

The Financial Reporting Council: a policy review

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Background

- FRA enacted in Bangladesh on September 6, 2015
- Led to the establishment of the Financial Reporting Council-an independent oversight body for the accountancy profession
- Mixed reaction from professional bodies and other stakeholder groups
- Objective of this presentation is to present:
 - A context for audit oversight in Bangladesh, and the formulation of the FRC
 - Concerns regarding the FRC
 - Proposal regarding potential ways ahead

The audit profession in Bangladesh: institutional context

- ICAB created by the Chartered Accountants Order 1973
- Historically self-regulated
- Problems with
 - Poor demand for qualified accountants (at present, ICAB has around 1,600 qualified members)
 - Failure to attract the best graduates (also, students entering the profession sometimes have poor communication skills, sometimes attributed to weaknesses in the tertiary education system)
 - Lack of disciplinary actions against members
 - Perceptions regarding poor quality audit
 - Poor levels of audit fees (significantly lower than India, Pakistan, Sri Lanka)

Positioning ICAB within the international financial architecture

- International Financial Architecture: ICAB is a member of the International Federation of Accountants (IFAC)
- Has to comply with IFAC's Statement of Membership Obligations (SMO) dealing with audit quality, education, disciplinary procedures, and code of professional ethics
- IFAC's compliance programme is supported by the international development community through the Memorandum of Understanding to Strengthen Accounting and Improve Collaboration (MOSAIC) programme
- Aim is to improve capacity of local accountancy profession

The audit profession in Bangladesh: institutional context

- Following World Bank ROSC and IFAC MOSAIC, the audit profession has gone through some significant reforms in recent years
- Major initiatives include-
 - Twinning arrangement with ICAEW for sustained improved in education and training provided by the ICAB
 - Establishment of ICAB's Quality Assurance Division (QAD): each audit firm has to be visited once in every 3 years

The audit profession in Bangladesh: institutional context

- Despite such initiatives, concerns regarding investigation and disciplinary functions of ICAB have remained
- Calls for an 'independent' regulator after the stock market crash of 2010
- However, in Bangladesh, (small) investors' knowledge about the auditing function is sometimes questionable- prior research (Siddiqui et al, 2009) suggests presence of 'knowledge gap' regarding the actual and perceived functions of the auditors
- ICAB has not been able to allay the concerns of the stakeholders

Regulatory response: the Financial Reporting Council

- Originally proposed by the World Bank ROSC report 2003. However, World Bank ROSC (2015) changed their views on FRC in Bangladesh, deeming it not to be necessary
- Financial Reporting Act passed by the national parliament on September 6, 2015
- FRA requires formulation of the FRC
- Mixed reactions

FRC Bangladesh

- Major areas of concern:
 1. Composition of the FRC
 2. Potential duplication of work between the ICAB and the FRC
 3. Unintended consequences of criminal actions against auditors
 4. Lack of Corporate Governance focus

1. Composition of the FRC

- Led by a Chair appointed by the government
- 12 member body (including Chair and CEO)
 - Six government nominees (in addition to chair/ CEO): representatives from the MoF, MoC, CAG office, Bangladesh Bank, BSEC, NBR
 - One Professor of Accounting from a public university
 - One representative from FBCCI
 - Two representatives of the accountancy profession (as ex-officio members)
 - Only ONE chartered accountant!

1. Composition of the FRC

- Inclusion of broader stakeholder groups to avoid 'conflict of interest'?
- However, much of FRC's function would involve overseeing the work of professional accountants as well as adoption of international accounting and auditing standards
- This requires highest degree of professional skill and competence in the area of financial reporting and auditing
- Would the proposed members, despite being highly competent in their relevant fields, be able to deliver this?

