

The Financial Reporting Supply Chain in Asia

The rapidly developing resort town of Negombo, located within 20 minutes of the recently expanded Bandaranayake International airport near Colombo in Sri Lanka, was a fitting location for the inaugural Financial Reporting for Economic Development Forum staged by the Confederation of Asian and Pacific Accountants (CAPA).

In his opening address, Sri Lanka's Deputy Minister of Finance & Planning, Dr. Sarath Amunugama, reflected on the rapid economic development in recent years and the current healthy 7.5 % growth rate. Whilst noting that financial management reforms need to keep pace, he was quick to point out that the country has a strong accounting profession, a comment supported by the leadership of CAPA.



CAPA is a regional body recognised by the global accountancy profession represented by the International Federation of Accountants (IFAC). As a regional organisation, it represents 31 professional accounting organisations across 23 jurisdictions of the Asia Pacific and aims to develop, coordinate, and advance the accountancy profession in the region.



The Forum was supported by the World Bank. “And without this support the Forum could not have proceeded,” said Brian Blood, Chief Executive of CAPA. Both organisations recognise the importance of high quality financial management and reporting across private and public sectors as a key driver of investment, employment, and ultimately the reduction of poverty. Fily Sissoko, Manager of the South Asia Region Financial Management unit of the Bank explained, “The accountancy profession has a vital role to play in the goal of shared prosperity.”

With globalisation, there is increasing focus on doing business in and with Asia. For Asia to be successful, it will be important to have effective capital markets and strong corporate governance systems.

Corporate scandals and collapses are often associated with companies outside of Asia; however the region has not been immune. Chandu Bhave would know – he was Chairman of the Securities and Exchange Board of India (SEBI) around the time of the Satyam scandal. At the Forum he joined in a panel discussing ‘ethics and the professional accountant.’

The Forum was based around the financial reporting supply chain, a term used to depict the myriad of players involved in the preparation, approval, audit analysis and use of financial reports. “When failure occurs, so often the first and possibly only question asked is *where were the auditors?*” said Faye Choudhury, Chief Executive of IFAC. Choudhury sees this as an imbalance in the public policy debate with a risk it leads to less than the best outcome. “As with any chain, it is only as strong as its weakest link, so all links in the chain need to be strong.”

Global accounting and auditing standards provide a sound starting point for high quality financial reporting since they arise from independent standard setting boards. They also provide consistency in a global marketplace. Implementing these standards can be a challenge, and a number of countries in Asia are late to the party. Their implementation and use requires a dearth of well-trained, professional accountants, and in some countries there is a need to build capacity. Whilst mandating professional qualifications for preparers of accounts is an idealistic goal, it just may not be possible where shortages of accountants exist.

This raised questions about the education systems supporting the profession and Professor Narayanaswamy from the Indian Institute of Management Bangalore, did not pull any punches suggesting that the gap between what academia is supplying and the needs of the profession has widened in some locations. “There is much to be done,” he conceded. “Academics in the Asia Pacific region and in SAARC and ASEAN should collaborate more in teaching and research, and there is a need to bring contemporary issues into the classroom.”

Financial reporting related reforms across Asia over the last 15 years have been substantial. Analysis from the Asian Corporate Governance Association (ACGA) revealed that in 1998 most countries in Asia did not have codes of corporate governance or require independent directors or audit committees. “Today the position is very different; with codes for Board governance having been introduced and often updated over the period, and all but Japan of the larger Asian countries requiring independent auditors and audit committees. Taiwan is still phasing in the requirement for independent directors, while audit committees will be mandatory as of 2014,” Sharmila Gopinath, a research director for ACGA based in India said.

However, whilst the reform has occurred and codes, standards, and principles are widely referenced, many of the speakers acknowledged the challenges, and indeed the will, to implement. Oftentimes it comes down to human behaviour and whether a strong corporate governance culture will be encouraged and enforced. An analogy often used in the Forum was ‘why is it that a car driver from Europe obeys the road rules in their own country, but if driving in Asia appears to change habits; or a driver from Asia not used to abiding rules in their own country quickly falls in line with driving requirements if visiting Europe?’ “Enforcement is the number one issue,” stated Sharmila Gopinath. “Without this, there is little incentive to always do the right thing.”

