We interviewed Mr Robert Peirce and asked him his views on being an external auditor for banks

(by Stephan Darimont, *Banking Boulevard,* Brussels, March 2012)

SD: Robert Peirce, good morning.

RP: Good morning

SD: You're a partner of the firm of PricewaterhouseCoopers in Brussels. Until recently, you were also chairman of the Belgian Institute of Bank Auditors. And, to top that off, you've taught financial information and how to audit it at several universities for over 20 years.

Today, I'd like to talk to you about your job as a banking auditor. Actually, it's a truly astonishing job, since it requires practitioners to somehow take a broad perspective, given how the different types of business banks do are so disparate, and yet it requires ever-more finely detailed specialism in subjects sometimes as arcane as mathematical modelling

RP: That's right. The job of a banking auditor has changed significantly in recent years due to the events that have come to haunt us in recent times, and it will be expanding into even more areas in the future. After all, it should be remembered that, in many countries like Belgium, Switzerland and, to a lesser extent, a couple of other European countries, the mission is twofold. It is not only an customer/service provider arrangement, i.e. to give comfort to the shareholders or investors as to the quality of the financial information, but in principle it is also part and parcel of the prudential oversight that is exercised over the markets, which is done hand in hand with the regulators. It's a profession that's gaining increasing attention from the European Union, which would like to see it made much more of a governance process for credit institutions; and in the United States, which would like to see much banking auditors and regulators getting much closer together. We're therefore in a far broader professional field than 15 – 20 years ago. The legal and regulatory aspects are vast, there's a need for actuaries, or, as you indicate, for modelling experts, you nowadays have to analyse macro-economic information. As the sovereign debt crisis is proving, we're faced with complex international taxation, supranational directives, government initiatives that sometimes contradict each other and, over and above all that, an increasingly complex information system.

Thus, now, if never before, there's no way you can go it alone to certify the fair view presented by financial information. In fact, the image of the expert of yore is now mutating into that of an orchestral conductor: he has to surround himself with high quality performers and musicians. His role is becoming that of a diagnostician, who has to identify the resources and skills that he has to have at hand. Financial institutions, banks, insurance companies and other firms are nowadays manned with people whose fields of expertise are increasingly specialised. In order to audit them, therefore, he has to surround himself with experts who're at least as specialised as the people he's auditing. So, the game has shifted; and it's not without its risks. It involves a cost. Investors and managers need to be convinced that it's a process that they can no longer duck. All of which goes to show that this is a job in evolution, opening up the way to new skills, even new careers, and is

on the strategic planning agenda of most of the big firms, including Price Waterhouse, which I'm a partner of.

SD: You talked just now about "fair view": here, too, things are sometimes far from simple because the fair view concept stems from accounting and regulatory standards that differ from continent to continent, or even from country to country, even within the European Union, isn't that so?

RP: Absolutely. This is an excessively complex issue, and one that has given rise to a great deal of criticism. Are the accounts still relevant? Do auditors still have any role to play in this context? Added to which, a host of parties with an interest in the information are unaware of the narrow scope that an audit actually covers. Investors, the workforce and some authorities are unaware that an audit only offers comfort to a limited degree. Of course, they're much more aware of the scandals. Everyone's heard of Enron and knows that it saw the demise of a highly renowned audit firm just after the millennium, with the loss of 100,000 jobs. In short, the populist images are well rehearsed. The input and integrity that the job calls for are much less well known. Because, ultimately, what does certifying a fair view mean? All it is is confirming that financial statements, a piece of financial information, correspond to a set of rules. The fact is, all would be well if there were just one set of rules. Unfortunately, countries have developed different sets of rules and it took a long time before we saw any international standards. What's more, the tax rules are different from these rules. Some regulations also differ, some regulators' rules do as well, and so you arrive at a paradox in which a single company has several sets of financial statements, which the auditor certifies all give a fair view, even though the results differ. There is therefore a truly urgent need for clarification. Yet another dimension has come to complicate our understanding of what is a fair view: the notion of fair value. Fair value is now present in all financial information, it's very hard to understand, it differs from net asset principles and in fact it creates veritable antagonism between the view taken by the markets and the vision of stability that our regulators would like to see installed. This doesn't make it any easier to get a handle on what a fair view is. It ought therefore to be clarified and made much more comprehensible. I feel that the role of the auditor will need to evolve in a number of directions. For example, where an establishment requires to make a judgment on the value of an asset, transaction or product. Its judgment will have to be given in a manner that's transparent, with the auditor's opinion pronouncing on the relevance of that judgment in the circumstances such as they exist. There is also a form of communication that will have to change: avoiding wooden language where operating risks need to be disclosed, for instance. The same goes for good governance reporting, which ends up being nothing but platitudes to please the masses: are the rules actually being stuck to? A sea change is needed to go way beyond simple mechanical application of the accounting rules. All these new assessments, new checks and new judgments will inevitably create reliance on new skills. If you very quickly look at how things have developed over time, at Enron and the scandals at the beginning of the noughties, they all led to greater emphasis being placed on internal control. That's the direction that was embarked on. Today's financial crises are showing that there are behavioural malaises that go far beyond what can be remedied just by internal controls. Which is why the skills that can be wielded by the players on the scene have to extend much wider than they did in the past.

