The Changing Face of the Profession

The profession has evolved from being a function to becoming a discipline. While a function is specific, a discipline is bounded only by the initiative and innovation of its members and their ability to identify opportunities and exploit them. Thus, the members of the profession today are no longer confined to being auditors of companies. On the contrary, they have demonstrated their ability to undertake every activity which takes place in the financial and commercial space. But there are certain challenges too. Read on to know more…

CA. Y. H. Malegam, Padma Shri awardee

(The author is former Chairman of National Advisory Committee on Accounting Standards and Former President of the ICAI. He can be reached at ymalegam@gmail.com)

In the aftermath of the Enron crisis, there were a number of responses from the profession. There is one which has remained in my memory. It suggested that the invention of the joint stock company in the seventeenth century was a seminal event whose importance has often been understated. It made possible the collection of the savings of a large pool of individual savers and the channelisation of these savings into vehicles for productive purposes. It thus made it possible for the fruits of the industrial revolution to be made available to industrial ventures and financed research and development and thus gave to society many of the benefits which we today take for

granted but which have immeasurably improved the quality of our lives.

This response then went on to argue that this happy development would not have been possible, unless along with the joint stock company, there was created a body which had the responsibility to safeguard the interests of these – often small – individual savers and give them assurance regarding the reliability of the financial results of these enterprises as reported by those to whom the management of these enterprises had been entrusted. Thus was born the accountancy profession and while we may rightly be concerned with the occasional lapses in the system, we should not forget the immense contribution which the profession has made to society.

It was left to a renowned professor in the Netherlands to give in the early thirties, the clearest exposition of the profession's role. In a series of articles which came to be known as the theory of inspired confidence, he argued that the profession exists because of a public need for an informed and independent opinion on the financial statements of joint stock companies based on an informed and independent examination of the books of accounts. This gave the public the necessary confidence to remain as investors in such companies. If this confidence is destroyed, the need for the profession would no longer exist. This confidence would be destroyed in two circumstances. First, it would be destroyed if the expectations of the public exceeded what the profession was capable of fulfilling. He recognised that these expectations would constantly change and the profession needed to adapt its procedures to meet these expectations. He called the time gap between the rise of the expectation and its fulfillment the "uncertainty gap". We know it as the "expectation gap". Second, it would be destroyed if the profession did not perform what it was capable of performing. He called this "the performance gap".

The propositions enunciated by Prof. Limberg continue to remain the fundamental premises on which the profession can justify its continued existence. However, since these essays were published – and particularly in the last four decades – the role of the profession has significantly widened and far-reaching changes have taken place in the services which it offers, the composition of its personnel and the processes by which it operates. An understanding of these changes is also essential to understand the opportunities which will be available to the profession and the risks which are emerging and to plot a course of action to meet with these changed circumstances. For the purpose of this discussion, six major issues can be identified.

There has been an increasing stratification within the profession. The gap between the larger firms – notably the Big Four – and the rest continues to widen. This should be a matter of concern for the profession.

First, the profession has evolved from being a function to becoming a discipline. While a function is specific, a discipline is bound only by the initiative and innovation of its members and their ability to identify opportunities and exploit them. Thus, the members of the profession today are no longer confined to being auditors of companies. On the contrary, they have demonstrated their ability to undertake every activity which takes place in the financial and commercial space. They are accountants, managers, entrepreneurs, bankers, captains of industry and financial intermediaries of every kind. In the discharge of this variety of functions, they have displayed the skills and expertise, which their training, experience and knowledge as chartered accountants have provided to them. However, despite the multiplicity of the roles they discharge, in the public perception, the profession still remains identified with its role as auditors.

Second, there has been an increasing stratification within the profession. The gap between the larger firms – notably the Big Four – and the rest continues to widen. This should be a matter of concern for the profession. There are those who argue that this process is unavoidable and that the creation of large firms has improved the overall quality of the service which the profession renders and increased its capability, to compete successfully with other disciplines which provide similar services. It is also argued that it gives the profession greater ability to influence public debate on accounting and related issues with an authoritative voice. On the other hand, there are arguments that this stratification stifles competition and destroys the innovation which greater competition would provide. These are valid arguments on both sides. However, the attempt to rectify this stratification through legislation and regulation must be seen as short-sighted as ultimately destroying the autonomy of the profession. The better and more lasting solution would be to develop a second level of accountancy firms, which can compete effectively with the larger firms and also reap the benefits which the larger firms currently enjoy.

