



International Federation of Accountants

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Agenda Item

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Committee: IAASB Consultative Advisory Group

Meeting Location: London

Meeting Date: September 20-21, 2007

ED-ISA 580 (Revised and Redrafted), “Written Representations”

Objectives of Agenda Item

To review a summary of significant comments on ED-ISA 580 (Revised and Redrafted), “Written Representations” and the Task Force’s recommendations.

The IAASB will consider the summary of significant comments and the Task Force’s recommendations, and the proposed ISA at its September meeting. **Approval of the final ISA is planned for the December IAASB meeting.**

IAASB Task Force

The IAASB Task Force members are: John Fogarty (Chairman); Josef Ferlings; Sylvia Smith; and David Swanney.

Background

The IAASB commenced this project in April 2004 in response to developments that indicated a need to revise extant ISA 580, “Management Representations.” These included concerns that auditors may be over relying on written representations. During the project, the IAASB considered matters such as the reasons for obtaining written representations, the evidence that they provide, and from whom they should be requested. Significant proposals were discussed with the IAASB Consultative Advisory Group at all stages of developing the proposed ISA.

ED-ISA 580 was issued in December 2006. The comment date was April 30, 2007. Fifty-four comment letters were received. (ED-ISA 580 and the comment letters are available at <http://www.ifac.org/Guidance/EXD-Details.php?EDID=0070>).

Significant Comments

The majority of respondents expressed general support for the proposed ISA. Significant comments relating to matters identified for the Representatives’ consideration are summarized below. The Task Force’s recommendations follow each significant comment.

FUNDAMENTAL PREMISE

1. ED-ISA 580 and proposed conforming amendments to proposed ISAs 200 (Revised and Redrafted), “Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing” and proposed ISA 210 (Redrafted),

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“Agreeing the Terms of Audit Engagements” explained that an audit of financial statements in accordance with the ISAs is based on the fundamental premise that management is responsible for (a) the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework; (b) the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error; and (c) the completeness of information made available to the auditor (for purposes of this paper referred to as “the premise”).

2. ED-ISA 580 required the auditor to obtain general written representations about the financial statements (ED-ISA 580.8) and internal control (ED-ISA 580.9).
3. Some respondents were concerned about the relationship between the premise stated in the ISAs and management’s responsibilities prescribed by law or regulation. Many respondents were concerned about the detailed elements of the general written representation about the financial statements and, in particular, those listed in the third bullet of ED-ISA 580.8. Many respondents were also concerned about the general written representation about internal control and, in particular, the request for management to confirm whether they believe that the internal control they have maintained is adequate for the purpose. Some respondents also recommended that the description of management’s responsibilities in proposed ISAs 200 (Revised and Redrafted), 210 (Redrafted), 580 (Revised and Redrafted) and 700 (Redrafted), “The Independent Auditor’s Report on General Purpose Financial Statements” be consistent.

Task Force’s Recommendation(s)

4. The Task Force continues to believe that, regardless of management’s legal responsibilities, the conduct of an audit of financial statements is predicated upon the premise. Therefore, the auditor should request management to agree the premise in the terms of engagement and provide written representations about the premise.
5. Based on the comments, the Task Force recommends that the premise be rewritten as follows:

ISAs are written, and audits are conducted, on the premise that management acknowledge and understand their responsibility:

- (a) *For the preparation and presentation of the financial statements¹ in accordance with the applicable financial reporting framework and that this responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements² that are free from material misstatement, whether due to fraud or error; and*
- (b) *To provide the auditor with all the information the auditor requires in connection with the audit of the entity.*

¹ In the case of a fair presentation framework, management is responsible for the preparation and *fair* presentation of the financial statements in accordance with the financial reporting framework; or the preparation of financial statements *that give a true and fair view* in accordance with the financial reporting framework.

² See footnote 1.

