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A web of private interest:

how the Big Five acccountancy firms influence and profit from privatisation policy

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UNISON

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SUMMARY

UNISON , the public service union, has produced this report to expose the vested interests of the five largest accountancy firms that now profit from the industry that has grown up around the private finance initiative (PFI) and public private partnerships (PPPs).

The government has used two reports to defend PFI, the Andersen Report (Value for Money Drivers in the Private Finance Initiative, January 2000) and the PricewaterhouseCoopers Report
(Public Private Partnerships: A clearer View, October 2001). The reports lack hard evidence and UNISON's investigation has revealed that both Andersen, PwC and the other three major accountancy firms are themselves beneficiaries of PFI policies and may find it hard to be impartial.

The Big Five accountancy firms act as auditors to both private and public sectors but increasingly have developed into management consultancy which now provides half of their profits. This has raised concerns as to whether auditors who also sell other services to their clients can remain independent.

Much of the consultancy work is on privatisation. At the same time, the Big Five have been at the heart of government policy development on privatisation acting as secondees to government departments; developing the value for money tests used for PFI projects; and producing reports for the government on the benefits of PFI and PPPs.

Public alarm is growing at the potential conflicts of interest of the different roles taken on by the Big Five. When UNISON examined PFI schemes where the Big Five acted as financial advisers, we found that in 45 cases the advisor to the public sector was also the auditor to at least one of the consortium members or bidders on the project.

A Web of Private Interest:
How the Big Five accountancy firms influence and profit from privatisation policy

1. Introduction

Companies profiting from privatisation are also running privatisation policies. The UK Government relies on the reputation and expertise of the Big Five accountancy firms (table 1) to develop, promote and implement Public Private Partnerships (PPPs) and the Private Finance Initiative(PFI) whilst the management consultancy arms of the Big Five profit hugely from the Government's flagship policy.

Table 1: The Big Five Accountancy Firms

	UK Partners	World Partners	UKStaff	World Staff
PricewaterhouseCoopers (PwC)		10,000		150,000
Andersen Worldwide	500		6,500	
KPMG	690		12,000	
Ernst & Young	430		7,200	
Deloitte Touche Tohmatsu			7,500	95,000

Source: Company Reports

What do the Big Five bring to privatisation, how big is the business, and what influence do they have over the policy and its implementation?

2. *True accounting and the rise of management consultancy*

The accountancy profession provides the indispensable public services of true financial reporting and auditing. Independent auditing is important in both the private and public sectors, for accountability to shareholders and taxpayers. Stock markets depend on trust in the quoted value of companies for private trading to take place and since the 1970s public bodies like health authorities and colleges have increasingly relied on private accountancy services for accurate audits.

The public auditing role of the Big Five is impressive. In evidence to a House of Commons Committee PwC describes itself as "the Audit Commission's largest private sector audit supplier responsible for the audit of approximately 13 per cent of all audit appointments it controls. PwC is the Commission's appointed auditor for some 165 bodies in England and Wales, operating from centres of excellence in London, the Midlands, Norwich, Manchester, Newcastle and Cardiff." (House of Commons. Select Committee on Environment, Transport and Regional Affairs. Tenth report session 1999-2000. The Audit Commission, HC 174-I; 22 June 2000 Appendix 4.)

There is a close link between auditing and management consultancy in local and central government. When PFI was developed in the early 1990s accountancy companies were well placed to step in as management advisors at the local level. Their reputations as independent auditors undoubtedly gave their clients confidence.

3. Half the Big Five's profits come from management consultancy

The accountancy industry now derives as much profit from management consultancy as it does from auditing. The large firms have broadened their range of services to the extent that they no longer call themselves mere accountants. Management and technology consulting, and advice on tax, corporate finance and recruitment have become standard services alongside accountancy.

U.S. revenues for management advisory and similar services for the five largest public accounting firms amounted to more than $15 billion in 1999. Revenues for these service lines are now estimated to constitute half of the Big Five's total revenues. From 1993 to 1999, the average annual growth rate for revenues from management advisory and similar services was twenty-six percent.

The concern of US financial watchdog, the Securities and Exchange Commission (SEC), is that auditors who also sell other services to their clients are no longer independent. (US Securities and Exchange Commission. Final Rule: revision of the Commission's auditor independence requirements, file number S7-13-00, 10 December 2001) The obvious danger is that auditing is compromised when it takes a back seat and is used to lever in more profitable consultancy work. Loss of independence means less trustworthy financial statements.

