

Keynote address at Joint HKICPA and IFRS Foundation IFRS Conference 2015

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President Ho, Chairman Hoogervorst, distinguished guests, ladies and gentlemen. Good morning and to our overseas visitors, welcome to Hong Kong.

I am honoured to have been asked to give the keynote speech at this very important conference. For those of you who do not know me, I was a practicing accountant throughout my entire professional career until I retired four and a half years ago.

I would like to spend a few minutes sharing with you my personal thoughts on the development of financial reporting standards over the years. I will then conclude by saying a few words on the importance of the auditing profession in the current regulatory environment.

My first accounting lesson

I started my training as an accountant over 40 years ago and had my first lesson in accounting in 1972 which was an introduction to double entries. I was taught that every debit must have a credit. My second lesson was that financial accounts should be prepared on a historical cost basis and whilst losses must be provided for as soon as they are anticipated, profits should only be taken up when they have been realised. I was told in no uncertain terms by my accounting lecturer that the prudence concept was the key guiding factor to all accounts preparation and I carried this concept with me all through my professional career.

Evolution in accounting standards

Accounting standards evolved over the years, but double entries and the prudence concept stood me in good stead and helped me to understand, interpret and apply accounting standards to real-life situations. However, as the world of finance became more complicated with the proliferation of financial instruments, derivative products and all sorts of equity and debt financing, it was inevitable that the true and fair presentation of financial statements could no longer just rely on the simple principles of double entry, cost accounting and prudence. This is when I began to find accounting standards and financial reporting standards increasingly difficult to understand.

In the old days, I knew exactly what it meant when a company reported a profit or a loss but increasingly this is no longer the case as the principle of revaluation creeps into accounting standards. One has to delve into the details to find out how much is actual profit or loss (as we used to understand them), and how much is the result of the revaluation of investments, financial instruments or properties. I have to say that to an old-fashioned accountant like me, unrealised gain is not real profit!



As major elements of the balance sheets are revalued to reflect current market price, the concept of financial statements capturing the financial position at a specific date probably needs a health warning. Readers should be warned that it only presents the financial position at a particular point in time in the past as by the time it is presented, it would already be out of date – especially under volatile market conditions.

Fair and true view of financial statements

What I am saying is that I understand why financial reporting standards are increasingly mandating revaluation and on-balance-sheet accounting of all types of derivatives instruments, but these only present the financial position at a particular point in time. Going forward, perhaps financial reporting needs to better reflect the dynamic situation of the real world by giving much more analysis and disclosing more of the underlying information behind the figures. There also need to be better connections between risk management and its accounting treatment. I am therefore happy to know that this conference will focus on the implementation of IFRS 9 on financial instruments and also that Hans will give us an update on future plans for financial reporting.

Auditors' responsibilities

Now putting on my regulator's hat, I would like to comment on the important role played by the auditing profession in ensuring that financial statements can be relied on. Another lesson I learnt during my training days was that the auditors' role is that of a watchdog rather than a bloodhound. I am afraid that in our changing world, auditors must sharpen their teeth and be prepared to take a bite. Personally I believe auditors should take a much firmer position with their audit clients when it comes to the interpretation of financial reporting standards. Too often we hear about the inappropriate application of accounting standards after something has gone wrong or there has been a change in ownership of a company. I am afraid financial reporting standards are only as good as their application and we need to ensure that they are applied across the world on a consistent basis. This is a role that the IASB can best perform.

China's first National Accounting Institute

Finally, I want to finish with something said by Zhu Rongji, the reform-minded former Premier who more than any other Chinese leader appreciated the important role that accounting and auditing played in helping China achieve more balanced, equitable and sustainable growth and integrate into the global economy. Among other things, Zhu Rongji was instrumental in establishing China's National Accounting Institutes in Beijing, Shanghai and Xiamen.

The mission of these three training centres is to make sure that officials, managers and accountants are properly trained in accounting principles and auditing techniques and most importantly, in Zhu Rongji's own words, "do not keep fake accounts" (不做假帳). A corollary of the former Premier's mandate is that in the event of fake accounts, auditors should catch them. However, he did not define what he meant by fake accounts. In today's world, this is by no means a simple task. Recording inaccurate or incorrect numbers would clearly be defined as fake accounting but what about deliberate misinterpretation of financial reporting standards? I would argue that this also amounts to fake accounts.

So here is my challenge to the auditing profession – you must ensure that there are no fake accounts!



Concluding remarks

Before I conclude I want to tell you that I showed my draft speech to Charles Grieve, a colleague of mine at the SFC whom many of you know very well. Charles has been involved in the work of HKICPA and IOSCO (the International Organization of Securities Commissions) as a member of its Auditing subcommittee for many years and is therefore very familiar with the development of financial reporting and auditing standards. I asked him if my speech will offend anyone and do you know what he said to me? He said and I quote “flying the flag for old-fashioned realised profits could make you sound a bit of a dinosaur but the good news is that the prudence concept is making a comeback in the current draft of IASB’s conceptual framework”. So it would seem I am not such a dinosaur after all. By the way, he told me to stress in my speech the importance of the convergence of FASB and IASB standards. So there, I have said it!

In conclusion, I believe that the IASB does a very important job in the world of international finance and I would like to wish you all a very successful two-day conference.

Thank you.