Insights into proposed financial reporting act

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MANY times, corporate failures and scandals lead to fingers being pointed at members of the accounting profession associated companies, with or without basis.

In Bangladesh as well, due to stockmarket debacles and failures in ensuring adequate corporate governance, a section of non-accountant people question the quality of corporate reporting and are taking a chance of regulating the professional accountants by non-professionals without proper knowledge of accounting practices that will ultimately ruin the profession of accountancy in Bangladesh.

Accounting practices comprise auditing, taxation, consulting, advisory services, etc. Except audit, all other services are rendered and shared by non-accountants as well.

Only chartered accountants (CAs) and certified public accountants (CPAs) do auditing worldwide, and Bangladesh is no exception. In some countries, ACCAs (the Association of Chartered Certified Accountants) are allowed to undertake audit practice subject to fulfilment of certain conditions.

Now, the question is why non-CA or CPA professionals cannot undertake audit services? The fundamental difference is that a practical training (of three years or so) is a must for auditing practice even after qualifying as a CA, as a requirement of the course. Without such practical training, auditing licence is not issued anywhere in the world.

Even in the UK, ACCAs from audit stream may join the audit practice only after they are attached to CA or CPA for a requisite. In the USA, no CPA is allowed to join audit practice until s/he acquires practical experience with a CPA firm for at least two years.

Surprisingly, the draft of the proposed Financial Reporting Act 2012 (FRA) in Bangladesh, does not deal with this issue, along with some other important ones.

The draft leaves open a floodgate for CMAs, and other accounting degree holders to become statutory auditors if the proposed Financial Reporting Council (FRC) registers them.

First of all, there might be some auditors or chartered accountants who have not adhered to professional ethics and their negligence is apparent in the reporting process. There are adequate provisions in the existing laws to sue the offenders responsible in line with global practice.

Also, regulatory authorities such as ICAB, SEC, Bangladesh Bank and IDRA may take disciplinary and penal actions against the persons responsible.

Incidentally, to the best of my knowledge, very few such legal cases have been initiated in Bangladesh. In such a situation, why is it so necessary to initiate such an unholy move to jeopardise the century-old accounting profession in Bangladesh?

Some points of the proposed FRA draft that the insiders are likely to oppose are outlined ahead.

a) Registration: The practising licence being issued, renewed, suspended and cancelled under specific rules to be framed upon the council being 'satisfied' does not seem right. It is not a matter of satisfaction, and should rather depend on the required qualifications and experience.

Moreover, the qualifications of auditors shall be defined in the proposed act, not in the proposed rules to be framed.

Again, this should not at all be the job of the council under the FRA. In essence, the FRC will issue practising certificate to auditors. But will they be competent enough to do so, or is there any precedence that such certificates are issued by a separate council bypassing professional institute?

As we see, the proposed FRC is to be comprised of heads of regulatory agencies.

First of all, do these heads have the enough time and relevant expertise for issuing such certificates?

Ultimately, clerks in the FRC will end up issuing such certificates, which will be a humiliation for the practising chartered accountants, and the possibility of corruption cannot be ruled out as exercising of power is involved.

In fact, practising certificates shall be the sole jurisdiction of the ICAB like any other country even with the FRC in existence.

The entire issue apparently intends to hammer chartered accountants by non-chartered accountants, not to improve quality, but rather to drive out the chartered accountants from the profession.

Practical training in audit firms and CA qualification should be mandatory for enthusiasts wanting entry to audit industry like any other country.

b) ICAB and ICMAB given the same status:

As far as the audit practice is concerned, there is no match of CAs with CMAs because they do not have practical training of three years or so in CA firms. Practical exposure and experience on audit and accounting are the foundation for auditing, mere academic knowledge is not enough.

c) Adoption of reporting and auditing standards:

The FRC, being a regulatory agency rather than a professional body, cannot undertake such technical responsibilities. Further, there is no complaint or allegation against the ICAB concerning adoption of financial reporting and auditing standards in Bangladesh. Thus, the regulatory role should be the responsibilities of the ICAB as a member of the International Federation of Accountants (IFAC).

d) Offence and penalty:

The five-year imprisonment clause in the draft as a penalty begs the question; for what kind of offences?

It must be considered that for civil offence, criminal penalty cannot be imposed.

If any auditors commit any criminal offence, s/he can be tried as per the existing laws -- why is it necessary to enact new law inserting penal actions against auditors?

Further, misuse of this clause and harassment of practising chartered accountants cannot be ruled out.

e) Proceedings against offence:

Offences under this act will be prosecuted under Criminal Law (Amendment) Act 1958. Does it mean that all the auditors and makers of financial statements including CFOs are engaged in criminal activity? If this is the perception, then very few practising CAs will be interested to stay in this noble profession.

There are many ways to improve the situation. Peer review and quality control review by regulatory agencies in consultation with the ICAB is a good option to start with.

After the Enron episode in the USA, Sarbanes-Oxley Act (SOX) was enacted without interfering with the independence of the accounting profession.

New rules and regulations came in for both management and auditors but not this way. The concerned authority must take guidance of these regulations under SOX.

Unfortunately, from its very inception, the recommendations of the ICAB have always been ignored.

There are other similar professions of public practice in Bangladesh, like medicine and law. There are lapses and public dissatisfaction but to the best of our knowledge, no such separate law for regulation by outsiders is in existence.

The question is why chartered accountants should be subject to additional and irrational screening by non-chartered accountants.

Professionals are guided by ethical bindings and self-regulations. The only question is how these bindings and self-regulations can be more judiciously imposed.

