



Mr. Mukund M. Chitale
(Former ICAI President and Former Chairman,
NACAS)

Evolution of Accounting & Auditing Standards and its Future!



Evolution of Accounting & Auditing Standards and its Future!

Author:

Mr. Mukund M. Chitale

When we look at the evolution of standards, broadly, there are three types of standards which the accounting profession should talk about - accounting standards, auditing standards, and naturally the quality control standards, which are considered as a part of auditing standards. If you look at the past, there used to be national standards, international accounting standards, and US-GAAP. Over a period of time, it was found that the international standards and US-GAAP were going in different directions. So, it was felt appropriate to start with IFRS (International Financial Reporting Standards). Every country in the world which has got its own regulatory body would normally evolve its own standards, like we have done in India. These were accounting standards, and the auditing standards.

In India, it is the Institute of Chartered Accountants of India (ICAI) which is standard setting body and the Companies Act has adopted those standards, initially through NACAS (National Advisory Committee on Accounting Standards) and now NFRA (National Financial Reporting Authority). They have the authority to formulate the standards, but the basic standards come from the ICAI. ICAI is a member of the international bodies, and therefore, by and large, we adopt the international standards. As a country, long time back, we decided to adopt IFRS, but with suitable modifications. So, most of the IFRS have been adopted, converged into India, which are now called IND-AS, making them suitable to the local needs of the legal requirements.

The Accounting Standards have become a part of the Companies Act; even the auditing standards have become a part of the Companies Act. While the standards are set, the drafts are issued, various components of the society give their response, those responses are considered, and then it becomes a standard, which is final. It is sent to the specific bodies, like NACAS earlier, now NFRA, and they will issue the standards. When we say evolution of standard, that is how they have evolved.

Ethics and Accounting Standards

By and large, all CA professionals carry a paper for their examination called ethics & value system. It is very nice to have such a paper, but one must consider it appropriate to have the ethics & value system in accounting itself. When we look at the accounting standard, there are two ways in which people analyze the standard.



People find out what is allowed by the accounting standard, and people also find out what is strictly prohibited by the accounting standards. So something which is allowed and something which is prohibited is very clearly known. But there are a few other people who try and find out what is not specifically prohibited by the accounting standard, and that is what gives birth to what is known as “creative accounting”. **I think it is the creative accounting which is the first cause of trouble for the accountancy profession in the world at large. Because the more and more creative accounting comes in, that gives rise to problems in the future. This is one area which entire accounting profession will have to be very careful about.**

Off Balance Sheet items

The next item will be **the off balance sheet items**. When we look at the balance sheets, today there are various items which are on the balance sheet, but items like derivatives, embedded derivatives, commitments, right to agree to sell, right not to agree to sell, right to dispose of and many other kinds of rights and obligations which do not necessarily get converted into financial terms, would be the issues that one needs to look at.

Ownership of Standards

The **sense of ownership about the standard is a major issue**. Today, it appears that the Auditors are owning the standards. I think it is the Industry which has to own the standards, otherwise, it becomes the job of the audit profession across the world to ensure that the standards are complied with. The accounting profession has to ensure that the standards are actually implemented while preparing financial statements and the auditing profession has to see that they are actually implemented by doing the audit. So, the sense of ownership of the standard in India and across the world is very important, and we will have to make efforts to ensure that the industry bodies start owning those standards. Unless this happens, there are going to be troubles in the future.

Constant Changes in Standards

Especially after IFRS has come in, we find that naturally across the world there are issues which are pointed out. Those issues get looked at the highest level; appropriate changes are made, those changes come into IFRS and consequently into Ind-AS. One should welcome such improvements which take place in accounting standards. But, constant changes in accounting standards practically every year, makes some people to believe as if we are changing the goal post.

Accounting standard is something which takes time for the accountants, auditors to understand, implement and practice. For the society to understand the importance it takes a longer time. So there is a need for the accounting profession to keep in mind that we may have to keep the



standards constant for a period of two or three years and then make changes at the appropriate time. If something was not right yesterday, just by making it right tomorrow, things are not going to change substantially. That will increase the belief in accounting standards in a much better way.

