Seeking the Truth in Tomorrow's Business Environment

The 150th Anniversary Conference of The Institute of Chartered Accountants of Scotland

The Speeches
Seeking the Truth
in Tomorrow’s Business Environment

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Friday, 22 October 2004
Royal Museum of Scotland
Edinburgh
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Preface

Over the past 150 years, ICAS has prided itself on living up to its motto, *Quaere Verum* meaning “Seek the Truth”. This is our opportunity to reaffirm that principle and look forward.

The international accountancy environment is at a turning point. Already our business environment is heavily influenced by the requirements of international capital markets and by changes in international trade. Also, the credibility of the profession has been seriously challenged as a result of recent scandals. The public has become less trusting of its professionals and professional bodies. This has accelerated the existing trend towards reliance on rules, codes of practice and complex regulatory structures.

Meanwhile, enforcement and discipline are coming under the auspices of independent regulators as the concept of self-regulation has been substantially discredited. Have regulators effectively become proxies for professional ethics? Should the accountancy profession be seeking to restore society’s trust in accountants by reaffirming the importance of integrity and seeking to change underlying attitudes to professional ethics?

If our profession is to thrive and meet society’s needs it must identify the role that society needs it to play in tomorrow’s business environment.

More than 250 decision makers, business leaders, regulators and accountancy professionals descended on The Royal Museum of Scotland in Edinburgh in late October to attend the ICAS Conference in celebration of the 150th Anniversary of the world’s first professional
body of accountants. My thanks go to the members of the Conference Organising Committee – Lawrence Brady, Debbie Currie, John O’Donnell, Fiona Mackay and Christine Waugh. Also to Aileen Beattie for her care in editing the report and Isobel Webber for typesetting the document.

The conference was truly an international gathering with representatives from 20 different countries, from America to Australia and New Zealand, from Finland to Romania. They came not only to acknowledge ICAS’ outstanding and long contribution to the accountancy profession worldwide, but also to take part in a vital debate prompted by the Conference theme: Seeking the Truth in Tomorrow’s Business Environment.

We were fortunate to have such distinguished speakers to help us to identify the agenda for tomorrow.

Ian Percy CBE
Conference Chairman
The Institute of Chartered Accountants of Scotland.

December 2004
Speeches From
The Institute's 150th Anniversary Conference

2004
Ian Robertson is President of The Institute of Chartered Accountants of Scotland and is a member of the Financial Reporting Council. Ian is Chief Executive of Leicester based house builder Wilson Boudean plc. He was Financial Controller of United Biscuits and Group Financial Controller of Northern Foods plc. Ian was Provost of Eastwood District Council from 1980-1984. He was a founding Director of Workwise Ltd, a charitable training scheme for young people in Glasgow's East End.

Playing a Leading Role in the Future Development of the Profession

Research has for many decades now been at the heart of the differentiation which has enabled us to answer the question – "Why ICAS?". Since 1981 ICAS Research has delivered 61 publications dealing with assurance services, accounting history, business reporting, risk and uncertainty, environmental reporting, the public sector and education and training.

Among the publications are reports such as the 1988 publication Making Corporate Reports Valuable which eventually set much of the agenda for the update of corporate reporting practice in the UK. While many of its recommendations seemed radical at the time they have long since become part of the mainstream of reporting practices in the UK and are enshrined in the SSAPs, FRSs, the OFR, the Combined Code and the UK Listing Authority rules.
Similarly, in 1993, ICAS published a research paper focusing this time on the future of assurance – *Auditing into the Twenty-first Century*. In this discussion document the Research Committee of ICAS explored the public’s expectations regarding the reassurance sought from the external audit of listed companies as well as the public’s expectations regarding the independence, accountability and legal liability of external auditors within the corporate governance framework in effect at that time. The committee also set out proposals for providing the public with more reassurances about these matters than was then provided. Both of these papers set out an agenda for future development and progress in their areas of study – and from what has happened since, clearly influenced the outturn.

So, to the background to this conference. In the last year, when ICAS turned once again to look at what the future might bring, and how ICAS itself could best prepare, research and thought leadership were once again at the top of the agenda. For it is through thought leadership that ICAS can differentiate itself. It is through focusing on issues where ICAS can make a difference, through the quality of thought, and through the clarity of presentation, that ICAS can ensure that it continues to be relevant in today’s evolving global structures.

We at ICAS have a very clear and independent vision of where we want our professional body to go and what we want it to be, in the future of our profession and of the UK. We believe that in this time of global commerce, our profession and our government still welcome the independent voice when it speaks out boldly for the public interest. We believe that size is not all that matters and that a body such as ICAS operating in a focused way and continuing the high standards we have upheld so strongly in the past, will always have a valid contribution to make. And, given our past performance, it is very relevant for me also to add that we believe that a body such as ICAS, by continuing with the highest educational standards – and imbuing the highest ethical standards too – can continue to supply those who will be the
women and men of influence in industry, commerce, public service, government, and our own profession for many years to come.

This heritage has informed the concept of the historic 150th anniversary conference. We wanted a legacy from such an event, an agenda from which to work so that we could augment words with action. And so came the idea which brings us together today – to share our thoughts, our concerns and our suggestions, and from that to gather these together to form the basis for future action.
THE RT. HON. LORD ROBERTSON OF PORT ELLEN is Deputy Chairman of Cable and Wireless plc. He was Secretary General of NATO from 1999-2003 and Defence Secretary of the United Kingdom from 1997-1999. He was MP for Hamilton and Hamilton South from 1978-1999. Lord Robertson is also a Non-Executive Director of the Weir Group plc and the Smiths Group plc.

CHALLENGES FROM A GLOBAL PERSPECTIVE

What does the former leader of the world’s most successful defence alliance have to say to a gathering of accountants?

First of all must be ‘thank you’. Knowing how expensive it is to speak to just one accountant, it is an immense privilege and huge opportunity cost to be speaking to so many of you today here in Scotland’s capital.

Second, let me congratulate you on your one hundred and fiftieth birthday. Accountants do not have the most exciting reputation – just marginally above estate agents, journalists and of course politicians – but it is fitting that the world’s oldest professional body of accountants was from my native land.

The third thing I have to say is, have we got our priorities right?

Nigel Turnbull’s report on documenting company risk was a bolt from the blue to companies, but was seen by many as just another incremental burden in the mountain of corporate governance regulation taking up so much executive time.
But at the same time compliance has been successful and many companies have as a consequence suddenly become aware of a range of threats to the business which they might face. It is said that some company reports now appear to have a cigarette-type risk warning prefacing any good news.

So far, so good. But the question I put to you today is this. Have we got a proper grasp of the range of threats and risks facing us as individuals, as companies, as countries, or as an international community?

Has Turnbull simply created a box-ticking culture which substitutes process for performance? Has it created a genuine mind-shift on the issue of risk or simply banished it to an updatable list which remains inadequate and which shunts the risk catalogue into a backwater wherein lie the ‘good idea but it’s not urgent’ issues?

When you look at the output of risk reports are we, or you as the accountants and auditors, satisfied that they have encompassed all the vulnerabilities facing the enterprise? How do we take into account that the enterprise is part of society and therefore part of a wider risk environment?

Let me answer these questions with some examples of vulnerabilities only rarely included in Turnbull type reporting.

First take the company telecommunications and IT policy and, if this seems like an advert for Cable and Wireless, it is, of course, purely coincidental.

Virtually every company today is dependent on its IT structure and the underpinning telecommunications link with the outside world. Failure of these systems for more than half an hour can be catastrophic for a business.

And yet how many companies still have only one copper wire coming into their premises? How many have redundancy and duplication built in as policy in case that one line or one system fails?
How many rely on a single provider for all services even when that reliance is a choke-point of almost suicidal vulnerability?

How many companies have estimated for how long they could survive without access to data banks and IT systems? Yet these are all very vulnerable to hackers, disgruntled employees, criminals and to external overload. How many companies do you know which have created a separate data bank far from the shores of this country to ensure the survivability of essential company records?

The all too obvious answers to these questions makes it clear that when we think of risk and vulnerability we need to think imaginatively about what might realistically befall companies. Failing to recognise how interdependent we all are on integrated systems will be no protection shield when imaginative terrorists, or motivated internal vandals, get a grip on the pinch points.

Just look at some of the global networks which make the contemporary world more efficient, more prosperous and of better quality – but also immensely vulnerable.

In transport, global satellite-using positioning systems are not optional extras but vital infrastructure. In aviation, two aviation-specific telecommunications networks link all planes in the world. In finance the international industry relies on two global networks and there are a few gigantic international commercial banks which have their own global networks which, if they failed, would have worldwide repercussions.

You might just think that was enough vulnerability, but there is more. The global communications networks are themselves so interconnected and interdependent that, with no world body looking after the protection of critical and complex infrastructure, we are all hugely vulnerable in almost everything we do now in life.

The experts call it CGII - Critical Global Information Infrastructure - but what it means is that we live now on a cliff edge
of dependence on things we do not see and rarely understand, but without which the world we know grinds to a halt.

Add in a few more ingredients to this cocktail of bad news and you get the measure of the enormous challenges facing us.

Take the rising tide of illegality. Organised crime has made a mockery of national borders. There is a Single Black Market from Dover to Dushambe, from Amsterdam to Almaty but there is no Single Legal Market beyond the EU. That is because the forces of law, order, sovereignty and national interest cannot find the same identity of interest as the smugglers and traffickers whose net worth eclipses that of many nation states.

They trade in people, prostitutes, asylum seekers and economic migrants; they trade in guns, cigarettes, in drugs and alcohol and in power and wealth; they dwarf countries and legitimate companies. They feed on their greed and corruption and they breed in ethnic and religious conflicts even when the participants are blind to ethnic origin and have no religion except money and hate. They are the forces of disorder and chaos. Their strength is our weakness and a qualitatively new danger.

The dark side of globalisation is that security threats too are networking and going global.

Al-Qaida offers the most obvious illustration. First, it proved conclusively that terrorism had gone global. Al-Qaida was based in Central Asia, led by a wealthy Saudi, trained its personnel in Europe, and carried out its operations from Africa to the United States. It used the Internet and powerful new encryption software to communicate freely anywhere in the world.

To add to the danger, global terrorism is linked up to proliferation. Laxer border controls and increasing travel make it easier for terrorists and terrorist states to get their hands on weapons, including weapons of mass destruction. Access to the Internet gives them the information they need to make what they cannot buy or steal. The information
found by the US-led coalition in Afghanistan leaves no doubt of that.

As we saw on September 11th, the new global terrorist wants blood – as much as possible. Which means that the nexus between global terrorism and proliferation has taken on a new, much more deadly nature.

To compound the agony, terrorism is getting new funding from organised crime. Just as an illustration, of the 24 terrorist organisations identified by the US State Department, 12 have links to international drug trafficking. That is no coincidence. Furthermore, international criminal cartels are themselves increasingly engaging in trafficking weapons and selling them to very nasty people.

This international power grid of terrorism, proliferation and organised crime is nourished by another characteristic of today’s world: the plethora of regional conflicts. These conflict zones, from the Balkans to the Caucasus and Central Asia to Africa, have become centres where terrorists find recruits, where organised crime traffics drugs and weapons and where loss of state control can mean loss of control over lethal weapons themselves.

And behind it all is money. Globalisation has made illegal money the lifeblood of the new network of security threats. Over and over, throughout the past decade, regional conflicts, narcotics trafficking, arms smuggling, civil war and terrorism have been facilitated and sustained by illicit financial networks embedded in the world’s legal financial system.

How easy it was for Al-Qaida’s bankers to have five hundred thousand dollars wired from a bank in Dubai for anonymous use in automatic teller machines in Florida and Maine. How difficult it has been, even with the backing of United Nations resolutions and 150 nations, to find out who raised or sent those dollars.

And when it comes to money, the knife cuts both ways. Because illegal money does not just feed other security threats – it also causes them.
Illicit finance has made possible the trade in diamonds that fuelled civil wars in Liberia, Angola and Sierra Leone. It allows countries surrounding Congo to engage in relentless asset stripping under the cover of war. A fraudulent pyramid scheme caused a financial collapse in Albania that led directly to civil chaos and the proliferation of small arms throughout the Balkans. We still see the effects today in increased tension and the occasional explosion of armed conflict.

This is a complex set of interrelationships - but the overall pattern is clear. Today's security threats have taken advantage of the infrastructure of globalisation - to support each other, to feed each other, to build on each other. They have networked. The result is a clear and present danger to our citizens, and to the stability of the international system.

Our challenge, as an international community, is to dismantle this network. To prevent, or stop, regional conflicts. To stop the proliferation of nuclear, biological and chemical weapons. To defeat terrorism. To control organised crime. And to ensure that the international financial system is used for the good of the international community, not exploited to undermine it.

To accomplish this, we need an international security network. Diplomats, militaries, international security organisations, financial institutions, law enforcement officials, and arms control experts must move beyond narrow definitions of their mandates. They must adapt to take on new challenges. And more and more, they must identify common challenges, and work together to solve them.

Addressing terrorism, for example, can no longer be a job only for law enforcement officials. Now, our militaries must also be prepared to tackle this challenge, both to protect themselves and to help protect our populations. Financial institutions must track, and freeze, terrorist money. Arms control experts must stop proliferation into the hands of terrorists, and alert our militaries when it does occur.
Similarly, stopping regional conflicts must be a job for more than just the military. Law enforcement officials must also be deployed into conflict zones, to prevent organised crime from taking hold. Financial experts must also be available to stop corruption. Civilian institutions in post-conflict areas must be supported, to preclude the instability that is the hothouse for so many other threats.

All of these changes require new thinking, new ways of doing business. Outdated Cold War habits and capacities do us no good against twenty-first century threats unless we adapt them to meet these new challenges. We need a global, integrated response, with deep cooperation between states, international organisations, international financial institutions, the private sector, and non-governmental organisations – all working together, in new ways, to meet this new network of security threats.

