

MEMORANDUM ON IAASB INVITATION TO COMMENT ON AUDITORS' REPORT

Background

The discussion about the contents of the auditors' report and the lack of clarity of its almost 'encrypted' language when read by the general public is not a new one. All improvements will then be welcome, with certain restrictions, for: (i) the user of financial statements and of the auditors' opinion is supposed not to be completely illiterate in terms of accounting and auditing; and (ii) a report that is too long and dense is likely to divert the reader's attention from essential issues, not necessarily contributing to enhance information quality nor to cover the information gap.

General remarks

Regarding the information gap it seems that some of the financial statements users' requests sound a little bit childish, in my personal view. There are indeed very important, strategic reasons for Management to have access to an amount of information substantially wider, detailed and deeper than the one that is made available to the public in general (outsiders), even if and when some of these outsiders are shareholders or other very legitimate stakeholders.

In principle, except if a new set of procedures is imposed to auditors, information on assessment, nature and management of the entity's risks **should in no instance be given by the auditor**, for there would be the danger of transmitting incomplete information. In principle, as the 'owners' of the totality of information are the managers and those charged with governance, these are the ones that can prepare, compile and disclose such information. The role of auditors **should continue to be** that of giving a certain level of assurance on those representations to the general public. Specifically, some areas (below) might be given additional attention, but this is the field of accounting standard setters, not IFAC.

- There should be acceptable that risks more specific to the entity be covered by explanatory notes (i.e., be Management representations).
- Key assumptions underlying judgments are supposed to be covered by explanatory notes. So, they are covered by the auditors' opinion and the need for a specific opinion on that **does not seem to be sufficiently justified**.
- Appropriateness of accounting policies chosen and changes on them: this is part of what an accounting framework should cover. In that case, it is supposed that that accounting policies and their changes, whenever relevant to understand the financial position, performance and cash flow of the entity, are

duly disclosed in notes. All of this is covered by the auditors' report, and the existence or not of any qualification or modification is enough to communicate to the user whether these accounting policies are right or wrong.

- Corporate governance is an interesting point. For the auditor to give an opinion on its effectiveness additional, specific procedures (similar to PCAOB requirements) should be required and, most likely, this may lead to a separate report (or separate paragraph(s)) disclosing responsibilities, procedures and opinion.

Direct communication between auditors and users is an item that could deserve some further attention, but, in the present circumstances I cannot see any practical purpose, as the auditors' report is supposed to be a public document.

In connection with wide publicity to auditors' reports, I evolved to the idea of creating a sort of repository (Internet or the cloud may be explored) of auditors' reports, always accompanied by the reporting elements they refer to. Anyone could then retrieve such documents (this cannot comprise, obviously, of documents that have restricted circulation, such as reports on due diligence investigations or agreed-upon procedures).

Specific issues for IAASB to pay attention

It may be useful to enrich the auditor report in order to contribute to close the information gap, but this has to be done without converting the auditor report in a long, confusing document, where most readers be unable to distinguish important information from irrelevant one. The aim is to add substance, not length.

We need to look at each category of users:

- (a) Shareholders that are not in a position to request detailed information, tailored to their needs: taking into consideration that these users are not necessarily technically prepared to deeply understand financial statements, more information in the auditors' report may contribute to narrow the information gap, but may add to the difficulties these users have to understand the report and the financial statements themselves.
- (b) Banks, institutional investors and professional analysts, can be slightly benefitted by additional information, but the amount of information on auditing procedures they could require would probably collide with the need of confidentiality of auditors' work papers. On the other hand, some of these parties many times are in a position to request specific information or may have the right to perform specific procedures carried out by their own professionals.
- (c) Government bodies and agencies, as a general rule, take the information in the financial statements just as a reference, or confirmation of financial position and

performance, for they are in a position to request specific information, to require that specific rules be applied for recognition and measurement and to send their own auditors to inspect the entity's accounting records and documentation. It does not seem that changes in the auditors' report can make any difference, except if and where additional responsibilities are given to the auditor regarding compliance with laws and regulations and with accuracy of taxes calculated and paid.

When thinking about the differences that may apply to different sizes of entities, the audit approach, the audit procedures and the content of reports should be the same. Proportionality will then be applied and make the difference.

In connection with the structure of auditors' report, current structure seems adequate. It follows a logical, didactic sequence and is educative, conducting the reader from a broad definition of the assignment and object of the examination, through a summary of the parties' responsibilities and coming to a conclusion (the opinion), letting other aspects (emphasis inclusive) duly segregated from the conclusion, clearly indicating that the opinion is not affected by those other aspects.

