Linah K Mohohlo: Post-recession role of accountants in business

Speech by Ms Linah K Mohohlo, Governor of the Bank of Botswana, to the Association of Certified Chartered Accountants, Gaborone, 17 September 2010.

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I would like to begin by thanking the Country Manager of Botswana's Association of Certified Chartered Accountants, Ms Gwen Sabarwal, for inviting me to be a part of the Association's Gala Dinner for 2010.

I am informed that it is the Association's tradition on this occasion to invite a notable person in the community to speak on some issue of topical interest. It humbles me, therefore, that I have been considered worthy of the platform for this year's event. You will agree that this time round, for me, any topical issue is bound to be coloured by, and related to, the recent global financial meltdown and related deepest economic recession since the great depression of the 1930s. The causes of the difficult economic episode are now common knowledge, with sources from private and public sectors at individual and collective levels, in areas of public policy, corporate strategy and business operations. In other words, all professions, including accountancy, contributed directly or indirectly to the economic meltdown. Now, everyone is looking through the rear view mirror while at the same time focussing on the road ahead.

Before delving more on the issues, I would like to commend your Association (Ms Sabarwal) for the commitment to training accountants in Botswana over the years. It is encouraging to learn that, since 1990, two years following the enactment of the relevant legislation, the membership of the Association of Certified Chartered Accountants in Botswana has grown to more than 350, and the student in-take has continued to increase. It is also encouraging to observe that the more than 96 percent membership retention level you have so far achieved is fairly comparable internationally. This should provide confidence that you will reach your 2010/2011 retention target of 98 percent with relative ease.

However, I happen to know that there is a big deficit in the supply of accountants in Botswana. Apparently the demand in the market is about 3 000, while the supply is just over 1 000, the lion's share of which are expatriates. I have no doubt that your Association shares this concern, given the fact that the shortage of professionals in accounting and related disciplines can only raise costs and, therefore, be unaffordable for many small and medium size enterprises. It could constrain business performance and deprive the economy generally of needed guidance in business governance, ethics, strategy and planning, with possible adverse consequences on sustenance of economic diversification and a relatively high growth rate for the economy. It is my hope, therefore, that steps will be taken to redress the situation, and this could include deliberate public policy intervention.

Distinguished Ladies and Gentlemen, the theme I was requested to address is ***Accountants for Business***. I believe this broad theme is currently guiding your exchange of views in your profession and, as a matter of fact, it will be addressed further at the World Congress of Accountants that is tenable in Malaysia next month.

For this evening, I have chosen to put a slant to the topic and speak on ***The Post-Recession Role of Accountants in Business.*** In this case, the word "business" is broadly and loosely intended to mean institutions (corporate or non-corporate, private or public) that are engaged in production of goods and/or services.

Although the global economic recession, from which we are slowly emerging, was, by and large, the result of a wide-ranging systems failure, I will confine my remarks to some of the lapses of the accounting profession that contributed to the economic meltdown. I will also highlight some lessons learned and some on-going remedial measures that should prevent a recurrence. I will then raise the issue of the need to increase the supply and quality of accountants in Botswana and urge you to be actively engaged in the area of accounting principles and reporting. This will be my main message, but at the end of my remarks, I will digress only a little and share with you some issues of public interest that fall within the purview of the mandate of the Bank, and in which accountants are undoubtedly interested.

It is now clear that the financial crisis and economic recession were the result of cumulative lapses in good corporate governance, particularly with respect to transparency in management, policy formulation and operational procedures. This includes a clear hierarchy of institutional structures such as boards, management and stakeholders, with well defined functional responsibilities to ensure accountability in organisations. There were lapses in enforcing checks and balances, prevention of conflicts of interest and adherence to fiduciary responsibility. Above all, in many instances, there was a lack of honesty, selflessness, integrity, openness, ethical conduct and responsible corporate citizenry.

By and large, accountants and other professionals at various levels of responsibility, and in a good number of financial and non-financial businesses, disregarded these cardinal guiding principles of good corporate governance and conveniently forgot that what is legal is not necessarily ethical. In the end, the financial and economic structure could not bear the weight of accumulated lapses; so, it collapsed.

While all this is now water under the bridge, it has been recognised in some quarters that the International Accounting Standards contributed more than their fair share to the financial crisis. It is pointed out that one new standard abandoned the traditional prudent principle of historical asset valuation and replaced it with a highly subjective and pro-cyclical “fair value” concept. As a result, brokers, analysts and investment bankers abused the standard. The upward movement of stock prices immediately inflated balance sheets which, in turn, further inflated the asset price and, when the economic downturn set in, the bubble eventually burst. It was known that the paper profits resulting from inflated asset book values could not be realised; and yet banks and other non-bank institutions took inordinate debt issuance risks. In addition, the “fair-value” principle was not much understood by the market, and was not transparent. In the event, balance sheets were hardly a useful basis for decision-making by economic agents. The far reaching economic and social consequences of this accounting practice are now a matter of record.

