Do we need to reinvent?

In this topical and relevant article on the vision of accountancy profession in the context of the ongoing changes in the economy, the author, ICAI past-President and ex-NACAS Chairman CA. Yezdi Hirji Malegam, raises a few pertinent questions before the accountancy fraternity and asks if the time has come for the professionals to reconsider their existing professional relevance and reinvent themselves in that light. He then goes on to discuss some important and fundamental concerns relating to relevance and trust issues in the context of the profession. Readers are sure to get an idea about the challenges that the profession faces in the present as well as it may do in the future, and also the areas that need to be reconsidered to comprehensively address them. Being one of most senior and respected chartered accountants, the author presents the fundamental prerequisites of professionals, taking the cues from an IFAC study on the role and domain of professional accountants. The author presents an account of the existing and future challenges before the profession, and suggests steps that might be undertaken to resolve them. Read on…

There comes a time in the life of every profession when it must pause and reconsider its relevance to society and reinvent itself in the context of a significantly changed environment. Has such a time come for our profession?

The profession was created[1] when there was a need to provide credibility to financial statements which were seen as the sole means of communicating to the investors the results of the stewardship and accountability of management. This was an important and essential condition for the development of the joint stock company system which in turn became the vehicle by which the savings of the society were channelised into productive uses and gave substance to the enterprise, innovation and economic growth of which we are the beneficiaries today. The profession can be justly proud of the essential contribution it has made to the development of this system.

CA. Yezdi Hirji Malegam

(The author is a past-President of the Institute (1979-80), who may be contacted at ymalegam@gmail.com.)

The world has however changed. While financial statements and their credibility remain necessary, they are no longer sufficient and investors are looking for more forward looking assurance. Corporate behaviour has also changed and social accountability has become essential. This changed environment has thrown up new challenges and it is in a deeper understanding of these challenges that the seeds of the re-orientation of the profession lie.

[1] *Chartered Accountants Act was brought in as well as The Institute of Chartered Accountants of India was established in 1949.*

The first challenge which needs to be addressed is the erosion which has taken place in the trust which the investing public had in the financial system. In the West, the seminal event was the financial crisis of 2008 and whose after-effects are still being felt. In India, trust has been seriously eroded by the failure of several large companies, the falsification of audited financial statements, rising non-performing assets of banks, often occasioned by frauds and the Ponzi schemes of finance companies. These developments have been viewed as a failure on the part of the watchdogs who were supposed to protect the interests of the investor, including regulators, independent directors and principally the auditors.

In trying to understand this failure, various allegations have been made against the profession. It has been stated that the profession has tried to boost its revenues by offering additional services, that in consequence it is tending to no longer be a profession but is degenerating into a trade, that it has sacrificed its essential professional scepticism and that though it had privileged access to the financial records of the failed companies it failed to see the failures and misdeeds.

While no doubt these allegations are unfair to the profession as a whole, the failures of a few have resulted in a slew of regulatory changes which have greatly widened the role and increased the responsibilities of directors and auditors of companies. As a result, directors and more particularly Audit Committee members have become more active and are looking beyond compliance and looking to auditors to provide them assurance on risk, controls and corporate governance.

The second challenge which needs to be addressed is the growing debate regarding the utility of the annual financial statements as an instrument which provides the information which investors need. Annual financial statements are essentially backward-looking. Investors, on the other hand need information which is forward-looking and they are more interested in the future prospects of the company, the long-term stewardship of the management, the risks to which the company is exposed and the manner in which those risks are addressed.

This concern is well expressed in the formation about 10 years ago of the International Integrated Reporting Council, currently headed by a former Governor of the Bank of England, which is rapidly gaining global support. Integrated Reporting is not intended to replace accounting standards or financial statements but will supplement them and its aim is to produce leaner, more meaningful corporate reports that give a comprehensive view of the organisation and concentrate on the main reporting areas that investors and other stakeholders want to know about. In doing so, it will focus on the company's strategy and how it is working and will help investors make better forward-looking decisions and encourage long-term investment. There is of course always the possibility that if its utility is more widely appreciated in the future, it could pose a threat to the conventional financial statement.

In India, trust has been seriously eroded by the failure of several large companies, the falsification of audited financial statements, rising non-performing assets of banks, often occasioned by frauds and the Ponzi schemes of finance companies. These developments have been viewed as a failure on the part of the watchdogs who were supposed to protect the interests of the investor, including regulators, independent directors and principally the auditors.

Integrated Reporting identifies the strategy of a business as reported by management and identifies key performance measures which are reliable and consistently employed to determine the credibility of the business to achieve that strategy. It thereby enhances the clarity and simplicity of information provided to the main users of corporate reports. The movement for Integrated Reporting has generated an active debate on the future of corporate reporting in the context of transparency, governance and sustainability and consequently of the future of traditional financial statements in that regard.