Composition of the oversight bodies in UK and USA

- PCAOB: five member board, two lawyers and two non-practising CPAs
- FRC UK:
 - 15 member board appointed by the government
 - Current Chair is a former banker
 - Six non-practicing chartered accountants, one qualified actuary
 - Two former CEOs of FTSE100 companies
 - One former permanent secretary
 - All members have substantial experience in accounting and auditing standards setting

<https://www.frc.org.uk/About-the-FRC/FRC-structure/FRC-Board/Members.aspx>

UK FRC: recent crisis

- In March 11, 2019, the UK government announced that the FRC will be scrapped and replaced by a new regulator for accountancy firms: The Audit, Reporting and Governance Authority
- This follows criticisms of the FRC by the Kingman Commission (2018):

‘A new board should be appointed. It should be significantly smaller than the FRC’s. It should not seek to be “representative” of stakeholder interests’ (Kingman Commission Report 2018, p. 9)

Composition of the FRC: international comparisons

- India: National Financial Reporting Authority Rules 2013
- The ICAI filed a case against the formulation of the NFRA, which was overturned by the Supreme Court in November, 2018
- The NFRA's composition:
 - Chairperson being a Chartered Accountant
 - Members – Accounting, Auditing, Enforcement;
 - Representatives from MCA, RBI, and SEBI
 - A retired Justice of a High Court
 - President of the Institute of Chartered Accountants of India (ex-officio)

Composition of the FRC: international comparisons

- Malaysian Accounting Standards Board (MASB)
 - 11 member board
 - Chair is a member of ICAA (Australia)
 - Three practicing chartered accountants
 - All three government nominees, the AG, and the representative from KL stock exchange and board of revenue Malaysia are chartered accountants
 - One university professor: an ACCA with a PhD in auditing
 - Two representatives from the industry, both qualified accountants (one chartered accountant and one ACCA)

Composition of the FRC: international comparisons

- Nigeria: Financial Reporting Council established in 2011
- Chair is a professional accountant (members of ICAN or ANAN)
- Four professional accountants (representing ICAN and ANAN)
- Many government nominees: Office of the Accountant General of the Federation ; Office of the Auditor General for the Federation ; Central Bank of Nigeria ; Corporate Affairs Commission ; Federal Inland Revenue Service ; Federal Ministry of Commerce ; Federal Ministry of Finance ; Securities and Exchange Commission ; National Insurance Commission ; Nigerian Stock Exchange ; National Pension Commission

2. Duplication of work, capacity development and resource constraints

- Global regulatory environment: as a member of the IFAC, ICAB is bound to comply with the IFAC SMOs, including adoption of IFRS and ISAs
- Adoption of international accounting and auditing standards requires substantial skills and expertise of the members
...and significant resource commitment

Duplication of work, capacity development and resource constraints

- FRC will monitor if the international accounting and auditing standards, as adopted by the FRC, are being properly implemented by the companies.
- The implementation of IFRS and ISA is a challenge for many companies.
 - However, this is a mammoth task that will require significant resource commitments.
- The BSEC, even after 25 years of existence, still struggles to monitor the implementation of IFRS in listed public companies due to resource constraints

Duplication of work, capacity development and resource constraints

- Bangladesh has a very small number of professionally qualified accountants
- The vast majority of accountants working in the PLCs do not have a professional accounting qualification, making implementation of IFRS difficult
- No 'second-tier' accountancy body
- If this remains unchanged, FRC inspections would not be very fruitful

Duplication of work, capacity development and resource constraints

- Each practising audit firm will be inspected by the FRC once in every three years
 - such inspection would involve looking at the performance of the auditors as well as questioning their judgements in individual audit assignments through detailed inspection of working papers
 - this would require substantial resource commitment as FRC would need to hire professional accountants for such review.
 - May not be easy with existing salary offered in competing regulatory bodies (eg BSEC)
- ICAB has a Quality Assurance Board and a Quality Assurance Department assisted by ICAEW which has been functioning in the area of audit and assurance practice review.
- Hence, some activities of FRC may turn out to be mere duplications of the functions already conducted by the ICAB, and give rise to potential complications

