

Integrity at Stake: Damage Cuts to the Core of Capitalist System and the Need to Better Regulate the Practices of the Accounting Fraternity

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ABSTRACT

The new global epidemic highlights the accounting and financial practices of the accountants and the auditors. The vices range from overstating profits to outright criminal behavior of diverting company funds. One symptom of its pervasiveness is how fast one event in a particular part of the globe spreads to the rest of the world including Malaysia. When accountants and auditors fail to discharge their fiduciary responsibilities competently and appear not to demonstrate the highest ethical practices, the damage cuts to the very core of the capitalist financial system. A common problem is the potential conflict between the accountant's traditional roles. The accounting fraternity, like any other important element in the capital markets, must also be accountable, responsible and transparent. The problem in Malaysia is not due to insufficient rules or regulations but rather lack of consistent enforcement of those rules. Such body can have the authority to regulate all accounting practices and professional behaviour in Malaysia. It should also have the power to conduct inquiries and make reprimands and acting as the sole authority to set standards of behaviour and code of conduct for the accounting and auditing fraternity in Malaysia.

Keywords: *auditing, regulatory body, business community, corporate governance*

Integriti di Ambang Bahaya: Kemusnahan Meresapi ke Akar Umbi Sistem Kapitalis dan Keperluan untuk Mengawal Amalan Badan Perakaunan

ABSTRAK

Epidemik terbaru di persada global mengenengahkan amalan perakaunan dan kewangan oleh para akauntan dan juru audit. Amalan buruk ini melibatkan persoalan dari catatan keuntungan berlebihan sehingga kepada gelagat jenayah yang melibatkan penyelewengan dana syarikat. Penunjuk kekerapan perlakuan ini ialah secepat mana masalah ini boleh merebak ke seluruh pelusuk dunia termasuk di Malaysia. Apabila para akauntan dan juru audit gagal untuk menjalankan tugas masing-masing secara kompeten dan tidak mencerminkan amalan yang beretika, maka akan berlaku kemusnahan kepada akar umbi sistem kewangan kapitalis. Masalah asasnya ialah kemungkinan besarnya berlaku konflik di antara peranan tradisi para akauntan. Komuniti perakaunan, seperti mana lain-lain perkara penting dalam pasaran modal, mestilah akauntabel, bertanggungjawab, dan telus. Masalah yang berlaku di Malaysia bukanlah disebabkan oleh kekurangan peraturan atau undang-undang tetapi lebih kepada kekurangan penguatkuasaan yang konsisten terhadap peraturan yang sedia ada. Dengan yang demikian, kewujudan komuniti tersebut akan mempunyai kuasa untuk mengawal kesemua amalan perakaunan dan gelagat profesional di Malaysia. Komuniti tersebut juga harus mempunyai kuasa untuk menjalankan penyiasatan dan menjatuhkan hukuman serta berperanan sebagai badan berkuasa mutlak untuk menentukan piawaian terhadap gelagat dan kod perlakuan bagi komuniti perakaunan dan audit di Malaysia.

Katakunci: *pengauditan, badan perundangan, komuniti perniagaan, governan korporat*

A corporate disease that the Europeans thought would only occur in the USA has hit home in a big way. Parmalat was a household name not only in Italy, but also in Europe, not least due to the exploits of its Parma football team. In the US, it began with Enron and then rapidly engulfed companies like Xerox,

WorldCom, Tyco and ImClone, just to name a few, within its ambit of destruction (Smerdon, 1998). Parmalaat not only shattered the smugness of the Europeans, but has also produced a growing unease and that most probably there are more bad European companies waiting to be uncovered.

As Italian and European authorities sift through the Parmalaat carnage, one focal point in this new global epidemic highlights the accounting and financial practices of the accountants. This unflattering spotlight also involves the auditors. The vices range from overstating profits, as in the case of Xerox, to outright criminal behavior of diverting company funds, as in the case of Enron and Parmalaat. The unsettling part is that these problems involve the big boys – mainly Arthur Andersen and KPMG. Size matters it seems. Maybe you have to be big to create big problems.

As in the tradition of globalization, one symptom of its pervasiveness is how fast one event in a particular part of the globe spreads like bush-fire to the rest of the world. And true to this tradition, this disease appeared to have reached Malaysian shores when it was reported last year that CSM Corp Bhd (formerly known as Cold Storage (M) Bhd) initiated legal action against its former directors and auditors (Finance Committee on Corporate Governance, 2001; Low, 2002). This case is still pending in the courts. In all these problems, at the centre of the turmoil is the accounting fraternity.

The accounting profession has a noble history and performs a very critical function in the financial world. But when accountants and auditors fail to discharge their fiduciary responsibilities competently and appear not to demonstrate the highest ethical practices, the damage cuts to the very core of the capitalist financial system.

Like it or not, since that fall of the Berlin Wall, the capitalist model seems to be the only workable system left. But when its most critical component – the accounting function that critically reports on financial well-being of business entities – exposes itself, deservedly or not, to be less than reliable, then this undermines the basic credibility and viability of the whole structure, premised on unimpeachable sets of annual audited accounts made available to shareholders and other users who are stakeholders to the companies concerned.

Since this is the only economic system we have, all interested parties have to work together collectively to undertake remedies that will restore public confidence. This is required not only to rescue the reputation of the accounting profession but also to rebuild the integrity of the market place. But for change to be real, should the accounting itself not be changed? This is the crux of the problem. Like any other interested party, the accounting fraternity seemed loathe to cede its sphere of authority and influence, even in the face of incontrovertible evidence that something drastic has to be done.

