

**THE ACCOUNTING PROFESSION REDEFINED:
*SETTING STANDARDS FOR GOOD GOVERNANCE***

**by Greg Navarro to the 1st conference and exhibit of the
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Distinguished officers of De La Salle University, officers and members of the Center for Business and Economics Research and Development (CBERD), colleagues in business and industry, partners in the academe, honorable guests, friends, ladies and gentlemen, good afternoon. Before I begin, let me congratulate the CBERD for organizing this first conference and exhibit on business and economics. With its twin objectives of providing a forum for business educators and researchers to share their research findings with a broader community and strengthening the linkages between the academe and the business sector, this event is very timely and certainly relevant to the current challenges we face in our country.

I am honored to be among esteemed academicians and pillars of industry in our country today. I say it's about time we came together to learn from each other and share our expertise and experience with those who can benefit from what we do best and what we know so well. For someone like me who comes from the professional services sector where the most vital element of success is having knowledgeable people, I find this exchange a very helpful vehicle for conveying the needs of business to the academic community which is the basic training grounds for those who come to join us later as professionals. By sharing with you what I know to be the demands of business and the national economy, I hope to be able to help the academicians among us today align the preparation of their graduates for our country's needs today. At the same time, I expect to gain new insights and knowledge from the results of research conducted by business educators which I could use for further fine tuning of our services to make them even more responsive to the needs of business and the national economy.

Without meaning any offense to the organizers of this event, I would like to start by saying that the theme "Emerging issues in Business and Economics: Governance and Innovation" may no longer be appropriate for one reason, and that is, I find that the twin issues of governance and innovation are already well upon us and no longer emerging. They stare us in the face---almost dominating every waking moment of our individual and collective lives. Wherever we look around us and even elsewhere in the world, we find that most of the challenges we face day-to-day arise from rapid change and innovation as well as from the call for ethical practice which is the core of good governance. I do agree fully that these two issues make up the most pervasive and current call of the times.

Innovation, by its very nature, invites questions of ethics precisely because whenever we tread on new ground, we don't know the terrain well enough yet to be able to set the rules of the game. If I may borrow examples from the sphere of medical research, I can quickly think of the raging issues of stem cell research, genetic engineering, cloning, cryogenics, and organ transplants as perfect examples of innovation bringing about moral questions. In the world of information technology which is closely linked to business, we now face ethical issues related to intellectual property rights, e-commerce, and even cyber crime ranging from credit card fraud to large scale financial scams. Indeed, it is very appropriate and timely to bring together these twin issues in one forum.

The Accounting Profession Redefined

Today, I speak to you as a representative of the accounting profession, better known as the Certified Public Accountants or CPAs. The goal I have set for myself is to bring the message that the accounting profession has evolved and is now at the forefront of leading the initiative towards good governance; hence, my topic: "The Accounting Profession Redefined: Setting Standards for Good Governance." I purposely asked the organizers of this event to allow me to speak on this subject because not only do I find it most timely and relevant, it is to me the single most important lesson in governance that I wish to emphasize to my colleagues in business and industry. I believe that if we begin from ourselves, the rest would follow closely. More importantly, we cannot claim any right to criticize others if we have not even begun to look at ourselves.

I cannot help but recall a very old joke that we, as accounting students years ago, used to get as a mild form of ridicule from fellow students who were in the more so-called technical or sophisticated courses like engineering, law, and medicine. It went this way, "What's the difference between counting and accounting?" The answer, of course, was, "In counting you say one, two, three.... In accounting, you say, a-one, a-two, a-three...." While this joke came as a part of youthful exuberance, in hindsight now I feel this was an early indication of the perception of people of the accounting profession as too simple and not that important to the proper governance of companies and society as a whole.

So now the time has come to assert the value of the accounting profession and redefine its role in setting the standards for good governance. But I must say at this juncture that no discussion of good governance can be made without going back to what I call the dark days of 2001 and 2002. I refer of course to the tumultuous exposure and eventual collapse of Enron, and with it, Arthur Andersen, as well as other major corporations in the US due to the lack of diligence in financial reporting or outright violation of accounting standards with the concomitant collusion of bankers, financial advisors, brokers and external auditors. While I do not wish to dwell on the misfortune of others, I find that it is only in highlighting the mistakes that we can bring out the lessons that have been learned. We can only move forward with the knowledge of the past as guide to the future.

