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***DISCLOSURE AND TRANSPARENCY***  
Accounting and Auditing

***BY***

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## **Introduction**

Good morning, ladies and gentlemen

It is a great pleasure to be at this event, this time as a speaker. I am a PwC partner acting as the risk and quality leader in Brazil.

As mentioned in the first meeting of this roundtable in São Paulo, the issue behind transparency and disclosure is accountability. Why is this important for the Latin American companies? Certainly to increase the availability, and to reduce the cost, of capital through global and domestic capital markets and to attract investments in Latin American countries. Companies due to lack of transparency are paying higher costs of capital and not obtaining enough foreign investments in the region.

What do markets and investors want? The answer is simple: High quality information! This means:

- Information that is comparable and comprehensive: that is prepared under common financial reporting principles, with full disclosure
- Fair information: that is information that represents economic reality, with balanced discussion of risks
- Information that results from good governance
- Reliable information: audited to a high standard.

## **Financial reporting**

The response we propose for comparable and comprehensive information is the adoption of International Accounting Standards. Why do we propose these standards? Because they are the only international accounting framework resulting from a due process.

The IASs will ensure comparability since they represent common recognition and measurement principles. They attend the requirement of full disclosure if the financial statements comply with all the requirements of each applicable standard. They promote fair presentation since transactions are accounted for in accordance with their substance and economic reality and not merely their legal form. IAS are based on principles rather than highly prescriptive rules.

The status of adoption of IAS in Latin America is different in each country, however the trend is clear:

In Argentina, accounting standards similar to IAS have been approved for implementation for fiscal years beginning July 1, 2002; however, certain differences will remain.

In Brazil, regulators and accounting professional bodies support harmonization with IAS. There is a project in the Congress to create a Committee on Accounting Standards to approve accounting standards in accordance with IASs. All new local standards are developed in accordance with IASs.

In Colombia the government was required by law to promote harmonization to IASs.

In Chile, regulators and professional bodies support gradual harmonization to IAS.

In Ecuador IASs are translated and adopted as local GAAP. However there is a time lag due to translation and the approval process.

Paraguay has already adopted IAS as equivalent to local accounting standards.

In Peru, IASs have been selected as the acceptable GAAP. However there is gap in the adoption time.

In Uruguay IASs approved by a technical commission are mandatory however, there are some IASs and interpretations which are not mandatory yet.

In Panama and Costa Rica, IASs were adopted officially in 2001 however, in certain sectors and industries, implementation is still partial. In El Salvador, full adoption is scheduled for 2004; however, in 2002 the disclosure of differences between accounting principles applied and IASs is required. In Guatemala, adoption is scheduled for 2002. In Nicaragua and Honduras the trend of professional bodies is to postpone full adoption to 2003/4.

## **Corporate Governance**

Certainly the previous sessions of this meeting have extensively discussed corporate governance practices in Latin America. On this point, I would like to emphasize that high quality information requires good governance practices.

## **Auditing**

I said that investors and markets need reliable information. In this context the auditor plays a key role in protecting the public and investors and maintaining the efficiency and reliability of the capital markets by providing an independent assessment of financial statements prepared by management.

The audit can be seen as one of the three elements to protect investors, the others being management and corporate governance. The auditor can greatly support good governance but cannot be a substitute.

## **Auditor's Independence**

To speak of auditor independence is to speak of the most inherent value of the auditing profession. Independence is the basis for the profession, equivalent to our integrity. Could anyone believe that the auditors have surrendered to the basis of the profession? The basic problem is that essence and appearance are sometimes confused.

The discussion today is hot. However I would like to point out a simplistic tendency to associate multidisciplinary services with loss of independence. To believe that a collapse of a corporation, in which auditors delivered both audit and non-audit services resulted from a loss of independence is not fair (Similarly to blaming an airplane crash on the engines, merely because the engines were found in the wreckage).

However, good auditing, by hundreds of thousands of people around the world, is unseen.

In terms of principles for auditor independence, the IFAC Code of Ethics has recently strengthened the rules relating to auditor independence. It establishes:

- Conceptual threats to independence
- Safeguards
- Complete set of definitions

- Examples describing specific circumstances and relationships that may create threats to independence, and the safeguards that may be appropriate to eliminate or to reduce them to an acceptable level, including: financial interests, relationships with clients, and provision of non-assurance services to assurance clients.

In some environments, the disclosure to audit committee of the consulting services provided to audit clients is now required. This approach is based on the existence of good corporate governance practices. Because we believe that independence is a value, we do not think that this disclosure adds 'independence' to the auditing practice. However, we can understand that this disclosure can improve the perception of the auditor independence.

### **Auditor rotation**

It has been suggested also that audit firms should be rotated every so many years. This approach is already applied to some extent in some countries in the region: Brazil, Bolivia, Ecuador and Paraguay.

Practical experience and previous analysis support our conclusion that, over the long term, mandatory auditor rotation would actually result in a significant reduction in audit quality because of lack of cumulative client knowledge, reduction in investments in audit training and industry specialization, increased client management disruption and distraction, and increased costs not always remunerated appropriately.