Similar to many other professional fraternity – doctors and lawyers come to mind – the accounting profession is a self-regulating professional enclave. But a body made up of your peers, ruled by your peers, with its own system of “judge, jury and executioner” consisting of your peers, inevitably may have a natural tendency for self-serving behaviour. Such a body may not be too onerous in regulating its members or too harsh in disciplining the wayward ones, for it risks losing its members or, even worse, it will be stripped of its legitimacy to regulate or even to exist.

An issue becomes a problem when self-interest considerations take precedence over professional standards, ethical behaviour or delivering on a public good. A common problem is the potential conflict between the accountant’s traditional roles, when appointed as such, as a company’s external auditor and the more lucrative business as corporate consultants.

All major accounting firms have been thriving on more profitable consultancy business – mainly in information technology, management consultant and financial advisory. Cases have emerged where audit integrity and rigour may have been sacrificed to win more lucrative consultancy contracts, from certain events that have come to the notice of the Malaysian public in recent times. When significant financial malfeasance goes undetected due to less-than-rigorous auditing work, then a disaster is waiting to happen and inevitably it usually does. Enron is a good example of this behaviour. So is CSM Corp's case – if the alleged claims are proven to be true. Coincidentally, for both companies Arthur Andersen was the external auditor.

Tat Sang Holdings Bhd is a lesser known problem. Tat Sang is a furniture manufacturer listed on the Second Board of the Kuala Lumpur Stock Exchange that went bankrupt just 18 months after its listing. At least in this case, the guilty party has been dealt in a court of law. Tat Sang had purportedly double-counted the profits it reported in its initial public offering (IPO) prospectus. Unfortunately, the reporting accountant in Tat Sang's IPO prospectus was also Arthur Andersen. Tat Sang has been suspended by the regulatory bodies and recently, auditors have taken legal action against the company for various breaches. Many would like to believe that a disaster like Enron or Parmalat will never happen in Malaysia. But there is also a growing belief that legal actions brought about by CSM Corp and Tat Sang are just the tip of the iceberg.

Let's not delude ourselves into thinking that accountants in Malaysia are saints – they are only human. Self-interest at times may not have been completely eliminated as a consideration and motivating factor. Just like in any other country. When was the last time it was widely publicized that the Malaysian Institute of Accountants (MIA) reprimanded one of its members for misconduct, or even queried a member for some alleged misdemeanour? MIA's code of conduct ought to fully address potential conflicts of interest situations when accountants undertake external auditing work and consultancy engagements with one and the same client. An explanation that its members are allowed to undertake both auditing and consultancy work with one client is called for in the interest of all parties concerned that value transparency, accountability and integrity in all corporate dealings.

The problem in Malaysia is not that we do not have enough rules or regulations. Some parties even argue that Malaysia may be over-regulated. Our problem in many instances is the lack of consistent enforcement of those rules. There could be valid reasons for this problem, such as insufficient manpower, lack of funds or untrained personnel. But all these reasons cannot detract from the fact that enforcement of existing regulations must improve.

Lack of rules-enforcement becomes more serious when the "policing body" is a self-regulating entity like the MIA. Taking cognizance of the standard protestations to the contrary from MIA, serious thought must be given to come up with a new paradigm that would be more effective for preserving the annual audited accounts of companies as valuable information to its many users. The community of accountants, like any other professional community, is small and insular, and this type of aggregation may tend to become an extended buddy-system. Hence, MIA may have to face changes from many quarters in the business community of insufficient independence to enforce regulations on its members, and at the micro-level, whether there is true independence among members.

This buddy-system based relationship has now extended to the relationship between auditor and client. One reason this may have happened is that the auditor-client relationship existed long enough such the relationship becomes too close and objectivity may inadvertently have taken a back seat. In the US, all the remaining big four accounting firms have settled at least one official incriminating case each by the Securities and Exchange Commission (United Nations Development Program, 2002). Despite this

evidence of wrongdoing, many large corporations still prefer the services of the remaining big four accounting firms.

The situation in Malaysia is probably different. We think it is, in fact, better since most of the big accounting firms are not embroiled in any fiasco, yet. But many industry watchers expect the trickle that started with CSM Corp to become a raging tsunami soon. The relevant parties may want to consider an alternative regulatory body to enhance professionalism in the industry, similar to the US Accounting Oversight Body. Such a body can be independent of the accounting fraternity by coming under the direct supervision of the Securities Commission, for example, which then has the sole discretion in appointing its members. The majority of the members can comprise non-accountants chosen from the various fields of industry and commerce. This body can have the authority to regulate all accounting practices and professional behaviour in Malaysia, and with powers to conduct inquiries and make reprimands. It can even be the sole authority to set standards of behaviour and code of conduct for the accounting and auditing fraternity in Malaysia. The Malaysia Accounting Standards Board will still remain and retain its function in setting financial reporting standards.

An independent body for accountants might be somewhat drastic and controversial. But maybe this is just the type of jolt the accounting fraternity needs to push it out of its comfort zone. The accounting fraternity, like any other important element in the capital markets, must also be accountable, responsible and transparent – not just be themselves but also to the business community in general, and to be seen to be doing so. But their obligations to observe the tenets of good corporate governance are manifestly higher because if they falter, this will not only affect their image and reputation but also destroy the integrity of the whole free market capitalist system as we know it in Malaysia. This article is written strictly in the interest of encouraging a healthy debate of these issues important to all of us.

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