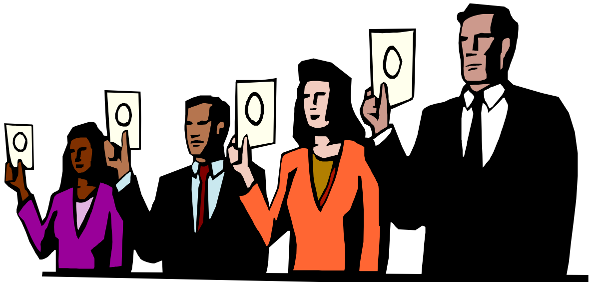
Desirable Traits of Accountants

Objectives

- Stock Market Failures and Accountants
- Role of Accountants
- Desirable Traits of Global Accountants



Desirable Traits of Accountants
(25 April 2017)

How much are the accountants to blame?

In the sub-prime crisis and its ruinous aftermath, accountants fell short as gatekeepers

By **HO YEW KEE**

THE Enron debacle gave rise to the significant debate concerning the role of accountants. The end result is the passing of the Sarbanes-Oxley Act which redefines the role of accountants and strengthens their independence and professionalism.

The main lesson from Enron is the failure of accountants as gatekeepers in ensuring that the financial assertions of firms are reliable and truthful. This naturally assumes that accountants play an important role in the provision of financial information to the capital markets for the purpose of the pricing of securities.

In the massive failures of financial institutions arising from the sub-prime crisis, again it is not unreasonable to question the role of accountants as gatekeepers.

In the valuation of financial assets and liabilities, accountants have been blamed for the use of the three m-to-m: mark-to-model, mark-to-market and mark-to-myth, as the share prices of financial institutions collapsed overnight.

The first m-to-m (mark-to-model) raises the question as to whether accountants have diligently discharged their responsibilities in understanding, parameterising and applying the models correctly. In addition, one can even question whether accountants are adequately trained to understand the sophisticated valuation models used by financial institutions.

There are at least three major failures in the context of the role of accountants. Firstly, the internal risk management function of financial institutions had failed in correctly identifying the risk of these sub-prime assets.

Secondly, accountants have failed to correctly value these assets and reporting them in their financial statements. Alternatively, they have failed to provide sufficient timely impairment losses.

Finally, independent auditors had failed to provide an independent assessment of the true values of these sub-prime assets.

The first mark-to-model raises significant concerns about the competency of accountants and their roles as quality financial information providers.

The second m-to-m (mark-to-market) raises the question as to whether accountants should blindly follow the mark-to-market rule in valuing their assets. This is especially critical when the market is experiencing a free fall because of a crisis of confidence and a concern for liquidity.

In this instance, accountants – instead of providing reliable and relevant information to the market concerning the value of their assets – are literally following the market and reacting to whatever the fair value of their assets are, as determined by the market. In so following the market, they exaggerate the crisis of confidence in the market.

The second m-to-m makes the accountant a bystander in the provision of financial information. Surely, accountants must have a positive role in a period of financial crisis.

Finally, the third m-to-m (mark-to-myth) calls to attention the ultimate role of the accountants. If the first two m-to-m are not applicable in a state of crisis, what then is the role of the accountants as supplier of financial information to the market? Can the accountants play a role in shoring up the confidence in the market?

In fact, the third m-to-m suggests that accountants may not be as influential as they think; in a state of crisis, they are literally powerless to influence the market. Worse, accountants are viewed as magicians who can pull any numbers out of the hat.

Three major lessons

It may be still premature to ask what we can learn from the crisis concerning the role of accountants. I can suggest three major lessons for the accountants in this crisis.

Firstly, it is necessary for accountants to understand and question their valuation models. Of course, it is true that accountants are gatekeepers rather than path breakers and thus their valuation skills may lag the financial innovations existing in the market. Nonetheless, in discharging their responsibilities as gatekeepers, they need to critically assess the valuation models and the parameters used. Accountants must understand the valuation models they are using.

