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INSTITUTO DOS AUDITORES INDEPENDENTES DO BRASIL

November 22, 2013
Ref.: SEC/210/2013 - DN

International Auditing and Assurance Standards Board **(IAASB)**
529 Fifth Avenue, 6th Floor
New York, New York, 10017
USA

Dear Sirs,

We, the Ibracon – Instituto dos Auditores Independentes do Brasil (Institute of Independent Auditors of Brazil), appreciate the opportunity to comment on the Exposure Draft of the Proposed New and Revised International Standards on Auditing (ISAs), as developed by the International Auditing and Assurance Standards Board (IAASB).

In general, we are supportive to changes to the current model of the audit report; however we have relevant concerns if key audit matters proposed section will in fact provide more information to the user of the audited financial statements or will cause more doubts. We also provided an observation that the expanded requirement to auditors report on going concern should be preceded by changes in guidance on the standards associated to the preparation of financial statements and associated assertion to going concern provided by management.

Our responses to each of the question made in the Request for Comments document are included in the Appendix to this letter.

Sincerely,

Idésio da Silva Coelho Júnior
National Technical Director
Ibracon - Instituto dos Auditores Independentes do Brasil

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Appendix I

Responses to request for specific comments:

Key Audit Matters

1. Do users of the audited financial statements believe that the introduction of a new section in the auditor's report describing the matters the auditor determined to be of most significance in the audit will enhance the usefulness of the auditor's report? If not, why?

Response:

We are an institute representative of the audit profession in Brazil; accordingly, we opted not to respond to this question directed to users of financial statements. However, through this response letter we comment our views and concerns regarding the introduction of the proposed key audit matters section to the audit report.

2. Do respondents believe the proposed requirements and related application material in proposed ISA 701 provide an appropriate framework to guide the auditor's judgment in determining the key audit matters? If not, why? Do respondents believe the application of proposed ISA 701 will result in reasonably consistent auditor judgments about what matters are determined to be the key audit matters? If not, why?

Response:

Except for our comments on paragraph 8 (c) as described below, we believe that the requirements and related application material proposed in ISA 701 provide an appropriate guide for determining the key audit matters by the auditors.

Regarding the consistency among auditors, we believe that judgment, experience and the approach adopted by different auditors may lead to different conclusions in determining the key audit matters. However, we also believe that the level of detail necessary to eliminate such differences would result in a prescriptive standard, which we feel would not be appropriate for a standard that aims to be based on principles.

Regarding paragraph 8 (c), we believe that its current wording may be understood as requiring that any significant modification of the auditor's planned approach would result in a key audit matter. However, we believe that this will not always be the case. For example: in some cases a significant modification may occur following a more efficient audit approach to test a specific account or process. In this scenario, we understand such modification would not be determined to be a key audit matter. Based on this understanding we propose the following amendment:

> *8.(c) Circumstances that required significant modification of the auditor´s planned approach to the audit* ***as a result of significant difficulties, contentious matters,***

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***etc., identified during the course of the audit**, including as a result of the identification of a significant deficiency in internal control.*

3. Do respondents believe the proposed requirements and related application material in proposed ISA 701 provide sufficient direction to enable the auditor to appropriately consider what should be included in the descriptions of individual key audit matters to be communicated in the auditor's report? If not, why?

Response:

Yes. We believe that the proposed ISA 701 provides sufficient direction to enable the auditor to communicate key audit matters in the auditor's report

4. Which of the illustrative examples of key audit matters, or features of them, did respondents find most useful or informative, and why? Which examples, or features of them, were seen as less useful or lacking in informational value, and why? Respondents are invited to provide any additional feedback on the usefulness of the individual examples of key audit matters, including areas for improvement.

Response:

We support the inclusion of examples. In general, we believe that all the different situations give a good illustration and are therefore useful for the purposes of issuing the standard. However we believe that some changes are necessary in some of the examples included, as indicated below.

Valuation of Financial Instruments

> "…. *The Group's investments in structured financial instruments represent [x%] of the total amount of its financial instruments*…..

We believe that the inclusion of the % that these financial instruments represent in terms of the total of financial instruments does not seem to be sufficiently useful information. It would be more useful to inform how much these financial instruments represent in relation to the total assets or equity.

