V Leeladhar: Value-based professionals - the need of the hour

Valedictory address by Mr V Leeladhar, Deputy Governor of the Reserve Bank of India, at the Western India Regional Council of the Institute of Chartered Accountants of India, Mumbai, 10 June 2005.

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It gives me great pleasure to be in your midst today. The Institute of Company Secretaries of India (ICSI) has been a critical player in the Indian endeavour to develop professionals to protect the interests of the stake holders, to ensure corporate governance and contribute to public good - a topic which is intrinsically linked to the theme of today, viz. value based professionals and the broader theme of corporate governance. These are difficult issues and given today's audience, we here deal with broad generic issues rather than particulars.

In the more innocent days of my youth, perhaps, the term value based professional would have been a tautology. It was then taken for granted that professionals possessed values. The word *profession* evoked fields that require extensive study and mastery of specialized knowledge, such as law, medicine, engineering, accounting, etc. This contrasted sharply with the more humble term *occupation*, which referred merely to the nature of a person's employment. To conduct oneself as a professional - exhibiting "professional behavior" - indicated that the person's actions remained in accordance with specific rules, written or unwritten, pertaining to the standards of a profession. Indeed, early sociological definitions of professionalism, in particular, involved checklists of perceived or claimed characteristics, which apart from esoteric knowledge or special skills, invariably included ethical behaviour. It also entailed the recognition of a social obligation to apply one's skill and wisdom for the general benefit or what is termed 'public good'.

One practiced a profession. It was in this context that the word mal-practice evolved. It was taken as the failure to provide professional services with the skill or ethics usually exhibited by responsible and careful members of the profession, resulting in injury, loss, or damage to the party contracting those services. It was with professions such as medics, accountants, lawyers, that mal-practice was associated and one could be charged for the same. While George Bernard Shaw characterized all professions as "conspiracies against the laity", professionals, nonetheless, were generally deemed to be a group of people who shared not only common knowledge and skills built upon a formalized framework of learning, but also a common and articulate set of values and ethics. It is thus that competence and ethics formed the bedrock of the professional. One did not exhort values in professionals - a professional without values was no professional at all.

Today, the world has changed. We no longer live in simple times. The cries for values and ethics in business today - the value based professional - stem essentially from a crisis of confidence. Whether in medicine or in finance, confidence is the linchpin of the professional - confidence in his *competence* to perform and confidence in his *integrity*. Till recently, competence was sought to be enforced through jealously guarded barriers to entry. Self regulation by the fraternity laid out codes of ethics and codes of conduct. These codes and standards have evolved over the years influenced, to no small degree, by crises that affect the profession from time to time.

The latest round of the crisis of confidence in the corporate sphere has been catalysed by the *unexpected* corporate failures of the 1980s, the 1990s and indeed the high profile collapses of new millennium. This perhaps added a new dimension in the discourse related to confidence, and this relates to confidence in the integrity of the *system* as a whole to subserve the needs of the market system, the stake holders and indeed society to provide reliable financial data and information on the 'full and fair' picture of a company's accounts and the changes therein.

Post mortem reports of accounts and of administrative lapses of failed companies given by liquidators / regulators / inspectors give us an insight into accounting as well as regulatory lapses and provide a stark contrast between the 'true and fair' picture of the organisation at various points of time in its life and what it was reported to be. Often times it has been perceived that practices such as balance date adjustments, deferring expenses, advancing revenue recognition and judicious or indeed creative use of complex business group structures, while conforming to the letter were sometimes intended to obfuscate and subvert the spirit of compliance.

The general perception is that accounting statements have failed to inform of the drift of financial affairs of the company towards impending failure. This has catalysed debate on issues like *accounting standards* as well as issues of *auditor independence* on the one hand and the issues of *integrity* and personal deviance, on the other. The causal roots of the recent corporate “misdemeanors” are debatable. At one level, they were attributed to a swashbuckling ethos and corporate culture initially spawned and made fashionable by the investment bankers of the 1980s - an era that has oft been alluded to as the ‘decade of greed’. This set in motion a period when dramatic financial success received acclaim, flamboyant star operators were viewed as folk heroes and cautionary words from regulators were viewed with distaste.

At another level, they are attributable to the changed business environment of relentless competition in which firms operate. This competition has brought with it pressures on corporate managements to consistently sustain and enhance their financial performance and demonstrably enhance shareholder value. The pressures on management, have in the recent past, also spilled over to auditors and how they conduct their business. These pressures have also brought into focus concepts of earnings management - the quality of earnings and how methods of earnings management may lead to or even constitute fraud. The accounting, regulatory and ethical failures subsuming the system, the cultural ethos and individual deviance have squarely resituated professional values and ethics and the broader governance issues onto the centre stage of boardroom concerns.