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6. The Task Force recommends that the descriptions of management's responsibilities, or the premise, in proposed ISAs 200 (Revised and Redrafted), 210 (Redrafted), 580 (Revised and Redrafted) and 700 (Redrafted) be amended to be in line with the description in paragraph 5 above.
7. The Task Force, however, debated to what extent proposed ISA 700 (Redrafted) should be aligned with the description of the premise in paragraph 5 above. To fully align the ISAs, the section on Management's Responsibility for the Financial Statements in the auditor's report will have to be re-titled and expanded to state that management is responsible to provide the auditor with all the information the auditor requires in connection with the audit of the entity. Although this information is of value to the auditor, the Task Force was uncertain about its value to readers of the auditor's report. The Task Force agreed to ask the Representatives for their views in this regard.
8. In response to the comments that law or regulation may prescribe management's responsibilities, the Task Force recommends that proposed ISA 210 (Redrafted), in those circumstances, require the auditor to determine the extent to which management's responsibilities prescribed by law or regulation are similar to those set out in paragraph 5 above. For management's responsibilities that are similar, the auditor may use the wording of the law or regulation to describe those responsibilities in the terms of the audit engagement, written representations and auditor's report. For management's responsibilities that are not similar, or that are not prescribed by law or regulation, the auditor is required to use the description of management's responsibilities in paragraph 5 above.
9. Based on the comments, the Task Force recommends that the auditor request management to provide the following written representations about the premise (extract from proposed ISA 580 (Revised and Redrafted) – **see Agenda Item 2-D of the September IAASB meeting material**):

“Financial Statements

9. *The auditor shall request management to provide a written representation:*
 - (a) *That they acknowledge and understand their responsibility for the preparation and presentation³ of the financial statements and that this responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation⁴ of financial statements that are free from material misstatement, whether due to fraud or error; and*

³ In the case of a fair presentation framework, management is responsible for the preparation and fair presentation of the financial statements in accordance with the financial reporting framework; or the preparation of financial statements *that give a true and fair view* in accordance with the financial reporting framework.

⁴ See footnote 3.

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- (b) *Whether, based on their knowledge and belief, the financial statements are prepared and presented⁵ in accordance with the applicable financial reporting framework.*

Completeness of Information

10. *The auditor shall request management to provide a written representation whether, based on their knowledge and belief, they have provided the auditor with all the information the auditor required in connection with the audit of the entity.*
11. *This written representation shall include whether:*
- (a) *All transactions have been recorded; and*
- (b) *Management has disclosed to the auditor all control deficiencies.”*
10. **See paragraphs 12-30 of Agenda Item 2-A of the September IAASB meeting material for a detailed discussion of the Task Force’s recommendations.**

Matters for Consideration by the IAASB CAG:

- 1. Do the Representatives agree with the description of the premise in paragraph 5 above?**
- 2. Do the Representatives agree with the principle of a consistent description of management’s responsibilities in all relevant ISAs?**
- 3. What are the Representatives’ views with regard to including in the auditor’s report a statement about completeness of information provided to the auditor?**
- 4. Do the Representatives agree with the proposal that, if management’s responsibilities are prescribed by law or regulation, the auditor should be permitted to use that description in the terms of the audit engagement, written representations and auditor’s report (that is, to the extent that the responsibilities are similar to those set out in paragraph 5 above)?**
- 5. Do the Representatives agree with the written representations about the premise set out in paragraph 9 above?**

AUDIT EVIDENCE

11. The explanatory memorandum accompanying ED-ISA 580 explained that audit evidence obtained during the audit may support or contradict the validity of the premise; however, such evidence is not sufficient without obtaining the general written representations about the premise. This is because the auditor may not be able to judge management’s knowledge, judgments or intentions solely on other audit evidence.

⁵ In the case of a fair presentation framework: Whether, based on their knowledge and belief, the financial statements *are fairly presented* or *give a true and fair view* in accordance with the applicable financial reporting framework.

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12. It also explained that extant ISA 580 requires the auditor to obtain written representations on matters material to the financial statements *when other sufficient appropriate audit evidence cannot reasonably be expected to exist*. To avoid over reliance on written representations, ED-ISA 580 requires the auditor to obtain written representations regarding specific assertions of the financial statements (“specific written representations”) *when the auditor considers it necessary to corroborate other audit evidence*. Specific written representations are particularly relevant in relation to assertions that involve judgment or intent, or that may not be complete. They do not constitute sufficient appropriate audit evidence by themselves and, accordingly, they do not relieve the auditor of the responsibility to obtain other audit evidence.
13. Respondents held diverse views as to the status of written representations as audit evidence. Few respondents suggested that the approach in extant ISA 580 (see paragraph 10 above) be re-introduced.