> "…..*We challenged management's rationale for using an entity-developed model, and discussed this with [those charged with governance], and we concluded the use of such a model was appropriate*…."

Firstly, the copied part above, we believe, should be part of the procedures performed and not of the additional information to the work performed. Secondly, we believe that it is not appropriate to include the conclusion here since it is not the objective of the auditor to conclude on each topic individually in this section of the report.

Acquisition of XYZ Business

According to the proposed ISA 701, it is required to disclose the auditing procedures applied and therefore this example is incomplete and not in accordance with the proposed standard.

Revenue Recognition Relating to Long-Term Contracts

This example was the one that generated most debate in our evaluation. It was not clear in which circumstances or context it would be included, i.e., whether or not problems were found by the auditor.

It seemed to us that this item was included simply because the auditor was unable to refute the risk of material misstatement brought by ISA 240.26: "When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition…"

As it is proposed, we understand that paragraphs similar to this one, and related to revenue recognition, will always be included in the reports in general, which we believe is not appropriate according to the proposed ISA 701.

Therefore, we recommend changing the example to make it more objective and intelligible and/or alternatively, include facts and circumstances and the rationale behind the inclusion of this example.

5. Do respondents agree with the approach the IAASB has taken in relation to key audit matters for entities for which the auditor is not required to provide such communication – that is, key audit matters may be communicated on a voluntary basis but, if so, proposed ISA 701 must be followed and the auditor must signal this intent in the audit engagement letter? If not, why? Are there other practical considerations that may affect the auditor's ability to decide to communicate key audit matters when not otherwise required to do so that should be acknowledged by the IAASB in the proposed standards?

Response:

We agree with respect to the provision that the communication of key audit matters should not be mandatory for companies that are not listed

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Therefore, we believe in cases in which the presentation of key audit matters is voluntary; the decision on its use in the auditor's report must be clearly defined in the engagement letter under the responsibility of the entity. We suggest including in the new standard a paragraph to make clear how and when it is decided and that this decision should be clearly stated in the engagement letter. We suggest that this issue also be emphasized in ISA 210.

6. Do respondents believe it is appropriate for proposed ISA 701 to allow for the possibility that the auditor may determine that there are no key audit matters to communicate?

(a) If so, do respondents agree with the proposed requirements addressing such circumstances?

<u>Response:</u>

Yes, we believe it is appropriate for the proposed ISA 701 to allow for the possibility that the auditor may determine that there are no key audit matters to communicate, additionally we believe that the requirement in paragraph 13 in conjunction with the application guide A47 and A48 are reasonable.

(b) If not, do respondents believe that auditors would be required to always communicate at least one key audit matter, or are there other actions that could be taken to ensure users of the financial statements are aware of the auditor's responsibilities under proposed ISA 701 and the determination, in the auditor's professional judgment, that there are no key audit matters to communicate?

<u>Response:</u>

N/A

7. Do respondents agree that, when comparative financial information is presented, the auditor's communication of key audit matters should be limited to the audit of the most recent financial period in light of the practical challenges explained in paragraph 65? If not, how do respondents suggest these issues could be effectively addressed?

<u>Response:</u>

Yes, we agree that when comparative financial information is presented, or either corresponding figures are presented, the auditor's communication of key audit matters should be limited to the audit of the most recent financial period.

8. Do respondents agree with the IAASB's decision to retain the concepts of Emphasis of Matter paragraphs and Other Matter paragraphs, even when the auditor is required to communicate key audit matters, and how such concepts have been differentiated in the Proposed ISAs? If not, why?

Response:

We understand that retaining the concepts of Emphasis of Matter and Other Matter paragraphs when the auditor is required to communicate key audit matters may cause misunderstanding to auditors in the preparation of their reports, and confusion to users of financial statements to understand such report.

It is unlikely that issues that would lead the auditor to include an Emphasis of Matter or Other Matter paragraph would not be a key audit matter. Therefore, we suggest that the concepts of emphasis and Other Matters paragraph should be retained only to the cases where auditors are engaged by non-listed companies to issue an auditors' report without the inclusion of key audit matters or it be used in very rare situations for listed companies. Examples of issues that would be included in Other Matters paragraph could be the change in auditors or restatements of prior year financial statements due to changes in accounting standards, polices or errors.

