

Striking a Balance between Protecting Public Interest and Fulfilling Professional Responsibilities

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Distinguished guests, ladies and gentlemen:

It is my honor to be here in magnificent Rome, the Eternal City, for the Congress. *“Fighting Corruption and Fraud: The Role of Professional Accountants”* is truly an important issue for the accountancy profession, as well as for the public. I appreciate the opportunity to share with you my understanding and views on this subject. Here, I will focus on the role of practicing accountants, namely auditors.

I. Raising the Question

Regarding the role of practicing accountants in fighting corruption and fraud, we should be clear that in providing auditing and assurance services, practicing accountants assume an important responsibility in protecting the public interest. Specifically, practicing accountants, as the independent party, provide auditing services, and thus reasonable assurance for the truthfulness and reliability of financial information, thereby protecting the public interest.

Through their conduct of audits, practicing accountants have already played significant roles in fighting corruption and fraud with the work that they do. They identify, in their unique professional ways, illegal activities such as corruption and fraud, and prevent these activities from undermining the reliability of financial statements. In other words, for identified illegal activities which may have material effects on financial statements, practicing accountants can help eliminate the effects of such activities and maintain the quality of the accounting information by communicating with management and those charged with governance and proposing appropriate adjustments and disclosures. In this process, practicing accountants act like “referees” and the auditor’s reports are their “whistles”, through which they express an opinion about whether the financial statements are truly and fairly presented, thereby playing a role in protecting the public interest.

Now there is a new issue before us, which is that the public increasingly expect practicing accountants to report identified illegal activities to regulatory institutions while remaining responsible for preventing corruption and fraud from damaging the quality of financial information. Since the beginning of the 21st century, a number of well-known financial scandals have occurred worldwide. Consequently, public condemnation of financial scandals is on the rise and there is the call for practicing accountants to assume some responsibility in this regard.

II. Our Analysis

Should the practicing accountants have a responsibility to report illegal activities of their clients? If so, how should they strike a balance between meeting regulatory requirements and keeping their confidentiality obligation to their clients? How should they protect the public interest while fulfilling professional responsibilities?

First, we should distinguish between the core role and the extended role of auditing.

Practicing accountants identify illegal activities to the extent that such activities affect the fair presentation of the financial statements of the clients. The less related are the illegal activities to transactions and events reflected in the financial statements, the less likely they will be identified. In this sense, from the professional point of view, practicing accountants are responsible for identifying illegal activities that materially affect financial statements as opposed to preventing the occurrence of such activities at the entities. That is, the core role of auditing is to express an opinion about whether the financial statements, in all material respects, are prepared in accordance with the applicable financial reporting framework, thereby providing reasonable assurance for the quality of the financial statements.

Reporting illegal activities to regulators can be regarded as an extended role of practicing accountants. It may be that practicing accountants can carry out their core role and the extended role equally well; however, the latter should not adversely affect their ability to carry out the former. Smooth and effective communication and coordination between practicing accountants and their clients is critical to accomplishing the objectives of auditing. Should practicing accountants be required to undertake the responsibility for reporting illegal activities, this may result in the audited entities being overly cautious and even willfully conceal information from the auditor. Hindered communication will affect the ability of the practicing accountants' core role in performing the audit. Thus, appropriate institutional arrangements are needed to prevent the occurrence of such scenarios.

Second, audited entities should be charged with the responsibility of reporting illegal activities.

Management and those charged with governance are responsible for guarding against, identifying and rectifying illegal activities and should also be held responsible for reporting these illegal activities. They should acknowledge and assume the responsibility for designing, implementing, and maintaining necessary internal

controls so as to be able to guard against, identify, and report illegal activities.

Along with audit work done, where illegal activities are identified, practicing accountants communicate with the appropriate level within management or those charged with governance to come up with a solution instead of taking the responsibility for disclosure onto their own hands. From this perspective, it is the client that is responsible for reporting illegal activities identified.

What is China's Solution to this Problem?

Now, I would like to discuss how China deals with this issue. Though this issue much concerns accountants in business, it is also helpful to consider circumstances faced by practicing accountants.

When the *Accounting Law* was first adopted in China in 1985, it stated, "Where any administrative staff of an entity who is in a leadership position insists on processing receipts or payments, which is believed to be in violation of the state's financial laws and regulations, the accounting department and accountants of such entity shall submit a written report to the competent superior authority requesting the matter to be dealt with and report the matter to the audit office of the government. Those that do not submit such a request shall be held responsible for such receipts and payments."

