% drop in its profits. Its chief executive got share options worth £9 million. More than five million people have suffered from the pension and endowment mortgages scandals, but the CEOs of the selling companies filled their pockets. For the period 1999-2002, Legal and General’s CEO got an extra 55.8%; Aviva, 45%; Prudential, 52.5% and 71% at Standard Life whose CEO also stands to get an annual pension of between £300,000 and £430,000 for life (requiring a fund of at least £7 million). Investors in Aberdeen Asset Management saw their savings vanish in the split capital trusts scandal, but for the three years from 1999 the company’s CEO received a total of £6.5 million. On his resignation (in October 2002) he got a bonus of £1 million. Despite the dreadful record of Railtrack, its chief executive picked up a golden goodbye of £444,000.

Despite equal opportunities legislation, the gap between male and female average full-time pay is 24% and growing. Part-time female workers earn 41% less per hour than men - the same gap as 25 years ago (Equal Opportunities Commission press release, 24 March 2003). In 2003, 270,000 employees were still paid less than the minimum wage\[^{13}\]. In

July 2004, a BBC survey found that racial discrimination is rife in employment\textsuperscript{14}. More than one in six Britons lives in poverty and the proportion of people with low incomes in absolute terms have remained roughly constant since 1979 despite an average income growth of over 40 per cent\textsuperscript{15}. Some 30\% of children live in poverty and 70\% of British workers cannot afford to enter the housing market or to save for their pension. In case these huddled masses yearning to be better off get uppity and start demanding more, companies like BT, Dyson, Dr. Martens, Ernst & Young, British Airways, Wedgwood, Lloyds TSB, Prudential and Black & Decker have moved jobs to Eastern Europe and the Far East. Companies are always looking for newer pastures to exploit.

**Tax Avoidance**

Companies are shrinking the tax base and social investment with it. They are happy to accept public subsidies, tax incentives, export credit guarantees and all the benefits of the social infrastructure but unwilling to pay their share of democratically agreed taxes. Organised tax avoidance enables footballers, millionaires and companies to avoid taxes while people on the minimum wage, nurses, pensioners and debt-ridden graduates, all pay a higher proportion of their income in tax than many companies and their executives.

Organised corporate tax avoidance cannot be blamed on higher rates of taxes. UK companies carry lower social security costs (e.g. National Insurance contributions) than their counterparts in Belgium, France, Germany, Netherlands, Portugal, Spain, or Sweden\textsuperscript{16}. The 30\% UK corporation tax rate is the lowest ever, with still lower rates for small companies. It is lower than in Austria, Belgium, Canada, France, Germany, Italy, Japan, Portugal, Spain or the US, as well as the average of OECD countries\textsuperscript{17}. Successive governments, appeasing corporations, have shifted the tax burdens to individuals with the result that the income tax collected from them has increased from £48.8 billion in 1989-90 to £114 billion in 2003-04, while corporation tax over the same period increased

\textsuperscript{14} http://news.bbc.co.uk/1/hi/business/3885213.stm; accessed 12 July 2004.


\textsuperscript{17} KPMG, (2004). *Corporate Tax Rate Survey*, London, KPMG.
only from £21.5 billion to £28.1 billion\(^\text{18}\), a bare 2.5% of the GDP despite the fact that from 1990-2004 UK companies have been recording an average rate of profitability of 11.5% against an inflation rate of around 3-4%. Corporate share of the total UK tax take has dropped from 11.5 per cent in 1997/98 to 7.7 per cent in 2003/2004.

Tax avoidance is part of an enterprise culture where contributions to society are seen as a ‘cost’ and a dodge is seen as ‘profit’. In pursuit of profit related bonuses, higher salaries and share options, company directors concoct artificial transactions which create and exploit legal loopholes. 52% of Britain’s major companies admit to using ‘novel tax planning ideas’ – a euphemism for complex tax avoidance schemes (Financial Mail on Sunday, 2 March 2001). Armies of accountants and lawyers devise tax avoidance schemes and exploit the archaic ‘domicile’ and ‘residence’ laws to enable companies to avoid taxes. The same groups then advise governments and demand special tax concessions for companies.

Millionaires like Philip Green could escape tax on dividends because of our archaic ‘domicile’ and ‘residence’ laws. Green’s Arcadia retail business (which owns BHS) is owned by Taveta Investments, which is in turn owned by Taveta Limited, a Jersey-based company controlled by the Green family. This company is reported to be in the hands of his wife, who lives in Monaco. Because the assets of Arcadia Group are held outside the UK and controlled by his wife, a non-UK resident, the 2004 dividend payment of £460 million would not attract the 25% tax. A UK resident receiving the same dividend would need to pay tax of £115 million (The Independent, 28 October 2004; The Guardian, 3 November 2004). Members of the Moores family used the UK social infrastructure to make millions through the Littlewoods empire, but upon selling the company for £750 million in October 2002 they used ‘residence’ in offshore jurisdictions, such as Monaco and the Isle of Man, to avoid £60 million of taxes. The same laws enable 65,000 non-domiciled persons, including shipping magnates, steel barons, princes, footballers and others to avoid UK taxes. In 2002, 16,000 of these declared earnings of £800 million, on which they paid no tax and their ranks continue to swell (The Independent, 28 October 2004). Reclusive Barclay Brothers control an empire generating annual revenues of $7.5 billion. Its major components, such as the Daily Telegraph, London’s Ritz Hotel and Littlewoods stores are controlled through companies and trusts based in Bermuda, Jersey and the British Virgin Islands, which create

possibilities for making money in the UK but avoiding its taxes.

Another tactic is to locate corporate offices in tax havens which provide secrecy, little public accountability or public information. The Murdoch empire operates a web of some 800 subsidiaries, many registered in offshore tax havens, such as the Cayman Islands, Bermuda, the Netherlands Antilles and the British Virgin Islands. A trawl through the 101 subsidiaries of Murdoch’s UK holding company, NewsCorp Investments, for an 11-year period shows that it generated profits of some £1.4 billion. At the going British corporation tax rate it should have paid tax of over £350 million, large enough to finance seven new hospitals, or build fifty secondary schools (The Economist, 20 March 1999). In fact, it paid virtually no corporation tax in Britain where it makes its profits from people who pay higher taxes because The Sun, News of the World, The Times and Sky TV aren’t paying their share.

New Labour donor, Richard Desmond, owns a media empire encompassing the Daily and Sunday Express, television stations and a number of top-shelf magazines. His two main UK holding companies, Northern & Shell and Portland Investment Limited, are owned by trusts in Guernsey, and from 1992 to 1999, their combined turnover was £301 million, with gross profits of £91 million and net of £5.6 million. The audited accounts show a total of £200,000 paid in tax, an effective rate of only 3.6%, one-tenth of the UK corporate tax rate (The Observer, 24 December 2000). Desmond’s business is operated with skeletal staff from Jersey, saving him £2 million in corporation tax in 2002 (Financial Times, 3 December 2003). One of his companies, RCD1, even qualified for a £1.58m tax rebate, despite showing pre-tax profits of £8.98m, because its most profitable businesses were based in an offshore tax haven.

Barclays Capital, the investment banking arm of Barclays Bank, operated a National Insurance Contribution (NIC) avoidance scheme, enabling it to avoid 12% of its payroll costs (The Daily Telegraph, 14 November 2002). The scheme, designed by PricewaterhouseCoopers paid annual bonuses to staff through a Jersey registered company. Other City banks operated Grant Thornton and Ernst & Young inspired offshore trusts to pay staff bonuses in a weak currency such as the Turkish lira or the Argentinean peso (The Times, 1 December 2002). An employee is given a loan in Turkish lira, which is then converted to sterling. As the Turkish lira weakens, it takes less sterling to buy the same amount of foreign currency, so the employee makes a gain. When the lira falls, the employee repays the loan, and keeps the profit, the intended bonus but exempt from income tax and national insurance contributions. The employer claims a loss of the amount lent to the employee offset
against the company's tax bill.

Richard Branson’s Virgin empire makes money in the UK but is controlled from offshore trusts. Since its commencement, Virgin Trains have received at least £2 billion in public subsidies19 but the taxpayers don’t know anything about the true ownership of the company because it is ultimately owned by secretive trusts in the British Virgin Islands. The 2001-2004 accounts of Virgin Rail Group Holdings Limited show that the company had “franchise receipts” (or contributions from the taxpayer) of £1.44 billion million plus £350 million in compensation for track access problems. On the 2001-2004 profit of £92 million the company paid tax of £23.8 million (26%), but in 2004 its owners received a dividend of £30 million.

Global corporations, such as Boeing, Caterpillar, Coca-Cola, Daimler-Chrysler, Eastman, ExxonMobil, General Motors, Kodak, Intel, Microsoft and others have skeletal companies in offshore havens to enable them to escape their tax obligations. Enron’s tax avoidance schemes were designed by Arthur Andersen, Deloitte & Touche, Chase Manhattan, Deutsche Bank, Bankers Trust and major law firms. The company used offshore subsidiaries to create opaque corporate structures and transactions that had little economic substance. Its published accounts showed net income of $2.3 billion for the period 1996 to 1999, but for tax purposes it claimed to have a loss of $3 billion. It paid no tax for 1996 to 1999. For the year 2000, it reported taxable income of $3.1 billion, but for tax purposes it claimed a loss of $4.6 billion, a calculation now disputed by the US tax authorities20. More than 60 percent of the largest and most profitable US companies, boasting pre tax profits of $1.1 trillion, did not pay any federal taxes for 1996 through 200021. A US government report showed that because of tax avoidance contractors located in tax havens always had a cost advantage over their domestic competitors and thus there was no possibility of fair competition, because these companies used

19 Per the 2003-2004 annual report of the Strategic Rail Authority

With advice from KPMG, WorldCom created "foresight of top management", a novel intangible asset. The company then licensed that ‘foresight’ to subsidiaries for royalties, which counted these royalties as tax deductible business expenses. The company receiving the US$20 billion income was located in a tax haven and paid little or no tax on it\textsuperscript{23}. A US Senate inquiry into the sale of tax avoidance schemes by KPMG and concluded that the firm “devoted substantial resources to, and obtained significant fees from, developing, marketing, and implementing potentially abusive and illegal tax shelters that U.S. taxpayers might otherwise have been unable, unlikely or unwilling to employ, costing the Treasury billions of dollars in lost tax revenues\textsuperscript{24}”.