The general dismay was, in fact, not with insolvencies per se but with *unexpected* collapses where the financial statements, regulatory warnings did not presage what was to come. The un-serviceability of accounts to give a true and fair picture of what lay in store, the inaction of regulators to gauge the pulse of the forthcoming events and the ethical failures of the organisational culture or of individuals that perpetuated acts of commission or omission painted a picture of a systems failure that often got blurred with the media focus on personalities and on deviant behaviour. This in turn has brought back into focus the quest for codes and standards as well as the issue of values and ethics in business.

While the quest for codes and standards, in generic terms is, in some ways, never ending, the endeavour in accounting and finance, nonetheless, is geared to improve the reliability of financial statements. This makes them more credible and increase shareholders’ confidence. Confidence in financial statements reduces the cost of capital and makes the markets more efficient. Thus, in a market economy, quality accounts, audits and the integrity of professionals create an enabling environment for economic efficiency and corporate growth.

Historically, the importance of published accounts was brought into focus by the UK’s Companies Act of 1844. This, over time, gave rise to the quest for standards, codes and quality in accounting in market based economies has been to shore up investor confidence by setting strong and binding accounting and auditing standards. It was thus that financial audits were preformed by auditors who were independent of the entities whose financial statements they audited. The purpose was to reduce incentives for conflict of interest which would compromise professional judgement. The early attempts in modern times to build binding standards date back to the early 1930s in the run up to the period when the Securities and Exchange Commission (SEC) was established in the US in 1934. It is interesting to recall some of the issues that arose in the 1930s which are redolent of the debates of today. One was whether audits should be performed by private firms or government auditors and another was whether the rules for the auditing profession would be set by auditors themselves or by outsiders.

The first issue of government auditors vs. private firms was resolved 1933 in favour of private firms. The second issue of whether auditing standards and rules should be set by those who laboured in the trenches, viz., the auditors themselves or by outsiders who were essentially the users of the accounting services was more contentious and was settled in the late 1930s - in 1939 to be specific. The issue was resolved narrowly, and not without considerable lobbying, in a 3-2 vote in favour of the auditors themselves setting their own accounting and auditing standards, i.e., regulating themselves, thus formalising the regime of self regulation.

This debate has come a full circle today, when the consensus has once again veered in favour of “outsiders” having a prominent, if not dominant, say in the setting of accounting standards in the quest for accounting quality. The recent events - high profile misstated earnings and frauds - have in no small measure helped catalyse this development. The underlying purpose of the endeavour for quality has been to restore the confidence of the stakeholders, the regulators and the society at large in the quality of the attest functions performed by accountants and the integrity of the professional.

It is in the context of this background, perhaps, that almost half the members of the Peer Review Board of the Institute of Chartered Accountants of India set up in 2002, are drawn from industry, banking, academics, etc. In the international arena, the dominance of outsiders is even more pronounced - the Sarbanes-Oxley Act of 2002 in the US envisages that of the 5 members of the Accounting Board only two members can be Certified Public Accountants. In some ways this reflects a movement to resituate the needs of the consumer of accounting services over the compulsions and convenience of the provider of these services.

At a fundamental level, this marks a substantial change that has been brought about in the recent times in the governance of the auditing profession. In fact, the move in the 1980s towards ethical behaviour got gradually subsumed under the expanded notion of corporate governance, renewed discussions on which emanated from the Cadbury Report of 1992. Over time, the voluntary nature of self regulation and corporate governance has metamorphosed into an overlay of additional layer of rules and compliances such as the Sarbanes-Oxley Act. Essentially, this is premised on two pillars : (a) the mechanism by which Corporations are directed and controlled; and (b) the mechanism by which those who direct and control a corporation are supervised.

In matters relating to Corporate Governance, Secretarial Practices play a critical role. In India Secretarial practices have evolved over a period of time in differing business environments and have had different usages. The need to harmonise and consolidate the diverse Secretarial Practices in use in India, has given rise to the quest for standards and codes in this area too. Towards this end, the Institute of Company Secretaries of India (ICSI) has constituted a Secretarial Standards Board (SSB) with the objective to formulate secretarial standards based on applicable laws, business environment and best secretarial practices. The Establishment of this Board represents a significant step towards harmonization, integration and standardisation of diverse Secretarial Practices prevalent in the corporate sector. These standards lay down the principles' which companies are expected to adopt and adhere to in discharging their corporate responsibility.

