Rameswurlall Basant Roi: The role of accountants in the process of economic development

Address by Mr Rameswurlall Basant Roi, Governor, Bank of Mauritius, at the Forum of Accountants organized by the Mauritius Institute of Professional Accountants, Flic en Flac, 20 July 2017.

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Hon Minister of Financial Services, Good Governance and Institutional Reforms

Chairman, Mauritius Institute of Professional Accountants

Distinguished guests

Ladies and gentlemen

Good morning

Thank you for having invited me to speak to an audience of accountants. It's a first for me. On the occasion of this Forum organized by the Mauritius Institute of Professional Accountants (MIPA), it's my pleasure to share with you some of my thoughts on the role of accountants in the process of economic development. Let me at the very outset stress that contributions of accountants to the process of economic development are generally not direct. But their services as external auditors of financial institutions make direct contributions to the efficient functioning of financial markets which, in turn, allocate scarce resources to economic sectors and facilitate the process of economic development.

I am an economist and a central banker by profession. An economist who is also a regulator of financial institutions does not always make a delightful company with accountants in the external auditing profession. A Cambridge University economist, Joan Robinson, who happened to have lectured me at one point in time, had once observed that the reason one must study economics is "to avoid being deceived by economists." Decades ago, when I had joined the Bank of Mauritius which is also the regulator of various types of financial institutions in the country, I had told to myself that I need to have a good understanding of accountancy in order to avoid being deceived by accountants. I am sure, you must be familiar with the phenomenon that some people talk in their sleep. Economists are sometimes said to talk in other people's sleep. In November 2015, the year when the banking license of the Bramer Banking Corporation Limited was revoked, I had given an address wherein, I hope, I had not talked in other people's sleep. And I hope, I will not do so today.

More than a quarter of a century ago, I was asked to speak briefly on the causes for the deteriorating conditions of a financial institution at a Rotary Club meeting. The laws of the land did not and still do not allow me to speak on matters that are classified as confidential. I chose to speak, in general terms, on the failures of in-house accountants and of external auditors to caution boards of directors of financial institutions on a number of vitally important issues even when the issues are clearly driving them to the edge of a cliff. A few years before this particular event, the Bank for International Settlements had already come up with the Cooke Committee Report, referred to as the Basel I nowadays. I had expected any accountant present there to have already taken cognizance of the Report. Sadly, an accountant, seated in the crowd, listened to me – restlessly and visibly quite irritated. When I was over with my very brief intervention, it was question time. Unhappy with my remarks, he tirelessly gave a lengthy exposé on the origin of the word audit, which I approvingly found scholastic, but ended with a strong conclusive statement that it is not the duty of auditors to caution board directors of financial institutions on, for example, their deteriorating prudential ratios. I later learned that the accountant had spent most of his professional life in a car dealer's warehouse.

This narrative is illustrative of how many of our accountants had failed to recognize how fast the auditing profession was evolving and how critically important are their roles in an economic system. I am more inclined to believe that, today, our accountants are very much aware that there are more differences, indeed very many important differences, than similarities between auditing a corner shop and a financial institution. When a corner shop goes bankrupt for whatever reason, it's not news. The owner or owners of the shop and the creditor or creditors, if any, are the only ones who are the losers. When a financial institution goes bankrupt, it's headline news. The differences of importance and of implications for a society cannot be much clearer. If the financial institution is systemically important, the entire industry, the economy and the society as a whole bear the brunt of losses, in one way or the other. We have been witnessing for a decade how the banking industry across the world has been forced to reconstruct its balance sheet at the same time. Lord William Rees-Mogg has put it fittingly that, "it is like the married couple who both feel chilly at night when they only have a single bed blanket on a double bed. Everyone is trying to maximize their cash take from everyone else." I need not elaborate on how the process of economic development is arrested and the economic well-being of the vast majority of people takes a buffeting once financial instability sets in. Accountants are one of the several key players whose role in the promotion of financial stability is decisively crucial.

At the pinnacle of the accountancy profession lies the International Accounting Standards Board, the IASB, whose mission is testimony to the importance of the profession. As you are aware, the IASB is the standard-setter tasked with the responsibility of developing International Financial Reporting Standards that bring transparency, accountability and efficiency to financial markets around the world. The Constitution of the IASB is unambiguous about the need to promote public interest. Its work serves the public interest by fostering trust, growth and long-term financial stability in the global economy. Accountants are, indeed, a vital cog in the successful carriage of the endeavour.

Accountants perform several roles in an economic system including, amongst others, auditors, consultants, financial analyst, tax planners and business advisers and influence the lives of millions of people globally. Their skills and competence are sought by companies, ranging from the smallest ones to the large multinationals and their audit reports are viewed by millions, including shareholders, governments, regulators, investors and the public at large. They must inspire trust at all times in the eyes of the people.

Trust is the cornerstone on which our society, as any other society, operates. It is essential to commerce. Trustworthiness gives the accountancy profession its touch of honour. A lack of trust is generally fatal to business success. Without trust, we end up having what is called a "bazaar economy." Without trust, economic prosperity disintegrates. Way back in 1913, J.P. Morgan testified to the US Senate that "a man I do not trust could not get money from me on all the bonds in Christendom." Trust is a precondition for mobilizing capital and ensuring its efficient re-allocation to different sectors of the economy. Savers will only be willing to entrust their funds to other economic agents if they can trust the information provided by the recipients of these funds. As such, accountants' responsibility is to give comfort that the financial information provides a true and fair picture of the affairs of the borrowers. Any misrepresentation of the financial condition eventually perpetrates distortions in financial markets.

