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The corrosive effects of neoliberalism on the UK financial crises and auditing practices: A dead-end for reforms☆

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ABSTRACT

The UK's financial sector has been the subject of frauds and crisis during every decade since the 1970s. The crisis has been fuelled by neoliberal ideologies which emphasise light-touch regulation, individualisation, excessive faith in markets and pursuit of private profits, with little regard for social consequences. Auditors are expected to flag matters of concern to shareholders and regulators, but that did not happen in the events leading to the 2007–2008 banking crash or any of the other headline scandals. Despite the failures, banking and auditing reforms continue to be grounded in neoliberal ideology and are unlikely to address the crisis.

1. Introduction

Crises and crashes are inherent to the capitalist system (O'Connor, 1987), and the banking crash of 2007–2008 triggered a financial crisis whose effects have been felt around the globe culminating in unprecedented corporate bailouts and austerity programmes (Stiglitz, 2003, 2010). The crisis related not only to banks and the financial sector, but also to various support structures, including regulatory agencies and auditing practices (Sikka, 2009; Turner, 2009; UK House of Commons Treasury Committee, 2008). The crisis has elicited complex and contradictory national responses, often conditioned by local antagonisms, ideologies, histories and institutional structures (Laeven & Valencia, 2010). In this context, the UK is a worthy candidate for study. It is the world's seventh-largest and Europe's third-largest economy, and the state has developed policies conducive to expansion of the financial sector (Erturk, Froud, Johal, Leaver, & Karel Williams, 2007; Ingham, 1984; Morgan & Goyer, 2012). At the height of the crisis, the UK government felt that the country was just "two hours away from a financial meltdown".[1] The government bailed out banks by injecting £375 billion through its quantitative easing programme[2] and by expanding borrowing. In May 2014, some seven years after the crisis hit the headlines; the government was still providing £934.7 billion of loans and guarantees to support the financial sector. This amount forms part of the official public debt of some £2219.2 billion, which is about 131.6% of the gross domestic product (UK Office for National Statistics, 2014), and has provided a justification for wage freezes, public expenditure cuts and an austerity programme. Between 2008 and 2014,

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[1] The Independent, Alistair Darling: We were two hours from the cashpoints running dry, 18 March 2011, http://www.independent.co.uk/news/people/profiles/alistair-darling-we-were-two-hours-from-the-cashpoints-running-dry-2245350.html (accessed 28.02.14).

[2] http://www.bankofengland.co.uk/education/Documents/targettwopointzero/t2p0_qe_supplement.pdf (accessed 03.03.14).

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the UK economy stagnated and the gross domestic product hardly increased.[3] One of the consequences is that UK workers, especially those in public services, have experienced the biggest real-term drop in their living standards since the mid-19th century.[4]

A variety of explanations for the crisis draw attention to matters such as subprime mortgages, financial innovation, inadequate capital, high leverage ratios, reckless risk taking, excessive executive remuneration, market failures, failure of regulation, business ethics, poor accounting, auditing and corporate governance arrangements (for example, see Admati & Hellwig, 2013; Bischoff, 2009; HM Treasury, 2009; Independent Commission on Banking, 2011a, 2011b; Stiglitz, 2010; Turner, 2009; UK House of Commons Treasury Committee, 2008, 2009a, 2009b, 2012; UK Parliamentary Commission on Banking Standards, 2013a, 2013b; Walker, 2009). A common UK response to the crisis is to restructure the regulatory bodies. After the revelation of frauds at the Bank of Credit and Commerce International (BCCI) in 1991, the blame for the regulatory failures was pinned on the Bank of England and the regulation of the finance industry was handed over to the Financial Services Authority (Arnold & Sikka, 2001). After the 2007–2008 crisis, the Financial Services Act 2012 abolished the Financial Services Authority and gave the Bank of England responsibility for stability in the finance industry.[5] The revamped structures continue to be populated by financial elites,[6] possibly in the belief that the industry is best regulated by those experienced in it, but this can also mean that the worldviews naturalized in the industry may not be scrutinized. The main legislative response to the banking crash is contained in the Financial Services (Banking Reform) Act 2013. The centrepiece of the Act is a possible ring-fencing of retail banking from investment banking at some future date, but without details of any rules for ring-fencing. In a fragmented system, it does not directly address matters relating to capital structure, leverage, accounting, auditing, corporate governance, executive remuneration, etc., as these are farmed out to a variety of other agencies. In promoting the legislation, the government said that the reforms would “create a stronger and safer banking system”.[7] In contrast, a former Chancellor of the Exchequer said that the legislation “will not ensure the safety of the financial system”,[8] and the chairman of the House of Commons Treasury Committee, which investigated some of the causes of the banking crash, said that the legislation was “so weak as to be virtually useless”[9] as it did not constrain excessive risk-taking by banks, and did not create robust regulatory structures (also see Independent Commission on Banking, 2011a, 2011b; UK Parliamentary Commission on Banking Standards, 2013b).