Secondly, accountants may need to reconsider the mark-to-market rules as the rules do not merely affect the valuation of an asset but the confidence of investors during a crisis. Much like the circuit breaker that was proposed after the 1987 financial crisis, accountants may need to seriously consider the equivalent of a circuit breaker in suspending the use of the mark-to-market rule when the market is no longer reliable or rational.

Finally, accountants need to seriously consider what their roles are in a state of crisis and how they can provide meaningful information to the market or to signal credibly to the market the true value of their assets and liabilities. This may require accountants to review their reporting responsibilities in the light of adverse financial information much like a specific accounting standard dealing with a hyper-inflation economy which is outside the norm of ordinary financial reporting.

In summary, when this financial tsunami subsides, there will be much discussion on the lessons to be learnt for the accountants and how accountants can play a larger role to prevent any future tsunami. The question is whether accountants will actually learn from this episode and what the lessons will be.

The author is vice-dean and associate professor of accounting at the NUS Business School. The views expressed here are personal

Ho Yew Kee, The Business Times (9 Oct 2008)

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(25 April 2017)

Market Failures

Mark-to-market: Dangers abound

BY HO YEW KEE

THE US Congress has authorised the administration to buy US$700 billion (S$1 trillion) worth of distressed assets. It has also asked the Securities and Exchange Commission (SEC) to consider the possibility of suspending the mark-to-market rule, and report back to the Congress within 90 days.

What is mark-to-market? Why is it controversial? What does it have to do with the current financial crisis?

Mark-to-market requires firms to report the fair value of their assets or liabilities according to the market price available at the measurement date. If financial institutions had bought investment products worth at least US$62 million, they must report their market value. If the market value rises to US$70 million, the financial institution would book a paper profit of US$8 million. If the products are worth only US$50 million, the financial institution would book an unrealised loss of US$12 million. The mark-to-market rule is designed to reflect the true value of assets.

There is a difference between assets held for trading purposes and those held until maturity. Changes in the market price of assets held for trading reflect potential gains or losses. But if the assets are held until maturity, price changes are irrelevant since it is the final price at maturity that matters. The mark-to-market rule allows for different accounting treatment according to the purpose of the investment.

Where investment banks are concerned, there is a presumption that their investments are for trading purposes. Thus they are exposed to the mark-to-market rule. In a financial crisis, that means there can be tremendous downward pressure on their asset values.

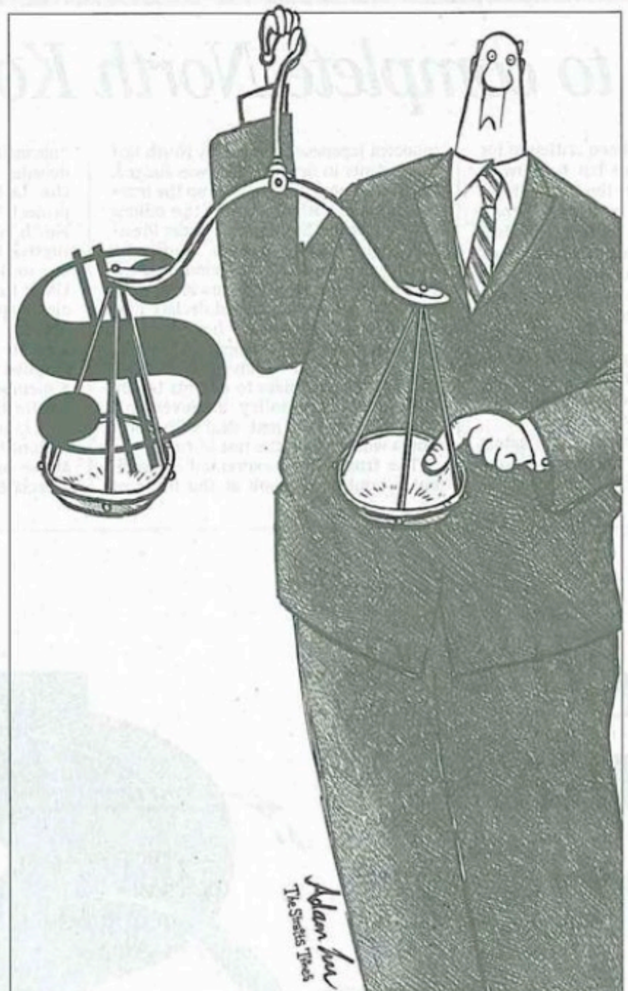
The rule is one of the most significant departures in recent years from the cost accounting convention. Its application may result in significant fluctuations in reported earnings. Some argue that such volatilities merely reflect the true underlying value of assets or liabilities. Others argue that the rule introduces a subjective element to the financial reporting process and may cause extreme volatilities. That is the main concern in the current crisis as extreme volatilities can worsen confidence.