3. Criminal actions against auditors: potential unintended consequences

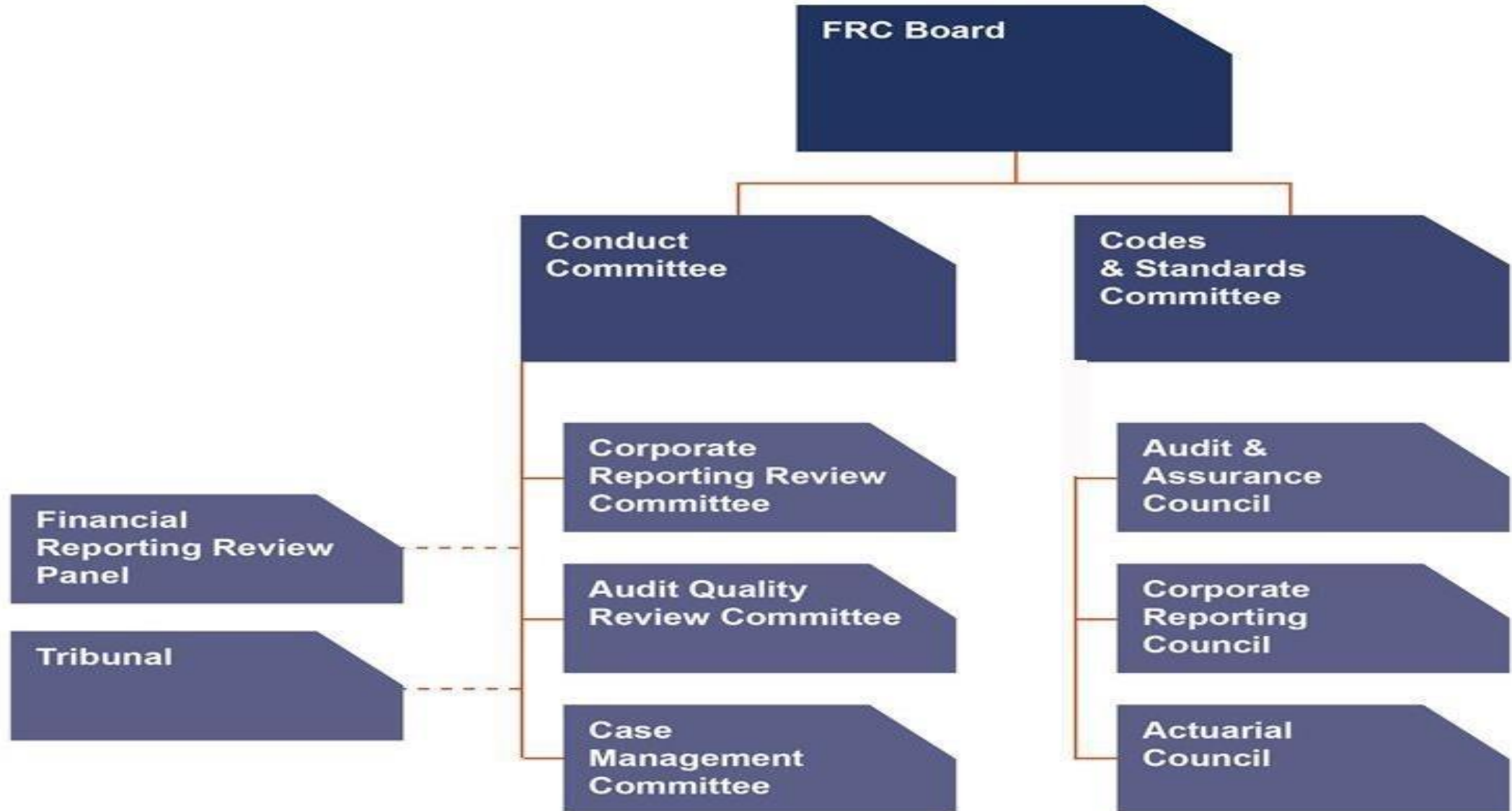
- The FRC has been entrusted with substantial power to take disciplinary actions against auditors.
 - The maximum punishment imposed by similar regulatory bodies is debarring an auditor (or audit firm) from practice (maximum 10 years, NFRA 2013)
 - In Bangladesh's case, the maximum punishment of 5 years imprisonment
- Bangladesh already has a shortage of qualified accountants, and such provisions might further reduce the profession's ability to attract bright students.
- Providing such sweeping power to any regulatory (non-judicial) authority may create scope for potential corruption

