

Regaining the public trust

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at the FEE Conference on Audit Policy (Brussels, 30 June 2011)*

Ladies and gentlemen,

In the first months after leaving politics, I never expected that I would face a full hall of accountants to talk about the lessons learnt from the credit crisis and topical issues in the accountancy debate. At the time, it looked like a closed chapter. Still, here I am today to talk to you, and it is with great pleasure that I do so.

First of all, however, I would like to mention a few things. Although I have been working at KPMG for almost a year now, I am still not an accountant. I even fear that I may never be one. Should I say ignorant things today about your profession – as you probably may come to expect from people with a political background – then you will have to be kind and forgive me. In any case, I will do my best to steer clear of your professional field.

I am also not here this morning to bring only messages and ideas from KPMG. For that, you should ask someone from the KPMG leadership, to the extent that you are not yet familiar with KPMG's vision. "But to be absolutely clear about the status of this speech today I'm now going to read out loud the disclaimer that has been given to me: "the views and opinions expressed in this speech are those of Wouter Bos and do not necessarily represent the views and opinions of KPMG".

What I would like us to do together today is building a bridge between two worlds that sometimes appear to be facing with their backs to each other. First of all, the

world of social opinion and, more specifically, politics. And secondly, the world of accountancy, of which I am now a part as a partner of KPMG.

Bringing together these worlds I see as an important task within KPMG. And I would also like to do this exercise with you today. Neither one of these worlds has the wisdom exclusively in their hands, but both worlds are actually in it together and cannot succeed without taking into account of each other's realities, images, dilemmas and expectations. Sometimes it rather looks as if a dialogue of the deaf is taking place between them instead of a real dialogue.

Today, I hope to be able to act as some kind of interpreter so that we can seek a common language. Perhaps the two worlds will never totally agree, but when mutual questions are not even understood, the answers will by definition never be satisfactory. That causes friction and frustration and no-one benefits from it.

Ladies and gentlemen,

In 1995, the US political scientist, Francis Fukuyama, author of the best-selling *The End of History*, wrote the book *Trust, the social virtues and the creation of prosperity*, in which he argued that trust does not only form one of the core fabrics of society, but is also essential for a proper functioning economy.

We must be able to trust that the food we buy is safe, that the computer does what the manufacturer claims and the brakes of our new car do fail after only two weeks. We must be able to be confident that paper bank notes or, in our day and age, the electronic balances on our bank account represent the value that they claim to represent. We must be able to trust that the agreements reached between companies and the contracts they sign will hold up.

In his book *The great disruption* four years later, Fukuyama asserted that this trust was subject to rapid erosion in many ways, causing major social but also economic problems. When trust makes way for suspicion, the seed has been sown for a type of cooperation that only functions through enforcement and sanctions, laws and controls.

Fukuyama thus finds the sore spot that is still as topical ten years later. In the West, many people have lost their trust and confidence in traditional institutions, such as government, political parties, churches and trade unions.

But they have also lost faith in each other: faith in a type of unwritten consensus concerning fundamental values and standards – the ‘bonum commune’ in classical terms – has made way for a society where trust is very easily seen as naive.

It is not surprising that this crisis of confidence has also spread to institutions and professions in which public trust plays a major part, for example, banks and insurance companies. But also doctors, judges and notaries public have lost the natural public trust and confidence in them. Increasingly, issues such as expertise and independence are no longer a given, but must be proven and accounted for. Trust has to be earned.

Ladies and gentlemen,

I’ve taken this roundabout way to demonstrate the crisis of confidence that currently appears to be visited upon the accounting profession has not come out of the blue. There is a social climate in which trust has a fundamentally different meaning.

This means that questions are now also raised about certainties in accountancy that have survived for over a century. And it also means that accountants these days will have to explain, be held accountable and answer questions pertaining to issues that have not previously been so high on the agenda.

All of sudden people appear as they did in that famous fairy tale saying that the emperor is not wearing any clothes. That’s a shock. Many accountants revert to a defensive reflex, or believe their profession is actually too complicated to explain to the broader public. But much to their surprise, accountants realise that this will not make the questions disappear. That being right and getting your way are not the same. In fact: that other people will start formulating their own questions that turn their trusted world upside down.