Desperate times require desperate measures but suspending mark-to-market may be too desperate a measure.

Complexities can also arise if the financial assets in question do not have quoted prices or they are not traded. Complex derivatives like collateralised debt obligations (CDOs) and credit default swaps (CDSs) are examples of such assets in the current crisis. Their true values now are anyone's guess because the market for them is illiquid.

US legislators and some market participants are thus urging the SEC to consider suspending the mark-to-market rule for these assets. The current transaction prices for CDOs and CDSs in the market do not represent fair value, they argue, as sellers are under compulsion to sell. Firms should be allowed instead to use the so-called Level 3 fair value hierarchy. This allows firms to use unobservable inputs to value their assets or liabilities. They can ignore market prices and use whatever valuation technique they deem relevant.

There is clearly a case for financial institutions to abandon the mark-to-market rule if they intend to hold the financial assets to maturity. In such cases, they should be shielded from current fire sale prices and not be forced to book unrealised losses. The rule has drastic consequences for banks in particular in a financial crisis: Their assets appear suddenly to decrease in value, thus making them look less solvent than they really are. The rule can result in a situation where the value of a bank's liabilities far outweighs the value of its assets, thus causing run on the bank.



The suspension of the mark-to-market rule can halt the downward spiral of asset prices. This would provide a break to the increasing unrealised losses of firms. If left unchecked, such unrealised losses can severely dampen confidence.

That said, the use of Level 3 fair value hierarchy may not help in shoring up market confidence because the assets' value will be at the discretion of the reporting entity. Liquidity in the financial market may be dampened because market participants refuse to accept such valuations. The rating agencies too may have difficulties accepting the valuations and this too may damage the reputation of the firm. In addition, firms may be subjected to legal wrangles if the market prices continue to be inconsistent with the Level 3 valuation and shareholders or counter-parties suffer losses. And finally, there is the issue of moral hazard: How can firms be trusted to value their own assets in a crisis situation?

It is questionable whether suspending the mark-to-market rule will do more good than harm. In the worst-case scenario, the regulator may be accused of helping struggling firms conceal their true financial position by shifting the goalposts.

Desperate times require desperate measures but suspending mark-to-market may be too desperate a measure. Sunlight is the best disinfectant and suspending the rule would obscure the true financial health of financial institutions. And this, in turn, may slow down the recovery process as good money is poured into bad firms.

The writer is Vice-Dean and Associate Professor of Accounting at the NUS Business School. This is the sixth article in the Straits Times-NUS Business School series on the financial crisis.

Ho Yew Kee, The Business Times (14 Oct 2008)

The unanswered questions in Tesco's accounting scandal

By Graham Ruddick,
Retail Editor, 06 Nov 2014

"When Tesco originally alerted the City to the potential shortfall in its profits, the company estimated that profits for the past six months had been overstated by £250m. It said this was primarily a "**timing issue**" – meaning that profits could eventually be booked in a later period – and related to the recognition of revenue and costs on deals with suppliers.

