THE MECHANISM OF MAINTAINING ETHICS IN INDIAN ACCOUNTING PROFESSION

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ABSTRACT

The days have gone when the accounting used to be merely a tool for debt collection, insurance claims or knowing annual profit-loss. The accounting has now a positive role in economic growth of a nation. Recently the World Bank, emphasizing the need of transparent accounting system, introduced 'Reports on the Observance of Standards and Codes' which will measure the country's growth pattern and determine the thirst areas at global level.

The ethical standards in financial reporting practices are not only the yardstick of corporate governance of a nation, but also is an important tool of investors' protection.

This paper intends to analyze the mechanism and regulatory framework which develops, designs, monitors and ensures the professional ethics in accounting and auditing profession in India. The paper will cover the historical background to the recent developments in regulatory mechanism of ethics in accounting. The comparative analysis will help in assessing the efficacy of systems prevailing in India as well as global level.

The paper contains the statistics of disciplinary cases referred to Disciplinary Committee of ICAI and will analyze the average time taken by the committee to form its opinion. The paper will also throw the light over some landmark disciplinary cases of the accounting profession in India.

Key words:

1. ***ROSC:*** ***(****Reports on the Observance of Standards and Codes)*
2. ***ICAI*** ***(****The Institute of Chartered Accountants of India) and* ***IFAC*** ***(****The International Federation of*

Accountants)

3. ***Disciplinary Mechanism:*** *The framework of developing, regulating and monitoring the professional ethics in the profession of accounting and auditing.*
4. ***Disciplinary Committee (old):*** *A standing committee of ICAI under section 21D of the Chartered Accountants Act, 1949.*
5. ***Board of Discipline:*** *The board constituted under section 21A of the Chartered Accountants (Amendment) Act, 2006*
6. ***Disciplinary Committee (New):*** *The committee formed under section 21B of the Chartered Accountants (Amendment) Act, 2006*
7. ***Professional Misconduct***

INTRODUCTION

In the era of fastest growing world, accounting is not only confined to reveal the profit and loss of the accounting year of the business entity, infact accounting emerged as a powerful tool in present day economy, economic development, planning, control and decision making, providing information in monitoring progress. The practice followed by accounting professionals has remarkable importance in the integrated economies that make the world a global business platform. Now there's emerging a need to transparent accounting system by which the various users of accounting like: owner, investors, employees, management, Government bodies, Bankers, creditors, suppliers Customers, Tax authorities, Regulatory Authorities, Researchers get benefited by such information but ample cases found in the corporate world that took the undue advantage of the loophole of the law and rather than satisfying the need of users or society as a whole, they keep their own motive on priority. For taking such instances in view, emphasis is laid worldwide on the Accounting professionals to bring transparency in financial reporting practices to safeguard the interest of stakeholders.

ACCOUNTING: THE HISTORICAL PERSPECTIVES

The historical background of accounting is found in ancient India. There are sufficient evidences exists in the world that proves accounting practices were followed during the time of Vedas, Upanishads. Various discussion on matters like system of tenure, trade, currency, medium of exchange, various occupations, economic and social conditions, are found in Rigveda, Atharvaveda, while earliest references to partnership arrangements and rules are found in Manu Smriti, Yajnavalkya Smriti, Narada Smriti, Brhaspati and Katyayana Smritis. As widely accepted, Manu was the first to provide partnership type of arrangement.

THE NEED OF TRANSPARENT ACCOUNTING SYSTEM

The word transparent in context of accounting is used in high quality statements. The need of transparent financial reporting is felt to gain the trust of investors worldwide and others users of accounting information and also because there are many scams and frauds occurred in the recent years in the world of finance that not only shaken the interest of investors but also badly affected the image and economy of any country that's why need is felt to bring more and more transparency in financial reporting system. For this all the necessary information of economic events of whole year should be disclosed to make the financial statements error and fraud free. And that should be easily understandable by all the interested parties. To make the financial statements transparent GAAP (Generally Accepted Accounting Principles) must be followed that will attract the investors internationally and desires spawn among them to make investment in the favor.

ETHICS IN ACCOUNTING

Ethics are the codes that deal with the ability to distinguish between right and wrong. One of the elements that many believe distinguishes a profession from other occupations is the acceptance by its members of a responsibility for the interests of those it serves. A high standard of ethical behavior is expected of those engaged in a profession. These standards often are articulated in a code of ethics.

The mission of the International Federation of Accountants (IFAC), is "to serve the public interest, IFAC will continue to strengthen the worldwide accountancy profession and contribute to the development of strong international economies by establishing and promoting adherence to high quality professional standards, furthering the international convergence of such standards and speaking out on public interest issues where the profession's expertise is most relevant." Ethics Standard Board for Accountants has been established by IFAC to develop and issue ethical standards of high quality.

Section 100 of General Application of The International *Ethics* Standards Board for Accountants (IESBA) Code reveals that a professional accountant must comply with the fundamental principles such as: Integrity, Objectivity, Professional Competence and Due Care, Confidentiality and Professional Behavior. But sometimes it is found that instead of keeping in view the interest of shareholders' and other associates, accounting professional give priority to the interest of owner and management that result in professional misconduct and leads to misleading information, manipulated accounts, falsification of financial statements, fraudulent activities, etc. All of those failures are ethics failures that represent breaches of fiduciary duties by individuals who accepted responsibilities but did not fulfill them.