A good example of such an eroding certainty is the fact that the object of the independent external auditor is also the client and paying for it. You are not used to anything different. And I am convinced that you, as the majority of your colleagues, genuinely believe that you audit the books of the company that will later pay you for the audit in a fully honest, critical and independent way.

Nevertheless, a problem immediately arises when someone says: “But surely it is not at all possible to perform an independent audit if the audited company also pays the bill? What if the result is not to the liking of the client?”

You may not agree with these questions, even find them out of order. However, if the public lose confidence in the fact that an auditor can be independent DESPITE the fact that the audited company also pays the bill, YOU have a problem.

Another such a sticky dilemma. The Dutch founder of public accountancy, Theodorus Limperg, described the accountant as the ‘trusted person in public matters’. With its audit and report, the auditor provides public assurance that a company or organisation presents a true and fair view in its financial statements of reality. As such, the accountant has a public task that is even enshrined in law.

To be able to arrive at that opinion, the accountant also has a trusted role with the organisation being audited, which is confirmed by signing the confidentiality clause. Without this duty, not a single company will let him in. This undeniably leads to potential tensions on the line. The system has an intrinsic weakness – how does the public know that the accountant indeed raises the alarm when something goes wrong? Is it not realistic to expect that client pressure on the auditor will be at its most intense when the company faces problems and wants to hide it?

I have no doubt whatsoever that most accountants will remain astute; however, I do understand this type of public issues. Still, in contributions to the debate by accountants, I often encounter defensive reactions which deny up front that there may be any problem, let alone that a solution is required. Then the dialogue falls silent. It is not enough for accountants to expect public trust; they will have to offer greater assurance that they’re performing their public duty properly. This

process starts by taking public doubts and questions seriously and to seek together for satisfactory answers.

Ladies and gentlemen,

Scepticism has arisen after the credit crunch about the public trust role of the *public* auditor. To keep it simple: Banks and other financial institutions appeared to be in excellent financial health. This was confirmed by accountants by issuing unqualified reports to the financial statements. However, the financial sector collapsed in a few months' time because far too generous mortgages had been furnished to poor Americans. The risks of this irresponsible mortgage policy found their way to all the financial institutions across the world by means of complicated and obscure constructions. When the bubble finally burst, it created a domino effect, with the collapse of Lehman Brothers working as an unparalleled catalyst. The banks only managed to survive by virtue of national governments offering many billions of euros of public funds to save them.

So far my personal version of the credit crunch for dummies.

After the crisis came the questions. Who's to blame? The banks that had become far too entwined with each other? The combination of investment banks and commercial banks serving the public? The incentives in the financial systems leading to irresponsible risks being awarded with royal bonuses and wrong decisions hardly being punished? The slack supervision by regulatory bodies?

But also the accountants who did not raise the alarm when everything pointed towards things going wrong ended up in the dock. Had we not assigned them the public duty to raise the alarm?

Accountants' reaction to this criticism was to emphasise that they had acted in compliance with laws and regulations, that the credit crisis was not a crisis of auditors. That was and remains a wrong reaction to an entirely understandable public concern, because that answer leaves only two alternatives: either the audit serves no purpose at all, so why continue to place it in a legal framework, or the existing laws and regulations do not produce the desired public outcome, which –

in this case – is a prompt signal from an independent institution that a financial institution is taking major risks.

By proving their formal-legal point, however understandable from a liability perspective, accountants risk losing their relevance and this is the basis for public trust. And then their ‘licence to operate’ will also expire.

In my opinion, there has been a short-circuit due to a misunderstanding in the accountancy debate that has been going on since the crisis. The search by the public and politicians for the weak links in the financial system – that we nowadays refer to as the system risks – was experienced by accountants as an attack on their professional integrity. It makes sense that this will lead to a defensive reaction. But then a useful and frank debate gets bogged down before it has even started.

I am convinced that a healthy, open and frank debate is possible and essential in the public interest and from a public perspective. What do the public and the market want? Assurance. Assurance that the financial information provided by a company is solid, also because an external accountant has had a critical look. This assurance can be given by an accountant. However, an audit opinion is not an insurance policy against every risk that may arise in the future, and be crystal clear about it.