However, when the company published its half-year results last month, Tesco **completely wrote off £263m of profits**. Not only that, but only £118m actually related to the previous six months, with the rest from previous financial years. Tesco's new finance director, Alan Stewart, also said the majority of this related to the recognition of revenues, not costs."

Toshiba's accounting scandal is much worse than we thought

Michal Addady
Fortune, September 8, 2015

Toshiba admitted on Monday *(6 Sep 2015)* that it had overstated its profits by nearly US$2 billion over the past 7 years, the Wall Street Journal reports.

The company announced in April that it had been facing accounting problems, but the extent was not understood until now.

An independent panel said managers at the company set aggressive profit targets that subordinates could not meet without inflating divisional results, the Journal said.

Toshiba has responded to this scandal by changing its management.

Major PR Nightmare for Any Corporation

Investor Relations

- Financial Information
- Presentations & Events
- IR News
- Toshiba Overview
- Corporate Governance
- Stock and Bonds
- IR Calendar

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Toshiba Corporation expresses sincere apologies to our shareholders, customers, business partners and all other stakeholders for any concern or inconvenience caused by issues relating to the appropriateness of its accounting treatments.

With the new management team and governance structure, Toshiba as a whole will unite to make every effort to regain the trust of shareholders, investors, all other stakeholders and members of the public, and asks for your understanding and ongoing support.

→ Actions Taken in Response to Inappropriate Accounting

IR News RSS

› Archive

Dec. 28 IR
Annual Report 2015 (FY2014) Financial Review part posted [PDF 600KB/76 pages]
Restated versions of Financial Review part of past Annual Reports posted
(FY2013, FY2012, FY2011, FY2010, FY2009)

Dec. 25 IR
Notice of Receipt of Dividend from a Toshiba Subsidiary [PDF 21KB/2 pages]

Dec. 21 IR
"Toshiba Revitalization Action Plan" and FY2015 Forecast

Dec. 21 IR
http://www.toshiba.co.jp/about/info-accounting/index.htm ll its TV Plant in Indonesia to China-based Skyworth [PDF 113KB/3 pages]

Stock Chart

Tokyo	Jan. 05 11:00
Price	¥246.5
Change	¥-8.5 (-3.33%)

TSE (Ticker 6502)

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Recent Accounting Frauds

Company	Transactions / Allegations	Effects
Satyam	Inflated profit and manipulation of the company's accounts	Founders (Ramalingum and Rama Raju) jailed 6 months and fined in 2014.
Olympus Corp	Former chairman Tsuyoshi Kikukawa and two other former executives pleaded guilty in September 2012 for covering up losses of $1.7 billion at Olympus for 13 years starting in the 1990s.	Olympus was fined US$5.86 million, and the three officials received suspended sentences from the Tokyo District Court.
Toshiba	$1.9bn in concealed losses over six years (2008 to 2014)	Resignation of half of the company's board of directors and fine for the auditors

Repo 105 – Off-Balance Sheet Device

① **"sell $600 worth of securities for $590 on 27 Dec 2016 with an agreement to buy them back in 10 days (7 Jan 2017) at $594"**
[Equities↓$10; Sec↓600; Cash↑$590]

26 Dec 2016

Securities	1,000	Liabilities	1,100
Cash	300	Equities	200
	1,300		**1,300**

Net Profit **$100**
ROA (100/1,300) **8.3%**
D/E Ratio (1,100/200) **5.5X**

② **"use the $500 to pay down the liabilities"**
[Cash↓500; Liab↓500]

27 Dec 2016

Securities	400	Liabilities	600
Cash	390	Equities	190
	790		**790**

Net Profit **$90**
ROA (90/790) **11.4%**
D/E Ratio (600/190) **3.2X**

③ **"buy and borrow back"**
[Equities↑6; Sec↑600; Liab↑500 ; Cash↓$94 (500-594)]