Going Concern

9. Do respondents agree with the statements included in the illustrative auditor's reports relating to:

(a) The appropriateness of management's use of the going concern basis of accounting in the preparation of the entity's financial statements?

Response:

Regarding the appropriateness of management's use of the going concern basis of accounting in preparing the entity's financial statements, we note that ISA 570 already requires the auditor to evaluate management's assessment of the entity's ability to continue on a going concern basis, and to perform additional procedures in case of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

IAS 1 requires that 'when an entity has a history of profitable operations and ready access to financial resources, the entity may reach a conclusion that the going concern basis of accounting is appropriate without detailed analysis' and without disclosures. Therefore, we believe that current IAS 1 should include more requirements and guidance for preparers of the financial statements, regarding their assessment of the entity's ability to continue on a going concern basis.

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Whereas accounting standards do not require any disclosure related to the appropriate use of the going concern basis of accounting in the preparation of the entity's financial statements, we strongly disagree with the proposal of including a requirement for auditors to provide a conclusion on the appropriateness of management's use of the going concern basis of accounting.

However, if the Board decides to maintain such a requirement, we believe that the following matters should be addressed in contact with standard setter bodies:

- *Financial statement preparers should have a requirement to perform a going concern assessment under all circumstances and a requirement to make an explicit disclosure to the entity's financial statements of the assessment's result, including the entity's analysis of its operational and business risks and their impact of the going concern analysis. This requirement, we understand, will be dependent of changes in the accounting standard.*

- *The current wording in the first paragraph of the Going Concern section as proposed in the 'Illustrative Auditor´s Report' should be amended as follows:*

  The consolidated financial statements of the Group have been prepared ***<u>by management</u>*** *using the going concern basis of accounting.* ***<u>In accordance with the International Financial Reporting Standards</u>*** *the use of this basis of accounting is appropriate unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so. As part of our audit of the consolidated financial statements, we have concluded that management's use of the going concern basis of accounting in the preparation of the Group's consolidated financial statements is appropriate.*

(b) Whether the auditor has identified a material uncertainty that may cast significant doubt on the entity's ability to concern, including when such an uncertainty has been identified (see the Appendix of proposed ISA 570 (Revised)?

In this regard, the IAASB is particularly interested in views as to whether such reporting, and the potential implications thereof, will be misunderstood or misinterpreted by users of the financial statements.

<u>Response:</u>

We recognize the efforts of the IAASB to discuss the options to enhance the quality of the auditor's report. However, we believe that the auditor should not be the primary party responsible for providing the statement that 'management has not identified a material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern. Instead, we believe that this explicit statement should be disclosed first by the preparers in the notes to the financial statements in order to allow the auditor to review/audit such assessment and then make a reference in the auditor's report.

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Therefore, we do not agree with the proposed paragraph to be added to the auditors' report in all circumstances other than when management states that there is a material uncertainty (and the auditor adds an emphasis of matter paragraph).

However, if the Board decides to maintain such a requirement, we believe that the following matters should be addressed:

(i) *to achieve the appropriate use of the management's use of the going concern basis of accounting in the preparation of the entity's financial statements it would be necessary that the prepares had a requirement to perform a going concern assessment and disclose their going concern assessment in the context of the preparation of the financial statements. The same requirement would be necessary in case management's assessment identified a material uncertainty.*

Based on that, we suggest the following amendments to the 'Going Concern Basis of Accounting':

- *When a material uncertainty has been identified (Going Concern Basis of Accounting in the Illustration 2 of the Appendix to the proposed ISA 570):*

  <u>As described in Note X, management's assessment on</u> *the material uncertainty identified above does not indicate that the going concern basis of accounting is inappropriate.* ***<u>Therefore, in accordance with International Financial Reporting Standards,</u>*** *the Company's financial statements have been prepared using the going concern basis of accounting. The use of the going concern basis of accounting is appropriate unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so. As part of our audit of the financial statements, we have concluded that management's use of the going concern basis of accounting in the preparation of the Company's financial statements is appropriate.*