Consequently, the suggested mandatory auditor rotation, while perhaps initially appealing, is not, in our opinion, in the public interest. It would actually provide less, not more, protection for stakeholders.

### **Scope of services**

Recent events have focused a great deal of attention on what services, beyond assurance and attest, can appropriately be provided by accounting firms, without diminishing the independence and objectivity required for the completion of a high-quality audit.

Certain non-audit services, by their very nature, can impair the objectivity of the external auditor. They should be, and historically have been, precluded by professional regulation. Examples of these services include, for example, acting in a management or decision-making capacity for the client; and establishing the fair values at which material assets should be included in the financial statements.

Certain other non-audit services have periodically been debated: "Do they or could they impair the objectivity of the external auditor?" Even though I do not believe the provision of internal audit services, information technology implementation services, and certain other management consulting services to audit clients create a conflict of interest or in any way detract from our ability to provide complete and objective audits—we understand that such services may create a perceived conflict of interest.

With a full commitment to the mission of providing independent and objective audits of organizations' financial information, we suggest a framework comprised of two broad categories of services that are appropriate for an accounting firm to provide:

- The first category of services directly supports the performance of a high-quality audit, and includes audit services, tax services, and risk management and control services.

- The second category comprises those services which, based on an analysis of threats and safeguards, the accounting firm can provide to clients to help them meet the challenges of a complex and changing business environment. And they allow the firm itself to build a professional practice with increased scope and depth. The services in this second category do not directly support the audit process; however, they do not impair independence or objectivity—in fact or appearance.

From our perspective, independence in essence should be evaluated from a financial point of view. The audit firm should be financially independent from clients and this does not relate to delivering non-audit services. If an audit multidisciplinary firm performs just the audit of the financial statements of a particular client and the related billing represents 30% of total revenue, independence is an issue. If the same audit firm delivers both audit and non-audit services for a client which represents 1% of total revenue, no concern at all.

## Safeguards

Large firms such as PwC implemented safeguards to ensure that we did not put ourselves in the position of providing services that conflicted with our audit mission or in any way jeopardized our independence. Safeguards designed to ensure our initial and ongoing independence with regard to audit clients include the following:

- **Client Acceptance procedures:** requiring investigation, including all aspects of independence, prior to accepting any audit client.
- **Documented Independence Policies:** providing guidance to the practice regarding the extent to which certain services can or cannot be rendered to audit clients. Further, that policy makes clear that the lead audit engagement partner must be consulted before any new professional service is rendered
- **Rotation of audit partner:** This procedure is mandatory for listed and non-listed entities.
- **Concurring Partner Review:** A mandatory concurring partner review performed by an experienced partner, focused on the completeness and quality of the audit work as well as all important or difficult issues (the concurring partner role provides a “cold” review independent of the client);
- **Consultations:** Required consultations on important issues with experienced national office partners who have no responsibility for revenues or client billing;
- **Use of Separate Personnel to Perform Non-audit Services:** Typically PwC utilizes personnel to perform non-audit services who are different from those who perform the audit engagement.
- The firm’s own disciplinary and internal review processes.

## International Standard on Auditing

Again to ensure high quality information, the financial statements used by investors and public should be audited and reviewed in accordance with an internationally-recognized framework.

The International Standards on Auditing have been issued by the International Auditing Practice Committee of the IFAC – International Federation of Accountants, the only really international forum for the discussion of these standards.

In order to attend the global demand of a single set of high quality standards, this committee is under restructured by:

- Changing its name to International Auditing and Assurance Standards Board
- Increasing the board size to 18 members, including now 3 public non-auditor members
- Opening the meeting to public since next June, here in Mexico City
- Increasing the staff resources to respond to market and professional requirements

I am proud of being the Brazilian representative at this board.

Ecuador, Peru and Uruguay have adopted ISAs for the audit of financial statements. In Argentina the profession has the harmonization of auditing standards in its agenda for 2002. In Brazil, there are no significant differences between Brazilian and International Standard on Auditing. However the Brazilian standards are very generic and could result in differences in application. The profession is studying the adoption of the IFAC independence rules. In Chile, the auditing standards, including independence, are aligned to US GAAS.

## Conclusion

In terms of financial reporting

- We agree that the quality of reporting standards, based on principles and not on prescriptive rules, must be improved in the region: we propose the rapid and comprehensive adoption of International accounting standards.

In terms of corporate governance

- We believe this is one of the most important elements to increase investor confidence and protection

In terms of auditing:

- A thought to be pointed out: we and the regulators have a single common objective: audit quality.
- We are convinced that the independence is a state of mind. We also agree to adopt an approach based on principles for determining auditor independence: we support the Independence standard issued by IFAC.
- We agree that it is necessary to raise the quality of auditing standards. Our proposal is to adopt the International Standards on auditing, already used by international firms.
- We agree that the independent regulation of the auditing profession will improve public confidence.
- We do not agree with mandatory rotation and we warn of the risks of implementing this procedure.

In other words, we agree to constructive change by proposing and supporting reforms that will make *a real difference*.

In my firm, we are proud of playing a role in the development of the Latin American capital market and economies as an independent and objective advisor to Latin American business.