THE ETHICAL STANDARDS IN INDIA

The Chartered Accountants Act, 1949 was formulated to regulate the professional practices of Chartered Accountants. The Act is administered through ICAI; which functions and discharges its duty through a 'Council'. To ensure discipline in the profession, The Chartered Accountants Act along with its schedules sets out different forms of behavior, which constitute misconduct under the law.

Professional misconduct is defined under the section 22 of the Chartered Accountants Act in two schedules. These are: The First Schedule and the Second Schedule.

The First schedule is categorized into four parts, Part I of the schedule deals with misconduct of a member in practice, it has twelve clauses; Part II deals with the misconduct of members in service and it has two clauses; Part III deals with the misconduct of members generally and has three clauses; Part IV of the schedule deals with other misconduct in relation to members of the Institute generally and has two clauses.

The Second Schedule is divided into three parts. Part I of this schedule deals with Professional misconduct in relation to Chartered Accountants in practice and Part I have ten clauses; Part II deals with Professional misconduct in relation to members of the Institute generally and has four clauses; and Part III deals with other misconduct in relation to members of the institute generally.

CODE OF ETHICS – TRANSCENDING THROUGH DIFFERENT STAGES

- The Chartered Accountants Act - Precursor to Code of Ethics.
- Code of Conduct for members (First edition in November, 1963)
- The 'Code of Conduct' was called as 'Code of Ethics' for the first time in its ninth edition in 2001.
- Today's Code of Ethics (2009) is the 11th edition of the Code. It is also the first edition after convergence with IFAC. It's structure is divided into two parts:
- Part A : Based on IFAC Code of Ethics
- Part B: Based on the Chartered Accountants Act,1949

THE REGULATORY MECHANISM IN INDIA

ICAI is an autonomous body and it functions through its committees. Some of its committees are standing committees while other are non-standing committees. ICAI has setup specific standing committee to handle the cases whenever any accounting professional found guilty or engaged in some misconduct and that is Disciplinary Committee. The Disciplinary committees, The Disciplinary Directorate, The Board of Discipline form the foundation of the disciplinary process of the ICAI, Disciplinary Committees: Disciplinary Committee (old) under section 21D of the Chartered Accountants Act, 1949 was constituted. Another Disciplinary Committee has been constituted by the Council of the Institute under Section 21B of the Chartered Accountants (Amendment) Act, 2006. **Board of Discipline was formed under section 21A of the Chartered Accountants (Amendment) Act, 2006. And** The Disciplinary Directorate is headed by an officer designated as Director (Discipline).

On receipt of any information or complaint that a member has allegedly engaged in any misconduct, the Director (Discipline) shall arrive at a prima facia opinion whether or not there is any misconduct. If the Director (Discipline) is of the opinion that the misconduct is covered by the items listed in the first schedule of the Chartered Accountants Act, 1949, he shall refer the case to the Board of Discipline. If he is of the Opinion that the case is covered by the Second Schedule or both schedules of the CA Act, he will refer the case to the Disciplinary Committee.

THE GLOBAL OVERVIEW: WHERE DO WE STAND

We found that the quality of legal framework, accounting standards and the oversight/enforcement process is of high quality and comparable with best global standards. In the study, we have seen that there are variations in the Rules or Laws governing auditors at global level. For taking an instance of United Sates of America(USA), United Kingdom (UK) and India, In USA Sarbanes Oxley Act, 2002 is followed while in UK Companies Act, 1985 and 1989, and India Companies Act 1956 and Chartered Accountants Act, 1949 is applicable as major law governing body, other variations from different point of view are as follows:

- **Qualification for being an Auditor:** In USA, Auditor must be Certified Public accountant, In UK, he must be a member of Recognized Supervised Board i.e. ICAEW, ICAS, ICAI & ACCA, while to be a Auditor in India, One should be a member of Chartered Accountants of India holding certificate of practice.

- **Appointment of Auditor:** Auditor is appointed by Shareholders in Annual General Meeting in USA, UK and India.
- **Regulator:** Security Exchange Commission is the regulatory body in USA, Auditing Practices Board is the regulator at UK, and in India the regulators are: ICAI, CAG, RBI, SEBI.
- **Governing Body:** Public Company Accounting Oversight Board is the governing body at USA, in UK Financial Reporting Council is the governing body and in India ICAI governs the aforesaid law through its various committees.
- **Auditor's Liability in case of fraud:** in USA, it's substantial if involvement or negligence is proved, in UK, liability can be limited by entering into liability limitation agreement as per Companies Act, 2006, while an auditor has unlimited liability in case of negligence or fraud in India.
- **Rotation of Auditors:** Audit Partner Rotation is in every five years in the country like USA, UK while in India Rotation of Auditors in case of PSUs is four years and three years in case of Banks ad there is no provision in other cases.

The regulatory mechanism in India is based on fundamental principles followed by Accountancy professional. These principles are: Integrity, Objectivity, Professional Competence and Due Care, Confidentiality, Professional Behavior, Technical Standards. The emphasis on all these principles has been laid down under the professional ethics by the International authorities also and these principles are accepted at global level. Those have been followed in India also. So far as the ethics are concern, that is being following. However, there is leniency in their implementation. But as the design of ethics is concern, our code of conduct is at par with International standards.

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