And it can be done. I am at the moment both depressed AND optimistic – and that is no contradiction in terms. I have offered you today a bleak analysis and one designed to make you think and reflect, but I contend we need not be pessimistic if we do the right things in the light of the analysis and we do them now. I submit to you one example of how it can be done. In NATO we did learn the lessons of 9/11 and of Bosnia, Kosovo, Macedonia and Afghanistan and what is more, we set about applying them. We brought in 12 new members to the 50 year-old Alliance – including the nations of the Warsaw Pact and even the three ex-Soviet Baltic States. That made us politically stronger and it added new niche military skills. We developed new relationships – with Russia, with Ukraine and with the countries of the Caucasus and Central Asia. We drew up complex, but workable new working links with the European Union which will allow, among other things, the EU to take over from NATO in Bosnia at the end of the year. We created new capacities to meet the emerging new threats and risks, such as a new cutting edge, high intensity NATO Response Force to go far, hit hard and stay long. We built in the first
ever multinational Chemical, Biological and Radiological Battalion to collectively meet the newest and most deadly dangers. We took our warships of the Mediterranean fleet away from submarine detection and set them to patrolling the sea-lanes used as the trafficker’s superhighway. Our collectively owned airborne early warning planes left Europe for the first time and secured the skies over the Salt Lake City Winter Olympics and then came back to do the same for the Summer games in Athens this year. And in one of the biggest changes of all we took the old Cold War Allied Command, Atlantic, based in Norfolk, Virginia and created a brand new Supreme Commander – for Transformation. New thinking and new capacities all joined together - uniting and keeping in step the militaries on both sides of the Atlantic.

This dramatic modernisation of NATO, from the shield which protected our freedom and democracy throughout the Cold War to the key political/military instrument of dealing with tomorrow’s dangers and risks, shows what can be done. Institutions can be reformed and reforged. Diplomacy can be re-energised. Conflicts like Bosnia, Kosovo, Macedonia, Afghanistan and yes, even Iraq, can be tackled and sorted – if the political will is there. However, stove-piping, turf protection, exaggerated sovereignties and political feebleness will be a recipe for the worst of all outcomes. Future generations will be the ones to suffer and they will never forgive us.

The accountancy profession, with its special Scottish rigour and intensity, has its role to play in all this. Honest accounting, ruthless and open-eyed auditing of public accounts and governmental processes can underpin the institutions of integrity and good faith. These values – of transparency, honesty, integrity and accountability are essential pre-requisite values of an ordered, decent and safe society. We must never allow these standards and these essential values to drop or be compromised. We are simply the custodians of what our children will inherit and that obligation should keep us awake every night.

I wish you well for your next hundred and fifty years.
CALLUM MCCARTHY is Chairman of the Financial Services Authority (FSA). He was the first energy regulator responsible for both gas and electricity as Chief Executive of Ofgem and Chairman of the Gas and Electricity Markets Authority from 1998-2003.

REBUILDING TRUST IN THE UK'S FINANCIAL SERVICES

It is an honour to be invited to address you in this, your anniversary year. My original training was as a historian and I am much struck by the various important events – the other important events – which occurred in 1854, the year of your foundation. These events marked themes which have proved of huge import over the subsequent 150 years. 1854 saw the first fractionation of petroleum by distillation – an invention which paved the way for the motor car age; it saw the first convention of the Republican party in the United States – still the ruling party in the world’s most powerful nation; it saw the treaty signed at Kanagawa which opened up Japan and Japanese trade to the world; it saw the famous demonstration (so critical to public health) by Dr John Snow in London that cholera was water-borne – the foundation of modern epidemiology. And, of course, it saw the foundation of this, the oldest professional body of accountants in the world.

In the 150 years since your foundation there have been many changes in accounting and audit. Very recently, these changes have accelerated and financial reporting in the UK – and indeed around the
world – is in the midst of the most radical and important change for a
generation. From January 2005 we will have International Accounting
Standards for all EU listed groups (the biggest change in financial
accounting since the introduction of the 4th and 7th Company Law
Directives). At the same time, the European Commission is moving
rapidly towards requiring the use of International Standards on Auditing
across the EU, and the UK Auditing Practices Board will anticipate that
change by introducing International Standards on Auditing into the
UK, with some additional UK specific rules, from 1 January 2005.

There are also changes to the standard setting and enforcement
regimes in the UK. The Financial Reporting Council has new powers
and responsibilities, and we can now safely say that all aspects of
accounting and auditing standard setting and oversight are independent
of the profession, while retaining a strong input from those in the
profession who can provide their expertise. It is early days for the
new FRC structure, but already we are seeing the development of
ethical standards for audits, by the APB; a proactive risk based regime
for enforcing accounting standards, from the Financial Reporting
Review Panel; the development of a standard on the Operating and
Financial Review, from the ASB; and of course a revised Combined
Code on Corporate Governance. We also have the Audit Inspection
Unit which is responsible for monitoring the audit of those entities
which may impact on financial and economic stability. Since June, the
AIU has been visiting audit firms to inspect the quality of the audit
for specific economically significant entities.

Against this background of change, I want to focus on three aspects
of concern to all of us: the FSA’s interest and role in accounting and
audit; developments at a European and international level and the
issues of principles and rules for accounting and audit. In some of
these aspects I would like to emphasise the role you play as individual
accountants and auditors.
Why does the FSA have an interest in accounting and audit? After all, we have no direct responsibility for any aspect of financial reporting or audit. The FRC has responsibility for accounting and audit, and is overseen by the Department of Trade and Industry. The FSA has a seat on the FRC (a post now held by my colleague Hector Sants) and we work closely with the FRC’s key Boards, but we have no control over the process. However, we are a major user of financial information, and one of our main objectives is to maintain confidence in the UK financial system. We therefore have an interest in market confidence in financial information. Let me give some examples:

- As a prudential supervisor we require firms that we regulate to retain levels of capital that reflect the risk of their business. Those capital requirements are drawn from the audited financial statements, and we need to be confident that the accounts are relevant and reliable and have been independently audited to a high standard.

- Again as a prudential supervisor we frequently use firms’ auditors or another independent accounting firm to undertake reviews and investigations on our behalf. I would argue that we are often major customers of the accounting firms, and like any of their other customers we are heavily reliant on the quality of the profession’s standards and quality control mechanisms.

- With our responsibility for overseeing markets (most particularly as the UK Listing Authority) we have an interest in high quality relevant and reliable financial information in order to maintain market confidence and the stability of markets.

- London is often described as the world’s most international capital market. Many of the participants are subsidiaries or branches of overseas holding companies, and we need to be confident that the overseas holding companies (and often the group as a whole)
is adequately capitalised. It is therefore in our interest to have a single set off globally applied high quality accounting and auditing standards.

- Finally we should not forget that the FSA has a responsibility for financial crime. We therefore need to be confident that financial information provided to the market is reliable.

As I have already said, the changes to financial reporting that we are seeing in the UK are being replicated in all of the major financial markets around the world. Much of the work to foster development of international standards is done by the various international organisations of regulators, most notably IOSCO (the International Organisation of Securities Regulators) and CESR (the Committee of European Securities Regulators) where the FSA plays an active role.

IOSCO endorsed International Accounting Standards for use in cross border offerings in 2000, and has a similar project underway on International Standards on Auditing. It has developed principles for oversight of auditors and for auditor independence, and has started work on developing a mechanism for co-ordinating work on enforcement of accounting standards.

CESR has a standing committee on financial reporting (CESRfin), which John Tiner chairs, and which has a similar agenda to IOSCO but with the more immediate objective of facilitating consistent application of IASs in the EU from 2005. In the last 18 months, CESRfin has published standards on the enforcement of accounting standards and the co-ordination of enforcement activities on accounting standards. Both these standards take a principles based approach to the subject of enforcement. CESRfin also published late last year recommendations on the information that companies should provide in their 2003 and 2004 annual accounts to explain the transition to IASs in 2005. Essentially there are four elements to this. First, companies should explain in their 2003 accounts the steps they are taking to prepare for
the change of accounting framework. Second, in 2004 they should – if possible – publish reconciliation from local GAAP to IASs. Third, their 2005 interim accounts should be based on IAS measurement and presentation principles. Finally, 2005 year end accounts should – of course – follow IASs. By following these recommendations, and communicating with the market in this way, companies can ease the impact on the market of the transition to international accounting standards. As professional accountants, you can support your companies either as preparers of accounts, as advisors or as auditors, by ensuring that they are provided with your full support in implementing these recommendations.

However, it is still not absolutely clear which standards will be applied in the EU next year. The IASB met the timetable it agreed with the European Commission and completed the set of standards to be applied in 2005 at the end of March. The standards have to be formally endorsed by the Commission’s Accounting Regulatory Committee before they can be required to be used, and the mechanism for completing that endorsement is now well established and working efficiently. However, there are continuing problems with the two standards on accounting for financial instruments – IAS 32 on disclosure and IAS 39 on measurement. The arguments have gone back and forth between the Commission, the IASB and the European banking and insurance sectors, as they have tried to resolve the remaining difficulties with the standards. The Commission has now endorsed IAS 39, but with a ‘carve out’ of two particularly controversial areas: the use of the fair value option and provisions relating to hedging. Though we understand that these ‘carve outs’ are temporary, and – in that phase which is by definition a contradiction in terms – “this is not a precedent” – we are still concerned about the consequences of the Commission’s approach.

The serious disadvantage of the Commission’s partial endorsement of IAS 39 is that it is a departure from the principle that only standards
issued by the IASB should be endorsed. It therefore could undermine the move to global accounting standards by creating separate ‘European standards’. We would not welcome this move. This is our major concern, but there are also many other concerns about the feasibility of the Commission’s particular approach. The process by which the decision was made was woefully inadequate, and seriously lacking in due process. Not surprisingly, the result leaves many questions unanswered. For example, can companies declare compliance with all international accounting standards, as required by IFRS 1, if they are not fully complying with IAS 39? Can individual listed companies still apply the full version of IAS 39? Have the full technical consequences of these carve outs been thought through? At a very late date, these issues have still not been resolved.

This uncertainty is of great concern for the EU securities regulators including the FSA. In the EU banking and insurance sectors, which are highly reliant on the confidence of markets in their financial reporting, there is still uncertainty about how to measure and present the most important assets and liabilities on their balance sheets. That is not a healthy basis on which to embark on a programme of harmonised accounting across Europe, still less the world.

Let me now turn to the important issue of principles-based standards. This is a continuing debate for those concerned with international accounting and auditing standards. On the one hand, a concern is expressed that principles, in accounting or auditing standards, many be too general and insufficiently robust in application by accountants and auditors. On the other hand, concerns are expressed that a focus on rules in such standards may lead to ‘creative compliance’ with the form of the standard rather than the spirit. Recent examples of corporate failure (of which more later) suggest that the culture of creative compliance is more of a concern.

This is a major issue for UK standard setters. We have long been accustomed to a standard-setting regime where the standards describe
the principles to be followed and expect preparers and users to exercise judgment in applying the standards to their particular circumstances. That framework has been used for accounting and auditing standards; it underpins the Combined Code on Corporate Governance; and it is the objective of the FSA’s work on reviewing the Listing Rules. For reasons I have already explained, the FSA’s declared long term objective is a single set of globally applied accounting standards that are capable of consistent application, interpretation and enforcement, and such a set of standards can only be made to work if they are principles based. It would not be possible to develop a set of rules that would work in every capital market in the world, and in any event experience in other markets is that detailed rules either stifle innovation or promote dysfunctional or even fraudulent financial engineering – or sometimes both. We have reflected this approach in our contribution to the European recommendations and standards issued by CESRFIn.

The UK system of corporate governance has developed to foster the consistent application of principles-based standards. The changes introduced by the FRC last year reinforced that approach. However, it is important to emphasise that principles-based standards should be applied in a principled manner, by preparers and auditors alike. Essentially, I think there are three elements to this and this is where I would like to focus on your role as individual professional chartered accountants and as an Institute.

First, we need company executives who are committed to provide relevant and reliable information to investors and who want to comply with the spirit of the standards – in accounting terminology to provide a true and fair view and to represent the substance rather than the form of transactions.

Second, we need strong minded independent auditors who can see the bigger picture and who will apply the principles through their professional judgment, even if standards do not specifically address the
particular issue — again in accounting terminology, auditors who believe that the true and fair view is paramount.

Third, we need high quality independent non-executive directors to monitor the relationship between the executives and the auditors, and make sure that the auditors’ independence is not compromised.

It is hard to exaggerate the importance that these principles should be applied in practice. Reliable financial information is essential if markets are to work. It is necessary for the market system to survive. Yet we have undergone what can only be regarded as a crisis in terms of the provision of reliable financial information, and the maintaining of standards of truth and fairness. In the US we have had the scandals of Enron and Worldcom, which have led to the legislative response of Sarbanes-Oxley — a legislative response which passed the Senate without dissenting vote, a measure of the strength of political feeling. In Europe, we have had issues of financial reporting in companies as varied as Ahold, Parmalat and Shell. There is no doubt that these events, occurring in various countries and involving firms which were considered of the highest standing, have cast an unflattering and damaging shadow on those who provide financial information — including those who provide audit opinions. We need to change this — and you have a central role in making this change. A great deal is at stake.

I started this speech by identifying events which had occurred in 1854 which still shape our world today. It is not fanciful to put among those events the foundation of this, the oldest professional body of accountants, as being as significant as the opening up of Japan or the spread of the internal combustion engine. The economic engine which drives all market economies is fuelled by reliable information. Developing the techniques which make that information meaningful, and maintaining the standards which result in true and fair information have been the task of accountants over the last 150 years. It remains as important today as ever. As professional accountants, you have a
key role to play in UK, European and international developments in accounting and audit both at a macro level, through participating in the various committees that draft or comment on international standards, and at a micro level, through your individual professional behaviour as auditors or accountants. In this speech I have outlined the interest and role of the FSA in these areas and the key role that you play.

I encourage all of you, as members of the oldest professional body of accountants in the world, The Institute of Chartered Accountants of Scotland, to play that key role – more important today than ever before.
Andrew Sheng is Chairman of the Hong Kong Securities and Futures Commission. He was Deputy Chief Executive of the Hong Kong Monetary Authority from 1993-1998. He is currently Chairman of the Technical Committee of the International Organisation of Securities Commissions (IOSCO).

The View from Hong Kong: Managing the Cultural Divide

I am most honoured to be invited to this historic conference to celebrate the 150th anniversary of The Institute of Chartered Accountants of Scotland. As a chartered accountant, albeit of that younger body in England and Wales, I feel quite humbled to be invited in such august presence, especially following such giants as Lord Robertson and Callum McCarthy and to precede Paul Volcker, Julius Muis and Sir David Tweedie would make any mortal shake. The sense of history is even more daunting as we are gathered here in the Royal Museum of Scotland, with history watching over us.

I have been asked to speak on the view from Hong Kong, that barren rock in the East and bastion of free markets that quite a few Scots helped to make one of the leading financial centres in Asia, if not the world.

Before I proceed, I have to preface my talk with the usual caveat – all opinions expressed here are personal and not those of the Securities and Futures Commission or of its members and staff.
Allow me to be presumptuous in addressing three questions: -

- First, what is the contribution of Scotland to global markets?
- Second, is there a culture divide between East and West with respect to accounting? and
- Third, what is the future of the global accounting profession?