In 1999, this article in the *Accounting Law* was amended. First, the amendment emphasized the accountability of an entity's leadership by stating: "The person in charge shall be responsible for the truthfulness and integrity of accounting work and accounting information". Second, revision was made to the part regarding accounting departments and accountants' responsibility for reporting unlawful activities by stating that the accounting department and accountants shall "have the right" rather than are mandated to report the matter. In other words, the Law defined reporting unlawful activities as the accountant's legal right rather than a legal obligation .

The amendment of the *Accounting Law* reflected the legislative institution's deeper understanding of where the responsibility for guarding against illegal activities lies. It redefined accountants' roles and responsibilities in fighting corruption and fraud and thus addressed the practical issues caused by the imposition of excessive responsibilities on accountants in the previous version.

III. Solutions to the Problem

Although entities have the main responsibility for guarding against, identifying, and reporting illegal activities, practicing accountants have their fair share of professional responsibilities and ethical obligations. Based on the above discussion, I would like to propose the following three suggestions regarding how we should look at and bring into play practicing accountants' role in fighting corruption and fraud.

Firstly, practicing accountants should diligently fulfill their professional

responsibilities.

Due diligence is not only a requirement of professional standards but also an ethical obligation. Practicing accountants are responsible for providing high quality auditing services and providing reasonable assurance that financial information is true and fair. These are important ways by which professional accountants safeguard the public interest. Therefore, practicing accountants should, in fulfilling their professional obligations of ensuring independence, objectivity, and fairness, continue to acquire and improve their professional capabilities, including that of identifying illegal activities that are likely to have material effects on financial statements, maintaining due care, being diligent in fulfilling their professional responsibilities.

Secondly, distinguishing between positive reporting and passive reporting.

Appropriate institutional arrangements are necessary to enable practicing accountants to do a good job in carrying out their responsibilities and reaching a balance between protecting the public interest and fulfilling professional responsibilities. We suggest making a distinction between positive reporting and passive reporting when considering the manner for reporting.

Positive reporting should be regarded as a right. Practicing accountants may opt for positive reporting to regulatory authorities when illegal activities are identified. When exercising this right, positive reporting should not result in violation of confidentiality. Similarly, practicing accountants may also choose not to report. In this case, they should not be subject to legal responsibilities and obligations.

In contrast, passive reporting should be regarded as an obligation. Notwithstanding that practicing accountants can opt not to make a positive report, they shall be liable for making a passive report. Such an obligation is reflected in two aspects: on the one hand, in response to inquiries and investigation by regulators, practicing accountants should cooperate and provide all relevant information they have acquired and possessed and should not conceal information on the basis of confidentiality; on the other hand, practicing accountants should request the entities involved to report and rectify the illegal activities, and should consider terminating the engagement when the entity refuse to do so for the entity's credibility is highly questionable in this case. Termination of engagement may be regarded as an important form of passive reporting by the practicing accountant.

Thirdly, strengthen cooperation and coordination in fighting corruption and fraud.

Each organization and profession plays a unique role in economic management. No single role can be substitute for another. Anti-corruption and fraud requires a systematic effort, so it is necessary that all parties, including entities, practicing accountants, regulators, and others, be fully involved and enhance cooperation and coordination with each exercising their own strengths to the fullest extent.

While practicing accountants diligently carry out their professional responsibilities,

entities should strengthen their corporate governance, improve governance structure, enhance internal control and enable auditing committees to play their roles. Eradicating illegal activities from their sources is fundamental to efforts to prevent and rectify such activities.

Regulators should continuously improve concepts and methods of regulation for greater regulatory efficiency and effectiveness. Regulators have distinctive advantages in discovering illegal activities, including a variety of channels, means, and capabilities for accessing information, and the key is how to leverage these. For instance, they may conduct intensive, in-depth reviews of relevant information reflected in financial statements and audit reports, which may provide clues leading to the identification of illegal activities. Also, they should be alert to an accounting firm's withdrawal from an engagement, for it might have been motivated by the presence of illegal activities. Specifically, they should request the entity to provide an explanation for such decision and make inquiries with the accountants concerned so as to prevent any breaches.

Finally, I'd like to thank the organizers of the Congress for giving me this opportunity to speak and to share my views .

Thank you all for your attention!