Oil companies, such as, Chevron, Texaco and Caltex are estimated to have avoided $8.6 billion in taxes by novel design of accounting and tax transactions with domestic and foreign governments\textsuperscript{25}. ‘Transfer pricing’ is a key mechanism for avoiding taxes. It enables multinational companies, including both British multinationals and those based in Britain, to siphon off profits by deliberately over-pricing imports and under-pricing exports\textsuperscript{26}. Tax authorities in China investigated 9,465 multinationals and found that "Almost 90 per cent of the foreign enterprises ……… use transfer pricing to dodge tax payments" (China

\textsuperscript{22} US General Accountability Office, (2004). Tax haven companies were more likely to have a tax cost advantage in federal contracting, Washington DC, GAO.
People’s Daily, 25 November 2004). US examples include paper transactions showing purchase of plastic buckets from the Czech Republic at $972.98 each, fence posts from Canada at $1,853.50 each, a kilo of toilet paper (about four rolls - unused) from China for $4,121.81, a litre of apple juice from Israel for $2,052, a ball point pen from Trinidad for $8,500 and a pair of tweezers from Japan at $4,896 each. The artificially low prices which shuffle profits to other countries include selling a toilet (with bowl and tanks) to Hong Kong for $1.75, prefabricated buildings to Trinidad at $1.20 and bulldozers to Venezuela at $387.83 each. For the years 1998 to 2001, such techniques enabled US companies to avoid an estimated $175 billion in taxes. The same companies also operate in the UK and must be operating the same schemes. British governments refuse to investigate. Britain is estimated to be losing between £25 billion and £85 billion a year in tax avoidance and evasion by companies, large enough to make a real difference to housing, health, education, security, transport and pensions. Developing countries are estimated to be losing more than $50 billion of tax revenues each year, large enough to free them from poverty and foreign aid.

PROFITS BEFORE PEOPLE

Companies make a great play of serving customers and communities, but profits usually come before people. Corporations are not accountable to consumers and savers. In the absence of real rights for consumers, employees and shareholders to elect directors/auditors, receive company accounts, examine corporate strategy, attend annual general meetings or ask searching questions, pensions and savings companies will continue to be looted to boost executive salaries, profits and dividends.

In the early 1970s, a DTI report concluded that Robert Maxwell was unfit to be a company director. Yet after surrounding himself with well-connected politicians, bankers, financiers and accountants, he re-emerged as chairman of Mirror Group (MGN) and Maxwell Corporate Communications (MCC), controlling more than 400 companies. When he committed suicide in 1991 some £458 million was missing from the

pension funds. The Maxwell empire was audited by Coopers & Lybrand (now part of PricewaterhouseCoopers), which “consistently agreed accounting treatments of transactions that served the interest of RM [Robert Maxwell] and not those of the trustees or the beneficiaries of the pension scheme, provided it could be justified by an interpretation of the letter of the relevant standards or regulations30”. The firm’s senior partner told the audit team that “The first requirement is to continue to be at the beck and call of RM [Robert Maxwell], his sons and staff, appear when wanted and provide whatever is required31”.

In the buoyant stock market of the 1980s and the 1990s, the values of pension scheme assets rose. Surpluses should have been used to provide higher pensions, or earlier retirement for employees. Instead, following the UK accounting standard on pension contributions32, many companies reduced their contributions to boost reported profits, dividends and, hence, executive pay. When stock markets declined, the same companies unilaterally ended ‘final salary pension’ for their workers, using another notorious accounting standard on pensions to legitimise it33. Privatised companies have raided the pension scheme surpluses to pay for the redundancies which followed flotation, and boosted profits by declaring prolonged ‘pensions holidays’ on the grounds that the pension scheme had surpluses.

In the early 1980s, the Thatcher government persuaded many to come off state pension schemes and exercise ‘freedom of choice’ by purchasing their own personal pension plans. Employers were not necessarily obliged (despite the terms of many occupational pension scheme trust deeds) to make a financial contribution to pension schemes, but the government offered an initial subsidy to encourage people to come out of the State Earnings Related Pensions Scheme and occupational schemes. Between 1988 and 1994, more than five million personal pensions were sold, often on the basis of misleading information. The purchasers lost some £13 billion on worthless pensions and other policies, though those marketing the schemes made millions in salaries, bonuses, perks and profits. Paltry fines (effectively paid by future stakeholders) have been imposed by the Financial Services Authority (FSA). No one has been arrested or

prosecuted. The puny fines have done nothing to curb predatory sales and encouraged the split capital and precipice bonds scandals. The belated £194 million compensation to 40,000 split-capital investors is barely enough and 6 million victims of the endowment mortgage scandal, losing an estimated £30 billion are yet to discover their fate.

Banks and credit card companies proclaim their virtue but change conditions without prior consultation. Despite claims of competition, they offer remarkably similar costs and interest rates, all indicative of a complex monopoly. Such policies enabled the Big Five banks (Barclays, HSBC, Lloyds TSB, Royal Bank of Scotland and HBoS) to declare profits of £30 billion in 2004. All are engaged in a massive effort to lure the people into excessive borrowing. Chasing ever higher profits, major banks fail to tell people they can get a higher greater return in other accounts. Despite huge profits they close branches without consultation: since 1990 around 10,000 branches of banks and building societies have closed, often in rural and less well off areas as banks switch to profiteering by internet banking and shifting jobs to offshore call centres (The Guardian, 6 January 2000; Financial Mail on Sunday, 16 Nov 2003). All this hits the elderly, the disabled, shift workers and anyone without transport. Lack of bank branches heightens exclusion and makes businesses vulnerable to theft and higher risk insurance costs.

America’s Community Reinvestment Act (CRA) 1977 bars banks from closing any branch unless it can prove to the satisfaction of the Federal Reserve that it will continue to look after the community’s banking and credit needs. Banks have to show that they are meeting the needs of low-income and minority areas where they operate, as a condition for opening new branches. Anyone can ask the bank to produce its CRA files for scrutiny. As a result, since the 1990s, banks seeking deposit taking licences, approval for mergers or relocation had to commit $4 trillion to not-for-profit loan funds and projects (The Observer Business, 9 April 2000, p.5).

Corporate lust for profits before people gave rise to BSE and CJD. Some 1.6 million infected animal carcasses were introduced into the human food chain (The Guardian, 9 October 2002). According to the World Health Organisation some 168,000 cases of BSE were reported in Britain, a disease that attacks the human nervous system, cripples the brain and results in death. More than 117 people died and nearly 4.7 million cattle had to be slaughtered. The stock market gamblers and the

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animal food producers made fortunes, but none came forward to tell the truth about their products or share their financial gains with the victims of BSE and CJD. The full extent of CJD and BSE would not be known for another 30-40 years and more than 100,000 people are at risk (The Guardian, 9 October 2002). Despite scandals, we are told little about the side effects of medicines, food additives, mobile telephones and other products. Tobacco and drug companies conceal the negative consequences of their products.

CORPORATE HANDS IN OUR POCKET

Companies produce customer charters and campaigns to convince us that we get the best prices and products. This glosses over monopolies and the excessive profits they routinely make. The privatisation of major industries has created abuses and utility prices are escalating whilst service is poor. This is supplemented by the Private Finance Initiative which guarantees corporate profits and exploits consumers and citizens through profiteering, abuse and shoddy services, with little threat of retribution.

Rip-Off Britain

Britain is the most expensive place in Europe to buy so many things. For example, motorists pay up to 60% more, even for cars assembled in the UK. An EU survey, published in 2002, compared the prices of 81 best selling models produced by the world’s 25 largest car manufacturers and found that for 52 out of 81 models, Britain was the most expensive. A Fiat Marea sold in Britain for £9,197 before tax compared to £5,583 in Denmark, Mazda charged 56% more for its 323 model. The Vauxhall Astra cost 53% more, a Nissan Almera 45% and a Renault Laguna cost 41% extra. Lured with warranties, customers still have to get their cars serviced at designated garages which can charge up to £150 per hour for labour35.

Four chains (Tesco, Asda, Sainsbury’s and the recently merged Safeway/Morrisons group) control more than 75% of the supermarket trade36. Their monopoly facilitates exploitation, restriction of choice and profiteering. British consumers pay more for household essentials than

35 As per a survey carried out by Warranty Direct (see The Guardian, 17 June 2004).
their European counterparts, even though the VAT rate is lower. The UK supermarkets have the highest profit margins in Europe. Their operating profits have increased from £884 million in 1988 to £3,355 million in 2003. Most of their employees hover around the minimum wage. Major supermarkets squeeze suppliers to maximise profits. Fifty years ago, farmers received between 45-60% per cent of the money that consumers spent on food. Today, that figure has dropped to just 7%. Coffee producers receive 5% of the price charged by supermarkets and farmers 3.4 pence a pound for potatoes sold at 28 pence a pound. Of the 50p per litre price of milk, farmers get less than 20p. The Food Standards Agency found that butchers and supermarkets sell chicken containing as much as 37% water while poorer families are priced out of a healthy diet. The Food Commission points to a 51% difference between the price of healthy, low fat supermarket food and the high fat, low fibre food the poor eat.