One hundred and fifty years of an esteemed profession is young when compared to Mesopotamian clay tablets dating back some 6,000 years ago, which were the first written records of stocktaking work done by accountants. Accounting scribes have always been important in the ancient civilisations because, instead of finding more Rosetta stones, archaeologists tend to find inventory lists of more mundane matters of commerce.

Modern day accounting must leap to late 15th century Venice, when the Italian monk Luca Pacioli wrote the first book that placed accounting information on the path of the Renaissance and Industrial Revolution that eventually took Western capitalism ahead of the rest of the world. Pacioli’s contribution to double-entry bookkeeping was the dictum that balance sheets must balance, so that cooking the books had to be more creative after Pacioli.

Our next point in history must move to 18th century Glasgow, when the venerable Scottish philosopher, Adam Smith, first expounded the moral philosophy of free markets. Students of history and Scotland cannot fail to notice that Smith’s six motives of human conduct (self-love, sympathy, the desire to be free, a sense of propriety, a habit of labour and the propensity to truck, barter and exchange one thing for another) bear quite a resemblance to all the attributes of the hardy, canny and entrepreneurial Scots who helped to build the British empire and today manage quite a sizeable chunk of global retirement savings, particularly from this lovely city of Edinburgh.
Now what has this potted version of global market history to do with Scottish accounting? Well you asked me for a view from the East, and I would argue that it was the bias towards scientific enquiry and objective information (and the quality of the governance that shaped markets) that in the end decided the competition between Western and Eastern civilisation during the Industrial Revolution. In short, one can assert quite confidently that the spread of British capitalism around the world cannot be divorced from its Scottish origins. Everywhere from the far flung outposts of the Falklands to New Hebrides, frugal, hard-working and entrepreneurial Scots were largely responsible for the a,b,c,d,e of the British empire: accounting, banking, commerce, defence and education. Niall Ferguson's book on Empire noted that "the East India Company was at the very least half-Scottish". When I grew up in what was then British North Borneo, my father's banker and accountant were Scottish, my English teacher was a McLeod and my first employer was a Dinwiddie. About half of the Chairmen of the Hong Kong Club, of which I am a proud member, have been Scots.

It is befitting therefore that we are here today to commemorate and celebrate the founding in Edinburgh of the oldest existing society of public accountants, The Institute of Chartered Accountants of Scotland, which received its Royal Charter in 1854. I must salute and congratulate ICAS for its achievements during its illustrious history, for the Institute has produced over the last 150 years, as the Lord Advocate remarked on the 50th Anniversary, the "favoured few":

... men of capacity and skill, men of resource and suggestiveness, men of sterling integrity, men fitted to be what they are - honoured members of a learned profession.

A century later, despite the world of globalisation, technology, financial innovation and disclosure, the value of the profession, as Sir Ian Morrow stated at the Centenary conference:
... has been and must be, to perform the duties of public accountants, to serve the public with unquestioned integrity and to put the public need before personal needs, despite the impact of divided loyalties and conflicting interests, because the public accountant's aim is truth and justice as he sees it.

I share our distinguished predecessors' views. In the age of complexity, the future of the accounting profession is at stake.

**Asian values versus global accounting standards**

Let me now turn to the second question, namely whether from the perspective of Asia, there could be Asian values and standards that differ from international accounting and auditing standards. Having grown up in an emerging market and worked in many developing countries when I was at the World Bank, I am very conscious of the cultural divide between the haves and have-nots. It is too easy for those who are emerging from poverty to decry that prosperity is denied them because of impossible standards imposed by the haves. It is also too glib for the successful to say that Asian values are responsible for present-day Asian growth. The same hubris affects those in the West who think that only their values account for global prosperity and harmony.

No man is an island and, even the Scottish writer Robert Louis Stevenson’s Robinson Crusoe must have companionship and shared values with his primitive friend Man Friday in order to survive. Hence, I am personally a great believer that Asian values or Western values are universal: the values of every Scot are shared by every Chinese, Indian, Malay, Arab or Persian: honesty, hard work, frugality and humanity. Values and standards can be universal, but perspectives must be local. The Chinese call this, somewhat expressively, the “bum pushes the brain” perspective, because your viewpoint depends on where you sit.
However subjective the perspective, there must be an objective standard that we should all aspire to. The relationship between accounting and the macro-economy is so fundamental that we tend to take it for granted. Reliable, accurate and timely information is a market fundamental. Good information is like good water — it is a public good.

The basic requirements of transparency, fairness and accountability are also fundamental to market stability, liquidity, corporate and public governance. The biggest lesson I personally learnt from the Asian crisis of 1997–98 was: bad accounting = bad statistics = bad analysis = bad risk management = financial crisis. From this crisis, and the aftermath of the corporate scandals since 2000, the world came to realise how we have taken the accounting and auditing profession for granted. Thanks to the leadership of Paul Volcker, Sir David Tweedie and many unnamed others, we are moving towards the greatest review and convergence of standards in the profession since its creation.

I personally support this convergence of accounting and auditing standards. Indeed, even though this task is not yet complete, the more monumental task of implementation across the world is only just beginning. Think for a moment. The miracle of the 21st century is not about technology and science, it is about how 40% of mankind, basically India and China, is lifting themselves out of poverty into the possibilities of prosperity through the market place. Adam Smith has lit the way.

Today, there are 120,000 chartered accountants in India and 140,000 certified public accountants in China, relatively small for a total population of 2.3 billion. If the two giants had the same ratio of qualified accountants to population as Hong Kong, they would need to train another 7.5 million persons. By the law of large numbers, these Asian economies face monumental tasks towards training both the quantity and quality of accountants for modern market economies.
It is in the interests of all accounting professions worldwide to assist these markets in that objective.

We cannot underestimate these challenges. As former Chinese Premier Zhu Rongji etched into the mottos of two principal schools of accounting in China: “Do not make false accounts”. These words apply equally today to many markets, emerging or mature.

Accountants as gatekeepers

Finally, I cannot resist adding my two bits on the future of the accounting profession. After Enron and other scandals, the accounting profession is under tremendous scrutiny. New legislation, IFAC and IOSCO standards on the accounting and auditing profession are being implemented around the world.

It is true that we cannot legislate good ethics. But if for some reason the ethics of companies are bad, and professionals condone such bad behaviour then, the professionals must be accountable to the public through proper sanctions. In other words, bad apples should not smell good and good professionals should not help bad apples to smell good.

As we all learnt when we sat our accounting examinations, the classic description of the role of the auditor is a watchdog but not a bloodhound. Unfortunately, some have interpreted this to mean that auditors have little responsibility over accounting fraud.

Over the years, I have come to appreciate that the secret of trust and confidence in any relationship, commercial or personal, is that one party (the entrepreneur or a leader) is the absorber of residual risks in his contractual relationship with others. Trust in a commercial relationship is reinforced when one party assures his counterparties that the contract holds in spite of uncertainties that the other counterparties cannot quite measure or insure against. The entrepreneur hedges against that residue risk through his capital – the greater the capital, the
greater the capacity to absorb unknown or residual risk. The greater that willingness to absorb residual risk, the greater his reputation as a trustworthy party to do business with.

Indeed, the whole concept of partnership and unlimited liability in the accounting profession is founded on the principle that the partner stakes his whole capital and reputation on fulfilling his professional standard of trust, integrity and objectivity.

My father used to say that there are three stages of making money. First, it takes blood, sweat and tears. Second, it takes money to make money and third, it takes a good reputation to make money. And we all know how quickly reputation and businesses dissipate rapidly when firms, even accounting firms, lose the public trust.

Unfortunately, the advent of litigation and rising cost of insurance have caused many entrepreneurs and even the accounting profession to protect themselves through what I call “the fine print”. When one can interpret several thousand pages of accounting standards for commercial advantage that mislead the reader, in the end, the principles of public trust and objectivity in accounting are violated.

By insulating residual risks of the profession through elaborate representation letters and other means, the accounting profession has shifted the residual risks of professional integrity and reputation to the preparers and users of financial information. By doing so, the burden of risk of bad accounting has fallen on to the public, very often the small retail investor. The result is that if the public feels that the profession is only “auditing the numbers” and not auditing the business, then, what do they need to pay the auditors for?

There is no doubt that, in recent years, financial fraud is the greatest challenge to the integrity of financial information. I am comforted that the Preface to the International Standards on Auditing published in February 2004 provides guidance relevant for all watchdogs, be they auditors, regulators, audit committee members, analysts, and even staff. It is that we all need to maintain an attitude of professional scepticism
throughout our work, recognising the possibility that fraud could exist, notwithstanding past experience as to the honesty and integrity of management and those charged with governance. It is a duty of all of us to be aware that fraud may exist and plan and conduct our work with this in mind.

In other words, the most precious part of the accounting profession is our professional judgment as to the consistency, neutrality, reliability, relevance and understandability of financial accounts. As professional accountants, we must exercise good judgment or be judged. That is the true test of good accounting. We cannot point to the company and say that we are not responsible for the accounts, unless we do not sign the audit opinion. We must be prepared to walk away from what we believe are accounts that do not meet our professional standards.

The future of any profession will always be what we as members make of it. Our reputation and success will make or break depending on our moral fibre and our professionalism.

Conclusion

To conclude, the accounting profession, auditors and preparers, are the craftsmen of a successful market economy: laying, building and certifying the quality of the bricks of reliable financial information. Markets function on information and trust; we all incur reputational risk if we depart from the high standards that ICAS has personified for the last 150 years. Ultimately, the market will judge the quality of information, the work, and reputation of the institutions that assure the integrity of the information. I am confident that, as the inheritors of a tradition of sterling integrity stretching back 150 years, Scottish CAs will jealously protect their reputation and the interest of the public. It remains for the rest of the world’s accounting profession to emulate the high principles that you and your predecessors have embodied.
Let me end with a poem written by a good friend and son of Edinburgh, Alasdair Morrison, when he was Taipan or head of a trading house in Hong Kong in 1991, that celebrates the virtues of Scotland in a distant land.

**LET no MAN UNDERESTIMATE**

The race of Scots expatriate,
Whose latent ardour flames apace
When freed from Scotland's cold embrace.
Twas Scots that formed from barren rock
This quintessential culture shock
Where mainly East and West now blend
But Scots to special rank pretend.
For in Hong Kong we've bridged the Schism
Between Adam Smith and Calvinism,
And nothing can be reckoned true
Without a Scottish CA's view:
And only Scotsmen seem to stand
With feet implanted in this land,
For while the valiant Scot agrees
His noblest portion is his knees
Those men of English or of Chinese race
Appear more conscious of their face.
But now we're hoist, tho' held in high regard,
Upon our parsimonious petard;
For, in this one great error caught,
We leased the land we should have bought.
And now the Day of Judgment lowers
To test the Scots' adaptive powers,
For many say about the Scots
We cannot change our native spots.
But we shall not fail or be ignored
By drafters of the Basic Law;
We shall unite and we shall be
A functional constituency.
So when the new elite decree
Just thirty percent democracy,
And when by Tamar's waters play
Young cadres from the P.L.A.,
We will not fear an empty sky
Or the lion dancer's dotted eye,
But from Shek O's shores to Taimoshan
We'll summon Burns' immortal clan
And, if we must, in the S.A.R.,
We'll toast our bard in Putonghua.”

In the 13 years since that poem was written, the scribe, Hong Kong, China and Scotland have all prospered. So let me say this in Putonghua:

“祝貴會基磐永固、聲譽宏遠”

which means:

*May The Institute of Chartered Accountants of Scotland have an enduring foundation and sterling reputation that will spread far and wide in the years to come.*
ENDNOTES:

1 I am grateful to Charles Grieve, Susanna Lau and Suet Peng Siew for assistance in the preparation of the speech, Alasdair Morrison for the use of his poem quoted here, Brian Stevenson, Stuart Leckie and Tan Gaik Looi for helpful comments and Rosetta Chiu for secretarial assistance. All errors and omissions are mine alone.


3 Niall Ferguson, “Empire”, Allen Lane, 2003

Sir David Tweedie is Chairman of the International Accounting Standards Board (IASB). He was the first Chairman of the UK Accounting Standards Board from 1990-2000 and was a Partner with KPMG Peat Marwick McLintoch from 1987-1990. A member of ICAS, Sir David is a former Lecturer in Accounting at the University of Edinburgh and former Technical Director of ICAS.

Education as a Cornerstone for Twenty-First Century Accounting

Let me take you back even before 1854, to the year 1696 when Scotland's Parliament (with then only 11 years of its existence left) passed its 'Act for Setting Schools' establishing a school in every Parish in Scotland not already equipped with one. The reason for this was obvious to any seventeenth century Presbyterian: boys and girls must know how to read Holy Scripture. The result was that within a generation nearly every Parish in Scotland had some sort of school and a regular teacher. The education must have been fairly rudimentary in some places - the fundamentals of reading and grammar and nothing more. But it was available and it was, at least in theory if not always in practice, frequent. Historians are still arguing about how many Scots really learned to read and write as a result of the School Act. But one thing is certain: Scotland's literacy rate was higher than that of any other country by the end of the eighteenth century. By one estimate, male literacy stood at around 55 per cent by 1720. By 1750
it was estimated it grew to as high as 75 per cent compared with only 53 per cent in England. The English would only catch up with their northern neighbours in the 1880’s – coincidentally about the time English accountants got their act together and formed the English Institute! In the meantime, from its modest beginnings the Scottish educational system had developed into one that had begun to train people to think for themselves.

The question I want to pose is what have we done with that precious legacy? Have we kept faith with our forbearers while keeping pace with all the changes we see around us? Above all, can Scottish accountants still think for themselves?

In this year of celebration, it is fitting that we should recognise and take pride in the achievements of the Institute and Scottish CAs both at home and abroad. Our education and examination system, and the expertise of Scottish accounting educationalists, have been exported right around the world - even as far as New Zealand. As a country, and as a profession, we have punched far above our weight. But this is an occasion not only to see how far we have come, but more importantly to lay down challenges for the future.

I asked whether Scottish accountants can still think for themselves. That is a question that raises challenges that are both personal and institutional. In essence I am asking: Are we laying the proper foundation for the future of chartered accountancy? Are we personally setting good examples for tomorrow’s leaders? Are we educating and training our people for what they face now and in the future?

It is a truism that over time, change is the constant. What is novel today is the speed at which change occurs. Think about changes in the world of business and accountancy over the 150 years of the Institute’s existence. Now, in a shorter time frame, think of the changes that have occurred over your career.