The third challenge which needs to be addressed is enhancement in the value of audit. There is a perception that, due to the use of technology, checklists, ratio analysis and standardised procedures, audits, *etc.*, are becoming very mechanical and auditors are losing the qualities of scepticism, professional judgement, gut-feeling, *etc.*, which used to characterise audits in the past. Allied to this is the practice of excessive documentation and

The challenge, therefore, is to determine how the role and scope of audit can be redefined to add value. This means that what is needed is a better understanding of the expectations of the investing public and how we can fulfill those expectations. This may require auditors to be able to identify and understand the future risks to which the business is exposed and offer assurance on how those risks are addressed as also on wider elements such as future viability as also risks which are likely to arise.

extensive disclosures which are seen as an attempt by the profession to restrict its liability rather than add value.

The challenge, therefore, is to determine how the role and scope of audit can be redefined to add value. This means that what is needed is a better understanding of the expectations of the investing public and how we can fulfill those expectations. This may require auditors to be able to identify and understand the future risks to which the business is exposed and offer assurance on how those risks are addressed as also on wider elements such as future viability as also risks which are likely to arise. This needs a continuing dialogue with all interested parties.

A good example of how this can be done is provided by the Audit Quality Forum of the English Institute. The objective of this forum formed about ten years ago, is to promote quality and confidence in audit through a dialogue with regulators and stakeholders. It periodically holds a seminar in which policymakers, regulators, members of the finance and accounting profession, NGOs and the wider public participate for a frank debate on the responsibilities of each stakeholder group to interact, to increase trust in the financial system.

Another area which can be addressed to improve the value which audit can provide is with relation to the "going concern" concept. Currently, the auditor is required to determine whether the "going concern" concept used in the preparation of the financial statements is justified. However, he is always conscious of the fact that questioning the use of the concept can become a self-fulfilling prophecy and can push a marginal company over the brink. In practice, therefore, auditors are reluctant, except in extreme cases, to commit themselves and take shelter behind assurances from management. As a consequence, remedial action is taken much too late.

The determination as to whether the "going concern" concept in the preparation of the financial statements is justified should be the primary responsibility of the Board. Under Section 134 of the Companies Act, 2013, the board is required to include in their report to the shareholders a Directors' Responsibility Statement. This statement includes an assurance that the annual accounts have been prepared on a going concern basis but it does not require the Board to confirm that the "going concern" concept used is justified. This is an unfortunate omission.

Given the importance of the subject, there is a need for a better understanding between regulators, boards and auditors as to what "going concern" means, how it is to be determined, what remedial actions need to be taken when it is so determined and when and in what manner disclosures should be made.

There is also a feeling that a standardised form of audit report does not adequately convey the value of the work done by the auditor but is viewed as a document for the denial of responsibility. An interesting experiment is under way in the UK where one of the Big-Four firms has in a few cases issued audit reports that have, in addition to the usual contents, disclosed the big issues the auditors have dealt with in the course of the audit, as also the conclusions they came to in relation to those issues. The response from Audit Committees and shareholders has been most encouraging, as they have found the reports more interesting and readable. It is possible that this trend will spread.

The fourth challenge arises from the growing divergence between the increase in the number of practising chartered accountants and the opportunities available in the traditional areas of practice. Audit and tax practice continue to remain the bread and butter of a large proportion of the non Big-Four part of the membership of the profession. In many countries, for example in the European Union, changes in regulations periodically increase the threshold limits which define small companies which are required to prepare only a simplified form of financial statements and are exempt from audit. If this trend continues, this exemption could be available to a large number of companies with a shrinkage of the audit population.

It may be noted, for example, that in the UK, it is estimated that out of 4.9 million private enterprises, as many as 99.9% would fall in the category of mini, small or medium size units. While there is no such move at present in India, it is possible that a similar demand may emerge in the future.

The profession has been accustomed to regulatory patronage whereby areas of work are reserved for the profession and to a public sector clientele where work is allocated to members of the profession on a pre-determined basis. In many cases, this forms a substantial proportion of the practice of a small firm. Understandingly therefore, the Institute feels that it must fight to retain this work for the profession even when the utility of such work is no longer accepted. A case in point is the repeated attempts to ask for audits of branches of banks when the Core Banking Solution (CBS) introduced in banks has centralised all record keeping.

With an increasing number of auditors competing for a shrinking market, there is the risk that the competition will be on price and this will ultimately have an adverse effect on the quality of work and consequently on the image of the profession. In such a situation, rotation is not a solution, as it does not increase the size of the cake. Equally for the Institute to agitate to retain work which has ceased to have an economic justification, is to flog a dead horse. What is needed is for the Institute to identify other areas of work which the profession can perform, to equip members with the necessary skills to adequately perform that work, to institute a system of examination and certification to give the necessary assurance of competence and to guarantee that competence.