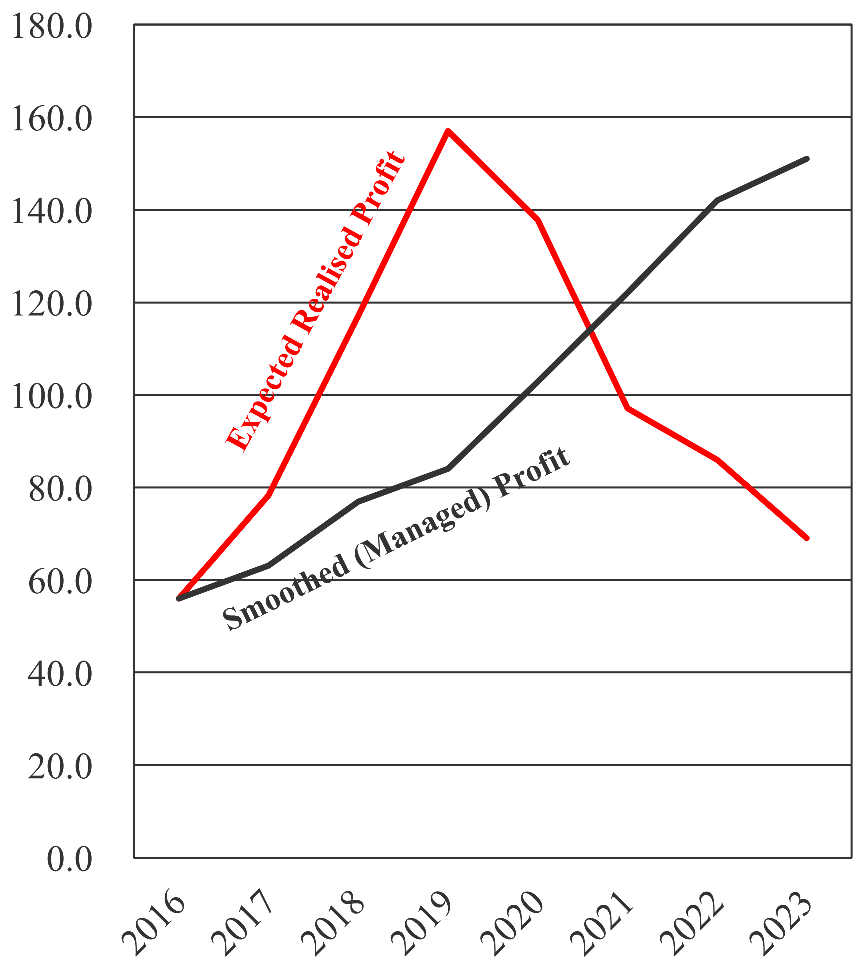
Fundamentally what has changed?

7 Jan 2017

Securities	1,000	Liabilities	1,100
Cash	296	Equities	196
	1,296		**1,296**

In the second quarter of 2008 Lehman Brothers used Repo 105 to move $50 billion off of its balance sheet, according to the Examiner's report.