Accounting & Business Objectives – The Interplay

I think the purposes are different, the business objectives are different. **Accounting measures the results of the business operations as they are communicated to the shareholders. And therefore, whenever people try and connect the business objectives with the accounting standards, there are bound to be different perceptions.** It has to be clearly understood that accounting is only a unit of measurement to understand, evaluate, record and disclose the results of the businesses as carried out by the business people.

Auditing Standards

When we look at the auditing standards things are slightly different. The measurement of implementation of auditing standard is quite difficult. In accounting, at least one can look at the disclosure results and find out that what is done is right or not. But in auditing, the ultimate result is an audit report, which normally is a standard report. **So, by itself, whether standards have been implemented in reality or not is a question mark and that really is the challenge before the audit profession. This is where the documentation becomes important.**

Documentation

The performance evaluation of auditors is certainly a question mark and everybody likes to comment on that. The most important thing is the service quality in the audit standards and its implementation and that would depend upon competence coupled with character. Competence alone is not sufficient unless the character is evident to support the competence. In this respect, documentation becomes very important.

Dealing with failures

Generally, as an accounting profession, whenever there are major failures world over or in our country, there is a big noise about standards not being sufficient. What we need to learn is how to deal with failures. **Whenever there is a commercial failure, one must find out whether it was a failure of an accounting or auditing standard or was it a failure of an individual person, individual firm or a group of firms?**

If we notice that the standards were appropriate, but it was a failure of the individual or firm, one need not talk about changes in accounting standards or the legal requirements but somehow over a period of time, **all of us have been used to changes in laws the moment there is a**



major failure. This is a knee-jerk reaction because if the standards were not up to the mark, by now, the standards would have been substantially changed. Whereas you will find that, actually the standards more or less have remained same for a long period.

As an audit profession the world over, we **should be able to distinguish between failure of a standard and failure of the actual implementer of the standard.**

Expectations Gap:

There are 2 types of expectation gaps. One is what the society expects and what we promise, there is a gap & the next would be, what we promise and what we perform. I think the second expectation gap is dangerous because what we promise is given by the standards and that when compared to actual performance, if there is a gap, all of us need to improve upon that. But what the society expects and what we promise, if there are gaps in these two items, all over the world various accounting bodies must come forward to meet that gap effectively. We must start educating the society & the most common example is the fraud detection.

Whether detection of fraud is the job of an auditor and can he do it in the course of audit that is done on a quarterly basis, annual basis, etc. is an area on which research would be more useful, especially to see if this was the objective of the auditing standards. **Therefore, what effective steps will have to be taken by the auditors in changing the standards? How much time it will take for auditors to detect the fraud every time? And can they really do that? This is a serious problem area for the profession at large in future.**

Society Expectations

Automatically, the utility and visibility of the audit profession will depend upon the neatness, compactness and conciseness of the accounting and auditing standards as visualized by the society. Ultimately, this is a service profession. As long as we are good for the society at large, our retention in the society will be permanent. But if we are not found to be good for the society at large, things will be difficult for the audit profession and therefore all over the world we will have to ensure that audit as done today and as we expect to do tomorrow, should be useful to the society.

Where the society expects a change, how do we look at the change to happen? Are we equipped to do the change? And if not, what is it that we can do to make the change?



Standards for Small Audits

One needs to look at whether there is a need for having separate standards for small audits. If there is a need for a separate standard, then one will really have to come out with specific details on that.

Quality Control Standards:

The present quality control standard is so nicely drafted that sometimes one wonders that if everybody was doing that, where was the question of any problems in auditing. Which means that, such a nicely drafted standard will need some implementation guide for all people to follow, so that people exactly know what is to be done out of such standards and implementation will become a reality of life. I hope that is where we will lead by implementing the standards through the quality control standards.

Let us expect the World Congress of Accountants to deliberate on these important issues and come out with proper directions for the future.