One unique challenge for Asia reflects the preponderance of closely controlled, often family related, companies. Majority control places increased focus for investors on related party transactions and transparency requirements. Link to this the challenges of putting in systems that encourage and support the raising of bad news - ‘whistle-blowing’ - then you have some real challenges. Investors demand confidence in financial reporting and Asia in general has some work to do to reduce the level of perceived unethical behavior or corruption.

Clement Chan, current President of the Hong Kong Institute of Certified Public Accountants and also Chair of the Asian-Oceanian Standard-Setters Group, put it nicely when he said: “The real question is what do we have to disclose to give a true and fair view.”



Professor Mervyn King

Financial reporting is moving ahead in other ways at the moment under the increasingly recognised ‘Integrated Reporting’ banner. Professor Mervyn King, Chair of the International Integrated Reporting Council who is a passionate advocate of integrated reporting noted: “Financial reporting, while not broken, is not sufficient on its own. Similarly, sustainability reporting is not sufficient on its own. While both these reports are critical, it has to be shown how the financial impacts on the non-financial and vice versa. The reality is that the resources used by a company and the relationships with its key stakeholders are interdependent and interconnected. An analysis of the market cap of companies listed on stock exchanges shows that only 20% of the market cap of companies is included as additives in a balance sheet according to financial reporting standards. Consequently the financial report does not inform the user of the ‘state of play’ in a company. Boards need to apply their collective minds to the financial and non-financial reports and ensure that the material

matters are explained in clear, concise, and understandable language in an integrated report so that the reader can make an informed assessment that the business of the company will sustain value creation in the short, medium, and long term.”

The integrated reporting journey is reasonably new and has a way to go to reach mainstream acceptance, with some stakeholders raising concerns over certain matters. The challenges include providing the company’s long term strategy knowing others will rely on that information - directors and auditors especially are closely considering their risks. However, it is clear many companies are embracing the spirit of integrated reporting, providing understandable information on the business’s total value creation, short, medium, and long term. It has to be accepted that business is at the junction of the economy, society, and the environment.

A pilot program has been underway for some time with companies from around the world participating. Diesel & Motor Engineering Plc. based in Sri Lanka is one such company, and Suresh Gooneratne, the executive director noted the benefits were exceeding the efforts and costs involved. Professor King did note that the number of companies involved in the pilot program from Asia was comparatively low, which supported a sense that Asia was not keeping pace in this new area of development.

The Forum was largely devoted to the private sector, however one session did focus on the financial reporting supply chain as it relates to the public sector. The level of interest and activity in this area has accelerated significantly in recent years following a number of high profile sovereign debt crises. Andreas Bergmann, Chair of the independent International Public Sector Accounting Standards Board was clear in his view: “Accrual accounting is state of the art.”



Suhas Joshi, Regional Advisor, Public Financial Management with the International Monetary Fund pointed out some of the challenges in achieving this goal and questioned if expected levels of success were always being achieved. Alan Edwards from the Chartered Institute of Public Finance and Accountancy based in the UK focused on some approaches to professionalise this sector, often working closely with donor agencies such as the World Bank. A large reform program underway in Bangladesh is seeing over 300 staff undertake professional training, and 65 officials from the Office of the Comptroller and Auditor General attained certificate level accreditation.

CAPA is also active in this area, and recently published “Improving Public Financial Management in the Public Sector – The Eight Key Elements of PFM Success” a toolkit allowing national professional accounting organisations to engage with key government stakeholders to discuss challenges and opportunities. “Professional accounting organisations have a vital role to play in ensuring the public sector has access to properly equipped, qualified accountants and auditors to manage and safeguard taxpayer funds,” explained Gillian Fawcett, Head of Public Sector at ACCA (Association of Chartered Certified Accountants) based in London.



Sujeewa Mudalige

The level of interest in the public sector debate was such that the next Financial Reporting for Economic Development Forum will likely focus predominantly on the public sector. “With support from the World Bank, CAPA looks forward to staging the next Forum within eighteen months, and we will move the location each time around Asia,” said Sujewa Mudalige, CAPA President, during his closing remarks.

Further information about the forum program, speakers and selected presentation materials can be found at:
<http://www.fredasia.org>

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