Issues that could be discussed to enhance transparency and to clarify certain aspects are:

- (a) Management responsibilities: further explain the role of governance bodies and Management, with an emphasis on the 'philosophical' base of relevant estimates, reasons for significant choices made when electing accounting policies, main (specific) valuation procedures, corporate governance structure, and the like.
- (b) Auditors' role and responsibilities: further explanations could be added regarding risk assessment considerations, rationale and responses (again, specific, relevant details, not generic blah, blah, blah). Alert: if and when a great deal of detail is necessary, the use of attachments could be thought of, in order not to make a too long report with details that may not be useful for a number of trained users. Auditors responsibilities regarding fraud should be explained in plain language.
- (c) Auditors' procedures: there may be considered the convenience of describing certain main procedures and those related to fraud, if any. Again, if a great mass of information can result from this, details may be included in attachments, to be read by users less familiar with auditing standards.
- (d) 'Other aspects' chapter could be more and better populated (see comments in other parts of this document).
- (e) **Any reference to going concern in the auditors' report has to be handled with great care. I personally am under the impression that if standard setters turn mandatory any form of debate on this issue in the auditors' report this may bring more risk than the market and the users can digest. I think that a**

general rule to include such comments in all the reports can raise suspicions of problems where there are not.

I strongly support the idea of: auditors' report should remain a single document; self explanatory sequence is also important for a number of less-trained users; conclusion must be placed after explanations on responsibilities and procedures (not at the beginning of the report); and additional details or information could be included in attachments, duly referenced in the main report.

The inclusion of a statement about auditors' responsibilities regarding other information in documents containing financial statements is perfectly understandable and sounds reasonable. There are many pieces of information in the MD&A that are related, extracted or/and linked to accounting records and documentation or is correlated to them. This information is likely to merit a certain level of assurance by auditors.

The problem I see is that MD&A includes certain pieces of information that would probably not be covered, at least under an assurance perspective, by the auditors' procedures, such as: market share; estimates on future trends of industry or/and consumption; projections of GDP growth; etc.

My proposal is that information in the MD&A that may be subjected to some sort of assurance be: (i) segregated in an specific part or chapter of the report (but this does not seem practical, as it may truncate the rationales or the sequence of information; or (ii) 'earmarked' or somehow covered by references, wherever and whenever it appears in the MD&A and specifically covered by an additional paragraph or paragraphs in the auditors' report. The wording in these paragraphs should refer to **"information that was extracted or is coherent with accounting records or/and documentation that forms part of the universe of information subjected to auditing procedures, as referred in this report"**.

The auditor may add details regarding procedures and limitations, with a view to the user to better understand the auditors' role. Again, I have a specific concern regarding the excess of information in the, say, auditor's main report; for this detail not to jeopardize a good understanding by the reader. Taking this into consideration, I would propose that details on procedures, limitations, risk assessment and auditor's response would be included in attachment(s).

I strongly oppose the idea of the auditor providing insights about the entity or the quality of its financial reporting in the auditor's report. The quality of the financial reporting depends on the accounting policies selected, on the internal controls put in place by Management, especially those that result in the preparation of the financials, and on a consistent effort towards quality carried out by a series of actors: persons responsible for corporate governance; committees; management and the entity's personnel as a whole. The result of such effort is a set of financial statements that is subjected to the examination of independent professionals. The possibility of the auditor including comments on these aspects can be confusing:

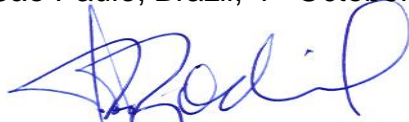
quality and adherence to the applicable accounting framework are the object of the auditor report. It has to be clear that the result is black (qualified) or white (clean opinion). Comments that do not affect opinion are very well placed as emphasis of matter or other issues. Period. Any other comment can be bad to the reader's understanding.

On the other hand, a report by the Audit Committee is an idea to be explored. In principle, it seems to me that such a report should explain the role and responsibilities of the Committee and comments on the procedures and results of those procedures, leading to the recommendation or conclusion on the financial statements. Guidance given by the Committee to the Management regarding choice of accounting policies may also be revealed.

I also believe that a report issued by those charged with governance would be appropriate, as a sort of sub product and to the extent the information is 'auditable'.

In connection with the above proposed 'earmarked' information in MD&A; Audit Committee report; additional information on risk assessment; report from those charged with governance; etc., if IAASB come to the conclusion that these elements may be useful, IAASB should design audit standards of assurance for the auditors to be able to report on that.

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