Having said that, I would like to add that my presentation this afternoon will take on a “back-to-basics” approach, walking you through the issues of governance as they relate to the concept and practice of accounting principles and audit standards. This is not to say that the issues are simple; they are in fact wide-ranging and very complex, cutting across the domains of government, business, the investing public, perhaps even the church and society-at-large.

So you may ask, if the accounting profession has been redefined, what was it before? Allow me to give a bit of history by way of paraphrasing from the excellent article entitled “The Accountancy Profession in the Philippines and the Philippine Institute of Certified Public Accountants (PICPA)” written by Ms. Emelita P. Agustin in the December 1994 issue of the *Accountants Journal* (Vol. 44(3). pp. 12-17).

Philippine accounting practices date back to the pre-Spanish period, when native inhabitants, later to be called Filipinos, conducted business with Chinese, Indians and Malays from neighboring countries. These trading activities prompted them to prepare crude accounting records that were then based mainly on cash receipts and payments. As time went on, other influences came in, with substantial changes brought in by the Spaniards and later on the Americans.

The Philippines has, for a significant part of its recent history, been exposed to many foreign cultures and influences. The Spanish brought substantial changes to language and religion. The first accounting firms were established by the British in the 1700s. However, the comparatively short American colonial period was the most significant in influencing major Philippine institutions including the educational system and the formalization of the professions. A number of American businesses established themselves in the Philippines during the 1920s and 1930s. Their activities and requirements influenced the establishment and initial growth period of the public accounting profession. During this time, the passage of the Accountancy Act in 1923 created the first Board of Accountancy (BOA) and gave it the authority to issue Certified Public Accountant (CPA) certificates.

Six years later, the Philippine Institute of Certified Public Accountants (PICPA) was established within the private sector to represent professional interests.

Since many of the leading Philippine companies were subsidiaries or branches of American companies, their accounting necessarily reflected US practices. Even after independence, the Philippines maintained its close links with the US through trade and investment. These links strongly influenced public and private sector accounting regulations and practices. Until the quite recently, up to the mid-1990s, private sector accounting standards replicated those of the US. Occasionally, the local Accounting Standards Council issued pronouncements to cover issues not covered by the US standards such as revaluation of fixed assets. Beyond this, however, our accounting principles and practices were virtual clones of the American version.

Likewise, the Philippine accounting and auditing regulatory framework is patterned after the US framework and has imitated changes in the US through the years. It includes both governmental and a supervised form of self-regulation. This being the case, it was no

surprise to find similar loopholes in our own accounting and auditing systems when the scandals rocked our profession in the early years of the new century.

Let us now turn our attention to where the accounting profession is today and how we got here. As I mentioned earlier, I am sharing with you today recent developments in the accounting profession in the context of good governance as this is the single most profound driver for the changes that we have undertaken.

Setting the Standards for Good Governance

What exactly do we mean when we talk of good governance and why do we have to mention the tragic events of 2001 and 2002? I must say that while the words “good” and “governance” are not new, the appreciation for good governance the way that it is today came about only as aftermath of the Enron collapse and the bursting of the dot.com bubble. In fact, the issue has drawn so much attention to the extent that there is now an effort to establish worldwide benchmarks for good governance practices. In a speech before the Institute of Corporate Directors Associates and Fellows in November 2003, former Secretary of Finance Isidro Camacho said, “These regular international events enable us not only to check on the actual progress we are making towards improving the corporate governance practices in our economies, but also how well all of us help promote good governance reforms to the level of regional and international best practices.” Certainly, this development augurs well for the business sector and the economy as a whole but, it must also be said that it is one thing to talk about good governance, it is another to actually practice what we preach. In the same speech, Mr. Camacho further said, “It is possible that corporate governance has not been taken to heart because companies do not realize that good corporate governance can be translated into real gains. To think of corporate governance as just another fad would be nothing less than tragic. I believe that investors really do care about the way corporations are governed, and good corporate governance really does translate into better performance.”