Smoothed Income as Performance Indicators

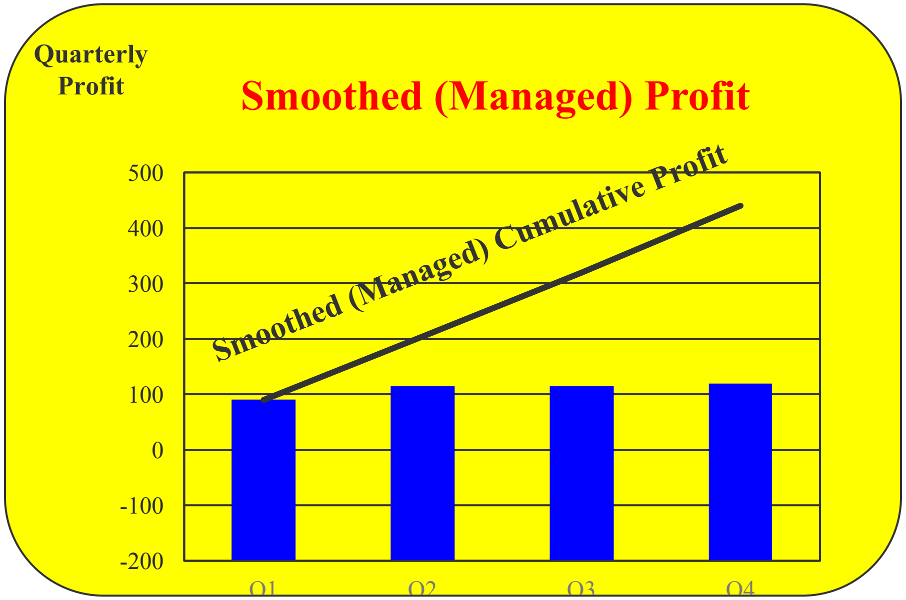


	Expected Realised Profit		"Adjust-ments"	Managed Profit	
	Net Profit	% Growth		Net Profit	% Growth
2016	56.0		0.0	56.0	
2017	78.2	39.6%	(15.0)	63.2	12.8%
2018	117.0	49.6%	(40.0)	77.0	21.9%
2019	157.0	34.2%	(73.0)	84.0	9.1%
2020	137.8	(12.2%)	(35.0)	102.8	22.4%
2021	97.0	(29.6%)	25.0	122.0	18.7%
2022	86.0	(11.3%)	56.0	142.0	16.4%
2023	69.0	(19.8%)	82.0	151.0	6.3%
Sum	**798.0**		**0.0**	**798.0**	

Which profit trend would you prefer?

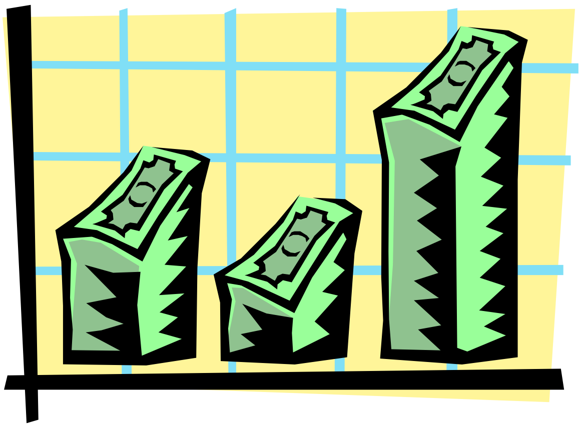
Quarterly Income Smoothing

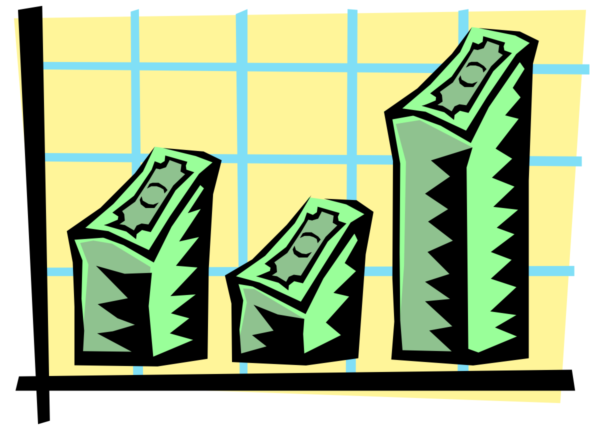
Which profit trend would you prefer?



	Expected Quarterly Profit	Expected Cumulative Profit	Adjustments	Managed Quarterly Profit	Managed Cumulative Profit
Q1	150	150	(60)	90	90
Q2	250	400	(135)	115	205
Q3	(120)	280	235	115	320
Q4	160	440	(40)	120	440

A Definition of Accounting





"the process of

identifying,

measuring, and

communicating

economic information

to permit informed judgments and decisions

by the users of the information."