Some of the areas of work that can be considered are the following:

a. With the centralisation of records in banks, the need for a more effective concurrent audit of branches has become more important. Also if banks do not have to incur large expenditure on branch audits, they can afford to pay higher fees for concurrent audit. However, there is a need for a much better understanding of the objectives of this audit, and a primary objective which must be recognised is the prevention and detection of frauds and irregularities. The audit, therefore, has to be focused and performed by senior persons.

b. Another area in the banking sector where the profession can provide services is with regard to the risk assessment of assets. Banks have a choice to determine the risk assessment of assets under the standardised method where they use rating agencies or through their own internal models. It is likely that as banks develop their data bases, more banks will move to the internal model. However, regulators and Audit Committees may feel the need for external evaluation of these models and their operation, given the risk that the models may be vulnerable to the bank's internal culture or that control weaknesses may exist.

c. As the need for audit may decline, the need for assurance in specific areas may increase. For example, the extension of responsibilities of directors and Audit Committees may create the need for assurance on such factors as risk management, internal controls and corporate governance as also to determine whether the Board's policy on ethics and corporate behaviour is operating at all levels within the organisation.

d. In many countries, insolvency practice is a significant part of professional practice and accountants act as receivers and liquidators. In India, there is a dire need for professional receivers and liquidators as official liquidators are unable to cope with the work load. There is no reason why the concerned regulators should not agree to this, if the Institute is willing to make the necessary arrangements for training and disciplinary jurisdiction, to give the necessary assurance.

e. Similarly, given the rising NPAs of banks, the work of Asset Reconstruction Companies is bound to increase. The profession can make a meaningful contribution to these companies in

With an increasing number of auditors competing for a shrinking market, there is the risk that the competition will be on price and this will ultimately have an adverse effect on the quality of work and consequently on the image of the profession. In such a situation rotation is not a solution, as it does not increase the size of the cake. Equally, for the Institute to agitate to retain work which has ceased to have a economic justification is to flog a dead horse.

areas like examination of books, verification of assets, restructuring of the business, valuations *etc.*

Allied with these new initiatives, the profession needs to restructure its own internal organisations. The profession needs to attract and retain the best talent. One of the major drawbacks to this goal is the culture of a large number of family-owned firms and firms where membership is largely concentrated in social and communal groups. From a wider perspective, the profession has to become an instrument of social mobility. This will have two advantages. It will attract to the profession, persons of less privileged backgrounds who have talent but not the network to get opportunities. It will also create a more socially conscious business world as also a diverse workforce, which can interact with an increasingly diverse client base. What is therefore required is identification and removal of the unnecessary barriers to entry, better practices regarding stipends during articleship and access to the brightest people irrespective of social background.

The challenges we have considered cannot be addressed in isolation because they are interlinked. There is therefore a need for a holistic approach. A change in role is critical to retain a share of the market; a declining share of the market with a rapidly growing membership will inevitably result in a decline in quality; and a decline in quality will result in a further erosion of trust, which in turn will result in a further shrinkage of the market. The starting point therefore should be the restoration of trust in the financial system. Members of the profession are both members of the senior management of companies as also the major providers of services to the companies. They are therefore the natural intermediary between the regulator, the company and the investing public. In a sense, therefore, they are the conscience keepers of the business world. To discharge this role, the profession needs to fulfill two prerequisites.

The first and most important prerequisite is the restoration of professionalism in the profession. Some years ago, an IFAC information paper "The Roles and Domain of the Professional Accountant in Business" identified three attributes that a professional must possess as:

a. the possession of skills, knowledge and expertise tested by examination and continuously developed in a structured and monitored context;
b. commitment to the values of accuracy, honesty, integrity, objectivity, transparency and reliability; and
c. being subject to oversight by a body with disciplinary jurisdiction.

From a wider perspective, the profession has to become an instrument of social mobility. This will have two advantages. It will attract to the profession, persons of less privileged backgrounds who have talent but not the network to get opportunities. It will also create a more socially conscious business world as also a diverse workforce which can interact with an increasingly diverse client base.

While no doubt these attributes are important and essential, professionalism has to go beyond definitions. It is a state of mind and a code of personal behaviour which encompasses courage of conviction, a willingness to accept mistakes and learn from them, a continuous process of self-assessment, pride and need for satisfaction in one's own work and a willingness to advance public interest even when it clashes with one's own self-interest. Professionalism is therefore not easily amenable to rules and regulation and has to be inculcated in an individual in the earliest stage of his career. The need therefore is to improve the culture of the profession which can be done by education, training and mentoring, but most importantly, by example, through the conduct of seniors in the profession. In the final analysis, if we lose professionalism, we will lose trust.

The second prerequisite is a willingness to accept and welcome change. In the evolving environment, the profession has to go beyond facts and figures and venture into the realm of opinions and judgements. It has to move from solely providing assurance on past performance to provide, in addition, assurance regarding the future. It can no longer confine itself to a single type of product but must be willing to offer choice and innovation.

No doubt, an extension of the role of the profession in these areas will raise complex problems of indemnity and liability. But the profession must be willing to take these risks if it wishes to survive. If it continues to resist change and defend its present role, it may win a few battles, but it will surely lose the war and it may well find itself in a position in the future, when it will be left with no role to defend. ■