Given this present perspective, allow me to backtrack a bit to trace the events which led to where we are today and the responses of the accounting profession to such events. In November 2003, the 103rd American Assembly comprising leaders from the worlds of accounting, finance, law, academe, media, and civil society together with current and former regulatory officials from the Federal Reserve Board, the Securities and Exchange Commission, the General Accounting Office, the Public Company Accounting Oversight Board, The Financial Accounting Standards Board, and the International Accounting Standards Board gathered together in Virginia, USA, to assess the present state of the accounting profession and to chart its future directions. In the opening paragraph of the conference proceedings, the Assembly boldly asserted that, “Never, in its lengthy history, has the accounting profession been required to deal with the kinds of challenges that it must confront today. A seemingly unending series of sensational accounting scandals has grabbed newspaper headlines over the last three years, eroding public confidence in the accounting profession and leading to the most sweeping amendments to the United States securities law since the Securities Act was passed by Congress in 1934...” Surely, the memory of the scandals that rocked the business world is still fresh in our minds and it serves to remind us

of the tasks and responsibilities now in our hands. I will paraphrase quite a bit from the American Assembly's report in this paper.

CPAs in the Philippines have not been spared of this challenge. Those of you here today who are my colleagues in the profession would know what we went through in the last three years and what we are now still hurdling as a consequence of those scandals. We've had our own share of such scandals in our country, and at the risk of offending some people, I dare say that we have not yet fully come to terms with the celebrated cases of Victorias Milling, Piltel, Ramcar, All Asia Capital, BW Resources, among others, and more recently the matter of financial reversals at CAP.

I suppose, just like our American counterparts, some of us in the profession succumbed to management pressure, agreeing to let management file incomplete or misleading financial statements. To some extent, we can blame these lapses on the way some accounting firms structured their compensation schemes, rewarding more the generation of new business rather than the quality of the audit performed. And since the audit profession serves as the public protector of the integrity of financial statements, the loss of confidence in the profession led directly to the loss of public confidence in the financial markets.

The scandals of course became a turning point for the profession. It led to a critical review of the principles and the rules and a re-examination of the practice of the profession. New rules were promulgated and new requirements were laid down. For example, companies have been required by the SEC to appoint independent directors; audit firms have been asked to separate their other advisory services to ensure independence; banks have responded to the call of the Bangko Sentral (BSP) for a reform agenda centered on promoting greater adherence to the enhanced standards on transparency, accountability, and fairness.

All these are elements of what I call the swing to the rightmost of the pendulum. It is perhaps basic human nature to react strongly in the opposite direction when we have become victims or when we have unwittingly or wittingly participated in acts that turned out to be harmful to many people. When we realize a mistake and accept our responsibility to rectify the situation, we tend to go to the opposite extreme, to overcompensate, in the hope that the mistake will never happen again.

Given the new zeal for good governance, what then should be the role of CPAs in ensuring that both the spirit and the letter of the law are respected? What changes are occurring in the accountancy profession? Are these good changes or are these extreme changes, representing the rightmost swing of the pendulum?

In response to the sensational accounting scandals, the US Government enacted the Sarbanes-Oxley Act of 2002 and consequently established the Public Company Accounting Oversight Board (PCAOB) primarily to restore public confidence in the accounting profession and install new safeguards in financial reporting. In the Philippines, the Securities and Exchange Commission or SEC promulgated a Code of Corporate Governance also in 2002. Listed companies generally complied and formulated their individual governance manuals and submitted these to the SEC. Even just a cursory look at the Code will show that there are many good provisions such as the requirement for independent directors;

setting up of audit and compliance committees by the Board; segregation of the Chief Executive Officer (CEO) from Chairman of the Board; listing of the qualifications of the members of the board; and others all intended to ensure transparency, accountability, and fairness in reporting the financial condition of companies. The Code further clearly delineates the relationship between the shareholders, the board, management, internal auditors and external auditors.

The challenge before us is to make this Code work, to change the way we work such that we will automatically comply with the Code without exerting special effort to do so. How do we transition precisely from the old ways of finding loopholes and going around the rules, the practice that brought about the scandals in the first place? Or how do we move from getting away with what's wrong rather than pursuing what's right? That change will have to come from each CPA in the profession. When we all start to do what is right, instead of what is convenient; when we decide in favor of the more conservative accounting method rather than the aggressive; when we adopt the benchmark treatment rather than the alternative; when we put our foot down and stand firm rather than bend with the wind of current thought and trend, that is when we will be able to make the Code work!

There is an ongoing argument in the accountancy world between principles-based accounting and auditing vs. rules-based standards. The common perception is that the U.S. was so rules-focused that the so-called "rule-checkers" became the source of all the problems. In contrast, it is believed that the International Audit Standards or IAS and the International Financial Reporting Standards or IFRS are more principles-based standards. The question posed to us then is whether the apparent dichotomy exists or it is just our perception that accountants may actually comply with all the rules but fall short of the principles. The 103rd American Assembly rejected this separation of rules and principles and concluded that the division is purely linguistic and artificial. In their conference document, they assert firmly that, "In practice principles must be accompanied by rules and vice-versa."

