Editorial

Seeing the vision

International Journal of Disclosure and Governance (2007) 4, 75–78.
doi:10.1057/palgrave.jdg.2050050

In November 2006, the CEOs of the six largest public audit firms issued a vision statement on the future of accounting, calling for change in almost all aspects of the way in which their businesses operate.¹ For an established industry to come together and draw attention to failings in their own business models and to invite rather than resist radical change is an unprecedented act. And yet, and most disappointingly, reaction to this statement focused narrowly on the claim that it was a device to reduce auditor liability, as exemplified by the headline in *the New York Times*.² Granted, the past history of these firms in pushing for tort reform in the US and the inclusion of liability waivers in audit engagements invites suspicion of self-serving behaviour. And yet, such a narrow point of view risks throwing the baby out with the bathwater. The big picture remains that a vital industry is admitting that the ways in which it operates now cannot be sustained and that a whole new paradigm has to be constructed if the industry is to remain viable and relevant.

Consider, first, the points the report makes about financial reporting: ‘Over the longer run, experts agree that the current systems of reporting and auditing company information will need to change — toward the public release of more non-financial information (some or much of which may be industry-specific) customized to the user, and accessed far more frequently than is currently done. It is time, therefore, for all global capital markets stakeholders involved to launch a process that will lead to the development of a new business reporting model, with a clear identification of the role of the independent audit and requirements dictated by that model.’

Note the key role of the consumer of accounting information in determining what adds value and what form disclosures should take. This has the potential to democratise the accounting industry that for far too long has relied on a ‘you take what we choose to give you’ model.

Of course, not everyone has reacted to the call for a new reporting system with equal enthusiasm. In an uncharacteristically short-sighted, and frankly, bone-headed commentary, *The Economist* chose to ridicule the vision statement:³ ‘In their Utopian fantasy, out would go quarterly reports loaded with complex historical figures and rules-dictated footnotes. Instead, readily accessible updates on a company’s state of health would be posted in (almost) real time on the internet. Not only would this put more onus on companies to post meaningful, rather than selective, information on their websites; it would also conveniently reduce the potential liability of the auditing company. An auditor would apply principles, not rules, to judge the fairness of a company’s numbers. And the judgment would be a rolling opinion, not one set in stone at the end of each reporting period. Neat, it is true, yet a bit naive. The beancounters are right that few investors or analysts use financial reports as anything more than a rear-view mirror these days. They would prefer forward-looking information including “soft” data on customer relationships, staffing levels and product development. But whether such information can be standardised enough to be computer-readable for comparison on company websites is questionable. So is the likely effect on share-price volatility of quasi real-time data: would it make some investors even more short-

termist in their outlook? And how would the market cope with the inevitable revisions?' Good questions, but again, the focus on the liability issue results in a criticism that effectively endorses the status quo and ignores the dramatic nature of the change proposed by the vision statement. And this in an article that concludes, contradicting all the snide comments made earlier, that 'the reporting exercise that firms and their auditors are expected to go through is increasingly seen as meaningless and irrelevant.' Indeed. And unlike *The Economist*, the industry is at least proposing doing something about it.

Returning to the vision statement, attention should also be paid to the call for more frequent reporting. When Section 409 of the Sarbanes-Oxley act called for 'Real time issuer disclosure,' it seemed to hasten a system of continuous reporting that some had been calling for. But the response of the SEC when implementing Section 409, which involved moving up the filing deadline for 10-Q's from 45 days from the end of the quarter to 35 days is a far cry from the disclosure on a 'rapid and current basis' as specified in Section 409.

Now instead of resisting change, the accounting industry is itself calling for far more frequent reporting, responding to today's net savvy users who demand that accounting information look like all the other data they gather from the web: up to date, customised for their needs and easily accessible in electronic form: 'It takes only a bit of imagination to realize that digitization and Internet can enable users of company data to customize what information they want and how they want it presented, in much the same way that they are now able to customize the products and services they are now able to purchase. For example, some investors may want to know the earnings, cash flows, and perhaps other variables for a company currently and over some past period. Others may want each of these variables compared to other companies in the same industry or a similar "peer group," or compared to averages for the market as a whole (or some portion

thereof). And why, in a world where most public companies' financial records are, or soon will be, in digitized form, should investors and other parties have to wait for a full quarter to receive pertinent financial information? Technology allows far more frequent disclosures, even daily, although with different levels of assurance about its accuracy than for financial statements that are subject to regular audits. Why shouldn't investors at least have access to information thus disclosed more frequently (assuming that the processes for generating that information have been audited)?'

The report also call for regulators to speed up the glacial process of 'converging' US GAAP with the IFRS standards used elsewhere in the world, while bluntly stating that both of these are interim measures that have to be surpassed by standards that explicitly take the technology-driven business of the 21st century into account.

The vision statement fully recognises the impact of globalisation: 'Ultimately, what investors and other stakeholders of public companies want and need is information that is relevant, reliable, timely, simply presented and comparable across jurisdictions so that all stakeholders have a way not only of accurately measuring past performance, but more importantly, making the best possible projections of future company performance. In a global setting, this objective can be attained only if earnings, cash flow or any other item of interest means the same thing in the United States, as it does in Europe, Japan, China, Brazil, Russia, India or any other part of the world (as is already true for many products that public companies now produce and sell throughout the world).'