If this course is to be seriously pursued, the following steps are necessary. First, it is necessary to accept that the era of family firms is over, except for a few niche areas. If firms wish to attract and retain the best talent, they need to provide persons the opportunity to develop their careers within the firm and reach the highest level, purely on considerations of merit and not family connections. Second, firms need to develop their own cultures which will breed pride in the organisations and induce persons to stay. Third, firms need to be prepared to invest in people and infrastructure. They need to take a long-term view, even if this means lower earnings for partners in the short-term. Fourth, they need to build on their strengths. Many small firms act in a non-audit capacity with large corporations. They need to translate this relationship into audit work. Fifth, as the Chairman of one of the second-tier firms in the UK recently pointed out, they need to target "the private-equity backed entrepreneurial, smaller listed and privately owned businesses". Finally, to achieve all the above – and most importantly – they must be willing to give up their individual entities and consolidate into larger firms. It is only then that they will be able to give clients the benefits of size and "bankable signature" that clients need.

Third, the advances in information and communication technology have had a significant impact on the manner in which the audit function is performed. It is not unusual to see audits being performed substantially off-site and questions and answers on audit being obtained by email to assist documentation. Audits, therefore, tend to be regimented with a check-list approach. While this no doubt, ensures full coverage and adequate documentation and also assists in complex computer driven audit procedures and better analysis, there is a danger that it misses an essential feature of audit. A good auditor needs professional judgement, an understanding of the business and a degree of skepticism in accepting information, all of which is not possible unless there is personal interaction and eye-to-eye contact with those who are responsible for preparing financial information.

There is another aspect of growing numbers which needs to be considered. A question is sometimes asked: "Are we producing too many Chartered Accountants?" I believe the answer is "No". What is however a relevant question is, "Are too many Chartered Accountants trying to provide the same narrow service, namely audit of financial statements?" The answer is clearly "Yes". We need to realise that audit of financial statements is only a sub-set of a wider service, namely the provision of "Assurance Services".

Fourth, there is the advent of national and international accounting and auditing standards and the development of corporate governance codes which have had a significant impact on the audit function. While the quality of financial information has significantly improved, too much of the audit time is perhaps spent in looking at the wording and phraseology of the disclosures or checking the details contained therein and in regulating compliances, and too little is left for considering the substance of the audit or the culture of the organisation and the behaviour of its executives.

It is somewhat ironic that while so much effort is being made to improve the quality of financial statements, there is a growing feeling that with the public demand for more real-time information and the ability of technical innovations to provide it, the relevance of annual financial statements is being questioned. As one cynic put it "shareholders don't read them and analysts don't need them". Serious thought, therefore, needs to be given to the utility of the annual financial statements, as also to the audit function and whether it provides to the public the information which it needs in the time-frame within which it needs it.

On the one hand, there is a demand for audited quarterly financial statements as a means of timely information. On the other, quarterly financial results are themselves seen as an inducement to the managements to take a short-term view to the detriment of the long-term interests of the entity. This is a conflict which will need to be resolved. However, the content of the audit function itself is a matter of much more serious consequence. The recent financial crisis has identified management of risk as a major area of concern and audit assessment of the manner in which entities manage and control risk can become a major part of the auditors' work in the future. The crisis has also highlighted the fact that in consideration of the 'going concern' concept, auditors have given too much importance to solvency and not enough – particularly in the case of financial firms – to liquidity. These are areas which the profession will need to address.

We also need to constantly keep in mind that the true test of a profession is not only its numbers, or the material welfare of its members but most importantly the value addition it makes and the respect its members enjoy in society. In the pursuit of these material gains, the profession must not run the risk of losing its soul.

Fifth, there is a growing perception that there has been a decline in the level of respect that the profession has hitherto enjoyed. That this is a global phenomenon is highlighted by a comment made by a former chairman of a Big-Four firm, who said that "when I embarked on a career in accounting as an articled clerk in the City, chartered accountants were people of status. Today they are rated marginally above estate agents." This may be an extreme view but it does carry some truth. When in the late 1970s, I visited many small towns as Vice-President and President, what was for me a matter of considerable pride and satisfaction, was the fact that local chartered accountants were often considered as pillars of society.