It is up to a business to provide all the information that is relevant to the shareholders and stakeholders, such as staff, financial institutions, the government, etc. Only then does the accountant enter the scene. First, the public and the market – in other words, all of us – have to decide what information we need and what degree of assurance this requires. For example, in the field of risk management, the quality of the managers or the sustainability performance. This implies, but certainly in this order of events, the request to the accountant to check and verify this information.

This will not always be possible in the manner that we are used to form the financial statements. “If you can’t measure it, you can’t manage it”, according to

the well-known top US entrepreneur, Jack Welch. The same applies to accountants. If you can't measure it, you can't audit it.

Without a legal framework and a proper framework of standards, the auditor cannot perform the work. Such a framework is necessary for increasing the relevance of the auditor's report, for example, by assessing the quality of an internal control framework and performing a sensitivity analysis. It should always be borne in mind whom the auditor reports his findings to.

Some seem to expect accountants to prepare some sort of alternative financial statements, preferably including information that the company itself does not want to release. This is in contrast to the basic principle that the organisation itself is primarily responsible for financial reporting. The publication of the management letter, which the accountant submits to the audit committee and the business is a deceptive solution. Partly because of the confidentiality clause, the management letter will be reduced to a letter with little substance.

This does not alter the fact that accountants should be given more space to offer their 'professional judgement' on issues going beyond the financial ratios from the past. And to make their auditor's report more than an empty standard report confirming the financial statements are compliant.

I am well aware of the reticence among many accountants to be given greater scope than they have at the moment. Many shareholders' interest in the accountant usually increases exponentially when something has gone wrong and the accountant emerges as the potential party to be held liable. We therefore cannot redefine the role of the accountant without also taking a realistic look at liability risks. Here, too, the auditor's report cannot serve as an insurance policy. The assurance offered by an accountant cannot imply that the accountant assumes liability for what is by definition an uncertain future.

Public confidence that accountants do their job properly does not go hand-in-hand with the assurance they provide with respect to financial and other reporting. That trust is inseparable from the perception of the quality of the accountant's work. Accountants often explained quality too one-dimensionally in

terms of technical quality. The public, on the other hand, usually understands quality as professional attitude: that the accountant is professional, critical and independent, is not influenced by a hidden commercial agenda and will remain judicious should the company apply pressure. Accountants will have to find a better balance in their external communications between professional quality and, what I will conveniently call, public and social quality. When this is not managed properly, the public and market will be less and less ready to simply accept trust in the quality of accountants and will want it still further enforced.

This leads to the threat of making organised distrust a legal issue. This will not serve anyone or make anyone happier. Above all, this will not bring back trust.

If a parent only has a huge stick as an educational tool, a child will never develop the confidence to make personal choices and take personal responsibility.

Besides investments in professional and technical quality, I also see steps being taken in other areas to further guarantee quality, independence and the correct professional attitude. This was achieved in the Netherlands by, among other things, broadening the dialogue between the prudential regulator and the accountants of the financial institutions and making it a real two-way dialogue. In addition, proposals are on the table to give supervisory directors a much more emphatic role in directing the accountant, which is also a good development. In the context of the checks and balances that characterise modern corporate governance, the external accountant must primarily serve the supervisory role of the supervisory directors, in particular the audit committee.

It is in my opinion also up to the supervisory directors to keep an eye on issues such as the quality of the audit, the relationship between audit and advisory work, the possible advantages of issuing a new tender for the audit, obtaining information about the opinion of regulatory bodies of accounting organisations, etc. This, by the way, also implies focusing on the quality and the attitude of the supervisory directors. There are some concerns about this among Dutch supervisory directors, particularly at medium-sized and small enterprises.

Moreover, I would applaud a much more lively debate during the general meeting of shareholders about the quality and the design of the audit. It is a wonderful paradox that shareholders are also demanding a broader role for the accountant, but those same shareholders enthusiastically applaud when the audit fee is reduced. Then, the broad quality debate loses its credibility.

The question is whether all of this is enough. Far-reaching ideas about fundamental changes to the current system are doing the rounds in politics, not least here in Brussels. Joint audits, mandatory firm rotation, segregation of audit and advisory, splitting up the Big Four – today, these are familiar proposals that caused a shockwave in the accounting world. I think that justified questions are being raised regarding several of these proposals. It is not clear by a long stretch exactly which problems will be resolved by the ideas floating all over the place. Apart from that, some of the proposals actually appear more of a threat to than an improvement of the quality of the profession.