My professional training some 35 years ago, unlike the block release teaching of today, involved Friday night and Saturday morning Institute
classes taught by part-timers. It also involved the 'masters' teaching their 'apprentices' the rudiments of core professional values. In my own firm (Mann, Judd Gordon, (Glasgow)) once a month the partners would spend an afternoon discussing technical and ethical issues with the apprentices. In those sessions the basics that were being taught in Institute classes would be questioned. My own master, Past President Professor David Flint, would question the basic accounting practices – for example, do individuals intuitively value their houses at cost? Almost nobody thinks of it that way. It was then that I suddenly realised how primitive the subject of accounting was. Like Scotland's seventeenth century boys and girls, I was being forced to think. Interestingly, tests I later conducted on students at Edinburgh University and employees revealed that given information about the age, and expected life of an asset, its selling price and its cost only 4 per cent of the population would value assets in terms of depreciated historical cost – the traditional method used by accountants. The overwhelming majority chose market values. Professor Flint's question still remains:

*Do financial statements really give a faithful representation of reality or are we accountants still clinging to the cuddly teddy bears of reliability and auditability rather than economic fact?*

I am concerned about the changes in communication and the focus on exams rather than knowledge. In other words the way in which accounting principles are taught is too often the transmission of a body of knowledge rather than an approach in which students are asked to reflect, study in depth and internalise such material.

I feel that politicians too often became involved. We place emphasis on transparency in financial reporting. Political interference can prevent transparency, and can give absurd accounting results – such as the current proposal in the US Senate to treat as an expense some but not all share options granted to employees – only the options granted to the top five executives. Should we then also record only
the five largest salaries as remuneration expense or display only the five largest creditors?

So what of the future? As I have said, change is a constant and will only increase in intensity. Globalisation and convergence are trends that are also likely to intensify, and in doing so to reduce the diversity in the world. For at least the short term, regulation and oversight will increase. And Scots will, I believe, continue to make a conspicuous contribution in the world of business.

The Scottish renaissance sent forth into the world a model of probity, competence and skill that forged the basis of the accountancy profession worldwide. Think of some of the firms' founders' names – Arthur Young, James McClelland, William Peat, James Marwick, Roger Mitchell, George Touch[e], Thomson McLintock – all Scots. The Scottish chartered accountancy profession has been providing services of consistently high quality in the public interest for 150 years. How does it continue to do so? What are the attributes required in order to demonstrate professional competence? How do we ensure that every member of the profession has, and importantly continues to have, the capability to perform work of the highest standard? Education is the cornerstone.

We have to get away from employing eagles and turning them into turkeys. We need teachers who can enthral the young and enthuse them with professional values so that they act ethically in making the judgment calls. At present we do little to encourage the best to move into academia. We need, therefore, to do far more to support the accounting academics we call upon to give our recruits a grounding in and enthusiasm for the subject. We fail to sponsor, and we train on the cheap.

We must ensure that graduates come into the accounting profession because of a willingness to endorse the professional ethics of service to the public and a keenness to uphold a transparent capital
market rather than because of a particular interest in training with the
notion that a CA qualification leads to mega-pounds.

If we are to continue as a robust, respected profession, we must
build on a solid foundation. This needs raw intellectual power. But are
we getting it? Are the best of our young people attracted to accounting
and auditing? Do they see an accountancy qualification as opening
doors in the business world? And if not, why not? And what does that
mean for the profession’s future? Does our profession have the attraction
of investment banking, law or other careers in business and finance?

It must never be forgotten that people around thirty years old
want careers that add purpose to their lives as well as to fulfil their
potential at work. Employers who fail to listen and to accommodate
these wider ambitions and encourage the idealism of youth risk leaving
the high flyers frustrated and demotivated.

The aim should be for tomorrow’s chartered accountants to
develop a conceptual understanding of accounting. For a conceptual
understanding that provides a foundation to cope with change is the
first ingredient required when exercising professional judgment.

So here are the requisites for a sound foundation for tomorrow’s
profession - raw intellectual power, plus a theoretical conceptual
understanding of accounting, plus professional skills and ethical values.
But any foundation will crumble in an environment that is buffeted
by the winds of change. So learning and education cannot stop when
the foundation is laid. They must be maintained.

Those of us here today share a guilty secret: accounting is not
rocket science. We are simply required to show a true and fair view
of the financial position and performance of a company. What does
a true and fair view mean? It means standing back, looking at the
accounts and asking ‘from what we know about the company do the
balance sheet and income statement reflect what we know to be the
case?’ If they do not, we have to return to the canvas and repaint the
picture until they do.
It is interesting to compare the mottoes of this great Institute and that of our sister Institute across the Border. The motto of the Institute of Chartered Accountants in England and Wales is ‘Recte Numerare’ – get the numbers right’. Our motto is Quaere verum – ‘Seek the Truth’. Once the IASB finds it the President has promised me that he will change our motto to ‘Eureka’.

But if we are to get there we have to stop fooling ourselves. For example, every accountant knows a debit is either an asset or an expense. Yet for some, there is always a temptation to include on the balance sheet extra categories that we could term as ‘whatsits’ – for example, an inconvenient loss that management does not want to show in the profit and loss account, (for example, losses on derivatives hedging a future cash flow).

Exercising professional judgment requires a conceptual understanding and application of professional values and application of professional values and ethics, and of course – as Enron and the recent accounting scandals have taught us – a backbone.

Young professionals need more than the opportunity to observe the application of professional values and ethics. They benefit from exposure to ethical problems and potential dilemmas. They benefit from discussions on issues that have potential ethical implications. Above all, they benefit from good examples. Today’s practitioners, like those of 35 years ago, must take the lead.

I began by referring to the Schools Act. As I said, the motive for its introduction was largely the desire to inculcate the moral and spiritual values of the time. Whether by design or by accident, the result was a community whose members were trained to think for themselves, a community that attached high importance to probity, integrity, trustworthiness and personal accountability. It is those qualities that provided the ethical mainspring for the founding fathers of this Institute, and made the Scottish auditor a byword for honesty and reliability. We,
the present generation of Scottish accountants, have that reputation in trust. It is always hard to win a reputation and easy to lose it.

The future of the profession, now and perhaps for the next 150 years, depends on whether we are still able to think for ourselves and are prepared to do what is right - regardless of the size of the audit fee. If we are to maintain our profession's highest ideals and pass them on intact to those who succeed us, then the priority must be (in its broadest sense of academic study, PQE and the inculcation of professional ethics) as a certain well-known Scot has famously said:

*Education, education and education. That is the cornerstone for Twenty-first century accounting.*
Nigel Macdonald is Convener of the ICAS Research Committee. He was President of ICAS from 1993-1994. He is a member of the Competition Commission and the Review Panel of the Financial Reporting Council, and serves on the board of the British Standards Institute.

Valuing Integrity and Ethics in Practice and in Business

Introduction

For the next few minutes I want to introduce a research study, published to coincide with this conference and the 150th anniversary of ICAS. Its topic is Ethics – it is called Taking Ethics to Heart – and you all have a copy.

At this stage you might say – we have a had a good lunch, so let us relax for a few minutes whilst this chap is talking, and maybe we will look at the study on the way back in the aeroplane or on the train tomorrow when we have finished the newspaper.

So I ask you a simple question – “are accountants trusted today?” If you think the answer is “yes” then you can relax – but if not, please listen to a brief overview of what this research study on ethics in the profession has found and what it recommends.
It is obvious that ethics matter — in our personal relationships and in the way society works, nationally and internationally.

It is also obvious that the world that has accepted — however reluctantly — that free trade is essential and that creating economic barriers so as to keep a country self sufficient and economically independent leads to economic stagnation. That same world has accepted — again however reluctantly — that communism does not work to motivate people and that capitalism is the only other game in town. So free trade has become connected with much more fluid movements of capital.

It is self evident that capital markets need information which is reliable if they are to work and allow capital to flow to where it can earn the best returns. So when information proves to be wrong, and people in good standing who were trusted to ‘get it right’ become suspected of having ‘gone native’ and/or knowingly misled others in order to keep share prices high, bonuses good or clients happy and fees flowing, the whole system is strained and the profession’s standing falls into question.

So professional ethics matter — not just to us as accountants — but to the communities we live in and serve, the same communities that give us our livelihood and our standing. Even if the accounting profession was enjoying unprecedented trust and standing it would still have been appropriate to take a look at whether there was anything that we should do to improve our ethical practice and procedures. All the more so to do so at a time when — post Enron, Worldcom, and others, the communities we live and work in have been forced to question our competence and independence — even if — to save our feelings — they mostly do it when we are not part of the conversation.

It is very easy to allow any discussion or consideration of ethics to become philosophical — to explore for example whether ethics are absolute or relative, to ponder whether it is by paying careful attention to the potential consequences of a decision that we can make good
ethical choices, or whether it is the way we evaluate the inputs to that decision that matters.

Because the whole area of ethical decision-making is difficult, with a range of conflicting factors which we have to try and prioritise, it is also attractive to look for a set of rules that we can follow – at least in most instances. Yet we know from so many aspects of our professional lives that if we substitute rules for principles, we end up losing our way. So more and simpler rules are not the answer, although rules are a part of the necessary supporting structure which we must provide.

The research study necessarily considered the overall framework in which ethics in business and the profession must be set, but it sought to avoid the risk of becoming simply an academic study by ensuring that its work was grounded in present day experience and that its recommendations are practical and relevant to professional life today.

The study’s findings contain some surprises and some important recommendations.

But before I tell you about some key findings, a word about the Research Committee of ICAS.

All major institutes of accountants have a research activity and ICAS is no exception. All have research directors and committees to decide which studies should be commissioned, how resources – often quite slender – should be allocated, and then to help review the results. Most such research committees have members drawn from all walks of professional life – not just academia.

ICAS is different in that its research committee periodically ‘takes its own jackets off’ and does research. Its research is different because it can combine analysis and synthesis with the insights of its own practical experience, and then apply that experience when it moves to the hypothesis stage, so that it can then test and conclude in a way which combines creativity and academic rigour with practical experience and insight.
In choosing the topic for our study we were mindful of this occasion and of our motto — Seek the Truth — and Aileen Beattie and the eminent members of the Research Committee chose ethics as the critical issue. We were greatly aided by Professor Christine Helliar our Director of Research and Professor Jan Bebbington who helped to lead this project, and whose combined commitment (along with that of the rest of the Committee) enabled us to complete it in time. My thanks go to them all.

So in this study on ethics we started by interviewing (in some considerable depth) selected accountants with extensive practical experience, and then came back and thought about what those interviews had revealed. We then formulated a pretty detailed questionnaire, which we sent to a large number of professional accountants covering the full range of ages and in all walks of life. Over 150 of those accountants responded and their replies gave us a clear picture of issues — enabling us to detect some trends and patterns — and also gave us their reactions to some of the potential initiatives and recommendations that we had identified.

So our findings reflect a good section of views and we believe that they are not 'ivory towered' in nature. We also hope that they will be influential in changing education and training practice, the way firms, businesses and individuals decide difficult ethical questions, and in the way institutes and institutions react to apparently questionable ethical practices.

We are proud of the impact some of our previous research studies have had and the worldwide impact of *Making Corporate Reports Valuable* has been referred to already today. It was accompanied by a number of supporting published reports such as a feasibility study looking at the application of these radical ideas covering The Post Office and an example company *Orchestia plc*, and an example drawn from an actual listed group which we called *Melody plc*. We also published six case studies comparing Management Information and External Reporting
within individual groups and a Survey of Corporate Reporting Practices by Major UK Companies and a thoughtful study Business Reporting: The Inevitable Change?

In auditing we have also pioneered some radical thinking and it is almost ten years since we published Auditing into the Twenty-first Century. And these groundbreaking studies have been supported by a wide-ranging list of other research publications of which those attending have a printed list. [NB This list is also available from the ICAS website]

It was against that background and tradition of producing from time to time studies that combined practical experience with a higher sense of purpose and proportion, that we tackled the issue of ethics. Let me now tell you what we found.

First we found, perhaps to our relief but not to our surprise, that all the accountants we had contact with were genuinely alive to ethical issues in their professional lives. Indeed many had quite revealing tales to tell about how such issues had been tackled and resolved, or in some case show those decisions had caused them to move on from a particular situation — either at their own instigation or at the instigation of their employer. So it would be seriously misleading to suggest that the issue of ethics is ‘dead’ in the minds and working lives of accountants today.

However we also found something quite serious. That is that accountants did not have a common or agreed way of looking at ethical issues. For the avoidance of doubt I am not talking about the fact that two different accountants might come to different conclusions about the same set of facts. I am highlighting the finding that there is no common decision-making process for ethical issues in our profession today. Despite clear professional guidance as to the ethical principles that must be followed, and guidance from CAJEC (the Chartered Accountants Joint Ethics Committee) as to what to do in some common situations creating ethical challenges, there is no common
thought process, decision chart or 'agenda'. Everyone is trying to start from what they see as first principles and inventing their own.

As a consequence of this absence of a common thought process, there is widespread uncertainty amongst individuals and within firms as to whether there is or could be a clear process that would help accountants to resolve ethical dilemmas. Most agree that consulting with others is a good idea -- if only to test out their own analysis with someone else who they trust and who is independent.

As an aside -- as one who had the privilege of serving on the Cadbury Committee and so helping to highlight the importance of good corporate governance which is now accepted throughout the capitalist world -- I was struck by the absence of any agreed 'agenda' about the topic in those early days. It seemed to me that nearly everyone who cared at all, and there were plenty of them, was trying to puzzle out for themselves what they needed to do to have good and effective governance in their boards.

When the Cadbury Committee published a clear set of principles (and encouraged boards to follow them or explain why they considered they did not need to) that action in itself created an 'agenda' for discussion in boards and elsewhere which has proved useful -- and has been extended since -- throughout the world.

In the area of ethics we seem to be at the same stage -- our research confirmed that most accountants do care a good deal about ethics, but we still lack a clear 'agenda' for the decision-making process. I link that thought to Andrew Sheng's powerful comments this morning about the importance of the Scottish legacy of bringing the scientific method to thinking around the world. It seems to me that if that method is applied rigorously the resulting analysis is replicable -- and will lead to a common thought process -- exactly what we are suggesting a common decision-making process for ethical decisions could deliver.

So one important recommendation of our report is that there is a need for a common decision chart that anyone can adopt -- and
to get the ball rolling we have proposed one in our report. Our aim was to identify a framework for ethical decision making – set out on page 60 of the book – which is sufficiently flexible to be usable in all normal circumstances, yet sufficiently rigorous to ensure that all key aspects have been considered, and we believe that we have done so. We do not claim it is the last word, but we hope it will provide a solid basis to build on.

