Financial sector

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Analysis

'Decline in quality': auditors face scrutiny over string of scandals

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In recent years, major audit firms have failed to spot key problems. We list the most prominent cases

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Britain has a good claim to be the birthplace of the modern audit profession. Yet more than 150 years after being forged in the heat of the industrial revolution, British auditors are under intense scrutiny after a string of scandals. Grant Thornton, the former auditor of cake chain Patisserie Valerie, which collapsed this month amid fraud allegations, argued this week that it is not the role of accountants to uncover fraud.

Last year, the Financial Reporting Council found that there had been a decline in quality across the "big four" auditors - Deloitte, EY, KPMG and PwC. In recent years auditors have been criticised for failing to spot financial problems at some of the UK's best-known companies. Here are some of the most prominent cases.

Patisserie Valerie

Auditor: Grant Thornton

The Serious Fraud Office is investigating the collapse of cake chain Patisserie Valerie after the company revealed that possible "fraudulent activity" had resulted in a £40m black hole in its accounts. The Financial Reporting Council (FRC) - the accounting industry regulator - said in November that it was investigating work carried out by Grant Thornton before the irregularities were uncovered. David Dunckley, Grant Thornton's chief executive, received an incredulous reaction from Rachel Reeves, the Labour MP and chair of the business select committee, when he told MPs this week said it was not the role of audit firms to uncover fraud.

Carillion

Auditor: KPMG

A damning report by MPs in May last year said that KPMG had been complicit in signing off the "increasingly fantastical figures" of Carillion, the building and support services firm that went bust at the start of 2018. The report added that internal auditor Deloitte had failed to identify "terminal failings" in risk management and financial controls, or "too readily ignored them". The big four earned £72m in fees between them from the company in the 10 years before it failed, in a bankruptcy that is expected to cost taxpayers at least £150m in costs like redundancy payments and legal fees. The FRC has opened an investigation into KPMG's auditing of Carillion.

Conviviality

Auditor: KPMG

Bargain Booze owner Conviviality fell into administration in April 2018 after a buying spree in which it snapped up a host of companies in the food and drinks industry. The company blamed a "spreadsheet arithmetic error" for the first of three profit warnings in three weeks shortly before its collapse. It also found a £30m tax bill for which it had not budgeted. The FRC opened an investigation into the audit carried out by KPMG in July.

Rolls-Royce

Auditor: KPMG

Rolls-Royce agreed in 2017 to pay £671m in penalties to settle long-running corruption allegations in a deferred prosecution agreement. Months later, the FRC said it had started investigating KPMG's conduct in relation to its audit of Rolls-Royce's financial statements between 2010 and 2013.

BT

Auditor: PwC

BT announced in 2017 that it had uncovered inappropriate behaviour at its Italian subsidiary, which misstated profits by more than £500m. The FRC is investigating PwC over its audit of the Italian division. In 2017 BT said KPMG would replace PwC as its auditor, ending a relationship that had lasted more than three decades.

Mitie Group

Auditor: Deloitte

Mitie reported a full-year loss in 2017 after an accounting review forced it to take a significant financial hit. The £88.3m charge meant the outsourcing company - a rival of collapsed Carillion - swung to a loss. The FRC announced an investigation into Deloitte's audit shortly after.

BHS

Auditor: PwC

PwC was fined £6.5m by the FRC for its auditing of BHS, which collapsed in 2016. The FRC said BHS's 2014 accounts were incomplete, inaccurate and misleading because they said Sir Philip Green's Taveta, BHS's then owner, would provide it with financial support. But Taveta's backing only applied while it owned BHS. When the audit was signed in March 2015, BHS was days away from being sold for £1 in a deal that eventually led to its collapse. PwC admitted there were "serious shortcomings with this audit work and that it is important to learn the necessary lessons". MP Frank Field criticised "complacent audit rubber-stamping" for the bankruptcy of the retailer, which came at a cost of 11,000 jobs.

Sports Direct

Auditor: Grant Thornton

The FRC said in November 2016 said it was investigating Sports Direct's auditor, Grant Thornton, over its failure to report a deal that Sports Direct struck with Barlin Delivery - which delivered online purchases to customers outside the UK. Barlin Delivery was owned by the brother of Sports Direct's founder and controlling shareholder, Mike Ashley. Sports Direct said Grant Thornton decided that the company did not need to disclose a "related party" transaction despite the close relationship. Sports Direct said last year it had terminated its deal with Barlin.

Ted Baker

Auditor: KPMG

KPMG was criticised by the industry regulator last year for breaching ethical standards in its dealings with fashion retailer Ted Baker. The auditor was sanctioned by the FRC for providing expert witnesses to Ted Baker in a commercial court case, which the regulator said compromised KPMG's independence as the retailer's auditor. KPMG was fined £3m, and there was a separate reprimand and fine of £80,000 for one of its audit partners.

Quindell

Auditor: KPMG

Insurance claims handler Quindell, now known as Watchstone, is being investigated by the Serious Fraud Office after delayed accounts in 2015 showed a £238m loss for the previous year, following questions over how it accounted for previous acquisitions. KPMG was fined more than £3.1m for misconduct related to its audit of Quindell after it failed "to obtain reasonable assurance that the financial statements as a whole were free from material misstatement".

The inquiries

Competition and Markets Authority An interim report in December proposed that audits of the UK's biggest companies, listed on the FTSE 350, should be split between at least two firms, one of which should be from outside the big four. These auditors escaped calls for them to separate their consulting and auditing arms.

Kingman review John Kingman, the chair of insurance group Legal & General, said the FRC was "built on weak foundations". In December, he suggested the watchdog should have the power to ban firms from auditing large listed groups and to investigate all company directors, not just those registered as accountants.

Government Outgoing London Stock Exchange chair Donald Brydon is carrying out a government-sponsored review into the audit industry.

Labour In a Labour-backed report, Prem Sikka, professor of accounting and finance at the University of Sheffield, called for the introduction of a state auditor and for the separation of the Big Four's auditing and consulting arms.

Parliament The business, energy and industrial strategy select committee is hearing evidence on the sector. Committee chair Rachel Reeves said the current audit market was broken and undermining public trust in business.