Cartels also gouge the consumer. In February 2003, Argos and Littlewoods were fined £22.65 million for fixing the price of toys and games (Office for Fair Trading press release, 19 February 2003). Thirteen of the world’s largest pharmaceutical companies colluded to raise the price of 12 vitamin products. In November 2001, the European Commission fined companies, including Roche, a record €855 million (£535 million) for price fixing. BASF was fined €296 million (The Observer, 25 November 2001, p. 9). Hoffman-La Roche AG, the “prime mover and main beneficiary” of the cartel arrangements, was fined €462 million. All these arrangements were conceived and executed at senior levels with regular meetings to exchange information about prices, sales value, volume and other data. Alfred Taubman, the former chairman of Sotheby’s, was found guilty of conspiring to fix commission rates with auction house rival Christie’s and Sir Anthony Tennant, a combination which controls 90% of the world’s art auctions (The Times, 6 December 2001, p. 3). The two organisations offered their customers almost identical non-negotiable terms, an arrangement which benefited Christie’s by £12-£15 million and Sotheby’s by £18 million.

Italy’s competition authority fined PricewaterhouseCoopers, Ernst & Young, Deloitte Touche Tomatsu, KPMG and Arthur Andersen £1.4 million for concluding agreements to substantially restrict competition on the auditing services market. The agreement set the fees for auditing, circulated an annual benchmark audit fee and working hours table according to the size and the sector of activity of the client firms. It laid

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http://www.agcm.it/agcm_eng/COSTAMPA/EPRESS.NSF/92e82eb9012a8c6c125652a00287fbd/991a5848bc88040dc125688f0056851d?OpenDocument&Highlight=2,kpmg
down rules for acquiring new clients in order to protect the market positions of each firm. By applying these rules, the auditing firms were able to agree, for example, on how to respond to requests for discounts from client companies, and to establish in advance the firm that would be awarded auditing contracts, in many cases making competitive tendering a mere formality (Financial Times, 22 Feb 2000, p.8). The UK government did nothing.

**Profits of Privatisation**

Water privatisation gave the incumbents a 25-year monopoly, leading to higher charges, deteriorating service and water cuts, coupled with insufficient investment. In 2001/2002, on average 22% of water failed to reach households because of leaky pipes. Some companies lost as much as 60%. Rather than eliminating the problem, they are planning to let leakages rise (Environmental Agency press release, 12 Nov 2003). Water prices since privatisation have risen by 58% in real terms and a further rise of up to 31% in real terms for 2005-2010 is planned, giving companies a profit bonanza with 25%-32% return on equity after inflation and taxes; several times greater than the regulator’s projections. In the ten years to 1999, the water companies cut 10,000 jobs to help pay for the £10 billion dividends paid to shareholders.

The electricity industry was broken up into 14 separate businesses, supplying electricity to some 26 million UK households. In the £8 billion a year domestic market, despite record price rises, each company claims to sell electricity at a price lower than its competitors. Some have resorted to misleading claims and fraudulent practices by forging customer signatures and issuing contracts on vacant properties. Energywatch, the energy industry watchdog, received 7,183 complaints in the 12 months to October 2004. People can save money by switching suppliers, but price comparisons across companies are difficult and obstructed by bureaucracy and termination fees.

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The railways were broken into over 100 separate entities sold at knock-down prices. No organisation had responsibility for the entire railway network, and profits took precedence over safety and regulation. With public subsidies steadily rising, guaranteed cash flows and assets at giveaway prices, some railway companies have received a return of 34% on turnover41. The £12 billion collected in subsidies since privatisation is supplemented by £10 billion of public investment in track and signalling equipment. Some £1 billion of dividends have been funded by subsidies, job losses, borrowings and above inflation hikes in train fares. British railways have been described as “the developed world’s least safe, most expensive and most unreliable rail systems” (The Observer, 22 October 2000) because rail travellers face the highest costs in Europe and more people die in railway accidents than in France, Germany and Spain. Lord Cullen's report42 on the Ladbroke Grove rail disaster, which resulted in 31 deaths, noted that the railway companies had "a combination of incompetent management, inadequate procedures, poor driver training and complacent attitude towards danger signals”. Here as all too often in the corporate world, health and safety is an afterthought.

Government could ask pension funds to build hospitals, schools and roads and then lease them to the government in return for income43, thus serving the people and safeguarding pensions. Instead, Labour has expanded the Tory idea of the Private Finance Initiative (PFI) to provide hospitals, schools, prisons and other public facilities quickly by paying more later. Instead of paying £30 million to build a hospital, under the PFI, the government pays contractors more through annual fees over a period of 25-30 years to fund, build and operate the facility. At the end of the contract the private sector often gets the asset while the taxpayer faces the risk of higher rents for obsolete facilities. To finance PFI deals private companies borrow money at a rate of between 2.5% to 4% higher than public borrowing which they then pass on to the taxpayer44. The government is effectively borrowing money, though under the Treasury rules this is not reported as such.

The companies are supposed to bear the risks. In practice they don’t and government provides huge subsidies by guaranteeing cash flows and profits. Many contractors use offshore tax havens to avoid taxes in the UK. The companies cut staff wages and working conditions to boost their profits. Nevertheless, 563 PFI projects to the value of £32 billion had been signed by April 2003 and are expected to rise to more than £47 billion by 2005/6\(^{45}\). The first £14 billion of PFI deals require the taxpayer to mortgage the future and hand over £96 billion to corporations over the next 26 years. PFI deals permit excessive profits and other unchecked abuses, many of which are detailed by the National Audit Office\(^{46}\). Penalties for poor performance are capped and some companies have received almost a 30% return on their investment.

PFI permits excessive profits but does not necessarily deliver better quality services. Over 90% of projects are late. The government admits that less than 25% of the projects delivered more than 80% of the promised benefits\(^{47}\). The project to provide IT for Magistrate’s Courts (project Libra) has been described as “one of the worst PFI deals”, by the Public Accounts Committee\(^{48}\) as costs escalated from £184 million to £400 million a disaster paralleled in the Passport Office, Social Security, the Health Service and the CSA IT systems. Under the PPP scheme for London Underground, monthly train failures jumped by 23%, track problems have risen by 20% to 76 a month and points failures are up by 38%. The Commission for Health Improvement (CHI) awarded the flagship NHS trust running Cumberland Infirmary in Carlisle and West Cumberland hospital in Whitehaven, the lowest marks for risk management, labour relations and information technology.

PFI is profitable because companies are not accountable and can run rings round senior civil servants, who are in any case potential consultants to the same firms. Accountancy firms provide advice to both sides as well as sitting on the government working groups which develop the policies or recommend which tender to accept while also advising bidders, even


\(^{47}\) HM Treasury (2003), op cit.

tendering in their own right, and producing “independent” reports portraying PFI as a resounding success\(^{49}\). By bringing in more than £500 million in fees it has been. For them.

**COMPANY AUDITORS: ASLEEP ON THE JOB**

Most audit reports are not worth the paper they are written on. Numerous companies subsequently involved in accounting problems have received a clean bill of health from their auditors. Auditors did not flag any problems with the accounts of Maxwell, BCCI, Polly Peck, Hollinger, Levitt, Mayflower, SFI (famous for the Slug & Lettuce pub chain whose shares were suspended in November 2002), Wickes, Wiggins, Marconi, Equitable Life, Cable & Wireless, or Coffee Republic which admitted to breaching its banking covenants (Daily Mail, 4 May 2003).

Four accountancy firms audit all of the FTSE 100, and 99% of the FTSE 350 companies\(^{50}\) and have UK income of nearly £5 billion. Major accountancy firms do ‘consultancy audits’, rather than the mundane audit job as watchdogs for stakeholders. They use audits to get a foot-in-the-door then sell all sorts of more profitable services, including recruitment of directors, tax avoidance schemes, design of systems of internal control and director remuneration packages. They design complex corporate structures and tax avoidance schemes and then pretend to audit them. They print T-shirts, badges and lay golf courses and will even check that the toilets are clean. Ernst & Young made US$4 million from HealthSouth for checking the cleanliness of parking lots and toilets.

In the UK, some accountancy firms receive more than 73% of their income from selling consultancy services, including sales to audit clients (Accountancy, October 2001, p. 7). It makes the auditor ever anxious to keep the relationship sweet to sell more services and reluctant to complain about dodgy practices which boost executive salaries. Audits are used as loss-leaders. Price Waterhouse (part of PricewaterhouseCoopers) undercut the incumbent auditor of the RAC by nearly 50% to secure its audit. Outgoing auditors, BDO Stoy Hayward, said “We believe that this demonstrates a determined approach to price their audit work on a predatory basis so as to secure an appointment which might enable them to introduce higher priced consultancy services to RAC in due course”

\(^{49}\) UNISON, (2003). *Stitched up: How the Big Four Accountancy Firms have PFI under their Thumbs*, London, UNISON.

\(^{50}\) Office of Fair Trading, 2004, op cit.
With ineffective regulation, firms skimp on the audit effort, employ novices and set unrealistic time budgets, resulting in non-performance and falsification of audit work\(^{51}\). The economic incentives for delivering good audits are weak. Unlike the producers of sweets or potato crisps, auditors do not owe a ‘duty of care’ to any individual stakeholder affected by their negligence\(^{52}\).

The extent of bad audit work only emerges when the company goes belly-up. Following a criminal conviction for shredding crucial documents, the US authorities closed down Enron’s auditor, Arthur Andersen. A former Ernst & Young partner has been fined and jailed for changing and destroying documents to impede a federal investigation into the collapse of NextCard (Daily Mail, 29 January 2005). In contrast, the UK government has failed to prosecute or close down any accountancy firm. Audit failures played a part in the crisis facing 30,000 Maxwell pensioners\(^{53}\) but the DTI took ten years to publish its report on Robert Maxwell’s\(^{54}\) frauds. Audit failures played a part in the closure of Polly Peck, valued at £1.7 billion, and the loss of 17,227 jobs. They also facilitated losses to 11,000 shareholders of Sound Diffusion Plc\(^{55}\). Following audit failures at Barlow Clowes, British taxpayers paid £153 million in compensation to investors. The British government failed to mount an independent investigation into the twentieth century’s biggest banking fraud at the Bank of Credit and Commerce International (BCCI), which resulted in the loss of 14,000 jobs as well as $1.85 billion for 1.4 million bank depositors\(^{56}\) despite the fact that a report by the US Senate concluded that BCCI’s [British] auditors were a party to a “cover up” and had caused “substantial injury to innocent depositors and customers of BCCI\(^{57}\)”.

