ACCOUNTANTS & AUDITORS: ETHICS AND MORALITY – A FAST DEVELOPING STORY

ROBIN BANERJEE
Chartered Accountant

Last week I met a few friends from my accounting fraternity – and the discussions hovered around a rather difficult recent phenomenon: Whether the audit-clients are becoming more unethical nowadays? Or is it that the accounting community carrying out audits, raising themselves from slumber and becoming stricter?

Just think of the scenario: It is reported that during the five-month period January to May 2018, 32 firms have resigned as auditors midterm from companies, compared to 36 auditor resignations in the whole of 2017-18 and 18 in 2016-17. The numbers in earlier years were all significantly lower. Fearing probable repercussions from regulatory authorities on corporate governance standards, more auditing firms are dropping their assignments like hot potatoes.

Deloitte resigned as auditor of Manpasand Beverages, the producer of MangoSip – one of the largest mango-drinks in India, after the auditee-company reportedly failed to share key data. Price Waterhouse (PwC) quit as auditor for construction and infrastructure company Atlanta Limited. Same happened at Vakrangee Ltd. where PwC quit, citing concerns to the corporate affairs ministry about the books of accounts, mainly related to its bullion and jewellery business.

Apart from the resignations, the audit of many big names have come under stricter 'audit opinions', with auditors flagging off some sticky issues. For instance, at Jet Airways, L&T Shipbuilding and Reliance Naval and Engineering, auditors have raised doubts whether these companies can continue as a "going concern".

And these are all bad news!

It may be noted that each auditee, where auditor resignations have taken place, has since then denied any irregularities, though their clarifications do not exactly answer the doubts raised by the concerned audit firms.

The key question is: have the environment changed and made auditors behave more responsibly? *Prima facie*, the exodus of auditors seem to be motivated by the fear of being pulled up by the market-regulator or worse the company getting caught with their hands stuck in the hanky-panky bowl.

DO CORPORATES CHEAT?

The vexed question is: do businesses swindle? And if they do, then the auditors have a lot to ponder, plan and perform.

A corporation is an artificial legal entity – it can buy, sell, borrow, lend and produce – but can it deceive and deceit? And if a company does cheat, then who should be held responsible? Is it not the people within who cheat? If the employees of a company cheat, can the responsibilities of the corporation be far behind?

Be it by choice or compulsion, the corporate world has not been immune to cheating. Businesses are a microcosm of our society and are made up of people like you and me. They have the same strengths and weaknesses as the people it consists of. Greed has been a major influencer for human behaviour since long. **No wonder, it has been said that many in the corporate world have the feet of clay.**

Auditors will therefore have to be aware that cheating can and will take place. Some will try to cut the corners, but many will not. It is the task of the auditors to sift through the basket of eggs to find the ones which are either rotten or are in the course of becoming decomposed.

WHO IS RESPONSIBLE?

When a corporation commits fraud, who should be held responsible – the management, the shareholders, the finance managers or the auditors?

Time and again companies have been penalised, taken to task and admonished for wrong doing. But the top management, who would have masterminded the unlawful activity, generally have got away rather lightly, if not scot-free. Take the example of Jeffrey Skilling, the ex-CEO of Enron Corporation, who spearheaded one of the worst accounting frauds in history and destroyed the company and trampled on the lifelines of thousands of employees. But Skilling got away with a relatively light punishment. Initially jailed in 2006 for 24 years, but his imprisonment term was reduced by 10 years, only to walk away soon, a free man by 2019.

Are shareholders, the ultimate owners of a joint-stock company, responsible for frauds if any? Let us take a peep into a corporation, by lifting its corporate-veil. **While in theory the shareholders own a company, but in reality it is the directors and the top management who run a corporation.** They decide everything – how much dividend to declare, how much bonus shares to issue and how much stock options to be allotted to themselves. Shareholders in general, hardly possess the ability or the wherewithal to influence corporate's behavior – negatively or otherwise, unless of course it's the controlling shareholders.

Now comes the finance team, the accountants and most importantly the CFO. Are they responsible? The CFO and her team, have a lot of responsibility on good governance. When it comes to doctoring the books of accounts, they would generally have the primary responsibility. However, there could be frauds committed 'on' the corporation, of which the finance team may not be aware. But for that purpose, a robust internal control process with concomitant internal audit system needs to be put into place.