It is heartening to note that this has been a collaborative endeavour with consultations across the sector. It is thus that the SSB comprises eminent members of the profession and is represented by the regulatory authorities such as the Department of Company Affairs, the Securities and Exchange Board of India and your institute's sister professional bodies such as the Institute of Chartered Accountants of India and the Institute of Cost and Works Accountants of India. We trust that the Guidance Notes developed by SSB and the clarifications given by it on issues arising out of the standards will contribute to better corporate governance.

We as regulators at the Reserve Bank, too, have sought to catalyse conditions for good corporate governance. We have been at pains to emphasise that compliance with regulatory requirements is the minimum requirement of good corporate governance and what are required are internal, peer and market pressures to reach higher than minimum standards prescribed by regulatory agencies. A critical element of our endeavors has been the transparency aspect that is emphasized by expanding the coverage of information and timeliness of such information and analytical content. Importantly, especially in the post-reforms phase, the central bank has reiterated several times over that deregulation and operational freedom must go hand in hand with operational transparency.

This also brings us to the moot question: What does it take to be a value based professional? This is a difficult question. There are, perhaps, qualities that individuals need to possess to make ethical decisions. First, recognising ethical issues and reasoning through ethical consequences of decisions. Second, the ability to look at alternate points of view and deciding what is right or appropriate in a particular set of circumstances. Third, the ability to deal with ambiguity and uncertainty and making a choice on the best information available.

The pace of technical change, scientific innovation, and cultural interchange in the global world of today, increasingly confronts us with situations of conflicts and unanticipated ethical challenges where we are forced to make decisions we are not prepared to make but cannot avoid. Often times, the existing moral knowledge and ethical guidelines prove inadequate or simply do not provide answers to modern moral problems. Worse, the pace of change is such that similar situations cannot be replicated in stable and recurrent conditions and it is therefore very difficult to look to or construct ethical guidelines for a fast changing present. What individual professionals, groups and organizations need to do in such situations is to acquire skills and methods that give them the ethical competence and confidence to handle ethical issues that may arise in everyday professional life.

Essentially what we need to know is how to apply our personal or organizational principles to concrete moral problems. Moreover, there can be a disconnect between individual and organizational values which leads to internal conflict and dilemmas. Worse, there can be a disconnect between the stated and prevailing values in an organization. We all have, at some point or the other, faced conflicts between loyalty and integrity. We are confronted with issues of dissent and how to deal with dissent. Emerging commercial structures such as outsourcing bring with it their issues of enjoining the agent to profess the values of the principal they represent. Besides, a corporate reality check indicates that we have to increasingly live with issues which range from black and white areas such as false and misleading claims, fraud and manipulation, etc. to more grey issues such as concealment of information, conflicts of interest, coercion, vulnerabilities, principal-agent problems and fiduciary duties.

Ethical dilemmas for individuals arise not from issues of corporate misconduct such as whether a particular practice is unfair, questionable, misleading or intended to deceive. It arises from one's own personal beliefs, moral values and commitment to right action. They are in short challenges to one's integrity. It arises from questionable behaviour in others or being pressured to indulge in questionable behaviour ones' self by just getting a job done. It can be fostered by the demands of the times or organisational pressures in the form of explicit instructions to do things that may be considered sleazy. It need not necessarily arise because the organization or superiors are corrupt but could grow out of the intense pressure to get a job done or, for that matter, from an organizational culture or a leadership that fosters an environment in which unethical behaviour takes place.

What is needed is a psychological approach to ethical competence where one can anticipate moral problems, recognize them and address them squarely with confidence. In resolving ethical dilemmas that professionals may be confronted with, communication plays an important role to explain first to one's own self and then to others convincingly the basis of the decision taken and why that was the best in the circumstances. At an organizational level, it needs all the leadership qualities, communication skills and sensitivity to inculcate a culture that raises the level of ethical awareness and carries the organization and the group along with credibility and confidence. And confidence is what the quest for the value based professional is all about.

It is thus not in codes and standards alone that a culture of the value based professional may be moulded. Nor in processes and compliance. While these are important, there are views that we need to cautiously work out the fine balance between processes and outcomes. In today's politically correct world of *form*, there are therefore increasingly cries for *substance* - indeed, one school of thought, in the accounting profession itself, feels that obsession with compliance begets a creativity that subverts. This brings the word dialectics, more associated with bohemia, revolution and the intellectual, squarely into the lexicon of the staid accountant and regulator. Value based professionals is not just about compliance alone, but living up to the spirit of compliance. These are difficult issues indeed, and we have more questions than answers. Today I sign off with a call for more innocent times and leave you with a chiasmus (where meaning is reversed as in a mirror image): I trust that value based professionals value the profession they profess and value the values they profess to value. I leave it to you to pause and ponder.