With the considerable widening that has taken place in the range of services which accountancy firms offer, auditing is no longer the major source of revenue. There are several other services which are more remunerative. These departments are often staffed by non-accountants. Audit personnel are, therefore, under peer pressure to perform and are likely to cut corners to internally compete with persons who are often not conscious of or bound by the same professional standards.

Second, the line between a profession and a business is getting blurred. IFAC has defined a professional as possessing three major qualities; first, the possession of skills, knowledge and expertise, tested by examination and continuously developed in a structured and monitored context; second, commitment to the values of accuracy, honesty, integrity, objectivity, transparency and reliability; and third, being subject to oversight by a body with disciplinary jurisdiction. Business on the other hand does not have these restraints. The distinction between a profession and a business is thin; but it is important and with the widening of the range of services it is often difficult to maintain particularly when competing with non-accountancy firms providing the same services.

The limitations on the scope of services which accountancy firms can render are being loosened. For example, in the U.K., accountancy firms have, since October 2011, been able to form a new type of business, Alternate Business Structure (ABS) which for the first time allows mergers between lawyers and accountants to create multi-disciplinary partnerships which will allow accountancy firms to become managers and owners of law firms.

Third, new entrants to the profession are brighter, more intelligent and with greater IT and communication skills, which makes them more sought after. They are also more ambitious and impatient for success. To attract and retain this talent, accountancy firms have been forced to re-design their reward structures with greater emphasis on revenues and profits rather than a strict ethical conduct.

Fourth, there are the problems created by growing numbers. Winston Churchill once said that democracy was not the best constitutional model but he did not know any better. The same can be said for a professional institution. Nani Palkhivala once said publicly that in his opinion, the Institute of Chartered Accountants of India was the best run professional institute in the country. It is, therefore, an indictment of the Institute's image that in the Companies Amendment Bill which is before Parliament, the Institute's autonomy in regulating the profession is sought to be diluted by the formation of the National Financial Reporting Authority. These developments pose a special responsibility on the persons who are democratically elected as leaders of the profession.

There is another aspect of growing numbers which needs to be considered. A question is sometimes asked: "Are we producing too many Chartered Accountants?" I believe the answer is "No". What is however a relevant question is, "Are too many Chartered Accountants trying to provide the same narrow service, namely audit of financial statements?" The answer is clearly "Yes". We need to realise that audit of financial statements is only a sub-set of a wider service, namely the provision of "Assurance Services". Experience abroad has shown that the scope for the extension of assurance services generally is immense and this is the alternative which should be explored if frustration among a large part of the membership is to be avoided. We need, therefore, to identify such services, provide special training facilities and certify competencies and sell such services to concerned authorities. This is a better option than trying to persuade clients – particularly government and semi-government agencies – to continue to provide work, which because of changed circumstances, they do not need.

Finally, there has been an important shift in the composition of the investing public. With the

growing middle class and with the emergence of institutional investors and financial analysts, there is now a significant body of shareholders who are knowledgeable and able and willing to enforce their rights. Allied to this is the growing clout and reach of the print and television media which is in a position to mould public opinion. When large audit failures occur – even though infrequently – they get magnified and significantly damage the image of the profession. This damage may be caused by a lack of public understanding of the nature of audit work or of the concepts of independence and expertise practiced by the profession. However, experience has shown that attempts to explain what audit is or what it is not, have not been successful. Some institutes have recognised that it may be better to publicise the value which audit can provide. An interesting attempt has been made in this connection by the English Institute with its Audit Insight Programme. Under this programme, audit experts get together to consider the most important factors influencing audit in their specialised field and by combining their experience, insight and observations aim to produce authoritative reports on specific sectors. The first report on the retail sector was issued in January this year and highlighted three issues critical to retail business, namely IT systems and data management, property portfolios and key performance indicators. It is hoped that these reports will be of use to investors, policy makers and financial journalists and thereby raise the profession's standing as a value provider.

The recent past has been a period of great prosperity for the profession. It has witnessed significant material gains both in terms of earning capacity and range of services, though these gains have not always percolated down to the smaller firms in the profession. We need to build on their achievements for the future with initiatives which can provide similar benefits for a larger spread of the profession. However, we also need to constantly keep in mind that the true test of a profession is not only its numbers, or the material welfare of its members but most importantly the value addition it makes and the respect its members enjoy in society. In the pursuit of these material gains, the profession must not run the risk of losing its soul. ■