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\(^{52}\) See judgement in *Caparo Industries plc v Dickman & Others [1990] 1 All ER HL 568* and *Al-Saudi Banque v Clark Pixley [1990] 1 Ch. 313*.


\(^{54}\) Department of Trade and Industry, (2001), op cit.


Government indifference lets lying dogs sleep. Accountancy regulators sweep things under their dust-laden carpets. After a ten-year wait Maxwell’s auditor, Coopers & Lybrand was fined £1.2 million and ordered to pay costs of £2.1 million; a total of just £6,000 per partner, tax deductible, with most blame placed on a dead auditor. After ten years, BDO Stoy Hayward were fined £75,000 for audit failures at Polly Peck with the blame placed on two dead auditors. In 1995, Barings, Britain’s oldest merchant bank, collapsed with £800 million of debts, some racked up by fraudulent activities. Seven years later, its auditors, Coopers & Lybrand, were fined £250,000 for audit failures. In May 2004, Arthur Andersen was fined £400,000 for delivering poor audits at Wickes for the period 1992 to 1995. In June 2004, the founder of the Versailles Group Plc was sentenced to six years prison for fraud but the auditors, Nunn Hayward, were fined only £50,000 for their “lamentably poor” audit. In June 2004, Bird Luckin, the former auditors of Queens Moat Houses got a fine of just £17,000 for allowing the company to boost its profits by recognising the following year’s earnings in the current year, capitalising maintenance expenditure and showing loss-making properties as generating a profit, with the result that the 1991 profits of £90.4 million turned out to be a loss of £1 billion. To date, no action has been taken against the auditors of Transtec, BCCI, Capital Corporation, Wiggins, Capital Corporation, London International Group, SSL International, Semple Cochrane, Equitable Life, or Independent Insurance. Thousands of misleading audits do not even register as ‘bad audits’ because the companies somehow survive.

British accounting practices have more holes than Swiss Cheese, as stakeholders in AOL, Bulmer, Boxclever, Cable & Wireless, Chiyoda Fire and Marine Insurance Company, Guardian iT, Kwik-Fit, MyTravel, NTL, Tiny Computers, RGB, Resources, Mayflower, Slug & Lettuce, Mayflower, Swiss Life, Wiggins, Wickes, and other companies have learnt. Most of the accounting weaknesses associated with Enron, WorldCom, Parmalat, Xerox, Global Crossing and Tyco are practised in the UK and readily permitted by the corporate dominated, funded and

59 Joint Disciplinary Scheme, (2004). Wickes Plc (Andersen and Others), London, JDS.
60 Joint Disciplinary Scheme, (2004). Versailles Group plc (Nunn Hayward and Others), London, JDS.
highly secretive Accounting Standards Board (ASB) and the International Accounting Standards Board (IASB). The 2,500 pages of UK accounting standards are the residue of negotiations amongst corporate elites and are not exactly full of principles or ethics. Indeed, ethical and moral conduct does not form any part of the operations of accounting standard setters. They allow companies to hide details of transfer pricing policies and tax avoidance schemes, but permit them to report unverifiable values and profits on derivatives, options and other financial products which are essentially clever bets.

In December 2003, Parmalat the Italian food company (with 300 UK employees) collapsed after admitting that it had lied about its finances. According to Italian prosecutors, it used subsidiaries in the Cayman Islands to misrepresent its assets. Enron used nearly 900 entities in secretive offshore havens to keep troublesome debt and transactions off its balance sheet. Indeed, such offshore links are present in almost all recent financial scandals. Yet major UK companies use offshore subsidiaries on a large scale to obscure their financial risks, which makes it impossible to make sense of their published accounts. British Nuclear Fuels Limited (BNFL) has been capitalising interest payments on loans and treating them as an investment for years. In common with disgraced US companies, the UK telecommunications companies massage their accounts by selling each other surplus capacity, known as ‘hollow swaps’. No real cash changes hand, but profits improve because the sale is treated as revenue, the purchase as a long-term investment amortised over many years.

In the US, after Enron, SEC pressure persuaded hundreds of companies to come clean and restate their accounts, or face the consequences62. In the UK, the government shunts things to the ineffective Financial Reporting Review Panel, yet another body dominated and funded by major corporations and accountancy firms. Despite scandals, “Since 1991, 14 companies have been required to revise their financial statements by issuing corrected accounts after investigation by the Panel. Over 50 other companies have been required to take alternative corrective action in respect of defective accounts” (Hansard, House of Commons Debates, 6 March 2003, col. 1152). The Panel did nothing about any of the companies involved in headline scandals. It now promises to be ‘proactive’. Don’t expect it to bite its masters.

Some 22 overlapping self-regulators (see Appendix 1 for details) regulate the accountancy industry, all exempt from compliance with the Freedom of Information Act. They are manned and dominated by the big

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businesses and run in their interests, which allows them to play fast and loose, launder money, operate cartels and pander to the interests who effectively run the self regulatory club. In the US, an SEC study found that PwC had committed more than 8,000 violations of auditor independence rules and concluded that the firm had “serious structural and cultural problems”. It was fined $5 million (SEC press release, 17 July 2002). A US judge banned Ernst & Young (EY) from securing new audit clients for six months and concluded that its partners “acted recklessly and negligently in committing wilful and deliberate violations of well established rules that govern auditor independence”. All these big multinational bean counters operate in the UK without being subject to the same scrutiny and regulation though Coopers & Lybrand partners were once fined £1,000 for violating professional rules to secure the Polly Peck receivership which brought in a £30 million fee. They must have trembled all the way to the bank.

ACCOUNTABLE TO NOBODY

Corporations are the playthings of their directors, bankers, accountants and lawyers and accountable to no one. Audit failures are institutionalised and regulators, such as the Institute of Chartered Accountants in England & Wales (ICAEW) are funded and controlled by major firms that it is supposed to be regulating. Indeed, it openly opposes laws curbing tax avoidance and is campaigning to secure liability concessions for the auditing cartel led by the ‘Big Four’ firms. Non-executive directors are the chums of company directors and don’t bite the hand that feeds them. Many are directors of tens of other companies and have neither time nor inclination to invigilate any one. Regulators like the Financial Services Authority may have started with good intentions but are easily captured by the industry they are supposed to be regulating. To be effective, regulators need distance from the regulated. They need to bring in different worldviews, vocabularies, values and agenda. Their sole concern should be to protect stakeholders, check corporate power and ensure that people

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come before profits. Little of this happens in self-regulation of chaps by chaps.

A favourite myth is that shareholders regulate corporations. In fact, they are too weak to call corporate barons to account. Individual shareholders don’t have the information, political and economic resources necessary to make management accountable. Company AGMs are stage-managed. Archaic proxy voting systems allow directors to cast thousands of votes and defeat resolutions they don’t like. Institutional investors have the resources, but little interest, for their success is measured by financial returns rather than by their involvement in the governance of companies. They manage financial risks by diversifying portfolios rather than by concentrating on getting involved in the corporate affairs of any one. The people ultimately own the pension funds, but their managers ignore the concerns of members. So, far from being a solution, many institutional investors are a source of problems by generating pressures for the quick buck brought in by mergers, take-overs, job shedding, financial massaging, closures and tax avoidance. As for the banks, they are only interested in securing a return on their loans. This makes them willing to pull the rug, rather than nurse ailing companies or support communities. They accept company shares as collateral for loans, which increase the pressures for companies to massage earnings and boost share prices. Employees invest their brains, blood, sweat, brawn and lives in companies but they have few rights. Even of consultation.

Final responsibility for regulation rests with the Department of Trade and Industry (DTI). It can’t simultaneously act as judge, jury, promoter, defender, underwriter, rescuer and prosecutor of big business. So it doesn’t even try. When it does initiate an enquiry it is always dilatory and usually secret. Effectively government has handed power to unaccountable business interests. Unsurprisingly, asset stripping is rife through mergers and take-overs which give big gains to speculators while reducing competition, consumer choice, creating monopolies, and bringing tax avoidance opportunities through ‘transfer pricing’ policies. Nothing beyond the occasional sermon has been done to check the greedy self rewarding of company directors, or the widening pay and reward gaps between the top people and mere employees.

In sharp contrast to its treatment of trade unions, employees, consumer associations and public sector workers, the government’s policy is that "Leading business executives are to be given a central role in setting strategy for the Department of Trade and Industry" (Financial Times, 22 November 2001). Government jobs, policymaking, advisory, and enquiry and regional development functions, task force
places, even ministerial jobs have been lavished on businessmen, such as Robert Ayling, Sir Peter Davies, Lords Haskins, Simon, Levy, Sainsbury and Marshall. The government handed control of the review of Company Law to corporate elites, with predictable results. Ever since the Companies Act 1967 (now part of the Companies Act 1985) there has been a requirement that "The matters to which the directors of a company are to have regard in the performance of their functions include the interests of the company's employees in general ......" (Companies Act 1985, Section 309). Having totally ignored it, government is now set to abolish that obligation.

Effective retribution could check corporate abuses, but Britain lacks effective regulatory structures. The Crown Prosecution Service, the Serious Fraud Office, the Metropolitan Police Fraud Squad, the Inland Revenue and Customs & Excise, all badly financed and fragmented, are no match for the might and the duplicitous skills of big business. The prosecutions of Kevin Maxwell, Ernest Saunders, Roger Levitt, Asil Nadir, George Walker, Stephen Hinchcliffe, Wickes’ directors and others do not inspire confidence. Yet instead of reforms, successive governments have preferred “reviews” which stymie real change. They have been happy for the well-oiled corporate machine to commission its own ‘do little’ reviews, as evidenced by the Cadbury, Hampel and Higgs reports. All opposed independent regulation of companies, redistribution of wealth, rights for stakeholders, public accountability of corporate power, or any ‘duty of care’ to stakeholders.