In the globalized world we find ourselves, accountants are expected to have thorough knowledge of the financials of companies and to be familiar with the numerous economic and political forces at work. The risks are too many. They certainly need to have in-depth knowledge of the drivers of performance and provide independent opinion on the opportunities and risk profiles of companies. It is the quality, reliability and objectivity of such information which stakeholders rely upon to make informed judgment and allocate resources efficiently, which is so essential to the process of economic development.

Let me digress to remind the accountants present here of the BAI Group episode. You will recall that the Bank of Mauritius had hired the services of nTan Advisory Ltd of Singapore to investigate into the various causes that led to the demise of the BAI Group. I personally went through a bulky document of more than 10,000 pages attached to the main Report. Suffice it to say, they do not speak well of the in-house accountants and the accountants in the external auditing profession. Had the external auditors given a true and fair picture of the financial standing of the Group, I am sure the nonsensical game, to use a very polite phrase, would have been avoided and the disruptive forces unleashed by its failure prevented from stalling the growth process of the economy.

When external auditors validate the books of fraudulent companies, the bill of indictment becomes burdensome. When auditors issue favourable opinions knowingly on doctored balance sheets, they stop serving public interest. They do not facilitate the process of economic development; they destroy it. Accountants, like some economists, are artists. They have a noticeable tendency to paint what their patrons, who pay them, want to see. I glossed over quite some files on the revocation of banking licenses by the Bank of Mauritius over the years. In all of the cases, external auditors had been regularly issuing a clean bill of health. Remember one thing: forget economic development, nations are often made bankrupt by fraudulent practices in financial institutions. In-house accountants and those in the external auditing profession have an immense responsibility to maintain rigors and financial discipline in financial as well as non-financial enterprises.

In the banking business, the so-called ‘disaster myopia’ that characterized many of the external auditors who had oversight responsibilities over these banks may lead to malevolent financial stability consequences. Three issues come to the fore in these cases. First, many external auditors have often limited themselves to the microcosmic world of compliance and failed to comprehend the new financially engineered risks that banks undertake. Second, there may have been an agency issue similar to credit rating agencies: as I mentioned earlier, external auditors are often remunerated by those very banks that they oversee. They may, thus, be tempted not to report evidence of any simmering malfeasances for fear of losing their business and third they may not fully endogenise the financial stability implications and may limit themselves to audit rules while discharging their duties.

An externally audited account undoubtedly constitutes a thumbmark of the quality of reporting. However competently conducted, it cannot be interpreted as a blanket cover that everything is perfect in an organization. The instances of corporate failures that had escaped the radar screen of external auditors and gained notoriety afterwards as with Enron, WorldCom, Nortel, Tyco and Parmalat are still vivid in our minds. Accounting irregularities at leading corporate entities are a stark reminder as to how much the absence of accurate, timely and comparable financial information can impede the effective working of markets. Auditors were the first ones to face a backlash and in some instances, their independence was even questioned.

I cannot overlook the criticality of international standards in my remarks this morning. The implementation of international standards provides credence to our financial system and facilitate comparison across jurisdictions. Countries’ financial systems are increasingly built on a compendium of best-practice international standards. The International Financial Reporting Standards (IFRS) form part of them. IFRS optimizes the decision making process by helping investors better identify opportunities and risks. These investors not only include individuals but also the big powerhouses such as sovereign wealth funds, pension funds and asset management companies, with billions of dollars and thousands of employees concerned. They need to maximize returns, minimize risks and maintain a diversified portfolio. As funds are invested in many countries, the adoption of IFRS has simplified matters when compared to the pre-IFRS world of wildly diverging national accounting standards.

I have, so far, highlighted the importance of accountants in the process of economic development of a country. As a final remark, let me very briefly reflect on a subject that many of us refrain from referring to for fear of being politically incorrect. It's on greed, governance and ethics. In financial markets, devoid of proper institutional rules and discipline, there is the law of the jungle – because of greed. In my view, depending on how the concept of greed is understood, there is nothing wrong with greed. In fact, our capitalist system can be interpreted as being based on the concept of greed. It's only when you are far removed from the domain of wisdom that greed takes a strong and pre-dominant foothold in your profession. Greed, the predator's gene, has to be tempered by fear of losses.

Unfortunately, we do not have the philosophical capacity to issue a guideline on greed but we have, years ago, issued a guideline on corporate governance. I urge you all to pay special attention to governance while conducting audits. I am particularly happy to note that there are increasingly more interactions between the accountants in the auditing profession and the Bank of Mauritius, not only on matters relating to governance but on many aspects of the auditing profession. The Bank of Mauritius gladly welcomes the interactions.

And, finally, a few words on ethical behaviour in the auditing profession. Remain loyal to your profession and always guide your clients to the best practices. Yours is an honourable profession. Maintain the standard required of you. Some high profile corporate failures in the past have been caused by creative accounting and concealing the true risks of the companies which were, in certain cases, moved off balance sheet. In some cases, accountants working for these companies devised such financial shenanigans which were facilitated by compliant or complacent auditors. These short term gains often result in long term pains, both for the individuals and the economy, too. Never condone such practices.

We cannot compromise our reputation by resorting to such questionable practices. A strong and stable banking system is vital to the robustness of an economy. You, as auditors, must refrain, at all cost, from producing audit reports that, instead, contribute to a weakening of the banking system. I am pretty well aware that the Bank of Mauritius is said to have been very tough and often quite rude with some of you as with others. As I have always said, the Bank of Mauritius is "cruel only to be kind" to you and our jurisdiction.

I urge the accountants to reflect on emerging challenges that the profession is facing and request the MIPA to collectively take steps to meet those challenges. You must be aware that a lack of skills in certain areas of auditing is now being palpably felt. Your association is having a formidable agenda for action. May I wish you all very fruitful deliberations during the Forum.

I thank you for your attention and wish you well in taking the profession forward.