The fear is well justified. One of accountancy's professional bodies in the US advises that the entire business adviser/audit process is based on understanding the client's business and acting in the owner's best interest. But this, as the SEC points out, is contrary to the auditor's public duty of impartiality.

The management consultancy arms of the Big Five are both clients and client advocates in the privatisation industry. As fee earners they benefit from the policy, and as auditors and consultants to the utility companies and private consortia buying into privatised sectors they benefit from their clients increased profitability.

In the UK the Big Five also act as financial adivsers on the many PFI and PPP projects. Table 2 lists the numbers of projects that each of the Big Five are advisers to and their capital value.

Table 2: The Big Five as Financial Advisers on PFI Projects

		Number of PFI/PPP Contracts			Project Capital Value
		In progress	Signed	Total	(£m)
1	**PricewaterhouseCoopers**	36	106	142	15,498.34
2	**KPMG PPP Advisory Services**	36	78	114	22,143.24
3	**Deloitte & Touche Ltd**	21	45	66	4,385.69
4	**Ernst & Young**	9	31	40	1,953.32
5	**Andersen**	6	26	32	10,294.99
	Total	**108**	**286**	**394**	**54,275.58**

Source: PublicPrivateFinance and OGC Database, May 2002

4. *The size of the privatisation business*

Privatisation became a major earner for UK accountancy firms when Mrs Thatcher came to power in 1979. By 1985, Price Waterhouse as it then was had set up a new section to deal with the burgeoning programme of privatisation. By the end of 1999 PwC had been responsible world-wide for privatisation deals worth about £22 billion, and in 2000 it led the table of PFI signings having advised on 90 UK PFIs worth £8.3 billion, nearly 40% of total signings by the big five in the UK. Only Arthur Andersen, with a quarter of PwC signings, achieved a higher value in that year (£9 billion).

In 2000 PwC handled 222 privatisation deals for international clients valued at $5.1 billion and described itself as “the market leader in project finance and privatisations”. PwC now boasts that it has “acted on more privatisation than any other financial advisor, from steel and heavy manufacturing to utilities, public transport, health and education services."

The fees associated with this type of work come from business case preparation, arranging finance, and advising public bodies and governments. More recently fees have been earned from refinancing existing PFI deals. Refinancing produces extra profits when loans are re-negotiated at lower rates of interest after completion of the construction period when risks have been reduced. For example, last year PwC was appointed to lead the deal that could land Carillion, United Medical Enterprises, and venture capitalist Innisfree around £20 million extra profit from refinancing the Dartford and Gravesham Hospital.

These gains are at the expense of the public sector. The National Audit Office calculated that when refinancing of the Fazakerley PFI prison contract increased shareholders’ rate of profit from 16% to 39% it left the prison service with increased liabilities of up to £47 million.

As we shall see, the same accountancy firms that extract windfall profits for their private sector clients also devised the system for the public sector that permits the gains.

5. *The Big Five as international lobbyists for privatisation*

With so much potential fee income riding on privatisation, it is hardly surprising that the Big Five should take an entrepreneurial interest in the policy.

Accountancy firms work with government to increase the export of privatisation expertise. Top firms KPMG and PwC have just launched a joint document with the Partnerships UK (PUK, a private sector agency in partnership with the government) and International Financial Services London (IFSL) to boost the export of management consultancy. Published in late 2001, *Public Private Partnerships, UK expertise for international markets* aims "to develop commercial opportunities" internationally in public services including health, education, transport, prisons and defence.

IFSL, formerly British Invisibles, is a private sector lobby group promoting the UK-based financial services industry. It works closely with the UK government and EC through the Liberalisation of Trade in Services (LOTIS) Committee. It markets the "expertise of UK firms" which it says is "crucial to the budding international market for public private partnerships." The expertise "has been built on the 400 PFI contacts worth over £17 billion signed in the UK up to the end of 2000". IFSL is banking on a further £20 billion by the end of 2002 "of which a half may be attributed to the London Underground and the National Air Traffic Services." It says it is currently active in promoting PPPs in Mexico, Spain, Germany, Denmark, Poland, Canada, Czech Republic and Egypt. The IFSL has a PPP working group chaired by Tim Stone of KPMG that runs training sessions for foreign governments. Stone is also the MoD's advisor on the largest PFI deal to date, the 'Future Strategic Tanker Aircraft'.

Accountancy firms also lobby governments to liberalise and privatise through the World Trade Organisation. Arthur Andersen has lobbied the US International Trade Commission and the new US chair of the Transatlantic Business Dialogue (TABD), a private lobby created to influence US and EC trade negotiators, is James Schiro of PwC.