Note the analogy between an accounting product and a physical good or service. This is a far reaching admission, opening the door to bringing into the practice of accounting many important tools that have greatly changed other industries, notably Total Quality Control and Business Process Reengineering. For all the years when accounting was seen as a 'profession' and not an industry, change could be held at

bay by arguing that what works for widgets will not work here. The vision statement officially declares that mentality dead, in the eyes of both suppliers and consumers of accounting information.

The report backs up its call for accounting terms that mean the same thing wherever the user happens to access the information by finally and explicitly endorsing XBRL as a mechanism for automating the processes by which financial information is generated, used and communicated. With SEC chairman Cox also calling for what he calls 'interactive' financial information and expanding the voluntary filing of 10k's tagged in XBRL, this report may presage the long awaited tipping point for XBRL.

How open minded this vision statement is can be gauged by the remarkable call it makes for audit opinions that go beyond the dichotomous qualified/nonqualified report that has characterised auditing for all its history: '...the current audit opinion is like an "on and off" switch: either a company's financial statements do or do not comply with prevailing accounting conventions. There is no "in-between". But in an environment where fine distinctions can and will be made, consumers and users may not be satisfied with being able to pay for and receive an "off or on" or "comply/do not comply" audit opinion. Just as most of us have become accustomed to the use of rheostats to finely adjust the volume of the music we hear or the intensity of light in our homes, users of financial information may demand from public companies the ability to receive more finely nuanced opinions from auditors about the degree of a company's compliance with a given set of standards, or the relative conservatism of judgments compared to peer groups. Or more boldly, investors even may want the auditor's views about the overall health and future prospects of the companies they audit. Regulators and the liability system in any country should accommodate these types of requests'.

The call for meeting the requests by investors for different kinds of audits are accompanied

by a suggestion that the industry tries to overcome the expectations gap by conducting audits explicitly designed to detect and deter fraud. For many years the industry has tried to convince users that audits do not in fact constitute a clean bill of health for a firm, but merely signify that its accounts are undertaken in accordance with accounting standards. Offering to create a system of random 'forensic audits' may be a device to reduce the liability exposure auditors face from the classic audit engagement, but at least this time they are offering a value-added alternative to investors, instead of simply telling them to be happy with what they can't have.

Perhaps most telling is the sections of the report that discuss the mentality of the accounting professionals: 'the most successful managers lay down some general principles or modes of behavior — like treating their co-workers and their customers as they would want to be treated — and perhaps some targets for performance (often rewarded with monetary incentives when achieved). They then let their employees use their training and experience to figure out how best to achieve the targets, while complying with the broad principles that define a business 'culture'. Simply put, successful leaders in any organisation want their employees to exercise their *judgment*. Indeed, employees and managers who cannot work in such environments are not likely to be hired in the first place.

Why should accounting and auditing be any different? Accountants and auditors are trained professionals who have the ability, by virtue of their education and professional experience, to apply the *spirit* of broad principles in deciding how to account for and report financial and other information. Rules that allow this judgment to be exercised will produce better, more reliable, and more useful information just as the exercise of judgment enables other companies to provide better and more useful products and services'.

This is more than a reprise of the longstanding debate over accounting standards written as rule

versus principles. While that topic receives extensive coverage in the vision statement, the report is more concerned with the recognition that accountants are trained professionals who can and should do more to exercise their judgment in the interests of full and timely disclosures, and not the green-eye-shaded number crunchers of caricatures who simply check boxes and don't contribute to the strategic success of the firm. And while the vision statement includes a great deal of 'inside the beltway' discussion of industry consolidation, improved training and hiring practices, the underlying intention is the reinvention of a profession towards one that better meets the needs of users and better exploits the intellectual capabilities of its personnel.

Self-serving the discussion about limiting the threat legal liability, however, poses to auditors may be the fact of the matter is that the survival of this industry is vital to the effective functioning of capital markets. One interpretation of the vision statements is that it is offering a grand bargain: reduced liability risks in return for a new business model that addresses the longstanding calls of users for an industry that provides them with information and judgments

that they need rather than what the industry is willing to provide.

This editorial has quoted the vision statement at length because the reality is that it has not become the focus of attention to the degree that its significance warrants. The statement ends with the statement 'The world is rapidly changing. Let us begin the conversation. It promises to be lively.' This journal intends to take up that challenge. In the issues to come, we will offer the opportunity for our readers and contributors to help shape change in an important and vital industry, change that will define governance and disclosure for generations to come.

Michael Alles
Issue Editor

REFERENCES AND NOTES

- 1 The full report is available at www.Globalpublicpolicysymposium.com.
- 2 Floyd, N. (2007) 'A Report by the World's Largest Auditors Urges Relaxed Standards for Liability'. *The New York Times*, 28th February.
- 3 *The Economist* (2006) 'Opening the books', 9th November.