4. Lack of corporate governance focus

- The FRC's core functions do not include promoting standards and codes on corporate governance
- Similar bodies around the world (for example, FRC in the UK) consider issuing codes on corporate governance (for companies) and stewardship (for investors) as one of their major functions.

‘The FRC has been an effective custodian of the UK Corporate Governance Code, which is still rightly regarded as world-leading’
(Kingman Commission, UK, 2019)

4. Lack of corporate governance focus



4. Lack of corporate governance focus

- Similar arrangements in other countries
 - FRC Nigeria issues and updates Code on Corporate Governance.
 - In January 2019, it issued an updated New Code on Corporate Governance (Nigeria FRC was formulated through the FRC act in 2011)

FRC: towards an effective oversight mechanism

1. Structural issues

- Composition
- Duplication of work
- Criminal actions against auditors

2. Core functions

FRC: structural issues

- Potential problem with expertise, resulting from the lack of presence of Chartered Accountants
- The MoF might consider revising the existing formation of the FRC board so that the right balance between competence and independence can be achieved
- Alternatively, the ex-officio members (from MoF, MoC, Bangladesh Bank, NBR, FBCCI, BSEC) can nominate professional accountants who would represent these agencies in the board.

Composition of the FRC: international comparisons

- Malaysian Accounting Standards Board (Financial Reporting Act, 1997)
 - the Secretary General of the Treasury or his **representative**;
 - the Governor of the Central Bank or his **representative**;
 - the Chairman of the Securities Commission or his **representative**;
 - the Chairman of the Audit Oversight Board or his **representative**
 - the Registrar of Companies or his **representative**;
 - the Chief Executive Officer of Bursa Malaysia Berhad (KL stock exchange)
 - The President of the Malaysian Institute of Accountants
 - Four other members who possess knowledge and experience in matters of financial accounting and in one or more of the following fields: law; business; or finance

Composition: MASB

Members	Qualifications
Chairman, Malaysian Accounting Standards Board	FCA
Accountant General of Malaysia	CA
Group Chief Executive Officer, Islamic Banking	FCCA, CA
Executive Director & Group Chief Financial Officer, Sime Darby Property Berhad	FCCA, CA
Chief Financial Officer, Prudential BSN Takaful Berhad	FCA, ICAEW
Partner, E&Y	FCA
Partner, local Malaysian audit firm	CA
Professor of Accounting, International Islamic University Malaysia	PhD, FCCA
Nominee, Securities Commission Malaysia	CA, CPA
Nominee, Companies Commission Malaysia	FCCA, CA

SLAASMB

Chairman

*Nominee of the Governor,
Central Bank of Sri Lanka*

R.A.A Jayalath BCom(Hons), MBA, MA, FCA

Ex Officio Members

Registrar General of Companies

D.N.R. Siriwardena B.A. (Hons.), Attorney-at-Law, LLB

Commissioner General
Department of Inland Revenue

Mr. Ivan Dissanayake BA (Sp), FPFA

Director General
Securities and Exchange
Commission of Sri Lanka

V.P. Wijegunawardane BA(Hons), M.Sc.
(Finance Economics)

Nominees

ICASL

A. Herath B.Sc., MBA, FCA

L.L.S. Wickremasinghe FCA, FMMAT

W.W.J.C. Perera FCA, B.Sc. (B.Admin), CFE

Chartered Institute of
Management Accountants of UK
(Sri Lanka Division)

S.N. Jayasinghe FCMA(UK)