SD: You seem to be saying that continuous education of banking audit professionals is crucial for audit firms on a number of grounds, because that's the foundation for their quality hallmark, which is a matter of competition between them. Is it therefore a question of who invests most in training?

RP: Now and in future, training is not only crucial, it's becoming the prime competitive argument among the big firms for attracting the best talent. They are therefore having to develop even more intense internal training to keep skills and quality at a top level. Astonishingly, even though we figure that skills are the prime guarantors of the profession's credibility, the authorities, including the European authorities, are instead developing structural solutions that are aimed at ensuring better independence. That poses a conflict. It's true that independence and competence are necessary for quality. But, if independence requirements end up having to limit the fields experts can work in (like I told you: an orchestral conductor surrounding himself with experts) and he can only exercise his skills in a context of "verification", it's pretty certain he'll quit the job, which will be bad for audit quality and bad for the credibility of the profession. The situation is therefore a fairly unenviable one. Independence and competence belong together. If one of them is missing, either the auditor's remarks are irrelevant or they risk being lax. There is no alternative, therefore, but for the big firms, despite everything, to wager on training as the only ultimate solution to ensure their survival.

SD: Well, that takes care of banking auditors. Since the sector got into crisis in 2008, we've seen nothing but banking legislation splashed across the headlines. Regulators and governments want to sharpen their analyses at any price; we hear of beefed-up controls on banks' liquidity, and many others. You're at the heart of the external audit professions. What do you have to say on the changes that are currently taking place in the banking sector and how far are these changes affecting how you do your job?

RP: The mass of legislation and regulation has skyrocketed, and we're probably only seeing the tip of the iceberg. New regulations, new ratios, a whole panoply of restrictions, which are taking an inevitable toll on businesses, their room for development, even their size and their products. A further aspect away from the regulatory field is a change in the area of sales: smartphones and tablets will become the primary tool for accessing the retail part of the market. So, we're seeing new players. The technological dimension has to get bigger and it's conceivable that the next competitors won't be banks battling against banks but the involvement of technology firms bringing the technology closer to the customers. Yet another aspect is the shifts in social, environmental and demographic pressures, which are changing the operating model. This is something that has to be factored in today. Communication will also have to develop along these lines. And these changes are even having an effect within the profession. The catastrophes we've seen, as in Japan and a good many others, will inevitably provoke changes in the attitude taken by bankers in terms of lending. This is a major factor. Austerity measures will also affect the conditions under which loans are granted, just to take that example. So, new means of communication, new products, new measures: new talent. And, where do you find talent? First up: we go to the competition. Second: we look abroad. Neither route has come to anything. Going

to the competition is met with retaliation: it's an option that quickly becomes a stalemate. Going abroad is a costly solution that brings in staff who are not necessarily loyal to their employer. A stop-gap, in other words. What's the long-term solution? In fact, there's no real solution that's within reach. The best solution needs imagination and creativity, you need to dovetail into your organisation people that, first, have a sense of security, have the feeling that they can really put their skills to work and who are given training that gives them the boost they need to get to the next level and is underwritten by the firm or by HR players in some cases. All this will mean a higher cost: it's a major challenge that will be hard to manage, but one that we've already made a start on.

SD: Thank you, Robert Peirce.

RP:**And thank you!**