According to the Companies Act 2013, the introduction of Internal Financial Control (IFC) has ordained the finance team to ensure orderly and efficient conduct of business, including adherence to company policies, safeguarding of its assets, prevention and detection of frauds and errors, accuracy and completeness of accounting records and timely preparation of reliable financial information. These are all onerous tasks. In addition, listed companies need to submit a certification from both the CEO and CFO under Regulation 33 of the SEBI Listing Obligations & Disclosure Requirements (LODR), 2015 has given an onerous task to the two top guys. They will need to not only confirm that to their best of knowledge the financial statements do not contain any materially untrue statements, no transactions are fraudulent and illegal and they have communicated to the auditors and the Audit Committee of instances of any significant frauds they have been aware of.

There is another important aspect the accounting team needs to consider. Most of the CFO team members would be employees of an organisation. If the employer desires to carry out hanky-panky, it is well neigh impossible for most employee-accountants to negate the ulterior intent of their bosses. And this is the greatest conundrum which faces most of the accounting community. What do you do when you know things are not above board? Should you protest? Can you walk out or should you join the bandwagon to save your skin with the job? Most literature would suggest that ethics is the king, and being ethical is any accountants' dharma. But when the employer pulls the strings of poor governance, little in my view, are the choices which can be made by the employees.

Now let us shift our attention to the auditors. What is the level of their responsibility? Can they take the sanctuary of the accounting reports and statements being 'true and fair', and do not guarantee its complete 'accuracy'? The primary responsibility for prevention and detection of fraud lies with the management team. An auditor do not guarantee that all material misstatements shall be detected. Auditors opinion on the financial statements is based on the concept of obtaining reasonable assurance from the documents, records and management team. In addition, if an auditor finds during the course of audit that fraud has been committed by the company or its employees, it must be reported immediately.

Let us look at the role of the Auditors in some more detail.

AUDITORS AND AUDITEES

Auditors are the eyes and ears of the shareholders and their boards. Their financial statements are relied on by the outside world to take a view on a company's state of affairs. Auditors verify whether accounting information and reports have been prepared appropriately (in fact, it should be prepared accurately subject to accounting judgements wherever applicable). Auditors are looked upon as protectors of the interest of the shareholders, creditors and the governments.

However, the trust reposed on the auditors are sometimes belied and some of them miss out in doing their duties fairly. And this the challenge the accounting fraternity is currently fighting against.

Many a times, the auditors fail to acknowledge that they have the responsibility of detecting impending financial disaster in a corporation and highlight on ongoing fraud. **Time and again auditors tend to wash their hands off on the plea that they were led up the garden path by the management, and they believed in what they were told and showed. This basic tenet may get challenged sooner than later, not only by public pressure but also by the accounting oversight boards set up by the various Governments.**

It is a fact that some auditees would try to get a 'better than actual' picture certified. Not all have this tendency but many have. And this is where the ethical standards of auditors get tested. What does an auditor do when audit fees are at stake? A very vexed question indeed, which the auditor and accounting community have been grappling since time immemorial.

RAP ON THE KNUCKLES

Prime Minister Narendra Modi gave Chartered Accountancy community a big jolt through his speech on Chartered Accountants' Day on July 1, 2017. The speech powerfully suggested at CAs' involvement in money-laundering and tax evasion. He also highlighted the ICAI's apparent poor record of disciplining its members. Used to being lauded for its efforts in "nation-building", the CA community was stunned by the Prime Minister's candor and the threat of severe action against errant CAs. This was a clarion call to get the CA community on board with ethical practice.

Then came the unfortunate Nirav Modi scandal at PNB. The Rs. 14,000-crore bank fraud perpetrated that surfaced in February 2018 has raised fresh questions about the effectiveness of auditing in banks. The public outcry gained ground when it came to the fore that Public sector banks (PSBs) have a variety of audits done by CAs including statutory, branch, concurrent, and stock audit. This development did not augur well for the accounting fraternity. Unfortunately, the rising non-performing assets of banks have also raised questions about the auditors' failure to review asset quality carefully and insist on provisions for bad loans.

In a significant move, the Central Government in March 2018 approved setting up of the independent regulator National Financial Reporting Authority (NFRA) that will have sweeping powers to act against erring auditors and auditing firms. The PNB fraud became the trigger point for this development. The CA community could not convince the powers that be, especially the Ministry of Corporate Affairs, that the ICAI was doing a good job in taking to task the recalcitrant auditors. And I tend to agree with the general belief that ICAI could have done a much better job to detect and punish the defaulting fellow members. The NFRA now becomes an overarching watchdog for the auditing profession, with the powers of the ICAI to act against erring chartered accountants getting now vested with the new regulator.