If you look at that decision chart and say, “this is pretty obvious” I have just two things to say to you. First – to suggest we may not have got it so badly wrong! Second – to remind you that not one of the many people we interviewed, or the far larger number that took the time to respond to our detailed questionnaire, suggested any such process. Instead many, if not most, remarked on the difficulty of identifying and addressing all the relevant issues, which is why so many found discussion with a colleague so useful.

However that decision chart was not the only recommendation. I do not have time in this short session to outline, let alone explain, all the 36 other proposals and recommendations we have made, and you may be relieved about that. You have a copy of the report and we hope that you will want to look carefully at them. But I would like to highlight a few.

We came to the conclusion that the ethics training within professional accountancy programmes needed to be reviewed carefully. Indeed two of the six Education standards issued by the International Federation of Accountants last October includes excellent guidance directly relevant to ethics training by professional bodies. To help put practical meat on these bones, during this last year ICAS has been supporting an IFAC research project, with some funding from the Scottish Chartered Accountants Trust for Education (SCATE). The result should be a step change improvement in practical training about how to identify and resolve ethics issues that are likely to arise. Examinations need to address these issues too, and we think having
a common decision chart will help move this whole area forward considerably.

But another important research finding of our study is that ethical issues do not really have day-to-day relevance to students because it is not until an individual rises to a position of responsibility, Finance Controller or Director, Audit Manager or Partner that these considerations really 'kick in'. So there is a need for further training at that stage, whether in firms and businesses or by supplementary continuing professional development training by institutes or others.

We had a number of other recommendations and proposals relevant to firms and businesses. The importance of the tone from the top is hard to over-emphasise – codes and rules alone will not deliver. We point out that Enron had issued excellent written ethical guidance for its staff. So we strongly support the proposal that the APB is expected to make shortly that firms have a designated 'ethics' partner. This part of the overriding need for all firms to separate risk management responsibilities clearly from audit business management responsibilities, if they have not done this already.

We also recommend that audit committees of businesses should review ethical practice explicitly as well as financial control, if the board itself does not undertake that task. The Smith guidance contained in the Combined Code already requires the Audit Committee to have regard to the integrity of the financial statements of the company, and to monitor internal audit and the independence, objectivity and effectiveness of the external auditors. We urge the extension of the monitoring role to ethical practice within the business.

Within professional firms we also draw attention to the need for firms to ensure that individual audit partners and audit teams cannot override technical advice within their firms in order to keep clients happy. In some firms this is a dismissable offence – in others it seems to be tolerated in practice. In Enron, for example, the local audit team in Houston overrode the clear technical advice from their firms
Chicago headquarters as to the appropriate accounting treatment. Of course if there is disagreement, there needs to be a dispute resolution process overseen by people in the firm without direct client or business responsibility.

Escalation procedures need to be well thought out and clear to staff as well, and rather than concentrate on whistle blowing in our report we have looked hard at how internal procedures can be structured to make this step truly something of very last resort.

We have looked at how Members Services could help professionals facing an ethical dilemma. It is clear from our research that a number of individuals have faced ethical crises with a clear feeling of 'being alone' and that some have considered their careers to have been adversely affected by the principled decisions they took. Actually the major accounting institutes already provide help to members who ask for it. However, the existence of such advice is not widely known and we think it should be, so we recommend much clearer publicity about this service. Many such issues appear to the individual to be unusual and even unique but in practice are not, and so we also urge the provision of help sheets and guidance about commonly encountered situations as is already provided by our sister body in England and Wales. We recommend that members should be allowed to refer to the fact that they have consulted their Institute in their CV's if they feel the need to (and we acknowledge the need for some safeguards to prevent abuse of that right).

We have certain recommendations about enforcement of codes of conduct too.

There are no easy solutions to the challenge of maintaining a high standard of professional ethics. The individual is key; for excellent procedures within training, or within firms, businesses and institutes alone are not sufficient. So we have focused in our report on how to help ensure that the individual is properly trained and supported in
his or her decision-making processes, with incentives for good ethical decision making and disincentives to the opposite.

Our recommendations for firms, businesses and institutions are directed towards helping reinforce good decision-making processes by the individuals who are responsible for those decisions – not as an end in themselves. As mentioned earlier, to help make these changes effective we have also highlighted what we see as the vital importance of creating and disseminating widely a common framework for ethical decision making, so as to create an ‘agenda’ and a common language to help all concerned to make good decisions and to make them consistently.

Our profession is responsible for the preparation and attestation of reliable financial information essential to the effective operation of capital markets here, in the wider European Community and internationally. We do not always succeed in doing so.

As a Research Committee we hope that our profession will continue to try to meet the responsibilities which that critical role implies, and that accountants – whether in business or in practice – will not be complacent about weaknesses that can be and have been identified. That is why the Research Committee of ICAS is pleased to offer this report, not only to this gathering of interested and eminent individuals but to the wider professional community, and we sincerely hope that it will stimulate thought and action in an area of critical importance to our profession and to the public interest.
Jules Muis is former Director-General of the Internal Audit Service, the Internal Auditor of the European Commission. He was Vice President and Controller of the World Bank from 1994-2000. Jules Muis is a Past President of the Royal Dutch Institute of Registered Accountants (Royal NIVRA). He was an Executive Partner with Ernst & Young (Europe) from 1992-1994.

**Commissioning Change in the European Union**

**Introduction**

First of all, let me congratulate ICAS on its 150th anniversary and on organising this event. I must also praise ICAS for the useful research on ethics, which we have just heard about, that it has carried out for the occasion. I hope that my modest EU perspective will contribute to the success of the day.

My thesis is simple. I believe that we have a professional credibility crisis, not just in the private sector but also in the public sector; the two are feeding closely on and off one another.
A brief statement on the present tumultuous state of the art of the accountancy profession

Let me begin, though, by acknowledging the formidable, historic contribution that the accountancy profession has made as part of the global financial architecture, despite there having effectively been a power vacuum at global level. Sometimes we have been ahead of the curve and sometimes we have been a follower of trends but, at all times, we have been dependent on the other institutional actors in the global financial architecture – as indeed they are dependent on us.

Our profession’s performance has, however, been dependent on the personal spine and force of conviction of each member of the profession. I believe that our profession’s workings have been predicated on the too fragile assumption that virtue will always be stronger than money and that, to an extent, we are condemned to move from crisis to crisis – which is where we are today.

Today’s crisis has resulted in an expensive, long-lasting loss of self regulatory power and credibility.

Striking features of the present crisis

Today’s crisis happened against vested wisdom and despite the excellent toolkits that had been developed in the nineties as a result of the crises of the seventies and eighties. We knew how important governance, institution building, ethics, understanding organisational behaviour, incentive and disincentive systems were for a proper functioning of the profession at all levels. We had all the tools but were blinded by the usual temptations. We sold those tools to the market, but did not apply them to ourselves and, as a result, we lost a few times too many. That obscured the tremendously good professional work that had been done over time. It was both a failure of collective leadership as well as individual spines. But we will never know how much of a
failure it really was, because the good work will remain unseen and its stalwarts, for most part unknown, cannot sing their own praises.

The European Commission experience

My job today is to put our subject matter into the perspective of the experience of the European Commission (EC). I must confess to being a strong Europhile, who applauds the formidable overall achievements of the Commission, over almost 60 years, as a tremendous change agent for the better on the policy front. The Commission has been less successful as a money manager of some Euro 100 billion funds flows/redistribution of wealth, of which about 80% is jointly managed with member states (agriculture, regional development funds etc) 15% is directly managed and 5% is for the administrative support of institutions and its bureaucracy.

My key question is how can the accountancy profession be regulated by an organisation, the EC, which failed to pay any attention to such regulation when it applied it to itself? How come the Commission, itself a regulator of the financial markets, the accountancy profession, good governance etc, has been unable over the last ten years to procure a clean opinion on its accounts? Why does it have an adverse opinion on its expenditures to the point that it caused the fall of the whole Commission in 1999? How come that almost five years later it will still not be able to assure compliance with standard practice (I am not talking about ‘world class’) in its fiduciary duty of care? How come it has not been able to create an enabling environment such that its management and staff, its beneficiaries, are structurally protected from chronic scandals that have marked its last ten years of financial management?

I will try to answer these questions with a number of systemic observations. When accepting my job as Internal Auditor, I wanted to focus particularly on structural barriers, as opposed to bringing in
a few scalps of a few Indians every year to satisfy the public appetite for blood. The latter approach would simply have found some poor suckers who could not resist the temptation that goes with fragile controls and given the Commission and everyone who depends on it a false sense of security. It would also have left in place fragile controls. Not only are these conducive to waste, fraud and error, but also the discovery risk of fraud and error under those circumstances is too low to know what the real leakage picture is.

This approach has not been popular with and at the Commission because it painfully puts the spotlight on senior management's prime responsibility to get it right, structurally. It challenges top management's leadership, vested interest, and status quo. It is reform, as defined by the Commission itself, in action in a substantive sense, rather than merely rearranging the deckchairs.

**The Reform Programme**

The Commission's 1999 Reform programme was basically sound. It led to the formulation of a solid set of fundamental principles of internal control (only very partially implemented by the end of this year). It did away with centralised transaction controls where those controls could better be done from the trenches. Its most effective change instrument, its silver bullet, was a World Bank borrowed/inspired management tool of annual management assurance statements on the state of controls. That really got management's attention, but was in part hollowed out by implementing rules that encouraged behaviour aimed at making sure that the scorecard showed the right line of progression.

Prodi Reform also borrowed heavily from, but gave little credit to, reform plans developed by its predecessor, the infamous Santer Commission. It grossly underestimated the holes in the Commission's accounting system, a fact that became more obvious two years after the
launching of the reform programme through various accounting crises. It recognised, but did not accept in implementation, governance as a key issue of relevance to controls and checks and balances. All of this would not have been calamitous if the flexibility had existed to look at reform as a discovery process, and much of the upheaval that followed could have been avoided. Yet, unfortunately, the Commission, as a bureaucracy, could not marshal such a flexible response. Another reason was that the Commission too often fell victim to the old counter-reform habits of denial and stonewalling. This was undoubtedly a missed opportunity for its leadership, since reform had given it a wonderful window of opportunity for more permanent fixes by design, rather than by the usual default that had marked its financial management history.

Finally, the Internal Audit Service brought to the fore other major issues which previously had not been on the table for discussion, eg the disconnect (in terms of controls) between the Treaty assumption that gives the Commission full budget responsibility for all funds committed/disbursed, on the one hand, and the Maastricht treaty assumption of subsidiarity. We put forward the view that the Commission is not equipped (nor ever will be) to meet the Treaty assumption unless the mutual responsibilities between member states and the Commission are more clearly defined through a protocol containing a full assurance statement by the member states, with legal jeopardy, in case at a later stage one discovered that the Commission had been given the run around by its own member states. I am happy to note that this issue is now getting some attention, although reluctantly, because any such acknowledgement requires an institutional strip act beyond the usual Emperor’s Clothes.
Governance

By bringing up governance as a control issue, one has to tinker not only with systems and procedural improvements but also with the Commission’s own internal distribution of power. Hence accountability constructs, in particular the position of the accounting and controller community, its empowerment, its skill base and so on become of importance – not least because they are operating not only for management, but also of management. Raising governance issues tinkers with the very essence of the decision and accountability powerbase and hence with vested interest and the status quo.

It also sharpens the accountability construct, at the expense of there being room for evasive actions when things go wrong. It is not easy to get a clear answer if, despite the rhetoric of the Prodi Commission’s Reform Programme, one has to deal with five different Chief Accountants in two years (as I had to), only one of whom accepted the notion of reasonable assurance-based responsibility for the integrity of the accounts as a whole. She was very short lived.

In addition there were substantial skills issues, functional responsibility questions in the resource management community, a tremendous resource shortage to deal with the challenges that go with a mainly process - rather than results-based fiduciary framework and confusion at the very top as to the propriety of having the Commissioner in charge of the Accounts also chairing the Audit Committee. Add to that a parade of accountants with a (perverse) bonus system predicated on the condition that no error or fraud was discovered and none of whom, except one, felt responsible for signing the accounts as well as internal auditors solely responsible/accountable to their department chief and no-one else etc. None of this protected and protects the Commission if one wanted to invoke professional responsibility before political responsibility - and political only in the last resort.
Why is it so difficult to have normality in a public multilateral institution and create an enabling environment for all players?

I thought about this question for a long time and thought I had found all the answers after my World Bank experience. But let me share my own observations on this:

(1) Warped institutional-cultural value system

Money management had only become a substantive issue (beyond policy setting and compliance) at the Commission after 1980 when the numbers became more substantial. There was no culture of recognising the duty of care and importance of the reputational risk that goes with money management until things went visibly wrong.

A number of problems with the institution's culture led to it becoming totally warped towards expediency:

- the institution's value system was inadequately calibrated to account for the checks and balances that go with money management;
- the resourcing of money management lagged behind the ever-expanding processes and procedures;
- accountants could do better in the operational/policy front lines and offices than in a back-office position of bean counting;
- the Treaty-designated function of the accountant is not translated into a position high enough on the institutional ladder;
the bean counters at all levels remain subservient to the bean makers, without compensating checks and balances, accountabilities and empowerment; and

- allegedly in the mid-nineties the procedural requirements became so convoluted, and the resources to deal with them remained so thin, that management was being judged by its ability/savvy to by-pass them (Eurostat)

and, of course, expediency led to cutting corners, which made matters even worse.

(2) "Housetraining"

I believe that a "politeness conspiracy" can work its way into an organisation's culture such that one loses the ability to know the truth. It is evidenced by the career-progression incentive system catering too much for a person's ability to ride the waves rather than causing them. If one has to be able to accommodate different waves on many foreign shores then one ends up with too many excellent surfers and too few dike-builders keenly going for new territories. It is an understandable phenomenon but, beyond a certain point, the law of diminishing returns sets in and one loses all ability to know the truth.

This also decides to a major extent the powerbase relationship between the political body of Commissioners and the bureaucracy one depends on. Unfortunately Reform has not been an encouraging example of showing the world how to change that. Hence we have ended up with too many whistleblowers and too many of them have been trashed (often, but not always, in the interest of the Commission) in their attempt to seek recognition for their grievances. It leads to a culture of coded language,
which makes it difficult to really understand the depth of the challenges at hand.

