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What's wrong with audit regulatory reform?

Blogger Chan Chun-ho shared his article, "FRC and audit (regulatory) reform", in Housenews.com and his personal blog. Since the consultation kicked off in October, few accountants have made their voice heard in public media. We are glad that a young accountant gave his opinions and showed his concerns for the development of the profession, even though we are of different views.

Chan maintained that the regulation of the profession shall be thoroughly overhauled and didn't agree that the new system would doom the profession to fail. He didn't elaborate his reasons, but what I got from his article was that "no one is serious with the works involved in an audit," "auditing staff pretend to finish jobs that they haven't, while partners glanced through the reports and documents causally." Even if the Institute sends its delegates to conduct practice reviews, these reviews are concluded with "no opinion". In the recent years, a number of listed companies are found with accounting irregularities, but no auditors have been held responsible. I suppose they are the reasons that Chan considered a reform desirable.

Conflict of interest as original sin

While there may be over-generalizations in Chan's article, let's start with my own story. After I finished my accountancy studies, my first job was being one of auditing staff in an accounting firm. I found it was a weird profession. Auditors review company accounts and receive fees from the companies. It can't be said no conflict of interest is involved, can it? I asked my senior and he told me this was how the profession operated. Later I found the whole world was operating on the same system.

Theoretically, auditors are responsible for company shareholders. In fact, the company management takes charge of the whole process from sourcing auditors to determine the audit fees. Of course, the appointment of the auditor should be passed through AGM, but it is just a formality. Taking listed companies as an example, have we heard that the resolution of auditor appointment was vetoed down? I believe the amount would be very small even if there are such cases. As who pays the service who is boss, the boss of auditors is the company management.

Therefore, auditing involves a conflict of interest. To minimize such an impact, auditors shall comply with a number of codes and guidance, such as no single clients account for the majority of auditors' income, auditors are not allowed to provide accounting and company secretarial services to the same company, etc. However, auditing is also a business, which strives for profits. With severe constraints, we can imagine how difficult it is to run this business.

In recent years, increasingly stringent audit standards and frequent change in accounting standards have coupled with keen market competition. Thus, time cost increases but income cannot be raised. Otherwise, they will lose clients. Those who do not wish to go against professional conducts can resort to finishing jobs with uncompensated overtime. Those who do not want to suffer from or have enough uncompensated overtime will pretend to finish those jobs that they haven't. That's how things turn to be what Chan described in his article.

Change the form but not the content

I totally agree with a reform, but I think what we shall do from the source of the problem, i.e. the appointment of auditors, instead of the regulation. The current market for accountancy profession is not easy and may turn to be more difficult if stricter regulation is imposed. In addition, the reasons for introducing the present reform are that the Institute is not independent in its regulatory role and give people an impression of protecting its members. The most simple and logical solution is to improve the independency of the Institute. For example, when the Institute is criticized for its finances dependent on members, we could look for other income resources. If we are worried about its objectiveness on case judgment, we can introduce committee comprising independent parties for drawing up judgments.

However, the new system basically takes away all the regulatory powers of the Institute, while it retains three of them including registration, setting up auditing standards and continuing education under the supervision of the oversight body (which is said that the FRC eagerly takes up the role). In short, all the regulatory powers will go to the new oversight body, which makes no much difference from the existing system under the Institute. The form is changed but the content remains. That's why many of our accountants think it improper.

Chan asked two questions at the end of his article. Firstly, who will be the ultimate victim? Is it auditors or innocent stakeholders? My answer is of course the auditors. Those who have a rough life now are those auditors and auditing practitioners who maintain professional conducts to protect public interests with uncompensated overtime. The new regulatory regime cannot alleviate their plight. Instead, it may do more harm on them. However, the reform is introduced in the name of public interest and even the Institute cannot dare to make a loud voice and to contradict these specious arguments.

Chan's second question: why do those have left the audit professional still protect its interests. Our answer is that we want to improve the profession. If fighting against uncompensated overtime is also counted as "protecting professional interest". We do endeavour our efforts in this direction.

(By) Young Accountant Association