The Royal NIVRA's adoption of IFAC's recommended auditor's report: An alternative view

PROF.DR STEPHEN A. ZEFF, DR KEES CAMFFERMAN RA AND PROF.DR WILLEM BUIJINK

In 1996, the NIVRA recommended that its members adopt a new audit report based on the model proposed by the International Federation of Accountants (IFAC), as follows: "In our opinion, the financial statements give a true and fair view (getrouw beeld) of the financial position ... and of the result ... in accordance with accounting principles generally accepted (algemeen aanvaarde grondslagen voor financiële verslaggeving) in The Netherlands and comply with the financial reporting requirements included in Part 9, Book 2 of The Netherlands Civil Code[1]."

The NIVRA thus replaced the single criterion of *"een getrouw beeld"* in the old report with a linkage between *"een getrouw beeld"* and *"algemeen aanvaarde grondslagen voor financiële verslaggeving"*. This latter phrase is new to the Dutch accounting literature. The link between the two phrases represents, in effect, an adoption of the terminology that has appeared in the standard form of the US auditor's report since 1939. Except for the reference to conformity with the law, and if "give a true and fair view of" were changed to "present fairly", the new opinion paragraph would be almost identical to the US standard form - in which "present fairly" is not an override but is defined by reference to "generally accepted accounting principles".

By connecting *"een getrouw beeld"* to conformity with "generally accepted accounting principles" (GAAP), the NIVRA risks creating the impression in the minds of the readers of financial statements that a "true and fair" override no longer applies to Dutch financial reporting. GAAP in the US and elsewhere evokes an image of a detailed set of rules and thus is hardly an appeal to an overriding quality of financial reporting, such as *"inzicht"* or *"getrouw beeld"*. Notwithstanding this newly adopted wording in the auditor's report, an override continues to be specified as *"inzicht"* in the *"Burgerlijk Wetboek"* and by the *"Raad voor de Jaarverslaggeving (RJ)"* and as *"getrouw beeld"* in publications by the NIVRA.

"Inzicht" or "getrouw beeld" - Is either serving as an override?

There are other indications that, for some time, the audit profession has been backing away from the use of either *"inzicht"* or *"getrouw beeld"* as an override.
The evidence for this statement is in the form of a number of translations into English of Article 362, paragraph 1, Book 2 Civil Code published during the last fifteen years from authoritative sources: audit firms, the RJ, the NIVRA, and leading auditors. In article 362, "insight" is accompanied by a qualifying passage, *"volgens normen die in het maatschappelijk verkeer als aanvaardbaar worden beschouwd"*. However, the history of the law and its interpretation make it clear that this phrase does not refer to a closed system of codified norms, and therefore the qualifier does not in any way diminish the power of "insight" to override whatever codified norms may be in existence. This was brought out by the NIVRA's own translation, in 1972, of that key passage in the *"Wet op de Jaarrekening"* (then in paragraph 5): "comply with standards that are regarded as being acceptable in economic and social life"[2].

However, in more recent translations of the same article, it has become common practice to couple "insight" with "generally accepted (or acceptable) accounting principles". A chronological listing of these translations and their authors appears as follows:

"The annual accounts shall in accordance with generally accepted accounting principles provide such insight as to enable a reasonable judgment to be formed of the financial position and results of the legal entity ...[3]"

"The financial statements must furnish, in accordance with generally acceptable accounting principles, such insight as to enable a reasonable judgment to be formed regarding the financial position and results of the legal entity ...[4]"

"The annual accounts shall in accordance with generally acceptable accounting principles furnish such insight as to enable a sound judgment to be formed regarding the financial position and results of the legal entity ...[5]"

"The financial statements must furnish, in accordance with generally acceptable accounting principles, such insight as to enable a reasonable judgment to be formed regarding the financial position and results of the legal entity ...[6]"

"The annual financial statements must, in accordance with generally accepted accounting principles, provide such insight as will allow a sound judgment to be formed regarding the financial position and the results of the company ...[7]"
A 1994 translation of article 362(1) by Moret Ernst & Young actually replaces "insight" by "true and fair view", as follows:

"The annual accounts shall, on the basis of generally accepted accounting principles, give a true and fair view of a legal entity's state of affairs and results and, to the extent that the nature of annual accounts permits, of its solvency and liquidity[8]."