(3) Politisation

All organisations are politicised, not all are political. The Commission, by its very nature, is both. Therefore “might makes right” is an unspoken traffic rule which is not conducive to plain speaking and getting to the bottom of things. In a political constellation of “dealers in hope” (Napoleon), “the glass is half full” language is by its very nature by far preferred over “the glass is half empty” language. (Read the bottom line of the European Court of Auditor’s annual report and you will see what I mean.)

Part of that semantic skewedness is understandable. The Commission itself is part of an overall institutional framework, and institutional gaming is an inevitable part of the scene. It also has to deal with voices that are openly out to destroy the European concept and misuse any acknowledgement of failure. Add to that the fact that the Commission’s budget dynamics over the last five years in particular has been that it has been swimming in programmatic money, with structural surpluses, whilst the delivery platforms ie its bureaucracy, has been kept paper-thin. As a result, the incentive system for frankness is wanting.

How keen will one be under these circumstances to set up effective control systems that may lead to a clawback of money that will only lead to more surpluses? Parliament has played a tremendously positive role in its wake-up call for the Commission to strengthen its good housekeeping mode. Yet Parliament, and Council, also wants the money out of the door. This blowing hot and cold from both corners of the mouth, and the concomitant gridlock in turning the annual discharge process into anything serious (how many private companies can get away with ten
years' substandard fiduciary performance?) explains the chronic phenomenon of the Commission (and the US federal government for that matter) getting away, year after year, with basically adverse opinions on controls and, as I read it, de facto disclaimers on its accounts and a systemic failure of the checks and balances little can be done about. Instead the symptoms of this deeper disease, the anecdotal, (Eurostat, Andreasen) has become an ongoing political distraction – a circus - sometimes for the right, sometimes for the wrong reasons.

All of this leads to gridlock in real solutions and ongoing exposure of individuals operating in any such environment. There are chronic stories of evasive “progress being made” statements, without ever really getting there, and the degrading of an excellent stated institutional value system into a sardonic if not cynical one.

None of this is necessary. The systems solutions, both professional and technical, are there. We know the principles of a sound checks and balances based governance structure. However, there also needs to be an up-front recognition that the EU is in a high risk business and that the Commission can never assume compliance responsibility for all the pumping stations its money goes through. As part of that, the architectural mapping of the EU’s money flow architecture should be revisited and national audit offices must play their role, having the EU’s interest – and not only national interest – in mind.

But all of this also requires political leadership which, and I put it now a bit unfairly in “the glass is half empty language”, I have yet to see happen. There is another opportunity for this new Commission to get there, and accounting reform will help, but I would warn against declaring victory too early: not until the end of its term.

I have been a proud contributor to some of the changes that have taken place at the Commission. My experience (both at the World Bank and the Commission) has been that if the political will is there, the public servants will be supportive. Without their support, I would
have been nowhere in being instrumental to the changes that indeed
have taken place.

I hope, however, that in 2009 this new Commission (and my
successor) will be able to throw the glass half empty/half full metaphor
out of the Berlaymont building and instead raise a full glass to the
achievement of its predecessor Reform Commission's basically sound
reform plans. The biggest bonus out of that would not only be an
ability to say, in an unqualified way, that the Commission can be sure
that the money has been spent for the intended purposes but also
that it has built an enabling environment for its staff to assure benign
compliance with the cultural value systems, as advertised. We would
no longer need a whistleblower statute – instead there would be a
magnificent opening for true deregulation.

In Closing

In closing, I would also point out that in a broader international
public sector context the (lack of) integrity of governmental finances/
accounting seems to be the rule rather than the exception - witness
the US Federal Government which has also been faced, for ten years
in a row, with a disclaimer of opinion on its consolidated accounts and
which receives from its external auditors a straight-shooting adverse
opinion on its controls systems as a whole. Since, practically speaking,
one cannot send the European Commission, nor the US Federal
Government for that matter, home every time they fail to procure
acceptable audit clearances on their accounts, the annual discharge
procedures of key regulators of the profession - discharge being the
most fundamental link in a system of fiduciary checks and balances
- has lost all its teeth and credibility. As a result, accounting scandals
in the public sector have degenerated into politicised cherry-picking
on and of relatively small symptoms of a major disease. For instance,
the Santer Commission was sent home in 1999 on a questionable
Euro 6000 invoice, the really big issue (an inability to produce proper accounts) having become too big to tackle.

I also deeply regret the Commission's carve-out provisions on IAS39. Its inability/unwillingness to endorse without qualification the IFRS (especially on a subject as important as derivatives) is an indication of the Commission's own assumptions on its accounting/control culture: that everything, including controls, is negotiable.

This structural lack of accounting discipline in the public sector spills over into the private sector, and vice versa, when dealing with matters of highly political or politicised interest for different, but mostly the wrong, reasons. That in turn reveals the perverse effects of election funding (US) as well as the political power of industrial lobbies. Standard setting by "Gesundes Volks Empfinden" (by cabal), becomes, and already is, a real prospect. If it works and politicians get away with it in one's own public housekeeping, why face the pain of alienating political support in dealing with the regulation of the rest of the world?

We have to understand that, in the design of informational integrity, the public and private sector are two wings of one plane and that corrosion of one wing means erosion of the dynamics of the other. As a result, what should be virtuous circles of mutual inspiration, degenerates easily into vicious circles serving only vested interest and the status quo, even against a backdrop of "making progress".

I believe that there is an urgent need to consider all actors in the international financial architecture as being not only part of the solution but also a major part of the problem. This is a precondition for progress beyond reactive, best efforts towards much needed, proactive, results-based fixes. That requires lifting the debate beyond non-committing lateral discussion platforms such as the Financial Stability Forum, useful as it may be or have been post the East Asian crisis, and to engage in a penetrating debate on the adequacy and effectiveness of the present governance debate - if only to prevent further systemic failures in an
ongoing fragile financial world system, based on too opportunistic standard setting.

Equally, the profession itself should have the courage to re-examine the present syntax of audit reports and the way this key professional toolkit is used in practice. More acknowledgement of up front residual risks is called for. I have done this myself by effectively signaling in my Annual Report as Internal Auditor of the Commission that ‘of course’ there have been pressures on me to influence my professional judgement (being ‘leaned on’), but that there have been no unmanageable issues and that I took full responsibility that the resolution of any such conflicts met regulatory standards.

My own assessment on whether these much needed paradigm fundamental overhauls will happen is outright pessimism. Progress is being, and will continue to be, made, but real change will continue to be mainly crisis driven.

[This was the text of Jules Muis’ written speech, as presented at the Conference in “the glass is half-empty” language.]
Paul Volcker is Chairman of the Trustees of the International Accounting Standards Committee (IASC). He served two terms as Chairman of the Board of Governors of the Federal Reserve System from 1979-1987. In total, Paul Volcker worked in the Federal Government for nearly 30 years, serving in office under five Presidents of the United States.

**Reasserting Truth in a Post-Enron World**

It has been more than a little disturbing to learn about so many breakdowns in financial reporting in one big company after another in recent years.

Scotland itself seems to have largely escaped, but the problems have been cosmopolitan – Enron, WorldCom, Tyco, Freddie Mac (I thought it appropriate to introduce a Scottish-sounding name), Royal Ahold, Parmalat, Royal Dutch Shell, the UFJ Bank in Japan – what a litany of transatlantic and transpacific scandals. And the accounting profession has borne the brunt of the criticism.

You know, and I know, that other once honoured professions share the responsibility: the investment bankers with their fertile minds who have so much money at stake and dream up the deals; the analysts who bend their analysis to support those deals; the lawyers increasingly willing to stretch law and ethics to justify “aggressive accounting”; the consultants who seem to be able with a straight face to support and
defend the most egregious compensation schemes – compensation that must strike the proverbial dour Scots Calvinist as not only egregious but also immoral.

But still, we have to concede there is a certain justice in singling out the accountant and the auditor for criticism. In hindsight at least, it has been evident that the profession has strayed from its vocation – even from the legal obligation to serve the investor – to tell the truth as it sees the truth.

In my opinion, at least, it is a demonstrable fact that it is difficult enough to hold to principle amid the enormous complexities and pressure inherent in the financial world of the 21st century. It is doubly difficult when one’s firm is anxious to sell more lucrative consulting services to an auditing client. It seems to me close to psychologically impossible to, on the one hand, sell opaque and obscure tax-avoidance schemes for a success fee and, on the other hand, maintain auditing discipline for the same company.

Whether you fully share these views or not, there cannot be any dispute the profession has had a wake-up call. There is a lot of lost credibility to recover. That is not a job for a single firm, however large, nor for one Institute, however honoured, nor for a single country, however powerful.

Unfortunately it has required legislation in the United States, tough and intrusive legislation with extra-territorial reach. Our Sarbanes-Oxley Act is having a large, and I think largely constructive, impact. But it clearly would be wrong, quite apart from the exceptional burdens placed on individual accountants and firms, to rest reform on official regulation.

What is needed is a constructive response by the profession itself, as individuals, as firms, and as collective organisations. ICAS has a strong tradition. The experience and the respect your organisation has rightly developed has been sustained. Those very facts demand a leadership position.
I am personally involved, as Chairman of the Trustees of the International Accounting Standards Committee Foundation, in another important effort to deal with one part of the problem. The Committee and the Board we appoint is, in effect, a joint effort by the profession, the business community, and regulators to develop coherent, enforceable, and common accounting standards.

The prime justification for International Accounting Standards is a positive one. An essentially borderless world of finance requires a standardised set of accounting standards if it is to operate effectively, promoting a truly economic allocation of capital. But there is an important defensive aspect as well. Agreement on a uniform set of understood accounting principles, and I emphasise the importance of clarity in those principles, should help those applying the standards to maintain professional discipline. Not so incidentally, high quality common standards should help to restore the credibility and pride of the profession.

I have also come to realise, however simple the objective and however great the potential benefit, that achieving international convergence and well understood, conceptually defensible, standards is an immensely difficult job.

There is, first of all, the huge intellectual challenge of developing accounting standards relevant to the modern world, with all its complexities and all the inherited differences and difficulties in national approaches. The old rule book of historic value does not seem quite right for a world with layers and layers of volatile finance, with derivatives of every kind dominating trading, with new complexities of insurance and pensions, with leasing that mimics ownership, and on and on. But can we be so sure that marking everything to volatile markets, even when we have to simulate a market price, really captures underlying reality? Must we live with a mixed and inherently complex and abstractly illogical accounting system?
But do not lose sight of the main story. There is a great deal of
good news in the area of achieving convergence and common standards.
Moreover that convergence has not been a matter of agreeing to the
least common denominator. There is a vigorous effort to achieve the
best result: rigorous standards applied with discipline.

In little more than three years, the IASB has completed five
entirely new standards and revised 17 standards inherited from its
predecessor organisation. Taken in its entirety this work provides a
workable platform for advancing common international standards.
More particularly it provides a practical framework for European
companies that are required to adopt international standards next year.
The reservations about parts of IAS39 should not, and has not, it seems
to me, diminished in any way the commitment within the European
Union, and specifically the European Commission, to support the
concept of international standards.

Beyond the European Union a large number of other countries
in all continents are preparing to adopt, or already have adopted,
International Financial Reporting Standards. A recent Deloitte &
Touche survey indicates 92 countries will encourage, permit, or require
these standards in 2005.

Of course the big enchilada is convergence between American
GAAP and the international standards. In that respect there is certainly
good news.

My sense is that the strong reservations about international
standards in the United States have faded. In the light of all that has
happened no longer can American standard setters, regulators, or even
American politicians, sit back and claim that US GAAP is the logical
and only model for the world. I believe current members of both FASB
and the SEC are committed to convergence. There is still work to be
done, a lot of it. But what is so encouraging is how much of that work
is being done together, by close liaison, by joint or complementary
projects, by agreed research, not just between the United States and the IASB, but with a number of other countries as well.

I would like to permit myself a little unaccustomed optimism. At the end of the day, I expect the weight of professional opinion and increasing business practice will deflect the intense, but highly concentrated, political effort to overturn expensing of stock options in the United States. In Europe there seems to me a reasonable prospect that many internationally active financial institutions will be ready, willing, and able to implement IAS in their entirety, pending final resolution of the controversy about IAS39.

I have taken a long time discussing accounting standards. Plainly that is only part of the reforms needed. At least as important are strong auditing standards and performance. In the United States the clear decision has been to impose that result by law rather than relying on the profession itself. We have a new regulatory apparatus, the Public Company Accounting Oversight Board, (PCAOB). In concept there may well have been better ways to achieve the desired result. My parochial view is that a thoroughly reformed Arthur Andersen might have been a better vehicle for constructive change -- and not so incidentally that would have left us with a less concentrated, more competitive, accounting profession.

Personal predictions aside, the PCAOB, known in Washington as Peekaboo, is on the job. For all the sharp corners of Sarbanes-Oxley and the costs involved, a forceful response to what was happening was surely justified. The law has been recognised as constructive by most American businesses. Skilful diplomacy and a complementary strengthening of supervision in a number of other countries, including Europe, have gone a long way toward smoothing extra-territorial concerns.

The fact is such concerns are practically inevitable if we are to reap the benefits of open financial markets. The only way forward, as
with accounting standards themselves, is a willingness to work toward common approaches.

There is another area, clearly related, where reform is in the air — or perhaps more accurately, in corporate boardrooms. There is, I think, a much greater understanding in the United States that the day of what came to be known as the “Imperial Chief Executive” is passing. Endless models for good corporate governance have been set out by business groups, by “wise men”, and by governments. In detail it is enough to make the head spin to keep track of it all. I do not want to join the new cottage industry of advisors on corporate governance, but there are two or three points that I think are important.

The common element in most of the discussion is that a corporate board should recognise that its indispensable role is not to manage the company but to oversee the management — to assure itself of the appropriate corporate values, including its ethics, to demand strong financial controls, and to independently determine remuneration policies.

All that requires a spirit of independence among board members, whatever the technical requirements. To my mind, for the typical large corporation, a non-executive chairman — at least a designated lead director — is a key, as is a strong audit committee, insisting upon and supporting a strong internal audit function and external audit function. To make my own bias explicit, fixed-price stock options with no performance test are demonstrably a highly capricious form of compensation. All too often heavy use of those options produces precisely the patterns of behaviour that undercut sustained performance and puts pressure on auditors.

Plainly a lot needed to be done and a lot is going on. I cannot say it has all been plain sailing. The tendency to return to business as usual is still there. In its partial initial inspections of the remaining “Big Four” accounting firms the PCAOB found continuing flaws in compliance and quality control. We begin to see reports of accounting
firms rebuilding lucrative consulting practices — the equivalent, in my view, of taking “just one more drink”. There is reluctance to give up what is euphemistically called “aggressive tax planning” despite one challenge after another. Overall top executive compensation in the United States somehow continues to rise from already questionable levels.