The accountancy firms have privileged access to the corridors of power. When representatives of the powerful public-private industry group, LOTIS, gave evidence to the House of Lords, it had to explain why alone among EC citizens it had direct access to the European Commission rather than access through its national government. (House of Lords. Select Committee on European Communities. Tenth report session 1999-2000. The World Trade organisation: the EU mandate after Seattle, HL 76, 22 June 2000.)

6. How do the Big Five influence policy development and implementation?

(a) Secondment

The accountancy firms have not simply sat back and profited from government polices. They have been at the heart of policy development. From this too they have earned fees. Their secondees work in government departments that devise, negotiate, and drive privatisation policy.

When in 1997 the Treasury created a Taskforce to encourage PFI, a merchant banker was appointed to lead it supported by a small team of experts from the private sector. Among these experts were personnel from the Big Five. The secondees laid on briefings for civil servants and "in-depth training in Private Finance Initiative (PFI) project management, project finance and negotiating skills."

(b) Evaluation and methodology

Accountancy firms have helped introduce commercial investment appraisal to the public sector. Among the techniques is the value-for-money (VFM) calculation that schemes have to pass to get government approval for PFI. The Big Five firms devise and run these calculations.

Thus, for PFI development and evaluation the government has relied on firms with an interest in profiting from the policies. One consequence is that PFI is managed by a parallel but private civil service away from public scrutiny.

(c) Propaganda

Andersen Report

In 2000, with PFI's financial soundness still being questioned, Arthur Andersen, of Enron fame (Box 1), came to the government's rescue with a report claiming that a study of 29 schemes showed PFI had saved 17% on conventionally procured projects and that most of the saving (60%) was due to the private sector assuming risks formerly borne by the public sector. (Value for Money Drivers in the Private Finance Initiative, Arthur Andersen and Enterprise LSE, January 2000)

But the study could not substantiate its central claim that PFI was 17% "cheaper" since most of the savings occurred in just three schemes. Nor could it show that the savings were mostly due to risk transfer. In fact, the source of most of the cost savings could not be identified at all.

In reality, the Andersen data simply recycled the rosy value for money claims made for government approval purposes before implementation. Ironically, it was an Andersen project that would show how unreliable such claims were. The Andersen Consulting PFI project known as National Iniurance Recording Scheme 2 (NIRS2) predicted economies so large that 80% of all savings ascribed to PFI risk transfer occurred in this one scheme. But the projected savings did not materialise. The project is currently running three years late, and the extra cost to the taxpayer has been put at £53 million, according to the National Audit Office.

PricewaterhouseCoopers Report

PwC has now stepped in with what it calls new "hard evidence". PwC, which describes itself as No.1 in the privatisation league table, has stepped up its promotion of PFI with a report that claims to have evidence that "PPPs work" (Public Private Partnerships: A Clearer View, October 2001). This will be balm to the ears of a government that says what works is all that matters.

However, PwC's evidence turns out to consist of 90 anecdotes about the benefits of PFI from senior managers directly responsible for introducing it. There is no financial or service data despite major criticisms that PFI increases costs and reduces staffing, service volume, and terms and conditions of employment. Asking those with the job of introducing PFI to their services whether the policy is good or bad is by any standards a pretty lame research method. But after 9 years of PFI the government is still relying on evidence of this sort from one of the policy's main financial beneficiaries.

Box 1: The Enron debacle

On December 2 2001, less than a month after it admitted accounting errors that inflated earnings by almost $600 million since 1994, the Houston-based energy trading company, Enron Corporation, filed for bankruptcy protection. With $62.8 billion in assets, it became the largest bankruptcy case in U.S. history.

The day Enron filed for bankruptcy its stock closed at 72 cents, down from more than $75 less than a year earlier. Many employees lost their life savings and tens of thousands of investors lost billions.
Source: American Institute of Chartered Public Accountants

Arthur Andersen were Enron's accountants and management consultants.

Misrepresentation of Enron profits was linked to understatement of its costs. Costs were understated by a process known as off-balance sheet accounting. Off-balance sheet accounting involves excluding from a company's sheet costs for which it is liable. A company can overstate its profitability in this way because it can show the profits it earns from a business without showing all its costs.

PPP and PFI involve off-balance sheet financing. Arthur Andersen was heavily involved in promoting the policy in the UK and internationally.