Quality of auditing is questioned on many occasions but it is surprising to note that shareholders in AGM, especially in listed companies, are reluctant to approve bare minimum fee for a good audit. Quality has a cost. This issue was never addressed.

On the other hand, paying more audit fee may not necessarily guarantee good services. But there must be some kind of consideration about volume of works, responsibilities, deployment of competent persons, quality of audit work vis-à-vis the fees offered for the audit engagement.

The review process can be strengthened in consultation with the ICAB and regulatory agencies. Further, it is necessary for the concerned authority to know more and in-depth about this profession before they enact such a law.

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Is inequality inhibiting growth?

RAGHURAM RAJAN

TO understand how to achieve a sustained recovery from the Great Recession, we need to understand its causes. And identifying causes means starting with the evidence.

Two facts stand out. First, overall demand for goods and services is much weaker, both in Europe and the United States, than it was in the go-go years before the recession. Second, most of the economic gains in the US in recent years have gone to the rich, while the middle class has fallen behind in relative terms.

In Europe, concerns about domestic income inequality, though more muted, are compounded by angst about inequality between countries, as Germany roars ahead while the southern periphery stalls.

Persuasive explanations of the crisis point to linkages between today's tepid demand and rising income inequality. Progressive economists argue that the weakening of unions in the US, together with tax policies favouring the rich, slowed middle-class income growth, while traditional transfer programmes were cut back. With incomes stagnant, households were encouraged to borrow, especially against home equity, to maintain consumption.

Rising house prices gave people the illusion that increasing wealth backed their borrowing. But, now that house prices have collapsed and credit is unavailable to underwater households, demand has plummeted. The key to recovery, then, is to tax the rich, increase transfers, and restore worker incomes by enhancing union bargaining power and raising minimum wages.

This emphasis on anti-worker, pro-rich policies as the recession's primary cause fits less well with events in Europe. Countries like Germany that reformed labour laws to create more flexibility for employers, and did not raise wages rapidly, seem to be in better economic shape than countries like France and Spain, where labour was better protected.

So consider an alternative explanation: Starting in the early 1970s, advanced economies found it increasingly difficult to grow. Countries like the US and the United Kingdom eventually responded by deregulating their economies.

Greater competition and the adoption of new technologies increased the demand for, and incomes of, highly skilled, talented, and educated workers doing non-routine jobs like consulting. More routine, once well-paying, jobs done by the unskilled or the moderately educated were automated or

outsourced. So income inequality emerged, not primarily because of policies favouring the rich, but because the liberalised economy favoured those equipped to take advantage of it.

The short-sighted political response to the anxieties of those falling behind was to ease their access to credit. Faced with little regulatory restraint, banks overdosed on risky loans. Thus, while differing on the root causes of inequality (at least in the US), the progressive and alternative narratives agree about its consequences.

The alternative narrative has more to say. Continental Europe did not deregulate as much, and preferred to seek growth in greater economic integration. But the price for protecting workers and firms was slower growth and higher unemployment. And, while inequality did not increase as much as in the US, job prospects were terrible for the young and unemployed, who were left out of the protected system.

The advent of the euro was a seeming boon, because it reduced borrowing costs and allowed countries to create jobs through debt-financed spending. The crisis ended that spending, whether by national governments (Greece), local governments (Spain), the construction sector (Ireland and Spain), or the financial sector (Ireland). Unfortunately, past spending pushed up wages, without a commensurate increase in productivity, leaving the heavy spenders indebted and uncompetitive.

The important exception to this pattern is Germany, which was accustomed to low borrowing costs even before it entered the euro zone. Germany had to contend with historically high unemployment, stemming from reunification with a sick East Germany. In the euro's initial years, Germany had no option but to reduce worker protections, limit wage increases, and reduce pensions as it tried to increase employment. Germany's labour costs fell relative to the rest of the euro zone, and its exports and GDP growth exploded.

The alternative view suggests different remedies. The U.S. should focus on helping to tailor the education and skills of the people being left behind to the available jobs. This will not be easy or quick, but it beats having corrosively high levels of inequality of opportunity, as well as a large segment of the population dependent on transfers. Rather than paying for any necessary spending by raising tax rates on the rich sky high, which would hurt entrepreneurship, more thoughtful across-the-board tax reform is needed.

For the uncompetitive parts of the euro zone, structural reforms can no longer be postponed. But, given the large adjustment needs, it is not politically feasible to do everything, including painful fiscal tightening, immediately. Less austerity, while not a sustainable growth strategy, may ease the pain of adjustment. That, in a nutshell, is the fundamental euro zone dilemma: the periphery needs financing as it adjusts, while Germany, pointing to the post-euro experience, says that it cannot trust countries to reform once they get the money.

The Germans have been insisting on institutional change -- more centralised euro zone control over periphery banks and government budgets in exchange for expanded access to financing for the periphery. Yet institutional change, despite the euphoria that greeted the latest EU summit, will take time, for it requires careful structuring and broader public support.

Europe may be better off with stop-gap measures. If confidence in Italy or Spain deteriorates again, the euro zone may have to resort to the traditional bridge between weak credibility and low-cost financing: a temporary International Monetary Fund-style monitored reform programme.

Such programmes cannot dispense with the need for government resolve, as Greece's travails demonstrate. And governments hate the implied loss of sovereignty and face. But determined governments, like those of Brazil and India, have negotiated programmes in the past that set them on the path to sustained growth.

As a reformed Europe starts growing, parts of it may experience US-style inequality. But growth can provide the resources to address that. Far worse for Europe would be to avoid serious reform and lapse into egalitarian and genteel decline. Japan, not the US, is the example to avoid.

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