Here we are in the true home of the accounting profession, the mother lode from which David Tweedie himself has emerged to lead the profession. This may be the place to share with you a personal vision. The role for the accounting profession above all else is to be a guardian of truth. Its prime responsibility is not to the company that employs it but to the investing public. To discharge that responsibility I see the rebirth and beginnings of a group of proud professionals dealing with intellectual and practical challenges the equal of any profession. The services provided should be highly valued, with compensation reflecting that value, even if the financial rewards do not match high-flying traders and investment bankers. I see signs that talented young men and women have renewed interest in a profession that our best, or what have been popularly considered the best, business schools have neglected for years.

All that is consistent with the fine traditions, the professional commitment and the sense of pride characteristic of The Institute of Chartered Accountants of Scotland for so many years.
Graham Ward CBE is Deputy President of the International Federation of Accountants (IFAC). He is a senior partner with PricewaterhouseCoopers. Graham Ward is also Vice Chairman of the UK's Auditing Practices Board (APB). He was President of the Institute of Chartered Accountants in England & Wales from 2000-2001.

Defining the Attributes of Tomorrow's Accountants

First, on behalf of the International Federation of Accountants and the whole of its family of member bodies, committees and task forces, let me offer our sincere congratulations to our oldest member body on achieving this marvellous 150th anniversary. The Institute of Chartered Accountants of Scotland has gone and will continue to go from strength to strength, personifying all that is great in terms of the attributes of accountants. Your record of service to the public interest and to business is exemplary and IFAC looks forward to working with you in continuing to serve for the next 150 years and beyond.

We have heard today from many eminent speakers about the challenges facing our profession. Meeting those challenges is at the heart of all of IFAC's activities.

IFAC's members comprise 157 accountancy and related organisations in 118 countries, together representing more than 2.5 million accountants.
IFAC’s focus is on protecting the public interest by continuing to strengthen the profession, particularly through the development of global quality standards. The standards we set in auditing, assurance, ethics, education and public sector accounting provide worldwide benchmarks and are fundamental to achieving our goal of improving the credibility of the profession and of the business and other constituencies it serves.

My remarks today centre on the ‘attributes of tomorrow’s accountants’. The short answer is “the same as the attributes of the best of today’s accountants”, which are succinctly captured in IFAC’s values: integrity, expertise and transparency.

But Chairman, you have invited me here today to give the long answer. So, before I look at what will be necessary tomorrow, let me just look at what is happening today.

It is understandable if we feel somewhat overwhelmed by the myriad challenges we face – professionally and technically, whether from competition or from regulation.

So I would like to sound a very positive note.

*It has never been a better time to be an accountant!*

Our profession is recognised as contributing to every sector and aspect of the global economy. We are not solely auditors. We are management accountants, business leaders, corporate financiers, business advisers. We should also not forget the large number of accountants who serve the public sector – a hugely important sector which accounts for 40% of global capital expenditure.

It is hardly surprising therefore that accountancy remains one of the top career choices for graduates.

Even aspiring students – teenagers – see us as one of the top sectors in terms of career progression. As an article in *CA Magazine* in April this year highlighted, we are attractive because our profession offers
career opportunities through training and continuous professional development. The next generation is waiting in the wings.

We are perhaps fortunate in the UK. Our economy is buoyant and business confidence has increased. The massive recruitment drive by accountancy firms of all sizes is proof of that. But it is also linked to an enormous amount of extra work for firms and businesses through increased regulation, for example Sarbanes Oxley and the introduction of IAS.

Firms in the UK are saying that competition for talent and skills is intense. As companies too are looking to recruit people with the requisite skills, everyone is fishing in the same pool of talent.

If we are to build that talent, we need to look at the broad strategic direction of our profession globally.

As many institutes around the world were already identifying some ten years ago, that involves being market driven, being relevant.

Our market is the public interest. Clearly this includes investors and the regulatory community; financial markets, be they public, for example for listed stocks and shares, or private, for example for bank finance of small and medium sized enterprises. We do well to remember that a well-informed market is the best regulator and that the role of the accountancy profession is empowering the market to judge business behaviour by putting information into the market that is both clear and fair. And we should not forget that the public interest is also served by accountants creating wealth, working in business to drive strategy, efficiency and financial integrity; by providing advice on taxation that is supported by the law and provides full disclosure to revenue authorities; by helping turn around ailing businesses, preserving ideas, jobs and the self respect of those employees and their families whose livelihoods are saved; and there are many, many other ways, too numerous to mention this afternoon.

For tomorrow’s accountants, relevance also means demonstrating professionalism, acting in the public interest, not losing sight of our
core purpose as custodians of transparency and integrity in financial reporting. It means staying focused on ethics as the foundation of that purpose and, crucially, acting and thinking globally, at local level, to fulfil that purpose.

For the avoidance of doubt this is equally relevant to professional accountants in business; the front line in producing robust and reliable financial reports; and to professional accountants in practice.

Let me examine some of these issues in more detail.

**Relevant – continuing professional development**

Tomorrow’s accountants need to remain relevant. That was surely at the heart of what David Tweedie was saying on education as a cornerstone for 21st century accounting. It concerns the combination of theoretical skills and real world practical skills. Increased business complexity and diversity is increasing the emphasis on competency.

As today’s teenagers have recognised, a one-off qualification is no longer enough. The speed of developments is such that continuing professional development is crucial if we are to remain as competent (and therefore relevant) tomorrow, as we were yesterday. IFAC’s education standards, including continuing professional development standards, recognise these key drivers. We know that it is important for individuals in terms of career development and it is important for professional bodies to be able to demonstrate those individuals’ continued high quality.

**Professionalism**

Given the recent regulatory developments in the light of corporate collapses, it is especially important to demonstrate our professionalism. This demonstration is fundamental to the success of tomorrow’s
accountants because our professionalism — our very licence to operate — is being questioned.

Professionalism is about individual modes of behaviour that command respect and build trust. It is about excellence in service as measured by recognised standards. It is about delivering services or working to standards that meet the needs of and are expected by those commissioning our work.

Such behaviours are indeed a necessary part of belonging to a profession but many trades could also be described as professional in these terms!

As any of us who have ever used services knows, what separates the professionalism of members of a professional body from the behaviours of other types of service providers, is the requirement continually to reinforce and demonstrate our professionalism, not merely to assert it through a one-off qualification. Continuing professional development is clearly part of that. But it is our membership of a professional body that confers on us the obligation to abide by professional standards and regulation and, last but not least, to always have at heart our accountability to the public interest.

Public interest

Somewhere along the line, in the recent past, these elements of professionalism have been perceived to have been lost or to have failed the public interest. Every set of financial scandals has eroded the public's trust in the ability of our profession to set standards and to be self-regulating. Standard-setting is being taken out of the profession's hands in the UK and the loosely monitored self-regulatory systems we first saw in the late '80s and early '90s are now moving on to being about truly independent oversight.

We know that standard setting is now fully a public interest activity. We accept it is very important to involve a broader constituency
than only accountants, in order to get the buy in of the very people who need to use and rely upon those standards. Certainly, IFAC’s own reforms in standard setting have been designed to ensure that this is the case beyond all doubt, to ensure transparency and so to build confidence in the process. A key part of that is establishing a Public Interest Oversight Board to oversee our standard setting and compliance activities.

Clearly, we are now at the stage where, unless we work together with regulators and governments to address their concerns, we may become marginalised and lose our status.

This is why IFAC has invested so much time and energy in relationship building with regulators internationally. We want to ensure that they understand that our goals are aligned with their public interest objectives (in our case, ensuring high quality accounting and audit worldwide) and build transparency and trust between us.

**Commoditisation of audit contributed to lack of trust**

But I believe that the current need to restore trust is not solely down to recent corporate crises. I think, if we look to the past, that it had its roots in the so-called commoditisation of audit which is often ascribed to the lifting of professional advertising restrictions in the 1980s.

It was a period when the UK audit market was facing increased governmental pressures to be deregulated, as well as competitive pressures from non-accounting organisations. The Monopolies and Mergers Commission was saying that our veto on advertising was a restrictive practice and arguing that no advertising means no competition and artificially higher fees. So we lifted the restrictions.
The effect? Price competition.

As a result the audit was regarded as less about quality and more about price. The perception – as *The Economist* magazine in 1985 pointed out – was a change from professionalism to commercialism. Audits were being viewed as a commodity bought from the lowest bidder rather than as a name-branded professional service. In the past, a change of auditor was seen as a sign to be concerned about the company. In this commodity like atmosphere, boards could fire tough auditors on “commercial” grounds and so the dynamic of the audit relationship changed. We now need to work, indeed are working, to restore the right dynamics.

The philosopher Santayana once said:

*Those who do not remember the past are condemned to relive it.*

Safeguarding the value of core activities in the public interest

We cannot allow ourselves to relive the past if we are to meet the expectations of us today, let alone tomorrow. The trends in regulation of the profession I have mentioned warn against it.

It would indeed be a pity if the long history of the profession in the UK – as a strong and persuasive body of professionals with a tradition of developing its own principles – stopped right here.

Tomorrow’s accountants must not lose sight of their core purpose. Preparers of accounts must safeguard the integrity of financial statements. Practising firms must meet the challenges of running a business, thereby attracting high quality people into the profession, and safeguarding the quality, integrity and value of the audit. I am heartened that my conversations with the global leaders of the major firms have revealed a passion and commitment to the quality and integrity that is required.
IFAC continues to focus on the development of high quality standards to help achieve these aims. In addition to its work on International Standards of Auditing, the International Auditing and Assurance Standards Board earlier this year released new standards on quality control for firms and for engagement teams, a new assurance framework and updated audit risk standards. It has also exposed for comment a document focused on improving the clarity of the standards: a key need to facilitate translatability and thereby high quality implementation of our standards throughout the world.

**Ethics**

Clearly, the values of our profession – our ethics – will be as fundamental to tomorrow’s accountants as they are to us today.

All IFAC staff and volunteers embrace and promote the values our organisation stands for – integrity, transparency and expertise. These values are reflected in our strategic plan, our professional standards and our decision-making processes as well as in IFAC's Code of Ethics which is applicable to all professional accountants in business and practice. Our code encapsulates the personal qualities which today’s and tomorrow’s accountants must have: integrity, objectivity, professional competence and judgment, due care, confidentiality and professional behaviour.

Last year, IFAC published an independent report on Rebuilding Public Confidence in Financial Reporting. It highlighted that the failure to recognise the primacy of integrity was a major contributor to the financial scandals of recent years.

It is time to ensure that integrity is the common link in the whole financial reporting chain. IFAC and FEE, our profession’s European umbrella body, are committed to encouraging that aim to be at the heart of governance policies, standard setting and national regulatory policies.
One of the report’s key recommendations was that effective corporate ethics codes need to be in place and actively monitored. So often in the past, we have heard that finance directors have in effect acted as the only conscience of the board when, of course, without underestimating the importance of the finance director, ethical behaviour should be at the heart of the board as a whole.

So while one cannot over-emphasise that the tone for an organisation needs to be set at the top, there is a key role for all professional accountants in business to help in practical ways to promote ethical values throughout an organisation. Moreover, as preparers of financial information, we are ideally placed to drive ethics through financial reporting from the very start.

IFAC’s Professional Accountants in Business Committee is focusing on Corporate Codes of Ethical Conduct. It is currently looking to develop guidance for professional accountants in business on the need for a corporate code of ethical conduct and how to develop and administer such a code.

This guidance will complement the Committee’s recent report on ‘Enterprise Governance’, which emphasises that a virtuous circle of integrity and ethics is fundamental, both to good governance and to business growth. That will be as important in the future as it is now.

**Think global**

Tomorrow’s accountants need to have a global mind-set. The world’s capital markets need them to be a key force for good in promoting high quality, transparent financial reporting based on a robust set of internationally accepted standards.

International standards will throw sunshine on financial reporting in a way not available in the more parochial 12th and 13th centuries, when the Popes first used off-balance sheet financing to overcome usury laws!
Much work, however, still needs to be done. An IFAC study on the challenges and successes of implementing international standards has just been released. That report, prepared by former IFAC Board member Peter Wong, emphasises that standard setters, accountants and others face significant challenges. A major issue is ensuring that the standards are accessible to a wide audience. The report highlights the need for translations and suggests that the standards be written in a less complex manner to facilitate translation processes. The Wong report's recommendations were discussed at a Financial Stability Forum seminar held on 15 October and an action plan is now being developed.

Conclusion

In conclusion, *Telling the Truth in Tomorrow's Business Environment* should become a straightforward commandment: “be honest, be diligent, make no false accounts”. The role of accountants and auditors – both in practice and in business – is central to achieving that.

Accounting is not practised in a vacuum – it reflects the social and economic environment in which it exists. The personal qualities that accountants will need to embody in tomorrow’s business landscape need to overcome any behaviours by others that try to force a different outcome to telling the truth.

And the accountants of tomorrow must be devoted to high quality with an unwavering commitment to professionalism. That rests on international high quality standards for the profession that enable accountants locally to provide services of globally recognised quality.

Both the public interest and the profession’s interest are congruent: tomorrow’s accountants must live the IFAC qualities of integrity, expertise and transparency.

Tomorrow’s accountants need us to lead now, exemplifying those qualities through our every action.
If we fail, our professional bodies could be taken out of the equation and we will lose our status and standing.

The best people will no longer join us. Professional bodies acting in the public interest will become trade associations acting in the private interest and the resulting lower quality of service delivery will irreparably damage investment; markets; jobs; and indeed, society as a whole. To earn our future in society we must demonstrate our commitment to high standards of professional and ethical behaviour through monitoring, enforcement and discipline. Independent regulation and our own self regulation must constitute a mutually reinforcing circle in the public interest.

What is needed, therefore, is a contract of trust between governments, regulators and our profession and this contract must not be broken. The future of our profession and of tomorrow’s accountants very much depends on it.

HIGGS, THE PROFESSION AND BEYOND – THE CORPORATE GOVERNANCE LANDSCAPE

Like your other speakers, I am honoured to have been invited to be here to mark the 150th anniversary of the world’s first professional body of accountants. It is always a pleasure to be back in Scotland. I lived and worked in Perth early on in my career and connections with Scotland have continued ever since.