Reliance on external auditors[10] has been central to regulation of the financial sector even though arrangements rarely deliver the promised outcomes (Collins, Dewing, & Russell, 2012; Matthews, 2005; Sikka, Willmott, & Lowe, 1989; UK House of Lords Economic Affairs Committee, 2011). Once again, despite numerous ‘red flags’, auditors gave a clean bill of health to almost all distressed banks (Sikka, 2009). A well-established approach is to mediate crises by individualising failures, producing soothing reports with promises of far-reaching reforms and the tweaking of accounting and auditing standards, the format of audit reports, codes of ethics and disciplinary arrangements (Collins et al., 2012; Matthews, 2005; Sikka & Willmott, 1995a, 1995b). The same pattern is being repeated again (for example see, European Commission, 2014; Financial Reporting Council, 2011, 2013; Sharman, 2012; UK House of Lords Economic Affairs Committee, 2011) with possibilities of auditor rotation and further restrictions on the sale of selected consultancy services to audit clients. Such reforms may well reassure sceptical stakeholders and secure some improvements in audit practices, but do not amount to any fundamental changes. For example, there is virtually no scrutiny of the pressures of commercialisation which persuade accountancy firms to prioritise welfare of client company directors over broader society (Hanlon, 1994), non co-operation with financial regulators (Arnold & Sikka, 2001), or organisational dynamics which encourage falsification of audit work (Otley & Pierce, 1996; Willett & Page, 1996).

In contrast to much of the official literature (for example, Bischoff, 2009; Financial Reporting Council, 2011, 2013, 2013; HM Treasury, 2009; Turner, 2009; Walker, 2009), this paper’s central argument is that the post-crash reforms of the UK financial sector and auditing practices are unlikely to provide a durable solution to the crisis. Typically, regulatory deckchairs are rearranged, and audit reports, auditing standards, codes of ethics and disciplinary arrangements applicable to auditors

[3] Financial Times, GDP estimates set to push UK economy above pre-crisis peak, 20 July 2014, http://www.ft.com/cms/s/0/a2938720-0e88-11e4-b1c4-00144feabdc0.html#axzz3EFbDOUCM (accessed 24.09.14).

[4] Financial Times, When will the big squeeze on wages end? 6 September 2013, http://www.ft.com/cms/s/0/1abaeafe-161e-11e3-856f-00144feabdc0.html#axzz39VMrgiZi (accessed 29.07.14).

[5] The Act created two new structures: the Prudential Regulation Authority (PRA), under the umbrella of the Bank of England, and the Financial Conduct Authority (FCA). The PRA is responsible for the prudential regulation and supervision of the financial sector. The FCA is responsible for the promotion of competition, functioning of markets, preventing market abuse and the protection of consumers.

[6] For evidence see http://www.bankofengland.co.uk/pra/Pages/about/prapeople.aspx and http://www.fca.org.uk/about/structure/board (accessed 25.06.14).

[7] Financial Times, Osborne backs sweeping reforms for banking industry, 8 July 2013, http://www.ft.com/cms/s/0/c94870ba-e7bf-11e2-9aad-00144feabdc0.html#axzz32IFckJHI (accessed 20.04.14).

[8] The Telegraph, Lord Lawson says banking reforms won’t make system safe, 5 April 2014, http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/10747096/Lord-Lawson-says-banking-reforms-wont-make-system-safe.html (accessed 20.04.14).

[9] The Telegraph, Andrew Tyrie: bank reform legislation ‘so weak as to be virtually useless’, 8 July 2013, http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/10167457/Andrew-Tyrie-bank-reform-legislation-so-weak-as-to-be-virtually-useless.html (accessed 20.04.14).

[10] Within the available space, this paper does not examine the role of fair value accounting in the crisis which has also attracted considerable attention (see Financial Services Authority, 2011; UK House of Commons Treasury Committee, 2009b; also see The Economist, The crisis and fair-value accounting, 18 September 2008, http://www.economist.com/node/12274096 (accessed 29.03.14).

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