Real change will not come as long as private profits are put before people. The public senses that private interest must be disciplined to serve public purposes. It sees that ‘trust the chaps’ and ‘leave it to the markets’ does not work. It feels, however dimly, that a wholesale change in corporate culture is necessary but is bamboozled by the corporate reassurance machine. A programme of democratisation, public accountability and effective independent regulation is needed. Only this can ensure that the

public interest prevails over private interests by bringing corporate power under democratic control.

**CONCLUSION**

Corporations exercise huge social power behind the publicly provided veil of limited liability. They have a legal personality and a right to default on debts. Limited liability shields managers and directors from the consequences of their actions. Despite bearing the brunt of corporate abuses, employees, shareholders, consumers, savers, investors, creditors, pension scheme members and citizens have too few rights or powers to call companies to account. Britain does not have an independent regulator for the corporate sector. Auditors go where their pockets lead them and collude with company directors. As a result, audit reports are rarely worth the paper they are printed on. The same firms sell tax avoidance schemes to deprive millions of people of pensions, healthcare and education, public transport and quality of life.

Elected governments may be concerned about reducing inequality, poverty, discrimination or environmental degradation but are increasingly overruled by corporations, which abandon local communities, avoid taxes and manipulate profits and capital in their own interest. Once people could influence things through the ballot box or industrial action, but in the era of markets, ministers and trade unions only wring their hands. Governments have become impotent against companies with the best accountants, auditors, lawyers, bankers, financial analysts and other advisers. Despite the pious proclamations of their mission statements, too many CEOs are more preoccupied with fat cat paycheques, bonus and share options, than with the welfare of customers, employees, shareholders or citizens.

Abuses are not just the result of a few ‘rotten apples’ but embedded in a corporate culture which eschews social responsibility, celebrates the quick buck and is driven by the systemic pressures to appease stock markets and institutional investors. Profit related remuneration at the top encourages financial engineering, poverty wages, disregard for health and safety and abuse of stakeholders. Too many companies feel, and are, free to abuse their position and power because in a poorly regulated system they can get away with it. There is no countervailing power, no effective regulation, no threat of retribution, all too little threat of exposure beyond a flickering media searchlight operated by other big corporations, which live in glass houses. In the corporate world virtue isn’t its own reward. Chaps world can’t be left to chaps to run.
CHAPTER THREE
What is to be Done?

Successive governments have abdicated their responsibilities. In the ensuing vacuum, corporate interests regulate and review themselves. They reject independent regulation, and rights for stakeholders, with the tacit agreement of the government. After the Enron and WorldCom scandals the US introduced the Sarbanes-Oxley Act and the SEC flexed its muscles. Britain got more reviews, a Treasury Select Committee report on the financial regulation of public limited companies. This was followed by weak Companies Act 2004 promoting failed ideas, such as rotation of audit partners rather than the necessary rotation of firms. The offshore link to corporate abuses was ignored. Despite the impact of corporate policies on employees, investors, savers, consumers and local communities, the Higgs Review of non-executive directors advocated greater concentration of power in the unitary board and opposed audit committees directly elected by stakeholders in favour of committees made up of directors’ chums, such as those which have already failed at Polly Peck, BCCI, Enron, WorldCom, Maxwell, Parmalat and Transtec. The corporate sector has remained free to regulate itself in its own interests.

Yet, as the power of corporations grows unchecked so the volume of protest and public concern grows about poor products/services, environmental degradation, uneven economic development, organised tax avoidance, wage inequalities, loss of pensions, endowment mortgages, cartels, scandals, worsening employment conditions, and CEO greed. Rail and food disasters, rip-offs by supermarkets, car manufacturers, pollution and BSE/CJD all show that employees, investors, consumers, and lives are affected by corporate policies. Yet government, which has the final responsibility for the welfare of citizens, has failed to introduce any major reforms of the way companies are governed. So the people are losing faith in the ability of political institutions to control the corporations and make them accountable.

Rather than being the private fiefdoms of the rich, the popular view of companies is that they should be more accountable, democratic, better regulated, dedicated to serving the real needs of real people and concerned with the public interest, rather than just their own. A new balance needs to be drawn. Democracy and public accountability must be invoked to change the environment in which corporations operate and stop them

organising their own accountability off the political agenda. This requires changes to both the regulatory framework and the internal governance of companies, as well as reforms of the institutions governing politics.

**The Regulatory Framework**

The Mafia cannot regulate the Mafia. In any regulatory system, there is a concern that the regulators will be ‘captured’ by those to be regulated. Yet this is the starting point in the self-regulation of companies and accountancy, with predictable results. New Labour accepted the principle of independent regulation with the Food Standards Agency and the Financial Services Authority but failed to apply the same principle to either the corporate sector or the accountancy industry. Both remain dominated by company executives, huge multi-national accountancy firms, greedy insolvency practitioners and bankers who are all shielded from public scrutiny and retribution.

To bring corporations under democratic scrutiny, the government must extend the principle of statutorily based independent regulation to the company sector. Ideally a pyramid structure of regulators all subordinate to a Business and Finance Commission (BFC) should be created to ensure that regulation, implementation, enforcement and prosecution are co-ordinated and focused. One part of this, the Financial Services Authority is already in place though it needs to be made more effective and accountable. It should be supplemented by a Companies Commission to ensure that all major (non-financial) corporations have a dedicated independent regulator.

Since accountancy lubricates all aspects of business activity, the Companies Commission must assume responsibility for all aspects of accounting and auditing policymaking, enforcement, monitoring and prosecution. Instead of the numerous overlapping bodies (see Appendix 1) which presently regulate accountancy, a single independent and statutory-based regulator is needed to eliminate duplication, waste and obfuscation. Co-ordination of regulation under this single umbrella will stop complainants and issues being passed from ‘pillar to post’. Joined up regulation will also make the FSA more effective and efficient in preventing companies from peddling dubious financial products. Rather than playing slow motion catch-up, the regulators can be proactive and the statutory base and independence will give them the power to deal with the biggest corporations and accountancy firms.

The Companies Commission will ensure that companies cannot boost profits, dividends and executive salaries by forgoing contributions to
employee pension schemes. Instead of being allowed to scrap final salary schemes and damp down pension rights, companies should be required to sustain them, for example by issuing share options to pension schemes. They are based upon a legal and moral contract and any company transferring resources out of them breaks it and should be investigated by the regulators. Companies reporting pension deficiencies should be required to make good past foregone contributions.

In co-operation with other regulators, the Commission should break the collusive relationship between the company, its merchant bankers, stockbrokers, lawyers and financial analysts. All should be licensed and monitored and required to keep all background information for ten years. In conjunction with the FSA, it must require investment banks to hive off equity research divisions so as to prevent the conflicts of interest which lead to dud research and hyping of share prices. They should be required to publish (e.g. on their web sites) minutes of all meetings held with the company and its executives, and any information received by them. All agreements with corporate clients should be made publicly available. Anyone hyping up share prices by publishing misleading information or receiving fees and commissions should face civil and criminal penalties.

The Companies Commission should always meet in the open and pursue a 'full sunshine' policy, with agenda papers, working papers, policy notes, correspondence, reports, background papers and minutes all accessible to the public. Unlike the present accountancy and insolvency regulators, it should be subjected to the full force of the Freedom of Information Act 2000. The same must also apply to all other regulators such as those regulating water, gas, electricity, telephone, food, financial services, or trading, which act on behalf of citizens. Members of the Commission, appointed by ministers, should be approved by the House of Commons Select Committees in ‘open’ hearings. The membership of the Commission should include a plurality of interests, including employees, consumers, NGOs, trade unions and employer interests, but be dominated by none. All members should sever connections with employers and serve for a maximum of five years. Public hearings should be an integral part of their proceedings and an independent Ombudsman should investigate complaints against the Commission with periodic scrutiny from the Parliamentary Select Committees. The Commission can be funded by licence fees from auditors, insolvency practitioners and other regulated entities, by increases in the cost of company incorporations, by charges for the filing of annual returns of large companies, and, as necessary, out of general taxation.

The basic role of the Commission will be to change corporate culture
and set a framework of rules and best practice, checking performance and withdrawing recognition from both directors and companies as necessary. It should be able to carry out speedy inquiries and close down companies engaged in harmful practices. It should also maintain a register of non-Executive Directors, drawn from business large and small, NGOs, trade unions, consumer associations, shareholder associations, academe and voluntary organisations, with PLCs required to appoint from this list. By incorporating the work of the Takeover Panel, it will be able to demand proof that mergers and take-overs benefit employees, local communities, shareholders, customers and society generally before they are allowed to go ahead. It will also need the power to regulate markets, control insider trading, profiteering and to send its own in-house inspectors into troubled companies at short notice to investigate and report. To ensure that lessons are learnt quickly, these reports must be promptly published to build up the necessary library of experience.

Companies Commission regulation of the accountancy industry means taking over all licensing, monitoring, and regulation of auditors and insolvency practitioners from accountancy trade associations. It should regulate the contents of published company accounts, including a requirement for companies to give details of all tax avoidance schemes and offshore structures that they use. The main test for all disclosure practices should be what is good for citizens rather than the convenience of capital markets. It should proactively monitor the accounts of the biggest companies, publishing the results of its deliberations as well as all background papers, correspondence and minutes. Whistleblowers must be actively encouraged, rewarded and protected. Contracts requiring employees to keep silent about anti-social activities of companies, especially those facilitating injury and harm should be unlawful. The rules for accounting should be based upon the rules currently applied to the computation of tax liabilities so that anyone breaching them will be committing a criminal offence.

The Commission should hold a public inquiry into the ‘fair value’ model of accounting currently being promoted by the Accounting Standards Board (ASB). Under it, companies second-guess future markets to arrive at figures for financial bets on derivatives, hedges, call and put options. The value of many financial products (e.g. derivatives and options) cannot be verified for many years and depends on uncertain future events and depending upon assumptions can range from zero to several millions though scandals, such as Long Term Capital Management
(LTCM), show that even Nobel Prize winners in economics are unable to work out the values of such securities. LTCM had to be rescued by a $3.6 billion bailout by the US Federal Reserve\textsuperscript{72}. Yet, the ASB allows companies to use such highly speculative values in balance sheets. Finally, the Companies Commission, in conjunction with the Financial Services Authority, will need to test all financial products before they can be marketed. Those deemed harmful should be banned.

