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David Andrews
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By e-mail: d.andrews@frc.org.uk

Dear David Andrews,

Proposals to Reform the Financial Reporting Council

As the Consultation on the future of the FRC was brought to our attention yesterday (9th) by Mr Brian Little, we have not had the opportunity to study the Consultation paper at great length. However we would very much like to contribute to the Consultation and, if it is at all possible, to extend your deadline as we would like to submit a more considered and detailed reply to the specific questions by the end of next week (20-01-12). In the interim, we make some basic comments.

We are not directly involved in the financial sector nor do we have a political interest but we hope you will consider these comments. It is unfortunate but possibly useful that we have had to dedicate the last five years of our lives investigating a major financial crime. That crime is now the subject of a criminal investigation by Thames Valley Police, 'Operation Hornet' and nine people have been arrested since it was started in June 2010. We commenced our enquiries in August 2007. Therefore we have had a quite unique opportunity to view the financial industry including the auditing profession, from an informed and public perspective.

However Operation Hornet, which is investigating a billion pound fraud originating from HBOS Reading, is not the subject of this letter except to say the fraud could not have happened without the complicity of many auditors. In particular what concerns us about your Consultation paper is the fact a similar crime could very easily happen again in the future despite the changes you intend to implement. We hope the following points will explain why we believe this to be the case:

1. You are suggesting or asking if the FRC should be limited to investigating or regulating businesses with a turn over of more than £500,000,000?

In the case of HBOS Reading, where at least 60 SMEs were destroyed, none of those businesses had a turnover of £500 million although, collectively, their turnover probably fitted the proposed criteria. In the majority of the smaller businesses, the same auditor was employed to prepare accounts while auditors from the 'Big 4' were used for the larger Companies. None of the businesses were named in the HBOS accounts between 2002 and 2008 (although at least one company in particular was 'material' to HBOS and should have been named). We can assure you some of the accounts prepared were works of pure fantasy and were written in such a way as to conceal the fraudulent activities involved. We would be happy to send you examples. Under your proposals, none of the businesses involved in the HBOS Reading scandal would fall under your proposed remit. Therefore, we suggest it would continue to be very easy for false accounting to remain under the radar of proper scrutiny should the FRC insist on such a high threshold.

2. The FRC will not consider individual cases.

Such a policy is identical to the FSA and TSC policy and it effectively stops any member of the public from reporting serious irregularities in the financial sector including accounting. We first attempted to report the HBOS Reading fraud to the FSA in 2007 and were unable even to get a dedicated e-mail address to send the evidence we had of fraud. In December 2007, we reported the matter to the Cambridge police but the Bank denied there was anything to investigate.

We reported our findings to the TSC who wrote and told us they also do not consider individual cases. They further confirmed they too struggle with the lack of transparency by the FSA. Regardless of how many times we explained that our companies were just two of many SMEs that were defrauded and that we had identified many others, we were repeatedly told no one, except for the Financial Ombudsman Service, could consider our evidence.

In taking this stance, we believe regulation in the financial sector risks eliminating some of the most valuable information and evidence available for an informed decision. Sadly, we have to conclude the regulation of the financial sector over the period running up to the credit crunch, was designed in such a way as to protect the financial sector from serious scrutiny and their most effective method was to eliminate investigation of public allegations. We are fully aware that, even now, examples of extreme irregularity by banks and their auditors are going unchallenged and we quote the example of a company called Corporate Jet Realisations which belonged to Bank of Scotland, as one of the worst of such examples. We would suggest the FRC should alter this policy and that, where a member of the public can produce concrete evidence of poor or irregular accounting that could, if not checked, be duplicated in other cases, this should be open to investigation by the FRC and not summarily dismissed.