This series of translations, in which the "insight" override is diluted by a linkage with GAAP, is troubling. One can easily believe that these translations were prompted by a desire to avoid cumbersome wording that would be difficult to understand for foreign readers. However, masking real differences by using the same wording for different concepts can hardly be helpful at all. In a different context, no one would consider it a service to British readers if *"Eerste Kamer"* were to be translated by "House of Lords".

More importantly, there is a possibility that this type of translation will influence the interpretation of the Dutch phrase in The Netherlands. By linking "insight" with accounting norms that are becoming more and more rule-oriented, these authors risk draining "insight" of much of the high aspiration that it portends for financial reporting. The backward translation of "generally accepted accounting principles" as *"algemeen aanvaarde grondslagen voor financiële verslaggeving"* in the version of the audit report recommended since 1996 clearly indicates this possibility.

One wonders at the self-imposed pressure by the Dutch audit profession to style its auditor's report in terms that comport with international trends. First, in 1972, the NIVRA's management board recommended *"getrouw beeld"* as the sole norm in the standard form of the audit report because, one presumes, it approximated "true and fair view" in the UK. *"Inzicht"*, the primary norm specified in the law, was not mentioned. Then, in 1996, the NIVRA recommended a new standard form of the audit report in which *"getrouw beeld"* is linked, very much in the US fashion, with a concept that had been, until then, alien to the Dutch accounting literature: *"algemeen aanvaarde grondslagen voor financiële verslaggeving"*. Again, the primary quality of financial reporting in the law, *"inzicht"*, is missing, even though the *"Richtlijnen"* state that the unmentioned *"inzicht"* is in fact an override to be invoked by the auditor. Why is the audit profession unwilling to place the *"inzicht"* override in the auditor's report itself? More importantly, why does the audit profession recommend wording in the auditor's report that suggests the absence of any override?

Why does the audit profession recommend wording in the auditor's report that suggests the absence of any override?

While we understand that the change in the recommended form of the Dutch auditor's report has been prompted by the IFAC recommendation, we believe that it is difficult to justify such report wording in a country, such as those in the EU, where financial reporting is governed by a "true and fair" override. It is pertinent to note that the audit profession in the UK, where the "true and fair" override originated, has not followed the IFAC recommendation.

What does one conclude? We have observed a number of authoritative translations into English implying that article 362(1) is not interpreted by the audit profession as containing an *"inzicht"* override. Yet we find that the law and the *"RJ"* continue to recognize that it does. And *"getrouw beeld"*, which performed the role of the override in the NIVRA's recommended auditor's report from 1972 to 1996, is not presented in the newly recommended auditor's report as if it were an override.

What should the NIVRA do?

It would be desirable, we think, to disengage *"een getrouw beeld geeft ..."* from *"in overeenstemming met algemeen aanvaarde grondslagen van financiële verslaggeving"*. This would mean, in effect, that the auditor should give three opinions: on compliance with the law, on accordance with other elements of the financial reporting framework, and on giving a true and fair view. According to IFAC:

"The financial reporting framework is determined by IASs, rules issued by professional bodies and the development of general practice within a country, with an appropriate consideration of fairness and with due regard to local legislation (ISA 700, paragraph 19)."

In the Dutch context, where "fairness" indisputably overrides both the law and national accounting standards (the *"Richtlijnen"*), "appropriate consideration of fairness" would be given effect by issuing a separate opinion on *"getrouw beeld"*.

It would be desirable to disengage "een getrouw beeld geeft ..." from "in overeenstemming met algemeen aanvaarde grondslagen van financiële verslaggeving".

Already, the auditor is obliged to provide a separate opinion in a case where the accounts give a *"getrouw beeld"* in the absence of conformity with specific legal requirements[9].