**Reform of Audit**

The current model for company audits was developed in the late nineteenth and early twentieth centuries. Since then multinational corporations, electronic communications and novel financial products have transformed both the scale, power and the risk of corporate activities. Yet the auditing model has never been rethought. Ex-post audits by compliant external auditors, in fact, day-trippers in the company, are totally inadequate in the era of instantaneous money transfers for banks, financial conglomerate and global corporations.

The auditing industry itself shuns public accountability. It is dominated by an international cartel of four multi-national firms, all headquartered in offshore tax havens who have a vested interest in the status quo and don’t want any rethink about the possibilities of creating alternative institutional frameworks to call them and their corporate clients to account. Despite costing billions, the auditing model continues to fail. The Commission should, therefore, hold a public inquiry into the current auditing model and consider replacing audits with insurance cover which would compensate stakeholders for director fraud, negligence, misrepresentations and misleading financial statements. Under such circumstances, insurance companies would have to decide the extent and limits of audits needed to determine the risks. Such a system would require auditors to contract directly with insurers making it difficult to abdicate responsibilities for detecting/reporting fraud and other irregularities. The Companies Acts would also need to stringently define the minimum requirements for disclosure. Failure to comply would make directors personally liable.

The Companies Commission could also take responsibility for appointing and remunerating company auditors with the cost met by a small levy on major companies. Audits could be conducted by staff directly employed by the Companies Commission. However, if audits by accountancy firms are still considered to be desirable the model will require

major reform. Unless major companies can demonstrate that auditors are acting exclusively as auditors and are totally independent of the company, its directors and their associates, the Commission should take responsibility for selecting and appointing the auditor, ratified by a simple vote of individual shareholders, employees, bank depositors and other creditors, where appropriate. Directors should not be able to subvert this (or any other) decision by proxy votes. If the company stakeholders are dissatisfied with the proposed audit firm they should be able to nominate an alternative.

After the collapse of Arthur Andersen, only four accountancy firms dominate company auditing and they continue to hold governments to ransom by demanding liability concessions and reduced accountability. So the Commission will need to break the monopoly of the Big-Four and expand the supply of auditors. No firm should be able to audit more than 10% of the FTSE 500 companies. The Commission should authorise new organisations, such as the Inland Revenue, Customs and Excise, the National Audit Office, and non-governmental organisations to conduct company audits, with the added benefit that this could also curb aggressive tax avoidance schemes and promote social responsibility.

Accountancy firms should not be able to obstruct international inquiries (as they did in Enron, BCCI, Barings, and International Signal Corporation Group) or prevent regulators from scrutinising their working papers. They frequently hide behind an assumed duty of confidentiality to clients, which prioritises private interests over public. The Companies Commission should have a statutory right of access to all auditor working papers, with powers to investigate the overall standards and organisational practices of firms implicated in audit failures. It should have the right to pass copies of auditor working papers to recognised international regulators. To prevent shredding of crucial information (as in Enron), auditors will be required to keep all audit working papers, files and background notes for ten years. Failure to comply should result in civil and criminal penalties. Auditor files should be available for inspection by designated representatives of stakeholders (e.g. an audit committee directly elected by stakeholders). The Commission will also need the power to fine and prosecute auditing firms and secure undertakings from them on improving quality control, organisational structures, practices and standards. Those failing to deliver improvements should be closed down though auditors and stakeholders will be able to seek a judicial review of the recommendations of the Commission.

The state guaranteed market of external auditing was not given to

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73 For evidence, see Mitchell and Sikka (2002), op cit.
accountants to use as a stall from which to sell other services. Using the audit as a sales platform makes auditors ineffective. It also gives them an unfair commercial advantage over other sellers of consultancy services. Auditors should not be able to sell consultancy or any other services to audit clients. Neither the audit firm nor any of its associates should be a party to any transactions being audited. These practices are not acceptable in local government, health or criminal justice organisations, where the Audit Commission appoints auditors and mostly prohibits them from selling consultancy services to their audit clients. Auditing firms accepted that constraint as a condition for being able to do public sector audits. Yet they resent the principle in the corporate sector where they do anything for a quicker and a bigger buck than audit provides.

Longevity in office led to auditor cosiness at Maxwell, Levitt, Queens Moat Houses, Polly Peck, Enron, Barings, WorldCom, Equitable Life, Atlantic Computers, Waste Management, Parmalat, Versailles, Transtec, Grays Building Society and many other failures. No audit firm or its associates should hold office in any group of companies or its subsidiaries for more than five years, with earlier rotation if the Commission deems it necessary. Where the auditors have been changed during the year, a report should be filed stating any matters discussed by the directors and the new proposed auditors. If accounting policy changes in the company coincide with the replacement of auditors, the incoming and outgoing auditors should give their views on such changes. 'Opinion shopping' is a widespread phenomenon in the UK as directors approach auditing firms to ask whether they approve of their favoured accounting policies and solicit offers to show company performance in the best light. Since director salaries, pensions, perks and bonuses are increasingly linked to accounting measures, there is a direct incentive to ‘opinion shop’. The inevitable result is ineffective audits. So the incoming auditors should provide details of any links between them, the company and its subsidiaries, and directors.

Auditor duties should be specified by statute, not by the accountancy trade associations. The Companies Acts spell out the directors' duties in considerable detail, but similar detail is absent for auditor responsibilities because the industry prefers vague arrangements to enable it to dodge responsibilities. Accountancy trade associations claim that auditors are not responsible for detecting and reporting fraud, even though after BCCI, financial sector auditors were given a ‘duty’ to report irregularities to the regulators. They also deny responsibility for commenting on business efficiency and effectiveness. Yet such audit objectives are commonplace in the public sector. Auditors of all PLCs should be required to search and report material fraud to the appropriate regulators, within 24 hours of becoming aware, and to do so even without the
knowledge of client companies.

No member of an audit team should obtain paid employment with an audit client for a period of five years after their last audit visit. The Caparo judgement which reduced auditor responsibilities should be repealed. Auditors should be required to owe a ‘duty of care’ to the individuals who are recognised as shareholders, creditors, pension scheme members and employees at the date of the audit report. Without such obligations auditors have little incentive to deliver good audits. All firms authorised to conduct the audit of a large company, as defined in the Companies Act, should be required to publish and publicly file meaningful information about their own affairs, including copies of the audit contract and audit tender, report on a company’s internal controls, the composition of the audit team, relationship with company directors and related companies, assurance given/received from directors, conflicts of interests, and details of meetings held with the audit committee, and so on. Audit reports should be accompanied by details of any legal and regulatory action taken against the firm and its staff and any out-of-court settlements made during the last five years.

**Internal Invigilation**

Effective external regulation must be accompanied by effective internal invigilation to make companies responsive to the interests of stakeholders rather than the short-term interests of CEOs, whose stay at a company is usually less than four years. That turnover rate is steadily increasing as pressures grow to produce quick results. Universal adult suffrage, the norm of public accountability, should be the basis of corporate governance. Employees invest their lives in companies and should enjoy the same rights as those investing money. Scandals, such as BCCI, Maxwell, Equitable Life and Independent Insurance show that bank depositors, employees and pension scheme members are all affected by corporate policies while pension miss-selling and the endowment mortgage scandal show how savers, depositors, borrowers and customers are affected by the decisions of directors. To safeguard their interests, they too should appoint and remove directors and auditors, attend AGMs, table resolutions, ask questions and initiate investigations. Shareholders, company employees and stakeholders generally should elect directors (executive and non-executive) of companies with more than 500

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employees. Company directors should be full-time and not allowed to hold directorships in more than one group of companies. Their powers, role and duties should be defined by legislation.

Scandals, such as WorldCom, Ahold, Parmalat, Maxwell, Hollinger and Enron, show that too much power is concentrated in relatively few hands. Executive directors are too easily able to manipulate matters relating to accountability and probity. This power is best controlled by ending the unitary board structure and replacing it with two-tier boards, the second tier consisting of elected independent non-executive directors representing stakeholders, host communities, employees and consumers. Non-executive directors should take responsibility for probity, accountability, accounting policies and internal controls. They should not hold multiple directorships or share options in the company.

Through archaic voting procedures and the proxy voting system, company directors can cast thousands of votes, stymie debate and rebuff searching questions. This must be ended. To ensure that absent stakeholders are fully aware of discussions and questions at AGMs, company websites should carry full transcripts of the meetings. Stakeholders should be entitled to vote through websites.

In the present system executive directors effectively appoint members of company remuneration committees, who are often directors of other companies, and ever ready to hype up the general level of financial rewards. These committees should be composed entirely of directly elected non-executive directors. They should recommend an executive remuneration package to stakeholders with full details of all present and future rewards (financial or non-financial) to directors being published. Executive salary packages should be approved by a vote of individual shareholders, employees and other stakeholders at the company’s annual general meeting. Company directors should not participate in these votes.

Company directors are the highest paid individuals in Britain. In return, they should do an efficient and effective job. If the interests of stakeholders can be furthered, by links to measures of corporate performance, these should be to job creation, employee training, customer satisfaction, equitable distribution of wealth, reduction in pollution, quality of products/services, regulatory action, services to local communities, etc. No director should receive more than ten times the average wage in the same company, ensuring that extra rewards for directors lead to better rewards for employees. Directors of major quoted companies should not hold shares in the companies employing them. This encourages ‘insider trading’, profit laundering
and share price hyping, none of which encourages wealth generation or care for stakeholders. For the same reason, directors should not be eligible for share options.