Task Force’s Recommendation(s)

14. The Task Force does not agree with the suggestion to re-introduce the approach in extant ISA 580 as it may give rise to over-reliance on written representations. The Task Force is of the view that circumstances in which other audit evidence cannot reasonably be expected to exist should be extremely rare. In such circumstances, the auditor should consider the effect of the inability to obtain sufficient appropriate audit evidence on the opinion in the auditor’s report in accordance with proposed ISA 705 (Revised and Redrafted), “Modifications to the Opinion in the Independent Auditor’s Report.”
15. Proposed ISA 500 (Redrafted), “Considering the Relevance and Reliability of Audit Evidence” defines “audit evidence” as all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Accordingly, the Task Force believes that written representations, similar to responses to enquiries, are audit evidence. They are necessary information that the auditor requires in connection with the audit of the entity. Written representations confirm that management acknowledge and understand the premise. They also corroborate other audit evidence for specific assertions of the financial statements which involve management’s judgment or intent, or which may not be complete.
16. Written representations alone, however, do not constitute sufficient appropriate audit evidence about the premise or specific assertions of the financial statements. Furthermore, audit evidence is influenced by its source and nature. The source of a specific written representation is not independent from the entity. Accordingly, written representations do not affect the nature or reduce the extent of other audit evidence that an auditor obtains about the premise or specific assertions of the financial statements.
17. The Task Force recommends that the status of written representations as audit evidence be clarified in the Introduction section of proposed ISA 580 (Revised and Redrafted). ***See paragraphs 3-4 of proposed ISA 580 (Revised and Redrafted) – Agenda Item 2-D of the September IAASB meeting material.***
18. The Task Force also recommends that the distinction between general and specific representations be deleted. Proposed ISA 580 (Revised and Redrafted) now refers to (a)

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written representations about the premise; (b) written representations required by other ISAs; and (c) written representations about assertions of the financial statements which involve management's judgment or intent, or which may not be complete.

19. Proposed ISA 580 (Revised and Redrafted) requires the written representations to be in the form of a representation letter addressed to the auditor. The application material explains that management's signing of the financial statements, or making a written public declaration in relation to the financial statements, is a representation to the users of the financial statements subsequent to the audit; not a representation to the auditor prior to issuance of the auditor's report. Such actions, therefore, do not serve as a substitute for the written representations. The expression of management's responsibilities in law or regulation also does not serve as a substitute for the requested written representations.
20. *See paragraphs 39-44 of Agenda Item 2-A of the September IAASB meeting material for a detailed discussion of the Task Force's recommendations.*

Matter for Consideration by the IAASB CAG:

6. **Do the Representatives agree that the guidance in the Introduction section and the application material sufficiently clarifies the status of written representations as audit evidence?**

UNRELIABLE WRITTEN REPRESENTATIONS / REFUSAL TO PROVIDE WRITTEN REPRESENTATIONS

21. The explanatory memorandum accompanying ED-ISA 580 noted that some IAASB members were concerned about the requirement in ED-ISA 580.19 for the auditor to disclaim an opinion on the financial statements when relevant parties do not provide the general written representations about the premise. Their concern was that this does not allow the auditor to judge the seriousness of the matter, particularly as the requirement would be triggered by a failure to provide one of the detailed elements of the general written representations.
22. It also noted that the majority of IAASB members, however, were of the view that a failure to provide a specific element of a general written representation would undermine the validity of the general written representation itself. If relevant parties had a concern about one or more aspects of the requested written representations it would be open to them to modify such representations appropriately to reflect this. In those circumstances, the auditor would be required to use judgment to evaluate the effect of the modified written representations. ED-ISA 580.A19 was added to explain how written representations that have been modified from those requested by the auditor may affect the audit and the audit opinion.
23. The majority of respondents did not support the proposed requirement for the auditor to disclaim an opinion on the financial statements when the auditor concludes that the general written representations about the premise are unreliable, or when management refuse to provide them. The respondents requested greater flexibility, allowing the auditor to apply professional judgment.