There is precedence for this suggestion. In the 1980's, Bak reported that: "Our British colleagues see "true and fair" as an independent norm that is to be used next to checking compliance with written rules. They will therefore want to see "and" added: "true and fair and in accordance with..."[10]."
In The Netherlands, *"getrouw beeld"* is no less an independent norm than is "true and fair view" in the UK.
Blokdijk argued that IFAC's recommended linkage "gives the impression of restricting *"getrouw beeld"* to the contents of the *"Richtlijnen"*. This is incompatible with the Fourth Directive"[11].

Also, between 1946 and 1962, one of the US Big Eight audit firms inserted an "and" in the opinion paragraph of all of its auditor's reports because of its professed desire to be giving two opinions - on fairness and on conformity with GAAP - rather than only a single, joint opinion. The firm believed that conformity with GAAP did not, in its view, necessarily produce a fair presentation[12].

A way to implement our suggestion would be to change the wording of the opinion paragraph to call for three separate opinions: ... *"een getrouw beeld geeft"* (of the financial position and results), *"in overeenstemming is met"* (the financial reporting framework) *"en voldoet aan"* (the legal requirements).

If a three-part opinion is not considered practicable, an alternative suggestion would be to replace the highly specific reference to the financial reporting framework with the more traditional reference: *"volgens normen die in het maatschappelijk verkeer als aanvaardbaar worden beschouwd"*. It should not be translated into English as "in accordance with generally accepted accounting principles". This framework is much more subjective and much less rule-oriented. It appropriately places emphasis on the judgments that the auditor must make in view of the requirements of the law and the recommendations in the *"Richtlijnen"*. It may be noted in passing that the *"maatschappelijk verkeer"* wording is in fact used in some of the examples of adverse auditors' reports in the *"Richtlijnen voor de Accountantscontrole"*[13].

In summary, we understand the pressures on the Dutch audit profession to use an auditor's report that is readily recognizable internationally. But it is also important, we think, to inform readers of the financial statements and the auditor's report that the auditor is obliged by law to give an opinion on *"getrouw beeld"* (or *"inzicht"*), taking into account more than just the codified financial reporting rules . ■

Noten

1) Richtlijnen voor de Accountantscontrole, Uitgave 1996 (Amsterdam: NIVRA, 1996), pages 528-529.
2) Wet op de jaarrekening van ondernemingen (Act on Annual Accounts of Enterprises), NIVRA Geschrift, no 6 (Amsterdam: NIVRA, 1972), pages 7.
3) The new Dutch legislation on annual reporting: Legislation implementing the EEC Fourth Directive (Amsterdam: Klynveld Kraayenhof & Co., 1983), page 15.
4) The Annual Report in The Netherlands (Title 8 of Book 2 of the Civil Code), PILOT (Netherlands) 16 (Amsterdam: NIVRA, 1984), page 11.
5) Council for Annual Reporting: Netherlands Accounting and Reporting Guidelines (Amsterdam: Raad voor de Jaarverslaggeving, 1986), Appendix 1, page 2.
6) Jan Dijksma and Martin Hoogendoorn, European Financial Reporting: The Netherlands (London: Routledge, 1993), page 74. The authors evidently adopted the NIVRA's translation of 1984.
7) Doing business in The Netherlands (Price Waterhouse World Firm Services BV, 1996), page 105.
8) Moret Ernst & Young, Current Netherlands Accounting and Reporting Rules: Title 9, Book 2 of The Netherlands Civil Code (Rotterdam: Moret Ernst & Young, 1994), page 32.
9) See the NIVRA's illustration of the unqualified opinion to be given where there has been a deviation from the financial reporting requirements in the law.
10) G.G.M. Bak, "IFAC-voorstel: uniforme tekst voor accountantsverklaring", 'De Accountant', volume 89, no 5, januari 1983, page 315.
11) J.H. Blokdijk, "De tekst van de goedkeurende veklaring bij de jaarrekening", VERA-reglosessie, April 1984, page 5.
12) For a discussion of the experience of this US audit firm, see Stephen A. Zeff, "Arthur Andersen & Co. and the two-part opinion in the auditor's report: 1946-1962", Contemporary Accounting Research, volume 8, no 2, Spring 1992, pages 443-467.
13) Richtlijnen voor de Accountantscontrole (Amsterdam: NIVRA, 1998), Appendices 1.13, 1.14 and 1.15.