Bar Association of Sri Lanka

P.L.C. Peiris Attorney-at-Law, FCA, FCMA(UK)

Ceylon Chamber of Commerce

Ms. N. Sivapragasam FCA, FCMA(UK)

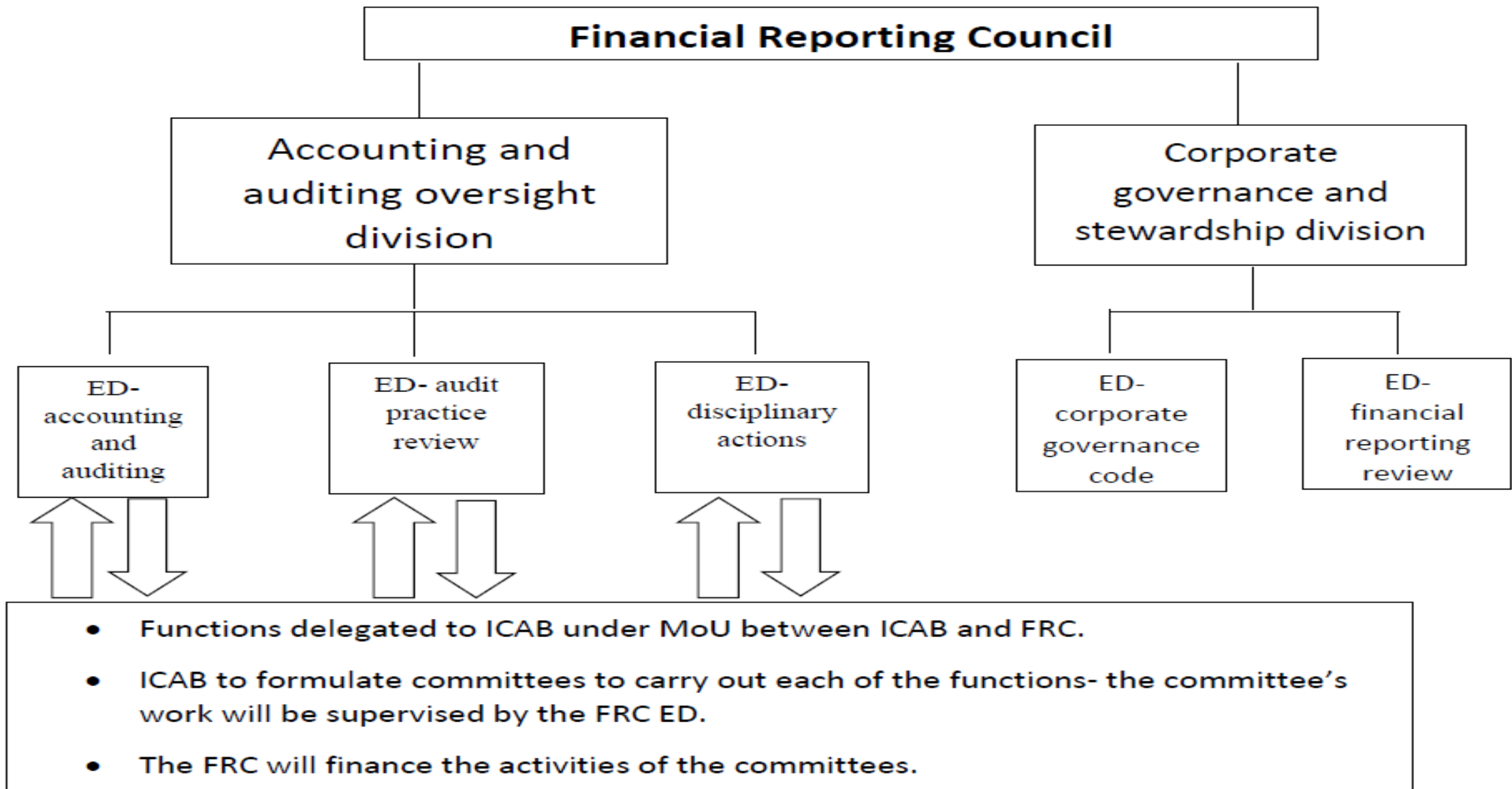
Sri Lanka Banks' Association

D.A.De Vas Gunasekara FCA, FSCMA

Duplication of work, and concerns regarding resources constrains

- There could be a transitional arrangement that would allow **FRC to delegate some its functions to the ICAB** for a mutually agreed period, until the FRC develops its own capacity to conduct such activities independently
- Requires changes within the FRC structure
- Such an arrangement is not uncommon- a significant number of global public oversight bodies have such arrangements in place (<https://www.ifiar.org>)

FRC and ICAB: a proposed framework of cooperation



2. Core functions of the FRC: Corporate Governance Regulations

- Bangladesh is one of the few countries in the world without a code of corporate governance that is applicable to all public interest entities.
- There are corporate governance orders issued by the BSEC and the Bangladesh Bank, but these are only applicable for listed and banking companies respectively, leaving the vast majority of public interest entities (including unlisted public limited companies, large charities, and NGOs) to operate in a virtually unregulated space.
- The FRC has a much larger remit compared to the BSEC or the BB

Corporate Governance Regulations

- The high degree of family ownership in the corporate sector in Bangladesh has given rise to a corporate culture where the value of corporate governance mechanisms are usually undermined.
- Important corporate decisions are made in informal family meetings, sometimes making formal board meetings a symbolic practice.
- The scarcity of qualified and skilled individuals in the corporate sector has resulted in a small pool of non-executive directors that the companies can choose from, giving rise to a familiarity threat that would undermine the role of non-executive directors as an important corporate governance mechanism.
- The role of audit committees have remained largely questionable, mainly due to the tendency of choosing family members (allowed due to the narrow definition of families in the existing regulations) and close associates as members of the audit committee.

Corporate Governance Regulations

