

IAASB CAG PAPER



International Federation of Accountants

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Agenda Item

G.2

Committee: IAASB Consultative Advisory Group

Meeting Location: New York

Meeting Date: April 2-3, 2007

Report Back—Written Representations

Objectives of Agenda Item

To provide a brief report back on the September 11-12, 2006 proposals of Representatives on proposed ISA 580 (Revised and Redrafted), “Written Representations.”

The IAASB approved the exposure draft of proposed ISA 580 (Revised and Redrafted) in December 2006 (*see Agenda Item B.2.1*). The comment date is April 30, 2007.

Representatives expressed important views at various stages of the development of the proposed ISA. Representatives are invited to share during the report back session views on the exposure draft that may be relevant to those Member Organizations or individuals that intend to respond to the exposure draft.

May 11-12, 2006 CAG Proposals

Below is an extract from the minutes of the September 11-12, 2006 CAG meeting¹ and an indication of how the IAASB Task Force or the IAASB responded to the Representatives’ comments.

Representatives’ comments	IAASB task force/IAASB response
<ul style="list-style-type: none">Ms. Sucher and Mr. Pickeur were of the view that the general representations, acknowledging the assumptions about management activities and beliefs, are matters for the engagement letter rather than for the representation letter. Ms. Singh also questioned the reason for including the assumptions in both the engagement and representation letters. <i>Mr. Fogarty explained that engagement letters are not required in terms of the ISAs, and that they are prospective – that is, management is undertaking to do certain things. The representation letter confirms that management has done those things. Of particular</i>	<p>The IAASB is of the view that an audit of financial statements in accordance with the ISAs is based on the fundamental premises that management is responsible for (a) preparing and presenting the financial statements in accordance with the applicable financial reporting framework; (b) designing, implementing and maintaining internal control relevant to preparing and presenting financial statements that are free from material misstatement, due to fraud or error; and (c) the completeness of information made available to the auditor.</p> <p>The IAASB acknowledges that legislation, the</p>

¹ The minutes will be approved at the April 2-3, 2007 IAASB CAG meeting.

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<p><i>importance is the representation whether all records, documentation, unusual matters of which management is aware, and other information relevant to the audit have been made available to the auditor. This representation can only be obtained at the end of the audit.</i> Ms. Koski-Grafer was of the view that the concerns of Representatives could be addressed by explaining in the ISA that an audit is based on certain assumptions about management activities and belief, and that the auditor has to confirm the continued appropriateness of those assumptions.</p>	<p>applicable financial reporting framework, or custom may establish management's specific responsibilities for preparing and presenting the financial statements. However, the extent of those responsibilities may differ across jurisdictions. The IAASB therefore proposes that ISA 200, "Objective and General Principles Governing an Audit of Financial Statements" be amended to explain that ISAs are written, and audits are conducted, based on the abovementioned premises.</p> <p>There is a risk that the premises may not be understood by management or, where appropriate, those charged with governance. To avoid misunderstanding, a proposed conforming amendment to ISA 210, "Terms of Audit Engagements" requires the auditor to obtain the acknowledgement and agreement of management and, where appropriate, those charged with governance that they understand the responsibilities.</p>
<ul style="list-style-type: none"> Mr. Johnson was of the view that the auditor states the assumptions in the engagement letter, obtains audit evidence during the audit that corroborates the continuing appropriateness of the assumptions, and obtains a representation letter at the end of the audit that confirms the continued appropriateness of the assumptions as well as other representations obtained during the audit. Mr. Johnson suggested that the IAASB communicate the objective of representation letters to preparers, auditors and users. 	<p>Mr. Johnson's comment confirms the above response.</p> <p>The objective of the auditor is described in paragraph 3 of the proposed ISA, which reads as follows: "The objective of the auditor is to corroborate, by means of written representations (a) the validity of the premises, relating to management's responsibilities, on which an audit is conducted; and (b) Other audit evidence obtained with regard to specific assertions in the financial statements." (But perhaps, Mr. Johnson had a public relations action in mind.)</p>
<ul style="list-style-type: none"> Mr. White was of the view that the problem is one of semantics – that is, "corroborating audit evidence" vs. "sufficient audit evidence." He described a process similar to that described by Mr. Johnson, noting that the representation letter is at best corroborating evidence of a series of understandings obtained during the audit. He suggested that the requirements and guidance 	<p>See the above responses. In addition to the objective in paragraph 3 of the proposed ISA, paragraph 7 reads as follows: "The auditor shall request relevant parties to provide the general written representations about the financial statements, including internal control, and the completeness of information made available to the auditor set out in paragraphs 8-10 for all financial statements and periods covered by the auditor's report. Such general written representations</p>

