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Instituto de Auditoria Independente do Brasil



MIND THE GAP

MIND THE GAP SERIES

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Do you know the role of
the Independent Audit?

No. 01

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Do you know the role of the Independent Audit?

MANY HAVE ALREADY NOTICED or came across the iconic expression “mind the gap”, on the platforms of London subway stations and also announced on the audio systems so that the user pays attention to the gap created between the platform and the subway car, a potential cause of accidents in more inattentive people. This phrase became so famous that it became a symbol of the London subway, printed on t-shirts and souvenirs brought by those visiting the English capital.

Just like in the London subway, Independent Audit often faces an expectation gap that should not be ignored: there may be differences in expectations between the auditor's performance and what society expects from their work, which also goes beyond legal and regulatory obligations on the responsibility of the Independent Audit.

Independent Audit is an established and effective response to increasing the reliability and credibility of the financial statements presented by entities, increasing security for investors and improving the functioning of the capital market, in addition to reinforcing the reliability of information for users, which range from shareholders, creditors, suppliers and, ultimately, society itself.

After all, especially in publicly-traded companies and public interest entities, the ownership and management of the company are not led by the same person:



Anyone can invest by purchasing shares in the expectation of the company's appreciation or the distribution of profits, but the investor does not follow the day-to-day decisions made by managers. Therefore, having access to and being able to analyze the financial statements is a way of learning about the direction of management and the business conduct. Publicly-traded companies, banks, insurance companies, among other entities, are required to disclose a series of information to reduce the asymmetry of information between the investor and the company's managers. The Independent Audit is one of the fundamental pieces to add credibility to this information: it is an independent party that analyzes and issues an opinion on the financial statements disclosed by the company.

Large companies, even privately-held companies, are also required to submit their financial statements to independent audit assurance, and it is not uncommon to hire audit services to increase the reliability of information to stakeholders, even when not required by law or regulations, and even in reports related to the disclosure of companies' Environmental, Social and Sustainability (ESG) practices.

Independent Audit, a highly regulated activity based on international standards and a strict code of ethics, works in favor of the market and for increasing the level of confidence in the information subject to its scrutiny.

This great responsibility generates expectations for investors, market agents and those interested in the performance of the businesses and the fairness of these companies.

But what, in fact, is the role of Audit? Many people may have doubts about the responsibilities and limits of the independent auditor's activities. Is the Audit responsible for investigating and reporting possible fraud? Should it foresee the companies' ability to continue as going concern? Should it be accountable to the management of the audited company, since the fees are paid by it? How to deal with conflicts of interest? Can it assist management and internal audit on best practices? What is the difference between internal audit and independent audit? Is the auditor's opinion a 4 guarantee that the company is safe to invest in? What are the obligations and limits of each actor involved in the company's corporate governance?

Independent Audit is a highly regulated activity based on international standards that require, among other aspects, the collection of structured evidence from tests (samples) of data populations, with the objective of issuing an opinion on corporate reports. Operates under a strict code of ethics, in

favor of the market and for increasing the level of trust in the information subject to its scrutiny. However, their performance is often confused with management's responsibility for care, and the lack of knowledge of the limits imposed by legislation and the auditors' own professional performance leads to expectations arising that are disconnected from reality regarding their role and performance. It is essential that laws and regulations are sufficiently clear and aligned so that the performance of audit professionals fulfills their expected obligations and conduct. This involves the preparation of the audit professional, the requirement for a technical qualification exam, continued development and updating of standards and regulations, in addition to attention to the regulator and standard-setter in the development of clarifying standards, which convey the behaviors and attitudes expected from the Independent Audit.. Furthermore, there is a need to be aware of the evolution and development of new technologies or the sophistication of transactions in the market, so that the audit can monitor with the necessary competence the challenges of verifying and issuing an opinion in a world in constant change and development.

With this in mind, Ibracon - Insti-

Itute of Independent Audit of Brazil, prepared a series of articles and materials, aiming to reduce the expectation gap, presenting the duties of the Independent Audit and its limits of action. Clarifying the obligations of each entity responsible for corporate governance provides a more productive debate on capital market safeguards and how we can help improve them. This expectation gap will be addressed from three different perspectives: (1) the knowledge gap - what society thinks is the audit's responsibility and what it actually is; (2) the performance gap - the auditor's performance and what is expected by current standards and legislation; (3) and the evolution gap - areas in which updates and the use of new tools are necessary so that the auditor can perform his functions in accordance with current technology.

This initiative to address the expectation gap in the three different approaches described above came from the Association of Certified Accountants (ACCA) and is present in articles and discussion texts by the International Auditing and Assurance Standards Board (IAASB), an independent regulatory body from the International Federation of Accountants (IFAC). More generally, the IAASB defines the expectations gap as the difference between what the users expect from the audit and what the audit actually is and does¹.

With the aforementioned separations into three approaches, it is possible to verify the origin of expectations and work on specific solutions for each of them, further contributing to a better informational environment and a healthier and more understandable capital market.

Ibracon understands that knowledge of audit duties is essential to constantly improve them. The Institute has among its banners The Importance of the Independent Audit Function to the Market and Society in General and is present in debates and meetings with the accounting profession, regulators, standard setters and society as a whole for the ethical development of the profession, contributing to the smooth functioning of the capital market.

This series is another of Ibracon's collaborations to debate the role of the independent auditor and those responsible for governance, aiming for a healthier and safer investment environment, helping to develop the market with a focus on transparency and in favor of the public interest.

¹ Free translation of the excerpt extracted from the IAASB document available at <https://www.ifac.org/system/files/publications/files/IAASB-Discussion-Paper-Fraud-Going-Concern.pdf>: "a difference between what users expect from the auditor and the financial statement audit, and the reality of what an audit is" (IAASB, 2020, p.8).

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