

National Financial Reporting Authority, India

21st World Congress of Accountants

Saturday, 19 November 2022, Jio World Convention Centre, Mumbai, India

Remarks delivered by NFRA Chairperson Dr. Ajay Bhushan Prasad Pandey, at Plenary Session
Accountancy Profession: Partner in Nation Building (Panel Discussion)

Hon'ble Shri Girish Chandra Murmu, Comptroller and Auditor General of India, Dr Debashis Mitra, President ICAI, CA Aniket Talati, Vice President ICAI, CA Manoharan, Past President ICAI and distinguished audience and foreign delegates.

It is my proud privilege to attend this 21st World Congress of Accountants hosted by ICAI for the first time in India

First, let me talk about the Role and Contribution of ICAI and the Members of ICAI so far

Accountancy Profession or Chartered Accountancy Profession is a critical building block in the society at large and commerce and industry in particular.

Any modern society for its orderly functioning needs to have robust frameworks in respect of Financial Reporting and the Taxation of various economic and business activities. Let me highlight the sheet-anchor role played by the ICAI and its members. In view of the role played by the ICAI and its members, India's Former President Late Dr. A.P.J. Abdul Kalam, called the Indian Accountancy Profession as 'Partner in Nation Building'.

ICAI contribution in the Financial Reporting Framework of India

High-quality Financial Reporting Framework is an essential ingredient for growth and development of any economy. In this part, ICAI and its members contribution is commendable and the few notable ones are as follows.

- Since its formation in 1949, ICAI through its Committees such as Research Committee (1955), Expert Advisory Committee (1975) has been making efforts to enable the nation with sound system of accounting and auditing systems.
- Since the 1970s, it has been instrumental in reforming and aligning the Indian Accounting and Auditing Framework to the International Best Practices and Frameworks and has established fully dedicated Standard -setting Boards. One of the noteworthy features is recent project of development of Ind AS Framework which substantially based on and converged with high-quality globally acceptable IFRS Standards. There are about 9 carve-outs in Ind AS. Because of this ICAI's practice to formulate standards based on International Standards, India could implement new framework called Ind AS based on IFRS Standards in a very short span of time.

Second, Taxation

A prominent one to mention is of compulsory audit of the books of accounts of certain assesses u/s 44AB of Income Tax Act introduced way back in 1984 as a measure to discourage tax avoidance and tax evasion. Before 1984, Taxpayers were maintaining their books of accounts in different ways and Tax Officers were spending time in scrutinising the information of Taxpayers. Tax Audit by CAs has helped establishing discipline in maintenance of financial records of Taxpayers.

India has emerged as Skill Capital of the world in the area of financial reporting services

Today, India is a major hub of global financial reporting services of many multinational organizations. Similarly, most of the Big 4 Audit Firms have established global delivery centers for audit and consultancy services in India.

ICAI has been playing vital role in developing and training technically competent Accountancy Professionals. Latest data of ICAI membership shows a huge family of 3 lakh 50 thousand CAs. Nearly 10K CAs are getting enrolled annually. Hence, Accounting and Financial Services of India has made us Skill Capital of the world.

How can ICAI and its members continue their journey of Partner in Nation Building going forward?

First, how to regain trust and confidence of stakeholders by performing good and effective audits.

This has three constituents viz. ‘Audit Quality’, ‘Independence’ and ‘Future of Audit Profession’, which are highly interdependent and are driven by a moot question whether the audits performed today meet the expectation of stakeholders.

In my view, Audit Quality will be achieved when the expectations of stakeholders are met. However, this moot question is not being rightly addressed, as the solution to the underlying cause is getting postponed or wished away by excessive dissection of something called as Audit Expectation Gap. As mentioned in Brydon Review Report¹ in the aftermath of Carillon failure, varieties of gaps such as Performance gap, Knowledge gap, Hindsight gap, Quality gap, Mis-perception gap, Evolution gap have come to surface. In fact, I tend to agree with a view mentioned in that report that the problem is not one of expectations, rather we have a grave ‘delivery gap’ when it comes to audit.

Now, in order to address this delivery gap so that a good audit is performed keeping in mind the stakeholders’ expectations, I have a few suggestions for the consideration of the Audit Profession.

Identification and Reporting on Frauds and Preventing Corporate Failures

A recent report of ACCA (the Association of Chartered Certified Accountants)² based on survey of 11K members of public in 11 countries, brings to fore the paradigm shift in the public expectation of audit as far as detection and reporting of fraud and preventing corporate failure is concerned.

¹ Brydon Review (Dec 2019)- REPORT OF THE INDEPENDENT REVIEW INTO THE QUALITY AND EFFECTIVENESS OF AUDIT

² Closing the Expectation Gap, ACCA

The survey results show c.35% want the audit to always detect frauds and another 25 to 40% want detection of material frauds. This is an area which has been agitating the public since decades. In this context, it would be relevant to note the views of CA Y H Malegam, Past President, ICAI nearly 25 years ago in 1998³ “The public wants protection against fraud and it cannot understand how companies for which an auditor has given an unqualified audit report could suddenly collapse later on because of certain management fraud.” In fact, he has again reminded in his recent article in ICAI journal⁴ that finding fraud can well become a major element of future audit reform. There is a growing expectation in the investing public and the regulators that the onus should be on the auditor to detect material fraud in all reasonable ways.

Preventing Corporate Failures

In the ACCA survey report mentioned earlier, there’s a global demand from the public for a wider audit scope.’