For instance, I can very well imagine that it could be healthy for a business to change auditor from time to time. That will ensure a fresh look at things and prevent an all too familiar relationship between the business and the auditor. The only question is whether you're not risking defeating the objective with mandatory firm rotation as is currently suggested.

At the moment we see that changing the accountant often puts pressure on the fee, while everyone knows that a lot has to be invested precisely when starting a new audit relationship in order to get to know the business. This then leaves you facing contrasting incentives that rather affect the quality of the audit negatively than positively. In addition, a legally enforceable rotation period may not suit an individual company because, for example, it may be busy with a merger or be under severe market pressure. In that case, a new auditor may just be the trigger in the wrong direction.

The only question is whether accountants are the best placed parties to raise concerns about mandatory firm rotation. Why would they? Regular rotation opens up the market and offers fresh opportunities to work with new clients. It will cause some anxiety in the beginning but eventually it will offer every

accountant a fair chance to present themselves to a potential client. There are good reasons for not wanting mandatory firm rotation; however, by assuming the role of advocate for their own cause, accountants are running the risk that others may suspect a hidden agenda for holding off firm rotation. In politics certainly, people not only look at the message but also at the messenger.

This example also reveals another weakness in the way many accounting firms have thus far conducted the debate. It is no big deal to shoot down every proposal calling for change in how accountants do their work by listing more disadvantages than advantages: prices are increasing, the client faces more effort, quality deteriorates, etc. But the question posed far too seldom by accountants so far is whether the relevant proposal, despite all these disadvantages, cannot also contribute to regaining public confidence in the auditor's report. And that is really what it is all about. And seen in that context, the identified disadvantages may well appear not such an obstacle.

In doing this, we have to be very careful. Nobody benefits from experiments with uncertain outcomes, certainly not in these times. We must also not lose sight of the task of identifying and reducing system risks and not overreact with solutions for sectors where there are no problems. This leads to unnecessary cost increases without any public benefit.

However, accountants cannot remain on the sideline; they, too, will have to identify their own 'lessons learned', what contribution they can make towards reducing existing system risks and what they are doing to regain public confidence. We don't really know that much about large economic crises because, thankfully, there have not been so many. What we do know, however, is that the next crisis is always bigger than the last. That is why it is not feasible for accountants not to play their part in preventing a next crisis simply because they believe that the credit crisis was not their crisis.

We must keep the debate alive, also in the right quarters. Although as a former politician I very well understand the inclination of national politicians to personally take the wheel, also as a sign of decisive action to their own

constituents, I would like to warn emphatically against a fragmented debate concerning the role of accountancy. We are living in a global economy, with global players and global markets. This demands a global view and, where necessary, global standards and global measures. In recent years, a lot has been invested in harmonising the international rules for financial reporting and controls. This creates more better comparability between markets and, as such, greater transparency. It would lead to an enormous loss of capital if all this work is destroyed by individual countries reverting back to drawing up their own. If there is one lesson from the credit crisis, then it is that global economies are inextricably interwoven.

However, we have to keep up the pace. The aim to reach European and, preferable still, international agreements, must not be allowed to slow things down. I am therefore glad that the European Commission, in the person of Michel Barnier, is taking an active lead in the current debate.

Ladies and gentlemen,

The debate over the role of accountants following the credit crisis has gained a new, topical impulse in recent months in view of the developments in Greece. The current situation also clearly shows how unruly and stubborn the reality can sometimes be. Hence, a few observations.

It is evident that the Greek crisis poses enormous financial risks, not only for international and domestic authorities who are forced to lend billions to Greece in order to stem the crisis. Financial institutions too – banks, insurance companies and pension funds – have major interests in the balance. Directly through their investments in Greek government bonds and indirectly because they may face problems should a Greek crisis befall other countries, such as Spain and Portugal, or foreign financial institutions, such as French and German banks.