I cannot argue with that statement, but I also firmly believe that the CPA should be firmly anchored on basic concepts and principles. Rules and regulations will remain important but only in a supportive role. This should be the model for CPAs in defining their role in good governance, that is, providing guidance through their proficiency in basic accounting principles to Management and the Board. Our in-depth knowledge and understanding of the core principles and basic rules of accounting and auditing equip us with the wherewithal to exercise judgment – for indeed the CPA's role requires more and more judgment amongst the choices available. In an article in the April 2003 issue of *The Economist*, it says, "The reality is that producing and auditing a complete set of financial statements in our increasingly complex global economy is now more of an art than a science, and one must be, by definition, reliant on judgments that flow from experience and a sophisticated understanding of business and accounting."

Providing the voice of experience and sound judgment in many areas of subjectivity should be the order of the day for CPAs. In this role we may have to retrace our roots to the basics we learned in school. And having honed ourselves in the basics, we should continue to educate ourselves and learn from the experience of others. This is where continuing

education and lifetime learning become imperative. This is a role in which we can best serve our respective

corporations in their quest for good governance. I would like to think that the Accounting Profession has already realized that these are the necessary steps to take and the perfect role to play in the business community.

I believe that the burning issue of the day is the approaching “full” adoption of the IFRS. As it is now, we do not yet have adequate guidance or expertise available here, or for that matter even abroad, to ensure the successful, seamless adoption of International Accounting or Financial Reporting Standards. Perhaps the large accounting firms with their international affiliation can claim knowledge and expertise, but the problem lies in the fact that these accounting firms are not the only ones who are tasked to implement IFRS. How about the thousands of small firms or the individual CPA practitioners all over our country? What about the business educators like some of you here today who will now have to teach the new standards to students? And then, how do we deal with our fellow CPAs who serve in the Government? or those in small and medium enterprises? They are the ones, more than those in the big CPA firms, who really need to become very well conversant in the new accounting standards.

May I point out some of the most pressing and practical implementation issues that we face in relation to the adoption of international accounting standards. First is the need to prepare budgets and financial plans using IFRS. Quite a number of the new international standards (improved standards) are coming on-line only in 2005. As of today, some of these standards are still going through some revisions at the level of the International Accounting Standards Board (IASB) yet we are already expected to prepare our budgets using these standards. For instance, IAS 19 on Employee Benefits would require the recognition of the Company’s liability arising from such benefits as soon as the employee has provided the service in exchange for such benefit. It does not matter much whether these are short-term benefits such as rice subsidies, de minimis payments, vacation and sick leaves or post-employment benefits such as retirement plans, life insurance, or medical care. IAS 19 requires the liability and the expense arising from these employee benefits recorded. As you are aware, many companies do not have formal retirement plans, much less funded retirement plans, and even less, actuarially- valuated retirement plans.

Second is the retroactive application of certain Standards. IAS 27 which covers Consolidated and Separate Financial Statements has been revised. We are more or less familiar with consolidation, and the use of the equity method in accounting for investment in subsidiaries in the financial statements of a parent company. I understand, however, that in the revised IAS 27, the parent company financial statements (F/S) will be carrying investments in subsidiaries at cost, instead of at equity in most situations. If this is correct, then we have to restate three or four years of previous financial statements in 2005 when we issue comparative financial figures. Most of the IAS that will take effect in 2005 will require prior period restatements.

Third is IAS 17 on leases which already took effect this year. Almost all of us who rent offices, or equipment or real property are affected by this standard. Since it requires the leveling of rental expense or income (depending on your point of view as lessor or lessee) over the period of the lease, we now have to reckon the average lease figure from day 1 of the lease agreement. This poses a distinct difficulty because generally our lease contracts have an annual escalation clause and we accordingly record the lease amount in accordance with such agreement. Just think of the implications on the Value Added Tax or VAT, on withholding taxes, and on income taxes that the poor accountant will now have to track because of the timing differences in recording for tax and for financial statement purposes.