I may draw your attention to the recommendation in the Brydon Review Report⁵ to redefine the audit and if that definition, if accepted, in my view is going to expand the scope and objective of audit in the future especially, in the area of Going Concern to Viability of the Audited Company. In this regard, it may be pertinent to note that latest amendments to Schedule III of Indian Companies Act require disclosures of many financial ratios by the management which will strengthen the auditors’ ability to comment upon the going concern status of the company.

Identification of business risks and understanding the entity’s business and operating environment

This is another area where the scope and extent of auditing need to undergo paradigm shift. The existing Standards on Auditing, SA 300, SA 315 etc. cast a duty on the auditor to understand the entity’s industry environment, its strategies, business model and business risks.

However, the auditors’ work in this area is primarily focused towards assessing risk of material misstatement. This scope may need to be broadened to look at from the perspective of viability or survival of the entity at least in the foreseeable future.

³ The Role of Accounting Professionals, CA Y H Malegam, The Chartered Accountant January 1998

⁴ Building Excellence with Integrity, Trust and Transparency, CA Y H Malegam, The Chartered Accountant July 2022

⁵ Ibid 1

In this context, independence of auditor is also very critical.

A big question many stakeholders routinely pose is why are the auditors not able to identify frauds or risk of corporate failures? Are auditors alone responsible for detecting frauds or risks of corporate failures? There is a difference between 'Being Responsible' and 'Being Alone Responsible'.

My personal view is before passing a value judgement on this issue, all players which include governments, regulators, companies must appreciate the challenging environment in which the auditors operate. We must evaluate whether they have real freedom and independence or face practical constraints while doing audit in the manner they want and whether there are factors which limit their professional freedom, independence, and their scope.

Here, two things can be very useful. One -Engagement with Stakeholders and Gathering their Expectations by the issuers

- the other by use of emerging technologies for data research, analytics, and third parties confirmation.

In the era of internet and social media platforms, there is a need to leverage them and evolve suitable mechanisms and means for the 'Two way' communication between the Stakeholders and Auditors, of course via the audit committees. Again, one may consider the suggestions in the Brydon Review Report. The suggestion there is to publish Directors' Risk Report prior to the Audit Committee where the scope of audit is discussed. Also, it suggests that Audit Committee may publish a formal invitation to shareholders to express any requests they have regarding the areas of emphasis they wish the auditor to incorporate in the audit plan. This innovative method of crowdsourcing of risk identification through the shareholders will not only help meet the expectation gap of the shareholders but also empower and strengthen the auditors to look into several areas which the conflicted management may not ideally want them to look into. This will also go a long way in establishing a transparent regime of corporate governance which we have been striving for decades.

The other area is use of technology, and data analytics in audit. Today we as a country are proud to have solved many long standing vexed problems through technology and data analytics, like in Aadhaar and UPI, GST, Income tax, faceless assessments and annual information

statement in Income Tax etc. We have used technology to minimize human interface or physical inspections and have been able to do external and third-party confirmation of information contained in more than 200 millions of tax returns and half a billion e-invoice every year in an automated manner and thereby improve compliance and tax collection significantly. We all need to put our minds together to see how technology can be used in the areas of audit too. We must be aware that the Stakeholders expectations and technology are going to change the nature of the audit in future.

Corporate Non-financial Reporting Initiatives and Frameworks

As we all know, since 1992 UN Conference on Conference on Environment and Development, many efforts in the area of sustainable developments have taken place internationally and nationally under various initiatives⁶ of United Nations and other non-state organizations.

In the above background of emphasis on sustainable development of the global community and economies, a number of corporate reporting frameworks have come up with variety of titles. A 2017 study by the World Business Council for Sustainable Development (WBCSD) indicated that the number of “reporting provisions” globally have increased tenfold in the 25 years since the 1992 Rio Earth Summit to about a thousand, indicating the complexity and need for such reporting.⁷ Also, recent report⁸ of IFAC indicates use of multiple frameworks/standards increased from 68% in 2019 to 80% in 2020.

Hence, there has been a need for consistency and comparability in sustainability reporting at a global level. There was a demand by the investors, central banks, market regulators, policy makers, corporate sector (preparers) and audit firms and request by G7 and G20 to IFRS Foundation for addressing the complex and fragmented sustainability disclosure landscape. Therefore, with the high-level objective of providing a global baseline, the IFRS Foundation, known for its success in establishing globally acceptable financial reporting standards, has embarked on a global mission to provide a globally acceptable non-financial reporting framework since November 2021. A few critical milestones to note are (a) establishment of fully dedicated

⁶ <https://sdgs.un.org/goals>

⁷ Report of the Committee on Business Responsibility Reporting, MCA, GOI, May 2020

⁸ The State of Play in Reporting and Assurance of Sustainability Information: Update 2019-2020 Data and Analysis

standard-setting board called International Sustainability Standards Board (ISSB) at UN Climate Change Conference (COP26) in November 2021 and issuance of two exposure drafts on Sustainability Disclosure Standards.

One of the positive aspects as I see today is that the ISSB has received overwhelming response, c.720 public comments, to the proposals in the above two exposure drafts; this reflects the extensive support and interest of stakeholders across the globe for a global baseline framework for non-financial reporting.

I also commend the initiative of ICAI to establish a separate standard-setting Board for non-financial reporting matters.

The way forward in my view are two folds.

- 1) We need to gradually start develop global sustainability reporting standards in other areas of environmental and social risks to the business and industry.
- 2) Global baseline in respect of audit and/or assurance of the non-financial reporting should be developed on priority basis.

Thank you.