- Bangladesh does not have sufficient numbers of qualified internal auditors.
- The vast majority of companies operate without a Chartered Accountant
- This, combined with the lack of interest/resistance from the family owners regarding financial transparency results in poor quality financial reporting
- An auditor only explains an opinion on the truth and fairness of these financial statements
- The HORSE needs to come before the CART!

Corporate Governance Regulations

- The FRC should be the SOLE custodian of the Code of Corporate Governance
- Will be responsible for the continuous development and updating of the Code
- The FRC will monitor implementation of the Code

2. Core functions of FRC: Audit fees

- Audit fees in Bangladesh are significantly lower than India, Pakistan and Sri Lanka
- ‘Dominant family control in listed companies has resulted in a corporate culture where governance functions such as audit are usually ignored by the family owners’ (Siddiqui, 2010)
- Clients are reluctant to pay higher audit fees, and they do not see the ‘value’!
- Lack of demand for high quality audit- previous research indicates that larger firms do not earn significant audit premium in Bangladesh (Siddiqui, 2016)
- Lower audit fees can drive lower audit quality- a comprehensive audit would require sufficient audit hours- this is not supported by the current fee regime in Bangladesh
- These are all outside the purview of the FRC!

Audit fees

- Improvements in audit quality can only be facilitated by higher audit fees, allowing the audit firms to
 - Allocate sufficient audit hours for a client
 - Maintain proper documentation/audit trails that can be traced later
 - Hire and retain high quality staff
- This would justify the FRC to take stricter disciplinary measures against audit firms
- The FRC needs to ensure that the audit fees paid to the auditors are sufficient for the purpose of a quality audit, and ensure compliance with such an arrangement (reduce undercutting!)

Conclusion

- FRC needs be viewed as an opportunity, not a threat!
- Concerns regarding control needs to be eliminated
- Consideration of issues relating to FRC structure, duplication of work between the FRC and ICAB, and disciplinary actions against auditors
- Wider cooperation between the ICAB and the FRC
- Rethinking the core functions of the FRC