Another development which has made life a bit more difficult for the auditors is the Insolvency and Bankruptcy Code 2016. Many defaulting borrowers failing to repay their committed debt amounts, could be subject to forensic audit. Fingers can then get pointed towards the auditors, if things are not found to be in order.

The appointment of NFRA and instituting of bankruptcy proceedings, have definitely made things tough and harsher for the auditors. No wonder that we are seeing more resignations of auditors in the recent times. If any nation has to develop and flourish, it is very important that the financial reports certified by the auditors, need to be reliable. There is nothing wrong in making movement towards attainment of this goal to make financial reporting more credible and dependable.

It may be also noted that the Companies Act 2013 have granted legal status to Serious Fraud Investigation Office (SFIO). This is a significant development exposing the accounting fraternity to the vagaries of a third-party government controlled investigations.

LET'S BE CAREFUL AND TEAM-UP

While many businesses prepare their accounting records to present the true picture of its health, there are several who play ducks and drakes with numbers. Accounting fraud usually begins small – by cutting some corners here and enhancing some revenue there. However, it is like riding a tiger. Very difficult to disembark. Once the mischief is done - the next quarter's profits are never sufficient to undo mistakes or mischiefs committed in the past.

Methodologies adopted by the tricksters and fraudsters are numerous. And the reality is accounting manipulations have been happening since the birth of accounting. Instances exist where auditors have been hand in glove with their clients. There are also numerous examples where auditors have not been able to detect wrongdoing in their client companies.

As economy progresses and information availability enhanced, the pressure on the auditors will only go up. The CA community who conducts most of the audits and especially the statutory audits, have to now come up to the expectations. There will continue to be wayward clients bent upon taking short-cuts to meet their immediate goals.

The moot point now is: the auditing community which is mostly consisting of CAs, now needs to hold themselves together against the unscrupulous in the business community. **The problem will be, if one auditor resigns and stands firm on ethics, others should not give way. This is yet not happening.** The resigning auditors' positions are being taken by someone else. But if, we the CA community stand firm on good governance, only we can be the winners – no doubt the economy and the country will come out with flying colours under the banner of clean and good governance.

THE LAST WORDS

At the gathering when I and my fellow CA fraternity members were debating what is in store for all of us, the consensus was clearly that increasing premium will be placed on good judgement, ability to distinguish the signal from the noise when it comes to reporting and auditing. The audit profession will evolve significantly in the next five years or so, changing more than what it has happened in the last several decades.

Keeping pace with advancing technology, discouraging immoral practices, sticking to ethics and acting 'together' against the black-sheep in the client-community, will become the fulcrum for the accounting and auditing community's continued relevance. ■

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now? And thereafter do we move to a new technology or do we revert to historical cost.

An alternate proposition would be that only those entities that frequently raise resources from local and international markets, who have international investors, who have a mass that matters or are comparable with the Fortune Global 500[ii] can be required to have FV accounting. To understand where India stands, we have only 7 companies in this global list with the highest at 168th position. The 500th company on the global list has revenues of US$ 21,609 Mn[iii] (INR 1,44,780 Crore). It would be worthwhile to do an analysis around this figure and determine what would be the right size for an entity to get involved in determination of FV and recognizing it in its financial statements. For others *(excluding sectors such as banking, insurance & lending)*, historical cost could continue. FV will be need-based information, not necessarily part of financial statements.

One size fits all is a good dictum. However, if the size of an average Indian business entity that applies FV accounting is much smaller than the average size of a global entity that applies FV accounting, aren't we justified in having something simpler commensurate with our size and nature of business?

This debate shall certainly not end with this article but may at the least trigger a thought process, and for that I would like to end with apologies to William Shakespeare by a bit rephrasing of Marallus speaking to two rejoicing commoners in Julius Ceaser, Act 1, Scene 1[iv] :-

Wherefore rejoice
What conquest brings fair value home?
What levels of hierarchy follows him to the statement of financial position to grace in probability weighted estimates
You measurement blocks, you recognition principles, you worse than senseless disclosure requirements
Oh you hard hearts, you cruel men of accounting
Knew you not historical accounting. ■

ii https://timesofindia.indiatimes.com/business/india-business/40-of-fortune-500-companies-asian-india-has-7-in-list/articleshow/59707630.cms
iii http://fortune.com/global500/list/
iv http://www.shakespeare-monologues.org/monologues/612