(ii) *in addition to the comments above we also suggest the paragraph A23 of the proposed ISA 570 to be amended not only to emphasize the use of a subheading. We believe that this paragraph should reinforce the need that the auditor's conclusion about the entity's ability to continue as a going concern should be expressed through the use of the term "material uncertainty" or equivalent, such as "significant doubt" following the requirements in paragraph 21 (b) of the proposed ISA 570. Our suggestion is to avoid that such situations may be lightened or softened by the inclusion words like 'doubt' or 'uncertainty'. Based on that we suggest the following amendments:*

- *A23. The identification of a material uncertainty is a matter that is important to users' understanding of the financial statements. The use of a subheading to* *clearly make reference to the fact that a material uncertainty has been identified and positioning this statement before the auditor's statement in relation to the appropriateness of management's use of the going concern basis of accounting alerts users to this circumstance.* ***Additionally, the auditor's conclusion about the entity's ability to continue as a going concern should be expressed through the use of the term "material uncertainty" or equivalent, such as "significant doubt" following the requirements in paragraph 21 (b).***

10. What are respondents' views as to whether an explicit statement that neither management nor the auditor can guarantee the entity's ability to continue as a going concern should be required in the auditor's report whether or not a material uncertainty has been identified?

Response:

We agree with the explicit statement that neither management nor the auditor can guarantee the entity's ability to continue as a going concern should be required in the auditor's report.

Compliance with Independent or Other Relevant Ethical Requirements

11. What are respondents' views as to the benefits and practical implications of the proposed requirement to disclose the source(s) of independence and other relevant ethical requirements in the auditor's report?

Response:

Independence and compliance with all other relevant ethical requirements are of great importance to enhance the overall credibility, therefore, we understand that the auditor's report should disclose the source(s) of independence and other relevant ethical requirements. But in the case of consolidated financial statements with multi-location components such disclosure should be limited to the IESBA's requirements (Code of Ethics for Professional Accountants of the International Ethics Standards Board for Accountants) or relevant Code, and the Code of Ethics in force at the Parent Company's jurisdiction. Detailing the various jurisdictions would not add value to the audit report.

Disclosure of the Name of the Engagement Partner

12. What are respondents' views as to the proposal to require disclosure of the name of the engagement partner for audits of financial statements of listed entities and include a "harm's way exemption"? What difficulties, if any, may arise at the national level as a result of this requirement?

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Response:

The disclosure of the engagement partner is already required in Brazil. We understand and agree that such requirement should be determined by each jurisdiction.

Other Improvements to Proposed ISA 700 (Revised)

13. What are respondents' views as to the appropriateness of the changes to ISA 700 described in paragraph 102 and how the proposed requirements have been articulated?

Response:

We are supportive with respect to the current proposals described in paragraph 102 regarding: (i) responsibilities of the auditor and key features of the audit, including the provision for reference to be made to such a description on the website of an appropriate authority and regarding this decision to be taken in each jurisdiction; (ii) reference to whom is responsible for overseeing the Company's financial reporting process; and (iii) the flexibility for national standard setters to determine how best to place the auditor's communication about other reporting responsibilities.

14. What are respondents' views on the proposal not to mandate the ordering of sections of the auditor's report in any way, even when law, regulation or national auditing standards do not require a specific order? Do respondents believe the level of prescription within proposed ISA 700 (Revised) (both within the requirements in paragraphs 20–45 and the circumstances addressed in paragraphs 46–48 of the proposed ISA) reflects an appropriate balance between consistency in auditor reporting globally when reference is made to the ISAs in the auditor's report, and the need for flexibility to accommodate national reporting circumstances?

Response:

Although we understand the Board's view that an auditor report should be specifically tailored to each jurisdiction, we believe that mandate (or strong recommendation) for the ordering of sections of the auditor's report would be recommended.

With the globalization of accounting and auditing rules, we understand that a standard ordering will help users in every country read and properly review the auditor's report. Allowing each country or regulator to establish the ordering could lead users to misunderstand the auditor's report, and could lead to the improper interpretation that each country has its own audit rules, not following the ISAs.