7. Conflicts of interest

As advisors to government the Big Five devise, audit, and evaluate the policy from which they are profiting. Public alarm is growing. The Greater London Authority is contemplating legal action against the London Underground PPP because PwC, which evaluated the deal, and Ernst & Young, who did the VFM calculations, are auditors to five of the eight private bidders set to profit from the contract. The European Union, if not the UK government, has rules forbidding potentially corrupting arrangements of this type.

Such conflicts are the rule not the exception. When UNISON examined PFI schemes where the Big Five acted as financial advisers to the public sector, we found 45 cases where the advisor to the public sector was also the auditor to at least one of the consortium members. (See tables 3 and 4)

Table 3 : Big Five as Auditors to 12 Major PFI companies

	AUDITOR	COMPANY
1	PricewaterhouseCoopers	Sodexho Holdings Ltd; WS Atkins plc;
2	KPMG	Amec plc; Carillion plc; John Laing plc; John Mowlem & Co plc
3	Deloitte & Touche	Taylor Woodrow plc; Interserve plc ISS UK Ltd; Serco Group plc
4	Ernst & Young	Jarvis plc
5	Arthur Andersen	Ecovert Group Ltd

Source: Company Annual Reports

Box 2 : Enron's "smoke and mirrors"

"If any part of British society should be embarrassed by Enron it is the one that is most partial to a similar kind of financial smoke and mirrors – not the business community but the Government.

"Enron degenerated into what looks suspiciously like fraud in its later years but there was no suggestion of wrongdoing or evil intent when it first started to use off-balance sheet vehicles, just as there is no suggestion of illegality in what the British Government is doing now. Enron's initial purpose was simply to flatter its reported figures – to show the accounts without some of the heavy costs associated with various activities, while still appearing to enjoy the benefits of those same activities."

Anthony Hilton. The Evening Standard, March 11, 2002

8. Conclusion

In Europe and the US accountancy is coming under growing criticism from regulators for acting against the public interest. Exercising regulators' minds is the changed structure of the accountancy industry. The industry now derives as much profit from management consultancy as it does from auditing. But accountancy firms' reputation for fair-dealing is based on their auditing services alone. Regulators' fear is that with auditing taking a back seat accountancy firms are losing their independence.

In the UK, such conflict of interest is endemic in the PFI industry. The web of private interest that joins public policy, management consultants, accountants, and the privatisation industry extends across the whole of PFI and PPP. We have to go back to the eighteenth century to find a system that in its essentials pays so little regard to standards of public administration.

There is an urgent need for an enquiry to establish the full extent of the problem and to produce remedies that meet the grave concerns raised in this report.

Table 4: PFI/PPP Projects where the Big Five act as financial advisers and as auditors

Project	Financial Adviser to public sector	Project stage	Contractor	Status on project	Auditor
Sheffield City Council – Schools	Deloitte & Touche	Signed	Interserve plc	Contractor	Deloitte & Touche
Inland Revenue/ HM Customs and Excise Serviced Accommodation (STEPS)	Deloitte & Touche	Signed	ISS UK Ltd	Shortlisted bidder	Deloitte & Touche
LB of Richmond Upon Thames - Schools Project	Ernst & Young	Preferred Partner	Jarvis plc	Contractor	Ernst & Young
University College London – Cruciform	Ernst & Young	Signed	Jarvis plc	Consortium member	Ernst & Young
Defence Housing Executive - Serviced Families Accommodation	KPMG PPP Advisory Services	Signed	John Mowlem	Bidder	KPMG
A92 Dundee – Arboarth	KPMG PPP Advisory Services	Shortlist	John Mowlem	Shortlisted bidder	KPMG
Ceredigion CC - Penweddig School	KPMG PPP Advisory Services	Signed	John Mowlem	Consortium member	KPMG
Oxford Radcliffe Hospitals NHS Trust - Radcliffe Infirmary	KPMG PPP Advisory Services	Shortlist	John Mowlem	Shortlisted bidder	KPMG
A13 Thames Gateway	KPMG PPP Advisory Services	Signed	John Laing	Shortlisted Bidder	KPMG
A13 Thames Gateway	KPMG PPP Advisory Services	Signed	Amec	Consortium member	KPMG
Newport CBC - Southern Distributor Road (SDR)	KPMG PPP Advisory Services	Signed	John Laing	Shortlisted bidder	KPMG
Newport CBC - Southern Distributor Road (SDR)	KPMG PPP Advisory Services	Signed	Amec	Shortlisted bidder	KPMG
Newport CBC - Southern Distributor Road (SDR)	KPMG PPP Advisory Services	Signed	Carrillion	Shortlisted bidder	KPMG
University Hospitals Coventry and Warwickshire NHS Trust - New Hospital	KPMG PPP Advisory Services	Preferred Partner	John Laing	Shortlisted bidder	KPMG
West Middlesex University Hospital NHS Trust	KPMG PPP Advisory Services	Signed	John Laing	Shortlisted bidder	KPMG
West Middlesex University Hospital NHS Trust	KPMG PPP Advisory Services	Signed	Amec	Pre qualified bidder	KPMG
North Staffordshire Combined Healthcare NHS Trust - Reprovision of Mental Health Facilities	KPMG PPP Advisory Services	Signed	Carrillion	Consortium member	KPMG
Secure Training Centre - Cookham Wood/Medway	KPMG PPP Advisory Services	Signed	Carrillion	Consortium member	KPMG