Distinguished Ladies and Gentlemen, it has been said that war is too serious a business to be left to the generals only. Likewise, it is now widely recognised that accounting is too important a profession to be left to accountants only. Indeed the United States of America and the European Union recently took measures to “soften” or dilute, as it were, the deleterious effects of “fair-value” accounting practice in financial institutions. Another emerging change is the call for more disclosures in accounting standards with which those of us outside the profession are grappling, obviously with the helping hand of accountants.

Long gone are the days when accountants confined themselves to the boring ivory tower of “number crunching” or, as at times pejoratively referred to, “bean counting”. In fact, it has been said that accounting has now entered a golden age; an age of the changing role of the accountant; an age of wide-ranging roles that include professional business advice, planning, reporting, identification of value drivers and risk mitigation.

In particular, it is increasingly desirable that the International Accounting Standards should incorporate disclosures of payments to governments by companies in the extraction of natural resources, especially those in the oil, gas and timber sectors. This needs to be done in both the public and private sectors to ensure that maximum revenue and other benefits accrue to the societies in which these companies operate. More generally, the accounting profession has cross-cutting socio-economic responsibility in a variety of ways including governance, business ethics, banking regulations and supervision, as well as financial stability.

In this respect, climate change and its effects have opened up new horizons in which accountants can be involved in a wide range of socio-economic issues. It is my hope that accountants from developing countries will take the lead in putting in place the necessary accounting and reporting standards on costing and financing of the mitigation of adverse socio-economic effects of climate change. These were agreed on at last year's United Nations Climate Change Conference in Copenhagen. You will agree that this is a multi-disciplinary area which, I believe, will involve close consultations between your profession as accountants and other disciplines.

Here at home, the Financial Reporting Bill that was passed by Parliament recently, and awaiting Presidential approval, will contribute considerably in widening the scope for the responsibilities of the accounting profession. Similarly, when the Botswana Accounting Oversight Authority is put in place, it should strengthen the professional accountability and ethical conduct of accountants.

As a related matter, Ladies and Gentlemen, you will know that, in a bid to circumvent a possible repeat of the recent financial crisis, the Basel Committee on Banking Supervision reached a landmark decision on September 12, 2010. This is known as Basel III, and it translates into a more than doubling of the common equity component of capital for global banks, from the current 2 percent to 4.5 percent, plus a new buffer of a further 2.5 percent, to reach a floor of 7 percent. The effective implementation of this new capital adequacy requirement is the period 2013–2019, and it is meant to make banks resilient to financial shocks and ensure a more healthy banking sector worldwide. Any bank capital falling within the buffer zone will face restrictions on paying dividends and discretionary bonuses. We await more of these proclamations and transformations going forward as the Basel Committee on Banking Supervision continues to be hard at work.

As a matter of fact, the Basel Committee is catching up with Botswana's regulatory framework on this matter. It should be of interest that the Bank of Botswana has, for more than 10 years now, insisted that domestic banks should maintain a capital adequacy ratio of 15 percent, which is more than double the new Basel Committee's minimum requirement. It should not come as a surprise, therefore, that, throughout the financial crisis, the domestic banking sector remained well capitalised, sound and profitable.

While on the subject of the domestic banking sector, let me digress a bit into an example of the Bank of Botswana's accountability to stakeholders on delivery of all its mandates, which include monetary policy, the objective of which is to maintain low, predictable and sustainable level of inflation. In meeting the inflation objective the Bank absorbs the banking system's excess funds by issuing Bank of Botswana Certificates, thus containing undesirable credit growth and determining the appropriate level of the Bank Rate. There is no doubt that not issuing central bank paper in the form of Bank of Botswana Certificates to absorb excess liquidity in the banking system would be inflationary and destabilising to the economy. And yet there is a view in some quarters that the cost of absorbing excess liquidity is too high, and banks would do the right thing if left to themselves; that somehow, the Bank is enriching commercial banks. The Bank of course disagrees with these views. In fact, the "*leave-banks-and-their-excess-funds-alone*" view runs counter to experience world-wide. On the contrary, banks cannot be left to accumulate excess money and be expected to do the right thing. In fact, it would be the height of irresponsibility if the Bank were not to intervene in the face of the continuing excess liquidity that is exclusively in the banking system. Indeed accountants, such as yourselves, would be concerned about unhealthy balance sheets resulting from, among others, the vagaries of what would no doubt be runaway inflation, as was the case for several years before BoBCs were introduced in 1991.

With respect to the Banks' responsibility of reigning in inflation by managing banking system liquidity and credit expansion, there is the related need for banks to encourage financial saving. It is well known that bank lending and investment which are a basis for the country's development cannot increase without attracting a faster rate of accumulating savings. The Bank is concerned that household voluntary savings rates are low, while borrowing levels are high compared to countries at a similar level of development. Commercial banks must, therefore, seriously consider developing savings products that offer attractive deposit interest rates, in their own long-term interest, rather than concentrating on short-term gains by maintaining wide spreads between lending and deposit interest rates and, at the same time, charging exorbitantly for the services rendered. Rest assured, this and other related matters are receiving the Bank's active attention.

Distinguished Ladies and Gentlemen, we await the next course of the meal to be served, and I do not want to frustrate your appetite further. This, therefore, concludes my submissions.

Please accept my best wishes for a pleasant and relaxing evening.

I thank you for your attention.