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Task Force's Recommendation(s)

24. The majority of Task Force members continue to believe that the auditor should disclaim an opinion when the auditor concludes that the written representations about the premise are unreliable or when management refuse to provide them. They are concerned that the lack of a stringent requirement in this regard may lead to different auditors arriving at inconsistent responses in similar circumstances.
25. Management's refusal to provide the written representations about the premise is strong evidence for the auditor that there may be unresolved issues in relation to the financial statements or in relation to the completeness of information provided to the auditor, even when the auditor may have formed the impression up to that point in the audit that the financial statements are appropriate and the information provided by management is complete.
26. Without obtaining the written representations about the premise, the auditor cannot obtain sufficient appropriate audit evidence about completeness because substantive procedures cannot adequately respond to completeness risks. By definition, a lack of completeness is not confinable – that is, a potential misstatement due to a lack of completeness cannot be confined to a defined monetary figure or particular disclosure. Pursuant to proposed ISA 705 (Revised and Redrafted), nonconfinable potential misstatements due to a lack of sufficient appropriate audit evidence are pervasive to the financial statements and therefore lead to a disclaimer of opinion.
27. The majority of Task Force members are of the view that the recommendation to align management's responsibilities, or the premise, in proposed ISAs 200 (Revised and Redrafted), 210 (Redrafted), 580 (Revised and Redrafted) and 700 (Redrafted), the recommendation to move the detailed elements of the written representation about the financial statements (ED-ISA 580.8 and, in particular, the third bullet) to the application material, and the recommendation to delete from the written representation about internal control the reference to the adequacy of internal control (ED-ISA 580.9) address many of the concerns raised by respondents in the context of the requirement to disclaim an opinion when the written representations about the premise are unreliable, or management refuse to provide them.
28. The Task Force considered the effect that unreliable "other written representations," or management's refusal to provide them, may have on the auditor's opinion. The majority of Task Force members concluded that unreliable written representations required by other ISAs or unreliable written representations about specific assertions of the financial statements, or management's refusal to provide them, may affect the reliability of the written representations about the premise. For example, the auditor may conclude that the written representation about the completeness of information provided to the auditor is not reliable if the written representations required by ISA 240 (Redrafted) are unreliable, or management refuse to provide them.
29. The majority of Task Force members recommend that proposed ISA 580 (Revised and Redrafted) continue to require the auditor to disclaim an opinion on the financial statements if the written representations about the premise are unreliable or if management refuse to

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provide them. *See paragraphs 16-20 of proposed ISA 580 (Revised and Redrafted) – Agenda Item 2-D of the September IAASB meeting material.*

30. *See paragraphs 48-57 of Agenda Item 2-A of the September IAASB meeting material for a detailed discussion of the Task Force’s recommendations and the view expressed by the Task Force member who does not support the recommendations.*

Matters for Consideration by the IAASB CAG:

7. Do the Representatives agree with the proposal to require a disclaimer of opinion on the financial statements when the auditor concludes that the written representations about the premise is not reliable, or management refuse to provide them?
8. Do the Representatives agree with the conclusion that unreliable written representations required by other ISAs or unreliable written representations about specific assertions of the financial statements, or management’s refusal to provide them, may affect the reliability of the written representations about the premise?

OTHER SIGNIFICANT COMMENTS

31. *See Agenda Item 2-A of the September IAASB meeting material for other significant comments identified by the Task Force:*

- Other written representations – paragraphs 31-34 of Agenda Item 2-A
- Who should provide the written representations? – paragraphs 58-63 of Agenda Item 2-A
- Date of written representations – paragraphs 64-67 of Agenda Item 2-A
- Threshold amount – paragraphs 68-70 of Agenda Item 2-A
- Small entities – paragraph 71 of Agenda Item 2-A
- Public sector entities – paragraph 72 of Agenda Item 2-A
- Proposed conforming amendment to proposed ISA 560 (Redrafted), “Subsequent Events” – paragraphs 73-74 of Agenda Item 2-A.

Material Presented – FOR IAASB CAG REFERENCE PURPOSES ONLY

Agenda Item D.1	Summary of Significant Comments on ED-ISA 580 (Revised and Redrafted) – <i>Agenda Item 2-A of the September IAASB meeting material</i>
Agenda Item D.2	Proposed Conforming Amendments to Proposed ISA 200 (Revised and Redrafted) – <i>Agenda Item 2-B of the September IAASB meeting material</i>

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Agenda Item D.3 Proposed Conforming Amendments to Proposed ISA 210
(Redrafted) – *Agenda Item 2-C of the September IAASB meeting material*

Agenda Item D.4 Proposed ISA 580 (Revised and Redrafted) – MARK-UP –
Agenda Item 2-D of the September IAASB meeting material

Agenda Item D.5 Proposed Conforming Amendments to Proposed ISA 700
(Redrafted) – *Agenda Item 2-E of the September IAASB meeting material*

Action Requested

The IAASB CAG is asked to review the significant comments on ED-ISA 580 highlighted in this paper, and to comment on the Task Force's proposed recommendations.