The Institute was born at the height of the Victorian ascendancy. Scottish accountants and engineers were key to the expansion and strength of the British Empire. 1854 also marked the birth of Oscar Wilde and the Charge of the Light Brigade. Oscar Wilde’s views on the accountancy profession were never, I think, formally recorded, but no doubt he would have made some cogent observations. Perhaps I might take the liberty of suggesting what he might have said. Mr Wilde did observe that “we are all of us in the gutter, but some of us are looking at the stars”. He might have added for today’s occasion
We are all of us held to account, but at least some of us are looking closely at the numbers.

The title of this session is "Higgs, the Profession and Beyond". It should really be called "Higgs, Smith, the Profession and Beyond". Sir Robert Smith’s report on the role of the audit committee is a major feature of the new corporate governance landscape. Robert is a distinguished Past President of the Institute and I should not let this opportunity pass without giving him due credit for the report.

I will start by explaining why I believe a strong profession is essential to strong corporate governance, and vice versa. I will then say something about the impact on the profession of Higgs, Smith and the new Combined Code. I will conclude by looking briefly at current developments and how the landscape might evolve over the next few years.

But first I should very briefly explain the responsibilities of the Financial Reporting Council, or FRC for short. The FRC’s aim is to promote confidence in corporate reporting and governance. The new FRC, in its expanded form, was created in April this year to be responsible for the setting, monitoring and enforcement of accounting and auditing standards, for the statutory regulation of audit and for the oversight of the regulatory activities of the professional accountancy bodies, and for corporate governance. It is unique in the wide range of its responsibilities.

**Strong corporate governance = strong profession**

Corporate governance is not just important for companies. In the public mind, the reputation of the profession is inextricably linked to the way companies behave. Fairly or not, corporate governance scandals and accounting failures damage the reputation of the profession just as much as they damage the reputation of business. We saw this most markedly in the recent Enron, Worldcom and Parmalat scandals.
Thus, strong corporate governance is essential for a strong profession. But the reverse is also true. The behaviour of the profession has a huge influence on the corporate culture in business – not just in your role as auditors, but through the presence of many members of the profession at the most senior level in companies. Members of this Institute are in pole position to provide real leadership in promoting confidence in corporate governance.

That is why to my mind the recent changes in the way the profession is overseen – including the expanded role of the FRC – will be as important for corporate governance as Higgs, Smith, and the new Combined Code if they help to strengthen the reputation of the profession.

The new oversight arrangements are a major step, but I believe they are the right step. In the post-Enron/Worldcom climate, leaving things as they were was not a realistic option. The real alternative to the arrangements we now have in place was more state regulation and more prescription.

That did not happen. The Government did not give a knee jerk response. Instead, it set up under the chairmanship of government ministers from the DTI and the Treasury an appropriately qualified and representative group to examine what should be done. The present arrangements, a widely supported, proportionate response, were the outcome. But the possibility of a wholly statutory approach with much more prescription has not gone away. It will come back on the agenda if the new arrangements are not seen to work well in the public interest. It is, therefore, in all our interests to make the new arrangements work.

All of us at the FRC recognise that the consent of the regulated is a critical element in making any system of regulation work effectively. The architecture of the FRC helps to achieve that. We are market-led, with our membership drawn from the business, investor and
professional communities. Our system depends on working in close partnership with those constituencies.

That said, we also have to remember that the FRC does have a wide range of regulatory powers and the public interest demands that it must be prepared to use them where necessary. I suppose that the best way of describing it is that the FRC aims to have a light touch, but not be a soft touch.

The new FRC only came into being on April 1st and thus the changes being brought in are still at an early stage. I recognise that change is not easy and it often takes time to find the right solutions and to bed them in. An example of this is the work on setting up independent arrangements for monitoring, investigation and discipline. Once in place, those arrangements should help to enhance the reputation of the profession. An important part of that architecture is the Accountancy Investigation and Discipline Board, the AIDB. I am glad that the discussions that the FRC has had with ICAS about these arrangements have now resulted in a positive recommendation for participation in the AIDB scheme being put to ICAS members. I hope they will find favour with members. We, for our part, will do everything possible to make them work in an intelligent and sensible manner.

**Relevance of Higgs, Smith and the revised code on the profession**

Moving on to corporate governance “proper”, I would like to say a few words about the impact of the new Combined Code on the profession.

The revised Code that followed the Higgs and Smith reports differs in significant ways from the earlier Code, for example in its provision on the balance of the board and its clearer definition of the roles of the Chair of the Board and the SID, the senior independent
director. I would like to highlight two changes that are particularly relevant to the profession.

The first is the much stronger role of the audit committee, in line with the proposals put forward by Sir Robert Smith. The new provisions tighten up the defences against fraud and poor financial control, reinforce a healthy culture of disclosure and compliance within the company, and give the committee the lead role in the relationship between the company and the external auditor. This includes developing company policy on the purchase of non-audit services from the auditor.

The second element is greater professionalism in the board room. The new Code includes provisions on the method of appointment, induction, professional development and performance evaluation. I believe that in the longer term this emphasis on professionalism will be seen as one of Higgs' most important contributions. And it is an area where members of this Institute can make a significant contribution, as Finance Directors and non-executive directors.

**Current developments**

The profile of corporate governance continues to increase and, while we need to give the recent changes time to bed down, things are not going to sit still entirely.

At the FRC, we are going to monitor the revised Code to see whether it is working as intended. Institute members see the Code in operation from inside their companies and from the perspective of the external auditor, so your input will be an important part of that process. We hope to find a way of keeping the Code relevant and up to date that does not involve constant change, but also avoids a big bang every five years or so.

We are also reviewing the Turnbull guidance on internal control. The review is being led by Douglas Flint, the Finance Director of
HSBC and an ICAS member. It is intended that any updated guidance will take effect in January 2006, and there will be full consultation on any proposed changes.

Turnbull is generally well thought of, and its brevity and breadth of scope are seen as strengths. We do not want to lose those strengths. But it has been five years since the guidance was issued, and a lot has happened in that time, including Sarbanes Oxley, so it is right that we look at it afresh to ensure it is still appropriate, and still providing the best possible guidance to companies.

We also need to look at how Turnbull dovetails with the new OFR, which will require companies to report on the main risks they face. Whilst the principle of the OFR is well accepted, translating the present voluntary arrangements into statutory ones has various potential pitfalls we need to avoid. We want to see it developed as a valuable tool for boards and for users of accounts. In its statutory form, we want to avoid it becoming a bland, box-ticking exercise poured over by lawyers to avoid the board saying anything which could get them into trouble. We are now engaged in the work to get the right result. Again, no doubt many of your members will participate in that process.

As with accounting standards, developments in corporate governance are increasingly happening at international not national level. Earlier this week, for example, the EU launched a new Corporate Governance Forum to exchange best practice. We welcome the decision by the European Commission to adopt a mixture of non-binding recommendations and binding legislative proposals to deal with its concerns on corporate governance.

In fact, the majority of its proposals are not legislative and we are very pleased that the “comply or explain” mechanism which the FRC promotes has found favour with the Commission. We are, however, aware that there are some proposals for legislation which could impact on areas covered by the Combined Code, including some of the proposed changes to the 8th Company Law Directive
on the statutory audit, and we shall be monitoring those proposals carefully. In general though the UK is well-placed to adapt to the new European requirements.

A great deal of what we do is increasingly decided outside the UK, and, if we believe in the strengths of the UK approach, then we all need to be in there influencing the debate. This is not something that should just be left to governments or regulators. Business, investors and the profession need to be actively involved in putting the UK case.

The future

Looking to the future, how would I like to see the corporate governance framework evolve?

It is instructive to look back at how things have evolved over the last three years since Enron and WorldCom made governments and regulators everywhere look again at the governance and accountancy systems of public companies.

In the UK I believe it has, to date, been a proportionate response. It has built on the strengths of our existing approach, working through the market and being business-led and profession-led. The Government has, by and large, taken the position that they will legislate only where self-regulation is not possible, and they deserve credit for that.

We need to retain that sense of proportion. We have a framework that should improve governance and increase transparency for shareholders. And we should aim to develop that in a way that ensures the UK remains at the leading edge. But in doing so we must make sure we do not stifle entrepreneurship and appropriate risk-taking, because it is entrepreneurship and risk-taking that produces returns for shareholders, not regulation. Regulation can set a framework, but it cannot make a board's judgments and decisions for them. That is why a vibrant, well trained, ethically sound profession is so important in helping to get those decisions and judgments right.
Over the next few years we need to allow the changes that have already been introduced to bed down and to make sure they are working as intended. We need to avoid regulatory indigestion and remain ever mindful of the cost of compliance when regulation is being considered. And we need to develop the corporate governance framework in an organic and evolutionary way, avoiding periodic revolutions.

Crucially, we need to do more to influence the way corporate governance is developing in the EU and internationally by demonstrating through our actions that the UK approach is both proportionate and effective. As the general policy approach which the EU wishes to adopt becomes clearer, attention is likely to turn towards enforcement. We strongly believe that the Combined Code should be enforced, but we equally strongly believe that shareholders, and not regulators, should take the lead in enforcement.

Conclusion

To return to where I started, I always believed that simply stated objectives are the best. Thus the FRC’s aim is encapsulated in the phrase “to promote confidence in corporate reporting and governance”. You will gather from my remarks why I believe that a strong profession is essential to strong corporate governance, and vice versa. All of us concerned with corporate governance and financial reporting took a severe knock as a result of the Enron and Worldcom scandals. Confidence was lost, systems and people were attacked, and there was a general sense that the public interest was not being well served by the existing arrangements.

We have all worked very hard over the last year or two to put that right. The reforms are in place, but the jury is necessarily still out about their effectiveness as they have been in place for such a short time. All the parties involved need to work constructively together.
to ensure confidence is fully restored and the new frameworks deliver what we have promised. A respected and effective profession is a key foundation stone for any effective corporate governance framework. I look forward to ICAS playing a full part in this work. I am sure it will. The Institute has carried out that role very effectively throughout its proud 150 year history, and I am sure it will continue to do so for at least the next 150.
Ian Percy CBE is Conference Chairman. Ian is the Chairman of Kith plc and Companies House. He is a Senior Non Executive Director of The Weir Group plc and Ricardo plc. Ian Percy represented the UK on the International Auditing Practices Committee from 1995-2000. He was Chairman of the Accounts Commission from 1991-2000. He was President of ICAS from 1990-1991.

Concluding Remarks and Closing Address

My Lord, President, Ladies and Gentlemen, I would firstly like to thank the speakers today for such a rich blend of experience and thought. I am sure you would all agree that they have put in an immense amount of work and thought deeply about the issues. So much so, that I believe that what has happened today will indeed, as we all hope, be a milestone in the profession’s history. It is difficult to sum up so much material in such a short time but I was reminded by Jules Muis today of the statement made by Martin Luther King, “Morality cannot be legislated but behaviour can be regulated. Legislation will not change the heart but it can restrain the heartless”.

It is interesting that each of our speakers has been addressing the role of individual chartered accountants rather than the corporate firms whom the capital markets have come to rely on so much. For me this draws home the continuing necessity for personal accountability and for each of us to ensure that our integrity is not fashioned by the commercial interests of those that surround us in a corporate
vehicle - a difficult issue but one which I am sure will continue to be examined.

David Tweedie stressed the need for thinking for ourselves and Andrew Sheng stressed our role as quality assurers - the need to exercise good judgment or to be judged - and that our standards should not vary whether we are in business as an executive or as a non executive director or in an Audit Committee or in public practice as the auditor or financial advisor. He stressed that we should not make a bad apple look good and that bad accounting leads to bad markets. As Tweedie says, “if it looks like a duck, walks like a duck, it probably is a duck”.

Callum McCarthy emphasised the need for principles, as rules stifle good reporting and indeed can encourage financial engineering. He brought home the need for all of us to consider substance over form but did not underestimate the difficulties in a more legally-based environment and more rule-based environment in which we live, where short term financial success is at a premium.

Paul Volker had a vision for us to be guardians of the truth and look forward to the rebirth of the proud professional, and challenged us to lead from the front. He challenged the major firms to take seriously the need for objective assurance which in the public perception should not be weakened by other commercial interests. His comment about the rebirth of consultancy within professional firms being “one last drink” I am sure will be a phrase that will resonate far and wide from this theatre today.

However, nobody has a monopoly of truth and the ICAS Research Committee’s excellent research study entitled, “Taking Ethics to Heart” throws out a number of challenges, not least for supportive and mentoring mechanisms which are required when professionals are under pressure to stray from the path of integrity or find their integrity being stretched. Whilst no one is suggesting that a chartered accountant should not be flexible as a man or woman of business, what is coming through to me is that he or she must be true unto themselves and
that that flexibility should not lead to the breaking point of elasticity. Another issue is to examine the education of our students and our members throughout life and this is an area which all speakers, in particular David Tweedie, stressed. The Scottish Institute's involvement of practitioners in the teaching process so that ethics can be understood from experienced practitioners should not be lost sight of.

We of course have evidenced today the sheer complexity of the issues that lie before us in a very fast moving materialistic world where senior executive remuneration, based on performance and constant demand for increase in shareholder value, stretches the credulity of behaviour and reporting. The issues are too complex for any one body to solve them alone and indeed it would take the introduction of all the bodies represented here today to find a way through to help us seek the truth in tomorrow's business environment.

Listening to George Robertson this morning, it was evident that the forces of bad behaviour are far more organised than the forces for good behaviour and I was struck by his example of how NATO reorganised itself and brought in other parties to try and face up to the challenges that lay before them. His illustration of terrorism transcending all our boundaries sends a very clear message. It also reminded me of the 1st of November 1990 when I, as President of the Institute, spoke on the need to review corporate governance in this country at the ICAS Savoy Dinner and the Lord Chancellor James Mackay asked me what I was going to do about it. We agreed that evening that those at the dinner from the Stock Exchange, the DTI, the Bank of England, the institutional investors and the profession should meet to take the matter forward. This led to the establishment of the Cadbury Committee and the rest is history.

I am pleased to say that the speakers today, together with a number of individuals including Richard Fleck as Chairman of APB, have agreed that we should meet in the near future to examine the results of this Conference and to see whether there are mechanisms that could
be taken forward, not to increase bureaucracy to stifle business, but to see whether there is a framework for the future which would help to stem the tide of greed, restore confidence in our global capital markets and confidence in the accountancy profession which is so important and critical in the public interest.

I thank all of you today for giving us the opportunity to listen and to respond and to encourage us as ICAS to take the lead, as Paul Volker said:

In the rebirth of proud professionalism and as guardians seeking the truth in our modern business environment.

ENDNOTE:

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1 Taking Ethics to Heart edited by Professor Christine Helliar, University of Dundee and ICAS Director of Research; and Professor Jan Bebbington, University of St Andrews, published by ICAS. ISBN 1-904574-10-6