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<p>rather reflect the process.</p>	<p>provide necessary audit evidence about the validity of the premises, relating to management's responsibilities, on which an audit is conducted. However, by themselves, they do not constitute sufficient appropriate audit evidence about the validity of the premises. Accordingly, they do not relieve the auditor of the responsibility to obtain other audit evidence."</p> <p>Paragraphs 12 and A12 discuss the corroborative nature of specific representations.</p>
<ul style="list-style-type: none"> In line with the comments of Messrs. Johnson and White, Dr. Manabat also explained that the audit is a process. The engagement letter contains the general terms for the engagement; however, it is likely that those who agreed the terms may not fully appreciate them. Also, as the audit progresses, relevant persons are asked to make specific representations. The representation letter confirms the terms of the engagement and other representations made during the audit. She was of the view that the representation letter is a very important document. Mr. Krantz was of a similar view. 	<p>See the above responses.</p>
<ul style="list-style-type: none"> Ms. Koski-Grafer suggested that the Task Force review the objective stated in the ISA. It should be outcomes-based. Based on the discussion, it is also important to clarify what corroborates what – that is, is it the audit evidence obtained during the audit or the representation letter obtained at the end of the audit that corroborates the assumptions in the engagement letter? <i>Mr. Fogarty was of the view that, based on the discussion, the objective could be for the auditor to determine whether the assumptions underlying an audit of financial statements exist for the particular audit engagement.</i> 	<p>See the above responses.</p>
<ul style="list-style-type: none"> Mr. Sekiguchi noted that it is important for the ISA to be specific as to the general 	<p>The requirement for general representations about the financial statements has been redrafted to be specific</p>

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<p>representations to be obtained, as an inability to obtain general representations will give rise to a disclaimer of opinion. Words such as “including the following” (paragraph 6(b)) and “appropriate general representations” (paragraph 13) should not be used. <i>Mr. Fogarty explained that those words are used because the applicable financial reporting framework may not address all the matters listed in the relevant paragraph.</i> Mr. Sekiguchi also asked about the effect of identified material weaknesses in internal control on management’s general representation as to whether it has fulfilled its responsibility for internal control relevant to preparing and presenting financial statements that are free from material misstatement. <i>Mr. Fogarty explained that the requirement is drafted to allow management to acknowledge that it has fulfilled its responsibility for internal control and to state any identified material weaknesses. Such a representation by itself will not give rise to a disclaimer of opinion.</i></p>	<p>as to the representations to be requested. See paragraph 8 of the proposed ISA.</p> <p>When relevant parties do not provide the general representations requested by the auditor, or where the auditor concludes that such representations are not reliable, the IAASB is of the view that the auditor is unable to obtain sufficient appropriate audit evidence, and that the possible effects on the financial statements of such inability are pervasive. The auditor therefore is required to disclaim an opinion on the financial statements in such circumstances. The proposed ISA, however, explains that a general written representation that has been modified from that requested by the auditor does not necessarily mean that relevant parties did not provide the representation. The reason for the modification nevertheless may affect the opinion in the auditor’s report. (See paragraph A19 of the proposed ISA.)</p>
<ul style="list-style-type: none"> Mr. Lamoureux was concerned about the references to management, while the engagement letter is signed by the audit committee on behalf of the board of directors. Inconsistency in the assumptions stated in the engagement letter and the representation letter should be brought to the attention of those charged with governance. Dr. Peters was of a similar view. <i>Mr. Fogarty confirmed that this was addressed in ISA 260 (Revised), “Communication with Those Charged with Governance.”</i> 	<p>Footnote 2 in the proposed ISA explains that the term “management” has been used to describe those responsible for preparing and presenting the financial statements. Other terms may be appropriate depending on the legal framework in the particular jurisdiction.</p>
<p>Referring to comments whether the representation letter is audit evidence, Mr. Fogarty explained that, even if the auditor has performed all the audit procedures but has not asked management whether it understands and has fulfilled its responsibility for internal control, whether the financial statements are</p>	<p>See the above responses.</p>

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fairly presented, in all material respects, and whether it has given him or her all the required information, the auditor will not be able to conclude that he or she has obtained sufficient appropriate audit evidence on which to base the audit opinion. Asking management to sign a representation letter reminds it of its responsibilities – if management has not fulfilled those responsibilities, it will cause management to pause. It is the reaction to the request for a representation letter that provides the evidentiary value. Ms. Koski-Grafer agreed that representation letters are necessary audit evidence, but was of the view that they are not sufficient audit evidence. This needs to be reflected in the ISA. Ms. Todd McEnally doubted whether management representations should be considered audit evidence because of the risk of over reliance.	