As part of an effective system of internal controls, major companies should have an adequately staffed internal audit system which reports to the Audit Committee, rather than the CEO. This Audit Committee should review its reports and findings and provide a summary to all stakeholders. It should also assist non-executive directors (or the second tier of directors) in developing policies on probity and accountability.

**Accountability**

Railway accidents, BSE/CJD, the plundering of pension schemes and other scandals show that a wider variety of stakeholders are affected by corporate conduct. Yet the duties imposed on company directors are mainly financial and their responsibility is to a very narrow group of individuals, namely shareholders. This should be changed so that directors owe a ‘duty of care’ to all stakeholders. There should be a new offence of ‘corporate killing’, so that companies and named directors can be prosecuted where mismanagement causes death or injury. Courts should have powers to close guilty companies. By using their enormous resources, companies can stop individuals from raising serious social concerns about employment, human rights, pollution, product safety and health hazards. To check corporate power, the libel laws need to be changed to favour the citizen rather than powerful corporations. Companies should not be able to conceal any information that could prevent injury, disease and harm to people. The public’s ‘right to know’ should take priority over any concerns about corporate secrecy and confidentiality. Companies are an artificial legal creation and should not be accorded the human rights enjoyed by natural persons. Indeed, the protection and advancement of human rights should form an integral part of the constitution of every company.

Instead of using corporate social responsibility reports as a soft PR tool, companies should be required to show that they are actively pursuing policies to strengthen equal opportunities, close gaps in gender and age pay and to end racial discrimination. They should be required to publish statistics on Key Performance Indicators (KPI’s), such as the composition and wages of the workforce and senior managers, together with details of job training, and of the measures taken to stop externalising of costs, by using the environment as a free dustbin, dumping pension costs or evading the consequences of product safety. Legislation rather than the business dominated Accounting Standards
Board (ASB) should set basic social and environmental standards for all major companies. Their social responsibility reports should provide meaningful information on:

<table>
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<th>Category</th>
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<tr>
<td><strong>Pay</strong></td>
<td>Highest and lowest, the number of workers on minimum provision and the ratio between top and bottom. The gap between the average male and female earnings and the steps taken to reduce it.</td>
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<tr>
<td><strong>People</strong></td>
<td>The composition of the workforce by gender, age and disability, together with the gender/ethnic composition of top management.</td>
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<tr>
<td><strong>Accidents</strong></td>
<td>The number of accidents at work, and the number of people who are suffering from work related incidents. Details of the legal action, if any, taken against the company and the settlement and promises that it has made.</td>
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<tr>
<td><strong>Democracy</strong></td>
<td>The consultations that take place with employees, consumers and local communities and their outcomes.</td>
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<tr>
<td><strong>Environment</strong></td>
<td>The amount of waste, carbon and pollution companies discharge into seas, rivers and the atmosphere, the kind of harm that can do or has done and the steps taken to curtail it.</td>
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<tr>
<td><strong>Consumer Service</strong></td>
<td>Number and nature of consumer complaints, how they are dealt with and how many upheld. When products were last tested and the main findings.</td>
</tr>
<tr>
<td><strong>Outsourcing</strong></td>
<td>The transfer of any service or part of production overseas, the effects of this on employment, communities and costs, the processes of consultation invoked in the decision and the provisions made on safety, pay, environmental standards and trade union recognition in the new host country.</td>
</tr>
<tr>
<td><strong>Tax Avoidance</strong></td>
<td>A report on the countries in which the company trades, makes profits and where these are booked for tax purposes, indicating any “special purpose vehicles” bought and from whom and the extent of the avoidance resulting on the national level of corporation tax.</td>
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Community Care Expenditure on community projects, sponsorship of the arts, sports and plans to improve the local social infrastructure.

All this will remind companies of their wider social obligations beyond the short-term pursuit of profit. It will also enable citizens to decide whether they wish to buy goods and services from the company concerned and help investors make their own assessments of corporate ethics, risks to future cash flows and the national and social sense of responsibility of companies they wish to invest in.

The value of information depends upon its timeliness. All large companies should file annual reports with Companies House within 60 days of year-end. The current seven months is too long and the six months proposed in the Company Law Review is barely an improvement. In the age of information technology, companies can produce reports within a very short period, and already do so for internal purposes. Bankers and other creditors imposing covenants through debenture trust deeds demand information within days of the year-end. Financial analysts get regular briefings to hype share prices. Ordinary stakeholders should not be the last people to receive information.

Directors hype up company results by claiming that performance was “good” or even “excellent”, or that the company has been a “good citizen”. In the absence of real knowledge of corporate targets and plans, such expressions are meaningless. Major companies must, therefore, be required to publish financial and non-financial performance targets to allow stakeholders to judge performance against commitment. When companies come to the stock market, they are required to publish profit forecasts as part of the prospectus. Profit forecasts are routinely and quickly produced at times of takeover bids and mergers. Major creditors and bankers regularly demand and receive forecasts. Any management worth its salt uses regular targets and forecasts to continuously measure and monitor performance. With forecasts so regularly and easily prepared, requiring publication is no hardship.

To ensure that directors accept full responsibility and fully understand the consequences of irresponsible actions and activities, they must personally certify all published company financial and non-financial statements and be personally liable for fraudulent or misleading statements. Personal certification of company reports should be a necessary condition for listing on any recognised stock exchange. The same should also apply to auditors. Defrauding employees, pension
scheme members, shareholders or other stakeholders should lead to mandatory sentences of 10 years in prison with appropriate fines.

Accountability needs to be broader than disclosures in annual accounts. Companies can be called to account through other means. They should not be able to make profits in a location, often with taxpayer support, then fly-off, shedding jobs to boost profits, while leaving local communities to mop up the mess and make good the environmental degradation. Before leaving or closing factories or major offices, companies should be required to make good all environmental and other damage caused by their operations, to repay all public grants, sweeteners, tax incentives and loans, with interest, and to make annual contributions out of their enhanced profits to the redevelopment of the area they leave, and the retraining of the workers they abandon.

Similarly, before closing branches, banks must be required to consult the local community and demonstrate that their withdrawal will not leave it, or particularly vulnerable groups such as the elderly and those without personal transport, any worse off for banking, credit and other facilities. Before opening new branches, banks should be required to demonstrate that they have policies to help poorly paid people and minorities in the area. Care for the community must be made an essential condition for renewal or extension of deposit taking licences.

**A Taxing Process**

Corporate tax avoidance has reached epidemic proportions. With the aid of bankers, financiers, lawyers and accountants, companies design complex and opaque corporate structures to avoid accountability. Places, such as Jersey, Sark, Gibraltar, Guernsey, the Isle of Man, the Cayman Islands, Monaco, Bermuda and the Bahamas, enable companies to avoid taxes, regulations and social responsibility. Many of these tax havens are Crown dependencies. Companies based in tax havens are not required to publish any information about their affairs. Indeed, competition between them is leading a race-to-the-bottom with ever laxer regulation and reduced social obligations. Thus Jersey, not content with facilitating tax avoidance/evasion and money laundering scams, entered the game of regulation hopping by passing Limited Liability Partnership (LLP) legislation in 1996, written by two accountancy firms to enable them to escape UK regulation, negligence lawsuits, and public accountability.75

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Under pressure from the EU and the OECD, the UK government commissioned the Edwards report\(^{76}\) on financial regulation in the Channel Islands and the Isle of Man. This produced some minor improvements, none of which prevent tax havens from enabling companies to launder profits, avoid tax and social obligations. A special House of Commons Select Committee should be set up to invigilate the governance of all the Crown dependencies, with a brief to end their tax haven status. In compensation, they should be given development aid to rebuild their economies which could be funded out of a small (e.g. 0.5 %) ‘Tobin Tax’ on speculative money flows.

Tax havens should be required not only to open up the books, publish information and establish effective independent financial regulators but also to exchange information with other countries so that companies and individuals who participate in looting and tax avoidance/evasion can be made accountable. The authority and powers of British financial regulators, such as the Financial Services Authority and the Companies Commission should be extended to all Crown dependency tax havens to mesh in with effective regulation there.

Tax avoidance is wealth transfer from ordinary people to corporations and their controllers. Companies use social infrastructures to secure profits then escape payment for it. Payment of democratically agreed taxes, is a fundamental part of social responsibility and companies making profits in the British Isles must be required to pay tax on the profits made here whether the company is headquartered here or elsewhere.

The present distinction between ‘domiciled’ and ‘non-domiciled’ tax status was invented to enable Britons running colonies to avoid tax in their new host countries. It continued into the post-imperial world and is now used by corporations and rich individuals to avoid taxes in the UK. It should be abolished. Wealthy individuals and corporations using offshore tax havens to avoid UK taxes must be required to deposit 25% of the sums transferred to tax havens as an advance payment of tax, to be offset against their final tax liability as and when agreed. Public contracts should not be given to companies registered in tax havens, or avoiding other forms of social responsibility. Any company opening an offshore operation should be required to table a resolution to that effect at the AGM and secure the support of stakeholders. All offshore entities

operated by British-based companies should be registered with the Inland Revenue and any bank, law or accountancy business encouraging tax avoidance through artificial transactions should lose its licence to trade.

Any UK company paying corporation tax below the legal rate (currently 30%) should be required to publish details of any tax avoidance schemes used for that purpose. Information about any offshore vehicles used and the fees paid for them should also be disclosed. The annual accounts of major companies should provide full details of reasons for locating in offshore havens, beneficiaries behind secret trusts, and tax loss to the host country. The must explain differences between accounting and taxable profits. Where companies avoid taxes through artificial transactions, aggressive transfer pricing schemes, or shell companies located in offshore havens, government could levy taxes based upon estimated UK revenues, market share and profits.