South West London Community NHS Trust - Queen Mary's Hospital	KPMG PPP Advisory Services	On hold	Carrillion	Shortlisted bidder	KPMG
University Hospitals Coventry and Warwickshire NHS Trust - New Hospital	KPMG PPP Advisory Services	Preferred Partner	Carrillion	Shortlisted bidder	KPMG
University of Hertfordshire - Accommodation and Sports Facilities	KPMG PPP Advisory Services	Signed	Carrillion	Consortium member	KPMG
Calderdale & Huddersfield Healthcare NHS Trust - Halifax General Hospital	PwC	Signed	Sodexho Holdings	Consortium member	PwC
Central Manchester & Manchester Children's University Hospitals NHS Trust	PwC	Pre-Qualification / Bidder Stage	Sodexho Holdings	Shortlisted bidder	PwC
Fazakerley Prison/ HMP Altcourse	PwC	Signed	Sodexho Holdings	Shortlisted bidder	PwC
The Royal Logistic Corps	PwC	Shortlist	Sodexho Holdings	Shortlisted bidder	PwC
Wirral Metropolitan Borough Council - schools	PwC	Signed	Sodexho Holdings	Consortium member	PwC
A92 Dundee - Arboarth	PwC	Shortlist	WS Atkins	Shortlisted bidder	PwC
Ayrshire & Arran Community Health Trust - Cumnock Community Hospital	PwC	Signed	WS Atkins	Consortium member	PwC
Bridgend Prison	PwC	Signed	WS Atkins	Consortium member	PwC
Cornwall County Council - Schools	PwC	Signed	WS Atkins	Consortium member	PwC
Dept of Education (NI) - Belfast Institute of Further & Higher Education	PwC	Signed	W S Atkins	Consortium member	PwC
Dept of Education (NI) - North West Institute of Further & Higher Education	PwC	Signed	WS Atkins	Consortium member	PwC
Doncaster & South Humber Healthcare NHS Trust - Mental Health Facilities	PwC	Signed	WS Atkins	Shortlisted bidder	PwC
East Renfrewshire Council - M77/Glasgow South Orbital Road	PwC	Shortlist	WS Atkins	Shortlisted bidder	PwC
East Riding of Yorkshire Council - East Riding Grouped Schools	PwC	Signed	WS Atkins	Shortlisted bidder	PwC

Falkirk Council - Grouped Schools	PwC	Signed	WS Atkins	Consortium member	PwC
Joint Services Command and Staff College (JSCSC)	PwC	Signed	WS Atkins	Shortlisted bidder	PwC
London Underground PPP	PwC	Preferred Partner	WS Atkins	Preferred Partner	PwC
North Wales Police Authority - Headquarters	PwC	Preferred Partner	W S Atkins	Shortlisted bidder	PwC
The Royal Logistic Corps	PwC	Shortlist	W S Atkins	Shortlisted bidder	PwC
Traffic Control Centre	PwC	Signed	WS Atkins	Shortlisted bidder	PwC
Tranche 1A: A30/A35 Exeter to Bere Regis	PwC	Signed	WS Atkins	Consortium member	PwC
Tranche 1A: A50/A564 Stoke to Derby Link	PwC	Signed	WS Atkins	Consortium member	PwC
Wellington College and Balmoral High School - Belfast	PwC	Signed	WS Atkins	Consortium member	PwC
West Yorkshire Passenger Transport Executive - Leeds Supertram	PwC	Shortlist	WS Atkins	Shortlisted bidder	PwC

Source: PublicPrivateFinance and OGC Database, June 2002

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