3. In several instances the Consultation refers to the investigation of matters that are 'in the public interest'.

We would suggest this statement should be very clearly defined by the FRC. In our experience, 'in the public interest' is an oxymoron to the phrase 'market confidence'. And yet both remits are frequently considered as compatible by regulators. Again, we know from experience it is almost impossible to persuade regulators and authorities to investigate and properly reprimand some financial organisations or those people with the responsibility of running those organisations. The reasons are very clearly because to do so and to expose serious irregularities, risks undermining market confidence and 'opening the floodgates'. Therefore it is sometimes considered to be 'in the public interest' to allow very serious situations to go unchecked and unpunished and we are concerned this view extends to the auditing world.

As an example we ask the committee to consider some of the very bizarre answers given to the House of Lords Economic Affairs Committee on 23rd November 2010 when the CEOs of the 'Big 4' quite blatantly confirmed their Firms did not challenge the grossly misleading accounts submitted by some of the big banks because the auditors believed they 'might' be bailed out by the taxpayer. How can this be right? Either accounts are prepared correctly and give a true financial picture of a firm, or they are not. In this instance it would seem auditors took it upon themselves to allow misleading accounts to be published because maintaining 'market confidence' was 'in the public interest'.

We ask, does the FRC consider honest accounting to be of primary importance or will 'market confidence' continue to be the overriding factor when considering public exposure of accounting irregularities?

4. We ask if, with regard to the FRC regulatory activities, this will include mandatory referrals to the relevant authorities where inadequate, misleading or false accounting is identified?

Many people are asking why some people in the banking sector have not faced criminal prosecutions for their misconduct. Similarly, we would ask why it is so difficult to report false accounting and why the penalty for this crime, when perpetrated by people in the financial sector, is often dealt with by way of 'severe reprimand' and a minimal (often reduced) fine to the Company involved as opposed to prosecution?

We take the phrase 'severe reprimand' from the FRC website with regard to the recent case of PwC and JPMS. We ask the question, what incentive is there for a Company like PwC to comply absolutely with codes and standards when the penalty for not doing so is a £1.4M fine and a reprimand? Almost certainly their client will have paid them many times the fine and, if no individual is held responsible for not complying with the FRC, no one is held accountable. As with the FSA reprimands and fines, the penalties to firms are of little or no consequence and do nothing to deter manipulation of financial statements.

We make this observation having recently tried to report a case of serious false accounting to the FSA and the police. The FSA, who now say they are taking the matter seriously, first attempted to excuse the firm concerned by saying they (the firm) did not intend for anyone outside of the business to know what had been done. The police (three different forces) have refused to investigate the matter even although Thames Valley Police have confirmed to us this is a blatant case of false accounting.

Therefore we ask, will the future remit of the FRC include referrals to the authorities where there is clear evidence of false or misleading accounting?

We do hope you will have the opportunity to consider the above points and also that you will allow us more time to submit further, detailed responses to the specific questions in your paper. We are by no means experts on financial matters but circumstances have made us far more aware of the pitfalls the public face when dealing with the financial sector. We would welcome the opportunity to share a more comprehensive explanation of our concerns so you might consider more extensively the public dilemma in this regard. Again, we would impress on you the fact a major fraud like that at HBOS Reading, could not have happened without the complicity of auditors and, although we haven't referred to it above, administrators from the same accountancy firms. We have a wealth of evidence to support this contention much of which is the basis of Operation Hornet and the FSA Section 168 Investigation.

Where financial irregularities go unchecked and unpunished it is, without doubt, the public who suffer most. This Country has been plunged into austerity by the 'mistakes' and 'excesses' of the financial sector. The auditors, more than anyone, should have recognised what was happening and we do not believe it is acceptable to explain the credit crunch as a global phenomenon. In many cases in the UK and especially in the case of HBOS, the Bank was allowed to run full speed into a brick wall – and others will do the same unless integrity is the key word of the future. This includes integrity in the audit section which, in some cases, has been sadly lacking. We would like to show you some specific examples. Not, we might add, because we expect you to take retrospective action but because it may stop future disasters.

Please let us know if you would like further information.

Yours sincerely

Paul and Nikki Turner

Unsigned as sent by e-mail