Transfer pricing rules intended to artificially avoid taxes should be unlawful. When stock is transferred to overseas parties on a cessation of business, often highly contrived, the open market price must be used to determine value. Excessive intergroup management fees and expenses should be disallowed for tax purposes, as should the cost of patents purchased from companies within the same group. Profits earned by a related non-resident from non-arm's length transactions with local associates should be taxed in full and artificial and fictitious transactions ignored. The Revenue should have the power to stop all transactions and schemes it deems to be entered into for the sole or dominant purpose of obtaining a tax benefit and all schemes for avoidance should be registered, vetted and, if necessary, vetoed by the Revenue before they can be sold. Changes in a company’s share ownership for the dominant purpose of utilising tax losses should be similarly disregarded. The onus should be upon companies and their advisers to show that transactions have a commercial substance. The recently announced £5,000 fine for accountants and lawyers who fail to register details of tax avoidance schemes is totally inadequate, indeed pathetic compared to the profits made by selling such schemes. Accountants and lawyers drawing up tax avoidance schemes using artificial companies or creative financial transactions should be personally liable for the lost taxes and interest on them. The Inland Revenue should have unhindered access to the files of accountants and lawyers promoting aggressive tax avoidance and transfer pricing schemes.

Dealing, even coping with the present massive scale of organised tax avoidance is an impossible task unless the Inland Revenue is beefed up and better staffed to take on the expertise and resources of major
corporations, accountancy and law firms who dream up avoidance schemes. Britain needs a highly paid and better supported elite tax squad to deal with the big boys, and avoid the perennial poaching which undermines the Revenue’s efforts by stealing trained people and turning gamekeepers into affluent poachers.

Cleaning up Politics

Abraham Lincoln said, “I see in the near future a crisis approaching that unnerves me and causes me to tremble for the safety of my country. …… corporations have been enthroned and an era of corruption in high places will follow, and the money power of the country will endeavour to prolong its reign by working upon the prejudices of the people until all wealth is aggregated in a few hands and the Republic is destroyed. I feel at this moment more anxiety for the safety of my country than ever before ….77” His fears are borne out as politicians, parties and policymakers are bought by big business. Wealth and power are being concentrated in few hands and the corporate elite promotes and enforces the myth that business wisdom is more valid than the public interest or citizen concerns. Cleaning up politics is a necessary precondition for effective corporate governance reform and for subordinating the business agenda to broader social needs.

American politicians and parties depend on company donations, sponsorships and support for television time and media campaigns. Major accountancy firms spent US$50 million to defeat Arthur Levitt’s proposals for curbs on the sale of non-auditing services and mobilised their political friends to overturn President Clinton’s veto on liability concessions78. Oil and energy companies, including Enron, lavishly funded George W. Bush’s 2000 presidential campaign to the tune of £135 million. On taking office he scrapped the Kyoto agreement on the environment, gave permission to drill for oil in Alaska, and gave his backers big contracts to rebuild Iraq79. The payback for supporting the 2004 campaign will also be high.

Corporate donations and gifts flow to parties and politicians in Britain too. Big accountancy firms, the utilities, banks, financial institutions, defence

78 This was the only Bill vetoed by President Bill Clinton during his eight years in office (Clinton, W.J., (1995). Veto Message, 141 *Congressional Record* H15, 214).
contractors and others have contributed cash, services and staff. They buy places at Labour’s “high plate” party dinners, governmental advisory committees, task forces, and Think Tanks, and contributions to party funds facilitates titles, contracts and jobs for those who make them. In return, New Labour, like the Conservatives, defers to the donors. It resists EU directives on employee rights, damps the Minimum Wage and the Working Time Directive, expands corporate power through privatisation and gives liability concessions to accountancy firms to protect them from the consequences of their own failures. After a £1 million donation from Bernie Ecclestone, Labour dropped its opposition to tobacco advertising and sponsorship in Formula One racing. It reluctantly returned the donation, but the public felt that government is for sale. Company executives admit that “their contributions buy them access to the legislative process” (Financial Times, 19 October 2000). Several firms have seen donations followed by contracts and some liken donations to political parties to “an escalating arm’s race [and] fear retribution for not giving and they describe contributions as being tied to legislative outcomes” (Financial Times, 19 October 2000). All this builds alienation, weakens trust, and reinforces the assumption that politicians are up for hire as tools of corporate wealth and privilege or recipients of brown envelopes stuffed with money.

We need public debate on how company influence can be curbed or eliminated. Yet it is straightforward to begin by banning the worst practices and bringing everything into the light. Parliamentarians should be prohibited from taking consultancies, fees, jobs or paid posts outside Parliament. Companies should be banned from making any political donations to individual politicians or parties. All corporate gifts, services or support for politicians or political organisations should be disclosed. Prior permission of all stakeholders must be obtained. If companies want to make political donations they should be used to sustain democracy, and given to a Foundation for Democracy, to be divided between the parties, according to share of the popular vote.

It is important to free politics from the suspicion that governments, ministers, or MPs do favours for money and encourage citizen participation, so that corporate power can begin be checked. Both can best be done by state funding of parties on a pound for pound basis for every pound raised by the party through membership fees. This gives parties the incentive to build up the maximum membership at the cheapest fee, a process which will strengthen their roots in civil society and give them a bigger workforce for the nitty-gritty of party work and a wider pool of talent for office than the dangerously narrow and shallow one now available. It will free them from the growing dependence on
donations from companies and the wealthy which their declining membership makes inevitable.

It’s impossible to keep politicians wholly pure and pristine, or ask companies to behave like Trappist Monks. Yet we can begin to control the intrusion of corporate power into policymaking and into the institutions of democracy. Companies, trade associations and related organisations have representations to make, arguments to put, and requests to proffer. They want legislation and policy change. The proper channel is through visible and transparent lobbying, working in the vast penumbra of interest groups attached to Parliament and to Departments, putting arguments and evidence to Select Committees and MPs, individually or generally. MPs should be informed, not bought. Their first interest, concern and duty should always be to the people not their own pockets.

**Conclusion**

We can have either democracy and public accountability or rampant corporate power with enormous private wealth and power concentrated in the hands of a few business executives, but not both. Companies generate economic activity. Yet corporate power can’t deliver human satisfactions or happiness. Indeed, unchecked corporate power now threatens so much, including the environment, earth’s scarce resources, the future of the human race, and even the survival of the planet.

Democracy and public accountability should not stop at the factory gate or office door but should form the basis of a new social settlement with companies, to ensure that they are run for the benefit of people, not the short-term interests of capital markets, CEOs and professional advisers. This agenda will need to be sustained by reforming the basis of school and university education so citizens learn about social responsibility, ethical conduct, compassion, care for the community, and the environment, rather than the dubious pleasures of speculation, greed, maximization of profits, financial engineering, consumer binges and the ever quicker and ever bigger buck.
CHAPTER FOUR
New Settlement New Business

The consequences of unchecked corporate power are scandals, speculation, asset stripping, rising social inequalities, dodgy accounting, financial manipulations, loss of pensions, savings, investment, jobs, homes, consumer rip-offs, tax avoidance and organised looting of companies and the environment. Shareholders can’t control companies. Auditors are ineffective and regulators captured, lightweight or invisible. The lives of ordinary people are affected by corporate policies and activities, but people have few rights. Yet the basis on which corporate power rests: the legal persona of limited liability company status and the accountants’ monopoly of external audit were conferred by Parliament on behalf of the people. In the face of failures and abuses, corporate privileges can be modified, even taken away. It’s time, therefore, to review the privileges, modify the structures and provide for democratisation, openness and accountability. That means a new social settlement with the corporations to ensure that the people rule.

The people sense that corporations are too powerful and that they abuse their social and economic power without effective control, responsibility and accountability. Yet many companies will resent reforms to democratise or change them. Without reforms they will continue to pursue narrow interests, harm innocent stakeholders and further discredit themselves. So the balance must be redressed and companies regulated and made accountable so they take account of the welfare of stakeholders, employees, pension scheme members, consumers, shareholders, citizens and society generally. Only reforms that advance democracy and accountability can give legitimacy and credibility to companies, restore confidence in their operations and stop them from being used as personal power bases or self-enrichment casinos.

Companies accustomed to getting their own way won’t necessarily welcome a new social settlement which makes them more democratic and accountable and their directors more responsible. They have no god but profit and in pursuing that almost anything does as long as it does not come to public attention. Companies are run by ambitious, powerful and often wilful CEOs who use corporate resources to oppose anything threatening their personal convenience. They disarm critics by proclaiming commitment to community, public service, consumers, citizens and employees. In practice they resent social obligations, regulation or employee and citizens’ efforts to have say in policy decisions or do anything which restricts their convenience. Naturally, self-interest dominates. In an age of greed that leads to
excessive self-enrichment and abuses.

Without reform, many companies will neither live up to their proclaimed intentions nor fulfil their public responsibilities. Abuses by some damage all and encourage others to desert the straight and narrow. Even Adam Smith recognised that to be successful, capitalism needs to be fair and ethical. Yet neither consumers nor stakeholders can invigilate companies without enforceable rights, legal and institutional support and a regulatory framework. Markets certainly can’t.

Previous advances in social obligations, such as the minimum wage, workers’ rights, equal pay, health and safety, environment, product/food safety, and the minimal provisions for openness and accountability had to be imposed in the teeth of opposition from big business, amplified by its lobbyists and media chorus. The same will be necessary again. Yet wiser business souls will see the need to build confidence in companies and work with the people. Scandals; abuses and exploitation have now made the time ripe to bring corporations under democratic control and end naïve government deference to business and to develop practical measures based on independent regulation, public accountability and democracy to strengthen the public interest and rebalance power between the people and the corporations. This should be the basis of a new social settlement which is neither corporate chaos nor state control, but allowing stakeholders to control and direct companies so that people come before profits.
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<td>Financial Services Authority</td>
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**NOTE:** There is some overlap. The list would be even longer if the Joint Monitoring Unit (JMU) and Joint Insolvency Monitoring Unit (JIMU) were included. Both are registered as separate organisations, but are owned by the accountancy bodies. The ACCA has a separate monitoring unit. The accountancy bodies also operate their own disciplinary panels. The above list also excludes the five Recognised Qualifying Bodies (RQBs), effectively the professional accountancy bodies, whose qualifications must be passed to enable anyone to become an auditor or an insolvency practitioner.
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