There is also the issue of long-term deposits such as what we have for our telephone lines, our power connection, and rental contracts. Under IAS, these deposits will now assume the nature of a financial asset (receivables) that one has to reflect at present value. As you all know hardly anyone among us bother to claim such deposits for utilities while our rental deposits are refunded only when we leave the rented premises. Does this mean then that we should all zero out these deposits in our financial statements because they are essentially worthless in today's money terms?

Another critical issue is the matter of BSP rules and regulations, more commonly known as Regulatory Accounting Principles, as well as other tax rules and regulations that do not follow the Generally Accepted Accounting Principles or GAAP. For instance, the BSP allows the staggered booking of the provision for doubtful accounts. In some instances, it even allowed the charging of doubtful accounts directly to surplus. This practice does not conform to GAAP, nor does it comply with IAS and Basel II.

One last example, under the new IAS 12, income taxes and deferred income tax are required to be recognized for revaluation of assets. If, for example, you decide to appraise fixed assets in order to reflect the revalued amounts in your balance sheet to improve stockholder's equity, you will now have to consider that your revaluation increment in equity will have to be reduced by the amount of deferred income tax accruing from such revaluation increment. If that does not sound confusing enough, IAS 12 also provides that depreciation on appraisal increase which used to be accounted for as a permanent difference in computing for deferred income tax will now be also subject to deferred income tax. To further compound the issue, selective revaluation is no longer allowed. Quite recently, many companies have received inquiries from the SEC asking why not all of their assets have been revalued even if the company has stated that it has adopted this as its accounting policy.

These are just the most urgent and most demanding of the present issues we face as practicing accountants, whether in corporate settings or in public practice. I know that we are poised to encounter more issues and difficult questions as we move forward with aligning our accounting practices in the Philippines with international standards. The Banker's Association of the Philippines and the Pre-need industry have written the SEC asking for postponement of certain international accounting standards. It will be interesting to note how the SEC will respond to these requests. That response will give us an indication on whether full adoption of International Financial Reporting Standards (IFRS) will be seriously monitored and implemented. Obviously, we are far from the end of the road. This thought brings me back to what I said at the beginning and that is, that we must begin from ourselves.

The experience of the accounting profession over the last three or four years is for me like a journey into the night, fearful and with a lot of struggle against our own demons, imagined and otherwise. Now, we are emerging into the light, waking up to a new day and a new beginning. And with this fresh start, we have redefined ourselves into the guardians of good governance.

CPAs: Leading the Way for Good Corporate Governance

“When the going gets tough, the tough get going,” we often say when we need to prime ourselves for demanding challenges ahead. The Accounting Profession is now in such a time and we must heed the call to lead the way to good governance. Accounting information is invariably used in a variety of market transactions and all stakeholders of business rely on the reliability, uniformity, and relevance of financial information presented to them. They assume that the disclosures are adequate, the figures realistic, and the credentials and reputation of the CPA preparing the financial statements are impeccable. The demand on CPAs today is to be like Caesar’s wife – above reproach.

To be fair, it must be said that the accounting scandals were not the only cause of the redefinition of the accounting profession. Accounting rules and practices are likewise shaped by economics and politics, and to some extent by social norms. Recent developments that have equally prompted the re-examination and change in the profession are the progressive globalization of the markets in which accounting reports are used, and the heightened internationalization of the political influences on accounting, particularly the growth of efforts among nations to coordinate their regulation of capital markets.

To all of these developments, the response of the accounting profession as a whole and of the individual CPA in particular, whether he is in the academe, the government, business, or public practice, has been highly commendable. The CPA has moved on from the stigma of the accounting scandals to addressing what is wrong, to correcting the errors, to adopting new and more stringent accounting and auditing standards, to remodeling the accounting curriculum, and to attracting the best and the brightest, so that once again the CPA will be the role model for all the professions. Like the mythical phoenix rising from the ashes to live again, the accounting profession is not only redeeming itself but is going even another step further: **HE IS LEADING THE WAY TO GOOD GOVERNANCE!**

In closing, I would like to paraphrase from the Good Book: “What does it profit a man if he gains the whole world and loses his soul in the process?” It is the individual’s integrity, professionalism, and ethical practice that make the difference. At our shop we try very hard to learn by doing, to preach by practicing, and to abide by such timeless principles: **INTEGRITY, QUALITY, EXCELLENCE!**.....Hoping that in the end we are able to redefine our partnership, with our people, with our clients, with the business community, with our profession.

Again, thank you for making me a part of this event and my wishes to the organizers and all the participants for a successful completion of this conference.

Good day.