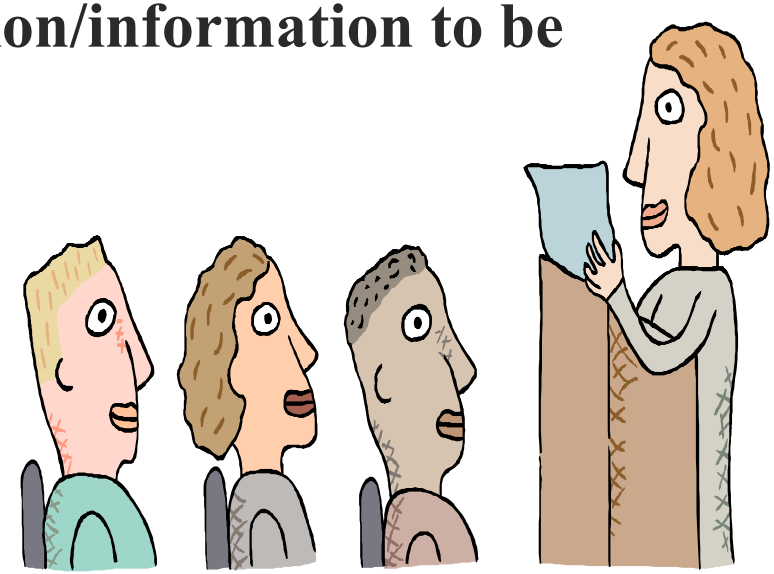
(ASOBAT AAA, 1966)

The Role of Accounting

- **Stewardship of financial resources (Accountability)**
- **Provision of information (Decision making role)**
- **Part of a wealth allocation or re-distribution mechanism. (Contracting role)**

The Three Core Issues in Accounting

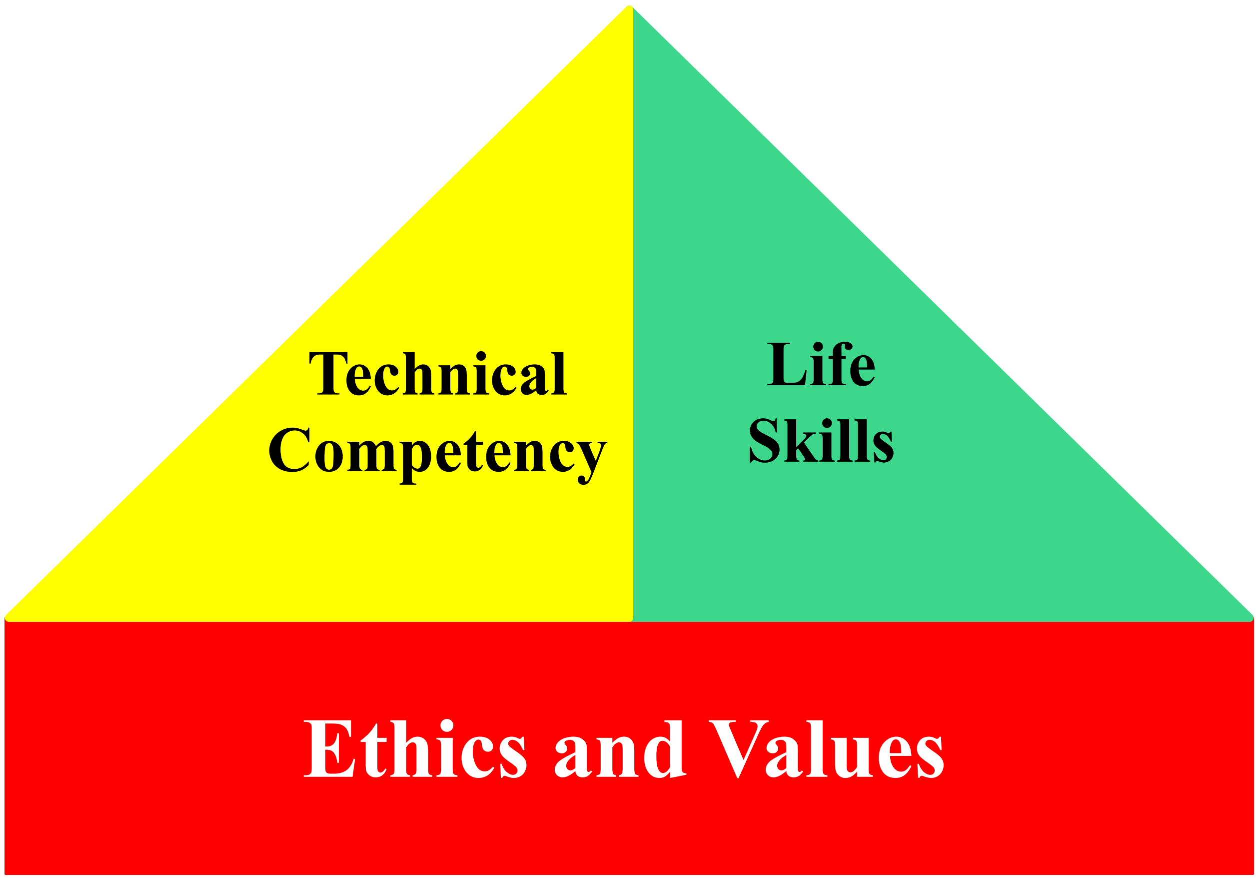
- Recognition (When should a transaction be recognised?)
- Measurement (How much is the transaction?)
- Disclosure (How is the transaction/information to be presented?)