Nobody knows what the final outcome will be, but it is clear that the domino blocks are once more dangerously close to each other. When one domino block falls, we can only wait and see where the row of falling dominos will end. A potential second credit crisis may be in the making. The crucial question today is

what the role of accountants should be in this run-up to a potentially serious financial crisis? How can accountants guard against accusations later again that they merely acted as 'silent observers' and did not raise the alarm far more actively?

According to some observers, this is a different crisis from the credit crisis. For instance, we can see it approaching far earlier. Moreover, there is now on-going serious contact between regulators, financial institutions and accountants – partly as an outcome of the lessons learnt from the previous crisis.

But I can assure you that most, if not all, financial institutions will produce proper financial reports, including the unqualified auditor's report issued by the auditor. This, simply because current laws and regulations leave the accountant with no choice. And if the bubble never the less still bursts, accountants will yet again claim that they had acted in line with the applicable laws and regulations, and confidence in the very same accountants will once again suffer damage.

It is possible to do it differently. Accountants could force financial institutions to take their loss on the Greek government bonds they have in house, which will totally reflect the spirit of fair value accounting. Accountants could insist on forming substantial provisions, also for the case that the Greek crisis has a far greater impact than in Greece alone. Accountants can draw up risk scenarios. Accountants could issue qualified reports conditional upon market developments in Greece.

In a nutshell, accountants can do what some critics claim they had failed to do in the run-up to and during the credit crisis: raise the alarm and anticipate approaching doom.

The impact would be enormous. Even before we know the outcome of the Greek crisis, the balance sheets of all the European and other financial institutions will show major shifts, extra equity would probably have to be attracted in order to strengthen the sea defences, and there would be a good chance of major unrest resulting on financial markets, among the public and authorities.

The very critics who blame accountants for a lack in decisiveness would then be able to accuse accountants of playing to the gallery. It looks, therefore, as if accountants can never win, and perhaps that may even be true – now in these uncertain times, precisely because a period of crisis or near-crisis is not really ideal for experimenting. However, it should not stop us from considering fundamentally new choices of how we can strengthen confidence in the regulation of financial institutions.

Allow me to leave you with a thought on this topic: As minister of Finance, I have in recent years been closely involved at the core of financial regulation. I've had to bail out banks and I've had to let banks go bankrupt. And I have gradually come to the conclusion that the basic premise underpinning our system of financial regulation is no longer viable. This premise goes: no news is good news, and when news reaches you, it is too late, because then it has already gone wrong. In a post-Wikileaks era, this philosophy is unsustainable. The financial sector is one of the few sectors in society where trust and regulation are still largely based on secrecy. This will turn out to be unsustainable.

We are irrevocably moving towards a system of greater transparency on the basis assessment ratios in the public domain, with lenders and others also knowing in advance when exactly a regulator will take action and how it will take action. And this therefore also offers an incentive not to let things get that far. This is a responsibility they will only accept if they know that taxpayers are not prepared to bail them out. In other words, a new system of financial regulation, containing elements that are familiar to us from the North American practice in the field of prompt corrective action, and fitting in with modern insolvency laws for financial institutions. That is the real fundamental change that will have to contribute to confidence and trust in financial institutions and in every entity seen as regulating these institutions.

Ladies and gentlemen,

Truth is in the eye of the beholder. Public trust in the role and the functioning of accountants is vital, also when inaccurate presentations and unrealistic expectations affect this trust. Therefore I would like to plead: be good and tell it!

Invest in quality and innovation. Allow young people the space to develop into solid professionals. Spread the message that the goal to deliver the best possible professional quality is not obstacle to commercial success, but precisely an absolute condition. And especially get involved in the public debate. Spread the word!

Transparency is an essential asset of our modern-day culture. Accountants are in a unique position to assist other organisations in achieving transparency by providing access to relevant and reliable information. Accountants will personally also have to show what they do, how they do it, what dilemmas they encounter and how they contribute towards our shared goal: transparent, efficient and reliable markets.

Within KPMG, but also outside, I would like to assist on that mission. Because I believe in the work, the talent and the drive of colleagues I work with every day. Because I believe that accountants fulfil a vital role in the economic system. And because I believe that accountants can contribute towards giving trust a new lease of life in our society and again making it a concept that binds us together.

Regaining the public trust will build bridges to a brighter future.

Thank you.