



Brendan Nelson



Scott Marcello

Brendan Nelson and Scott Marcello explore the possible need to expand the future role of the auditor in financial services.

The role of the auditor in financial services: Is reform desirable?

Clarity and reality

Financial Reporting today is clearly complex and often not well understood. Why is this the case? One key reason is that we often lose sight of what should be the overriding objectives. Too often, we succumb to treatments and positions that we believe to be conceptually pure or technically superior but that are potentially less than relevant and all too often not understandable.

In the extreme, what good is served if each and every accounting pronouncement is perfectly consistent, globally harmonized, and aligned with well developed conceptual underpinnings, if users find that information wholly irrelevant and incomprehensible? Adding to this, the objectives or underlying concepts used to develop accounting standards are not really agreed; this is particularly true when you consider issues from a global perspective. This was evident in the recent debate in the US regarding fair

value accounting for investments. Some people strongly support the use of fair value, others hate it. Probably a majority believe it is a valid principle, but have significant concerns about when it should be viewed as the most relevant attribute for measurement in financial statements. Vast amounts of energy have been invested in this issue but confusion remains.

Another issue is, frankly, who reads all of this information anyway? Annual reports today have grown to hundreds of pages, including information of widely varying importance and relevance. How many people read and really understand all of this information? Is it more than a handful of people? And how many is that when you exclude the auditors, certain members of management and certain regulators?

The role and involvement of the auditor with respect to information also may often be poorly understood. Most people recognize the technical content an auditor provides: their opinion on the

fair presentation of a company's financial statements and, in some cases, the internal controls relevant for financial reporting. But there is a vast amount of information included in companies' filings that is not subject to audit work. Users of financial statements may be quite surprised to learn that many pieces of information that they view as being very significant to their analysis are not covered by the audit – liquidity for example.

So how can the auditing profession contribute to improving the global paradigms for regulation and financial reporting? Accountants, when you think about it, can help in leading the debate. When it comes to accounting rules and financial statement reporting, they can help keep the real goals in sight and in proper perspective. Apart from the regulators, accountants are one of the few groups uniquely qualified to understand complex financial institutions and provide genuine insight about their business, their operations and their



Apart from the regulators, accountants are one of the few groups uniquely qualified to understand complex financial institutions and provide genuine insight about their business, their operations and their reported information. They can bring a varied and global perspective, and professionalism and objectivity to important and challenging debates.

reported information. They can bring a varied and global perspective, and professionalism and objectivity to important and challenging debates.

Progressing that thought, together, management, regulators and auditors have to move toward providing insight and important perspective rather than expanses of accurate, but possibly less relevant information:

- more relevant and important information has to be prioritized and unimportant, obvious, or

redundant information has to be eliminated from the equation

- second guessing should be minimized while still respecting the need to protect stakeholders
- it needs to be recognized that the role of financial reporting is to provide relevant and reasonably reliable information, not to predict the future with certainty
- and it's important to recognize the judgment and intellectual capital that can be added by management, regulators and auditors

On this last point, a critical question is whether this intellectual capital will flow freely and to its full extent if it is hampered by the potential for significant legal liabilities. The potential liability issues that prevail, particularly in America, may now need to be finally and fully addressed.

Now you could argue we would say this wouldn't we? But we genuinely believe that reform *is* desirable and that the auditing profession can and should make a significant contribution.

For more information please contact:

Brendan Nelson
Vice Chairman, KPMG in the UK
Global Chairman, Financial Services
Tel: +44 20 7311 6157
e-Mail: brendan.nelson@kpmg.co.uk

Scott Marcello
Joint Regional Coordinating Partner,
Financial Services, Americas region
Tel: +1 614 249 2366
e-Mail: smarcello@kpmg.com