Role of Accountants

- **Curator** of financial information for the purpose of decision making
- **Strategic partner** of management for the purpose of ensuring economic prosperity and continuity of the business
- **Moderator** of the behavior of self-interest management

Desirable Traits of Accountants



Technical Competencies

Domain Competencies

- Financial Accounting
- Managerial Accounting
- Audit and Assurance
- Finance and Financial Management
- Taxation
- Commercial, Securities and Company Law
- AIS, IT, Analytics and Big Data
- Economics and Statistics

Functional Competencies

- Analytical
- IT Savvy
- Microsoft Office & VBA
- Meticulous and Paying Attention to Details
- Resourcefulness

Life Skills

- Communication and Presentation Skills
- Teamwork and Negotiation Skill
- EQ – Ability to Relate
- AQ – Ability to Withstand Adversity
- Personal Masteries – Time Management, Self-Discipline, Self-Awareness, Self-Motivated
- High Level of Curiosity – Willing to Learn
- Ability to Make Sound and Wise Judgement

Ethics and Values

- Sense of Excellence
- Independence and Impartiality
- High Moral Values – Honesty and Integrity
- Trustworthy and Confidentiality
- Professional Service Quality (Client Focus)
- Patient

How Can Accountants Not be Replaced by Artificial Intelligence

- Provision of service which consists of sound professional judgement ➡ **Step Up**
- Learn how to use technology to get the work done ➡ **Step Aside**
- Highly updated knowledge covering multiple domains and disciplines while connecting to IT ➡ **Step In**
- Personal touch and highly specialized skills which cannot be replicated by robots ➡ **Step Narrowly**
- Ability to manage client, adaptable to changing circumstances and to create new businesses ➡ **Step Forward**

https://www.fastcompany.com/3058800/how-to-avoid-being-replaced-by-a-robot by George Lorenzo

Conclusion

- Accountants will always be needed in an unstructured world which requires professional judgment
- Accountants must re-tool themselves with modern technologies to enhance their value propositions
- There are core behavior, knowledge and competencies which an accountant need to be successful